New South Wales Treasury Corporation

Kiama Municipal Council

Financial Assessment and Benchmarking Report

3 October 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 Kiama Municipal Council, the LIRS Assessment Panel and the DLG. TCorp shall not be liable to Kiama Municipal 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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Index

Section 1 Executive Summary

This report provides an independent assessment of Kiama Municipal Council (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; one to assist in its road renewal works program ($1.1m), and the other to assist in the upgrading of the Kiama Leisure Centre ($1.5m). Both loans are to be repaid over 10 years.

TCorp's approach has been to:

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

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

- Council has incurred operating surpluses (excluding grants and contributions for capital purposes) in two of the last three years
- Approximately 60% of the Council's revenue base is derived from own sourced revenue (annual charges, and user charges and fees). They can rely upon these revenue streams on an ongoing basis for financial flexibility
- Employee costs have been well controlled over the past three years, in line with expected NSW wage indexation rates

One area of concern is that Council have become dependent on property development as a source of revenue. While this has proved profitable in the past, Council will not be able to continue relying on profits from land sales indefinitely. An alternative source of income will be required to replace these profits as a source of revenue.

The Council reported $8.8m of infrastructure backlog in 2011 with an infrastructure asset value of $147.6m. Other observations include:

- The Council's infrastructure backlog is trending marginally higher
- Compared to benchmark ratios Council appears to be underspending on asset renewal and asset maintenance
- A continuation of this level of expenditure will likely result in the backlog continuing to grow

The key observations from our review of Council's 10 year forecasts are:

- The forecast shows deficit positions are expected in nine out of 10 years when capital grants and contributions are excluded. This is the weakest forecast ratio and highlights that over the longer term Council could face financial sustainability issues
- Overall, Council's level of fiscal flexibility is sound as own sourced revenue is maintained at levels above 60% for the majority of the forecast
- The future capital program is highly dependent on the receipt of funds from the sale of property over the lifetime of the forecast
- With the exception of the comments noted above in respect of the long term operating deficit position and on-going reliance on profits from land sales, the key assumptions that underpin the financial forecasts are considered to be reasonable

In our view, the Council has the capacity to undertake the combined additional borrowings of $2.6m for the two LIRS projects. This is based on the following analysis:

- The DSCR remains above the benchmark of 2.00x in the 10 year forecast
- The Interest Cover Ratio is well above the benchmark of 4.00x in the 10 year forecast
- We also believe Council have the capacity to undertake a further $9.0m in borrowings in 2016 as part of their LTFP strategy

In respect of the Benchmarking analysis, TCorp has compared the Council's key ratios, on a consolidated basis, with other councils in DLG group 4. The key observations are:

- Council's financial flexibility, as indicated by the Operating Ratio and Own Source Operating Revenue Ratio, is generally below the group's average
- Council was in an adequately liquid position which is forecast to be below the group's average liquidity level over the medium term
- Council has a higher level of gearing to its peers. Its DSCR and Interest Cover Ratio were generally above benchmark but below the group's average over the review term
- Council has a comparatively low level of Infrastructure Backlog, however its asset maintenance, asset renewal and capital expenditure levels were below the group's average in the past three years

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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 and performance measured against a peer group of councils which will complement their internal due diligence, and the IP&R system of the Council and the DLG.

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

The key areas focused on are:

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

2.2: Scope and Methodology

TCorp's approach was to:

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

In undertaking its work, TCorp relied on:

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

Benchmark Ratios

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

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

Therefore these benchmarks are intended as a guide to performance.

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

Ratio	Benchmark
Operating Ratio	> (4.0%)
Cash Expense Ratio	> 3.0 months
Unrestricted Current Ratio	> 1.5x
Own Source Operating Revenue Ratio	> 60.0%
Debt Service Cover Ratio (DSCR)	> 2.0x
Interest Cover Ratio	> 4.0x
Infrastructure Backlog Ratio	< 0.02x
Asset Maintenance Ratio	> 1.0x
Building and infrastructure asset renewal ratio	> 1.0x
Capital Expenditure Ratio	> 1.1x

2.3: Overview of the Local Government Area

Kiama Municipal Council LGA	
Locality & Size	
Locality	Illawarra
Area	258 km²
DLG Group	4
Demographics	
Population	21,139
% under 18	25%
% between 18 and 59	57%
% over 60	18%
Expected population 2021	22,100
Operations	
Number of employees (FTE)	248
Annual revenue	$45.9m
Infrastructure	
Roads	232 km
Bridges	29
Infrastructure backlog value	$8.8m
Total infrastructure value	$147.6m

Kiama Municipal Council Local Government Area (LGA) is located in the Illawarra Region of New South Wales, about 120 kilometres south of Sydney. The LGA is bounded by Shellharbour City in the north, the Tasman Sea in the east, Shoalhaven City in the south, and Wingecarribee Shire in the west and is predominantly a rural area with urban townships along the coast.

