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Hawkesbury City Council

Financial Assessment and Benchmarking Report

27 August 2012

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

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Disclaimer

This report has been prepared by New South Wales Treasury Corporation (TCorp) in accordance with the appointment of TCorp by the Division of Local Government (DLG) as detailed in TCorp's letters of 22 December 2011 and 28 May 2012. The report has been prepared as part of the Local Infrastructure Renewal Scheme (LIRS) announced by the NSW Government.

The report has been prepared based on information provided to TCorp as set out in Section 2.2 of this report. TCorp has relied on this information and has not verified or audited the accuracy, reliability or currency of the information provided to it for the purpose of preparation of the report. TCorp and its directors, officers and employees make no representation as to the accuracy, reliability or completeness of the information contained in the report.

In addition, TCorp does not warrant or guarantee the outcomes or projections contained in this report. The projections and outcomes contained in the report do not necessarily take into consideration the commercial risks, various external factors or the possibility of poor performance by the Council all of which may negatively impact the financial capability and sustainability of the Council. The TCorp report focuses on whether the Council has reasonable capacity, based on the information provided to TCorp, to take on additional borrowings within prudent risk parameters and the limits of its financial projections.

The report has been prepared for Hawkesbury City Council, the LIRS Assessment Panel and the DLG. TCorp shall not be liable to Hawkesbury City Council or have any liability to any third party under the law of contract, tort and the principles of restitution or unjust enrichment or otherwise for any loss, expense or damage which may arise from or be incurred or suffered as a result of reliance on anything contained in this report.

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Section 1 Executive Summary

This report provides an independent assessment of Hawkesbury City Council's (the Council) financial capacity and its ability to undertake additional borrowings. The analysis is based on a review of the historical performance, current financial position, and long term financial forecasts. It also benchmarks the Council against its peers using key ratios.

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

Council has made one application for a Timber Bridge Replacement Program for $5.0m over 10 years.

TCorp's approach has been to:

- Review the most recent three years of Council's consolidated financial results
- Conduct a detailed review of the Council's 10 year financial forecasts. The review of the financial forecasts focused on the particular Council fund that was undertaking the proposed debt commitment. As the Council operates two funds we focused our review on the General Fund as the loan will be attached to the General Fund

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

- Council's underlying operating performance (measured using EBITDA) has remained consistent over the three year period
- 75.8% 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 reported infrastructure backlog of $80.6m in 2011 represents 14.9% of its infrastructure asset value of $538.1m. Other observations include:

- Council's infrastructure backlog has remained static between 2010 and 2011
- The most significant proportion of the backlog at 83.0% relates to roads. Council do not have any water infrastructure
- Compared to benchmark ratios Council appears to be underspending on asset renewal and asset maintenance

Council are in Group 3 in terms of implementation of the Integrated Planning and Reporting Framework.

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

- The forecast shows deficit positions are expected in all 10 years when capital grants and contributions are excluded. The forecast deficits are higher than current performance. This highlights that Council could face long term sustainability issues.
- Council's own source revenue is above benchmark for the majority of the forecast

In our view, the Council has the capacity to undertake the combined additional borrowings of $5.0m for the LIRS project. This is based on the following analysis:

- The DSCR remains above the benchmark of 2.00x in the 10 year forecast
- The Interest Cover Ratio is above the benchmark of 4.00x in nine of the 10 forecast years

We also recommend:

- As Council's investment properties currently have a vacancy rate of between 10% and 15% we would recommend that Council reassesses its investment portfolio and develops a strategy that seeks to either improve its vacancy rates or consider the sale of some of its surplus properties at the appropriate time

[To insert summary comments about the benchmarking.]

Section 2 Introduction

2.1: Purpose of Report

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

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

The key areas focused on are:

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

2.2: Scope and Methodology

TCorp's approach was to:

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

In undertaking its work, TCorp relied on:

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

Benchmark Ratios

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

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

Therefore these benchmarks are intended as a guide to performance.

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

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

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2.3: Overview of the Local Government Area

Hawkesbury Council LGA	
Locality & Size	
Locality	Sydney Metropolitan
Area	2,800km²
DLG Group	6
Demographics	
Population	62,353
% under 18	29%
% between 18 and 59	54%
% over 60	17%
Expected population 2025	62,353
Operations	
Number of employees (FTE)	257
Annual revenue	$55.7m
Infrastructure	
Roads	1025km
Bridges	64
Infrastructure backlog value	$80.6m
Total infrastructure value	$538.1m

Hawkesbury City Council Local Government Area (LGA) is located about 50km Northwest of the Sydney Central Business District. Of the almost 2,800km² of land within the Hawkesbury LGA, 71% is contained within National Parks, Nature Reserves and State Recreation Areas.

Until recently Hawkesbury City remained largely rural but urban expansion within Sydney has since transformed the southern part of the LGA into dormitory suburbs. The northern part of the LGA still contains some farmlands, with the vast area of national parks relatively untouched due to the inaccessible terrain.

Hawkesbury LGA's current population of 62,353 is expected to remain unchanged over the next 10 years. Council's projections show less than 1.0% increase p.a. in some years and decreases in others.

Council had 257 full-time equivalent employees at the end of 2011.

2.4: LIRS Application

Council has made one LIRS application.

Project: Timber Bridge Replacement Program

Description: A program to replace seven existing timber bridges currently in poor condition with reinforced concrete structures including sealing approach roads. The concrete structures will generally be constructed at a higher level with larger dimensions.

