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Yass Valley Council

Financial Assessment, Sustainability and Benchmarking Report

24 April 2013

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

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

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

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

The report has been prepared for Yass Valley Council, the DLG and the Independent Local Government Review Panel. TCorp shall not be liable to Yass Valley 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 Yass Valley Council's (the Council) financial capacity, and its future Sustainability. The analysis is based on a review of the historical performance, current financial position, and long term financial forecasts. It also benchmarks the Council against its peers using key ratios. TCorp's approach has been to:

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

The Council has not addressed its declining financial position over the review period based on the following observations:

- Council has incurred increasing operating deficits (excluding grants and contributions for capital purposes), while Council's underlying operating results (measured using EBITDA) have declined from $6.3m in 2009 to $5.9m in 2012
- Council's Infrastructure Backlog is on an upward trend, and Council has been unable to fund the required asset maintenance or asset renewal amounts
- Council has not agreed on service levels with its community

The Council reported $19.7m of Infrastructure Backlog in 2012 which represents 11.8% of its infrastructure asset value of $166.5m. Other observations include:

- A significant portion of the backlog (64.2%) is related to roads

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

- Council's financial forecast is in real dollars. Whilst not explicit, DLG's Integrated Planning and Reporting Manual states that councils need to consider and make assumptions about the following areas: demographics of the LGA, economic forecasts, inflation forecasts, and interest rate movements amongst other matters. We would expect Council's forecast to include the impacts of inflation.
    - o The problem with presenting or analysing forecasts in real dollars is in situations where revenues and expenses are not increasing at the same or similar rates. For example, in the case of Yass Valley, revenues over the past four years have increased by 10.0%, whilst expenses have increased by 24.3%. If this disparity in growth rates is projected over the 10 year financial forecast period, Council's financial results will be considerably worse than the current forecast position. This issue needs to be addressed by Council so that a clearer picture of Council's likely financial position can be seen. Council has advised that their current LTFP will be 'carefully reviewed and refined over the next 12 months in order to provide an accurate base for decision making'
- The current forecast shows deficit positions are expected in all 10 years when capital grants and contributions are excluded. This is Council's weakest forecast ratio and highlights that over the longer term Council faces Sustainability issues

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- Council has to balance meeting liquidity requirements with the need to invest in its infrastructure (particularly roads). However, as noted above, Council does not have sufficient resources in the foreseeable future to make any significant reduction in their Infrastructure Backlog and it is likely that the Backlog will continue to increase. Council is aware of their asset backlog and the need to address their revenue sources.

In our view, the Council does not have the capacity to undertake additional borrowings. This is based on the following analysis:

- While the DSCR is greater than 2.0x for the majority of the forecast, TCorp cannot make any estimates of potential borrowing capacity based on the current LTFP where the forecasting approach is fundamentally different to TCorp's

We consider Council to be moderately Sustainable in the short to medium term but is in a deteriorating position in respect of its longer term Sustainability. In respect of the long term Sustainability of the Council our key observations are:

- Council's LTFP for its General Fund forecasts operating deficits of over 20.0% p.a. The forecast annual revenue is lower than historic amounts by over $2.0m due to conservative forecasting of operating grants and contributions. Should Council continue to receive operating grants at historical levels this would allow Council to increase its expenditure on asset maintenance and Council's prospects for continuing Sustainability
- Council is not spending sufficient amounts on asset renewal and this will reduce the quality of assets and impact the provision of services
- With an increasing population Council needs to address these issues and consider means of generating additional revenues or reducing operating expenses if it is to achieve Sustainability

In respect of the Benchmarking analysis TCorp has compared the Council's key ratios with other councils in DLG group 11. The key observations are:

- Council's financial flexibility as indicated by the Operating Ratio is below the group average and has been below benchmark in the last three years
- Council's Own Source Operating Revenue Ratio is above the average
- Council's DSCR and Interest Cover Ratio were below the group averages and above the benchmarks over the review period and are forecast to decline below the benchmarks in the medium term
- Council was in a sound liquidity position which is expected to decline in the medium term
- Council's performance in terms of its Infrastructure Backlog Ratio was better than the group average but weaker than the benchmark
- The Capital Expenditure Ratio was around the group average and above the benchmark
- Council's Building and Infrastructure Asset Renewal Ratio and Asset Maintenance Ratio were below the benchmarks and around or below the group averages

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Section 2 Introduction

2.1: Purpose of Report

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

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

The key areas focused on are:

- The financial capacity of the Council
- The long term Sustainability of the Council
- The financial performance of the Council in comparison to a range of similar councils and measured against prudent benchmarks

2.2: Scope and Methodology

TCorp's approach was to:

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

In undertaking its work, TCorp relied on:

- Council's audited financial statements (2008/09 to 2011/12)
- Council's financial forecast model
- Council's IP&R documents
- Discussions with Council officers
- Other publicly available information such as information published on the IPART website

In completing the report, TCorp worked closely with Council management to analyse and understand the information gathered. The Council was given a draft copy of the report for their review and comment. Council has acknowledged that the findings of the report summarises Council's financial position. The report is viewed by management and Council as a useful reference document to assist their development of long term sustainability.

Definition of Sustainability

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

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

Benchmark Ratios

In conducting our review of the Councils' financial performance, forecasts and Sustainability we have measured performance against a set of benchmarks. These benchmarks are listed below.

Benchmarks do not necessarily represent a pass or fail in respect of any particular area. One-off projects or events can impact a council's performance against a benchmark for a short period. Other factors such as the trends in results against the benchmarks are critical as well as the overall performance against all the benchmarks.

As councils can have significant differences in their size and population densities, it is important to note that one benchmark does not fit all. For example, the Cash Expense Ratio should be greater for smaller councils than larger councils as a protection against variation in performance and financial shocks. Therefore these benchmarks are intended as a guide to performance.

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

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

2.3: Overview of the Local Government Area

Yass Valley Council LGA	
Locality & Size	
Locality	Southern Tablelands
Area	3,999 km^2
DLG Group	11
Demographics	
Population as at August 2011	15,020
% under 20	28.7%
% between 20 and 59	51.4%
% over 60	19.9%
Expected population 2026	18,800
Operations	
Number of employees (FTE)	135
Annual revenue	$25.3m
Infrastructure	
Roads	1,222 km
Bridges	55
Infrastructure backlog value	$19.7m
Total infrastructure value	$166.5m

Yass Valley Council Local Government Area (LGA) is located on the Southern Tablelands of NSW approximately 270 km southwest of the Sydney CBD and 60 km north from the centre of Canberra. The main town servicing the LGA is Yass with the smaller villages of Binalong, Bookham, Bowning, Gundaroo, Sutton, Murrumbateman and Wee Jasper supporting the outlying areas.

The LGA is one of the fastest growing areas in New South Wales with an annual population growth rate of 2.3% between 2006 and 2011, compared to the State average of 1.4%. The median age within the LGA is 40 and the population is forecast to increase by 33.3% between 2011 and 2031.

Being 60 km from Canberra many residents commute to work there. The LGA possesses a variety of agricultural industries including grazing, cropping, viticulture, and horticulture.

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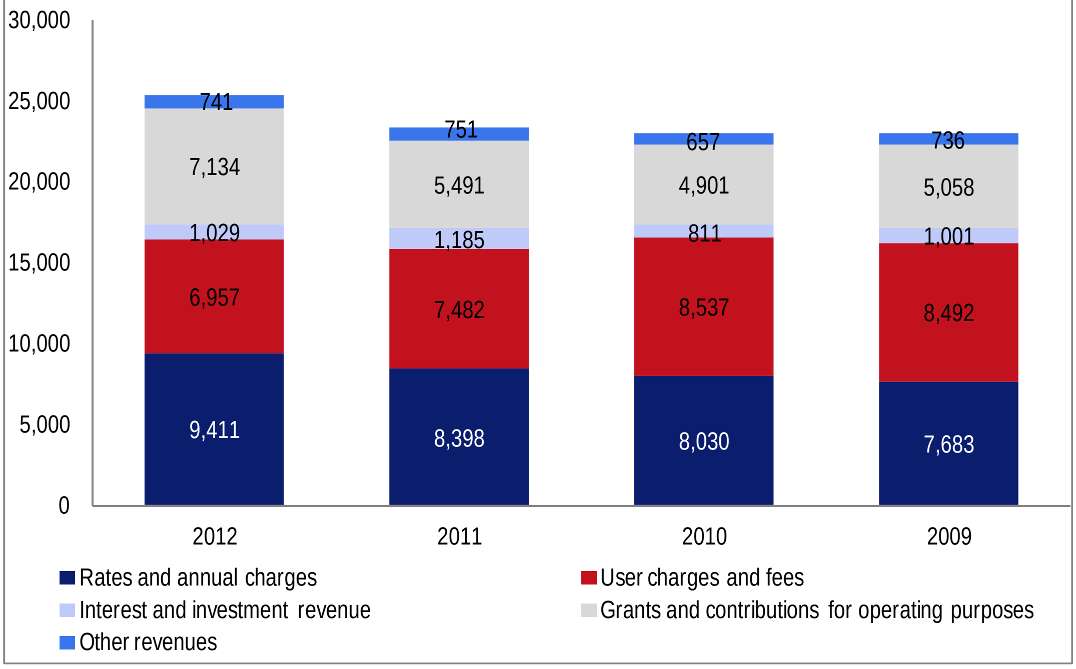
Section 3 Review of Financial Performance and Position

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

3.1: Revenue

Figure 1 - Revenue Sources for 2008/09 to 2011/12 ($'000s)



Key Observations

- Rates and annual charges increased by 12.1% to $9.4m in 2012 due to additional assessments as well as increased water charges.
- User fees and charges have been decreasing year on year due to declining work from RMS. RMS fees decreased from $3.1m in 2009 to $0.9m in 2012.
- User fees and charges also include revenue from caravan parks, cemeteries and swimming pools. While the cemeteries and caravan parks reported small surpluses in 2012 the net cost to Council to provide swimming pool services was $0.2m.
- Grants and contributions for operating purposes increased in 2012 and 2011 due to the prepayment of 2013 Financial Assistance Grants and increased Roads to Recovery funding ($0.9m in 2012).
- Other revenues consist mainly of rental and recycling revenue.

