



Parkes Shire Council

Financial Assessment and Sustainability Report

Date: 24 June 2015



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1 Executive Summary

In September 2012, TCorp provided Parkes Shire Council (the Council) with a Financial Assessment and Benchmarking Report as part of the work undertaken for the Local Infrastructure Renewal Scheme assessments. An update to this report was provided in February 2013 to include the 2012 annual financial accounts, a review and inclusion of Council's 'progressive delivery program' scenario, and the Sustainability section that formed part of the work TCorp completed for the Independent Local Government Review Panel.

In the two reports TCorp made the following observations:

- If Council was successful in a proposed SRV application (which has subsequently been approved by IPART and began in 2014), then it was forecast to achieve an operating surplus by 2017 when capital grants and contributions are excluded.
- Council's financial flexibility was historically impacted by its reliance on grants and contributions as indicated by the Own Source Operating Revenue Ratio being below benchmark, however the SRV was expected to improve this ratio.
- Council had effectively managed its employee expenses with below CPI increases achieved in each year.
- With the adoption of the proposed SRV, Council's Infrastructure Backlog Ratio was expected to reduce with the additional rates revenue used to address the asset renewals and maintenance shortfalls.

TCorp's report stated that Council had a Financial Sustainability Rating (FSR) of Moderate with an Outlook of Negative when analysing the 'base case' scenario that did not contain the proposed SRV. Following receipt of the report Council has successfully applied for the SRV that will provide a 63.05% increase in rates over the four years from 2014 to 2017. This was approved by IPART to enhance service levels, improve existing infrastructure, invest in new infrastructure and reduce the Infrastructure Backlog.

Council is currently completing its Fit For the Future reform package proposal. As part of its proposal, Council has requested that TCorp complete an updated Financial Assessment and Sustainability Report including an updated FSR and Outlook.

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

- With the benefit of the additional SRV rate monies, Council's operating performance is predicted to improve so that Council is able to achieve consistent operating surpluses from 2016.
- Council's financial flexibility is forecast to improve to the benchmark level as the SRV boosts their own source operating revenue.
- Council is forecasting the cash and cash equivalents balance to reduce to a low of \$0.315m in 2021, a sufficient level to provide a liquidity buffer. Council will have to maintain its strong control on receivables in order to achieve the forecast levels of cash and investments.
- Council is forecasting to reduce its borrowings to \$2.0m by 2024, only using an additional \$2.2m in 2016. It may be beneficial to use a higher level of borrowings over the forecast period to strengthen Council's liquidity levels.

- Council does have capacity to utilise additional borrowings if required as indicated by sound DSCR and Interest Cover Ratio results and could possibly use additional borrowings to fund capital expenditure and ensure a satisfactory level of liquidity is maintained.
- Council has forecast a strong improvement of their asset renewals and purchases as indicated by the Capital Expenditure Ratio that is forecast to average 1.56 times over the forecast period.

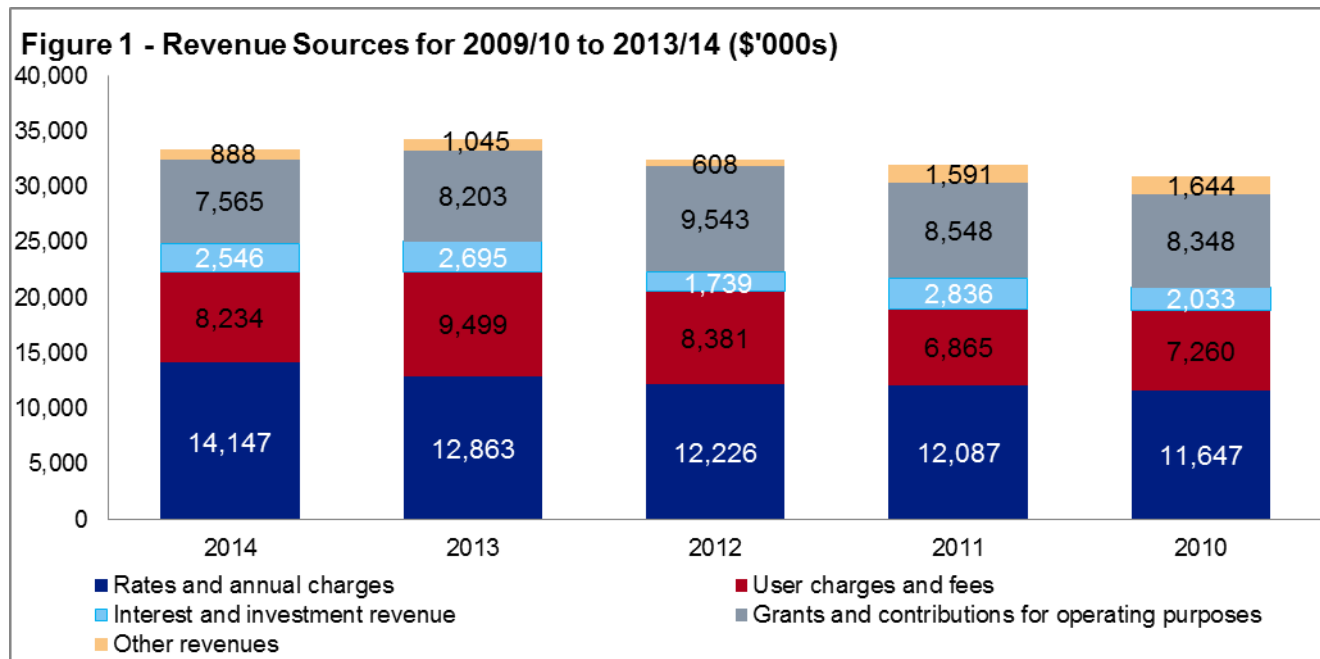
In respect of the long term Sustainability of the Council, TCorp assesses Council to currently have a Financial Sustainability rating of Moderate, and the Outlook for Council has now improved to Positive. The key observations behind this change in Outlook for the General Fund are:

- The SRV of 63.05% (that is continuing until 2017 and then is permanently kept within the rates base) positively impacts both Council's operating performance and their asset renewals and purchases.
- Council is forecasting an improvement in their operating performance that will enable operating surpluses from \$1.0m in 2016 to \$3.9m in 2024. This improvement, driven by the SRV, is forecast to improve Council's FSR to Sound within three years.
- Council's Own Source Operating Revenue is forecast to improve to the 60% benchmark by 2018 providing Council with higher financial flexibility.
- In order for Council to achieve the forecast operating performance it will have to limit operating expenses to an average annual increase of 1.7%. Over the review period Council's operating expenses have actually decreased from \$26.1m in 2011 to \$24.7m in 2014 although it is noted that this has been possible because of the reduction in materials and contract expenses during this period.
- Council's I,P,P&E is forecast to increase over the 10 year period as Council increases its asset base with the assistance of the SRV rate funds. Council's I,P,P&E is forecast to increase to \$469.6m in 2024, from \$424.7m in 2014 highlighting Council's commitment to its Capital Expenditure Program.

2 Review of Financial Performance and Position

TCorp has updated its review based on the 2013 and 2014 annual audited accounts of the Council.