Council operate a number of commercial activities including the Blue Haven retirement facility, property development, holiday parks, and a leisure centre. Staffing numbers have remained consistent over recent years.

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2.4: LIRS Application

Council has made two LIRS applications.

Project 1: Kiama Leisure Centre Project

Description: The Kiama Leisure Centre is a multi-purpose indoor sport complex consisting of an eight lane 25 metre pool, wading pool, sauna and spa, large multi use hall, gymnasium and aerobics room and crèche built in the 1980's. The project involves the removal of the asbestos roofing and external wall sheets and replacement with colorbond roofing. The project also includes the upgrade of the amenities, kiosk and reception area.

Amount of loan facility: $1.5m

Term of loan facility: 10 years

Project 2: Road Renewal Works Program

Description: Implementation of the rural and urban roads renewal program for the 2013 financial year as identified in Council's strategic asset management plan and LTFP.

Amount of loan facility: $1.1m

Term of loan facility: 10 years

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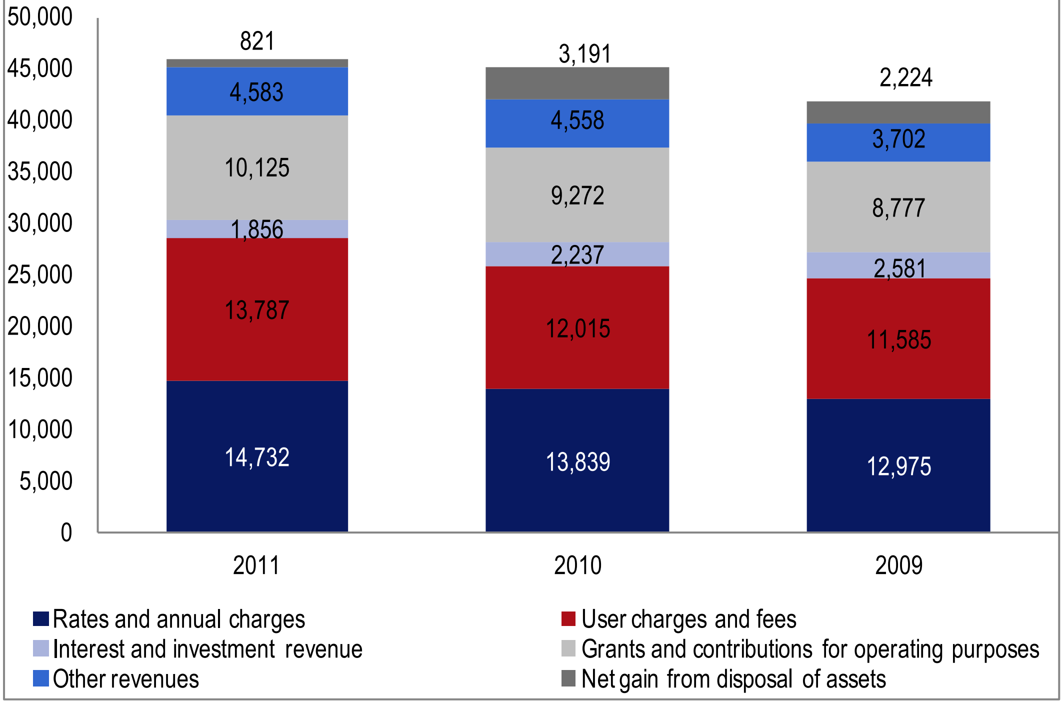
Section 3 Review of Financial Performance and Position