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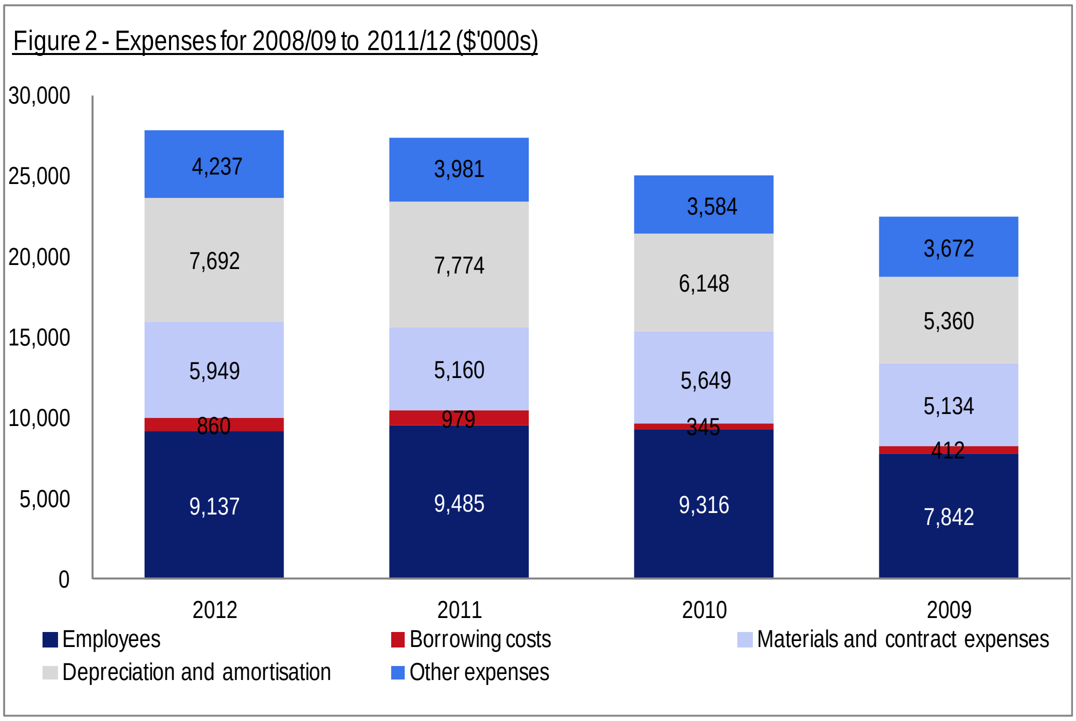
3.2: Expenses



Key Observations

- Employee expenses increased by 16.5% over the review period to $9.1m in 2012. Salary and wage increases of 14.5% and decreased capitalisation of costs contributed to the increase. Salaries and wages increased in 2012 but a decrease in superannuation expenses and increased capitalised costs lowered overall employee expenses.
- Borrowings costs increased as total borrowings outstanding increased from $6.5m in 2009 to $15.0m in 2012. The increase in borrowings is mainly due to works associated with the Yass Valley Dam Wall project.
- Materials and contract expenses were driven by increases in raw materials and consumables which increased from $4.5m in 2009 to $5.0m in 2012.
- Depreciation charges increased over the review period from $5.4m in 2009 to $7.7m in 2012, with the major increases in 2011 following the Asset Revaluations process which increased the value of Council's infrastructure assets.
- Other expenses include electricity, heating, and insurance.

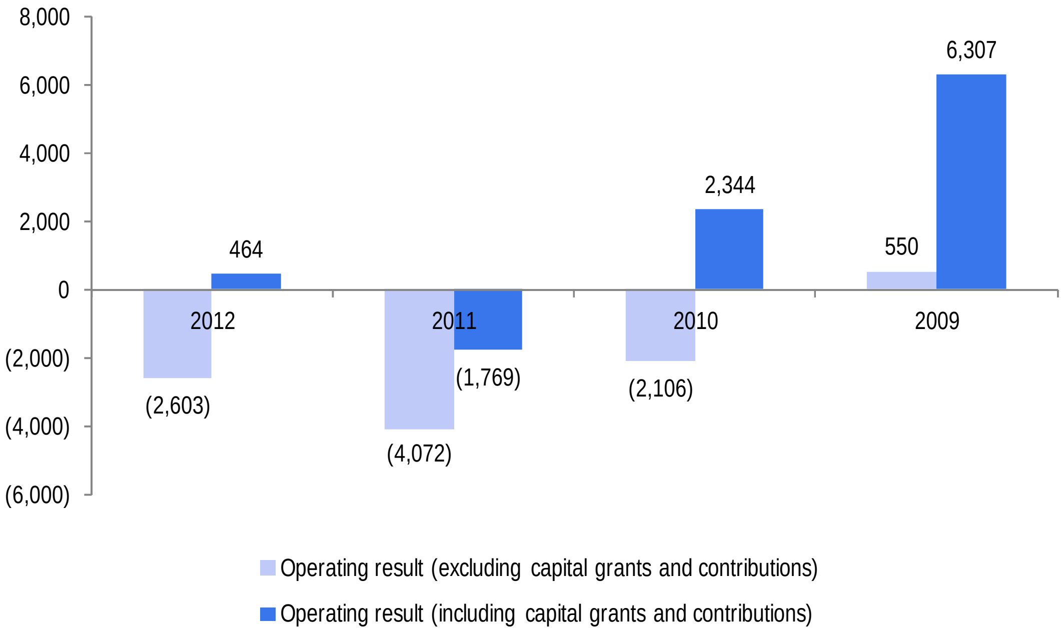
3.3: Operating Results

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 2011/12 ($'000s)



Key Observations

- Council's operating performance has declined over the review period, mainly driven by increased employee and depreciation expenses. Council's operating performance in 2012 was overstated in 2012 due to the prepayment of $1.2m of Financial Assistance Grants from 2013.
- Council expenses include a non-cash depreciation expense, ($7.7m in 2012). Whilst the non cash nature of depreciation can favourably impact on ratios such as EBITDA that focus on cash, depreciation is an important expense as it represents the allocation of the value of an asset over its useful life.

3.4: Financial Management Indicators

Performance Indicators	Year ended 30 June			
	2012	2011	2010	2009
EBITDA ($'000s)	5,949	4,681	4,387	6,322
Operating Ratio	(10.3%)	(17.5%)	(9.2%)	2.4%
Interest Cover Ratio	6.92x	4.78x	12.72x	15.34x
Debt Service Cover Ratio	3.19x	2.41x	4.79x	6.58x
Unrestricted Current Ratio	4.32x	3.43x	3.20x	3.57x
Own Source Operating Revenue Ratio	57.8%	62.0%	60.5%	56.3%
Cash Expense Ratio	10.4 months	9.3 months	7.1 months	4.1 months
Net Assets ($'000s)	393,471	401,343	380,095	288,129

Key Observations

- Council's EBITDA has declined over the four year period.
- Council's Interest Cover Ratio and DSCR indicate that they had flexibility in regard to carrying more debt. Both ratios have been above their benchmarks over the review period.
- The Unrestricted Current Ratio and Cash Expense Ratio have been well above the benchmarks in all four years indicating liquidity is sufficient.
- The Own Source Operating Revenue Ratio has been around the benchmark level in all four years.
- Net Assets have increased by $105.3m between 2009 and 2012 due to the Asset Revaluations which increased the value of Council's infrastructure assets and community land.
- The Asset Revaluations over the last four years have resulted in some volatility in Net Assets. 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 the ongoing operations of Council.
- When the Asset Revaluations are excluded, the underlying trend in all four years has been an expanding Infrastructure, Property, Plant and Equipment (IPP&E) asset base with asset purchases being larger than the combined value of disposed assets and annual depreciation. Over the last four years this amounted to a $10.9m net increase in IPP&E.
- Council had total borrowings outstanding of $15.0m in June 2012, being 3.8% of Net Assets. Of these borrowings $11.0m related to the upgrade of the Yass Valley Dam Wall.

