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# Blue Mountains City Council

## Financial Assessment and Benchmarking Report



**17 September 2012**

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

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## Disclaimer

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

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

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

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

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# Section 1 Executive Summary

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

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

Council has made two applications, firstly for the Blaxland Waste Management Facility Resource Recovery Centre, and secondly the Springwood Community and Cultural Facilities Upgrade, with loan facilities of $4.9m and $6.0m respectively.

TCorp's approach has been to:

- Review the most recent three years of Council's consolidated financial results
- Conduct a detailed review of the Council's 10 year financial forecasts. The review of the financial forecasts focused on the particular Council fund that was undertaking the proposed debt commitment. As the Council operates only one fund we focused our review on this General Fund

Historical financial results indicate that the Council has been well managed in most areas over the review period based on the following observations:

- Revenue in 2011 has increased by 10% over 2009 levels mainly due to the SRV and the approved Environmental Levy
- Expenses have been well managed although depreciation expense has increased as a result of the Asset Revaluation process
- Liquidity and financial flexibility is sound with Council's Unrestricted Current Ratio, Cash Expense Ratio and Own Source Operating Revenue Ratio all above benchmark in the review period
- Council has maintained its DSCR and Interest Cover Ratio above benchmark in the review period

The Council reported $34.9m of infrastructure backlog in 2011 which represents 5.8% of its infrastructure asset value of $605.0m. Other observations include:

- Infrastructure backlog has decreased primarily due to more detailed asset condition assessments and valuations
- The largest category of backlog is in buildings which represent 60.8% of the backlog in 2011. One of Council's LIRS applications is building related
- Council has been spending less on maintenance than required. The shortfall in annual maintenance was $3.9m in 2011
- Council's Capital Expenditure Ratio is above benchmark, on average over the three years to 2011. This indicates that the Council has invested sufficiently in capital expenditure over the review period but is underspending on maintenance of existing assets. Council's capital expenditure has focussed on renewal and upgrade of existing assets

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

- In the current LTFP, the forecast capital expenditure is significantly below the levels required to maintain an acceptable asset base because of insufficient funds. Net assets are forecast to decline over the forecast period indicating a deterioration in the Council's asset base
- Operating Ratio is far below benchmark in all forecast years and is not expected to improve substantially if current trends continue. Council management is working on strategies to improve the operating position in the long term. Liquidity ratios are at benchmark in most of the forecast years but are particularly weak in the short term to 2015
- Council's DSCR and Interest Cover Ratio are below benchmark in all forecast years due to a higher amount of borrowings forecast in 2012 and 2013. Increased borrowings are forecast in 2012 and 2013 to complete major works
- Discussions with Council management reveal that a Strategic LTFP Case has been developed which seeks to provide options to improve Council's forecast financial position

In our view, the Council would only have the capacity to undertake the additional borrowings of $10.9m for the LIRS projects if the following actions are undertaken:

- Council to consider this report and support a program of community consultation and seek to identify the opportunities for expenses reduction and/or additional revenue raising sources. The aim of this program should be to achieve improvements in the forecast Operating Ratio and EBITDA
- Council to consider seeking extensions of the SRV and Environmental Levy which are critical to the Council's debt repayment abilities
- Council to reassess its LTFP forecasts to ensure that future asset renewal and replacement funding requirements are correctly included and supported by Council's AMP

[To insert summary comments about the benchmarking.]

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# Section 2 Introduction

## 2.1: Purpose of Report

This report provides the Council with an independent assessment of their financial capacity, Sustainability and performance measured against a peer group of councils 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 LIRS Assessment Panel for its use in considering applications received under the LIRS.

The key areas focused on are:

- The financial capacity of the Council to undertake additional borrowings
- The 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 particular Council fund that was undertaking the proposed debt commitment. For example where a project is being funded from the General fund we focussed our review on the General fund
- Identify significant changes to future financial forecasts from existing financial performance and highlight risks associated with such forecasts, 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 2010/11)
- Council's financial forecast model
- Council's IP&R documents
- Discussions with Council officers

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- Council's submissions to the DLG as part of their LIRS application
- Other publicly available information such as information published on the IPART website

Benchmark Ratios

In conducting our review of the Councils' financial performance, 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 |
| Infrastructure Backlog Ratio | < 0.02x |
| Asset Maintenance Ratio | > 1.00x |
| Building and Infrastructure Asset Renewal Ratio | > 1.00x |
| Capital Expenditure Ratio | > 1.10x |

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## 2.3: Overview of the Local Government Area

| Blue Mountains City Council LGA | |
|---|---|
| Locality & Size | |
| Locality | Sydney Surrounds |
| Area | 1,432km$^2$ |
| DLG Group | 7 |
| Demographics | |
| Population | 75,942 |
| % under 18 | 25% |
| % between 18 and 59 | 52% |
| % over 60 | 23% |
| Expected population 2025 | 78,000 |
| Operations | |
| Number of employees (FTE) | 490 |
| Annual revenue | $95.7m |
| Infrastructure | |
| Roads | 637km |
| Bridges | 34 |
| Infrastructure backlog value | $34.9m |
| Total infrastructure value | $605.0m |

The Council Local Government Area (LGA) is located in the greater Sydney area. It attracts over 3m visitors a year making it one of the top three most visited tourist destinations in Australia. Tourism accounts for about 40% of total employment in the LGA.

After a small decline in population in 2006, the population growth has been at a very low rate. The LGA's demographic is older than the state average. The LGA's median age is 42 compared to the state average of 38. 15.7% of the population is over 65 compared to a state average of 14.7%.

The LGA covers 143,000 hectares, 70% of which are incorporated in the World Heritage Blue Mountains National Park.

The Council was granted a SRV of 7% increase (inclusive of the 2.8% rate pegging) in 2011. The Council can then apply the rate pegging percentage increase to the SRV inflated amount for the next two years. The SRV is used for asset renewal and maintenance works.

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## 2.4: LIRS Application

Council has made two LIRS applications.

Project 1: Blaxland Waste Management Facility Resource Recovery Centre

Description: The project will provide a new Resource Recovery Centre which will include a small vehicle drop off and sorting area, recycling shed and re-use shed. The project aims to minimise what needs to be buried in landfill. The recycling shed will provide facilities for the community to drop off recyclable materials for free. The re-use shed will provide facilities for the community to drop off a range of items that could be used again and for others in the community to take away for free.

Amount of loan facility: $4.9m

Term of loan facility: 10 years

Project 2: Springwood Community and Cultural Facilities Upgrade

Description: The $15.5m project includes upgraded accommodation for the Library headquarters and Springwood library branch, Council district offices and customer service centre, community services offices and activity rooms including a 500 seat community theatre/ hall, Civic open space and children's playground.

