ANNEXURE 2 TCORP ASSESSMENT - TCorp Final Financial Assessment, Sustainability and Benchmarking Report Kogarah

New South Wales
Treasury Corporation

Kogarah City Council

Financial Assessment, Sustainability and Benchmarking Report

05 March 2013

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

New South Wales
Treasury Corporation

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

.

New South Wales
Treasury Corporation

Index

Section 1 Executive Summary

This report provides an independent assessment of Kogarah City 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 three 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.

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

- Council's underlying operating performance (measured using EBITDA) has increased by $2.3m since 2009 to $5.1m in 2012
- 73.2% of the Council's revenue base is derived from own sourced revenue (annual charges and user charges and fees). Council can rely on these revenue streams on an ongoing basis

The Council reported $1.2m of infrastructure backlog in 2012 which represents 0.4% of its infrastructure asset value of $249.8m. Other observations include:

- Council's infrastructure backlog has been maintained at consistent levels since 2009
- Council is marginally underspending the required amount to maintain their existing assets at an acceptable level
- Compared to benchmark ratios Council appears to be underspending on asset renewal
- Council do not have any water or sewage infrastructure

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

- The forecast shows deficit positions are expected for the entire forecast period. The result improves from 2013 on and increases above benchmark in 2020
- Council's own source revenue is above benchmark for the entire forecast period
- Council's capital expenditure is below benchmark for the entire forecast period indicating Council could face issues in the future in respect of its asset quality

In our view, the Council has the capacity to undertake additional borrowings of up to $12.9m. This is based on the following analysis:

- Based on a benchmark of DSCR>2x, $12.9m could be borrowed in addition to the existing borrowings of $0.2m

In terms of Sustainability, TCorp believes Council to be moderately financially sustainable. While it has recorded operating deficits, the operating result is forecast to improve over time, although remains in deficit.

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

- In the long term Council is not spending sufficient amounts on asset renewal and this may lead to a reduction in asset quality and ultimately adversely impact service levels
- Council is proactive in addressing their challenges and issues as illustrated by their initiatives to address their Flood Management Program.
- Council's financial forecasts indicate that Council has the capacity to undertake a level of borrowing in the long term to fund its capital projects
- Council's long term sustainability is dependent on achieving or improving on, forecast levels of employee expenses and materials and contracts expenses

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

- Council's financial flexibility is reasonably sound as indicated by the Own Source Operating Ratio being well above benchmark and in line with the group's average
- Council's Cash Expense Ratio is below benchmark and the group average. The ratio does not take into account Council's investments and when these are included Council will not have any liquidity issues. The Unrestricted Current Ratio is also below the group average however it is above benchmark over the review period. Both ratios are forecast to remain at current levels in the medium term
- Council's DSCR and Interest Cover Ratio are well above benchmark and outperformed the group average in the medium term which indicates Council is not highly geared when compared to other Councils
- Council has a low level of Infrastructure Backlog. The Asset Maintenance Ratio is at benchmark levels and outperforming the group average. The Building and Infrastructure Asset Renewal Ratio has been below benchmark over the review period but generally in line with the group average since 2011. The Capital Expenditure Ratio has been below the group average in the past four years and is on a downward trend. It is forecast at levels consistent with the groups average in the medium term

New South Wales
Treasury Corporation

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

In undertaking its work, TCorp relied on:

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

Definition of Sustainability

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

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

Benchmark Ratios

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

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

Therefore these benchmarks are intended as a guide to performance.

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

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

New South Wales Treasury Corporation

2.3: Overview of the Local Government Area

Kogarah City LGA	
Locality & Size	
Locality	Sydney Inner
Area	16km²
DLG Group	2
Demographics	
Population as at 2011	55,806
% under 18	23%
% between 18 and 59	57%
% over 60	20%
Expected population 2021	59,000
Operations	
Number of employees (FTE)	259
Annual revenue	$43.2m
Infrastructure	
Roads	169km
Playgrounds	56
Infrastructure backlog value	$1.2m
Total infrastructure value	$249.8m

Kogarah City Council Local Government Area (LGA) is located 16km south of Sydney CBD forms the heart of the St. George region. It is bounded by the City of Rockdale, the City of Hurstville and Georges River to the south.

The LGA comprises 17 suburbs which include Allawah, Beverley Park, Connells Point, Hurstville, Kogarah, Kogarah Bay, Kyle Bay, Mortdale and Sans Souci.

The current population of 55,806 is expected to grow by 5.7% to 59,000 in 2021.

Council had 259 equivalent full time employees at the end of the financial year in 2012.

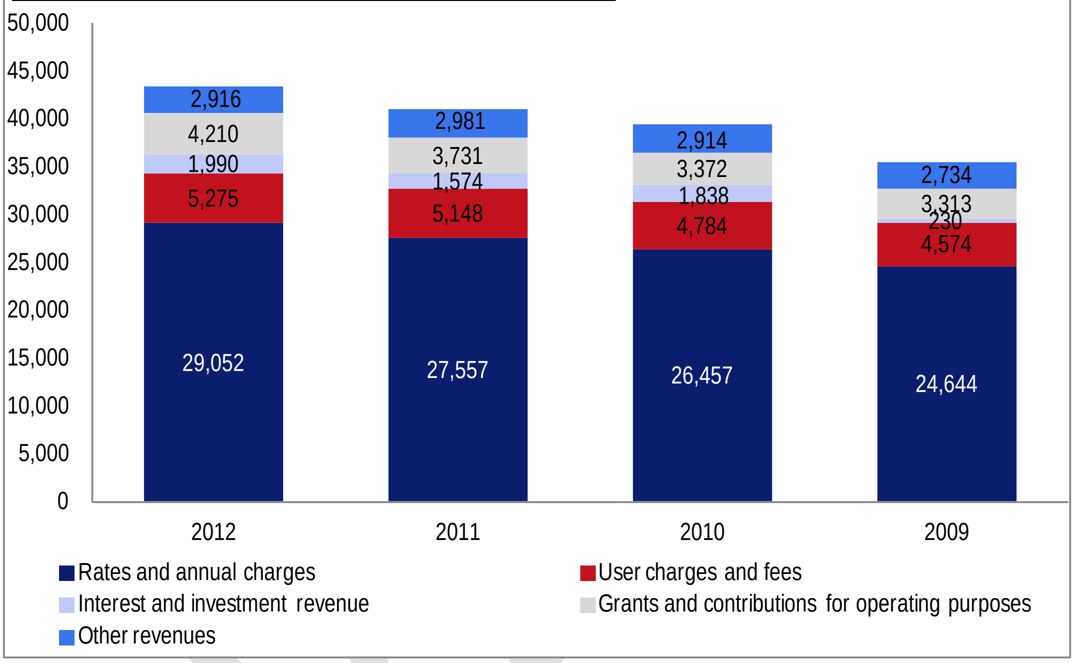
New South Wales
Treasury Corporation

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 5.4% in 2012, 4.2% in 2011 and 7.4% in 2010. In 2010 Council was successful in its application for an SRV of 5.9% (including rate peg) for four years commencing in 2010. The income generated is to be used to maintain infrastructure. In addition Council have a DLG approved Environmental SRV of 3% in place from 2006 until 2013 inclusive.
- 2010 also saw an increase of $1.0m in domestic waste management service charges due to increases in government levies. There were also additional costs due to a new waste collection contract which included legal fees and some contract costs from the previous contract which had not been applied in full over the period of the contract.
- User fees and charges increased in line with CPI in 2012. In 2011 user fees and charges increased by 7.6% driven by a $0.2m increase in restoration charges from Energy Australia works (following damage caused to Council assets by Energy Australia which they subsequently reimbursed).
- Interest and investment revenue has been maintained at consistent levels since 2010. Operating grants and contributions increased by 12.8% ($0.5m) in 2012 driven by a $0.4m