Amount of loan facility: $5.0m

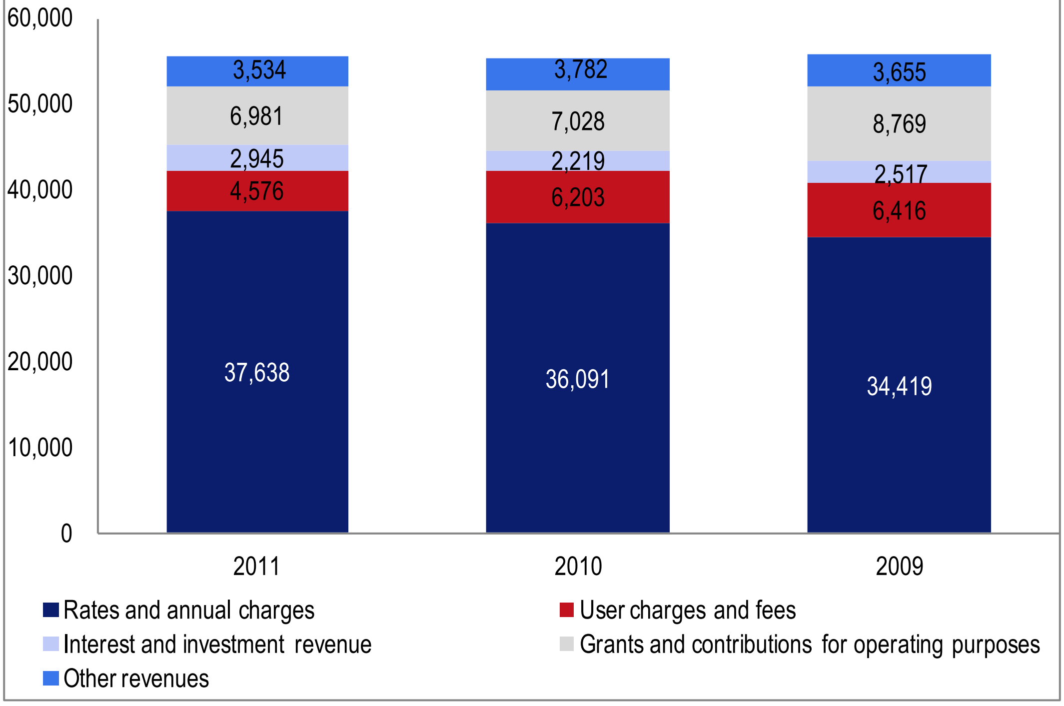
Term of loan facility: 10 years

Section 3 Review of Financial Performance and Position

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

3.1: Revenue

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



Key Observations

- Rates and annual charges increased by 4.3% in 2011 and 4.9% in 2010. The revenue growth was driven by the IPART approved rate increases plus increases in domestic waste management services.
- User fees and charges have been decreasing year on year with a decrease of $1.6m in 2011. Swimming centre/sports stadium revenue decreased from $2.1m in 2010 to $0.1m in 2011. Council owned two leisure centres which were reporting losses each year. The centres were outsourced to an external organisation (YMCA) who receives all revenue and pays all expenses for the centres. However Council is responsible for any deficit that might occur. Up until the 2010 financial year, the revenue and expenditure for the leisure centres were consolidated into Council's financial statements and the revenue of $2.0m was shown as Council's revenue. As a result of an accounting policy review by Council's external auditors, from 2011 the external organisation's accounts are no longer consolidated with Council's figures.
- Operating grants and contributions decreased by $1.7m in 2010. This was driven by a $0.8m reduction in roads to recovery grants and a $0.3m reduction in child care service grants. .

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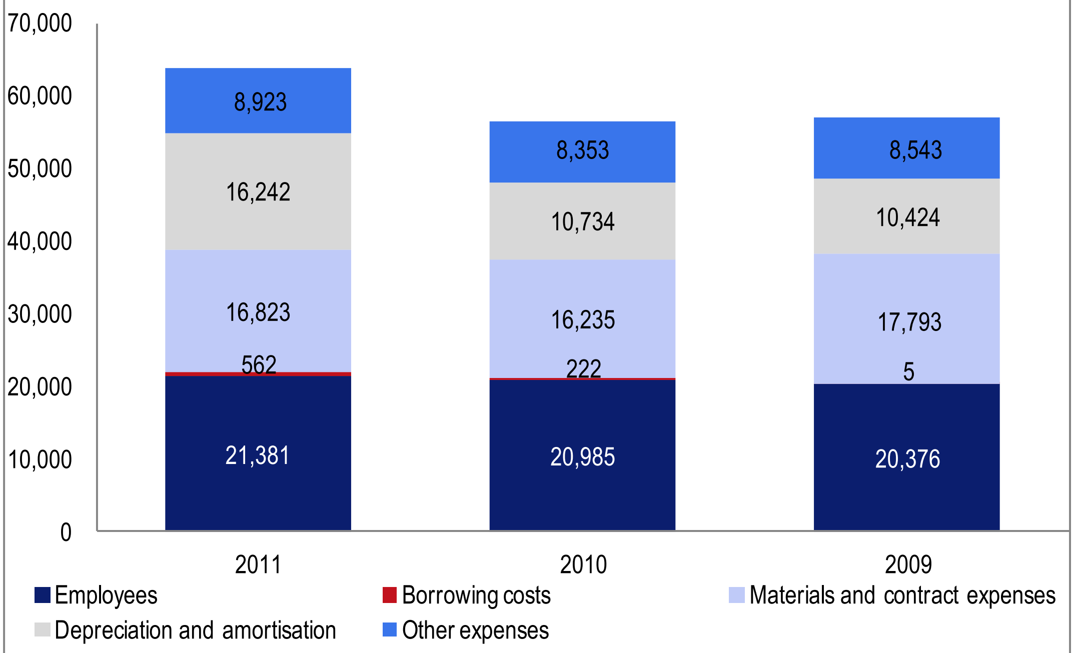
Council had significant revenue from rental income on investment properties at $1.6m p.a. for the past 3 years. Council has a portfolio of 70 investment properties, 64.0% are retail and commercial, 15.0% residential and 21.0% are land only. 64.0% are under formal lease varying from 3x3 to 5x5 year terms. Residential leases are subject to a continuation clause. The current vacancy rate is between 10.0% and 15.0% p.a. While this is expected to reduced to 7.0% Council should consider alternative strategies to reduce this vacancy rate and the risk to Council

3.2: Expenses

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



Key Observations

- Employee costs increased by only 1.9% in 2011. They increased by 3.0% in 2010 in line with CPI.
- Materials and contract expenses have remained static over the three year period.
- In 2010 the Asset Revaluations process increased the value of Council's infrastructure assets. This resulted in the annual depreciation charge increasing 51.3% in 2011 to $16.2m.
- Other expenses have increased by 6.8% in 2011 driven by increased waste contributions.