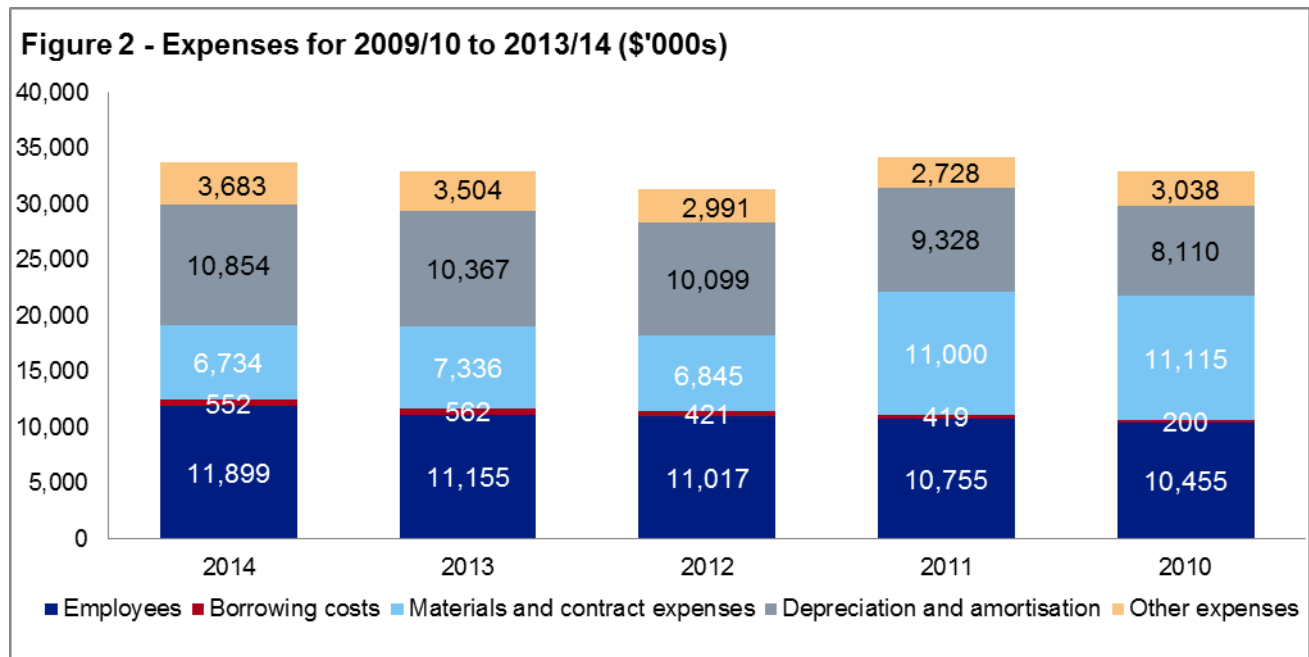
2.1 Revenue



Key Observations

- Total revenue has increased by \$2.5m (7.9%) over the review period to \$33.4m in 2014 from \$30.9m in 2010. It decreased by \$2.1m (5.8%) in 2014 after a \$3.0m (9.1%) increase in 2013.
- Rates and annual charges increased by \$1.3m (10.0%) in 2014 after Council were successful in applying for a four year SRV that began in 2014. The SRV was approved by IPART at 13% p.a. and will be permanently included in the rate base after the four years.
- User fees and charges decreased by \$1.3m (13.3%) in 2014 which cancelled out the \$1.1m (13.3%) increase in 2013. A decrease of \$1.5m in RMS charges for work council employees completed on state roads was the reason for the 2014 reduction with 2013 increasing on the back of a \$1.2m increase in water user charges.
- Interest and investment revenue increased in 2013 from 2012 in line with an increase in the total cash and investments held. Cash and investments grew again in 2014 however the returns reduced due to the reduction in the RBA cash rate.
- Operating grants and contributions have been on a downward trend since 2012 due to the prepayment of the Financial Assistance Grant (FAG) in some years and not in other years. This has seen FAG payments reduce from \$6.7m in 2012 to \$5.2m in 2013 and \$2.8m in 2014. The timing of the FAG payments meant that only 50% was received in 2014 and this timing issue will be rectified from 2015 onwards which will boost revenues going forward.

2.2 Expenses



Key Observations

- Total expenses increased by \$0.8m (2.4%) over the review period from \$32.9m in 2010 to \$33.7m in 2014.
- Employee expenses have increased year on year but the annual increase had remained below 3% until 2014 when they increased by 6.7%. This increase was driven by a \$0.9m increase in salaries and wages and a \$0.3m decrease in the amount that was capitalised. These increases were partially offset by a \$0.7m decrease in employee leave entitlements.
- Materials and contract expenses have decreased significantly from the 2010 and 2011 levels and is the main reason why total expenses increased at a subdued rate over the review period. The higher costs in 2010 and 2011 related to works that were required to repair Council's flood damaged roads. In 2014, Council decided to categorise this expense item differently and included capitalised works of \$13.2m against a \$19.9m total expenditure.
- Depreciation increased by 4.7% in 2014 due to the reassessment of Council's buildings in 2013 while road asset depreciation also increased by \$0.3m (8.0%).

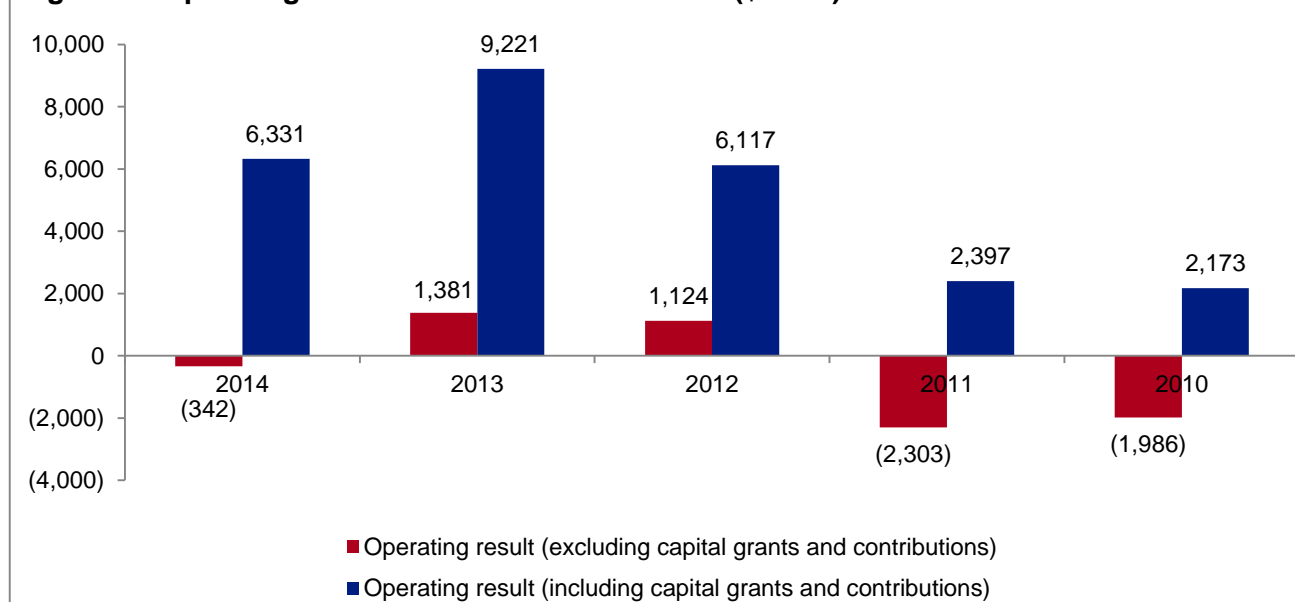
2.3 Operating Results

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

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

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

Figure 3 - Operating Results for 2009/10 to 2013/14 (\$'000s)



Key Observations

- When capital grants and contributions are excluded, Council has achieved operating surpluses in two of the past five years. The surpluses have primarily been achieved because of the positive results in the Water and Sewer Funds.
- The operating deficit in 2014 occurred because of the 5.8% decrease in total revenue against a 2.4% increase in expenses. While Council was boosted by the SRV, the four other revenue categories all reduced for various reasons, all of which were essentially outside of Council's control. The full annual FAG payment that will again be received in 2015 will assist Council's 2015 operating performance.