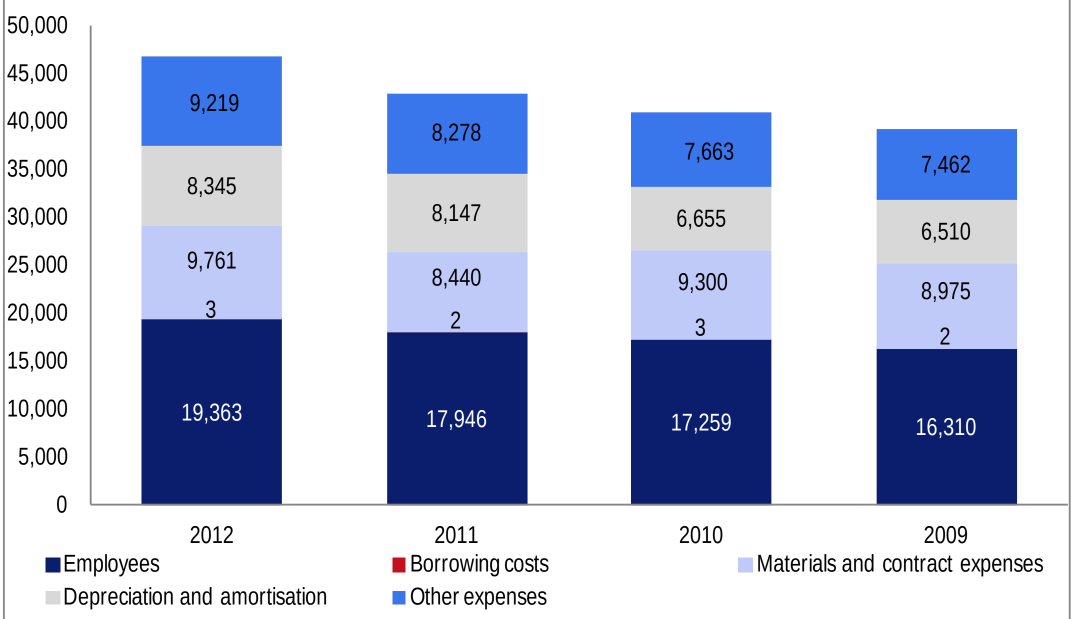
New South Wales Treasury Corporation

increase in financial assistance grants. 2011 saw an increase of 10.6% ($0.3m) driven by a $0.2m grant allocated for roads to recovery.

- Other revenue has been maintained at consistent levels over the four year period. Council derives significant revenue from parking fines which generated around $2.0m in revenue in the past three years.

3.2: Expenses

Figure 2 - Expenses for 2008/09 to 2011/12 ($'000s)



Key Observations

- In 2012 employee expenses increased 7.9% ($1.4m). This was driven by a 5.8% ($0.9m) increase in salaries and wages of which $0.2m was due to overtime for restoration works on the Energy Australia project. There were also some longer term vacancies filled and additional staffing at child care centres. Employee expenses increased by 4.0% ($0.7m) in 2011 and 5.8% ($0.9m) in 2010. The number of equivalent full time staff increased by 3 in both years as well as slight increases in superannuation.
- Materials and contracts expenses have fluctuated over the period with an increase of 15.7% ($1.3m) in 2012 following a decrease of 9.2% ($0.9m) in 2011. In 2012 other materials and contracts expenses increased by $0.5m due a number of additional grant funded projects.
- In 2010 Council awarded a new waste management contract which delivered significant savings compared to the previous contract resulting in a $0.6m decrease in waste management expenses in 2011.
- In 2010 Council revalued its road, footpaths and stormwater assets which increased the value of Council's infrastructure assets. This resulted in the annual depreciation charge increasing 28.2% ($1.8m) to $8.4m in 2012.
- In 2010 Council revalued community land which resulted in a fair value decrement of $152.7m. When this one off adjustment is removed, other expenses increased by 8.0% ($0.6m) to $8.2m in 2011.
- Other expenses increased by 11.4% ($1.0m) in 2012 primarily due to a $0.6m increase in waste disposal expenses driven by the increased waste levy charge by the State government.

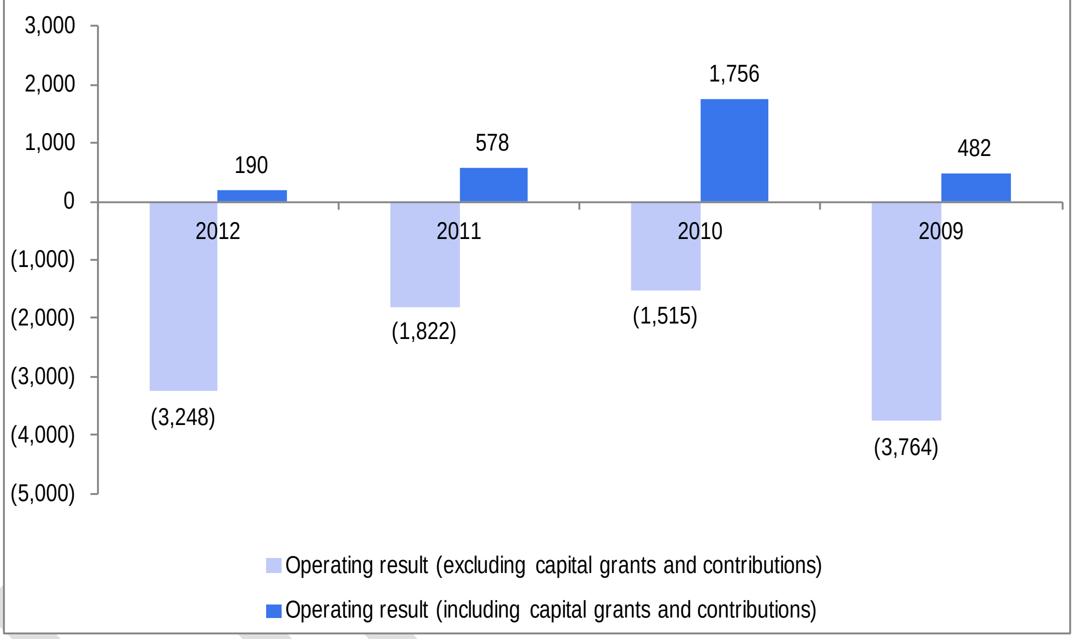
3.3: Operating Results

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 has consistently posted net operating deficits, excluding capital grants and contributions, for the last four years. The improved result in 2010 was driven by increased rates revenue. The deficit increased by 78.3% ($1.4m) in 2012 driven by increased materials and contracts and other expenses.
- Council expenses include a non-cash depreciation expense, ($8.3m in 2012), which has increased by $1.8m since 2009 following the Asset Revaluations process. Whilst the non-cash nature of depreciation can favourably impact on ratios such as EBITDA that focus on cash, depreciation is an important expense as it represents the allocation of the value of an asset over its useful life.

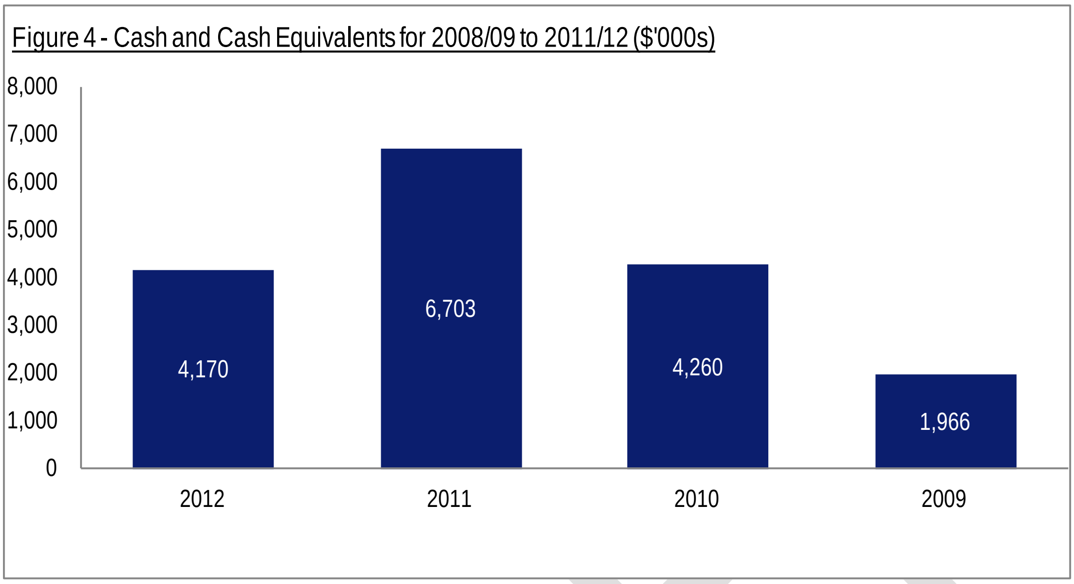
3.4: Financial Management Indicators

Performance Indicators	Year ended 30 June			
	2012	2011	2010	2009
EBITDA ($'000s)	5,100	6,327	5,143	2,748
Operating Ratio	(7.5%)	(4.4%)	(3.8%)	(10.6%)
Interest Cover Ratio	1,700.00x	3,163.50x	1,714.33x	1,374.00x
Debt Service Cover Ratio	1,700.00x	3,163.50x	1,714.33x	1,374.00x
Unrestricted Current Ratio	2.43x	2.41x	1.78x	1.83x
Own Source Operating Revenue Ratio	73.2%	75.4%	73.3%	73.5%
Cash Expense Ratio	1.3 months	2.3 months	1.5 months	0.7 months
Net Assets ($'000s)	411,906	406,212	545,957	498,786