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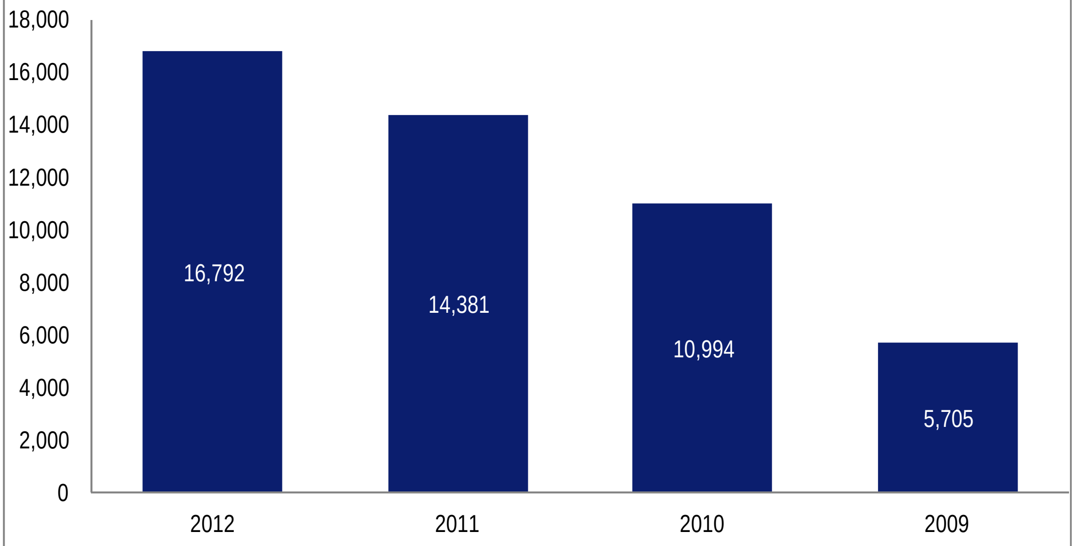
3.5: Statement of Cashflows

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



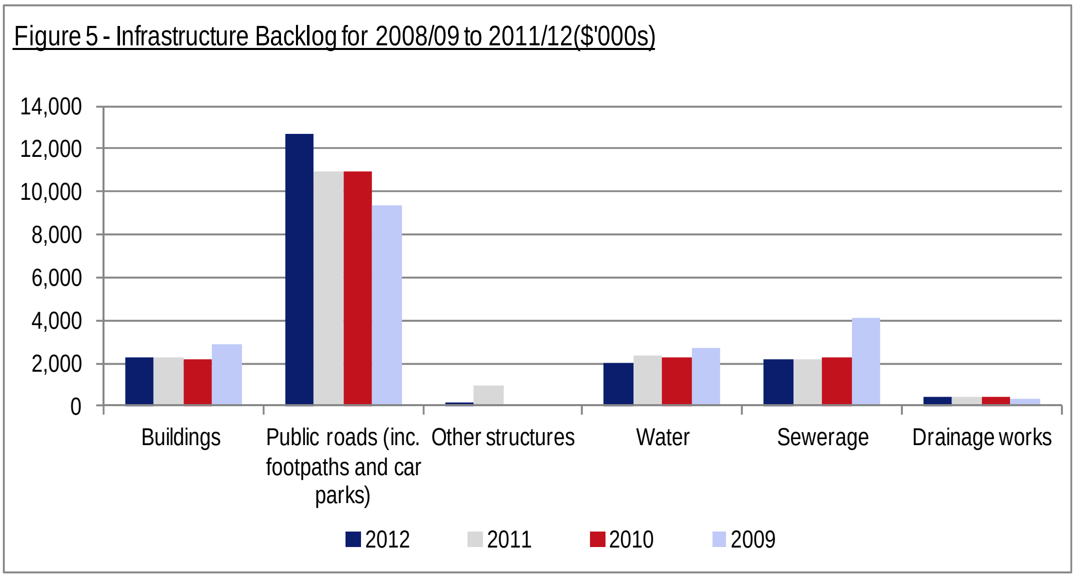
Key Observations

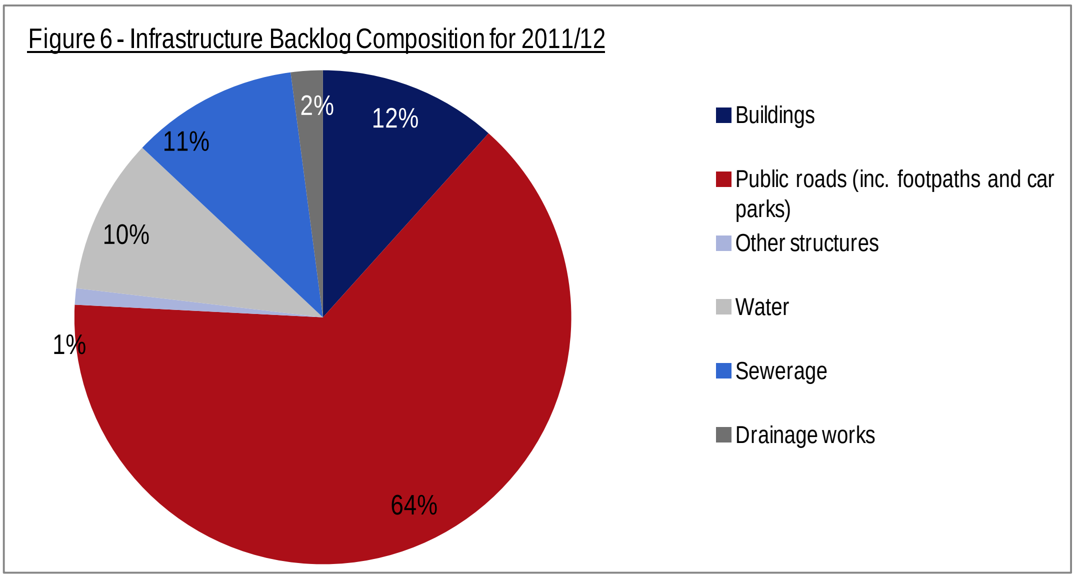
- In total, the Council had cash and investments of $26.0m ($16.8m in cash and equivalents) in 2012, up from $18.4m in 2009.
- Within total cash and investments $16.6m is externally restricted, $8.6m is internally restricted and $0.8m is unrestricted.
- Included in investments are $2.3m in CDO assets, $7.0m of other long term financial assets such as principal protected investments [Question for Council – please explain the basis on which these securities are principal protected].
- As at October 2012 Council held CDO's and other principal protected securities with a total face value of $11.0m. Council valued these investments at $9.6m. $9.9m of the face value of the investments were not paying any interest. Council's auditors issued a qualified audit opinion each year over the review period due to their inability to obtain sufficient evidence to satisfy themselves of the value and recoverability of Council's investment assets.

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





Roads are the largest part of the Infrastructure Backlog (64.2%). The Backlog has increased marginally over the review period. To ensure that the Backlog does not increase any further, Council will have to match predicted asset depreciation with planned capital expenditure and available revenue. Council recognise that there is a funding gap between expenditure required to keep assets in their current condition, and budgeted capital renewal expenditure. For the road assets, Council estimate the gap to be $2.3m p.a. If this gap is not funded it is likely that the Infrastructure Backlog will grow.

Council has not carried out any detailed research on customer expectations, and is yet to fully define the desired levels of service with the community. This will be undertaken in future versions of the Asset Management Plans.

3.6(b): Infrastructure Status

Infrastructure Status	Year ended 30 June			
	2012	2011	2010	2009
Bring to satisfactory standard ($'000s)	19,718	19,198	18,033	19,413
Required annual maintenance ($'000s)	7,742	8,383	8,541	6,805
Actual annual maintenance ($'000s)	4,082	4,766	4,391	4,062
Total value of infrastructure assets ($'000s)	166,463	172,368	170,213	110,972
Total assets ($'000s)	414,810	419,152	396,716	299,357
Building and Infrastructure Backlog Ratio	0.12x	0.11x	0.11x	0.17x
Asset Maintenance Ratio	0.53x	0.57x	0.51x	0.60x
Building and Infrastructure Renewals Ratio	0.71x	0.78x	0.88x	0.75x
Capital Expenditure Ratio	1.27x	1.25x	1.18x	2.07x

The Building and Infrastructure Renewals Ratio and Asset Maintenance Ratio both indicate that Council has not been spending the required amounts on asset renewal and maintenance. A continuation of this level of spending will likely see deterioration in the quality of Council's assets and an increase in the Infrastructure Backlog. While the Capital Expenditure Ratio would indicate that Council has prioritised new assets ahead of asset renewal, the availability of grant funding influences Council's investment decisions.

3.6(c): Capital Program

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

Capital Program ($'000s)	Year ended 30 June			
	2012	2011	2010	2009
New capital works	6,017	8,588	N/A	7,876
Replacement/refurbishment of existing assets	4,154	4,745	N/A	2,873
Total	10,171	13,333	N/A	10,749

Special Schedule 8 shows that Council have expended more on the construction of new assets on rather than the renewal of assets over the review period. By increasing the focus on the renewal of assets Council could reduce the Infrastructure Backlog or at least prevent it increasing quickly. Figures for 2010 are not available.

