

SRV APPLICATION ATTACHMENT F

NSW Treasury Corp Report



New South Wales  
Treasury Corporation

**Bellingen Shire Council**

**Financial Assessment, Sustainability and Benchmarking Report**

12 March 2013

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

## Disclaimer

This report has been prepared by New South Wales Treasury Corporation (TCorp) in accordance with the appointment of TCorp by the Division of Local Government (DLG) as detailed in TCorp's letters of 22 December 2011 and 28 May 2012. The report has been prepared to assist the DLG and the Independent Local Government Review Panel in its consideration of the Sustainability of each local government area in NSW.

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

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

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

TCorp's approach has been to:

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

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

- Council's Unrestricted Current Ratio has been well above benchmark the past four years indicating Council had sufficient liquidity
- Council has incurred operating deficits (excluding grants and contributions for capital purposes) in each of the past four years, and Council's underlying operating results (measured using EBITDA) have declined from \$5.0m in 2010 to \$3.6m in 2012
- Eight flood events over the past four years has affected Council's operating expenses and ability to fund asset renewal

The Council reported \$22.4m of infrastructure backlog in 2012 which represents 8.6% of its infrastructure asset value of \$260.9m. Other observations include:

- The Council's Infrastructure Backlog is on an upward trend, and Council has been unable to fund the required asset renewal amounts over the review period
- A significant portion of the backlog (51.5%) is related to roads

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

- Council is forecast to consistently record operating deficits
- The forecast capital expenditure is insufficient to meet the cost of forecast asset renewals

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

- Based on a benchmark of DSCR>2.00x, Council would not be in a position to borrow further until 2018
- Based on a benchmark of Interest Cover Ratio>4.00x, Council would not be in a position to borrow further until 2019

In respect of the Sustainability of the Council our conclusion is that Council is currently in a moderately Sustainable position over the short to medium term but that this position has been deteriorating. Continuation of the past trends will place the long term Sustainability at risk. Our key observations are:

- Council's current LTFP for its General Fund forecasts operating deficits of over 30.0% p.a. The forecast revenue is lower than historic amounts by over \$4.0m due to the discontinuation of flood restoration grants. Should Council continue to receive operating grants at historical levels this would improve asset maintenance and Council's prospects for continuing Sustainability
- Council is heavily reliant on the provision of operating and capital grants from other areas of government and would not be Sustainable without the continued provision of these grants
- Council is expected to consider lodging a submission for a SRV in 2015. A successful application would better enable sufficient asset renewal
- The flood events in recent years have negatively affected Council's capacity to invest in capital expenditure

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
- Council's Own Source Operating Revenue Ratio is below average but is forecast to improve as grant income is forecast to decline from historical levels
- Council's DSCR and Interest Cover Ratio are above the benchmarks. In the medium term Council's forecast ratios are expected to remain above the benchmarks
- Council was in an acceptable liquidity position which is expected to continue in the medium term
- Council's performance in terms of its Infrastructure Backlog Ratio was lower than other councils in the group but would need to improve to meet the benchmark. Council's Asset Maintenance Ratio is above the group average and benchmark. Council's Capital Expenditure Ratio and Building and Infrastructure Asset Renewal Ratio have been in line with the group averages and at or below the benchmarks

## **Section 2 Introduction**

### **2.1: Purpose of Report**

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

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

The key areas focused on are:

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

### **2.2: Scope and Methodology**

TCorp's approach was to:

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

In undertaking its work, TCorp relied on:

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

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

#### Definition of Sustainability

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

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

#### Benchmark Ratios

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

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

Therefore these benchmarks are intended as a guide to performance.

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

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



## 2.3: Overview of the Local Government Area

Bellingen Shire Council LGA	
Locality & Size	
Locality	Mid North Coast
Area	1,605 km <sup>2</sup>
DLG Group	11
Demographics	
Population as at 09 August 2011	12,518
% under 20	25.9%
% between 20 and 60	46.9%
% over 60	27.2%
Expected population 2036	14,602
Operations	
Number of employees (FTE)	142
Annual revenue	\$27.3m
Infrastructure	
Roads	636 km
Bridges	100
Infrastructure backlog value	\$22.4m
Total infrastructure value	\$260.9m

Bellingen Shire Council Local Government Area (LGA) is located on the Mid North Coast halfway between Sydney and Brisbane and just south of Coffs Harbour. It has a total area of 1,605 square kilometres with a coastline of approximately 10km. State forests and National Parks cover 53.0% of the LGA.

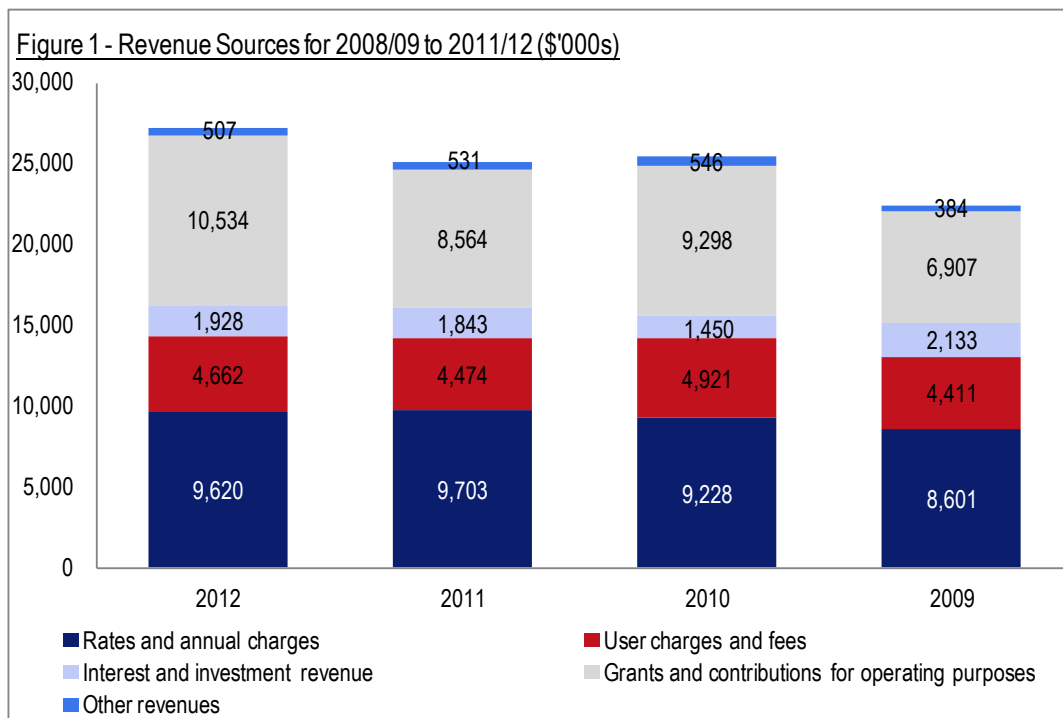
While the traditional industry base of timber, dairy, potato and meat processing are essential to the economic health of the LGA, emerging and developing industries include tourism which is underpinned by the Dorrigo Rainforest Centre, national parks, cultural attractions and a successful events sector. Aquaculture, agribusiness/processing, arts and cultural industries, organics and regional cuisine and aged care have also developed in recent years.

Over the past five years the population of Bellingen Shire has increased at an average annual rate of 0.9%. The population is expected to grow at a rate of between 0.3% and 0.4% p.a. between now and 2036. It is expected that the percentage of pensioners in the LGA will grow to 25.6% by the same year.