<u>Key Observations</u>

- Council's underlying operating performance (measured using EBITDA) has decreased slightly in 2012 due to increased expenses.
- The Operating Ratio was below benchmark in three of the four years. The ratio was marginally above benchmark in 2010 driven by increased rates revenue from the commencement of an SRV.
- Council's Interest Cover Ratio and DSCR were well above their respective benchmarks reflecting Council's very low levels of borrowings ($0.2m in 2012). This indicates Council has flexibility in regard to carrying more debt.
- The Unrestricted Current Ratio has been above benchmark each year indicating Council had sufficient liquidity.
- The Own Source Operating Revenue Ratio is above the 60% benchmark. This indicates that Council had sufficient financial flexibility.
- The Cash Expense Ratio was below benchmark each year but a proportion of Council's investment is invested in long term deposits which are not captured by this ratio.
- Council's Net Assets decreased by $142.7m between 2010 and 2011 following the revaluation of community land. Overall Council's Net Assets have decreased by $86.8m since 2009 mainly due to Revaluations.
- When Asset Revaluations are excluded, the underlying trend in all three years has been a decrease in the infrastructure, property, plant and equipment (IPP&E) asset base with asset purchases being less than the combined value of disposed assets and annual depreciation. Over the three years this amounted to a $1.6m decrease in IPP&E assets.
- Council has minimal borrowings of $0.2m representing 0.06% of Net Assets.

3.5: Statement of Cashflows



Key Observations

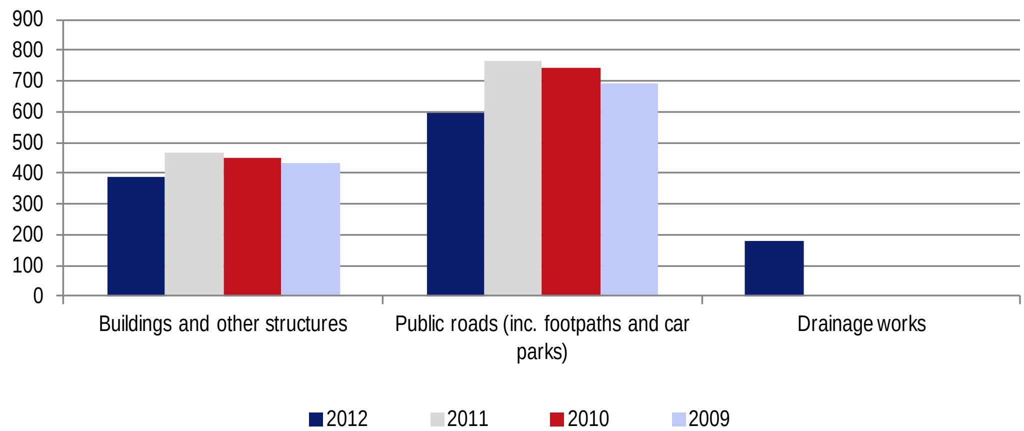
- Cash and cash equivalents have fluctuated over the four year period with an increase of $2.2m since 2009. The decrease in 2012 was due to increased expenses and a decrease in the sale of investment securities.
- The cash balances along with the Unrestricted Current Ratio indicate Council had sound liquidity.
- Of the $31.8m in cash and investments, $18.5m is externally restricted, $12.8m is internally restricted and $0.5m is unrestricted.
- Of the $27.6m in Council's investment securities $10.6m is invested in managed funds (under the grandfather provision), $12.0m in long term deposits and $5.0m in NCD's/FRN's.

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)



Council reported $1.2m in infrastructure backlog in 2012. The backlog relates to public roads at $0.6m, buildings and other structures at $0.4m and drainage works at $0.2m. Council does not have any water or sewage infrastructure.

3.6(b): Infrastructure Status

Infrastructure Status	Year ended 30 June			
	2012	2011	2010	2009
Bring to satisfactory standard ($'000s)	1,160	1,232	1,196	1,125
Required annual maintenance ($'000s)	3,451	3,364	3,266	3,266
Actual annual maintenance ($'000s)	3,402	3,281	3,215	2,325
Total value of infrastructure assets ($'000s)	249,796	253,063	246,283	195,812
Total assets ($'000s)	422,901	417,082	559,847	508,812
Building and Infrastructure Backlog Ratio	0.00x	0.00x	0.00x	0.01x
Asset Maintenance Ratio	0.99x	0.98x	0.98x	0.71x
Building and Infrastructure Asset Renewals Ratio	0.75x	0.74x	0.74x	0.71x
Capital Expenditure Ratio	0.65x	0.85x	1.04x	1.35x

The Building and Infrastructure Backlog Ratio and Asset Maintenance Ratio have been above or close to benchmark over the past four years indicating Council is spending sufficient amounts to maintain assets in their current condition.

The Building and Infrastructure Asset Renewals Ratio has been below benchmark each year and indicates Council is spending at levels below the required level on asset renewal.

The Capital Expenditure Ratio, which takes into account assets which improve performance or capacity, was marginally below benchmark, in total, over the past four years. The 2012 decrease was driven by lower IPP&E purchases and an increase in asset disposals following the sale of a Council owned property.

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

Council adjusted the way their backlog was reported in 2009 and has used current costs since 2009 to determine the backlog. The backlog figure is based on current asset condition and renewals carried out during the year. The backlog is revalued each year and therefore Council feel the backlog figure represents a fair value figure which has not needed to be significantly readjusted as a result of the revaluations taken place. Council has advised that they have completed up to date asset management plans for each asset class.

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	0	0	0	4,088
Replacement/refurbishment of existing assets	6,432	7,419	7,712	5,262
Total	6,432	7,419	7,712	9,350

From 2010 to 2012 all of Council's capital expenditure was on the renewal of existing assets some of which did have a portion of upgrade or expansion. While Council did spend on some new capital works, none were classed as major non-recurrent new capital works projects.

<u>Jubilee Oval Project</u>

In 2011 Council completed the Jubilee Oval community facility renewal and upgrade. The renovation project included a northern grandstand extension with an additional 1466 undercover seats, lift service, hospitality room, corporate suites upgrade, an additional four indoor and 23 outdoor corporate suites. There were also facility upgrades and a new western entry and turnstile upgrade, digital audio/visual upgrade for the entire stadium and four new NRL change rooms. A new community facility was also constructed within the southern grandstand that offers community groups and other organisations a modern space for hosting meetings and events. As the majority of the works undertaken at the Jubilee Oval were refurbishment and renewal Council do not consider this a new capital project.