Capital projects in recent years include:

- Council has completed preliminary investigation and development works associated with upgrading the Yass Dam to provide a secure water supply for the future. The total cost of this project is estimated to be $23.0m and construction has commenced. Council have so far borrowed $11.0m to fund the project and expect to draw down a further $5.0m in 2013. $6.0m of the borrowings is an interest free loan from the NSW Treasury.
- Reconstruction of Chinamans Creek Bridge
- Illalong Bridge replacement
- Sealing of 1.7 km Southwell Road
- Pedestrian bridge at Red Hill Road, Bowning
- Yass High School cycleway
- Dog Trap Road – Road Reconstruction works
- Southwell Road – Road upgrading and sealing works
- Victoria Street Sutton – Road upgrading and sealing works
- Gravel re-sheeting of 7km of gravel roads across the LGA

3.7: Specific Risks to Council

- Ageing population. The LGA population similarly to most regions in NSW contains a population whose profile is ageing. Council's challenge is continuing to provide relevant services. Council made a contribution to the Gwen Warmington Lodge Aged Care facility in 2011 of $0.6m. Council also provide a home living support service.
- Population growth. During 2010 the ABS released information stating that Yass Valley is the fastest growing inland LGA in NSW. This presents many challenges to Council particularly in the provision of adequate community services that meet current and future community needs. Council has started to develop strategies to deal with the expected population growth. For example during 2011 Council's Community Development Section worked with providers of Community Care services to develop a model for a single point entry service for residents requiring Community Care Services. Council also instigated a Yass Valley Health Services Committee to provide advice to Council regarding the provision of current and future health service needs.
- Natural disasters. The LGA has been declared a natural disaster area as recently as 2010. As a result Council have had to prioritise repair work at the expense of other projects which are deferred in Council's delivery program.
- Investment Portfolio. As at June 2012 Council held $2.3m in CDO assets and $7.0m of other long term financial assets such as principal protected investments. The impact of the global financial crisis on these investments has resulted in many of these assets no longer earning any investment revenue. If Council were not to receive the full face value of these investments at their maturity it would affect Council's liquidity and ability to invest in asset renewal.

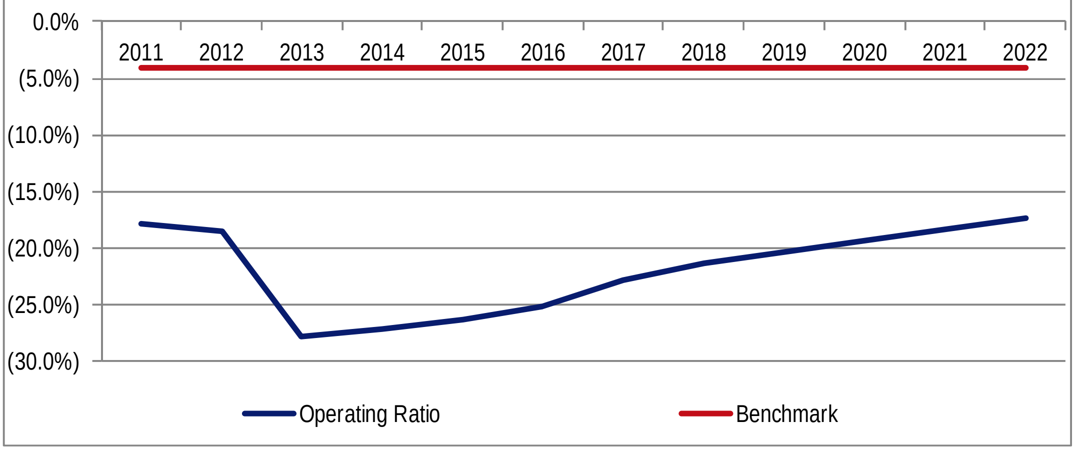
Section 4 Review of Financial Forecasts

The financial forecast model shows the projected financial statements and assumptions for the next 10 years. We have focused our financial analysis upon the General Fund and Waste 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.

For the purpose of our analysis the General Fund includes the Waste Fund also. While the Waste Fund is also an independent entity and able to adjust its fees like the Water and Sewer Funds, Council's LTFP groups the General Fund and Waste Fund together. The Waste fund accounts for roughly 10.0% of combined revenues.

4.1: Operating Results

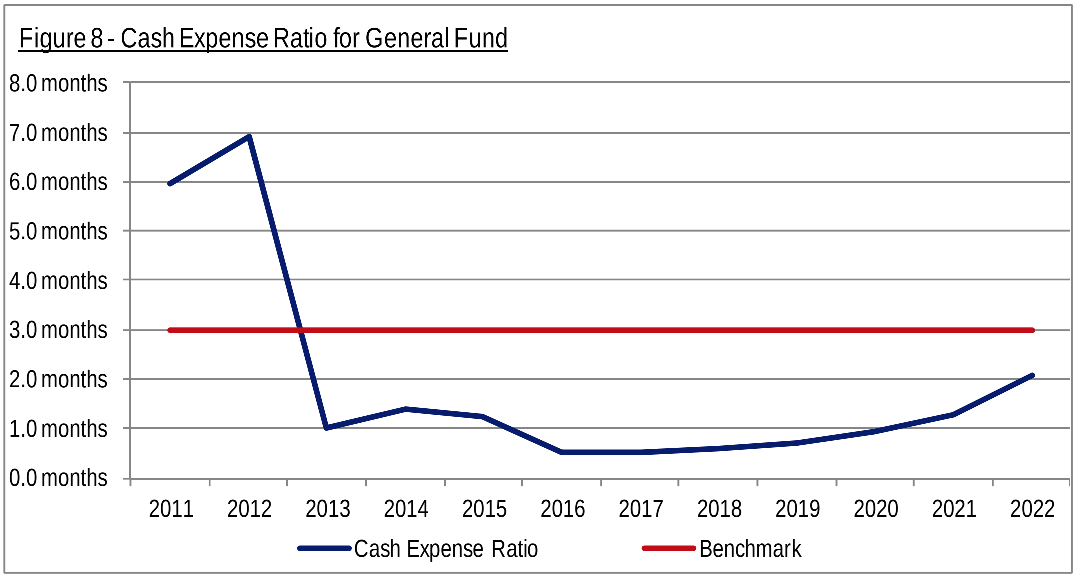
Figure 7- Operating Ratio for General Fund



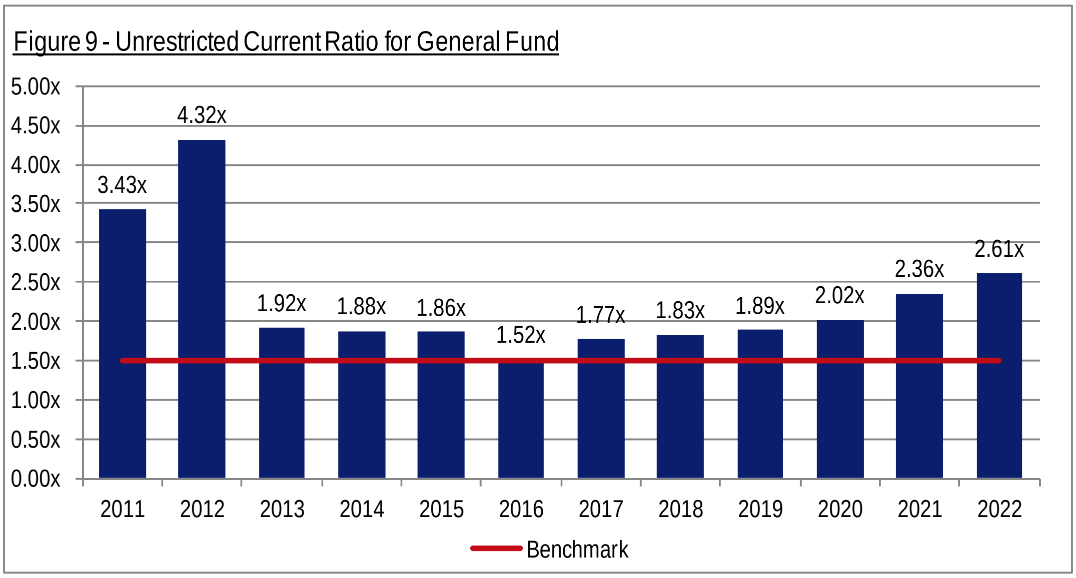
Council's Operating Ratio remains below the benchmark for the lifetime of the forecast. The ratio declines in 2013 due to operating grants and contributions being less than historically received. Council has forecast low levels of operating grants and contributions because these sources of revenue are not committed and guaranteed but this is a much lower level than what has been historically received. Continuous deficits at these forecast levels will lead to sustainability issues in the long term if operating grants and contributions are reduced as forecast.

4.2: Financial Management Indicators

Liquidity Ratios

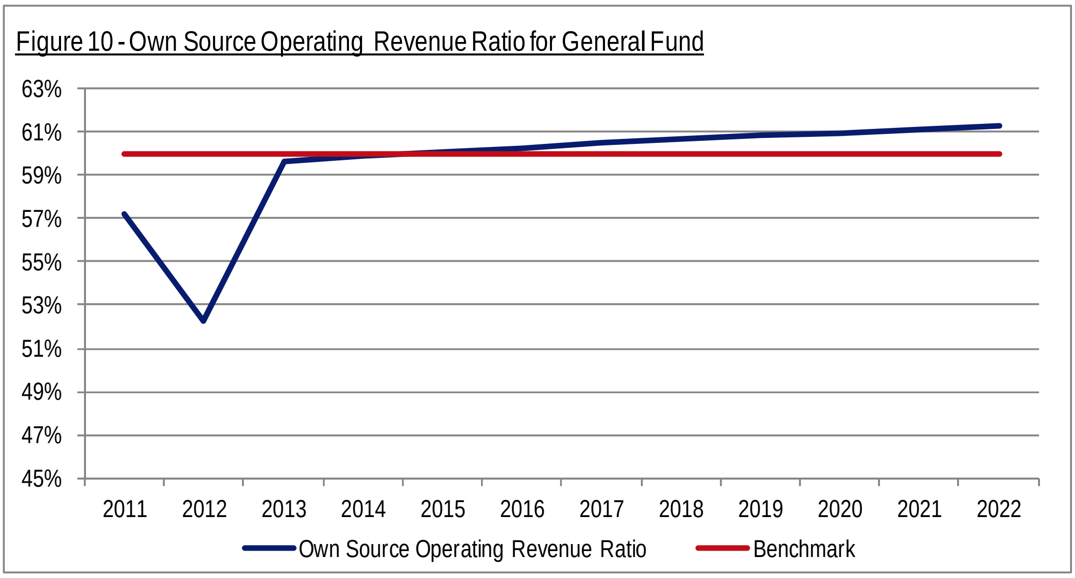


The Cash Expense Ratio declines below the benchmark in 2013 and remains so for the lifetime of the forecast. Were investments to be included in the calculation of the ratio, Council would be above benchmark.