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

3.1: Revenue

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



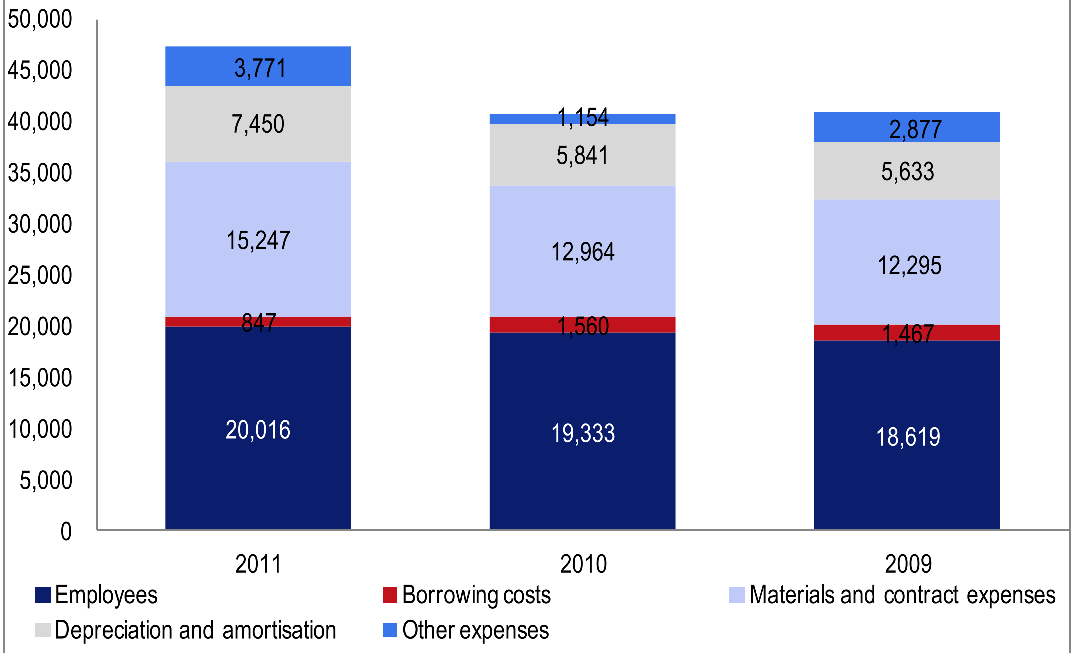
Key Observations

- Rates are Council's main revenue source and have been increasing in the last number of years due to the Council, with the approval of the Minister of Local Government, increasing rates by 6.5% for the 2010, and 2011 financial years. These two SRV's expire in 2014 and 2015 and do not remain in the ratings base.
- Increased revenues were also achieved in user fees and charges. Holiday park income rose from $6.4m in 2009 to $7.3m in 2011 and produced a surplus of $1.3m in 2011 and $1.0m in 2010. New fees from council properties brought in an extra $0.5m in 2011.
- Other revenue grew between 2009 and 2011 due to increased amortisation from the Blue Haven retirement facility. Blue Haven residents make a capital contribution to Council and a proportion of these payments are repayable to occupants on vacating the premises. This liability is reduced over time, and the reduction is recognised as income.
- 2010 was the year with the largest gains from the disposal of assets mainly due to proceeds from the sale of real estate assets. During 2010 the sale of 17 lots at Council's Elambra Estate development generated gains of $2.9m. Real estate development is a key commercial activity for the Council. The Elambra Estate development has capacity for a total of 250 new

homes and is now in its seventh stage of development. Over 200 of the lots have now been sold. After the completion of this development Council will start work on a new development of 60 lots at Spring Creek. It is forecast to complete this development over one year.

3.2: Expenses

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



Key Observations

- Employee expenses have risen each consecutive year. Most increases are attributable to wage increases prescribed by relevant industrial agreements. Employee costs have been rising around 1% above the level of CPI which is consistent with historic NSW wage increases.
- Borrowing costs reduced significantly in 2011 due to a loan principal repayment of $17.5m relating to the Blue Haven retirement facility.
- Materials and contracts costs increased significantly in 2011. The main drivers of this increase were storm damage repairs of $0.4m, Blue Haven maintenance costs, and 2010 budgeted expenditure which was unspent that year and carried over into the 2011 budget year.
- The Asset Revaluations process resulted in the value of Council's roads, bridges and footpaths, and community land being increased. This revaluation process resulted in the 2011 depreciation charge increasing by 27.5% to $7.5m.
- Other expenses were significantly lower in 2010 compared to 2009 and 2011, due to fair value decreases to investment properties in those years. Employee costs seem to be managed well, however materials and contracts, and other expenses seem to be more volatile, which is

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to be expected when Council conducts property development, and operate retirement facilities, in addition to more traditional Council activities.