Amount of loan facility: $6.0m

Term of loan facility: 10 years

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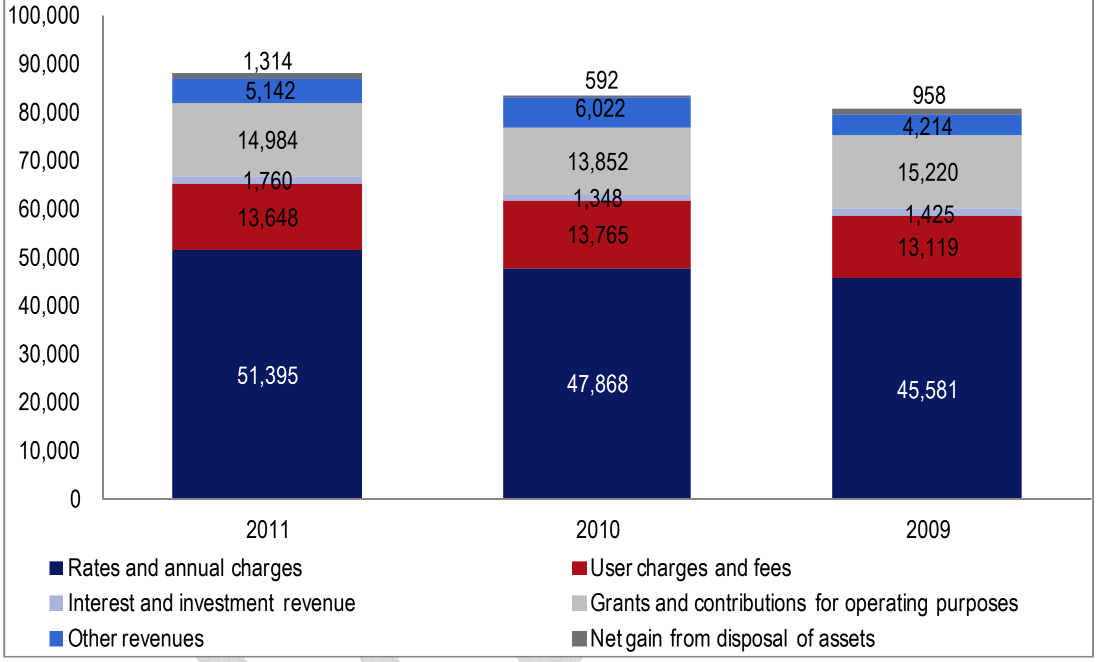
# Section 3 Review of Financial Performance and Position

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

## 3.1: Revenue

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




Key Observations

- Over half of the Council's income is derived from rates and annual charges and this has been increasing steadily assisted by the SRV introduced in 2010. The Council also has an existing 10 year Environmental Levy which will expire in 2015.
- The Council is not heavily reliant on user charges and fees with only 15% of its income from this source. This category of income has been consistently generating around $13m of revenue each year. It charges around $3m p.a. for Domestic Waste Management Services, $2m p.a. for its regulatory and statutory services, and around $4m p.a. for its Swimming Centres.
- The Council earned a small surplus on its Caravan Parks of $239,000 in 2011 but made deficits on its swimming pools and tourism activities.
- Overall, Council's revenue has been gradually increasing year to year at 4.1% in 2011 and 5.7% in 2010, mainly due to the consistent increase in rates revenue.

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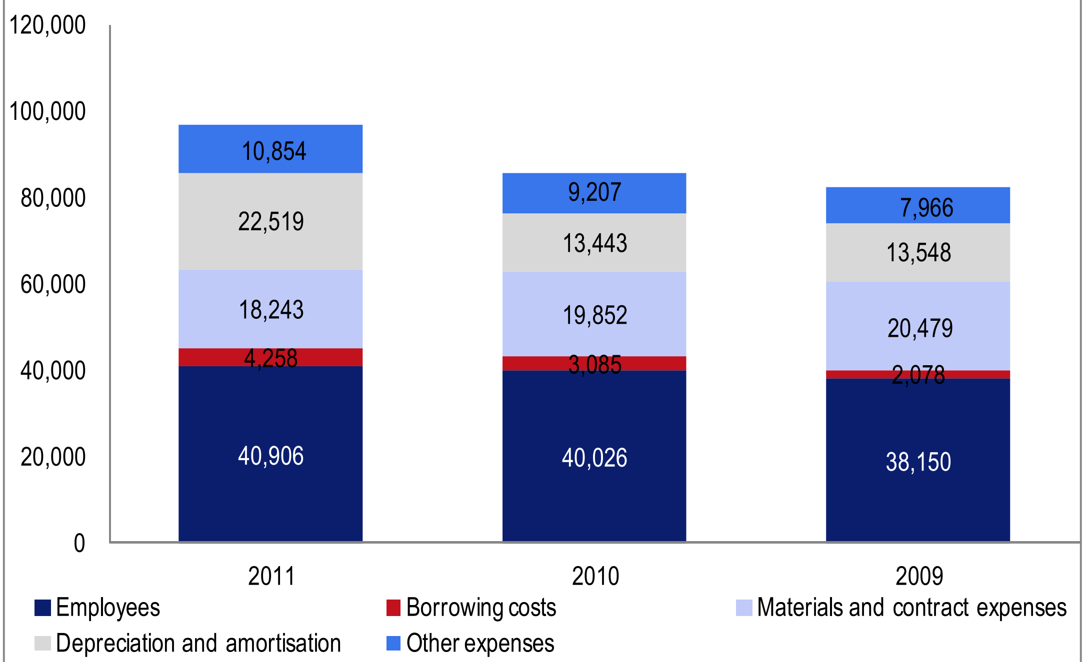
## 3.2: Expenses

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




Key Observations

- Employee expenses have increased by 4.9% in 2010 and 2.2% in 2011. Superannuation expenses increased by 23.5% from 2009 to 2010 due to increased defined benefits employer contributions. The number of full time equivalent employees fluctuated over the period. It increased from 478 in 2010 to 490 in 2011 which led to some of the wages and salary cost increases in 2011. This is partly offset by a decrease in other employee on-costs. A key factor in the decrease in employee on-costs is a new workers compensation model which has delivered significant savings to Council.
- Materials and contracts expenses have decreased over the last three years which could be a sign of the Council's efforts to increase efficiencies and tighten expenditure.
- Depreciation expense has increased by $9.1m from 2010 to 2011. This is mainly due to higher depreciation on roads, bridges, footpaths and stormwater drainage assets which underwent the Asset Revaluation process.
- Other expenses have increased by 15.6% in 2010 and 17.9% in 2011 mainly due to the introduction of the Waste Levy in 2010. The Levy expense was $1.7m in 2011. This was partly offset by increases in the Council's revenue from domestic waste management services annual charges which increased by $1.5m over the same period
- Overall, Council appears to manage its expenses well with no stand out increases noted when the non-cash item of depreciation is excluded.