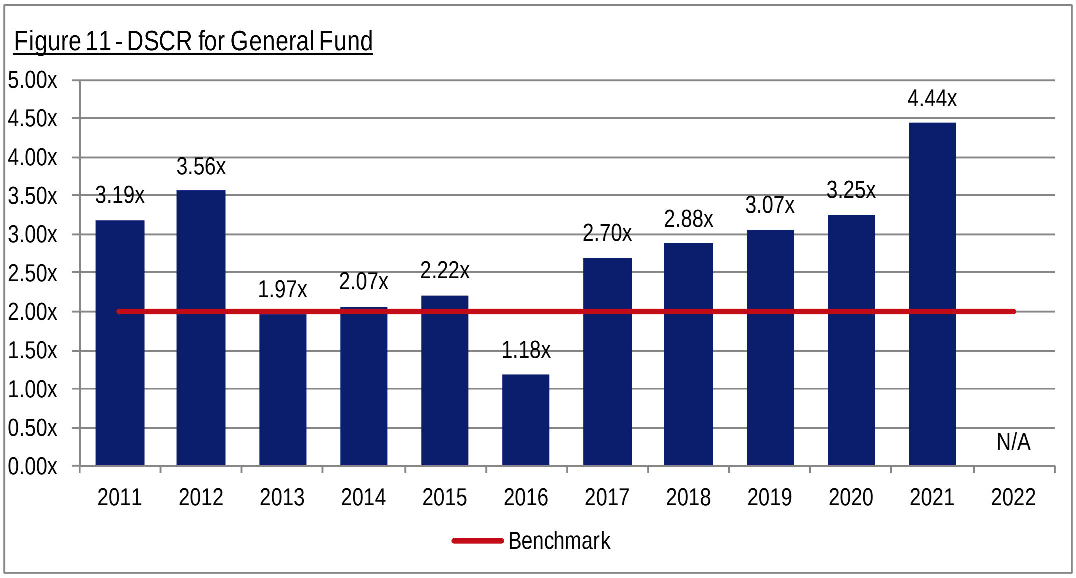


The Unrestricted Current Ratio indicates Council should have sufficient liquidity for the lifetime of the forecast.

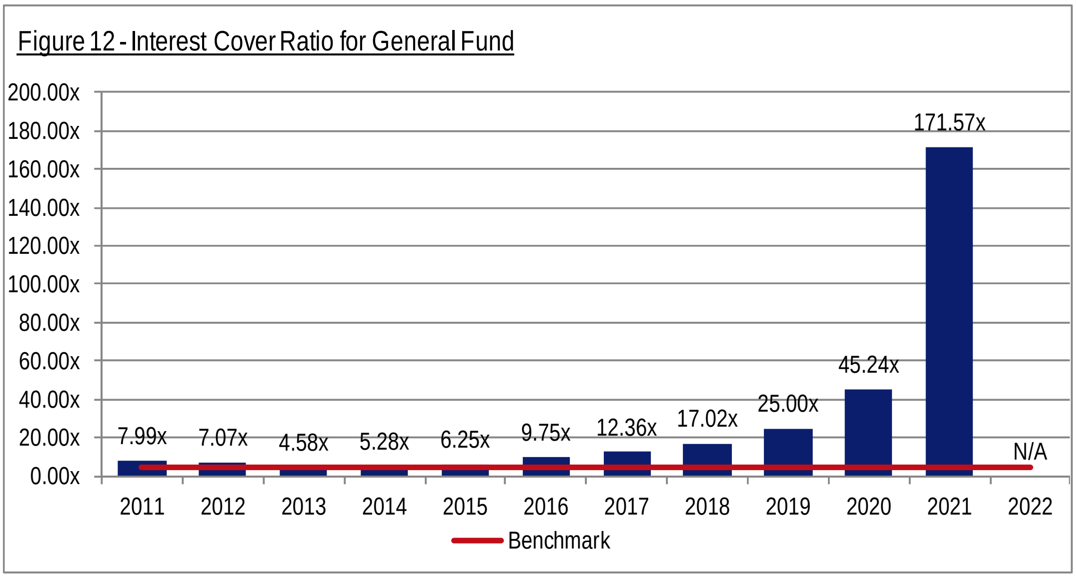
Fiscal Flexibility Ratios



The Own Source Operating Ratio increases from 2013 onwards as revenue such as rates and annual charges are increasing each year while operating grants and contributions are forecast to remain static.

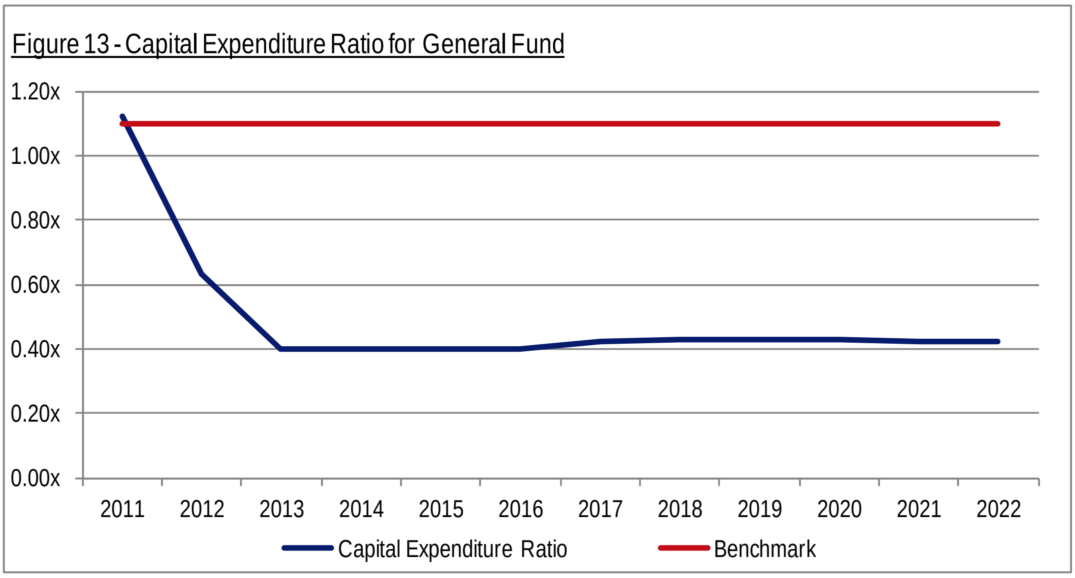


The DSCR is below benchmark in 2016 due to loan repayments of $0.8m in relation to the purchase of development land. Outstanding borrowings peak in 2012, and Council is due to have all debt repaid by 2022.



The Interest Cover Ratio, similar to the DSCR, shows the Council has sufficient capacity to service scheduled debt commitments. There is capacity to service further debt interest costs before the Council's ratio decreases to the 4.00x benchmark.

4.3: Capital Expenditure



The forecast capital expenditure is insufficient to meet the cost of required asset renewals. The total deficit for capital expenditure versus depreciation across the 10 year period amounts to $35.8m in nominal terms. Council will need to revisit its LTFP to reassess whether it can increase capital expenditure, perhaps by amending service levels with the community, or finding further efficiencies.

4.4: Financial Model Assumption Review

Councils have used their own assumptions in developing their forecasts.

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

TCorp's benchmarks:

- Rates and annual charges: TCorp notes that the LGCI increased by 3.4% in the year to September 2011, and in December 2011, IPART announced that the rate peg to apply in the 2012/13 financial year will be 3.6%. Beyond 2013 TCorp has assessed a general benchmark for rates and annual charges to increase by mid-range LGCI annual increases of 3.0%
- Interest and investment revenue: annual return of 5.0%
- All other revenue items: the estimated annual CPI increase of 2.5%
- Employee costs: 3.5% (estimated CPI+1.0%)
- All other expenses: the estimated annual CPI increase of 2.5%

<u>Key Observations and Risks</u>

- The LTFP assumes "baseline" service levels but service levels have not been agreed with the community.
- In forecasting their results, Council have used a model designed with the assistance of the NSW Office of Public Works. This approach forecasts all revenues and costs in real dollars.
- The underfunding of capital works versus forecast depreciation, results in a shrinking assets base with General Fund Net Assets expected to decline from $346.3m to $328.6m by 2022.
- Council forecast other revenues of $3.7m p.a. compared to $0.6m in 2012.
- Expenditure is forecast to fall as loans are paid off and borrowing costs reduce.
- Employee expenses are forecast to remain static for the lifetime of the forecast.
- Lower levels of grants and contributions than historically received have been included in the LTFP. Council do so as the sources of some grants and contributions do not give adequate advance notice and Council has a relatively fixed expenditure pattern based on permanent staff levels and operating costs.
- Council is forecasting flat income streams with no growth with the exception of rates and annual charges which are forecast to increase by between 1.5% and 2.0% p.a. Although the population is forecast to increase by about 2.0% p.a., it is difficult to see how this can result in this level of real rate increases.
- Council's financial forecast is in real dollars. Whilst not explicit, DLG's Integrated Planning and Reporting Manual states that councils need to consider and make assumptions about the following areas: demographics of the LGA, economic forecasts, inflation forecasts, and interest rate movements amongst other matters. We would expect Council's approach to include the impacts of inflation.
- The problem with presenting or analysing forecasts in real dollars is in situations where revenues and expenses are not increasing at the same or similar rates. For example, in the case of Yass Valley, revenues over the past four years have increased by 10.0%, whilst expenses have increased by 24.3%. If this disparity in growth rates is projected over the 10

year financial forecast period, Council's financial results will be considerably worse than the position shown. This issue needs to be addressed by Council so that a clearer picture of Council's likely financial position can be seen.