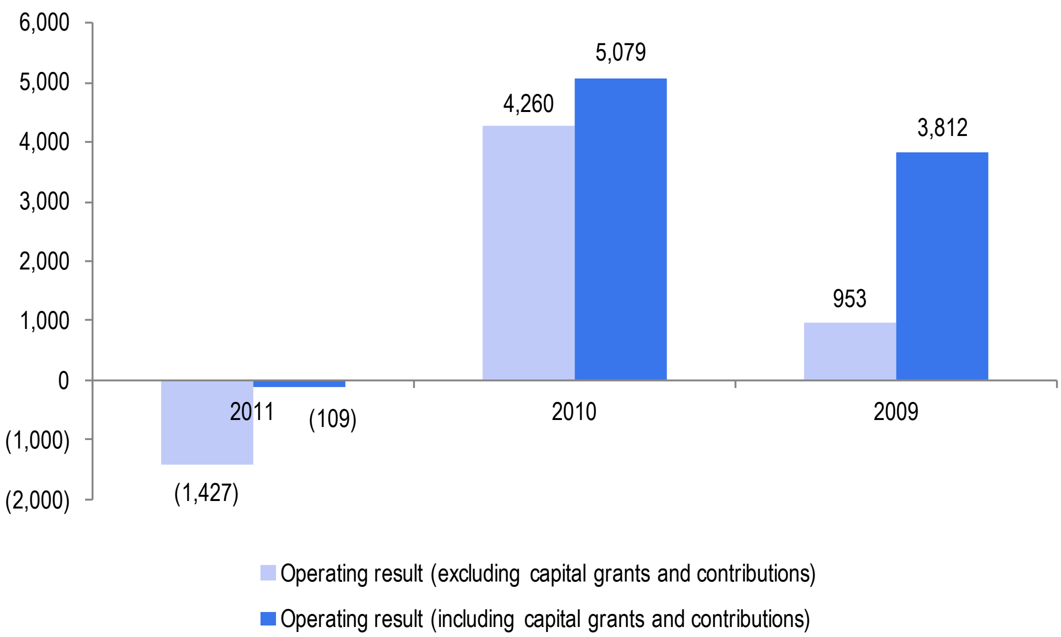
3.3: Operating Results

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 are excluded, as well as one-off items which Council have no control over (e.g. impairments).

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

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

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



Key Observations

- Council has consistently posted net operating surpluses excluding capital grants and contributions until 2011. Council posted a deficit in 2011 due to the higher depreciation charges, and the increased materials and contracts costs.
- Council expenses include a large non-cash depreciation expense ($7.5m in 2011), which has increased substantially over the past three years following the Asset Revaluations process. Whilst the non cash nature of depreciation can favourably impact on ratios such as EBITDA that focus on cash, depreciation is an important expense as it represents the allocation of the value of an asset over its useful life.

3.4: Financial Management Indicators

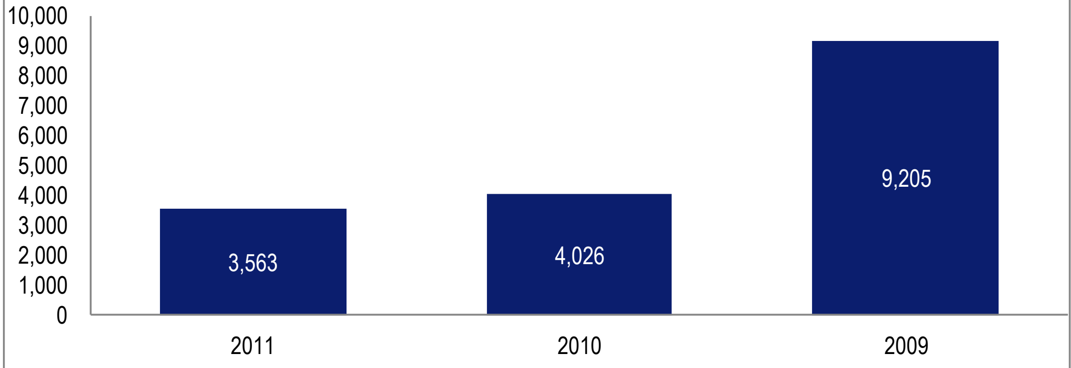
Performance Indicators	Year ended 30 June		
	2011	**2010**	**2009**
EBITDA ($'000's)	6,870	11,661	8,053
Operating Ratio	(3.1%)	9.4%	2.3%
Interest Cover Ratio	8.11x	7.48x	5.49x
Debt Service Cover Ratio	0.35x	4.19x	3.20x
Unrestricted Current Ratio	2.91x	1.54x	3.31x
Net assets ($'000's)	318,043	288,125	242,506

Key Observations

- Council's EBITDA has been volatile year on year, with gains on the disposals of property playing a major role. In 2009 and 2010 the Council had Interest Cover Ratios and DSCR exceeding the benchmarks indicating they had flexibility in regard to carrying more debt. The 2011 DSCR ratio was adversely affected by a one off principal repayment of $17.5m related to the Blue Haven retirement facility. The Blue Haven facility broke even in the last two years, however income is forecast to drop due to decreased capital contributions.
- The Operating Ratio worsened in 2011 due to the increased depreciation expense, and lower gains from the disposals of assets, and the carryover of materials costs from 2010.
- The Unrestricted Current Ratio was above the benchmark of 1.50x over the past three years, indicating Council has sound liquidity.
- Net Assets have increased by over $75.5m between 2009 and 2011 due to the consecutive Asset Revaluations in 2010 and in 2011 that increased the value of roads, bridges, and drainage infrastructure.
- When the Asset Revaluations are excluded, the underlying trend in all three years has been a marginal decline in the 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 $4.2m decrease in IPP&E assets.
- Council has total borrowings of $5.7m, being 1.8% of Net Assets.