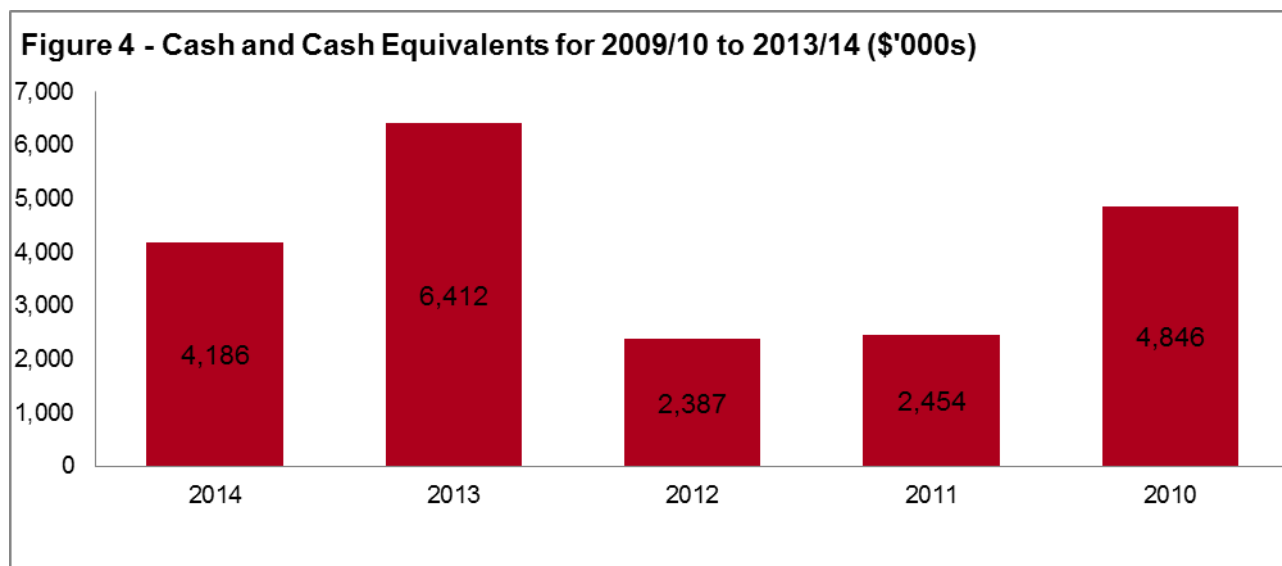
2.4 Financial Management Indicators

Performance Indicators	Year ended 30 June				
	2014	2013	2012	2011	2010
EBITDA (\$'000s)	11,064	13,455	11,644	7,444	6,324
Operating Ratio	(1.0%)	7.1%	3.5%	(7.2%)	(6.4%)
Interest Cover Ratio	20.04x	23.94x	27.66x	17.77x	31.62x
Debt Service Cover Ratio (DSCR)	12.42x	12.24x	22.35x	14.57x	31.62x
Unrestricted Current Ratio	2.99x	5.19x	3.90x	4.73x	2.63x
Own Sourced Operating Revenue Ratio	55.9%	51.7%	55.0%	51.7%	53.9%
Cash Expense Ratio *	27.6 months	3.5 months	1.4 months	1.2 months	2.4 months
Net assets (\$'000s)	579,524	568,398	547,199	524,048	516,191

Key Observations

- Council's EBITDA has improved on the back of increased depreciation and borrowing costs over the period. The drop in 2014 coincides with the return to an operating deficit in this year.
- Council has increased its total borrowings from \$5.0m in 2010 to \$7.9m in 2014 but its DSCR and Interest Cover Ratio remain strongly above their respective benchmarks of 2.0 and 4.0 times.
- Council's Unrestricted Current Ratio has fluctuated over the five years however it has remained securely above the 1.50 times benchmark.
- Council's Own Sourced Operating Revenue Ratio has consistently been below the 60.0% benchmark indicating Council's reliance on revenue streams that it does not have direct control over. The SRV that began in 2014 should provide an improvement in this ratio although the 2014 improvement was also due to Council only receiving 50% of the FAG.
- Council's Cash Expense Ratio improved above the benchmark in 2013. TCorp has reviewed this ratio and from 2014 onwards the ratio will include current term deposits in the calculation of this ratio. This is why the ratio improves significantly in 2014 as Council's \$47.2m of current term deposits are included.
- Council's net assets have increased year-on-year, however when revaluation amendments are removed, the underlying increase of I,P,P&E equates to \$4.5m over the five year period.

2.5 Statement of Cashflows



Key Observations

- Council's cash and cash equivalents have varied over the review period as shown in figure 4. Overall, cash and investments combined have increased from \$33.9m in 2010 to \$61.8m in 2014.
- Of the \$61.8m, \$52.7m was externally restricted (with \$43.1m relating to water supplies and sewerage services), \$8.6m was internally restricted and \$0.5m is unrestricted. The large restricted funds in the Water and Sewer Fund are due to be utilised in 2016 and 2017 when replacements for both water and sewer treatment plants are planned to be constructed and completed.
- Within Council's investments of \$57.6m, \$47.2m was in current term deposits, \$7.5m was in non-current term deposits, \$1.5m was in NCD's/FRN's and \$1.4m in CDO's.
- The \$1.4m CDO relates to Council's last remaining Hickory CDO issued by Westpac. The CDO has a face value of \$2.0m and is due to mature in June 2016. The estimated market value of the CDO had risen to \$1.6m as at 30 April 2015 and Council expects 97% of the full \$2.0m to be recovered upon maturity. In the event of another GFC type event, the guaranteed CDO amount received could potentially reduce to 59% of the \$2.0m although Council has accounted for this eventuality within its current reserves.
- Council is awaiting confirmation of a legal recoveries dividend amount relating to the Lehman Brothers CDO that matured in 2012. It received \$1.145m in 2013 in respect of a distribution from the legal recoveries against the \$2.8m realised loss carried for the CDO. Council expects to receive the dividend in the near future and hopes to be in a position to confirm this figure and include it within the 2015 financial statements.

2.6 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.