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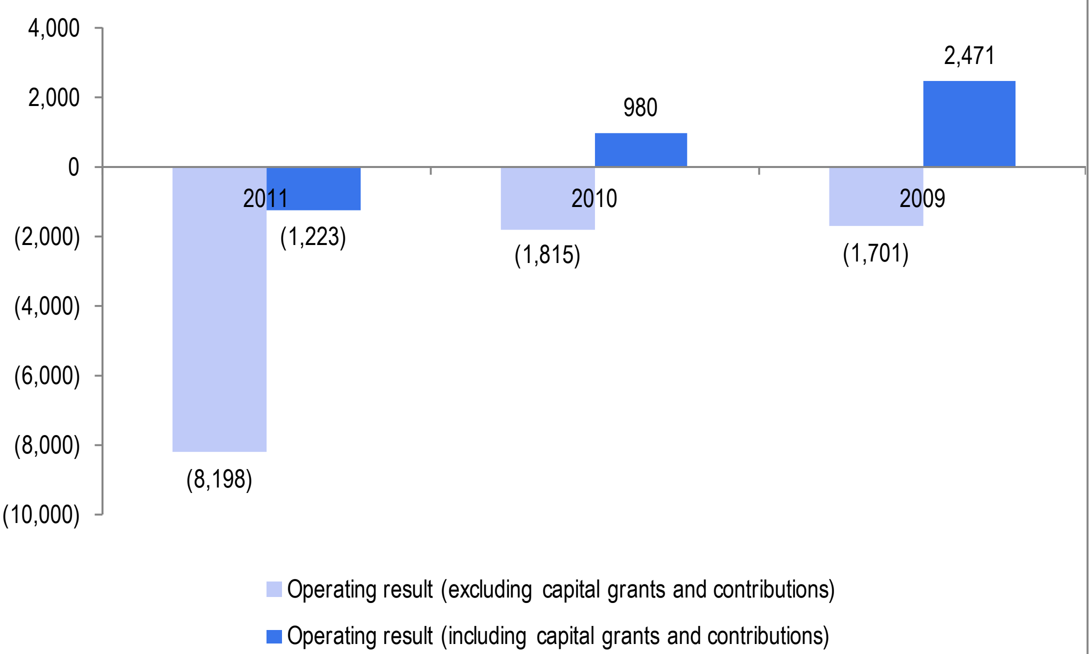
## 3.3: Operating Results

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

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

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

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




Key Observations

- Council has focused on balancing its working capital budget which is achieved each year but has not achieved balanced operating results when taking into account non cash items.
- 2011 was particularly impacted by the higher depreciation expense. 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.

Revenue increased by 10.0% over the two year period but expenses increased by 17.7% over the same period. This trend of a growing deficit needs to be addressed by Council and cannot be sustained into the future.

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## 3.4: Financial Management Indicators

| Performance Indicators | Year ended 30 June | | |
|---|---|---|---|
| | **2011** | **2010** | **2009** |
| EBITDA ($'000s) | 18,579 | 14,713 | 13,925 |
| Operating Ratio | (9.3%) | (2.2%) | (2.1%) |
| Interest Cover Ratio | 4.36x | 4.77x | 6.70x |
| Debt Service Cover Ratio | 2.49x | 2.34x | 2.73x |
| Unrestricted Current Ratio | 2.01x | 1.75x | 1.57x |
| Own sourced operating revenue ratio | 68.1% | 71.2% | 69.3% |
| Cash expense ratio | 4.5 months | 3.1 months | 3.3 months |
| Net assets ($'000s) | 818,778 | 781,589 | 419,857 |

Key Observations

- EBITDA has been increasing consistently for the last two years reflecting its higher rates revenue with the SRV and controlled operating expenses excluding the non-cash depreciation expense.
- The Operating Ratio is deteriorating and falls below benchmark in 2011 largely as a result of increased depreciation expense.
- Both the Interest Cover Ratio and DSCR are above benchmark for all three years. These ratios indicate that the Council had sufficient funds to meet its debt requirements.
- The Council's liquidity ratios including the Unrestricted Current Ratio and Cash Expense Ratio are above benchmark in all three years. They have also improved throughout the period supporting the Council's ability to withstand short term shocks and servicing of its immediate commitments.
- The Council's Net Assets have increased by $398.9m in the last two years mainly due to the consecutive Asset Revaluations in 2010 and 2011. This process increased the value of roads, bridges and footpaths, community land, and other structures.
- When the Asset Revaluations are excluded, the underlying trend has been an expanding infrastructure, property, plant & equipment asset base with asset purchases being larger than the combined value of disposed assets and annual depreciation. Over the two years this amounted to a $6.1m increase in IPP&E assets. Most of these increases are related to planned major capital works.
- The Council has total borrowings of $46.7m with total debt at 5.7% of Net Assets.

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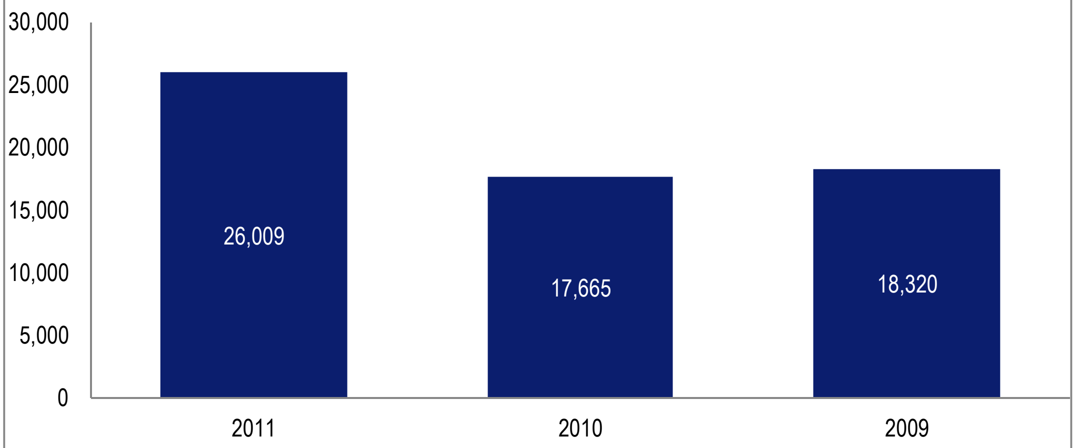
## 3.5: Statement of Cashflows

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




Key Observations

- Council's cash balance has increased over the review year period mainly due to increases in cash from operating activities. Particularly in 2011, cash payment for material and contracts cost is lower due to project work timing differences. The Council also received $4.9m more cash in grants and contributions in 2011 compared to 2010. This is mainly attributed to a $3.0m capital grant for the Lawson Clean Technology Park.
- Council had $5.3m of investments at 30 June 2011. This includes $2.9m in NCDs and FRNs, $1.9m in CDOs and $0.5m in other long term financial assets. Some of these investments are no longer prescribed by the ministerial investment order and will be disposed of when financially advantageous to the Council.
- The Council has created an investment default contingency reserve which at 30 June 2011 had a balance of $1.6m invested in cash deposits (classified as cash and cash equivalents) and is within the Council's internal restricted funds.
- Of the Council's $31.4m of cash and investments, $10.4m is externally restricted, $18.6m is internally restricted and the remaining $2.3m is unrestricted.
- The Council's level of internally restricted and unrestricted assets, along with its liquidity ratios indicates that Council has sufficient liquidity to manage their short term liabilities.