3.5: Statement of Cashflows

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



Key Observations

- Council's net position in cash and equivalents has decreased over the last three years. Increased purchases of investments in 2011 and 2010, plus increased principal repayments in 2011 lowered cash balances.
- Overall the cash balances along with the Unrestricted Current Ratio suggest the Council was comfortable in meeting their day to day obligations.

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 ($'000's)

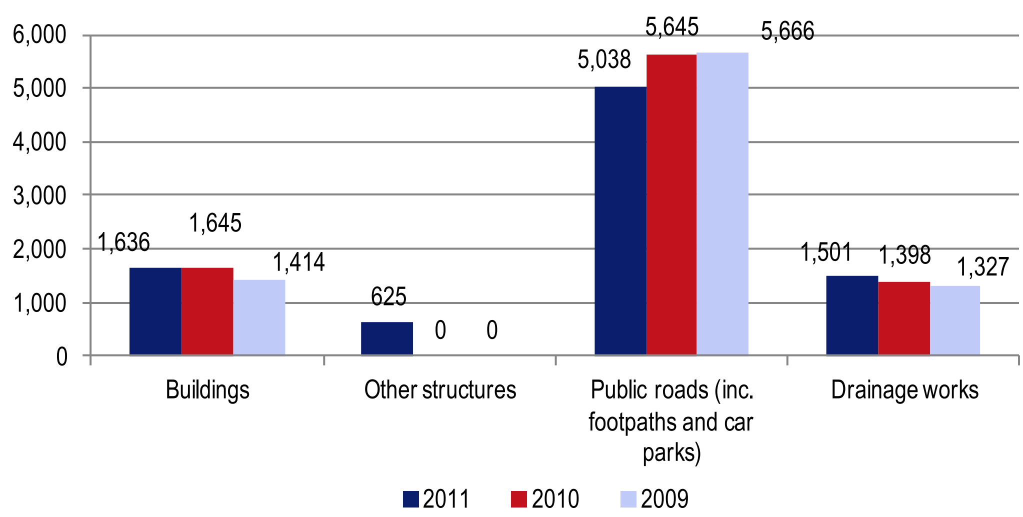
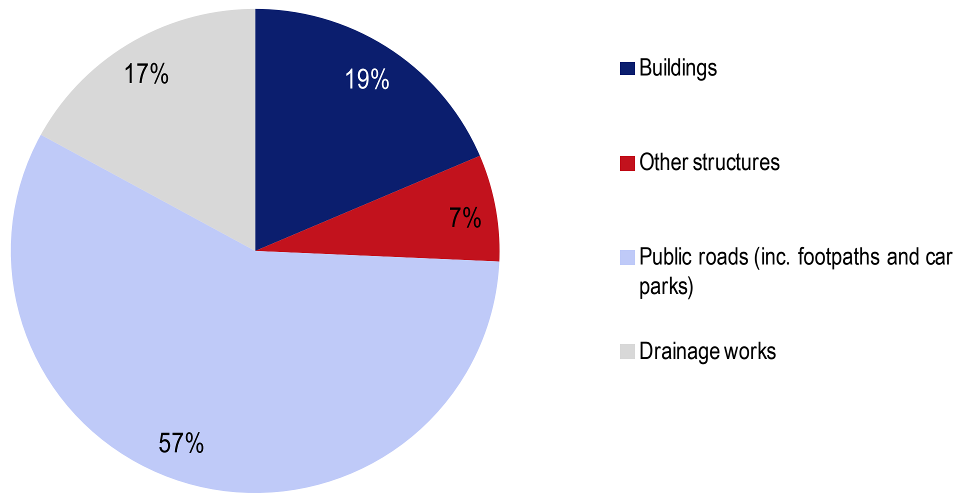


Figure 6 - Infrastructure Backlog Composition for 2010/11



The Council reported an $8.8m backlog in 2011 up from a reported backlog of $8.4m in 2009. Typical of many rural councils, the backlog is mostly road related (57%).