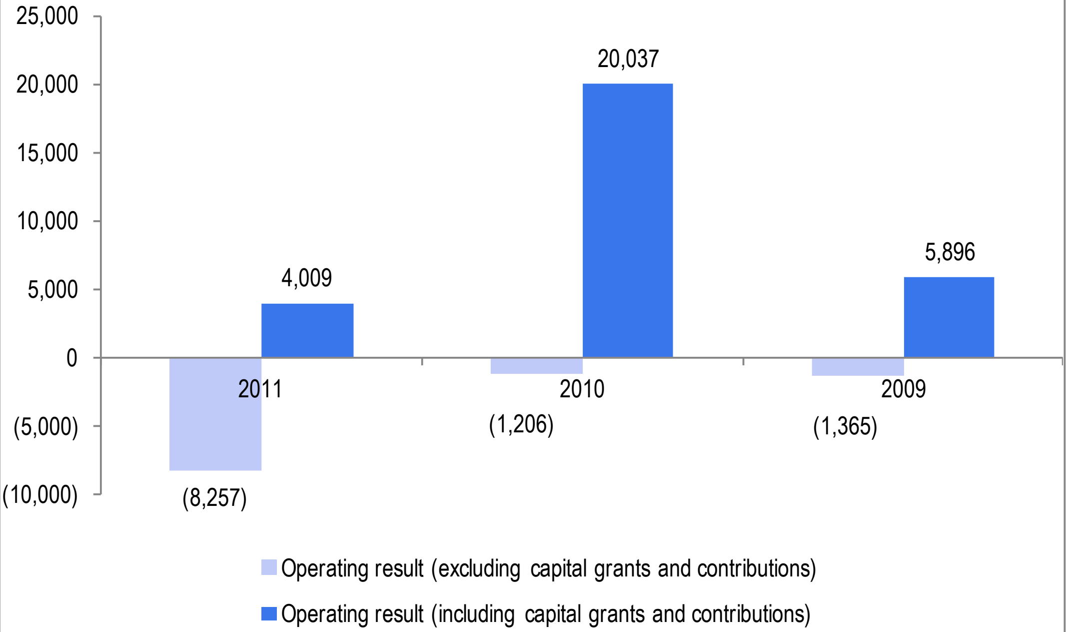
3.3: Operating Results

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

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

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

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



Key Observations

- Council has consistently posted net operating deficits excluding capital grants and contributions for the last three years. The increased 2011 deficit was driven by higher depreciation charges.
- Council expenses include a large non-cash depreciation expense, ($16.2m in 2011), which has increased by $5.5m since 2010 following the Asset Revaluations process. Whilst the non-cash nature of depreciation can favourably impact on ratios such as EBITDA that focus on cash, depreciation is an important expense as it represents the allocation of the value of an asset over its useful life.

3.4: Financial Management Indicators

Performance Indicators	Year ended 30 June		
	2011	2010	2009
EBITDA ($'000s)	8,547	9,750	9,064
Operating Ratio	(14.8%)	(2.2%)	(2.4%)
Interest Cover Ratio	15.21x	43.92x	1,812.80x
Debt Service Cover Ratio	8.88x	43.92x	148.59x
Unrestricted Current Ratio	4.26x	4.35x	4.37x
Own Source Revenue	62.1%	55.2%	64.8%
Cash Expense Ratio	2.1months	4.5months	5.2months
Net assets ($'000s)	781,861	687,219	481,965

Key Observations

- Council's EBITDA has been maintained at consistent levels over the last three years.
- The Operating Ratio has decreased below the benchmark in 2011 mainly due to increased depreciation expenses.
- Council's Interest Cover Ratio and DSCR were well above their respective benchmarks indicating Council had flexibility in regard to carrying more debt.
- The Unrestricted Current Ratio has been above benchmark each year indicating Council had sufficient liquidity primarily due to the fact that Council hold $35.7m in long term deposits.
- The Own Source Revenue is above the 60% benchmark in two out of three years and indicates Council had sufficient financial flexibility. The decrease in 2010 was due to increased capital grants for that year.
- The Cash Expense Ratio fell below the benchmark (>3.0 months) in 2011 but Council also held a substantial amount of cash in long term deposits.
- Council's Net Assets have increased by $300.0m between 2009 and 2011 due to Asset Revaluations in 2010 which increased the value of roads, bridges and drainage infrastructure.
- When the Asset Revaluations are excluded, the underlying trend in all three years has been an increase in the infrastructure, property, plant and equipment (IPP&E) asset base with asset purchases being greater than the combined value of disposed assets and annual depreciation. Over the three years this amounted to a $32.8m increase in IPP&E assets.
- Council had total borrowings of $2.8m representing 0.36% of Net Assets.

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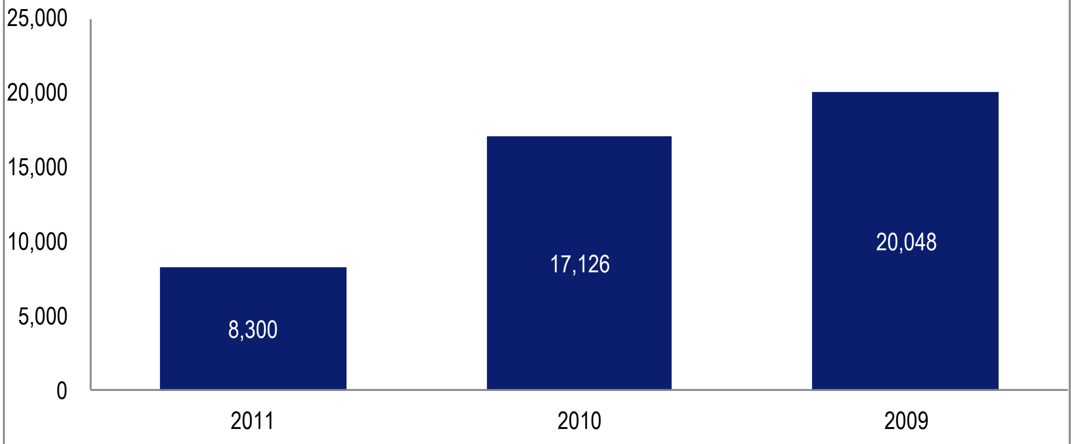
3.5: Statement of Cashflows

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



Key Observations

- Cash and cash equivalents decreased in 2011 due a decrease in short term deposits of $7.0m and at call deposits by $2.2m. Long term deposits increased by $10.0m to $35.7m. The cash reserves along with the Unrestricted Current Ratio indicate Council had sound liquidity.
- Of the $44.0m in cash and investments, $15.0m was externally restricted, $17.3m was internally restricted and $11.6m was unrestricted.
- Council's investments portfolio comprised $43.3m in term deposits which Council advises all mature within a 12 month period.