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### 3.6: Capital Expenditure

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

#### 3.6(a): Infrastructure Backlog

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

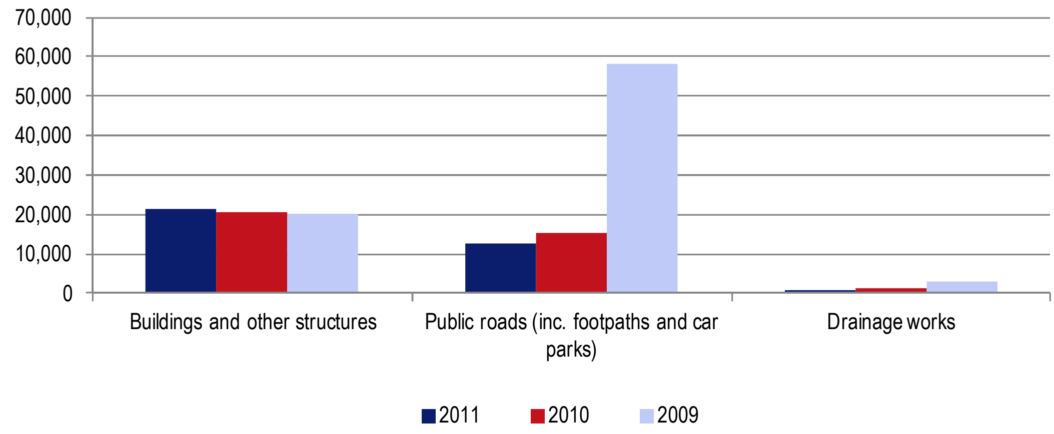
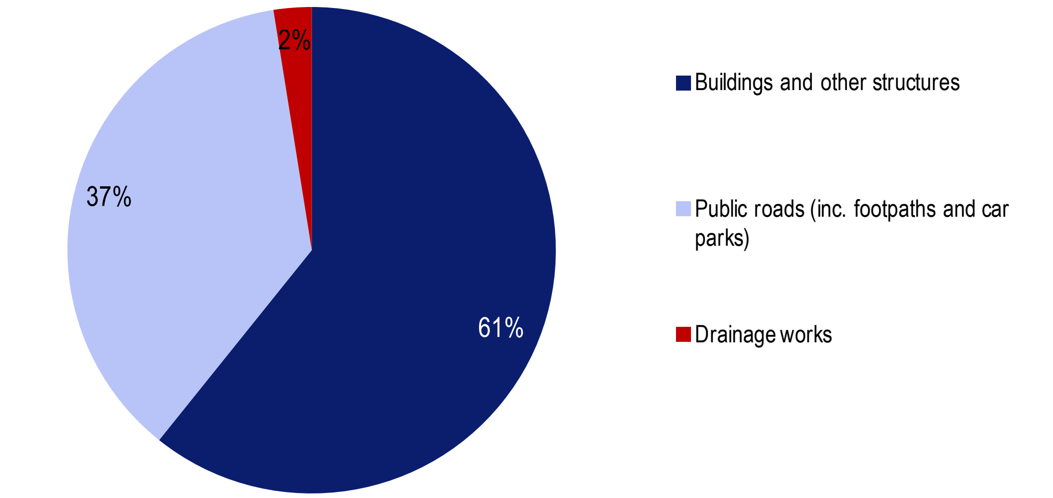



Figure 6 - Infrastructure Backlog Composition for 2010/11




Council's largest category of backlog is buildings which represents 60.8% of the backlog in 2011. This backlog has been gradually increasing year on year as actual maintenance has been lower than what is required.

The public roads backlog is the second largest category and this has significantly reduced since 2009. The Council has a road network repair and resurfacing program to continue to reduce the backlog.

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However, there is still a maintenance shortfall of $3m to $5m each year for road assets. Road assets, and in particular kerbs and gutters, were subject to a more systematic assessment process and more inspections which provided more accurate backlog figures from 2010 onwards. The Council is continually refining this process.

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### 3.6(b): Infrastructure Status

| Infrastructure Status | Year ended 30 June | | |
|---|---|---|---|
| | 2011 | 2010 | 2009 |
| Bring to satisfactory standard ($'000s) | 34,893 | 37,309 | 81,342 |
| Required annual maintenance ($'000s) | 14,554 | 14,759 | 13,579 |
| Actual annual maintenance ($'000s) | 8,326 | 7,299 | 8,093 |
| Total value of infrastructure assets ($'000s) | 605,037 | 594,120 | 228,088 |
| Total assets ($'000s) | 886,315 | 848,722 | 479,494 |
| Building and Infrastructure Backlog Ratio | 0.06x | 0.06x | 0.36x |
| Asset Maintenance Ratio | 0.57x | 0.49x | 0.60x |
| Building and Infrastructure Renewals Ratio | 0.22x | 0.36x | 0.35x |
| Capital Expenditure Ratio | 0.70x | 1.66x | 1.29x |

The reduction in the Building and Infrastructure Backlog Ratio is partly related to the reduction in the backlog value following more detailed asset condition assessments and valuations but also the carrying value of infrastructure assets have increased due to Asset Revaluations. The Asset Maintenance Ratio and Building and Infrastructure Renewal Ratios are below benchmarks in all three years. Underspending in these areas could lead to an increasing backlog. The value of the backlog is volatile whilst Council continues to improve its asset condition assessment process and redraft its Asset Management Plan.

Although the Capital Expenditure Ratio was below benchmark in 2011, it was above benchmark in two of the three years which indicates the Council has spent a sufficient amount on capital expenditure and a substantial amount of the expenditure is on new assets. The 2011 Capital Expenditure Ratio is also lower because it reflects the increased depreciation expense following Asset Revaluation.

Council's expenditure on new assets particularly relate to major projects, such as the Cultural Centre, Katoomba Library & Civic Centre; Katoomba Waste Management Facility; and Lawson Town Centre redevelopment.