<u>Proposed Capital Works</u>

Customer Service Centre and Library Upgrade	$1.5m
Kogarah CBD Streetscape works	$0.8m
Carss Park Community Facility	$0.7m
Hogben Park Basketball Court	$0.3m
Harris St Drainage works	$0.1m

3.7: Specific Risks to Council

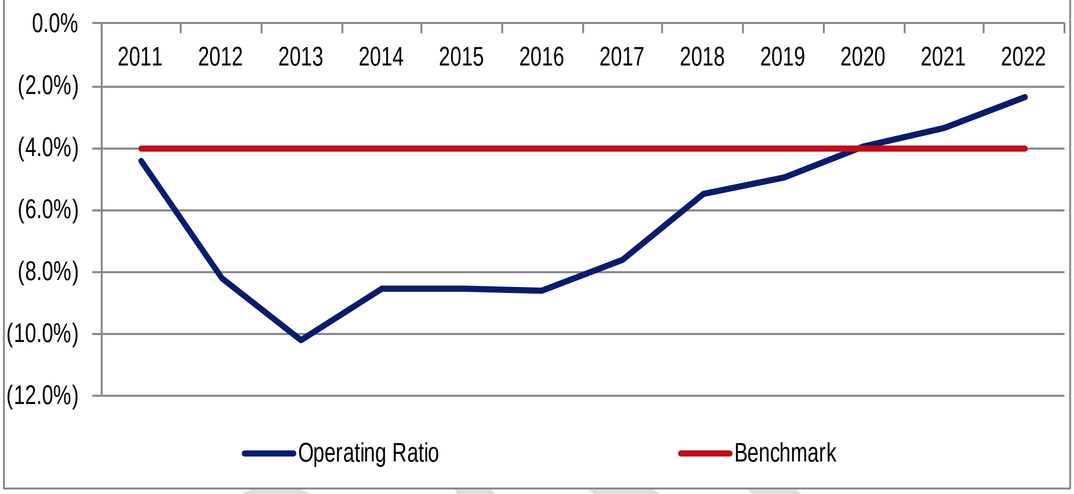
- Ageing Population. Council has an increasing older (65+) population which will place additional pressure on existing infrastructure and services. A range of housing choices to suit the different needs of people living in Kogarah City is a key concern to the community and in particular that future housing suits the needs of the ageing population. The ageing community have identified a strong desire to be able to stay in the suburbs where they have raised families and have social networks and connections. Future residential development must be designed to meet the changing needs of the LGA as they move through different life stages, so that opportunities exist within the City of Kogarah for young people to move away from home, but still be close to their families, while older people have the opportunity to downsize to a smaller, more appropriate dwelling in their existing suburb. Council recognise that it will be a challenge to appropriately manage the future population growth while retaining and protecting their 'low density' suburbs.
- Housing affordability is an important issue for the younger members of the LGA. It is becoming increasingly difficult to purchase a house or unit in order to stay in the area close to other family members. Providing a choice of housing options that are affordable and are responsive to the needs of our community is a priority.
- Council recognises that climate change is a significant issue. The LGA is a highly urbanised area and with an increasing population it is becoming more crucial to minimise the impacts on the local environment. With the development of Floodplain Risk Management Plans, Council's progressive Flood Management Program has now reached the implementation stage. The plans have identified a number of stormwater asset upgrade works that are needed to mitigate flooding problems.
- The drainage capacity assessment studies undertaken as part of the Flood Management Program have identified that one of the biggest challenges for Council lies in managing and upgrading its drainage assets. In light of the above and, based on the community feedback received during the floodplain risk management planning process, Council is proposing to dedicate stormwater management service charges received until 2013 to principally fund the Flood Management Program.

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 Council operates only one Fund as it does not operate water or sewerage infrastructure.

4.1: Operating Results

Figure 7- Operating Ratio for General Fund

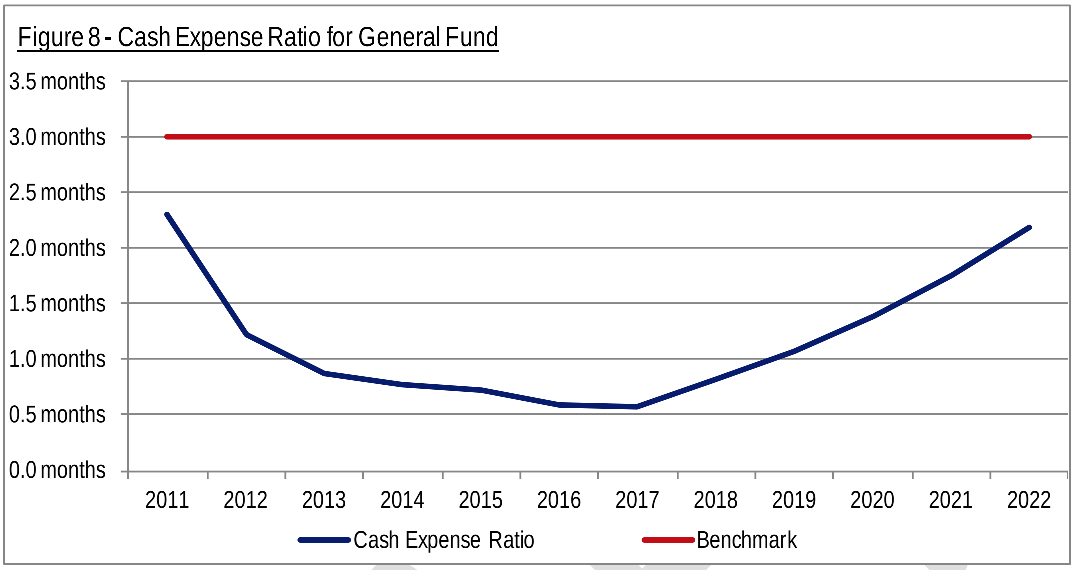


The Operating Ratio forecast shows deficit positions are expected in all 10 years when capital grants and contributions are excluded. Operating grants are forecast to decrease by $2.0m in 2013 due to the prepayment of 2013 grants in 2012 and also conservative budgeting from Council. The reduction in operating grants causes the ratio to decrease sharply in 2013. Materials and contracts expenses are forecast to decrease by 3.6% in 2017 due to a program of environmental works scheduled to be completed by 2017. This decrease in materials and contracts expenses causes the result to improve from 2017 on. While the ratio rises again over the lifetime of the forecast and increases above benchmark in 2020 it remains in a deficit position.

New South Wales Treasury Corporation

4.2: Financial Management Indicators

Liquidity Ratios



This ratio indicates that Council operates with little room for flexibility in regard to liquidity. The ratio is below benchmark for the entire forecast period however it trends upwards from 2017 due to the decrease forecast in materials and contracts expenses. Council has an environmental levy in place until 2013 with a program of environmental works attached which ends in 2017. On application Council outlined their proposed schedule of works to DLG. Council must report the works in their annual report each year to ensure it is being used for the approved purpose.

This ratio does not take into account Council's level of investments. When these are considered, Council will not face liquidity issues.

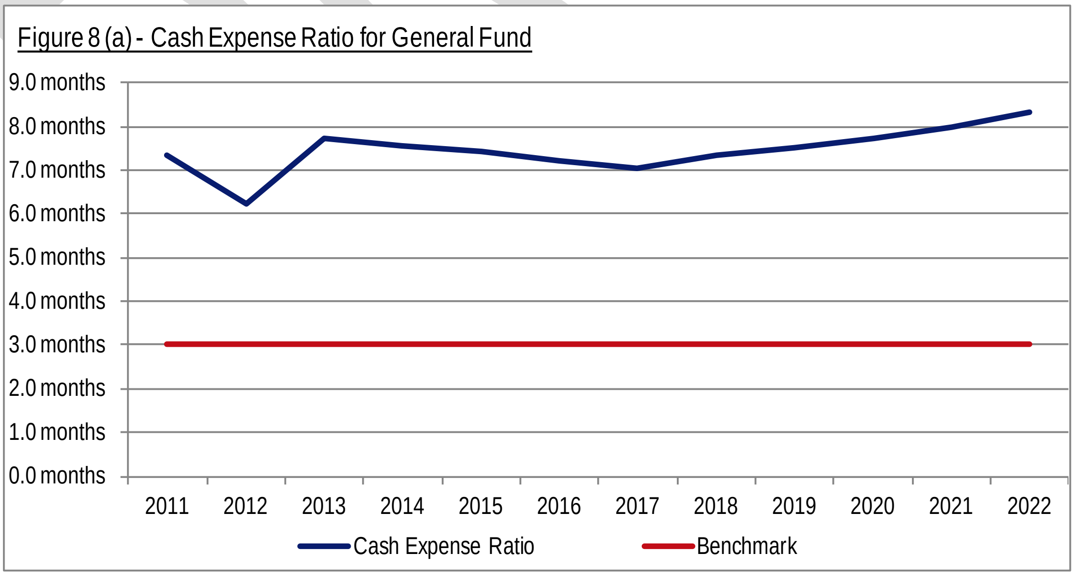
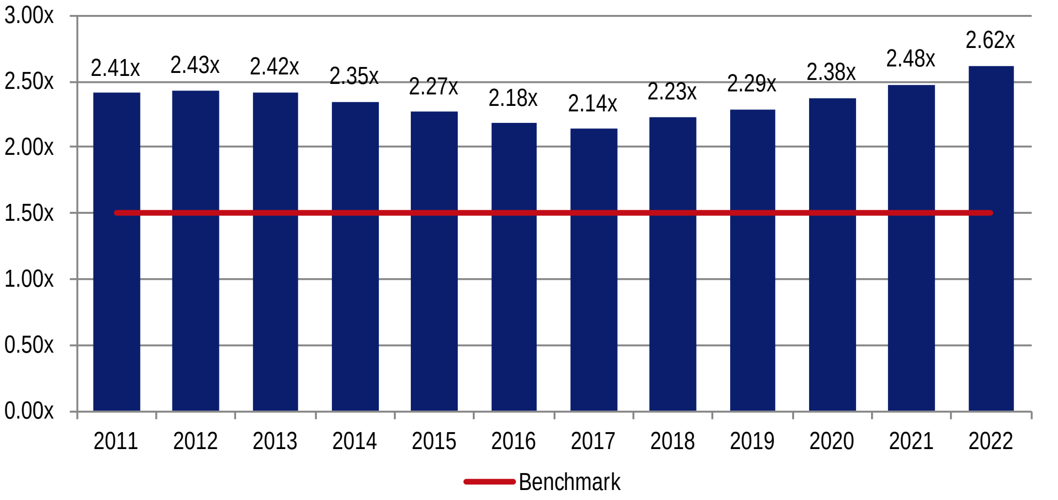