3.6: Capital Expenditure

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

3.6(a): Infrastructure Backlog

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

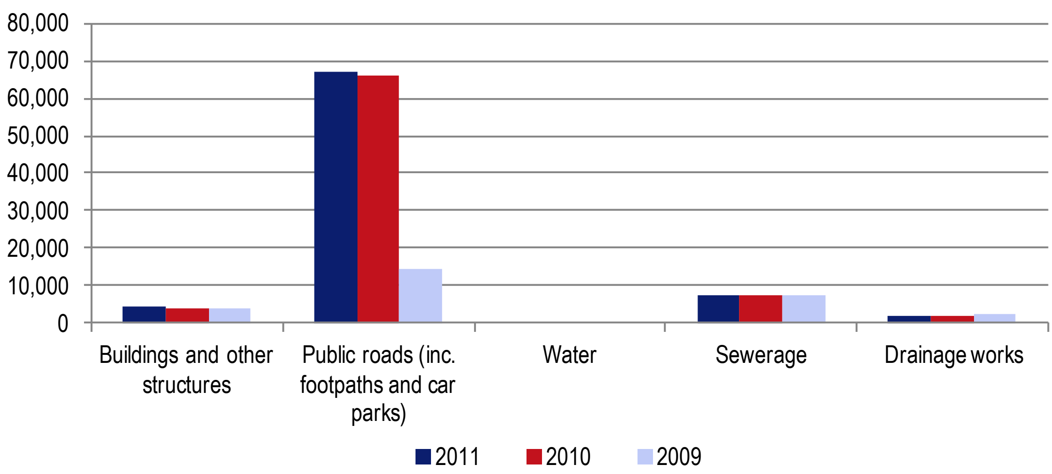
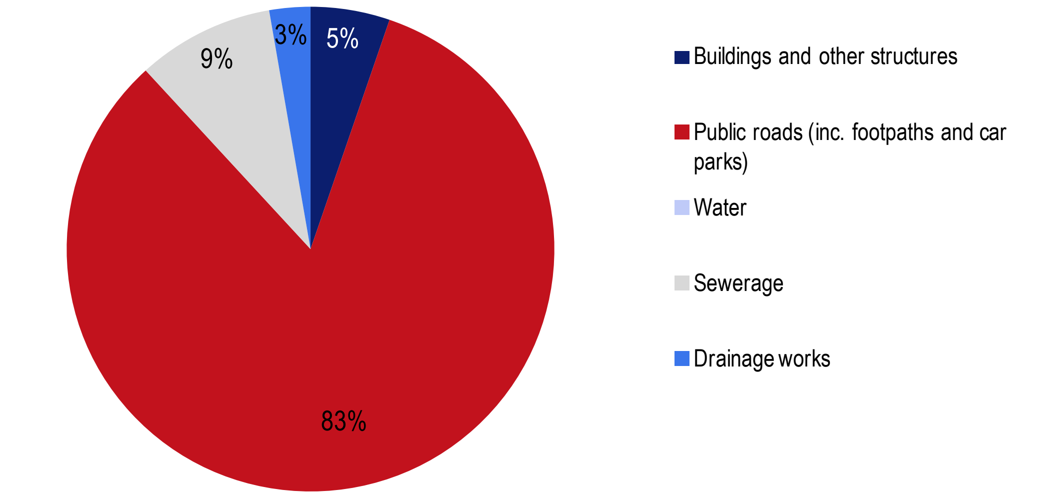


Figure 6 - Infrastructure Backlog Composition for 2010/11



Council reported $80.6m in infrastructure backlog in 2011. The backlog predominantly relates to public roads (including bridges) at $66.8m and this is being partly addressed in the LIRS project. The overall backlog has increased by $52.7m since 2009 as part of the Asset Revaluations process. Council is confident once their bridges are upgraded the current maintenance cost should reduce .

3.6(b): Infrastructure Status

Infrastructure Status	Year ended 30 June		
	2011	**2010**	**2009**
Bring to satisfactory standard ($'000s)	80,636	79,386	27,868
Required annual maintenance ($'000s)	13,035	17,511	17,274
Actual annual maintenance ($'000s)	8,777	8,063	8,218
Total value of infrastructure assets ($'000s)	538,059	462,193	282,728
Total assets ($'000s)	803,628	707,156	497,643
Building and Infrastructure Backlog Ratio	0.15x	0.17x	0.10x
Asset Maintenance Ratio	0.67x	0.46x	0.48x
Building and Infrastructure Renewals Ratio	0.58x	0.83x	0.66x
Capital Expenditure Ratio	1.49x	2.79x	1.53x

The Infrastructure Backlog Ratio has increased since 2009 as the total value of Infrastructure Backlog has increased at a greater rate than the value of the infrastructure assets.

The Asset Maintenance Ratio and Building and Infrastructure Asset Renewal Ratio indicate the Council is spending at levels below the benchmark on asset renewal and asset maintenance.

The Capital Expenditure Ratio which takes into account capital expenditures which improve performance or capacity, indicate Council's asset base is being enhanced over the last three years.

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.

3.6(c): Capital Program

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

Capital Program ($'000s)	Year ended 30 June		
	2011	2010	2009
New capital works			
Replacement/refurbishment of existing assets	24,896	30,758	16,491
Total	**24,896**	**30,758**	**16,491**

Capital works expenditure decreased in 2011 due to decreased capital grants for new capital works.

In 2011, Council completed a new extension on the Bowen Mountain Park Hall and an extension to the Oasis Health and Fitness Club. A number of footpath reconstruction projects were completed for $0.1m and roads rehabilitation works were completed including Terrace Road North Richmond and Old Bells Line of Road, Kurrajong.

Council also completed a number of parks and recreation projects in 2011 including installation of a viewing observation deck with seating and park seating between Howe Park and Rickabys and installation of a computer based irrigation system at Richmond Park.

Capital renewal funding projections are being developed by managers responsible for the assets based on available information in hand. Council focuses on balancing the budget for the forthcoming year and this is generally based on Council's current financial capacity and historic expenditure trend. However greater emphasis is now placed in preparing a 10 year funding projection and analysis of funding models for "bridging" the asset renewal funding gap in the long term financial plan.

Council has initiated action to improve its Asset Management knowledge, systems and processes, and it is anticipated that with improved asset knowledge Council's asset renewal funding forecast will become more robust.

3.7: Specific Risks to Council

Infrastructure maintenance and renewal backlog. Council considers the existing and increasing infrastructure maintenance and renewal backlog a primary risk. The LIRS project funding will help relieve some of these issues.

Population profile. Council's estimated population movement over the next 10 years is nil. Based on census information population in the Hawkesbury LGA is estimated to remain unchanged as projections show less than 1.0% increase p.a. in some years and decreases in others. This is a major concern and will result in an increasingly older population and place increased pressure on existing infrastructure and services. There are currently both residential and commercial development proposals before Council which could change this situation if they eventuate.

Investment property revenue. Council has a significant proportion of revenue from investment properties. While there are long term leases in place for 64.0% of these properties, they also have a current vacancy rate between 10.0% and 15.0% p.a. Council expect this vacancy rate to decrease to 7.0% in the future due to lease agreements now in place for two major revenue generating properties. Given the volatility of the property market, Council needs to continue to monitor this revenue stream closely.

Flooding is a major risk in the Hawkesbury LGA and affects all asset types. Extended periods of rain can significantly affect infrastructure assets in particular roads and can result in additional unplanned maintenance demands (e.g. potholes) which must be addressed if additional damage is to be avoided. As flooding is a known risk to Council a draft flood risk management study and plan has been prepared and is due to go on exhibition within the next two months.