## Section 3 Review of Financial Performance and Position

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

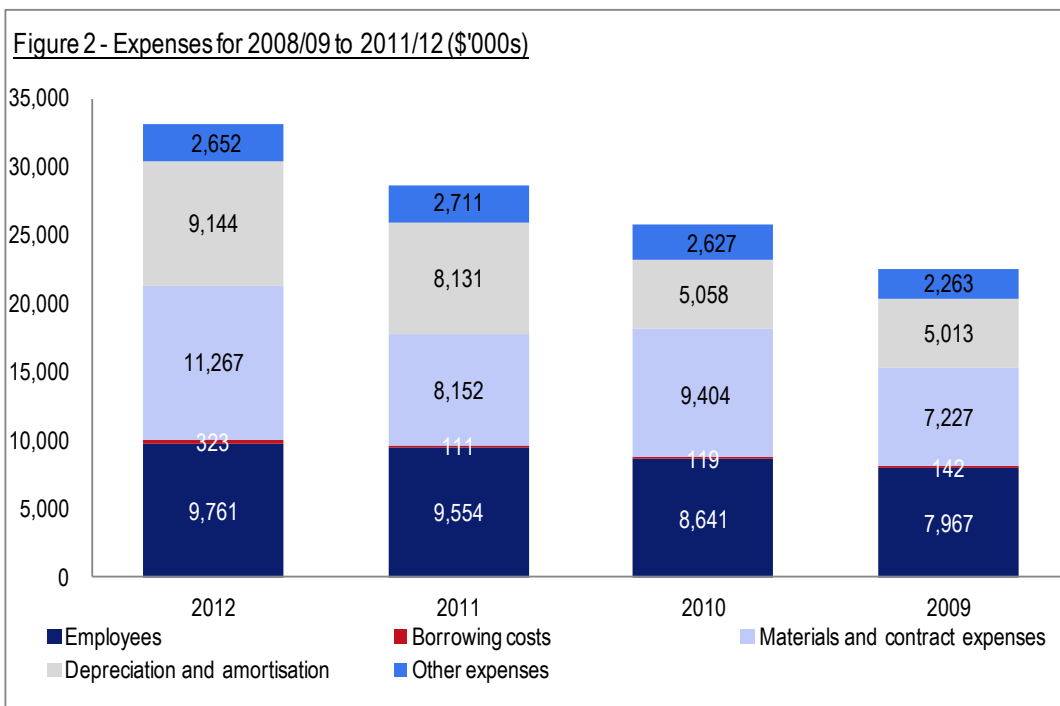
### 3.1: Revenue



### Key Observations

- In 2011 rates and annual charges increased above the IPART approved rate peg due to increases in domestic waste charges and water supply charges. Annual charges decreased in 2012 mainly due to a fall in demand for water supply services.
- General rate revenue continues to be boosted by a permanent 5.0% road levy introduced in 1996, and a permanent 4.0% environmental levy introduced in 2005. These levies contributed \$0.3m, and \$0.2m respectively in 2011.
- User fees and charges largely comprise service charges for water, sewage, and waste management services, plus RMS charges. RMS charges received decreased from \$3.2m in 2010 to \$2.5m in 2012. Council also generated fees from cemetery and caravan park operations.
- Operating grants and contributions increased due to flood restoration grants of \$5.0m and \$3.8m in 2012 and 2011. Operating grants also increased in 2012 due to the early receipt of six months of the 2013 Financial Assistance Grant.
- Other revenues contain revenue from Council's investment properties.

### 3.2: Expenses



#### Key Observations

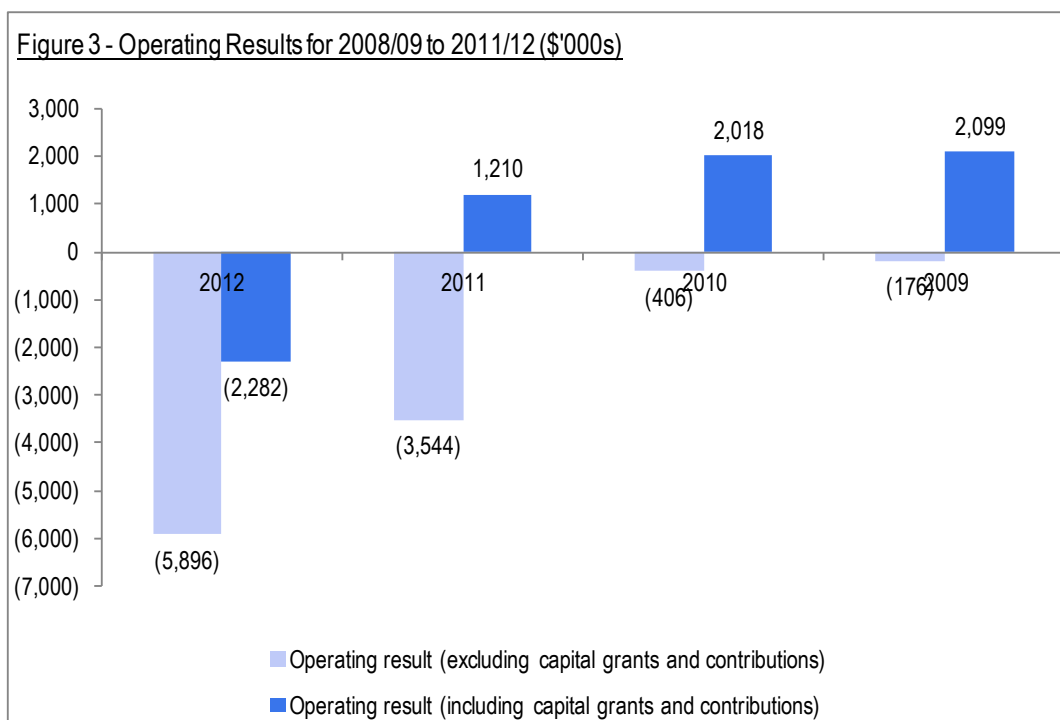
- Employee expenses increased by 8.5% in 2010 11.4% in 2011, and a further 2.2% in 2012 to \$9.8m. These increases were largely as a result of overtime payments in relation to work required from the flood events, and increased staff numbers. Staff numbers increased from 128 in 2009 to 142 in 2012.
- In 2012 Council engaged consultants to undertake an organisational review. The report was completed in June 2012 and made recommendations such as the use of trainees, and implementing more efficient overtime procedures. The consultants have also proposed a new organisational structure which will incur additional costs to implement and recurring costs each year of \$0.05m. The organisational review has been endorsed by Council.
- Material and contracts expenses increased by 30.1% to \$9.4m in 2010 following increased level of maintenance as a result of the floods. Costs continued to rise year on year, up to \$11.3m in 2012 due to State road works expenses (offset by revenue from RMS) and continued flood repairs and maintenance expenses.
- Following the Assets Revaluations process the depreciation expense increased by 82.4% to \$9.1m in 2012.
- Other expenses include annual street lighting costs of \$0.1m. Council implemented a new energy efficient street lighting system in 2011 which should generate savings of \$0.6m over the next 10 years.

### 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.



#### Key Observations

- Council has consistently posted marginal net operating deficits excluding capital grants and contributions. The deficit increased in 2011 and 2012 due to increased depreciation charges.
- Council expenses include a non-cash depreciation expense, (\$9.1m in 2012), which has increased substantially over the past four years 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.
- The biggest issue for Council has been that since 2009, revenues have increased by 21%, whilst expenses have increased by 47%. This mismatch in growth rates of revenues and expenses needs to be addressed.

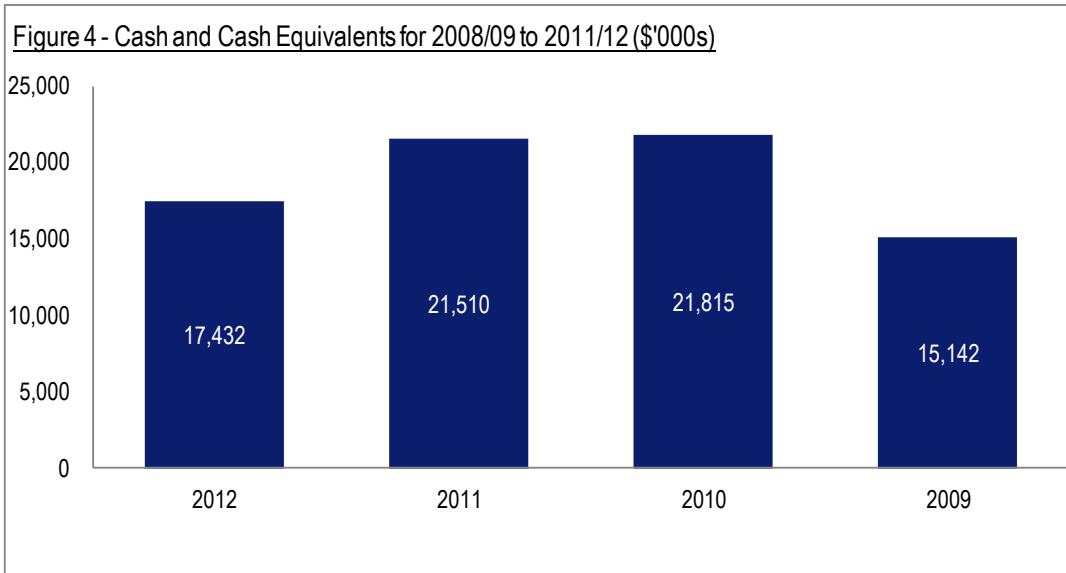
### 3.4: Financial Management Indicators

Performance Indicators	Year ended 30 June			
	2012	2011	2010	2009
EBITDA (\$'000s)	3,571	4,698	4,771	4,979
Operating Ratio	(21.6%)	(14.1%)	(1.6%)	(0.8%)
Interest Cover Ratio	11.06x	42.32x	40.09x	35.06x
Debt Service Cover Ratio	5.58x	23.26x	19.39x	13.42x
Unrestricted Current Ratio	2.13x	2.99x	4.16x	3.83x
Own Source Operating Revenue Ratio	46.3%	47.5%	50.8%	52.7%
Cash Expense Ratio	8.8 months	12.6 months	12.7 months	10.4 months
Net Assets (\$'000s)	546,185	529,258	513,334	280,158

#### Key Observations

- Council's EBITDA decreased marginally over the four year period. Council's Interest Cover Ratio and DSCR indicate that they had some flexibility in regard to carrying more debt. The DSCR has been above the benchmark of 2.00x over the past four years.
- The Unrestricted Current Ratio has been above the benchmark of 1.50x over the past four years indicating liquidity is sufficient
- Net Assets have increased by \$266.0m between 2009 and 2012 due to the consecutive Asset Revaluations in 2010, 2011, and 2012 that increased the value of roads, bridges, footpaths, drainage, water, and sewerage assets.
- The Asset Revaluations over the last four years have resulted in a high level of volatility in Net Assets over this period. 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 a 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 four years this amounted to a \$6.5m increase in IPP&E assets.
- Council had total borrowings of \$5.2m in 2012, being less than 1.0% of Net Assets.