2.6.1 Infrastructure Backlog

Figure 5 - Infrastructure Backlog for 2009/10 to 2013/14 (\$'000s)

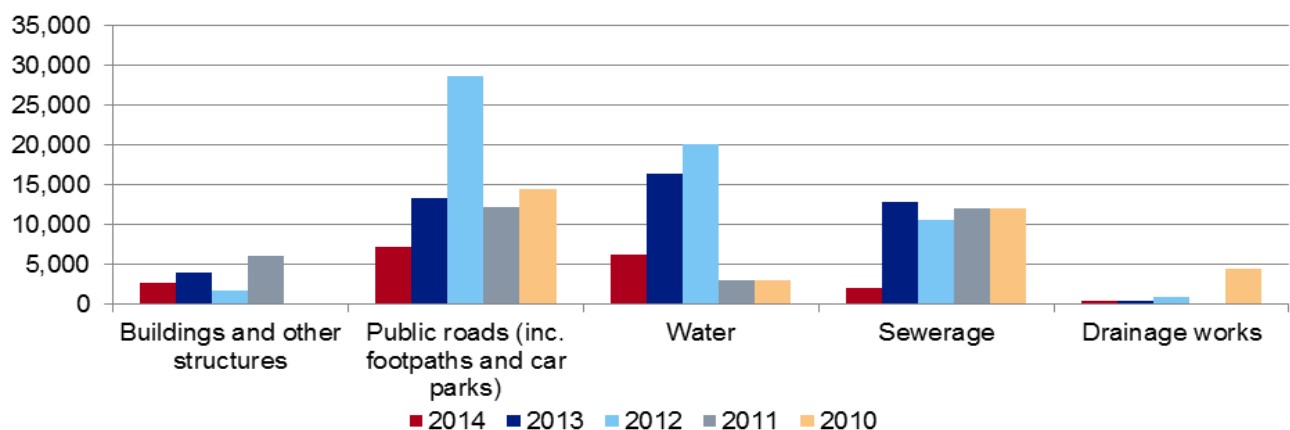
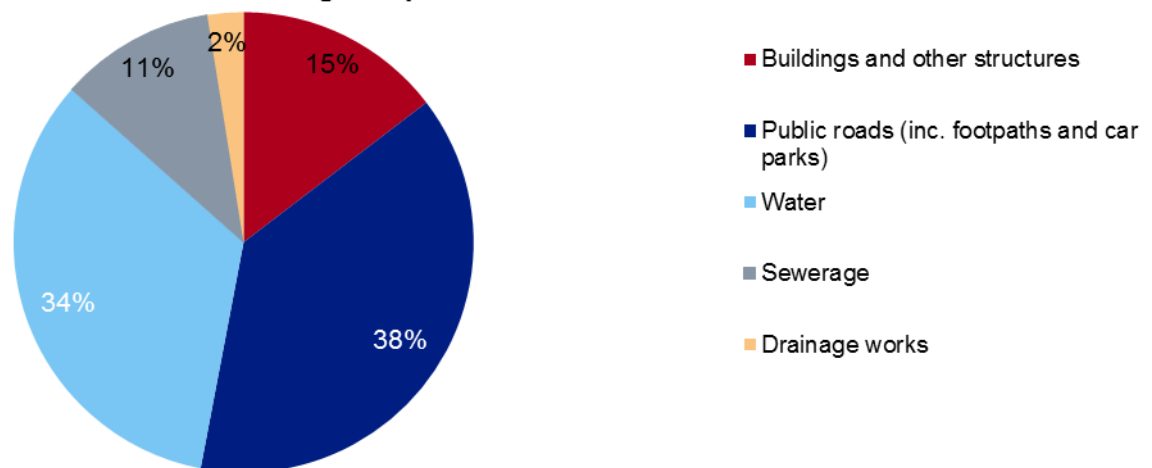


Figure 6 - Infrastructure Backlog Composition for 2013/14



Council's Infrastructure Backlog has reduced significantly to \$18.8m in 2014 from \$47.0m in 2013 and \$62.0m in 2012. During the last two years, roads backlog has reduced from \$28.7m to \$7.2m, water backlog has reduced from \$20.1m to \$6.3m and sewerage backlog has reduced from \$10.6m to \$2.1m.

Council has improved the accuracy of their asset registers and now report their backlog in line with the Integrated Planning and Reporting manual. Second, with the commencement of the SRV in 2014, Council has allocated additional funding to asset renewals. The additional SRV funds have reduced, and will continue to reduce, the Infrastructure Backlog.

2.6.2 Infrastructure Status

Infrastructure status	Year ended 30 June				
	2014	2013	2012	2011	2010
Bring to satisfactory standard (\$'000s)	18,813	47,022	62,001	33,278	33,917
Required annual maintenance (\$'000s)	6,740	6,238	8,952	7,842	7,621
Actual annual maintenance (\$'000s)	6,832	6,914	6,035	6,147	7,031
Total value infrastructure assets (\$'000s)	459,714	452,538	449,447	475,835	476,101
Total assets (\$'000s)	596,115	583,353	561,515	535,240	528,433
Infrastructure Backlog Ratio	0.04x	0.10x	0.14x	0.07x	0.07x
Asset Maintenance Ratio	1.01x	1.11x	0.67x	0.78x	0.92x
Building and Infrastructure Asset Renewal Ratio	0.82x	1.02x	0.46x	0.21x	0.70x
Capital Expenditure Ratio	1.19x	1.04x	1.27x	0.48x	1.46x

While Council's Infrastructure Backlog has decreased, the Infrastructure Backlog Ratio remains above the 0.02 times benchmark at this stage. The additional SRV funds are expected to continue to assist the reduction of this ratio.

Council has adequately invested in asset maintenance in the past two years although the five year average equals 0.90 times, below the 1.00 times benchmark. This is mainly due to the Water and Sewer Fund maintenance works being below the benchmark rather than the General Fund.

Council has also improved its Building and Infrastructure Asset Renewal Ratio in the past two years compared to the previous three years however the five year average for this ratio equals 0.77 times, again below the 1.0 times benchmark. This ratio will continue to improve as Council invests in asset renewals.

Council's Capital Expenditure Ratio has a five year average of 1.09 times, in-line with the 1.10 times benchmark. With the expected capital expenditure to be spent in the Water and Sewer Fund in the next few years, alongside higher capital expenditure in the General Fund, this ratio is expected to continue to increase.

2.6.3 Capital Program

The following figures are sourced from the Council's Annual Financial Statements at Special Schedule No. 8 and are not audited. As this schedule is not audited it is not compulsory to disclose this information and 2012 data is not complete. New capital works are major non-recurrent projects.

Capital Program (\$'000s)	Year ended 30 June				
	2014	2013	2012	2011	2010
New capital works	4,135	4,654	0	4,131	4,881
Replacement/refurbishment of existing assets	10,326	11,555	0	1,507	7,778
Total	14,461	16,209	0	5,638	12,659

In 2013 Council's major capital works included:

- \$8.6m on road renewals.
- \$1.3m on Parkes swimming pool upgrade and refurbishment.
- \$0.5m on Dam surface storage.
- \$0.5m on bridges and culverts.