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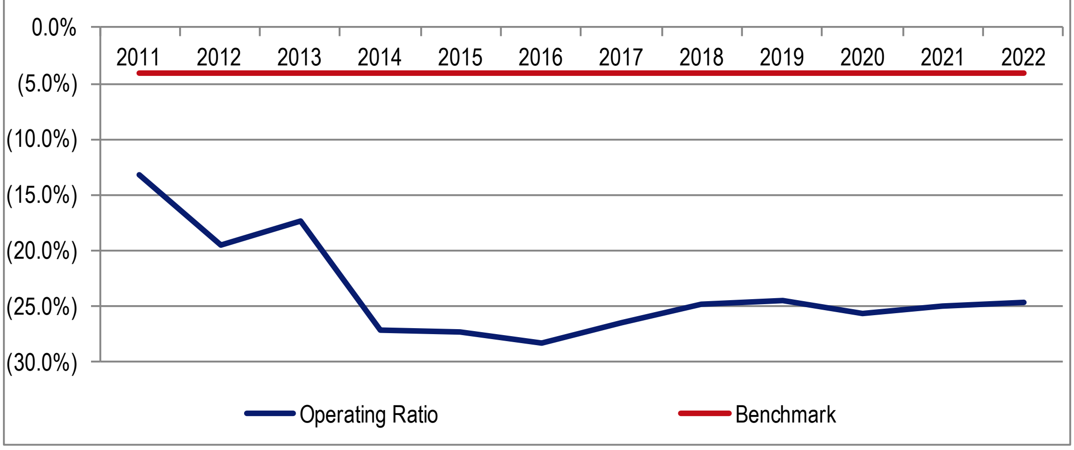
Section 4 Review of Financial Forecasts

The financial forecast model shows the projected financial statements and assumptions for the next 10 years. The model includes the $5.0m loan without any LIRS subsidy.

The LIRS loan relates to the General Fund, therefore we have focused our financial analysis solely upon this Fund. Council's consolidated position includes a Sewer Fund however this is operated as an independent entity, which unlike the General Fund is more able to adjust the appropriate fees and charges to meet all future operating and investing expenses.

4.1: Operating Results

Figure 7- Operating Ratio for General Fund



The Operating Ratio forecasts shows deficit positions are expected in all 10 years when capital grants and contributions are excluded. The depreciation expense and increased materials and contract expenses are impacting this Ratio. Council could face financial sustainability issues in the future unless additional revenue sources are found, services are amended and/or expenses reduced.

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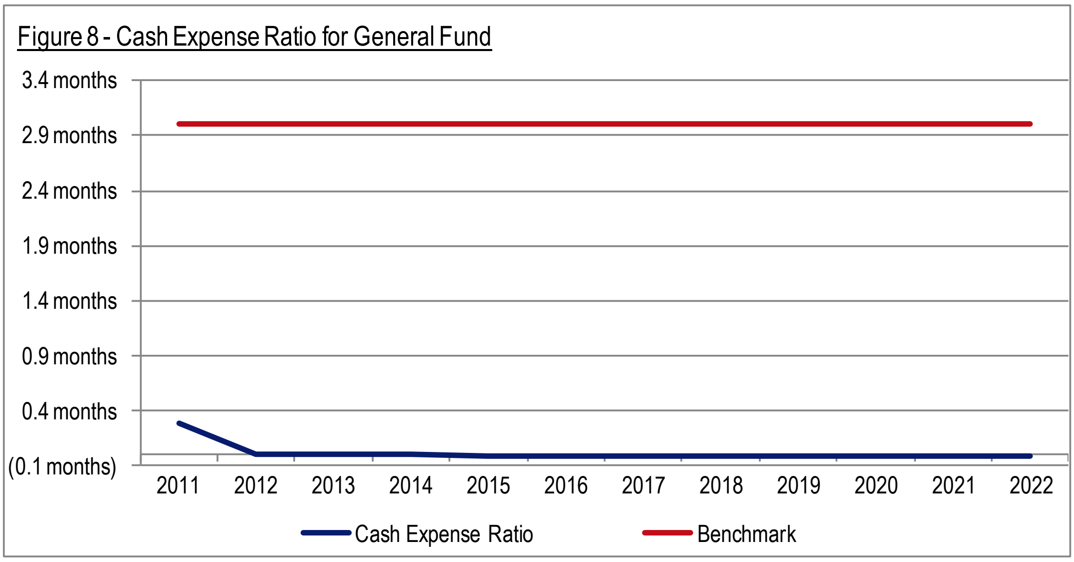
4.2: Financial Management Indicators

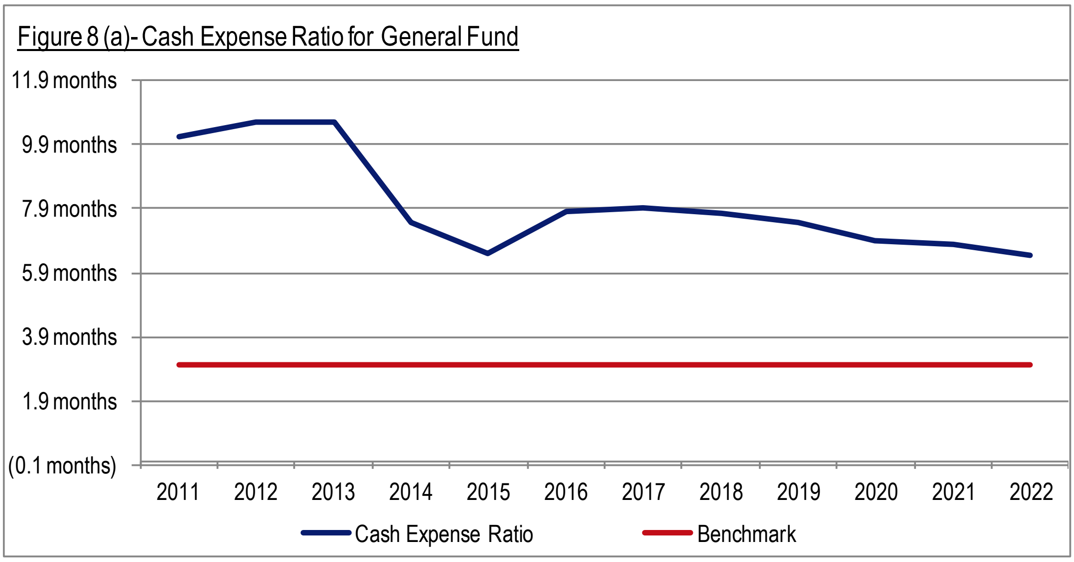
Liquidity Ratios



The Cash Expense Ratio indicates that Council operate with little room for flexibility in regard to liquidity. This ratio is well below benchmark with little improvement forecast over the long term.