### 3.5: Statement of Cashflows



#### Key Observations

- In total, the Council had cash and investments of \$32.8m (all held in cash or equivalents) in 2012 of which \$27.5m is externally restricted, \$4.3m internally restricted and \$1.0m is unrestricted.
- Council's investment portfolio was solely made up of \$15.4m in long term deposits.
- Council's Cash Expense Ratio being well above the benchmark indicates Council had sufficient liquidity to meet all its short term obligations as they fall due.

### 3.6: Capital Expenditure

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

#### 3.6(a): Infrastructure Backlog

Figure 5 - Infrastructure Backlog for 2008/09 to 2011/12(\$'000s)

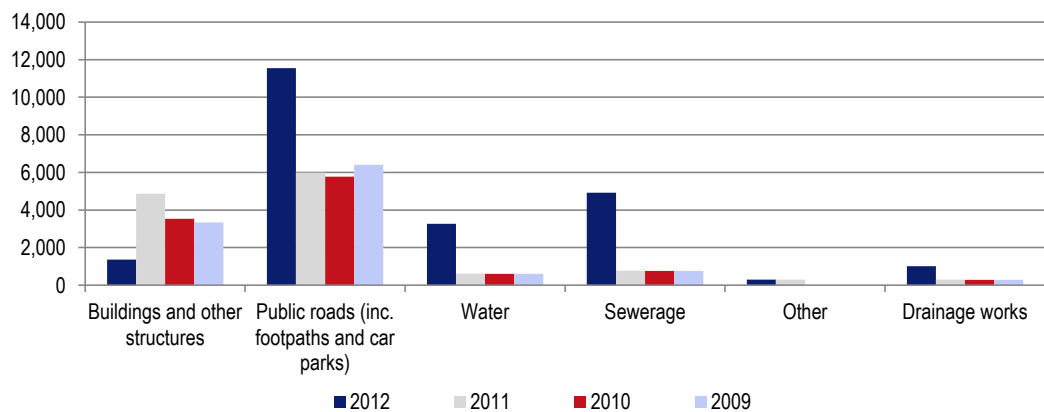
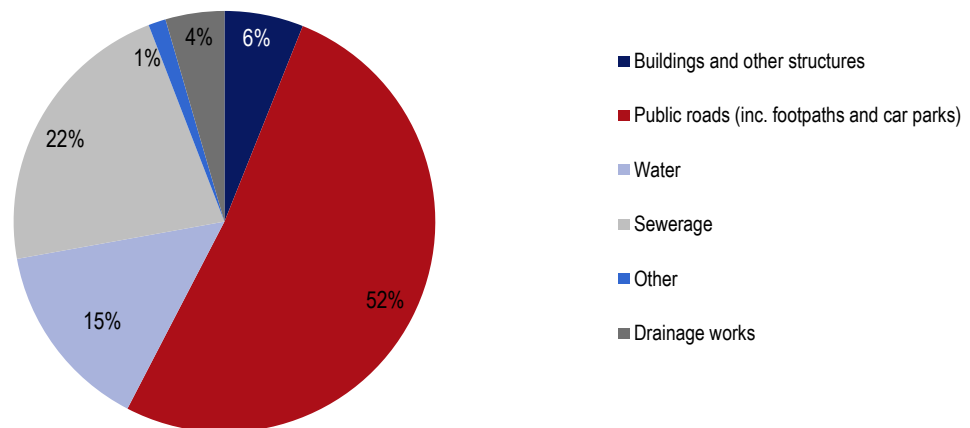


Figure 6 - Infrastructure Backlog Composition for 2011/12



Council conducted a consumer satisfaction survey for the first time in 2012. Community feedback included complaints in relation to the condition of assets such as roadside vegetation, grading, potholes, and timber bridges. There was also community opposition to costs associated with the Works Depot upgrade and Administration Building extensions.

Council's ability to reduce the Infrastructure backlog of \$22.4m is dependent on external funding, and further development of Asset Management Plans. Council have indicated that the cost of implementing asset management software is a key challenge.

A SRV application is to be considered for submission for the 2015 financial year. The proceeds from any SRV, if approved, will be used to assist with funding some of the road infrastructure backlog. The impacts of any SRV are not included in the current forecast LTFP.

### 3.6(b): Infrastructure Status

Infrastructure Status	Year ended 30 June			
	2012	2011	2010	2009
Bring to satisfactory standard (\$'000s)	22,408	12,831	10,930	11,364
Required annual maintenance (\$'000s)	3,718	2,299	2,122	3,016
Actual annual maintenance (\$'000s)	6,717	4,710	8,539	2,915
Total value of infrastructure assets (\$'000s)	260,917	244,218	230,929	128,415
Total assets (\$'000s)	558,318	539,984	519,211	286,220
Building and Infrastructure Backlog Ratio	0.09x	0.05x	0.05x	0.09x
Asset Maintenance Ratio	1.81x	2.05x	4.02x	0.97x
Building and Infrastructure Renewals Ratio	0.79x	0.51x	0.69x	0.61x
Capital Expenditure Ratio	1.17x	1.00x	1.39x	2.46x

Council have been meeting or exceeding both the Asset Maintenance Ratio and the Capital Expenditure over the last three years.

The Capital Expenditure Ratio shows that sufficient capital expenditure is occurring, and unlike the Building and Infrastructure Asset Renewal Ratio, this ratio takes into consideration capital expenditure which improves performance or capacity. Council's capital expenditure priorities are influenced by the availability of grant funding, for example a \$1.9m Federal Government grant to construct a new Youth Centre.

Council have been meeting the Asset Maintenance Ratio in recent years, but this is due to Council receiving significant flood restoration grants. Should these grants be no longer forthcoming, the benchmark for this ratio will not be met.

Council's ability to renew assets over the review period has been significantly affected by the increased asset maintenance costs due to the flood events. For example the NSW government announced funding of \$10.0m for repairs to a section of road from Bellingen to Bowraville. The uprooting of trees and numerous soil and rock slides left a 3.5km section of the road closed. Council, along with Nambucca Shire Council submitted a further claim in January 2011 seeking further State funding for the restoration of the road. In 2012 Council obtained approval for the restoration to be carried out under a Declared Natural Disaster Relief Grant which is administered by the RMS. Council have accepted a tender of \$3.0m from contractors to repair their section of the road after consultation with the RMS.



### 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	5,174	1,500	1,003	0
Replacement/refurbishment of existing assets	5,668	7,761	4,481	5,000
<b>Total</b>	<b>10,842</b>	<b>9,261</b>	<b>5,484</b>	<b>5,000</b>

Examples of major capital works completed or commenced over the review period include:

- Council received \$1.9m in Federal funding to construct a new Youth Centre
- Council commenced work on a \$4.5m upgrade of the Raleigh Works Depot in 2011
- The upgrade of the Jarret Park skatepark was completed in 2010
- Preliminary design work commenced on a new Sewerage Treatment Plant which is estimated to cost \$7.0m
- 

### 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 approved the construction of a 60 bed aged care facility in Raleigh which will cost \$9.8m.
- Ageing workforce. Council have acknowledged the challenge of replacing experienced staff and the loss of their corporate knowledge. Council has adopted a Workforce Management Plan which develops initiatives related to recruitment, and the retention and transfer of knowledge and skills.
- Natural disasters. The LGA has been declared a natural disaster area nine times in the last four years. As a result Council have had to prioritise repair work at the expense of other projects which are deferred in Council's delivery program.
- Reliance on grant funding for asset renewal. Council do not have the financial resources to clear the Infrastructure Backlog without external assistance. Council have employed a grant officer to enable a more proactive focus on the impact of council co-funding.