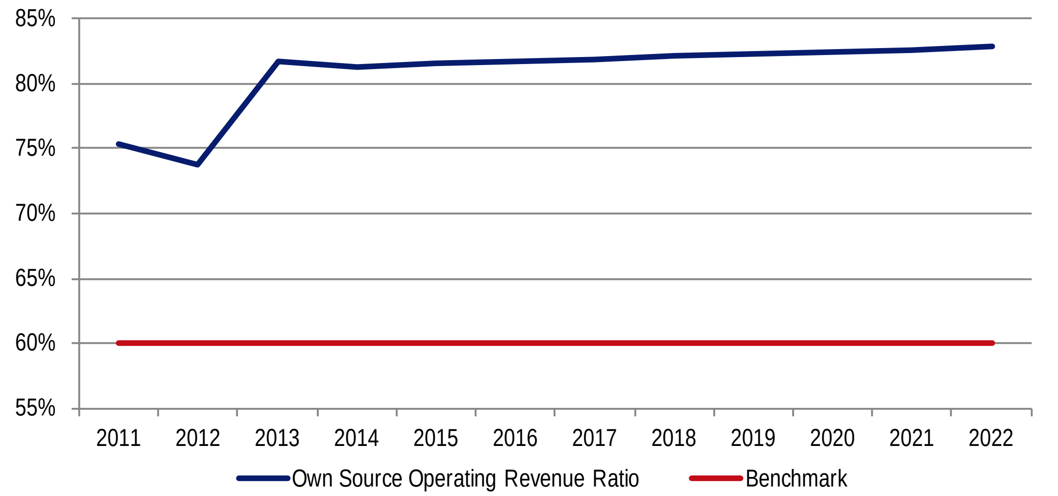
Figure 9 - Unrestricted Current Ratio for General Fund



The Unrestricted Current Ratio is above benchmark for the entire forecast period indicating Council has sound liquidity.

Fiscal Flexibility Ratios

Figure 10 - Own Source Operating Revenue Ratio for General Fund

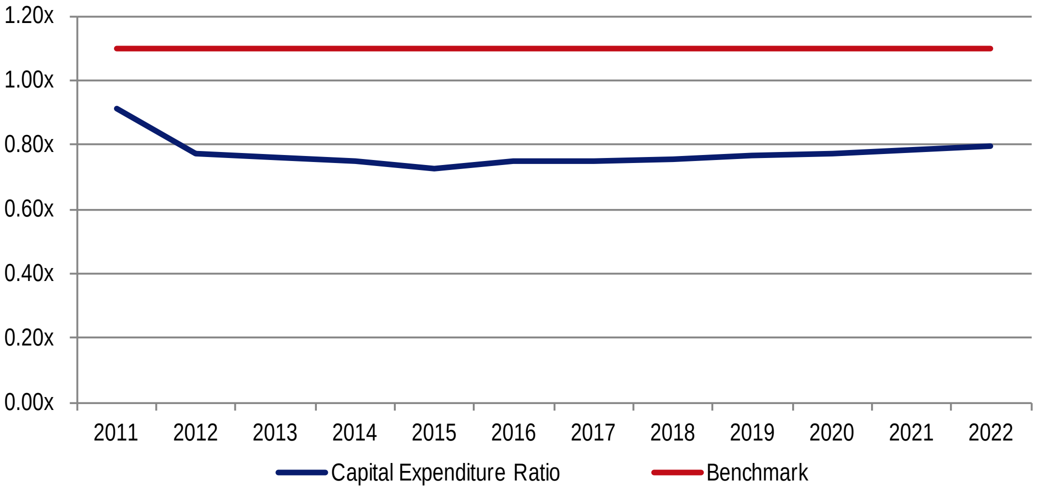


The Own Source Operating Revenue Ratio is above benchmark for the entire forecast period. This indicates the Council is not highly reliant on external revenue sources. The ratio rises in 2013 and remains at levels above 80% for the remainder of the forecast period due to capital grants and contributions being forecast lower than the historic levels.

Council's DSCR and Interest Cover are both well above the benchmark of 2.00x at over 1,000.00x for the entire forecast period as Council have not forecast any additional borrowing above the current borrowings of $0.2m.

4.3: Capital Expenditure

Figure 11 - Capital Expenditure Ratio for General Fund



The Capital Expenditure Ratio is below benchmark for the entire forecast period. The low levels of expenditure forecast will increase pressure on existing assets.

The total deficit for capital expenditure versus depreciation between 2012 and 2022 amounts to $22.1m.

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%
- All other revenue items: the estimated annual CPI increase of 2.5%
- Employee costs: 3.5% (estimated CPI+1%)
- All other expenses: the estimated annual CPI increase of 2.5%

<u>Key Observations and Risks</u>

- Rates and annual charges are forecast to increase by 7.9% in 2013 due to the SRV in place. From 2014 following the conclusion of the SRV's they increase by approximately 3.6% p.a. with the exception of 2017 and 2020 when they increase by 4.2% p.a. This is due to anticipated population growth over the period which they have factored into 2017 and 2020 only. Council has based this on historic performance in this area.
- User fees and charges are forecast to increase in line with CPI except in 2013. User fees and charges decrease by 12% in 2013 due to decreased restoration charges in 2013 following the completion of the Energy Australia works.
- Employee expenses are forecast to increase by 3.8% p.a. over the period with the exception of 2013 when they decrease by 3.8%. Council did not include a decrease in employee expenses in their budget for 2013, however employee costs came in higher than anticipated in 2012 due to the overtime for Energy Australia works which are now completed.
- Following an increase of 15.6% in 2012 materials and contract expenses increase by 12.2% in 2013 and 5.8% in 2014 decreasing as their grant funding and environmental works decrease. From 2015 onwards they increase between 2.4% and 3.7% p.a. with the exception on 2018 when they decrease by 3.6%. While this is higher than CPI in some years, it is in line with and lower than some of Council's historic results in this area and given that Council have no major projects forecast over the period these levels should be achievable.
- We consider the assumptions reasonable and where different to TCorp expectations, these assumptions were supported by data.