4.5: Borrowing Capacity

Subject to the issues raised in section 4.4, when analysing the financial capacity of Council we believe the Council is not able to incorporate additional loan funding in addition to the existing borrowings in the short to medium term. Some comments and observations:

- Council is forecasting significant operating deficits each year of the forecast
- The growth in expenditure in recent years in not reflected in the LTFP, and if this trend was to continue it would further reduce borrowing capacity

4.6 Sustainability

TCorp believes Council is moderately Sustainable but only in the short to medium term. Council has a record of reporting operating deficits and these are forecast to increase.

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

- Council's current LTFP for its General Fund forecasts operating deficits of over 20.0% p.a. Deficits of this magnitude are not sustainable. The forecast annual revenue is lower than historic amounts by over $2.0m due to conservative forecasting of operating grants and contributions. Should Council continue to receive operating grants at historical levels this would improve Council's prospects for continuing Sustainability
- Council has not been spending sufficient amounts on asset renewal and the current LTFP forecasts a relatively low level of capital expenditure. In the longer term this will reduce the quality of assets and diminish Council's capacity to provide services
- The Asset Management Plans forecast a maintenance and renewal funding gap of $3.3m p.a.

Section 5 Benchmarking and Comparisons with Other Councils

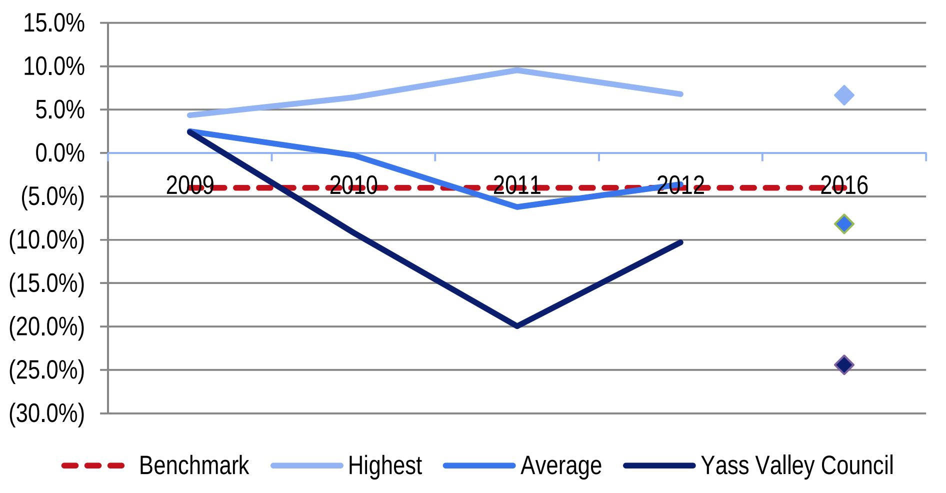
Each council's performance has been assessed against ten key benchmark ratios. This section of the report compares the Council's performance with its peers in the same DLG Group. The Council is in DLG Group 11. There are 21 councils in this group and at the time of preparing this report, we have data for all of these councils.

In Figure 14 to Figure 23, the graphs compare the historical performance of Council with the benchmark for that ratio, with the average for the Group, with the highest performance (or lowest performance in the case of the Infrastructure Backlog Ratio where a low ratio is an indicator of strong performance), and with the forecast position of the Council as at 2016 (as per Council's LTFP). Figures 21 to 23 do not include the 2016 forecast position as those numbers are not available.

Where no highest line is shown on the graph, this means that Council is the best performer in its group for that ratio. For the Interest Cover Ratio and Debt Service Cover Ratio, we have excluded from the calculations, councils with very high ratios which are a result of low debt levels that skew the ratios.

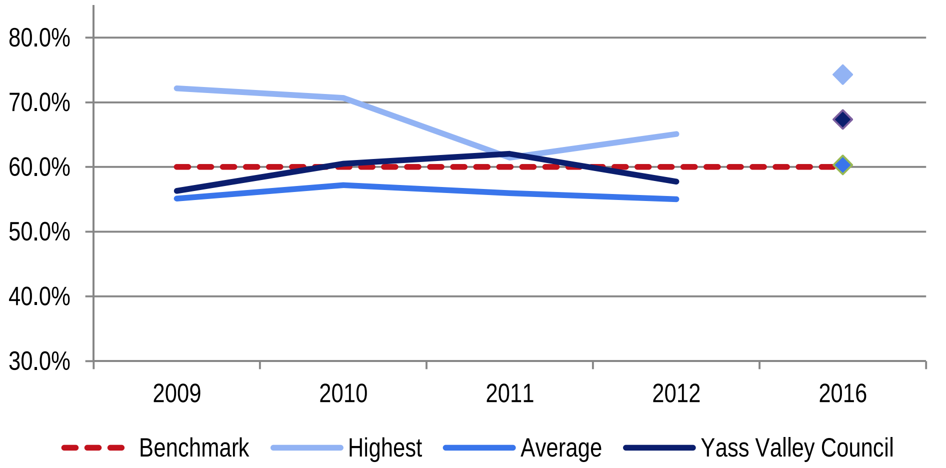
Financial Flexibility

Figure 14 - Operating Ratio Comparison



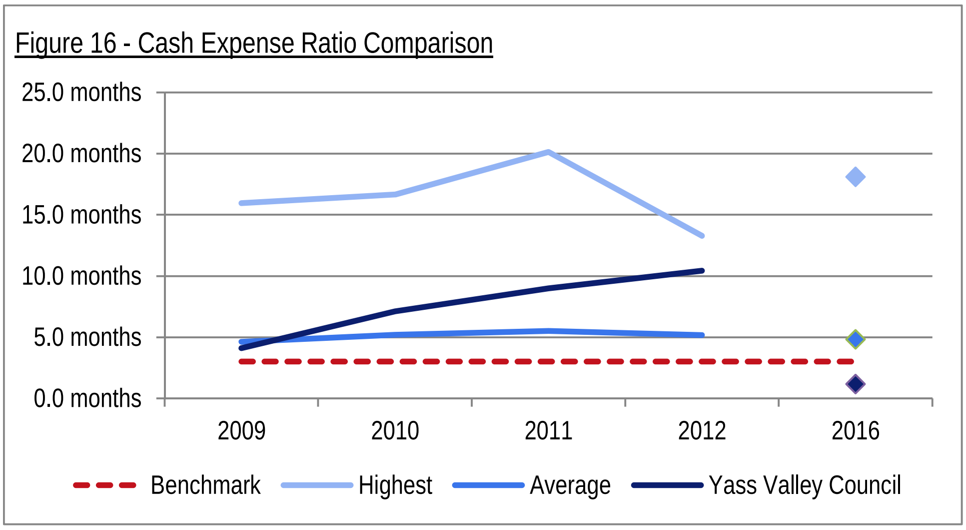
Council's Operating Ratio was below the group average and benchmark in the last three years. The ratio is forecast to decline in the medium term and to remain below the benchmark and at the group average.

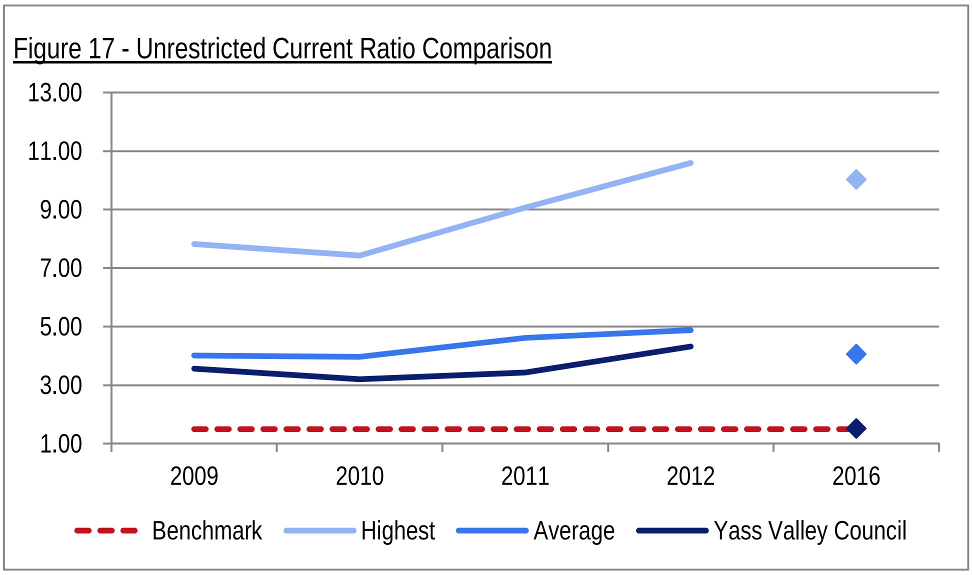
Figure 15 - Own Source Operating Revenue Ratio Comparison



Council's Own Source Operating Revenue Ratio was around the benchmark and above the group average over the last four years. The ratio is forecast to improve in the medium term to be above the group average and benchmark.