3.6(b): Infrastructure Status

Infrastructure Status	Year ended 30 June		
	2011	2010	2009
Bring to satisfactory standard ($'000's)	8,800	8,688	8,407
Required annual maintenance ($'000's)	5,231	4,806	3,565
Actual annual maintenance ($'000's)	3,680	3,149	2,827
Total value infrastructure assets ($'000's)	147,607	143,946	135,365
Total assets ($'000's)	393,515	381,586	331,229
Infrastructure Backlog Ratio	0.06x	0.06x	0.06x
Asset Maintenance Ratio	0.70x	0.66x	0.79x
Building and Infrastructure Asset Renewal Ratio	0.32x	0.27x	0.27x
Capital Expenditure Ratio	0.49x	0.52x	1.42x

Council has an Infrastructure Backlog Ratio of 0.06x. The Asset Revaluations has not greatly affected the valuation of the backlog.

However the Asset Maintenance Ratio, Building and Infrastructure Asset Renewal Ratio, and the Capital Expenditure Ratio, all indicate the Council is spending at levels below the benchmark on asset renewal and asset maintenance. Based on these forecasts, the asset base will continue to decline and Council will need to focus on improving this if the backlog is to reduce and the current service levels are to be maintained.

3.6(c): Capital Program

Some of the capital works undertaken by Council in the last three years have been:

- Footpath reconstruction
- Road works
- Replacement of playground equipment
- Black Beach and Kiama Harbour Landscape improvements
- Gerringong Cemetery extension
- Meehan Drive traffic management scheme
- Coastal walking track between Kiama and Gerringong

3.7: Specific Risks to Council

- High level of engagement in commercial activities. Council's high investment in areas such as property development leave them more open to market risks such as a general economic downturn, or a property market depression.

- $1.8m of Council's CDO portfolio cannot be accurately valued by the auditors. The potential negative impact on the operating result and net assets is the carrying amount of these investments.
- The lack of new residential land for development, which has a direct impact on growth in rates revenue. Council have identified a land development project of at least 60 lots (Spring Creek) in their LTFP which will improve their rating base. This is forecast to take place from 2016 onwards.
- Capital expenditure is not matching the depreciation of assets. The asset base will decline, and the Council will face sustainability issues unless investment is increased.
- The Council have engaged in property development for over 20 years and have a number of successful developments completed. After the completion of the Elambra estate, and the Spring Creek development, the risk for Council is that they will not be able to replace this key revenue source. Council have indicated that they are attempting to mitigate this risk by setting up a committee made up of two councillors and the General Manager, to improve the revenue base and explore entrepreneurial opportunities. Council also mitigate risk during each of these developments by developing the lots in stages, thereby decreasing the potential losses.
- Council's two existing SRV's expire in 2014 and 2015 respectively. $0.4m will drop out of the rating base in 2014 and $0.3m will drop out in 2015. If alternative funding or increased efficiencies are not found to replace this revenue, Council may be forced to cut services or reduce capital expenditure.

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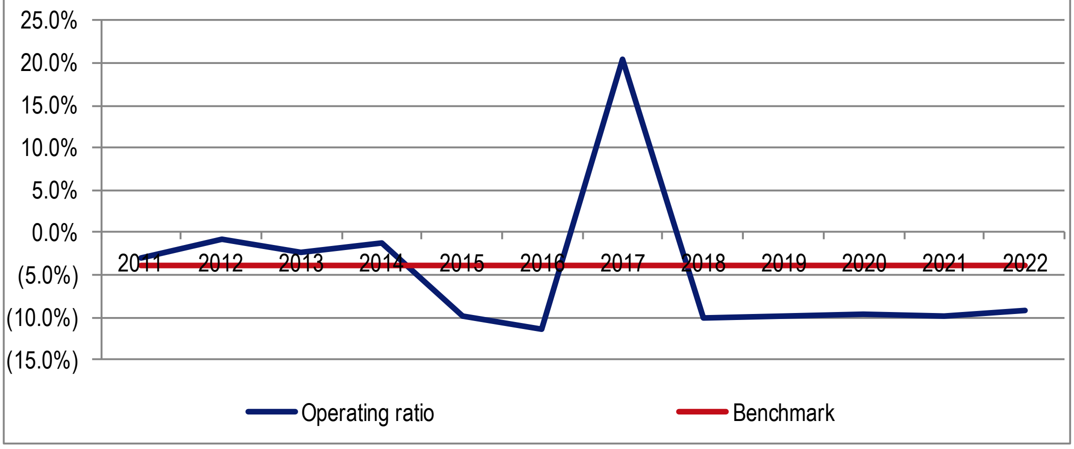
Section 4 Review of Financial Forecasts

The financial model shows the projected financial statements and assumptions for the next 10 years. The model includes the costs of the two LIRS loan projects ($2.6m) without any LIRS subsidy.

Council operate just one General Fund covering all activities.