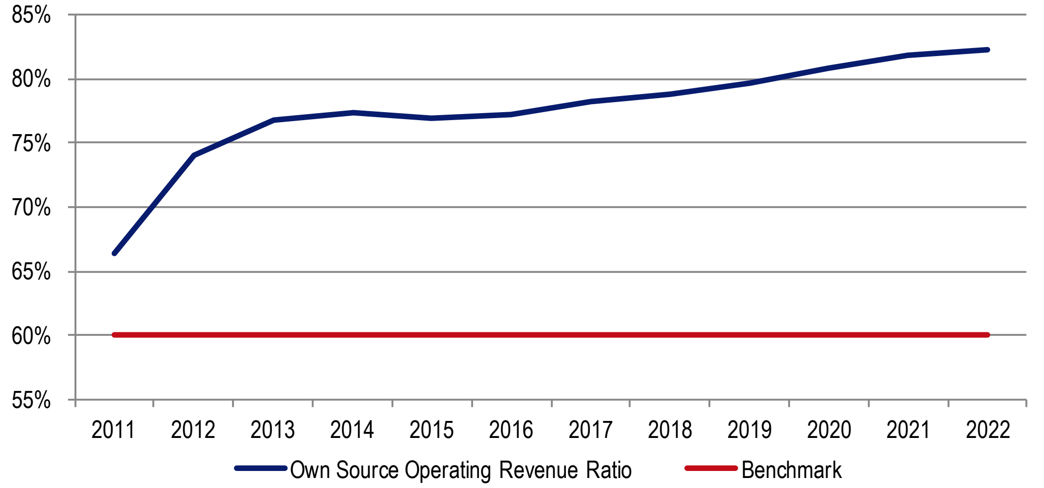
This ratio does not take into account Council's level of investments. Council held $35.7m in term deposits in their current investments portfolio as at 30 June 2011.

When Councils current investments are considered the Cash Expense Ratio will remain above benchmark over the forecast period and will not face liquidity issues (Fig 8(a)).



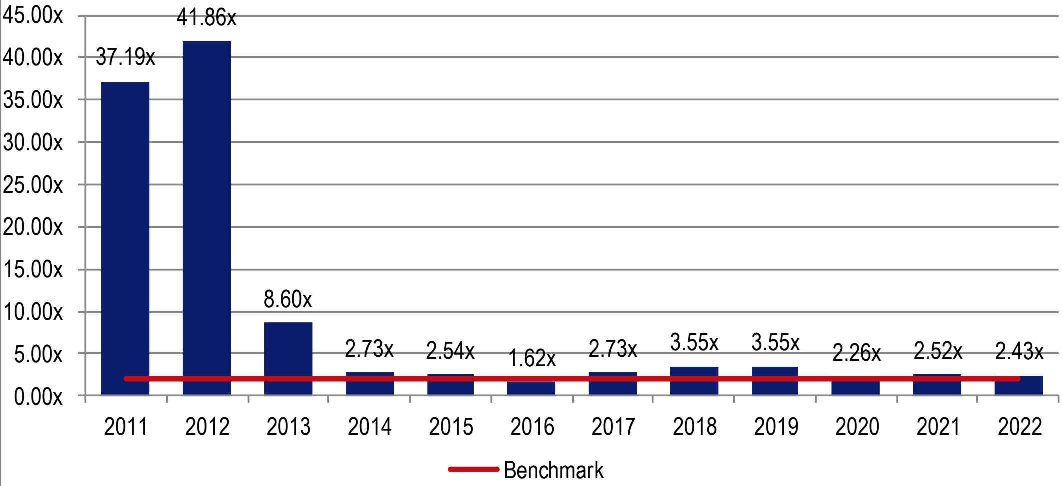
Fiscal Flexibility Ratios

Figure 10 - Own Source Operating Revenue Ratio for General Fund



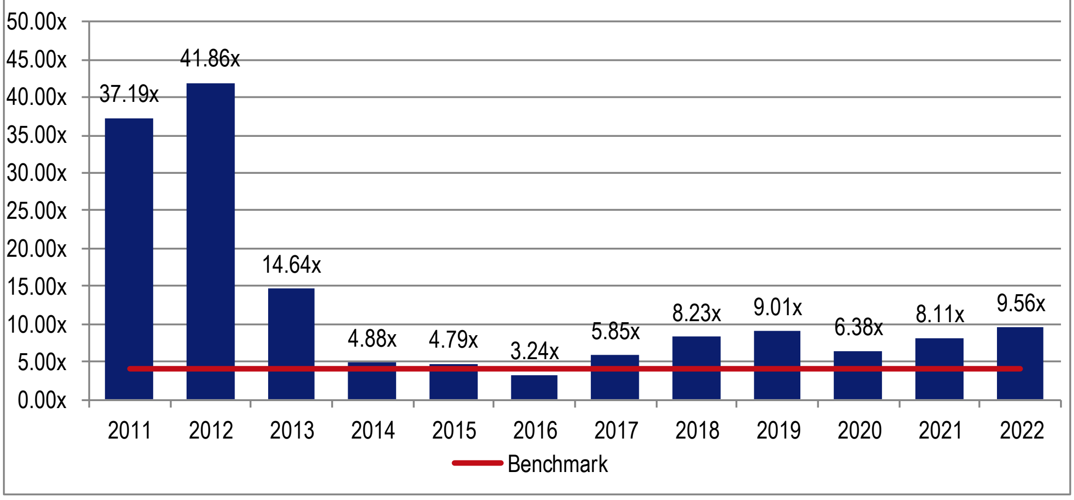
The Own Source Operating Revenue Ratio is above benchmark for the entire forecast period. This indicates the Council is not highly reliant on external revenue sources. The ratio is rising over the lifetime of the forecast due to user fees and charges being forecast higher than the historic operating results primarily due to increased waste management fees.