Liquidity





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

Debt Servicing

Figure 18 - Debt Service Cover Ratio Comparison

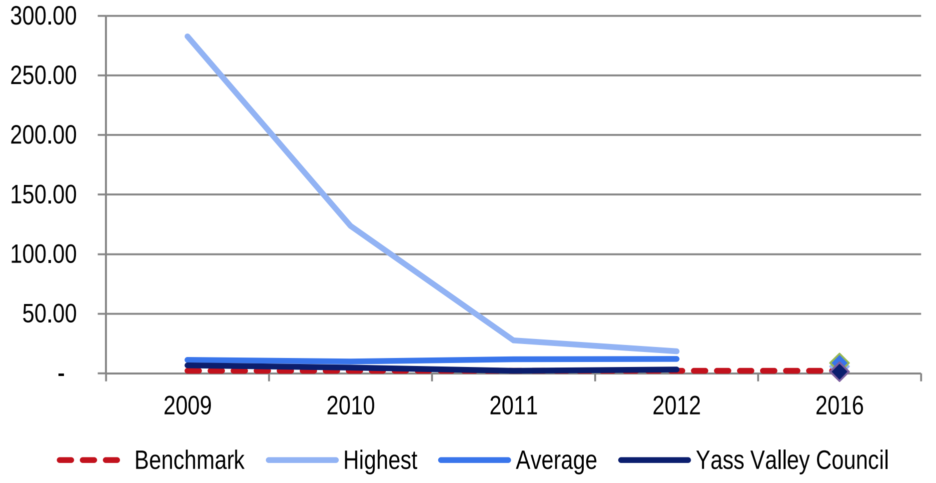
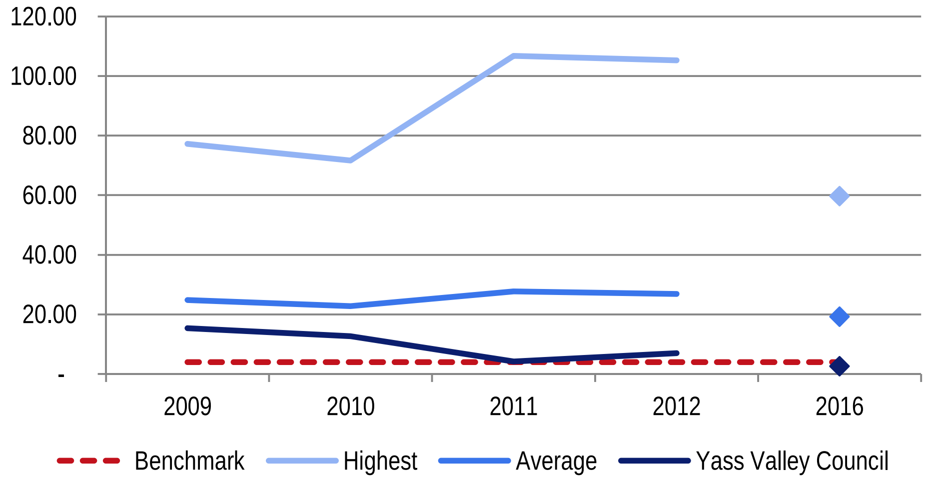


Figure 19 - Interest Cover Ratio Comparison



Over the review period, Council was above the benchmarks and below the group averages. These ratios are forecast to decline in the medium term to be near the benchmarks.

Asset Renewal and Capital Works

Figure 20 - Capital Expenditure Ratio Comparison

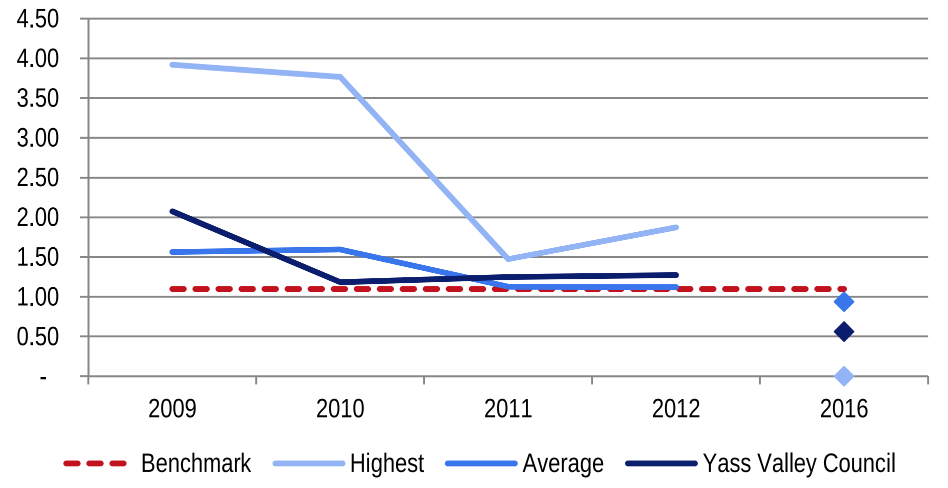


Figure 21 - Asset Maintenance Ratio Comparison

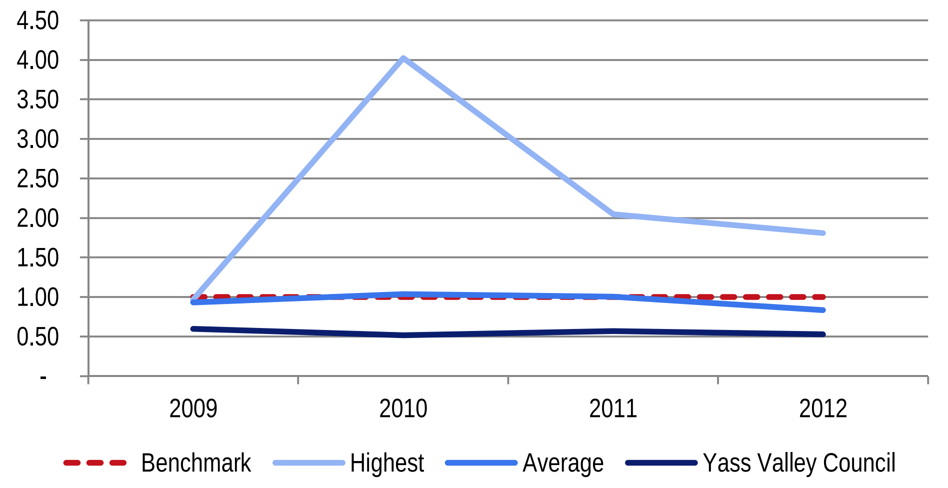


Figure 22 - Infrastructure Backlog Ratio Comparison

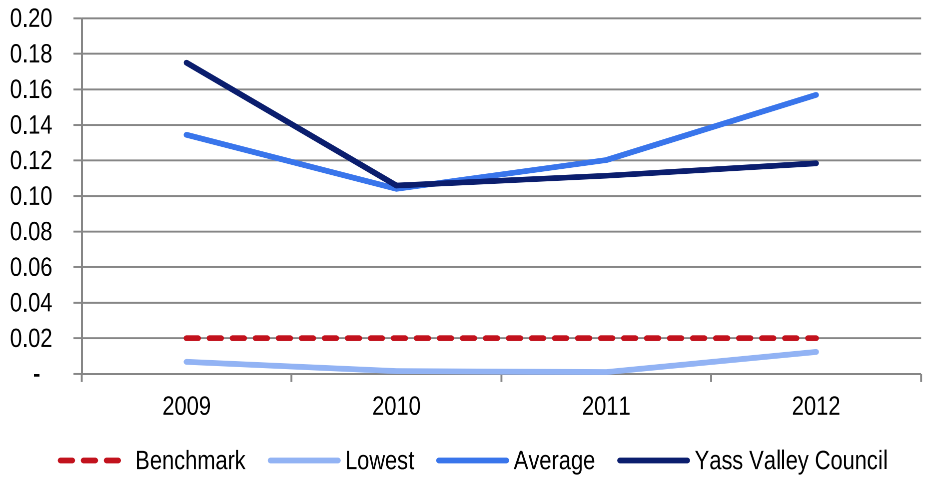
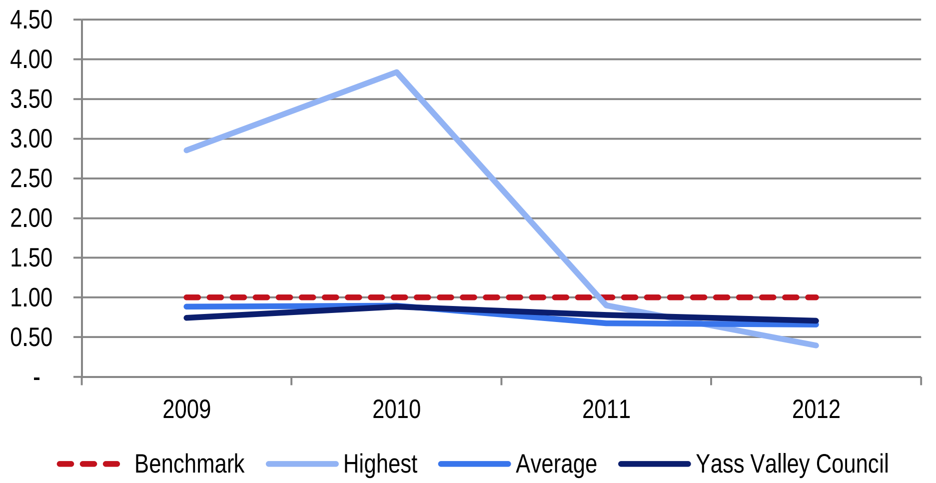


Figure 23 - Building and Infrastructure Asset Renewal Ratio



Overall, Council had a lower Infrastructure Backlog Ratio than other councils in the group but it would have to reduce to reach the benchmark. Council's Capital Expenditure Ratio was around the group average and above the benchmark. Council's Building and Infrastructure Asset Renewal Ratio and Asset Maintenance Ratio were below the benchmarks and around or below the group averages.