### 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 and the figures may include expenses which are not capitalised. These figures differ from the numbers used to calculate the Capital Expenditure Ratio in the Section 3.6 (b) table which are obtained from Note 9a of the financial statements.

| Capital Program ($'000s) | Year ended 30 June | | |
|---|---|---|---|
| | 2011 | 2010 | 2009 |
| New capital works | 12,092 | 6,256 | 7,758 |
| Replacement/refurbishment of existing assets | 23,553 | 25,297 | 36,367 |

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| | | | |
|---|---|---|---|
| **Total** | **35,645** | **31,553** | **44,125** |

The Council has spent a greater portion of its major capital program on replacement/refurbishment of existing assets. Some of the capital works undertaken by Council in the last three years have been:

- Blue Mountains Business Park incorporating $3.5m of federal government funding
- Lawson Town Centre Development
- Blue Mountain Cultural Centre Precinct including the Blue Mountain Cultural Centre, the new Katoomba library, Katoomba Civic Centre and laneway connections
- Design work on Springwood Town Centre project. The project is funded by a $9.5m federal grant
- $7m Katoomba Waste Management Facility upgrade which included a new waste transfer station and upgraded resource recovery facilities

### 3.7: Specific Risks to Council

- Natural disasters. The LGA has had four Natural Disaster Declarations since 2009 due to two storm events and two bushfires. The Council is proactive in preventing the occurrence of bushfires including hazard inspection programs and approval of reduction burning. Meeting unexpected costs associated with the events are substantially reliant on being able to receive both State and Federal funding under various "natural disaster" funds.
- Low population growth. The LGA has historically low population growth levels and there is limited potential for land development. Some areas in the LGA are forecast to experience population decline. The Council is limited in its opportunities to grow its rate base and the location of infrastructure and services will need to be shifted to cater for the changing demands. This issue should be managed through the Council's Asset Management Planning and through the community consultation process to review changes in service and infrastructure levels.
- Ageing population and increase in service demand. The LGA's population age is higher than the state's average and the population is ageing as the area continues to attract retirees. This trend in demographics places heavier demand for certain infrastructure and services which cater for retirees. This issue should be managed through the Council's Asset Management Planning and through the community consultation process to review changes in service and infrastructure levels.
- CDO holdings. Council as at 30 June 2011 held CDOs valued at $1.9m. The recovery of the investments is dependent on legal proceedings. A substantial amount of the holdings have been written off and the Council has created an investment default contingency reserve to mitigate the risk.
- Property investment. The Council has a portfolio of property investment worth $17.6m at 30 June 2011 which generated $0.5m of net rental return in 2011. Council has in place a Corporate Property Policy to manage the risks associated with the investment activities.

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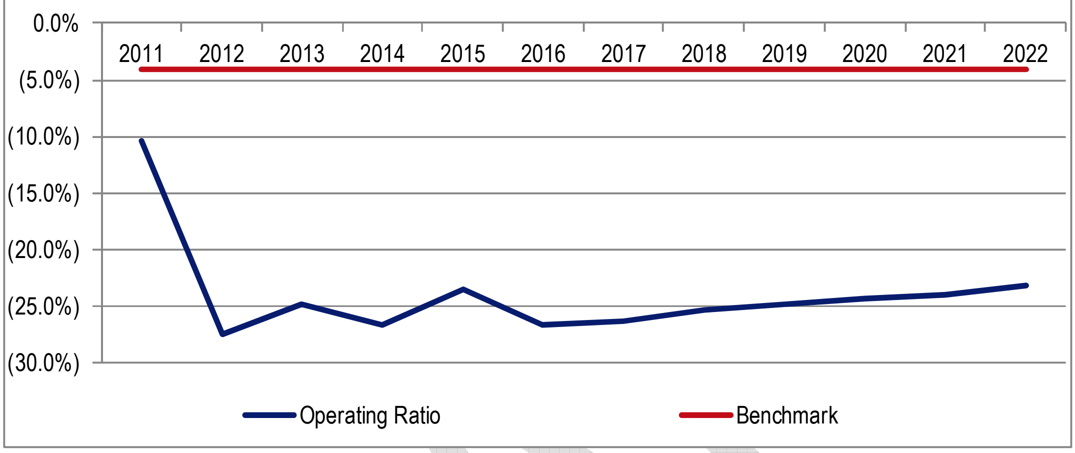
## Section 4 Review of Financial Forecasts

The financial forecast model shows the projected financial statements and assumptions for the next 10 years. The model includes the $4.9m and $6.0m loans with LIRS subsidy.

The Council only operates one General Fund.

### 4.1: Operating Results

Figure 7- Operating Ratio for General Fund




The Operating Ratio forecast is well below benchmark in all forecast years. This is expected to improve only marginally over the forecast period with the best Operating Ratio in the forecast in 2022 at negative 23.1%. The drop from 2011 to 2012 is mainly due to higher forecast depreciation expense (38.7%, $8.7m increase from 2011) after Asset Revaluations, and changes in depreciation assumptions and valuation techniques. Employee expenses are forecast to increase (5.1%, $2.1m increase from 2011) due to higher superannuation costs from anticipated changes in superannuation legislation.

The slight improvement in 2013 is due to higher forecast operating grants and contributions compared to a decline in 2012. The spike in 2015 is related to the $2.7m expected profit from the planned disposal of non-strategic assets.

The Operating Ratio dips in 2014 and 2016 are linked to the expiration of the SRV and the Environmental Levy respectively.

Council is aware that the continuous level of deficits is not a sustainable position and has initiated a community engagement process to determine an acceptable and affordable level of services.

Council is also considering applications to extend its existing SRV and to extend the existing environmental levy. This will improve the Council's operating position and assist the funding of asset renewal but it is unlikely to shift the operating results to a surplus position.

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## 4.2: Financial Management Indicators