In 2014 Council's major capital works included:

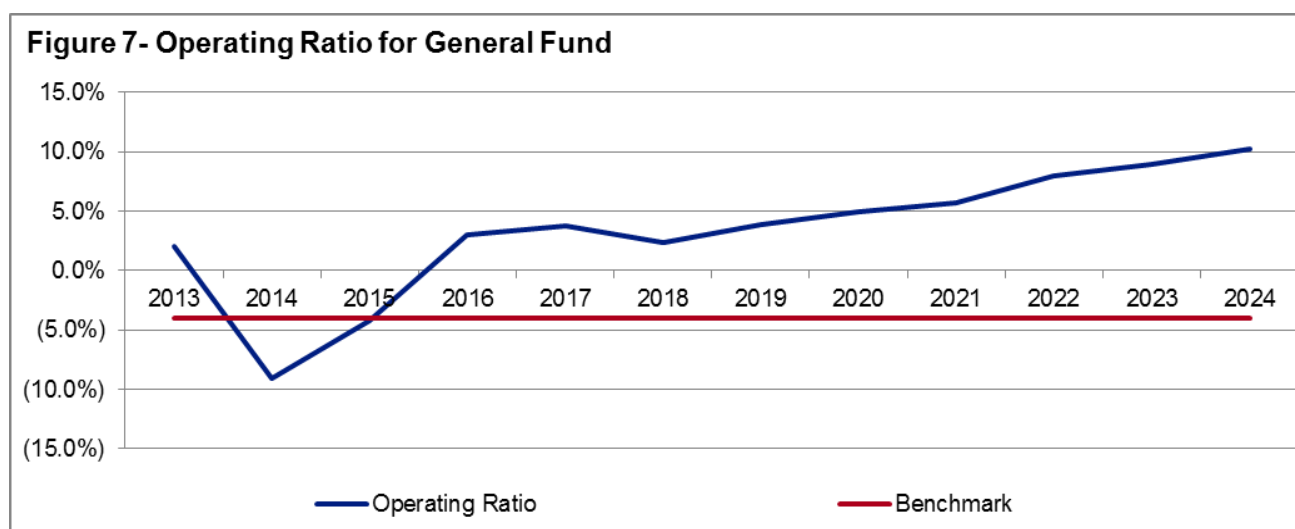
- \$6.2m on road renewals.
- \$1.0m on Lake Endeavour Dam safety upgrade.
- \$0.9m on runway lighting at Parkes Aerodrome.
- \$0.7m on tankers for the Bushfire Brigade.
- \$0.5m on pre-construction work for the Parkes Water treatment plant.
- \$0.5m on bridges and culverts.

3 Review of Financial Forecasts

The revised 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.

The LTFP has been based on improving the existing standard of services to the community by using the additional rates revenue to benefit the community by improving Council's infrastructure assets.

3.1 Operating Results



With the assistance of the SRV, Council is projecting to achieve an operating surplus from 2016 with the surplus forecast to improve to a level of 10.2% in 2024.

The improvement in 2015 is expected because of the second year of the SRV, the full annual FAG payment being received, increased user charges and fees because of higher RMS works being completed and a reduction in depreciation expenses by \$265k that has been identified following a revaluation of Council's road assets during the year.

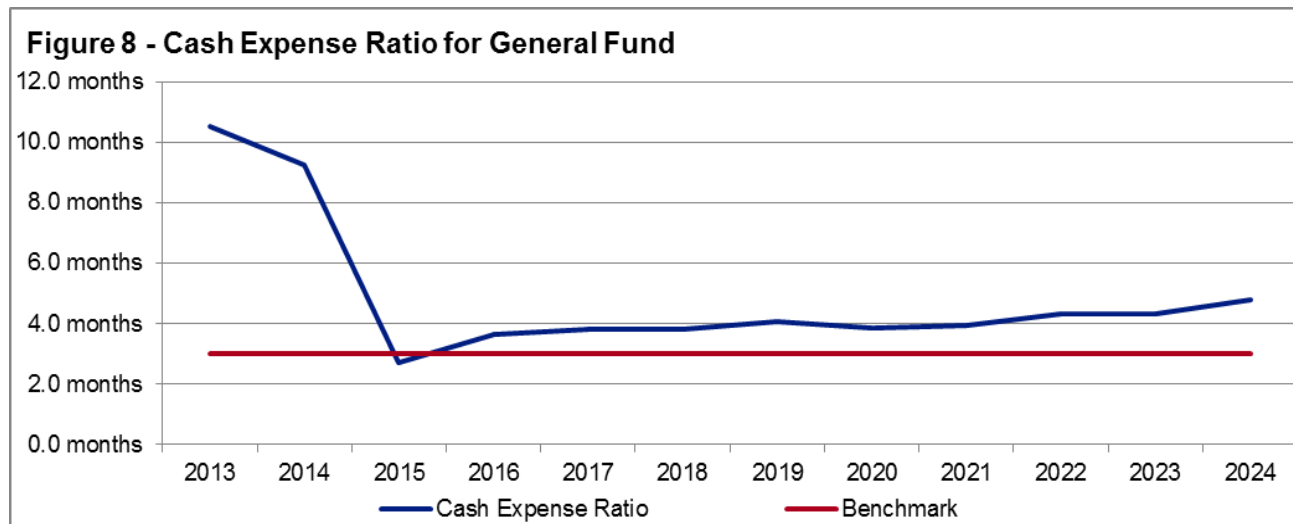
The 2016 increase is predominantly because of the SRV while the final year of the SRV in 2017 is forecast to not have such an impact with a decrease in operating grants and contributions currently forecast offsetting the SRV increase to an extent in this year.

After the SRV concludes in 2017 and a marginal decrease in the operating result in 2018, Council's operating result is forecast to gradually improve further. Operating revenues are forecast to increase at rates between 2.7% and 3.2% p.a. compared to the annual increases of operating expenses of between 1.3% and 2.4%.

The improvement from 2018 onwards is especially reliant on strong expense control and historically Council has a relatively good record in this regard.

3.2 Financial Management Indicators

Liquidity Ratios

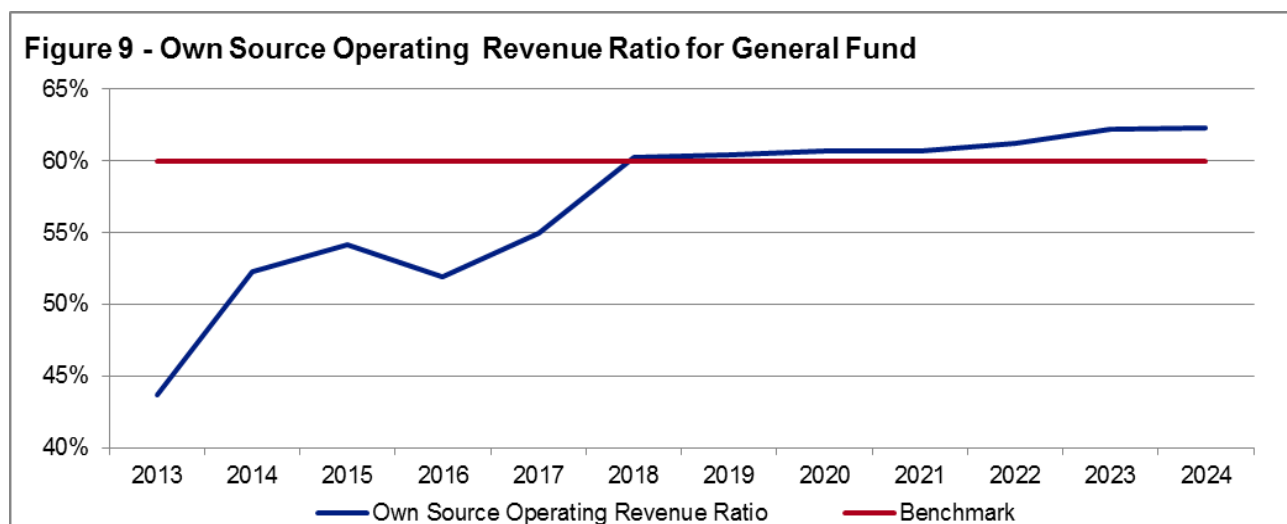


Council's Cash Expense Ratio is forecast to reduce considerably to be marginally below the benchmark in 2015, despite the ratio including current term deposits. The ratio is then expected to improve to above the benchmark and increase gradually over the remaining nine years. The decrease in 2015 is forecast because of the increased capital expenditure that is forecast between 2015 and 2017. The projected capital expenditure across these three years of \$39.5m is to be financed through a combination of Council's cash reserves (\$37.3m) and an increase in borrowings (\$2.2m).