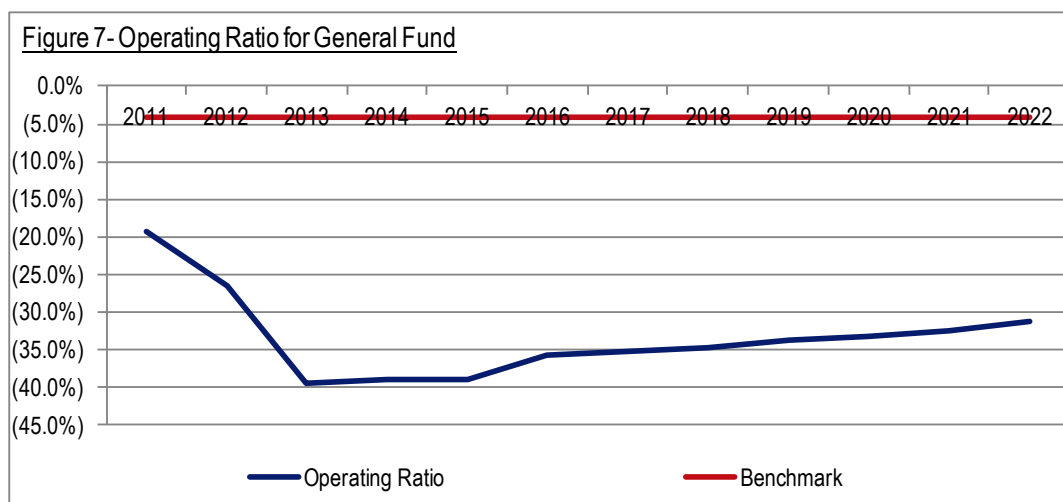
## Section 4 Review of Financial Forecasts

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

Council also operate both a Water Fund and a Sewer Fund.

The below graphs show actual results from 2011 and 2012, and forecast results from 2013 onwards.

### 4.1: Operating Results

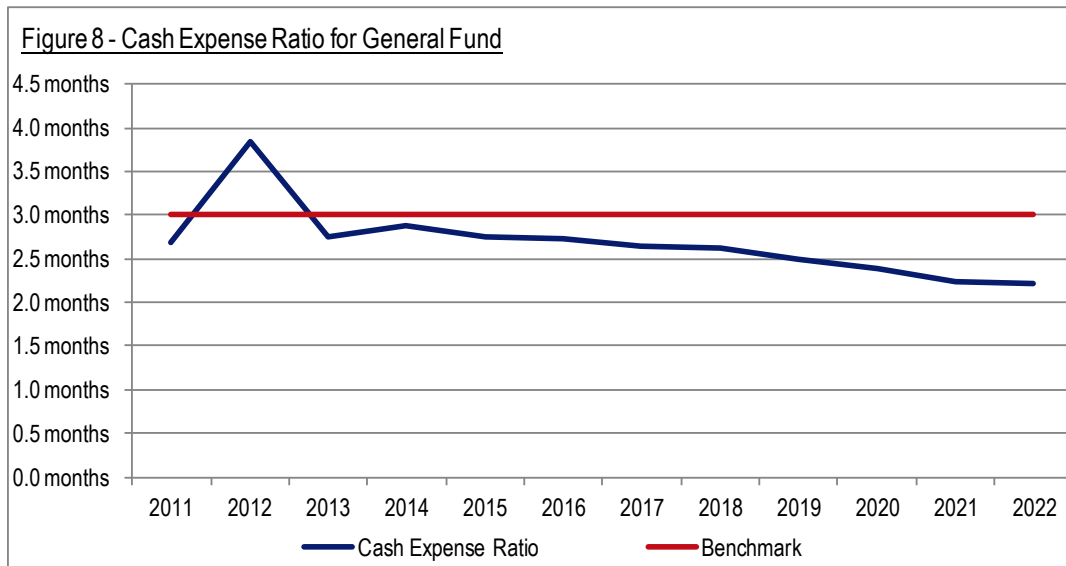


Due to a decrease in forecast operating grants and contributions in 2013, the financial position deteriorates and Council is forecasting to remain consistently in deficit for the remainder of the forecast period.

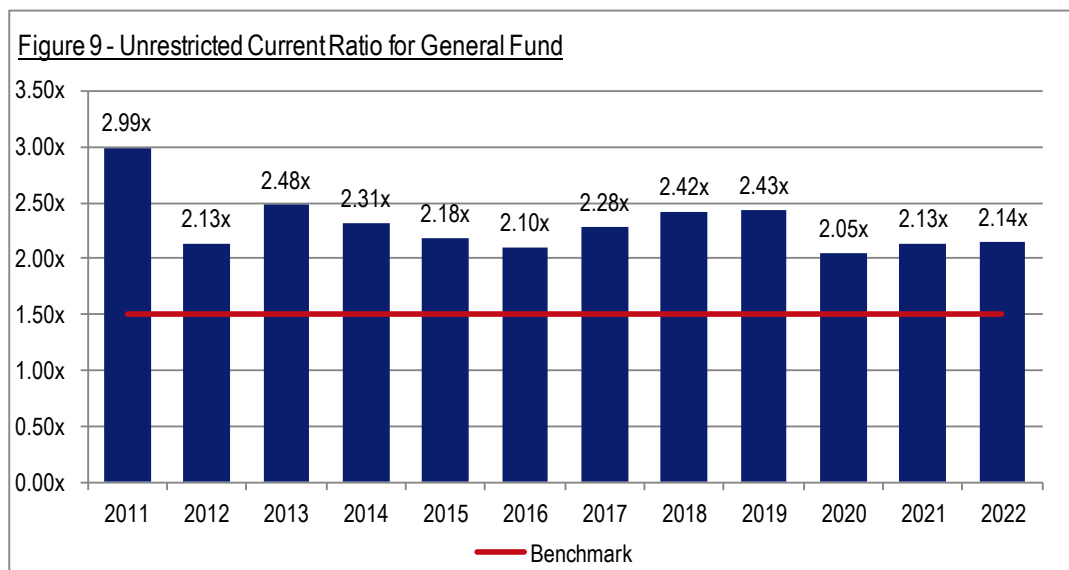
Council has forecast low levels of operating grants and contributions because these sources of revenue are not committed and guaranteed but this is a much lower level than what has been historically received. Continuous deficits below the benchmark will lead to Sustainability issues in the long term if operating grants and contributions are reduced as forecast.

## 4.2: Financial Management Indicators

### Liquidity Ratios



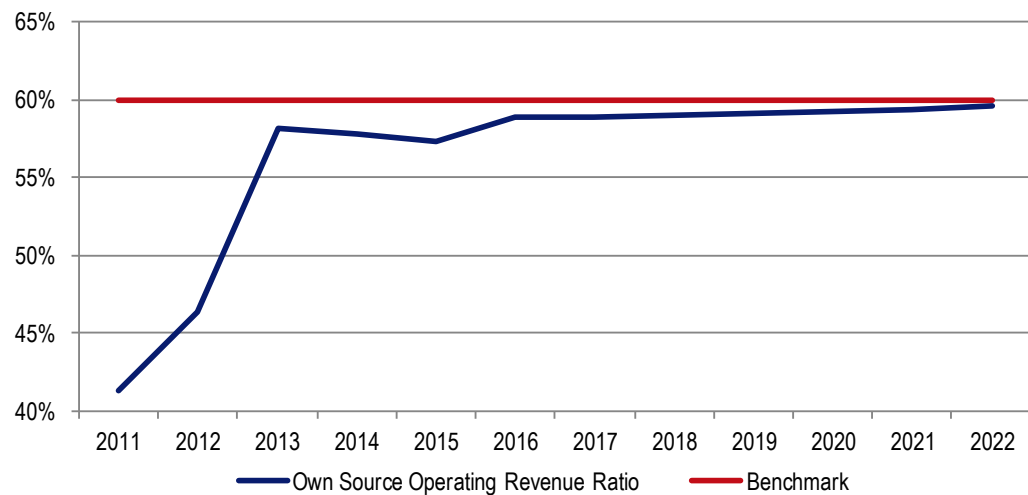
The Cash Expense Ratio indicates that Council operate with little room for flexibility in regard to liquidity. This ratio is forecast to decline below the benchmark in 2013. However, this ratio does not take into account Council's level of investments. When investments are considered, Council has access to sufficient levels to support their liquidity position.



The Unrestricted Current Ratio remains above the benchmark each year of the forecast. This ratio indicates that Council is forecast to have sufficient liquidity to meet its short term obligations.