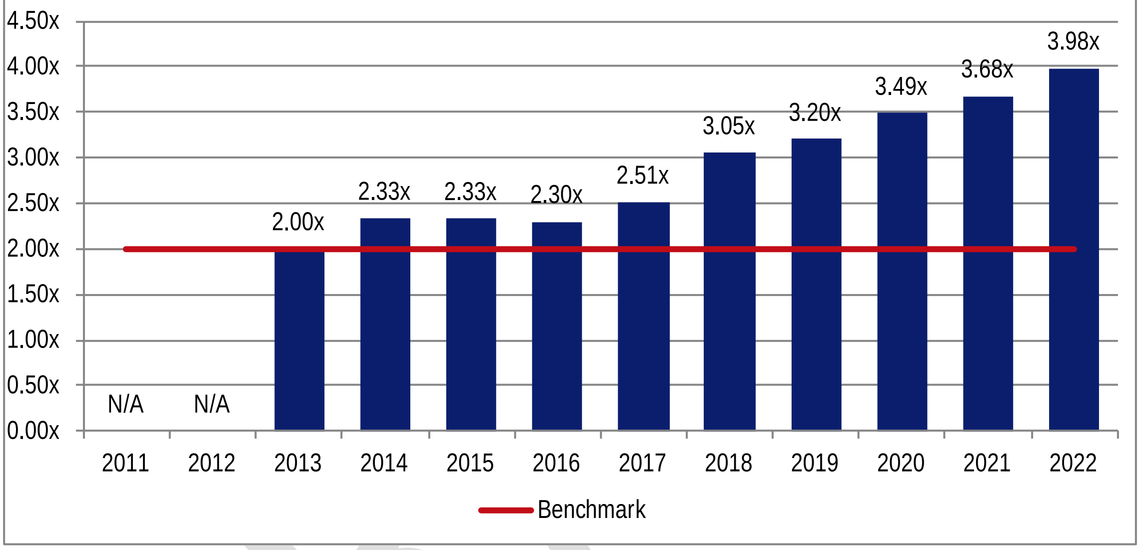
New South Wales Treasury Corporation

4.5: Borrowing Capacity

When analysing the financial capacity of the Council we believe Council will be able to incorporate additional loan funding in addition to its existing debt of $0.2m. Some comments and observations are:

- Based on a benchmark of DSCR>2x, $12.9m could be borrowed in addition to any existing borrowings
- This scenario has been calculated by basing borrowing capacity on a 10 year amortising loan at a rate of 7.50% p.a.

Figure 14 - DSCR for General Fund



4.6 Sustainability

General

Council, winner of Australia's Sustainable Cities award in 2011, has an Environmental Sustainability vision to achieve a "Clean, Green, and Sustainable City". Council's Environmental Sustainability Delivery Plan serves as a framework providing direction to Council on environmental sustainability.

Council has established a dedicated department which coordinates its environmental sustainability initiatives and is actively involved in the environmental management of Council's key resources and infrastructure such as catchment and waterways, roads and traffic and recreation and urban landscape.

Council has a number of community initiatives in place within the LGA such as Mayor's Green Grants program which provides small grants to groups who have an idea to improve the local environment, Carss Park Community Garden and Retail Your Rubbish. Retail Your Rubbish is an initiative set up by Council which aims to reduce the amount of waste sent to landfill by selecting areas to host a clean-up garage sale.

Council has also implemented a joint waste collection service with Hurstville and Rockdale to improve efficiency and reduce traffic congestion. Council has already seen a reduction in costs in 2011 due to this initiative.

Financial

In terms of Sustainability, TCorp believes Council to be moderately financially sustainable. While it has recorded operating deficits, the operating result is forecast to improve over time, although remain in deficit. As TCorp consider the assumptions made in the LTFP reasonable we feel the forecast is achievable.

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

- In the long term Council is not spending sufficient amounts on asset renewal and this may lead to a reduction in asset quality and ultimately adversely impact service levels
- Council is proactive in addressing their challenges and issues. Following the drainage capacity assessment studies as part of the Flood Management Program Council is proposing to dedicate stormwater management service charges received until 2013 to principally fund the Flood Management Program which should enhance this asset class and reduce the associated backlog
- Council has maintained a very conservative level of borrowing and forecast no additional borrowing for the next 10 years. Council's financial forecasts indicate that Council has the capacity to undertake a level of borrowing in the long term to fund its capital projects
- Council's long term Sustainability is also dependent on achieving forecast levels of employee expenses and materials and contracts expenses

New South Wales
Treasury Corporation

Section 5 Benchmarking and Comparisons with Other Councils

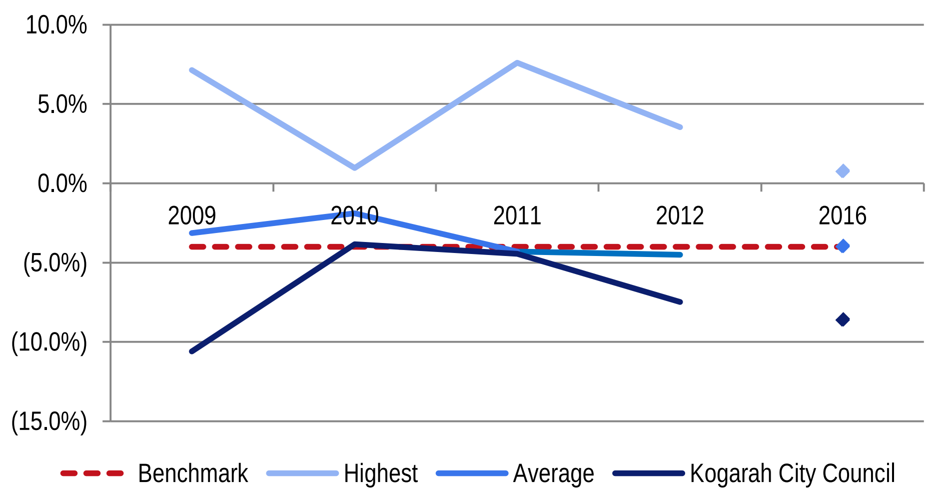
As discussed in section 2 of this report, each council's performance has been assessed against ten key benchmark ratios. The benchmarking assessment has been conducted on a consolidated basis (that is, for councils that operate more than one fund, the results of all funds are included). This section of the report compares the Council's performance with its peers in the same DLG Group. The Council is in DLG Group 2. There are 14 councils in this group and at the time of preparing this report, we have data for all of these councils.

In Figure 15 to Figure 21, the graphs compare the historical performance of Council with the benchmark for that ratio, with the average for the Group, with the highest performance (or lowest performance in the case of the Infrastructure Backlog Ratio where a low ratio is an indicator of strong performance), and with the forecast position of the Council as at 2016 (as per Council's LTFP). Figures 22 to 24 do not include the 2016 forecast position as those numbers are not available.

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

Financial Flexibility

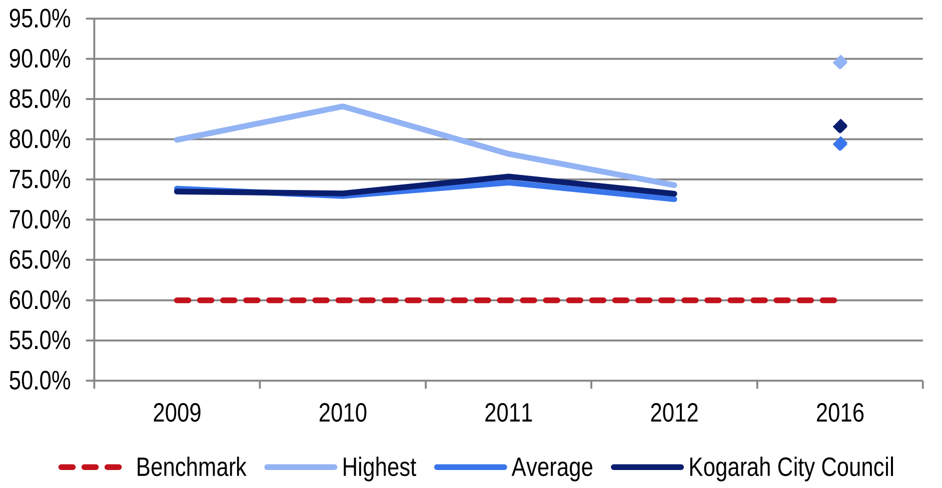
Figure 15 - Operating Ratio Comparison



Council's Operating Ratio was below the group average and benchmark over the review period. Council experienced a decline in operating results in 2012 due to employee and materials and contracts expenses. The ratio is forecast to remain below benchmark and the group average in the medium term. .