Council has not updated its forecast Unrestricted Current Ratio as part of its Fit For the Future application given that the ratio is not required for the submission.

Council is forecasting the cash and cash equivalents balance to reduce to a low of \$0.315m in 2021, a sufficient level to provide a liquidity buffer. Council will have to maintain its strong control on receivables in order to achieve the forecast levels of cash and investments.

Fiscal Flexibility Ratios



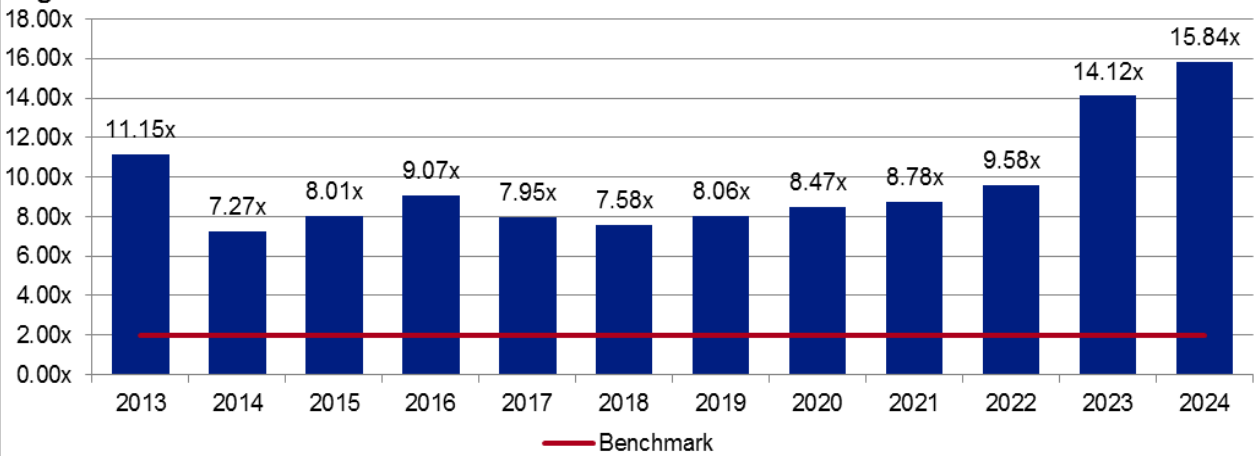
Council's own source operating revenue is forecast to improve because of three factors.

First, the SRV will increase Council's own source revenue over time as the above rate peg increases are permanently embedded into the rating base.

Second, the user charges and fees are forecast to increase from the 2014 total as Council expects to be contracted to complete additional RMS works.

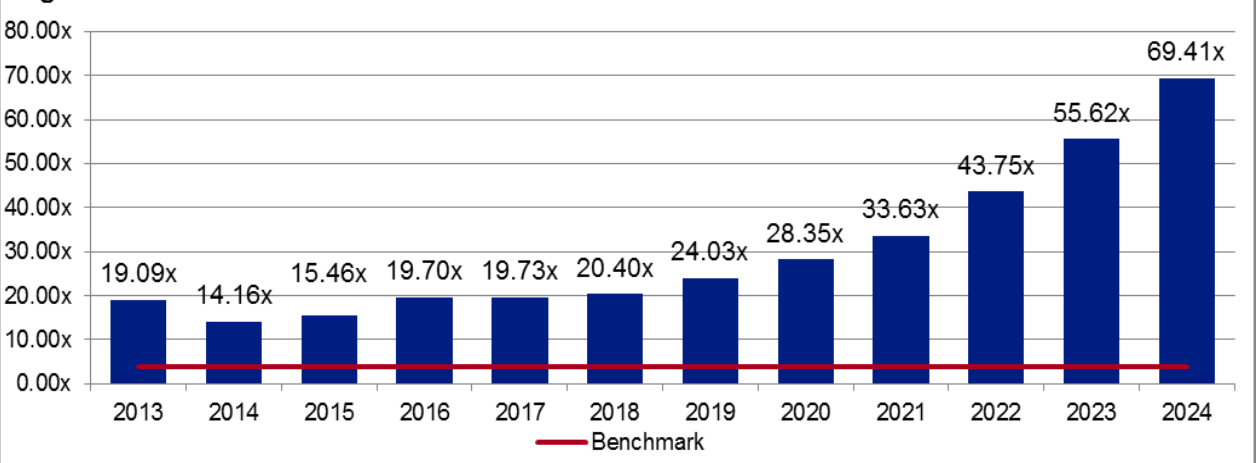
Third, Council has forecast reduced capital grants and contributions, with these reducing from \$3.8m in 2014 to \$2.1m in 2018 and \$1.5m in 2023.

Figure 10 - DSCR for General Fund



The DSCR is forecast to remain above the benchmark throughout the next 10 years with Council planning to use \$2.22m in borrowings in 2016 but then reducing their total borrowings from a maximum of \$7.8m in 2016 to \$2.0m by 2024. As the borrowings total reduces, the ratio improves from 2018 onwards.

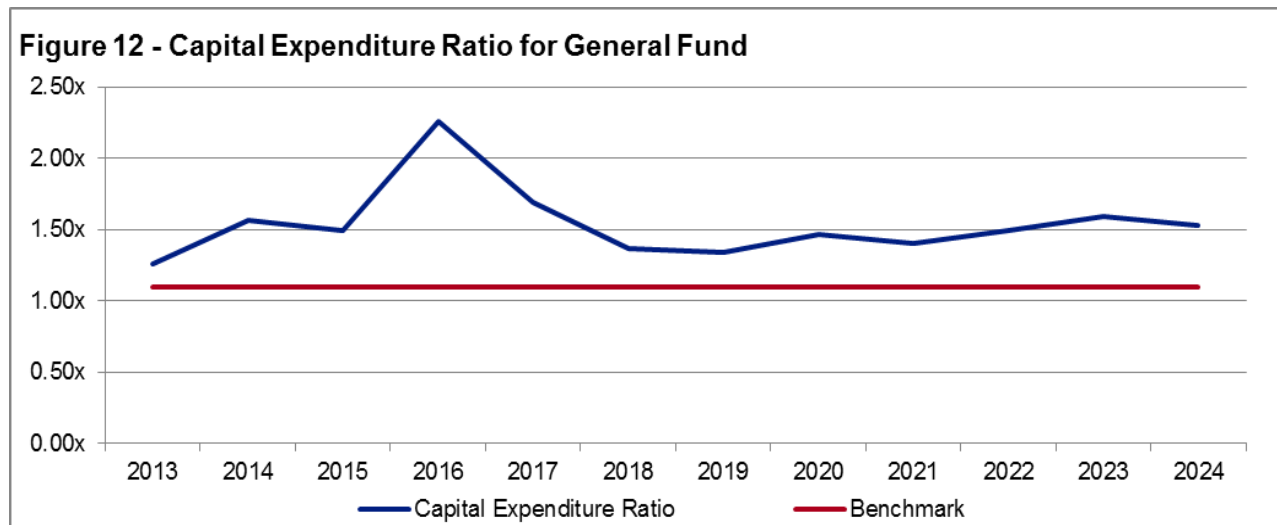
Figure 11 - Interest Cover Ratio for General Fund



Similar to the DSCR, the Interest Cover Ratio is forecast to remain comfortably above the benchmark through the forecast period. The ratio climbs rapidly towards the end of the 10 year period as Council's interest expense decreases by more than 50% between 2019 and 2024.