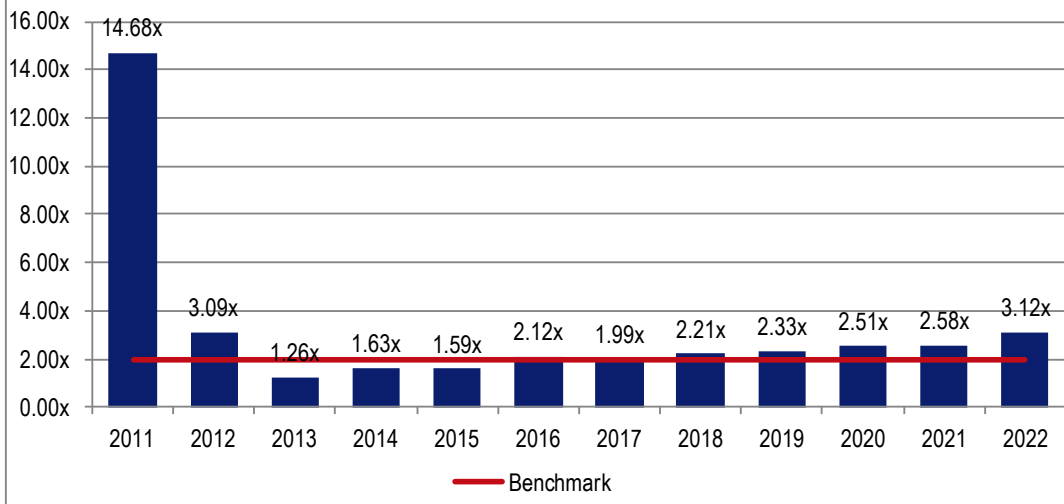
## Fiscal Flexibility Ratios

Figure 10 - Own Source Operating Revenue Ratio for General Fund



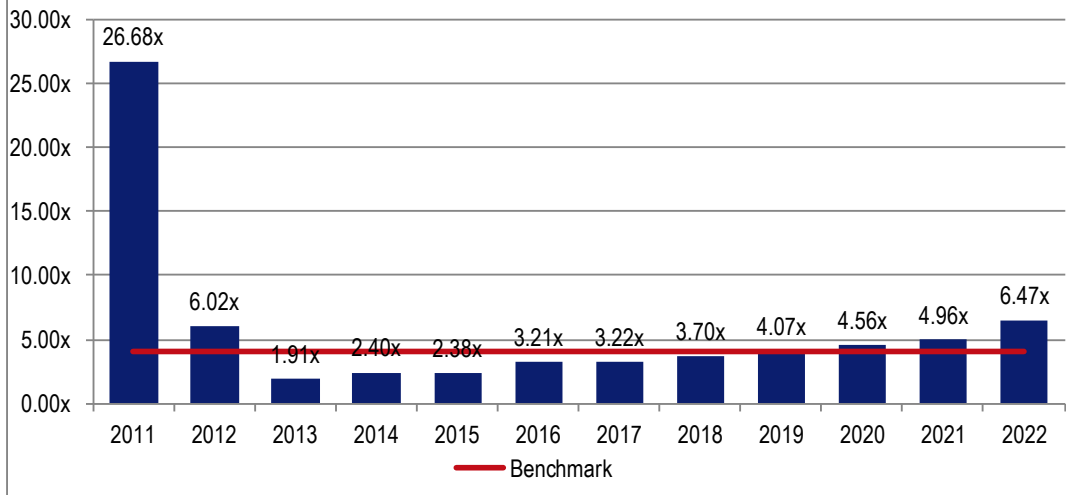
Historically, the Own Source Operating Revenue Ratio has been below the benchmark. The ratio is skewed upwards near the benchmark from 2013 onwards due to both operating and capital grants and contributions forecast to be lower than historically received.

Figure 11 - DSCR for General Fund



The DSCR shows that Council has the capacity to service all forecast borrowings. Outstanding borrowings in the General Fund will peak in 2013 at \$4.9m reducing to a low of \$2.7m in 2022. Council do not plan to borrow any further beyond their existing borrowings. The DSCR decreases in 2013 due to \$2.0m being borrowed in June 2012 to fund the Council depot upgrade.

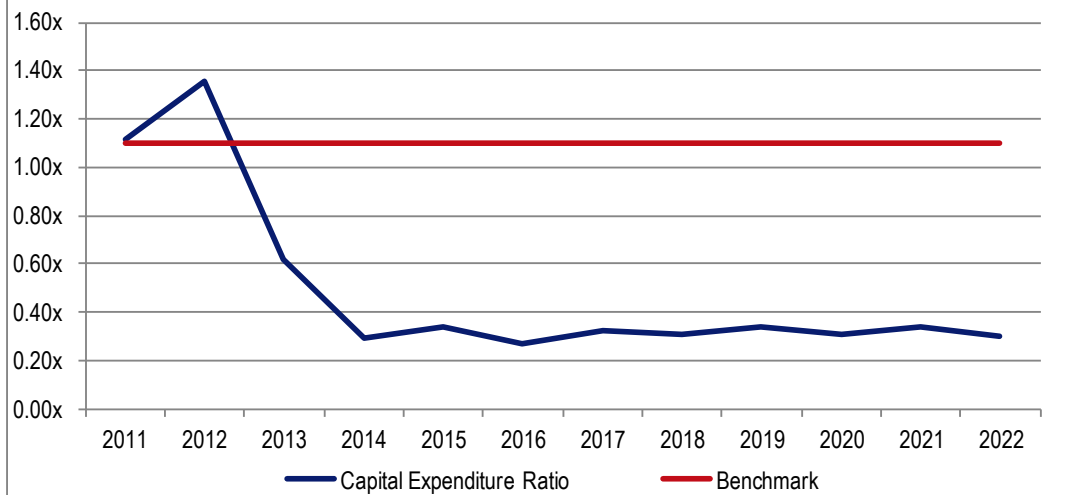
Figure 12 - Interest Cover Ratio for General Fund



The Interest Cover Ratio, similarly to the DSCR, shows the Council has sufficient capacity to service currently scheduled debt commitments. There is no capacity to service further debt interest costs in the short to medium term

#### 4.3: Capital Expenditure

Figure 13 - Capital Expenditure Ratio for General Fund



The forecast capital expenditure is well below the benchmark levels needed to meet the cost of required asset renewals. The lack of capital grants and contributions built into the LTFP and the continued operating deficits do not allow for sufficient capital investment. The total deficit for capital expenditure versus depreciation across the 10 year period amounts to \$35.3m in nominal terms. Council's 10 year capital works program focuses on road reseals and bridge replacement.

#### 4.4: Financial Model Assumption Review

Councils have used their own assumptions in developing their forecasts.

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

TCorp's benchmarks:

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

#### Key Observations and Risks

- The LTFP assumes that the community will continue to expect the levels of service currently provided by Council.
- Council is currently undertaking a review of service levels as part of its Community Strategic Plan review. No new services have been included in the LTFP over the forecast period. The impacts of an increasing and ageing population will be considered when reviewing Council's service levels.
- Rates and annual charges are forecast to rise by between 3.0% and 3.6% p.a. which is consistent with historic IPART approved rate pegs.
- User fees and charges fall from \$3.1m in 2012 to \$1.7m in 2013 before gradually increasing by approximately 1.5% p.a. The level of user fees and charges are highly dependent on RMS fees received for maintenance of State roads, and it is considered likely that these forecast decreases are conservative.
- Operating grants and contributions are forecast to decrease from \$10.4m in 2012 to \$3.7m in 2014, before gradually rising by approximately 5.0% p.a. over the lifetime of the forecast. Council has been in receipt of flood restoration grants over the review period which will not be forthcoming in the future (unless further flooding events occur). The flood restoration grants have enabled the Asset Maintenance Ratio to be above benchmark the last three years. The discontinuation of these grants will likely see the ratio fall below the benchmark.
- Employee expenses are forecast to increase by 12.5% in 2013. This is a variance caused by the 2012 employee expenses being less than forecast. The LTFP was built on the 2012 forecast amounts rather than the actual. Employee expenses then increase by between 1.5% and 3.0% p.a. Given historic NSW wage indexation rates, and Council's record of increases of between 2.2% and 10.6% p.a., Council will be challenged to achieve these low wage increases.

- Materials and contract costs are forecast to decrease from \$10.5m in 2012 to \$5.3m in 2022. Due to flood repairs and maintenance in the last number of years, it is reasonable to expect that these costs should decrease.
- Overall eight flood events in the last four years makes it difficult to compare past performance versus the forecasts, while Council's low level of own source revenue also makes it harder to accurately predict revenue.