New South Wales Treasury Corporation

Figure 16 - Own Source Operating Revenue Ratio Comparison



Council's Own Source Operating Revenue Ratio was above benchmark and has tracked the group average. The ratio is forecast to marginally improve in the medium term and remains above the benchmark and group average.

Overall, Council's financial flexibility is sound.

Liquidity Ratio

Figure 17 - Cash Expense Ratio Comparison

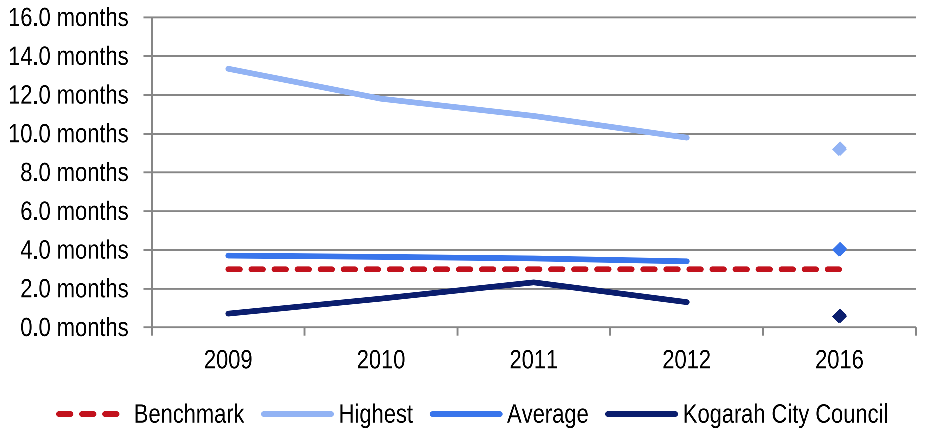
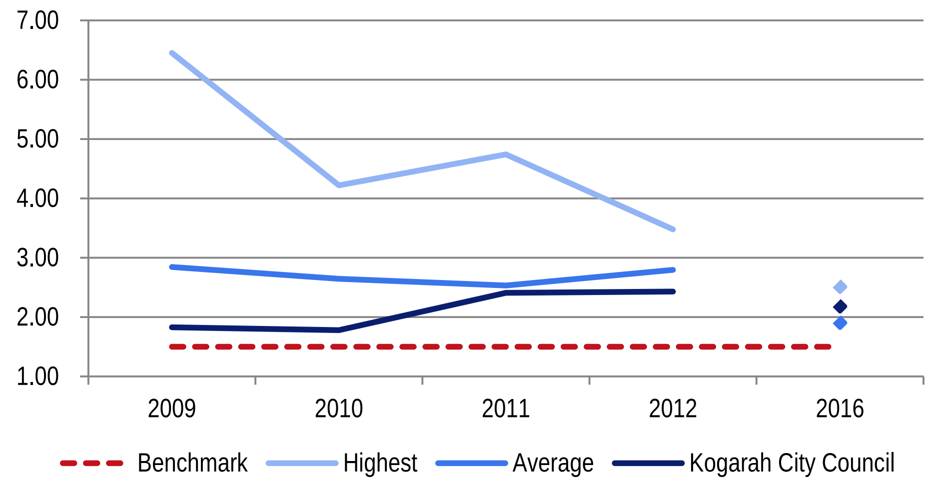


Figure 18 - Unrestricted Current Ratio Comparison



Council's Cash Expense Ratio was below benchmark and the group average over the review period. The ratio is forecast to remain at this level in the medium term.

The Unrestricted Current Ratio while above benchmark, was below the group average over the review period. The ratio is maintained at this level in contrast to the group average which is forecat to decline in the medium term. Overall, Council's liquidity position is reasonably sound.

New South Wales Treasury Corporation

Debt Servicing

Council's Interest Cover and DSCR were well above benchmark and the group's average over the review period reflecting Council's low levels of borrowing. As Kogarah has the highest DSCR and Interest Cover we have excluded the graphs.