It is evident that Council has the capacity to utilise additional borrowings should the need arise.

3.3 Capital Expenditure



Council's Capital Expenditure Ratio is forecast to remain at strong levels over the next 10 years. The funds allocated to the purchase of infrastructure, property, plant and equipment (I,P,P&E) over this period is \$115.8m. This is in comparison to the cumulative depreciation total of \$74.1m.

TCorp would expect the benchmark to be met or to be marginally exceeded in line with a forecast increase in population and a focus on reducing the Infrastructure Backlog. However, Council's forecast results are at significantly high levels with the ratio results ranging from 1.34x in 2019 and 2.26x in 2016. The ratio is at a high level in 2016 because Council have brought forward a number of projects in this year as it looks to expend the SRV funds and improve its asset quality earlier than previously scheduled.

The major one-off projects forecast to be completed in 2016 include:

- \$1.2m for the development of a hockey field at Cheney/McGlynn Park
- \$1.2m additional works to improve rural roads
- \$1.0m for an upgrade to Council's information technology systems
- \$0.8m for footpath renewals throughout the LGA
- \$0.7m for the redevelopment of the Parkes Regional Airport
- \$0.4m for two waste depot upgrades

Council has a structured internal framework in place when assessing and managing all capital projects. With 2016 being the largest annual capital program in Council's history it has engaged a specialist project manager and team to manage the estimated \$60m capital works within the Water and Sewer Fund. With the internal framework in place and the added assistance of the contracted project team, Council is confident that it can manage the increased capital expenditure during 2016 and 2017.

3.4 Financial Model Assumption Review

Council has used its 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 LTFFP.

TCorp's benchmarks:

- Rates and annual charges: TCorp notes that the Local Government Cost Index (LGCI) increased by 3.4% in the year to September 2011, 2.8% in 2012, and 3.6% in 2013 and 3.4% in 2014. In December 2013 IPART announced that the rate peg to apply in the 2014/15 financial year will be 2.3%. Beyond 2015 TCorp has assessed a general benchmark for rates and annual charges to increase by mid-range LGCI annual increases of 3.0%.
- IPART developed the LGCI to use for setting the maximum allowable increase in general income for local government in NSW (rate peg). The LGCI is the measure of movement in the unit costs incurred by NSW council activities funded from the general rate base.
- Interest and investment revenue: annual return of 5%
- All other revenue items: the estimated annual CPI increase of 2.5%
- Employee costs: 3.5% (estimated CPI+1%)
- All other expenses: the estimated annual CPI increase of 2.5%

Key Observations and Risks

- The LTFFP is based on improving the existing standard of services to the community, using the additional rates revenue from the SRV to improve Council's infrastructure assets.
- The SRV contributes to annual rates and charges increasing by 8.2% in 2015, 12.2% in 2016 and 11.2% in 2017 after which the annual increment reduces to 3.0% p.a.
- User charges and fees are predicted to increase by 117.7% in 2015 due to Council completing a higher level of RMS works than in 2014. The 2014 total for RMS of \$0.9m was significantly lower than years prior. User charges and fees are then forecast to reduce by 14.1% in 2016 before increasing by 3.4% p.a.
- Employee expenses are forecast to increase by 2.9% p.a., below the TCorp benchmark of 3.5%. It is noted that Council has historically been able to control the annual increase in this category to 3.3% p.a. therefore it will need to improve this performance if it is to achieve the LTFFP figures.
- Depreciation is forecast to increase by 1.0% p.a. in each year, in line with the average annual increase in I,P,P&E.
- Council has forecast a high level of capital expenditure, especially in 2016 and 2017. This is mainly to be funded through reserves and the additional SRV funds. Council needs to be certain that these additional asset renewals and purchases do not put a strain on its liquidity.

3.5 Sustainability

Based on the information received and the revised LTFP, TCorp believes Council to currently have a Financial Sustainability Rating of Moderate. The Outlook for Council is currently Positive.

In considering the longer term financial Sustainability of the Council we make the following additional comments in relation to their General Fund:

- Council is forecasting an improvement in their operating performance that will enable operating surpluses from \$1.0m in 2016 to \$3.9m in 2024. This improvement, driven by the SRV, is forecast to improve Council's FSR to Sound within three years.
- Council's Own Source Operating Revenue is forecast to improve towards the 60% benchmark by 2018 providing Council with higher financial flexibility.
- In order for Council to achieve the forecast operating performance it will have to limit operating expenses to an average annual increase of 1.7%. Over the review period Council's operating expenses have actually decreased from \$26.1m in 2011 to \$24.7m in 2014 although it is noted that this has been possible because of the reduction in materials and contract expenses during this period.
- Council's cash and cash equivalents are forecast to reduce to marginally below the 3.0 months benchmark in 2015 before improving above the benchmark in and remaining within an upward trend thereafter.
- Council is forecasting to reduce its borrowings to \$2.0m by 2024, only using an additional \$2.2m in 2016. It may be beneficial to use a higher level of borrowings over the forecast period to strengthen Council's liquidity levels.
- Council's I,P,P&E is forecast to increase over the 10 year period as Council increases its asset base with the assistance of the SRV rate funds. Council's I,P,P&E is forecast to increase to \$469.6m in 2024, from \$424.7m in 2014 highlighting Council's commitment to its Capital Expenditure Program.
- Council's ongoing 'three pillar approach' of Asset Management, Financial Management and Community Engagement highlights the focus and importance that Council has placed on its Integrated Planning and Reporting.
- Council is part of the Mid-Lachlan Alliance and has participated in the CENTROC Joint Organisation of Council's pilot that has focused on regional collaboration and cost savings.

4 Conclusion and Recommendations

Based on our review of both the historic financial information and the 10 year financial forecast within Council's LTFP we consider Council to have a Sustainability rating of Moderate with an Outlook of Positive.

Under TCorp's methodology, a council rated as Moderate is considered to be in an acceptable position, with its performance in line with the benchmark for the ratios used to calculate the FSR. The Positive Outlook indicates that the FSR is expected to improve during the next three years based on Council's operating performance as detailed in the LTFP.

The major difference between where Council is now compared to the analysis compiled in TCorp's previous report in 2013 is that there is a clear improvement projected that is expected to improve Council's operating position over the next 10 years.

We base our recommendation on the following key points:

- Council is forecasting to achieve an operating surplus from 2016 onwards within their General Fund. This is an improvement from the historic operating deficits.
- Council is expected to improve its financial flexibility given the additional SRV funds that continue to improve Council's annual rates and charges.
- Council continues to improve the assessment of its assets through its AMP. The latest review of Council's road assets in 2015 has reduced their depreciation expense by \$265k.
- Council is using the additional SRV funds to focus on improving their asset base, both through new purchases and asset renewals that will increase the I,P,P&E total while reducing its Infrastructure Backlog to below the 0.02 times benchmark.

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

- Council will have to continue its strong control of its receivables to ensure it is able to achieve the forecast cash and investment balances.
- Council will have to continue its sound control of its operating expenses as it has forecast that its operating expenses will increase at an average rate of 1.7% p.a. A variation of this annual increase will quickly impact Council's ability to achieve a break-even operating position.