#### 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 its existing debt facilities. Some comments and observations are:

- Based on a benchmark of DSCR>2.00x, Council would not be in a position to borrow further until 2018
- Based on a benchmark of Interest Cover Ratio>4.00x, Council would not be in a position to borrow further until 2019
- Should Council secure approval to an SRV, any additional funds generated could be used to service additional borrowings

## 4.6 Sustainability

TCorp believes Council is moderately Sustainable in the short to medium term. Council's position is deteriorating and the current LTFP forecasts a worsening financial position, particularly in respect of its capital expenditure. Council has a record of reporting operating deficits which have increased in recent years largely due to significant costs increases which have not been matched by revenue increases. The LTFP does not demonstrate any major improvement in these deficits over the forecast period. Unforeseen financial shocks such as major floods or other disasters would continue to require assistance from other levels of government.

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

- Council's forecast capital expenditure program significantly understates the level of expenditure required on asset renewal and in the long term this will impact on the quality of the Council's assets and its capacity to deliver services
- The floods in recent years have increased the challenge for Council of maintaining a sustainable LGA. Widespread damage to key assets has resulted in Council having to defer other capital projects. The LTFP includes a detailed capital works program outlining how the renewal of assets rather than new capital works are Council priorities
- Council's long term Sustainability will be improved should it receive approval to the introduction of an SRV in 2015
- Council's longer term Sustainability position will be clearer once it builds into the Community Strategic Plan and LTFP the level of services agreed with the community and the required level of asset maintenance and renewal required to deliver these services
- Council is heavily reliant on Government operating and capital grants to meet both service level operating costs and capital expenditure requirements
- Council does not have the financial capacity to undertake borrowings to improve its capital expenditure shortfalls



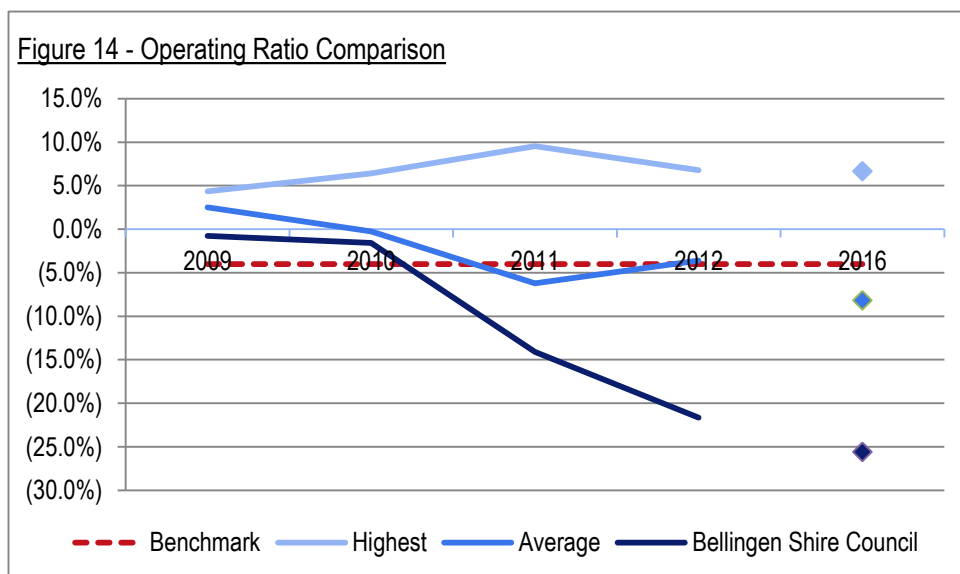
## Section 5 Benchmarking and Comparisons with Other Councils

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.

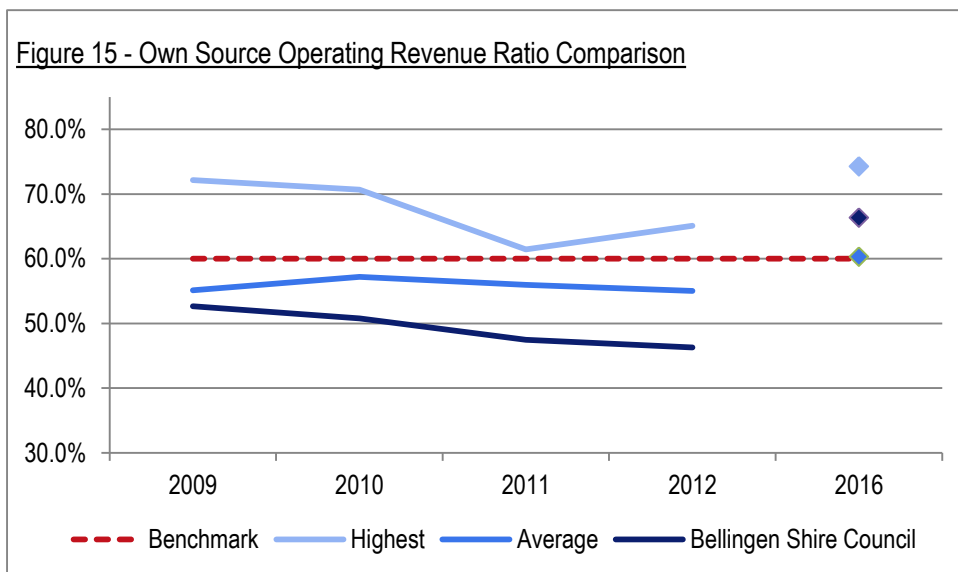
In Figure 14 to Figure 23, the graphs compare the historical performance of Council with the benchmark for that ratio, with the average for the Group, with the highest performance (or lowest performance in the case of the Infrastructure Backlog Ratio where a low ratio is an indicator of strong performance), 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



Council's Operating Ratio was below average in the past four years and declined over the period. The results are forecast to decline further in the medium term and remain below the group's average and benchmark.



Council's Own Source Operating Revenue Ratio was below the group average and benchmark. The ratio is forecast to improve in the medium term to be above the group average and benchmark as grants are forecast to decline from historical levels.

## Liquidity

Figure 16 - Cash Expense Ratio Comparison

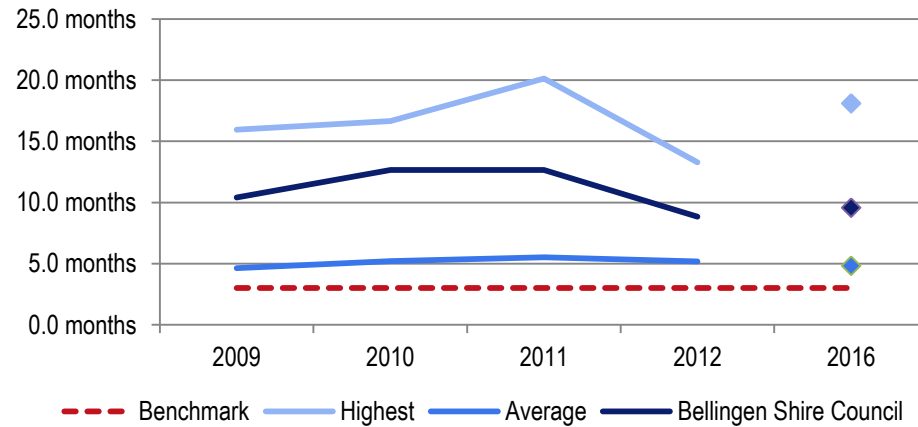
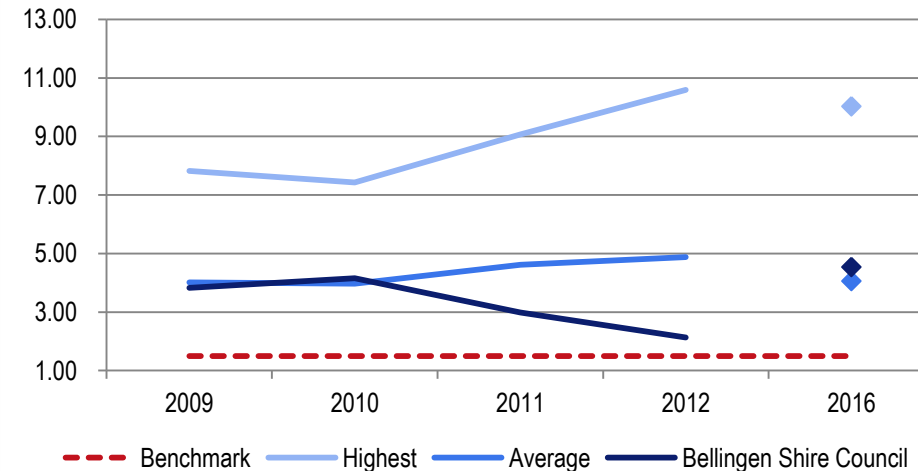


Figure 17 - Unrestricted Current Ratio Comparison



Council's Cash Expense Ratio was above the group average and benchmark over the last four years and this is forecast to continue in the medium term.