4.1: Operating Results

Figure 7 - Operating Ratio

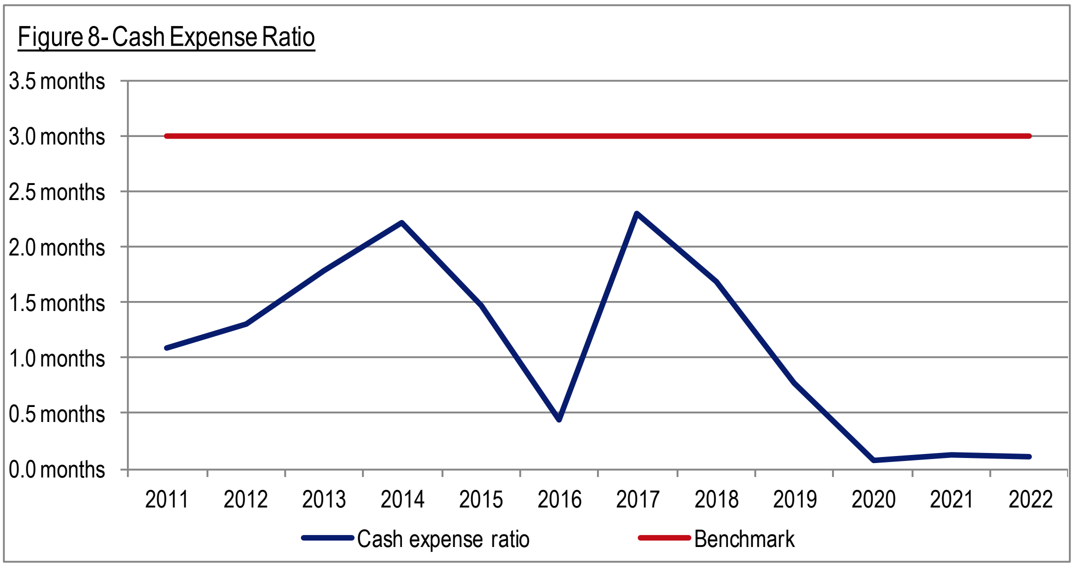


The Council's operating results consistently forecast net operating deficits excluding capital grants. Land sales of $18m in 2017 from the completion of the Spring Creek development give a positive operating result for one year alone. We would expect that these land sales would occur over more than one year, which smooth the operating performance results. Gains from the disposal of assets boosted the returns each year of the forecast; and the operating deficit would have been significantly worsened were it not for these gains from disposals worth between $0.5m and $18.7m p.a. However asset sales cannot be sustained indefinitely.

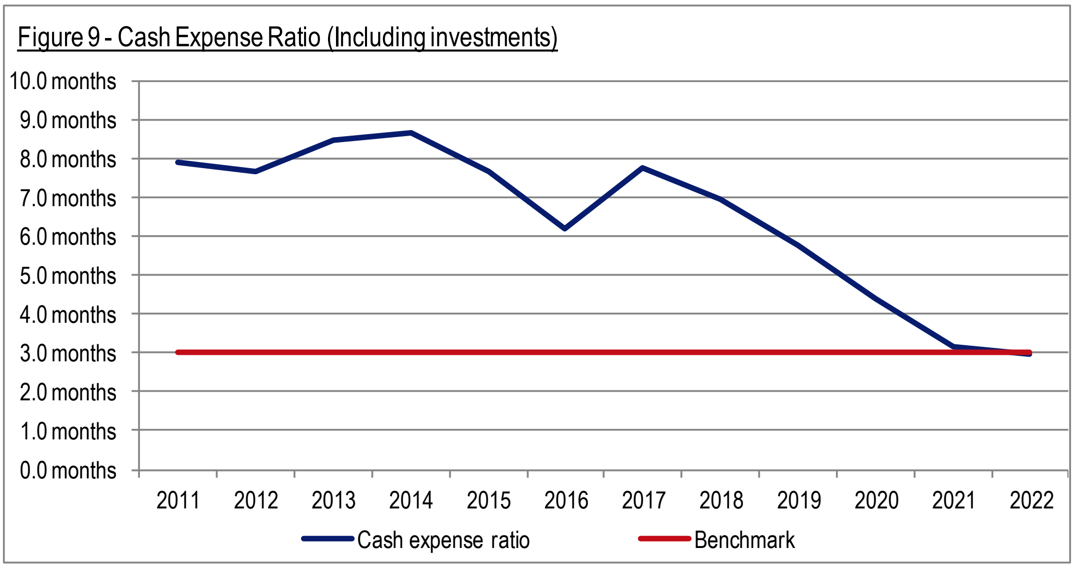
4.2: Financial Management Indicators

The financial management indicators are linked to the utilisation of debt early in 2013 and improve until further debt is incorporated by the Council in 2016. The forecast utilisation of debt is discussed in the Fiscal Flexibility Ratios section.