Asset Renewal and Capital Works

Figure 21 - Capital Expenditure Ratio Comparison

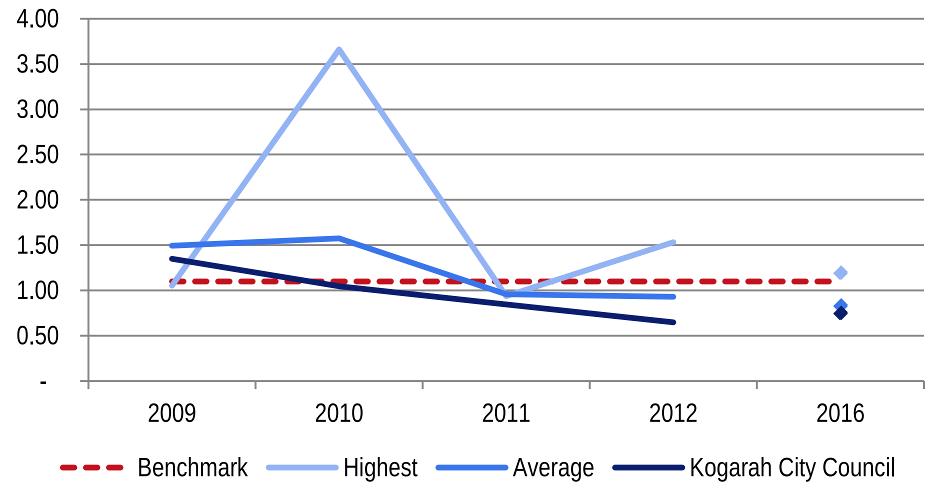


Figure 22 - Asset Maintenance Ratio Comparison

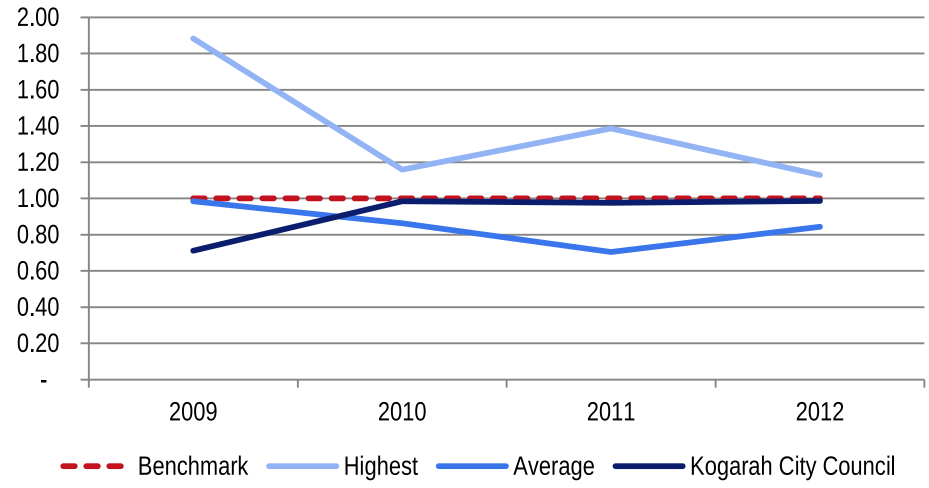


Figure 23- Infrastructure Backlog Ratio Comparison

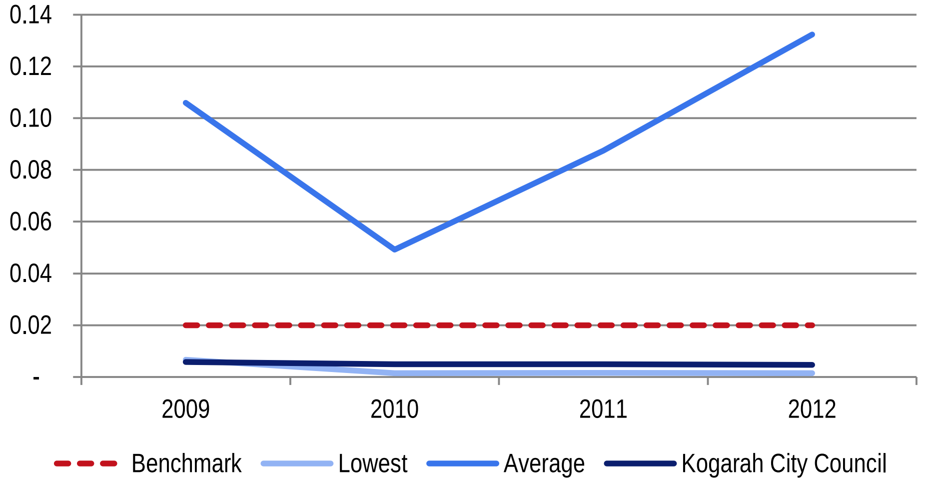
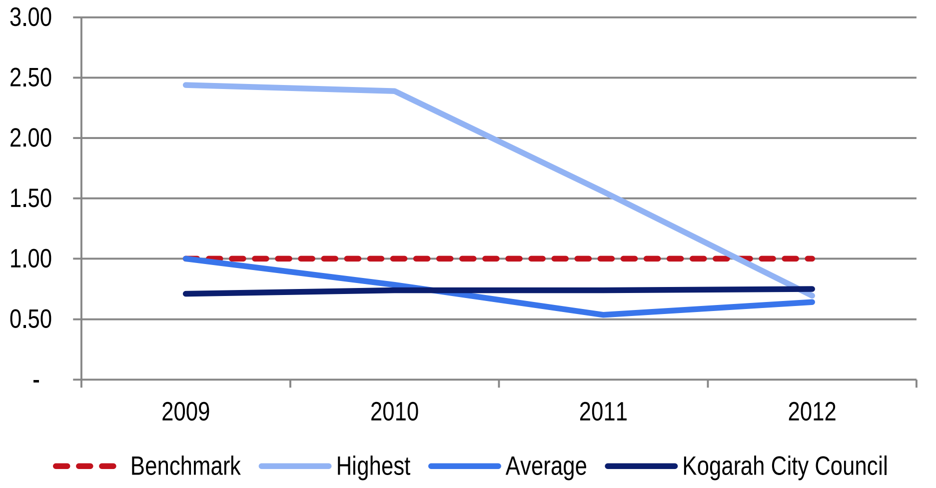


Figure 24 - Building and Infrastructure Asset Renewal Ratio



Council's Infrastructure Backlog is below benchmark and tracked the group average over the review period . Council's Asset Maintenance Ratio has tracked benchmark levels and has outperformed the group average since 2010 indicating Council is spending sufficiently on asset maintenance. The Building and Infrastructure Asset Renewal Ratio has been below benchmark and while it has out performed other councils since 2010 the ratio indicates that Council is underspending on asset renewals.

Council's Capital Expenditure has been below the group average and on a downward trend over the review period. The ratio fell below benchmark in 2010 and continued to decrease. The ratio is forecast to improve slightly in the medium term in line with the group average.

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.

We base our recommendation on the following key points:

- The majority of Council's performance indicators were above benchmark between 2009 and 2012
- Council is currently spending sufficiently to maintain their assets at an acceptable standard
- Council's Operating Ratio is forecast below benchmark until 2020 however does trend upward from 2012 onwards
- Council has financial capacity to undertake borrowings to fund future capital works if required

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

- Capital expenditure has been forecast below benchmark for the next 10 years. Council needs to address this issue and allocate funds for required capital projects
- The success of the LTFP is dependent on Council maintaining their expenses as forecast. Council needs to monitor these costs closely in order to achieve or improve on their forecasts

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	29,052	27,557	26,457	24,644	5.4%	4.2%	7.4%
User charges and fees	5,275	5,148	4,784	4,574	2.5%	7.6%	4.6%
Interest and investment revenue	1,990	1,574	1,838	230	26.4%	(14.4%)	699.1%
Grants and contributions for operating purposes	4,210	3,731	3,372	3,313	12.8%	10.6%	1.8%
Other revenues	2,916	2,981	2,914	2,734	(2.2%)	2.3%	6.6%
Total revenue	43,443	40,991	39,365	35,495	6.0%	4.1%	10.9%
Expenses							
Employees	19,363	17,946	17,259	16,310	7.9%	4.0%	5.8%
Borrowing costs	3	2	3	2	50.0%	(33.3%)	50.0%
Materials and contract expenses	9,761	8,440	9,300	8,975	15.7%	(9.2%)	3.6%
Depreciation and amortisation	8,345	8,147	6,655	6,510	2.4%	22.4%	2.2%
Other expenses	9,219	8,278	7,663	7,462	11.4%	8.0%	2.7%
Total expenses	46,691	42,813	40,880	39,259	9.1%	4.7%	4.1%
Operating result (excluding capital grants and contributions)	(3,248)	(1,822)	(1,515)	(3,764)	(78.3%)	(20.3%)	59.8%
Operating result (including capital grants and contributions)	190	578	1,756	482	(67.1%)	(67.1%)	264.3%

Table 2 - Items excluded from Income Statement

Excluded items				
Grants and contributions for capital purposes	3,438	2,400	3,271	4,246
Interest revenue/ (losses)	N/A	N/A	N/A	(616)
Fair Value Adjustment in Investments	(293)	694	(1,397)	(846)
Revaluation Decrements	N/A	152,728	N/A	N/A
Net gain/(losses) from the disposal of assets	(345)	(38)	340	2

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	4,170	6,703	4,260	1,966	(37.8%)	57.3%	116.7%
Investments	15,679	14,564	15,247	18,257	7.7%	(4.5%)	(16.5%)
Receivables	2,929	2,415	2,437	2,098	21.3%	(0.9%)	16.2%
Inventories	334	333	322	304	0.3%	3.4%	5.9%
Other	355	340	316	2	4.4%	7.6%	15700.0%
Total current assets	23,467	24,355	22,582	22,627	(3.6%)	7.9%	(0.2%)
Non-current assets							
Investments	12,026	8,522	7,823	6,000	41.1%	8.9%	30.4%
Infrastructure, property, plant & equipment	387,408	384,205	529,442	479,694	0.8%	(27.4%)	10.4%
Total non-current assets	399,434	392,727	537,265	485,694	1.7%	(26.9%)	10.6%
Total assets	422,901	417,082	559,847	508,321	1.4%	(25.5%)	10.1%
Current liabilities							
Payables	4,836	5,243	5,417	4,678	(7.8%)	(3.2%)	15.8%
Borrowings	259	56	25	36	362.5%	124.0%	(30.6%)
Provisions	5,900	5,571	5,448	4,821	5.9%	2.3%	13.0%
Total current liabilities	10,995	10,870	10,890	9,535	1.1%	(0.2%)	14.2%
Non-current liabilities							
Borrowings	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Provisions	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Total non-current liabilities	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Total liabilities	10,995	10,870	10,890	9,535	1.1%	(0.2%)	14.2%
Net assets	411,906	406,212	548,957	498,786	1.4%	(26.0%)	10.1%

Table 4-Cashflow

Cash Flow Statement ($'000s)	Year ended 30 June			
	2012	2011	2010	2009
Cash flows from operating activities	7,927	8,661	9,106	5,705
Cash flows from investing activities	(10,663)	(6,249)	(6,801)	(5,656)
Proceeds from borrowings and advances	N/A	N/A	N/A	N/A
Repayment of borrowings and advances	N/A	N/A	N/A	N/A
Cash flows from financing activities	0	0	0	0
Net increase/(decrease) in cash and equivalents	(2,736)	2,412	2,305	49
Cash and equivalents	4,170	6,703	4,260	1,966

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.

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

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

Depreciation of Infrastructure Assets

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

EBITDA

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

Grants and Contributions for Capital Purposes

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

Grants and Contributions for Operating Purposes

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

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

Independent Commission Against Corruption (ICAC)

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

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

Independent Pricing and Regulatory Tribunal (IPART)

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

Infrastructure Backlog

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

Integrated Planning and Reporting (IP&R) Framework

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

Local Government Cost Index (LGCI)

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

Net Assets

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

Roads and Maritime Services (RMS)

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

Section 64 Contribution

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

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

Section 94 Contribution

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

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

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

Special Rate Variation (SRV)

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

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

The applications are reviewed and approved by IPART.

Sustainability

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

Ratio Explanations

Asset Maintenance Ratio

Benchmark = Greater than 1.0x

Ratio = actual asset maintenance / required asset maintenance

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

New South Wales Treasury Corporation

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.