Council's Unrestricted Current Ratio has declined over the review period to be below the group average though it has remained above the benchmark. The ratio is forecast to improve to be around the group average and will remain above the benchmark in the medium term.

On average over the past four years, the Council's liquidity position has been acceptable and this is forecast to continue.

## Debt Servicing

Figure 18 - Debt Service Cover Ratio Comparison

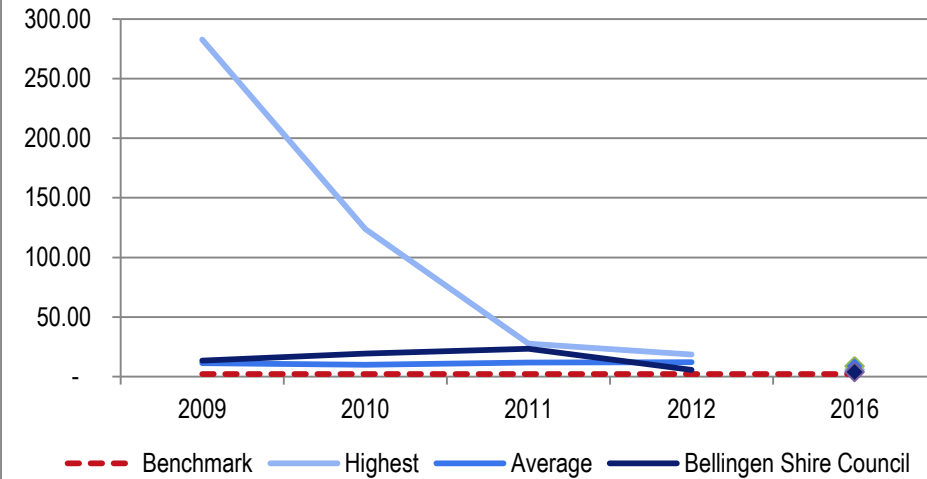
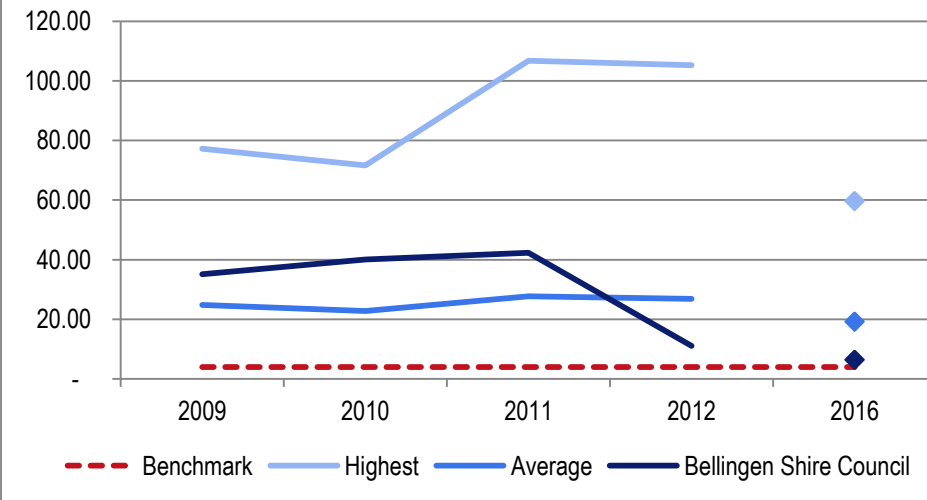


Figure 19 - Interest Cover Ratio Comparison



Over the review period, Council's DSCR and Interest Cover Ratios declined below the group averages but remained above the benchmarks. The ratios are forecast to remain above the benchmarks in the medium term.

## Asset Renewal and Capital Works

Figure 20 - Capital Expenditure Ratio Comparison

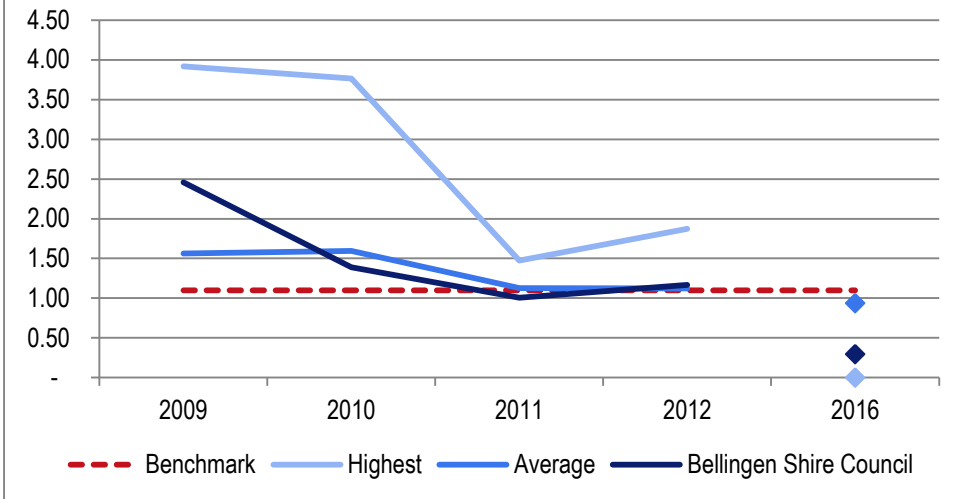


Figure 21 - Asset Maintenance Ratio Comparison

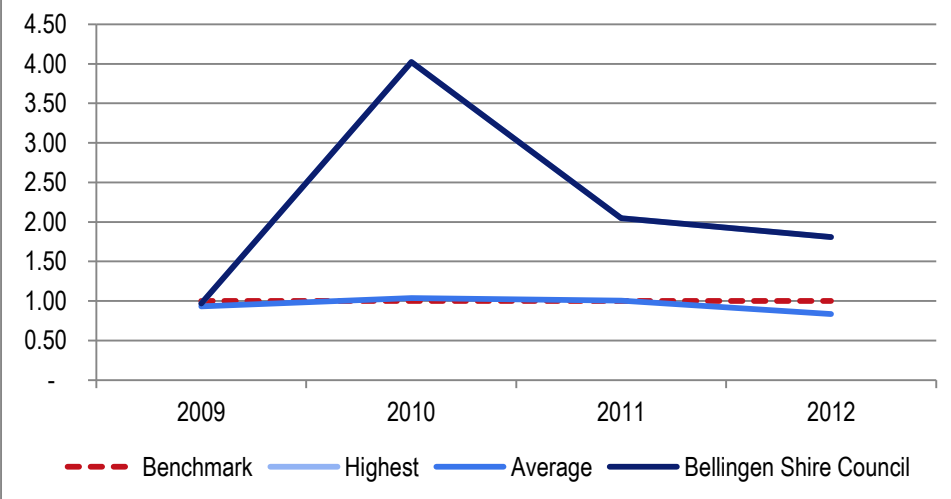


Figure 22 - Infrastructure Backlog Ratio Comparison

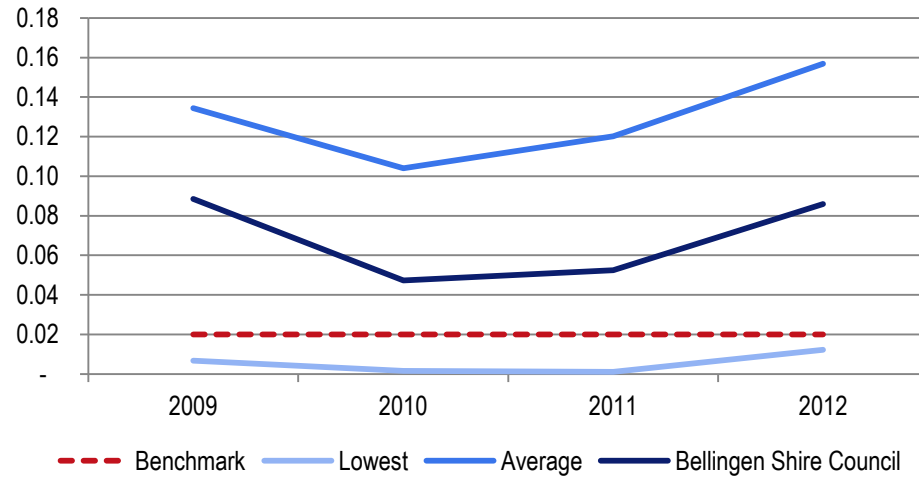
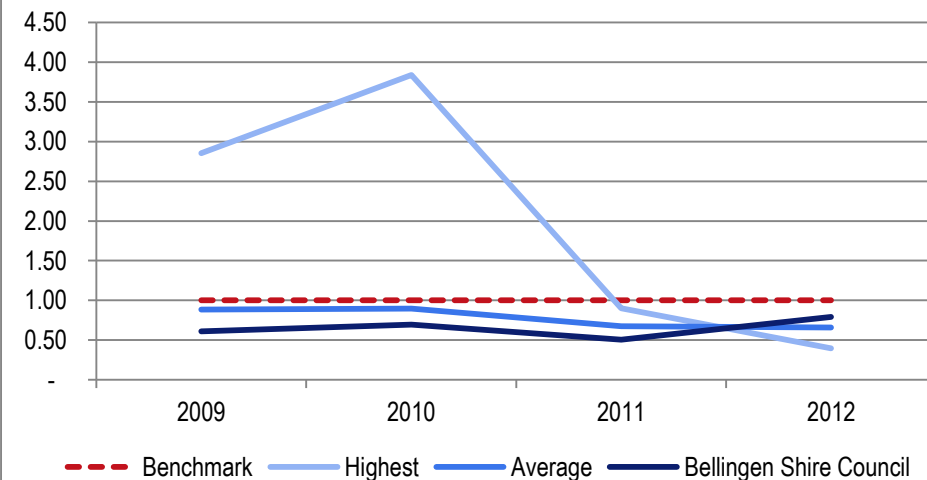