New South Wales
Treasury Corporation

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 moderately Sustainable in the short to medium term but is in a deteriorating position in respect of its longer term Sustainability.

We base our recommendation on the following key points:

- Council has incurred increasing operating deficits (excluding grants and contributions for capital purposes) in each of the past three years, and these deficits are forecast to increase over the forecast period. Increases in expenses need to be addressed.
- As Council's current LTFP is presented in real dollars we consider that this understates the future deficits that Council is facing. Further, the LTFP has a forecast level of capital expenditure that is well below benchmark levels required to maintain assets and support service delivery. Council has advised that they will be reviewing and refining their LTFP over the next 12 months in order to provide a more accurate base for future decision making
- Council is not spending sufficient amounts on asset renewal and in the long term this will reduce the quality of assets and potentially impact the provision of services
- With an increasing population Council needs to address these issues and consider means of generating additional revenues or reducing operating expenses

New South Wales Treasury Corporation

Appendix A Historical Financial Information Tables

Table 1- Income Statement

Income Statement ($'000s)	Year ended 30 June					% annual change	
	2012	2011	2010	2009	2012	2011	2010
Revenue							
Rates and annual charges	9,411	8,398	8,030	7,683	12.1%	4.6%	4.5%
User charges and fees	6,957	7,482	8,537	8,492	(7.0%)	(12.4%)	0.5%
Interest and investment revenue	1,029	1,185	811	1,001	(13.2%)	46.1%	(19.0%)
Grants and contributions for operating purposes	7,134	5,491	4,901	5,058	29.9%	12.0%	(3.1%)
Other revenues	741	751	657	736	(1.3%)	14.3%	(10.7%)
Total revenue	25,272	23,307	22,936	22,970	8.4%	1.6%	(0.1%)
Expenses							
Employees	9,137	9,485	9,316	7,842	(3.7%)	1.8%	18.8%
Borrowing costs	860	979	345	412	(12.2%)	183.8%	(16.3%)
Materials and contract expenses	5,949	5,160	5,649	5,134	15.3%	(8.7%)	10.0%
Depreciation and amortisation	7,692	7,774	6,148	5,360	(1.1%)	26.4%	14.7%
Other expenses	4,237	3,981	3,584	3,672	6.4%	11.1%	(2.4%)
Total expenses	27,875	27,379	25,042	22,420	1.8%	9.3%	11.7%
Operating result (excluding capital grants and contributions)	(2,603)	(4,072)	(2,106)	550	36.1%	(93.4%)	(482.9%)
Operating result (including capital grants and contributions)	464	(1,769)	2,344	6,307	126.2%	(175.5%)	(62.8%)

Table 2 - Items excluded from Income Statement

Excluded items ($'000s)				
	2012	2011	2010	2009
Grants and contributions for capital purposes	3,067	2,303	4,450	5,757
Interest revenue/ (losses)	415	674	931	(1,767)
Interest free loan received	0	0	2,468	0
Fair value adjustments to rental properties	0	0	365	0
Revaluation decrements IPP&E	(1,021)	0	0	0
Property contribution to Aged Care Facility	0	(582)	0	0
Gain/ (Loss) on disposal of assets	506	(1,627)	120	93

New South Wales Treasury Corporation

Table 3 - Balance Sheet

Balance Sheet ($'000s)	Year Ended 30 June				% annual change		
	2012	2011	2010	2009	2012	2011	2010
Current assets							
Cash and cash equivalents	16,792	14,381	10,994	5,705	16.8%	30.8%	92.7%
Investments	0	0	8,353	3,330	N/A	(100.0%)	150.8%
Receivables	3,141	2,865	2,872	2,509	9.6%	(0.2%)	14.5%
Inventories	459	439	432	423	4.6%	1.6%	2.1%
Other	0	0	41	19	N/A	(100.0%)	115.8%
Total current assets	20,392	17,685	22,692	11,986	15.3%	(22.1%)	89.3%
Non-current assets							
Investments	9,235	9,725	9,304	9,374	(5.0%)	4.5%	(0.7%)
Receivables	0	0	652	1,140	N/A	(100.0%)	(42.8%)
Investments accounted for through equity method	390	349	347	345	11.7%	0.6%	0.6%
Infrastructure, property, plant & equipment	382,253	388,853	361,181	274,337	(1.7%)	7.7%	31.7%
Investment property	2,540	2,540	2,540	2,175	0.0%	0.0%	16.8%
Total non-current assets	394,418	401,467	374,024	287,371	(1.8%)	7.3%	30.2%
Total assets	414,810	419,152	396,716	299,357	(1.0%)	5.7%	32.5%
Current liabilities							
Payables	2,275	2,911	3,121	2,320	(21.8%)	(6.7%)	34.5%
Borrowings	963	1,006	933	569	(4.3%)	7.8%	64.0%
Provisions	2,447	2,190	2,019	1,882	11.7%	8.5%	7.3%
Total current liabilities	5,685	6,107	6,073	4,771	(6.9%)	0.6%	27.3%
Non-current liabilities							
Borrowings	14,062	10,022	10,079	5,980	40.3%	(0.6%)	68.5%
Payables	0	0	17	16	N/A	(100.0%)	6.3%
Provisions	1,592	1,680	452	461	(5.2%)	271.7%	(2.0%)
Total non-current liabilities	15,654	11,702	10,548	6,457	33.8%	10.9%	63.4%
Total liabilities	21,339	17,809	16,621	11,228	19.8%	7.1%	48.0%
Net Assets	393,471	401,343	380,095	288,129	(2.0%)	5.6%	31.9%

New South Wales Treasury Corporation

Table 4-Cashflow

Cashflow Statement ($'000s)	Year ended 30 June			
	2012	2011	2010	2009
Cashflows from operating activities	7,352	6,088	9,514	11,573
Cashflows from investing activities	(8,938)	(2,717)	(11,155)	(13,753)
Proceeds from borrowings and advances	5,000	976	7,500	0
Repayment of borrowings and advances	(1,003)	(960)	(570)	(549)
Cashflows from financing activities	3,997	16	6,930	(549)
Net increase/(decrease) in cash and equivalents	2,411	3,387	5,289	(2,729)
Cash and equivalents	16,792	14,381	10,994	5,705

New South Wales Treasury Corporation

Appendix B Glossary

Asset Revaluations

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

Collateralised Debt Obligation (CDO)

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

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

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

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

Division of Local Government (DLG)

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

Depreciation of Infrastructure Assets

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

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[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.

Sustainability

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

Ratio Explanations

Asset Maintenance Ratio

Benchmark = Greater than 1.0x

Ratio = actual asset maintenance / required asset maintenance

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

Building and Infrastructure Renewals Ratio

Benchmark = Greater than 1.0x

Ratio = Asset renewals / depreciation of building and infrastructure assets

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

Cash Expense Cover Ratio

Benchmark = Greater than 3.0 months

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

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

Capital Expenditure Ratio

Benchmark = Greater than 1.1x

Ratio = annual capital expenditure / annual depreciation

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

Debt Service Cover Ratio (DSCR)

Benchmark = Greater than 2.0x

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

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

Building and Infrastructure Backlog Ratio

Benchmark = Less than 0.02x

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

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

Interest Cover Ratio

Benchmark = Greater than 4.0x

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

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

Operating Ratio

Benchmark = Better than negative 4%

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

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

Own Source Operating Revenue Ratio

Benchmark = Greater than 60%

Ratio = rates, utilities and charges / total operating revenue (inclusive of capital grants and contributions)

This ratio measures the level of a council's fiscal flexibility. It is the degree of reliance on external funding sources such as operating grants and contributions. A council's financial flexibility improves the higher the level of its own source revenue.

Unrestricted Current Ratio

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

Ratio = Current assets less all external restrictions / current liabilities less specific purpose liabilities

Restrictions placed on various funding sources (e.g. Section 94 developer contributions, RMS contributions) complicate the traditional current ratio because cash allocated to specific projects are restricted and cannot be used to meet a council's other operating and borrowing costs. The Unrestricted Current Ratio is specific to local government and is designed to represent a council's ability to meet debt payments as they fall due.