Appendix A Historical Financial Information Tables

Table 1-Income Statement

Income statement	Year ended 30 June					% annual change			
	2014	2013	2012	2011	2010	2014	2013	2012	2011
Revenue									
Rates and annual charges	14,147	12,863	12,226	12,087	11,647	10.0%	5.2%	1.1%	3.8%
User charges and fees	8,234	9,499	8,381	6,865	7,260	(13.3%)	13.3%	22.1%	(5.4%)
Interest and investment revenue	2,546	2,695	1,739	2,836	2,033	(5.5%)	55.0%	(38.7%)	39.5%
Grants and contributions for operating purposes	7,565	8,203	9,543	8,548	8,348	(7.8%)	(14.0%)	11.6%	2.4%
Other revenues	888	1,045	608	1,591	1,644	(59.5%)	260.2%	(61.8%)	(3.2%)
Total revenue	33,380	34,305	32,497	31,927	30,932	(5.8%)	9.1%	1.8%	3.2%
Expenses									
Employees	11,899	11,155	11,017	10,755	10,455	6.7%	1.3%	2.4%	2.9%
Borrowing costs	552	562	421	419	200	(1.8%)	33.5%	0.5%	109.5%
Materials and contract expenses	6,734	7,336	6,845	11,000	11,115	(8.2%)	7.2%	(37.8%)	(1.0%)
Depreciation and amortisation	10,854	10,367	10,099	9,328	8,110	4.7%	2.7%	8.3%	15.0%
Other expenses	3,683	3,504	2,991	2,728	3,038	5.1%	17.2%	9.6%	(10.2%)
Total expenses	33,722	32,924	31,373	34,230	32,918	2.4%	4.9%	(8.3%)	4.0%
Operating result (excluding capital grants and contributions)	(342)	1,381	1,124	(2,303)	(1,986)	(113.5%)	124.7%	148.8%	(16.0%)
Operating result (including capital grants and contributions)	6,331	9,221	6,117	2,397	2,173	(38.9%)	69.5%	155.2%	10.3%

Table 2 - Items excluded from Income Statement

Excluded items	2014	2013	2012	2011	2010
Grants and contributions for capital purposes	6,673	7,840	4,993	4,700	4,159
Interest revenue/ (losses)	949	1,227	459	0	0
Legal recoveries relating to Lehman Brothers CDO	0	1,145	0	0	0
Net gain/(loss) from the disposal of assets	202	1,016	0	1,144	1,071

Table 3 – Employee Numbers

	2014	2013	2012	2011	2010
Full Time Equivalent Employees at year end	158	159	158	155	151

Table 4 – Balance Sheet

Balance sheet (\$'000s)	Year ended 30 June					% annual change			
	2014	2013	2012	2011	2010	2014	2013	2012	2011
Current assets									
Cash and cash equivalents	4,186	6,412	2,387	2,454	4,846	(34.7%)	168.6%	(2.7%)	(49.4%)
Investments	47,200	49,303	43,931	34,448	27,583	(4.3%)	12.2%	27.5%	24.9%
Receivables	7,710	4,424	5,240	5,330	7,678	74.3%	(15.6%)	(1.7%)	(30.6%)
Inventories	3,510	3,773	3,371	3,409	3,553	(7.0%)	11.9%	(1.1%)	(4.1%)
Other	0	2	16	16	17	(100.0%)	(87.5%)	0.0%	(5.9%)
Total current assets	62,606	63,914	54,945	45,657	43,677	(2.0%)	16.3%	20.3%	4.5%
Non-current assets									
Investments	10,378	3,103	4,012	6,271	1,500	234.5%	(22.7%)	(36.0%)	318.1%
Receivables	0	32	29	55	60	(100.0%)	10.3%	(47.3%)	(8.3%)
Infrastructure, property, plant & equipment	521,870	515,043	501,550	483,245	483,179	1.3%	2.7%	3.8%	0.0%
Total non-current assets	1,261	1,261	979	12	17	0.0%	28.8%	8058.3%	(29.4%)
Total assets	533,509	519,439	506,570	489,583	484,756	2.7%	2.5%	3.5%	1.0%

Balance sheet (\$'000s)	Year ended 30 June					% annual change			
	2014	2013	2012	2011	2010	2014	2013	2012	2011
Current liabilities									
Payables	3,792	2,721	3,101	1,822	3,041	39.4%	(12.3%)	70.2%	(40.1%)
Borrowings	437	339	235	98	92	28.9%	44.3%	139.8%	6.5%
Provisions	4,033	4,228	4,208	3,926	3,672	(4.6%)	0.5%	7.2%	6.9%
Total current liabilities	8,262	7,288	7,544	5,846	6,805	13.4%	(3.4%)	29.0%	(14.1%)
Non-current liabilities									
Payables	102	100	0	0	0	2.0%	N/A	N/A	N/A
Borrowings	7,445	6,882	6,167	4,760	4,858	8.2%	11.6%	29.6%	(2.0%)
Provisions	782	685	605	586	579	14.2%	13.2%	3.2%	1.2%
Total non-current liabilities	8,329	7,667	6,772	5,346	5,437	8.6%	13.2%	26.7%	(1.7%)
Total liabilities	16,591	14,955	14,316	11,192	12,242	10.9%	4.5%	27.9%	(8.6%)
Net assets	579,524	568,398	547,199	524,048	516,191	2.0%	3.9%	4.4%	1.5%

Table 5 - Cashflow

Cash Flow Statement (\$'000s)	Year ended 30 June				
	2014	2013	2012	2011	2010
Cash flows from operating activities	13,923	20,474	18,063	13,993	9,393
Cash flows from investing activities	(16,810)	(17,268)	(19,674)	(16,293)	(14,675)
Proceeds from borrowings and advances	1,000	1,356	1,644	0	4,950
Repayment of borrowings and advances	(339)	(537)	(100)	(92)	0
Cash flows from financing activities	661	819	1,544	(92)	4,950
Net increase/(decrease) in cash and equivalents	(2,226)	4,025	(67)	(2,392)	(332)

Appendix B Glossary

Asset Revaluations

In assessing the financial sustainability of NSW councils, IPART found that not all councils reported assets at fair value¹. 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 (now OLG) with representatives from the Department of Premier and Cabinet and NSW Treasury.

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

Office of Local Government (OLG)

OLG (previously DLG) is an Office in the Planning and Environment cluster and is responsible for local government across NSW. OLG’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 OLG has a policy, legislative, investigative and program focus in matters ranging from local government finance, infrastructure, governance, performance, collaboration and community engagement. OLG strives to work collaboratively with the local government sector and is the key adviser to the NSW Government on local government matters.

Depreciation of Infrastructure Assets

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

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.

Financial Sustainability Rating (FSR)

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

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

The FSR is an assessment of a council's capacity to meet its financial commitments in the short, medium and long term. The FSR for each Council has been determined based on the review and consideration of a Council's historical performance against a set of benchmark indicators. The rating methodology consists of seven FSR categories. The FSR is calculated using weighted benchmarks according to the relative importance of each benchmark in terms of a Council's financial capacity and sustainability.

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).

Outlook

The Outlook assigned to Council is TCorp's assessment of the potential movement of Council's FSR within the next three years. The outlook methodology consists of three categories. A positive Outlook indicates that a Council's FSR is likely to improve in the short term, whilst a Neutral Outlook indicates that the FSR is likely to remain unchanged. A Negative Outlook indicates that a Council's FSR is more likely to deteriorate and is a sign of a general weakening in performance and sustainability.

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 + current term deposits / (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.

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