Liquidity Ratios

Figure 8 - Cash Expense Ratio for General Fund

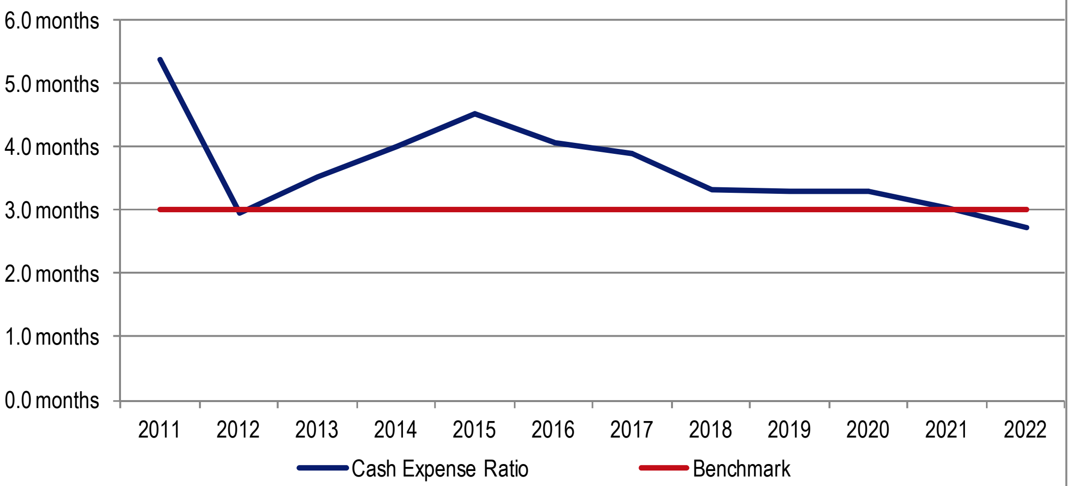
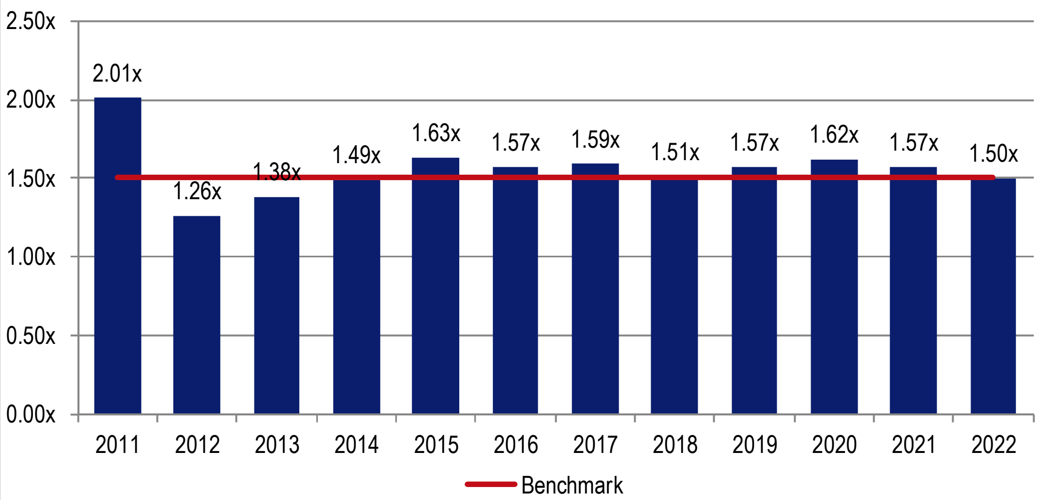



Figure 9 - Unrestricted Current Ratio for General Fund




The Cash Expense Ratio has been calculated using both cash and cash equivalents, and current investments because the Council's financial model does not distinguish between these two categories. In 2011, Council's current investments of $5.3m included $2.9m of NCDs and FRNs, $1.9m of CDOs, and $0.5m of other investments. This Ratio calculation is overstated as not all current investments are liquid and readily redeemable.

Based on this analysis, the Council's Cash Expense Ratio is above benchmark in most forecast years. The highest point is at 2015 when the Ratio reaches 4.5 months where cash and investments is at the highest level in the forecast. This is related to the series of disposal of assets at $1.3m profit in 2013, $1.4m profit in 2014 and $2.7m in 2015.

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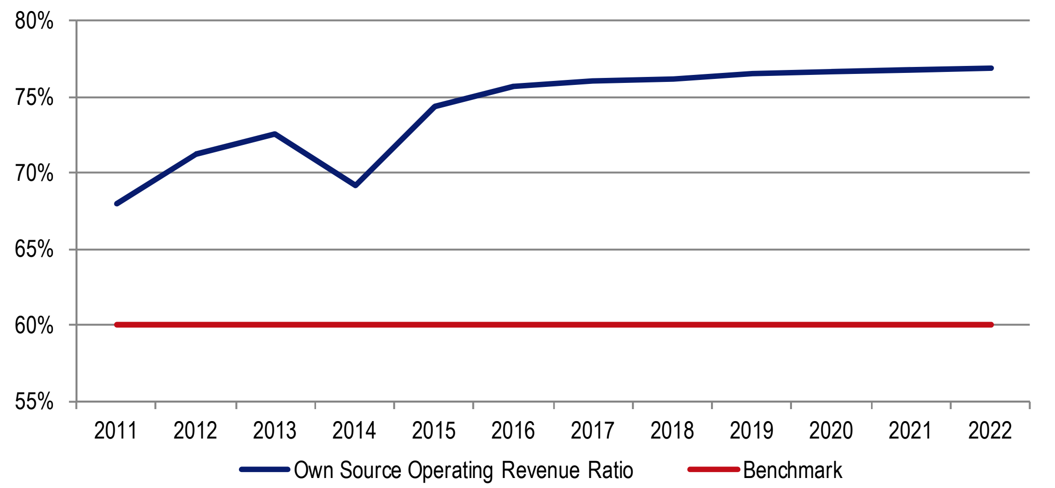
The Council's forecast Unrestricted Current Ratio is below benchmark in the short term to 2015. This is forecast to improve gradually and is above benchmark from 2015 onwards.

Overall, the Council's liquidity position is satisfactory but it should be aware of the weaknesses highlighted by the forecast in the short term.

Fiscal Flexibility Ratios

Figure 10 - Own Source Operating Revenue Ratio for General Fund




The Council's Own Source Operating Revenue Ratio is well above benchmark in all the forecast years. The Ratio is rising over the lifetime of the forecast due to capital grants and contributions forecast being lower than historically received. This skews the proportion of the Own Source Revenue Ratio upwards. The dip in the Ratio in 2014 is due to the expiration of the SRV and higher capital grants forecast.

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Figure 11 - DSCR for General Fund

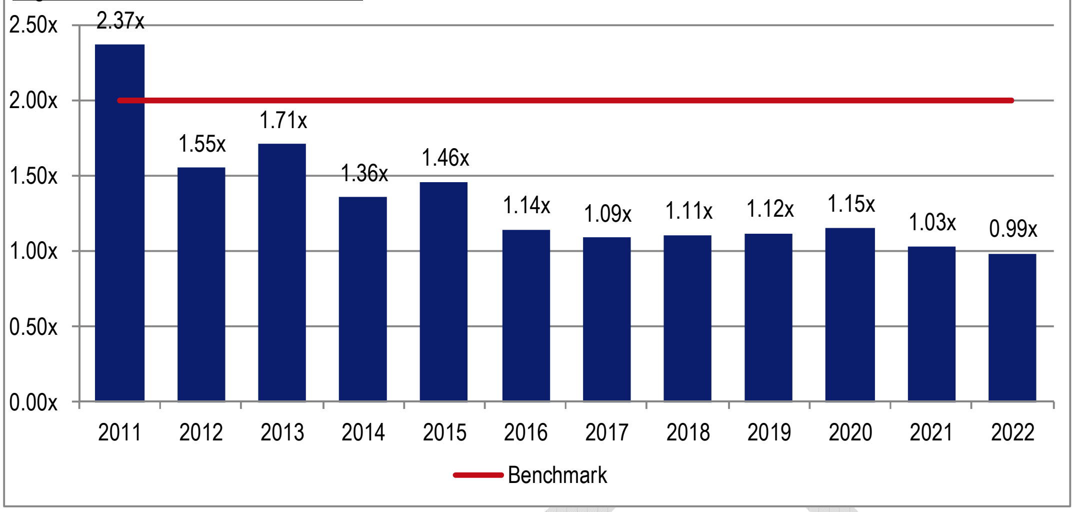
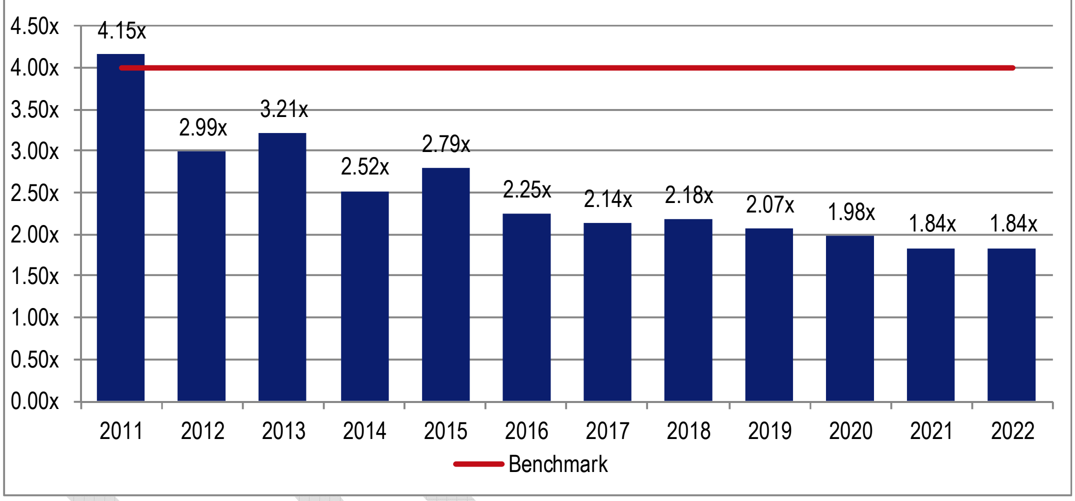