Figure 23 - Building and Infrastructure Asset Renewal Ratio



Overall, the Council has a lower Infrastructure Backlog Ratio than other councils in the group though it would need to improve to reach the benchmark.

Council had the best Asset Maintenance Ratio in the group and was above the benchmark. The Council's Capital Expenditure Ratio and Building and Infrastructure Asset Renewal Ratio were around the group averages and at or below the benchmarks.

## Section 6 Conclusion and Recommendations

Based on our review of both the historic financial information and the 10 year financial forecast within Council's long term financial plan we consider Council to be moderately Sustainable in the short to medium term but is in a deteriorating position in respect of its longer term Sustainability.

We base our view on the following key points:

- Council's liquidity position is acceptable but Council does not have significant reserves to withstand any major unforeseen financial shocks such as flooding without the support of other levels of Government
- Council has incurred increasing operating deficits (excluding grants and contributions for capital purposes) in each of the past four years, and these deficits are forecast to increase over the forecast period. Increases in expenses need to be addressed
- Council does not have the financial capacity to undertake borrowings to meet its capital expenditure requirements
- Despite having had a road levy in place since 1996 to provide additional maintenance funding, 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. Sufficient asset renewal would be better enabled with the introduction of a planned SRV in 2015 which could assist with funding the renewal of some of the road infrastructure backlog
- Council's own source operating ratio is below benchmark. Council should look to ways to increase this ratio to decrease reliance on external funding, which would better enable long term financial management
- Council needs to update its Community Plans and Asset Management Plans, then update its LTFP to present a clearer view of its financial forecasts based on required service levels

## 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
<b>Revenue</b>							
Rates and annual charges	9,620	9,703	9,228	8,601	(0.9%)	5.1%	7.3%
User charges and fees	4,662	4,474	4,921	4,411	4.2%	(9.1%)	11.6%
Interest and investment revenue	1,928	1,843	1,450	2,133	4.6%	27.1%	(32.0%)
Grants and contributions for operating purposes	10,534	8,564	9,298	6,907	23.0%	(7.9%)	34.6%
Other revenues	507	531	546	384	(4.5%)	(2.7%)	42.2%
<b>Total revenue</b>	<b>27,251</b>	<b>25,115</b>	<b>25,443</b>	<b>22,436</b>	<b>8.5%</b>	<b>(1.3%)</b>	<b>13.4%</b>
<b>Expenses</b>							
Employees	9,761	9,554	8,641	7,967	2.2%	10.6%	8.5%
Borrowing costs	323	111	119	142	191.0%	(6.7%)	(16.2%)
Materials and contract expenses	11,267	8,152	9,404	7,227	38.2%	(13.3%)	30.1%
Depreciation and amortisation	9,144	8,131	5,058	5,013	12.5%	60.8%	0.9%
Other expenses	2,652	2,711	2,627	2,263	(2.2%)	3.2%	16.1%
<b>Total expenses</b>	<b>33,147</b>	<b>28,659</b>	<b>25,849</b>	<b>22,612</b>	<b>15.7%</b>	<b>10.9%</b>	<b>14.3%</b>
<b>Operating result (excluding capital grants and contributions)</b>	<b>(5,896)</b>	<b>(3,544)</b>	<b>(406)</b>	<b>(176)</b>	<b>(66.4%)</b>	<b>(772.9%)</b>	<b>(130.7%)</b>
<b>Operating result (including capital grants and contributions)</b>	<b>(2,282)</b>	<b>1,210</b>	<b>2,018</b>	<b>2,099</b>	<b>(288.6%)</b>	<b>(40.0%)</b>	<b>(3.9%)</b>

Table 2 - Items excluded from Income Statement

Excluded items (\$'000s)				
	2012	2011	2010	2009
Grants and contributions for capital purposes	3,614	4,754	2,424	2,275
Net gain/(loss) from the disposal of assets	168	(139)	187	25
Impairments	0	0	0	(2,039)



Table 3 - Balance Sheet

Balance Sheet (\$'000s)	Year Ended 30 June				% annual change		
	2012	2011	2010	2009	2012	2011	2010
<b>Current assets</b>							
Cash and cash equivalents	17,432	21,510	21,815	15,142	(19.0%)	(1.4%)	44.1%
Investments	15,357	10,500	8,500	13,500	46.3%	23.5%	(37.0%)
Receivables	5,182	8,389	4,110	5,479	(38.2%)	104.1%	(25.0%)
Inventories	293	288	318	361	1.7%	(9.4%)	(11.9%)
Other	116	51	142	286	127.5%	(64.1%)	(50.3%)
Total current assets	38,380	40,738	34,885	34,768	(5.8%)	16.8%	0.3%
<b>Non-current assets</b>							
Receivables	14	19	28	91	(26.3%)	(32.1%)	(69.2%)
Infrastructure, property, plant & equipment	518,658	497,961	483,032	250,095	4.2%	3.1%	93.1%
Investments accounted for using equity method	1,266	1,266	1,266	1,266	0.0%	0.0%	0.0%
Total non-current assets	519,938	499,246	484,326	251,452	4.1%	3.1%	92.6%
<b>Total assets</b>	<b>558,318</b>	<b>539,984</b>	<b>519,211</b>	<b>286,220</b>	<b>3.4%</b>	<b>4.0%</b>	<b>81.4%</b>
<b>Current liabilities</b>							
Payables	3,528	4,042	1,829	1,890	(12.7%)	121.0%	(3.2%)
Borrowings	147	312	93	127	(52.9%)	235.5%	(26.8%)
Provisions	2,760	2,560	2,330	2,477	7.8%	9.9%	(5.9%)
Total current liabilities	6,435	6,914	4,252	4,494	(6.9%)	62.6%	(5.4%)
<b>Non-current liabilities</b>							
Borrowings	5,087	3,239	1,049	1,142	57.1%	208.8%	(8.1%)
Provisions	611	573	576	426	6.6%	(0.5%)	35.2%
Total non-current liabilities	5,698	3,812	1,625	1,568	49.5%	134.6%	3.6%
<b>Total liabilities</b>	<b>12,133</b>	<b>10,726</b>	<b>5,877</b>	<b>6,062</b>	<b>13.1%</b>	<b>82.5%</b>	<b>(3.1%)</b>
<b>Net assets</b>	<b>546,185</b>	<b>529,258</b>	<b>513,334</b>	<b>280,158</b>	<b>3.2%</b>	<b>3.1%</b>	<b>83.2%</b>

Table 4-Cashflow

Cash Flow Statement (\$'000s)	Year ended 30 June			
	2012	2011	2010	2009
Cash flows from operating activities	9,527	6,778	8,347	3,974
Cash flows from investing activities	(15,288)	(9,492)	(1,547)	(18,227)
Proceeds from borrowings and advances	2,000	2,500	0	0
Repayment of borrowings and advances	(317)	(91)	(127)	(229)
Cash flows from financing activities	1,683	2,409	(127)	(229)
<b>Net increase/(decrease) in cash and equivalents</b>	<b>(4,078)</b>	<b>(305)</b>	<b>6,673</b>	<b>(14,482)</b>
Cash and equivalents	17,432	21,510	21,815	15,142

## Appendix B Glossary

### Asset Revaluations

In assessing the financial sustainability of NSW councils, IPART found that not all councils reported assets at fair value.<sup>1</sup> In a circular to all councils in March 2009<sup>2</sup>, 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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<sup>1</sup>IPART “Revenue Framework for Local Government” December 2009 p.83

<sup>2</sup> 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.

#### 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.