Figure 11 - DSCR for General Fund



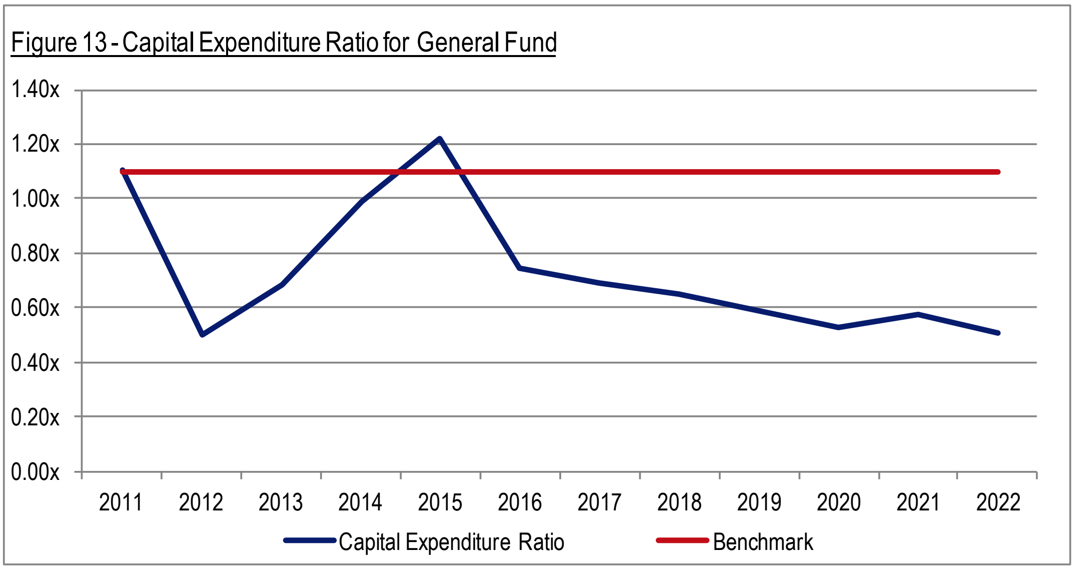
Council's DSCR fluctuates over the 10 year forecast but remains above benchmark in nine of the 10 years. In 2016 the DSCR is at its lowest point at 1.62x. This is due to reduced forecast EBITDA in 2016 caused by increased materials and contracts expenses for additional projects forecast to be undertaken in that year.

Figure 12 - Interest Cover Ratio for General Fund



The Interest Cover Ratio, similarly to the DSCR indicates the Council has sufficient capacity to service additional debt commitments, including LIRS.

4.3: Capital Expenditure



The Capital Expenditure Ratio is below benchmark from 2011for the forecast period with the exception of 2015.

The low levels of capital expenditure forecast for nine of the 10 years will increase pressure on existing assets. While depreciation is forecast to increase between 2012 and 2022, capital expenditure is forecast to decrease resulting in a deficit for depreciation versus capital expenditure of $62.0m.

The capital expenditure spikes in 2015 to $20.8m due to an additional $8.0m allocated for proposed land acquisition and $3.0m for other minor projects.

4.4: Financial Model Assumption Review

Councils have used their own assumptions in developing their forecasts.

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

TCorp's benchmarks:

- Rates and annual charges: TCorp notes that rates increased by 3.4% in the year to September 2011, and in December 2011, IPART announced that the rate peg to apply in the 2012/13 financial year will be 3.6%. Beyond 2013 TCorp has assessed a general benchmark for rates and annual charges to increase by mid-range LGCI annual increases of 3.0%
- Interest and investment revenue: annual return of 5%
- All other revenue items: the estimated annual CPI increase of 2.5%
- Employee costs: 3.5% (estimated CPI+1%)
- All other expenses: the estimated annual CPI increase of 2.5%

Key Observations and Risks

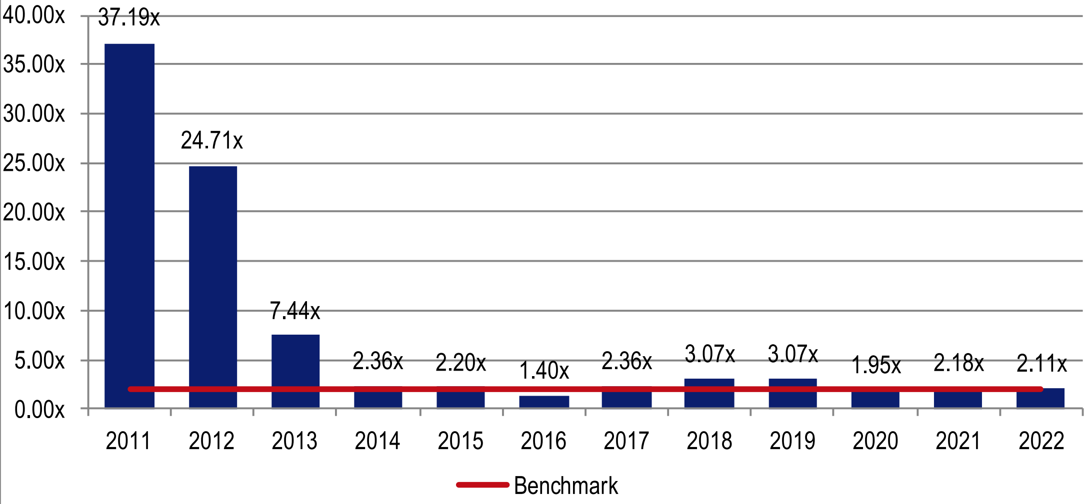
- Rates and annual charges are forecast to increase in line with the 2013 rate peg increase of 3.6%p.a. until 2015. In 2016 they increase by 4.85% p.a. and by over 5.0% p.a. from 2018. General rates have been forecast to increase by 3.0% p.a. however Council has forecast an increase in Domestic Waste Charges from 2016 for the remainder of the forecast in order to maintain the Domestic Waste Program in light of expected S88 Environmental Levy increases.
- User fees and charges are forecast to decrease in 2012 following the historical decreases in 2011. An increase of 14.5% is forecast in 2013 due to increased fees expected from three subdivision sites at Pitt Town, Kingsford Smith Village Seniors Housing Development and Stannix Park. These fees are payable by the developers and Developer Approval (DA) has been approved for all sites. User fees and charges are then forecast to increase by up to 10.0% p.a. for the remainder of the forecast period driven by significant increases in waste management facility charges. These are offset by increases in other expenses.
- The annual increase in employee costs is forecast at 5.1% in 2012 and around 3.0% for the remainder of the forecast. This is in line with historic increases and considered reasonable.
- Materials and contracts expenses fluctuate throughout the forecast period with an annual increase of 34.5% forecast in 2013 and 8.4% in 2016. These increases are forecast according to a list of future works Council.
- Overall we consider the assumptions reasonable and where different to TCorp expectations, all such assumptions were supported by data.

4.5: Borrowing Capacity

When analysing the financial capacity of the Council we believe Council will not be able to incorporate additional loan funding in addition to the LIRS loan facilities and other proposed borrowings already included in Council's financial forecasts. Some comments and observations are:

- Based on a benchmark of DSCR>2x, an additional $1.0m would bring the DSCR below benchmark in four of the 10 years forecast
- This scenario has been calculated by basing borrowing capacity on a 10 year amortising loan at a rate of 6.4% p.a.

Figure 14 - DSCR for General Fund



Section 5 Benchmarking and Comparisons with Other Councils

[This section still being finalised]

Section 6 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 be in a satisfactory financial position. Both past performance and the financial forecasts support our findings that Council has sufficient financial capacity to service the additional borrowings proposed under its LIRS application.