Figure 12 - Interest Cover Ratio for General Fund




The Council's debt servicing ratios are below benchmark in all the forecast years and decline over the forecast period. This is due to a forecast decline in EBITDA and a static level of debt repayment of $3m to $4m per year and interest cost of $4m to $5m per year. The borrowings level is forecast to gradually decline from a balance of $57.0m in 2013 to $48.8m in 2022. The total borrowings level was $44.7m on 30 June 2011.

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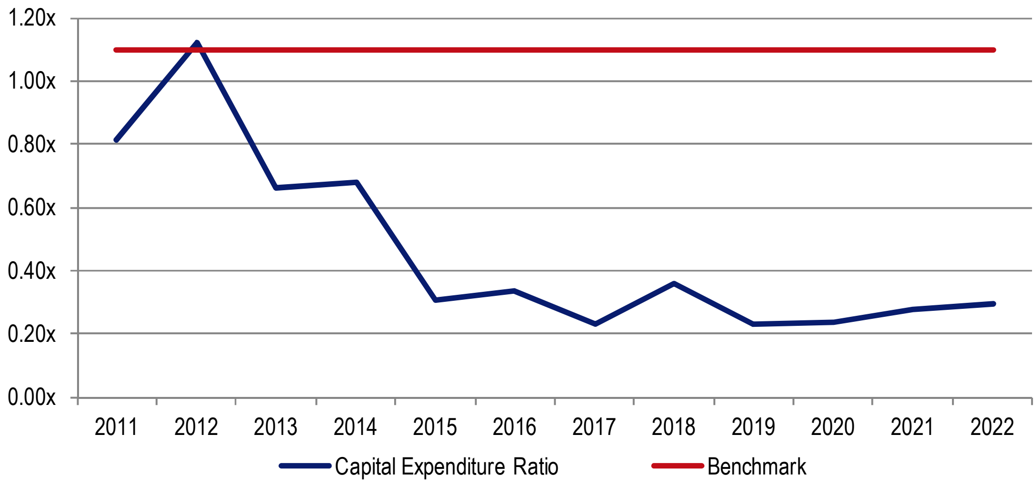
## 4.3: Capital Expenditure

Figure 13 - Capital Expenditure Ratio for General Fund




Council's forecast capital expenditure level drops from 2013 onwards because the Council has not projected any major capital works projects. The major capital works proposed in 2013 and 2014 are the Blaxland Waste Management Facility, Springwood facilities upgrade and the Blue Mountains cultural centre.

$3.9m p.a. to $4.5m p.a. is forecast to be spent on renewal capital expenditure from 2014 onwards.

Based on the current model, Council will not be spending enough to renew its ageing infrastructure. The total deficit figure for capital expenditure versus depreciation from 2013 to 2022 amounts to $201.6m in nominal terms.

The Strategic LTFP Case being developed by Council management begins to address the issue of Council not spending enough to renew its ageing infrastructure.

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### 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 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%

Key Observations and Risks

- Council has assumed that the same range of services will continue but the service level and quantity may be reduced accordingly to match Council's financial constraints.
- Rates and annual charges revenue is assumed to increase at 3.9% p.a. to 4.6% p.a. Any variations to this are linked to the expiration of the SRV and Environmental Levy. These assumptions seem optimistic given that population levels are forecast to remain stable and a shortage of land available for development [Check with Council that this model does not include an SRV assumption.]
- Operating grants and contributions increases by 3.3% p.a. to 3.6% p.a. which seems reasonable.
- Employee expenses are forecast to increase annually in the range of 4.2% p.a. to 4.9% p.a. This is driven by a 4.1% p.a. salary and wages cost, and a 4.2% p.a. to 9.5% p.a. superannuation cost increases. This appears consistent with historical increases.
- Materials and contracts cost fluctuates between the forecast years but is averaged to increase by 3.1% p.a. which is considered reasonable.
- The forecast capital expenditure is well below benchmark and appears to be insufficient to maintain assets. Council is working on different strategies to improve funding allocated to maintenance and renewal of assets.
- Net assets and in particular infrastructure, property, plant and equipment are forecast to decline over the forecast period.

### 4.5: Borrowing Capacity

When analysing the financial capacity of the Council we believe Council will not be able to incorporate any further loan funding in addition to the already forecast loans. The Council has already incorporated $57.0m of borrowings in its 2013 forecast which result in below benchmark forecast DSCR and Interest Cover Ratio.

## Section 5 Benchmarking and Comparisons with Other Councils

[This section still being finalised]

## Section 6 Conclusion and Recommendations

Based on our review of both the historic financial information and the 10 year financial forecast within Council's long term financial plan we consider Council to currently be in a satisfactory financial position but this position is forecast to deteriorate according to the current Long Term Financial Plan. The following observations were made:

- Council's forecast borrowings result in below benchmark DSCR and Interest Cover Ratios
- Council's overall historical performance is satisfactory but this position rapidly declines from 2011 and into the forecast years. This is mainly driven by increased depreciation expense. Although this is a non-cash expense it indicates that the Council cannot fund the renewal of its deteriorating assets and it is an unsustainable position
- Council is aware of its financial sustainability issues and have commenced a community consultation process to rationalise its service levels to generate expense reduction and/or revenue increases
- Council is considering an extension of its SRV and environmental levy to improve its forecast operating position. A successful SRV application in 2013 is critical to the Council's ability to fund the loan associated with the LIRS projects and its other scheduled debt repayments
- Changes in service levels to reduce expenses, and the SRV application will be subject to the support of the incoming councillors in September 2012
- Further refinement and integration of the Council's Asset Management Plan with its Long Term Financial Plan are required to provide a more realistic and sustainable forecast position

TCorp's approval for the LIRS subsidy is subject to the Council acknowledging that it is critical to improve its operating position. To help achieve this, they can seek to obtain the SRV and environmental levy extension, and reduce expenses through its service level review. The success of these events is critical to the Council's affordability of the additional $10.9m loans and its other forecast debt repayments.

Council's Strategic LTFP Case proposes to replace ongoing loans with a Special Rate Variation. We are advised that the Strategic LTFP Case will be submitted to Council for adoption in 2012/13.

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# Appendix A Historical Financial Information Tables

Table 1- Income Statement

| Income Statement ($'000s) | Year ended 30 June | | | % annual change | |
|---|---|---|---|---|---|
| | 2011 | 2010 | 2009 | 2011 | 2010 |
| **Revenue** | | | | | |
| Rates and annual charges | 51,395 | 47,868 | 45,581 | 7.4% | 5.0% |
| User charges and fees | 13,648 | 13,765 | 13,119 | (0.8%) | 4.9% |
| Interest and investment revenue | 1,760 | 1,348 | 1,425 | 30.6% | (5.4%) |
| Grants and contributions for operating purposes | 14,984 | 13,852 | 15,220 | 8.2% | (9.0%) |
| Other revenues | 5,142 | 6,022 | 4,214 | (14.6%) | 42.9% |
| Net gain from disposal of assets | 1,314 | 592 | 958 | 122.0% | (38.2%) |
| Net share of interests in JV and associated entities | 339 | 350 | 3 | (3.1%) | 11566.7% |
| **Total revenue** | 88,582 | 83,797 | 80,520 | 5.7% | 4.1% |
| **Expenses** | | | | | |
| Employees | 40,906 | 40,026 | 38,150 | 2.2% | 4.9% |
| Borrowing costs | 4,258 | 3,085 | 2,078 | 38.0% | 48.4% |
| Materials and contract expenses | 18,243 | 19,852 | 20,479 | (8.1%) | (3.1%) |
| Depreciation and amortisation | 22,519 | 13,443 | 13,548 | 67.5% | (0.8%) |
| Other expenses | 10,854 | 9,207 | 7,966 | 17.9% | 15.6% |
| **Total expenses** | 96,780 | 85,612 | 82,221 | 13.0% | 4.1% |
| **Operating result** | (8,198) | (1,815) | (1,701) | (351.7%) | (6.7%) |

Table 2 - Items excluded from Income Statement

| Excluded items ($'000s) | | | |
|---|---|---|---|
| | 2011 | 2010 | 2009 |
| Grants and contributions for capital purposes | 6,975 | 2,795 | 4,172 |
| Interest revenue/ (losses) | 0 | 1,242 | (3,009) |
| Net gain from the disposal of non-current assets classified as "held for sale" | 110 | 0 | 0 |

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Table 3 - Balance Sheet

| Balance Sheet ($'000s) | Year Ended 30 June | | | % annual change | |
|---|---|---|---|---|---|
| | **2011** | **2010** | **2009** | **2011** | **2010** |
| **Current assets** | | | | | |
| Cash and equivalents | 26,009 | 17,665 | 18,320 | 47.2% | (3.6%) |
| Investments | 5,348 | 6,974 | 8,901 | (23.3%) | (21.6%) |
| Receivables | 5,649 | 5,313 | 4,208 | 6.3% | 26.3% |
| Inventories | 444 | 487 | 422 | (8.8%) | 15.4% |
| Other | 520 | 1,157 | 705 | (55.1%) | 64.1% |
| Total current assets | 37,970 | 31,596 | 32,556 | 20.2% | (2.9%) |
| **Non-current assets** | | | | | |
| Receivables | 346 | 359 | 427 | (3.6%) | (15.9%) |
| Infrastructure, property, plant & equipment | 828,731 | 799,715 | 431,348 | 3.6% | 85.4% |
| Investments accounted for using the equity method | 1,711 | 1,372 | 1,022 | 24.7% | 34.2% |
| Investment property | 17,557 | 14,190 | 14,141 | 23.7% | 0.3% |
| Non-current assets classified as held for sale | 0 | 1,490 | 0 | N/A | N/A |
| Total non-current assets | 848,345 | 817,126 | 446,938 | 3.8% | 82.8% |
| **Total assets** | **886,315** | **848,722** | **479,494** | **4.4%** | **77.0%** |
| **Current liabilities** | | | | | |
| Payables | 7,314 | 6,794 | 9,128 | 7.7% | (25.6%) |
| Borrowings | 3,558 | 3,136 | 3,124 | 13.5% | 0.4% |
| Provisions | 10,143 | 9,741 | 8,671 | 4.1% | 12.3% |
| Total current liabilities | 21,015 | 19,671 | 20,923 | 6.8% | (6.0%) |
| **Non-current liabilities** | | | | | |
| Borrowings | 43,128 | 43,434 | 33,068 | (0.7%) | 31.3% |
| Provisions | 3,394 | 4,028 | 5,646 | (15.7%) | (28.7%) |
| Total non-current liabilities | 46,522 | 47,462 | 38,714 | (2.0%) | 22.6% |
| Total liabilities | 67,537 | 67,133 | 59,637 | 0.6% | 12.6% |
| **Net assets** | **818,778** | **781,589** | **419,857** | **4.8%** | **86.2%** |

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Table 4 - Cashflow

| Cashflow Statement ($'000s) | Year ended 30 June | | |
|---|---|---|---|
| | **2011** | **2010** | **2009** |
| Cashflows from operating activities | 20,288 | 7,505 | 17,348 |
| Cashflows from investing activities | (12,060) | (18,538) | (15,195) |
| Proceeds from borrowings and advances | 3,058 | 13,582 | 7,826 |
| Repayment of borrowings and advances | (3,212) | (3,204) | (3,026) |
| Cashflows from financing activities | (154) | 10,378 | 4,800 |
| **Net increase/(decrease) in cash and equivalents** | 8,074 | (655) | 6,953 |
| Cash and equivalents (excluding bank overdraft) | 26,009 | 17,665 | 18,320 |

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# Appendix B Glossary

Asset Revaluations

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

Collateralised Debt Obligation (CDO)

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

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

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

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

Division of Local Government (DLG)

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

Depreciation of Infrastructure Assets

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

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

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

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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.

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Infrastructure Backlog

Infrastructure backlog is defined as the estimated cost to bring building, infrastructure and other structures 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.

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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

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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

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

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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.