We base our recommendation on the following key points:

- Council has sufficient financial capacity to manage the additional $5.0m debt highlighted by a DSCR and Interest Cover Ratio above benchmark in nine of the 10 years forecast
- Council's Own Sourced Operating Revenue Ratio is forecast to be above the benchmark for the entire forecast period
- Council is currently in Group 3 in terms of implementation of the Integrated Planning and Reporting Framework. As Council continues to address and improve their Asset Management knowledge, systems and processes, it is anticipated that Council's asset renewal funding forecast will become more robust

We would also recommend that the following points be considered:

- Council's population is not expected in increase over the next 10 years. Council needs to implement strategies to attract and retain people in the LGA
- Council has a significant portion of its revenue from their investment portfolio. They need to monitor these carefully so they remain a source of revenue as opposed to an expense on Council
- As Council's investment properties currently have a vacancy rate of between 10% and 15% we would recommend that Council reassesses its investment portfolio and develops a strategy that seeks to either improve its vacancy rates or consider the sale of some of its surplus properties at the appropriate time

New South Wales Treasury Corporation

Appendix A Historical Financial Information Tables

Table 1- Income Statement

Income Statement ($'000s)	Year ended 30 June			% annual change	
	2011	2010	2009	2011	2010
Revenue					
Rates and annual charges	37,638	36,091	34,419	4.3%	4.9%
User charges and fees	4,579	6,203	6,416	(26.2%)	(3.3%)
Interest and investment revenue	2,945	2,219	2,517	32.7%	(11.8%)
Grants and contributions for operating purposes	6,981	7,028	8,769	(0.7%)	(19.9%)
Other revenues	3,534	3,782	3,655	(6.6%)	3.5%
Total revenue	**55,674**	**55,323**	**55,776**	**0.6%**	**(0.8%)**
Employees	21,381	20,985	20,376	1.9%	3.0%
Borrowing costs	562	222	5	153%	4340.0%
Materials and contract expenses	16,823	16,235	17,793	3.6%	(8.8%)
Depreciation and amortisation	16,242	10,734	10,424	51.3%	3.0%
Other expenses	8,923	8,353	8,543	6.8%	(2.2%)
Total expenses	**63,931**	**56,529**	**57,141**	**13.1%**	**(1.1%)**
Operating result	**(8,257)**	**(1,206)**	**(1,365)**	**(584.7%)**	**11.6%**

Table 2 - Items excluded from Income Statement

Excluded items ($'000s)			
	2011	2010	2009
Grants and contributions for capital purposes	12,266	21,243	7,261
Entities using the equity method	208	377	0
Fair Value Adjustments in Investing Activities	0	0	178
Fair Value Adjustments in Investment Properties	0	206	331
Premium on Interest Free Loan	0	1,124	0
Net gain/(losses) from the disposal of assets	290	256	526

Table 3 - Balance Sheet

Balance Sheet ($'000s)	Year Ended 30 June			% annual change	
	2011	2010	2009	2011	2010
Current assets					
Cash and equivalents	8,300	17,126	20,048	(51.5%)	(14.6%)
Investments	35,700	27,500	20,500	29.8%	34.1%
Receivables	4,176	5,080	3,472	(17.8%)	46.3%
Inventories	189	209	178	(9.6%)	17.4%
Other	145	111	170	30.6%	(34.7%)
Total current assets	48,210	50,026	44,368	(3.0%)	12.8%
Non-current assets					
Investments	0	0	0	0	0
Receivables	1,184	844	751	40.3%	12.4%
Inventories	0	0	0	0	0
Infrastructure, property, plant & equipment	726,453	629,013	425,834	15.5%	47.7%
Investments accounted for using the equity method	1,626	1,418	1,041	14.7%	36.2%
Investment property	25,855	25,855	25,649	0.0%	0.8%
Total non-current assets	755,118	657,130	453,275	14.9%	45.0%
Total assets	**803,628**	**707,156**	**497,643**	**13.6%**	**42.1%**
Current liabilities					
Payables	6,082	5,506	5,015	10.5%	9.8%
Borrowings	382	376	0	1.6%	0
Provisions	7,527	6,611	6,018	3.9%	9.9%
Total current liabilities	13,991	12,493	11,033	12.0%	13.2%
Non-current liabilities					
Borrowings	2,463	2,500	0	(1.5%)	0
Provisions	5,313	4,944	4,645	7.5%	6.4%
Total non-current liabilities	7,776	7,444	4,645	4.5%	60.3%
Total liabilities	**21,767**	**19,937**	**15,678**	**9.2%**	**27.2%**
Net assets	**781,861**	**687,219**	**481,965**	**13.8%**	**42.6%**

Table 4-Cashflow

Cashflow Statement ($'000s)	Year ended 30 June		
	2011	**2010**	**2009**
Cashflows from operating activities	22,063	14,735	16,359
Cashflows from investing activities	(30,489)	(20,533)	(25,462)
Proceeds from borrowings and advances	0	2,876	0
Repayment of borrowings and advances	(400)	0	(56)
Cashflows from financing activities	(400)	0	(56)
Net increase/(decrease) in cash and equivalents	**(8,826)**	**(2,922)**	**(9,159)**
Cash and equivalents	8,300	17,126	20,048

Appendix B Glossary

Asset Revaluations

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

Collateralised Debt Obligation (CDO)

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

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

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

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

Division of Local Government (DLG)

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

Depreciation of Infrastructure Assets

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

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

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

EBITDA

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

Grants and Contributions for Capital Purposes

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

Grants and Contributions for Operating Purposes

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

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

Independent Commission Against Corruption (ICAC)

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

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

Independent Pricing and Regulatory Tribunal (IPART)

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

Infrastructure Backlog

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

Integrated Planning and Reporting (IP&R) Framework

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

Local Government Cost Index (LGCI)

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

Net Assets

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

Roads and Maritime Services (RMS)

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

Section 64 Contribution

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

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

Section 94 Contribution

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

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

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

Special Rate Variation (SRV)

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

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

The applications are reviewed and approved by IPART.

Ratio Explanations

Asset Maintenance Ratio

Benchmark = Greater than 1.0x

Ratio = actual asset maintenance / required asset maintenance

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

Building and Infrastructure Renewals Ratio

Benchmark = Greater than 1.0x

Ratio = Asset renewals / depreciation of building and infrastructure assets

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

<u>Cash Expense Cover Ratio</u>

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.

<u>Capital Expenditure Ratio</u>

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.

<u>Debt Service Cover Ratio (DSCR)</u>

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

<u>Infrastructure Backlog Ratio</u>

Benchmark = Less than 0.02x

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

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

<u>Interest Cover Ratio</u>

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.