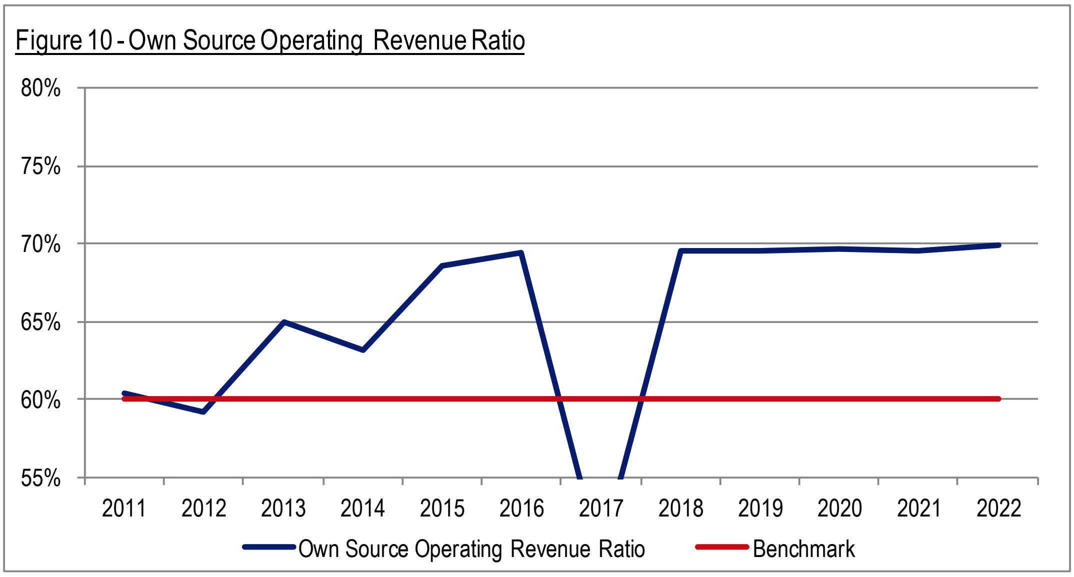
Liquidity Ratios



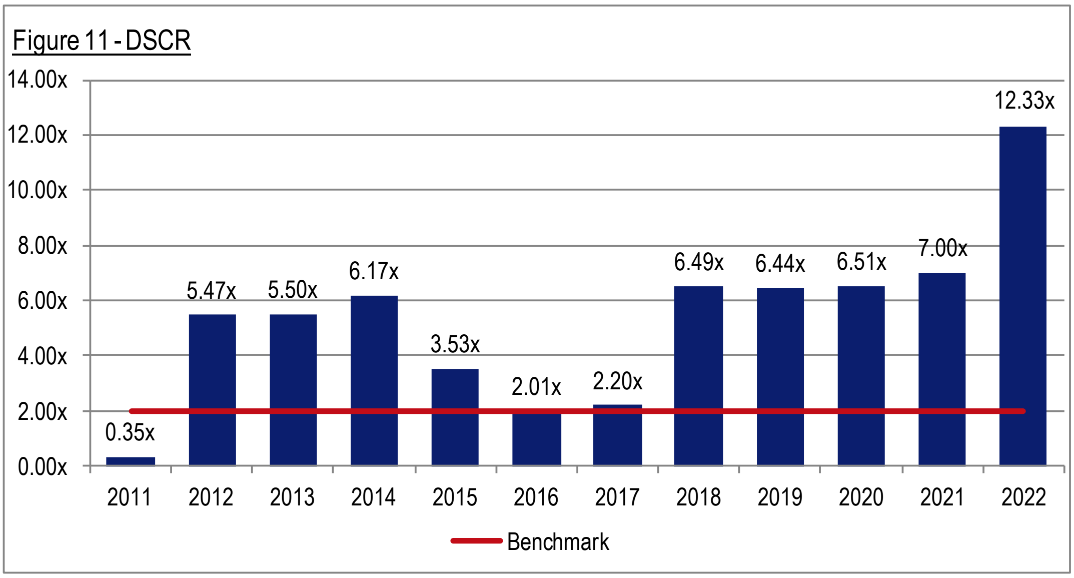
The Cash Expense Ratio indicates that Council operate with little room for flexibility in regard to liquidity. This ratio is already below benchmark, and is forecast to decrease over the long term. However, this ratio does not take into account Council's level of investments. When investments are considered, this shows that Council will not actually face liquidity issues, and remain above the benchmark for the life of the forecast. 87.8% of Council current investments were term deposits at 30 June 2011.



Fiscal Flexibility Ratios



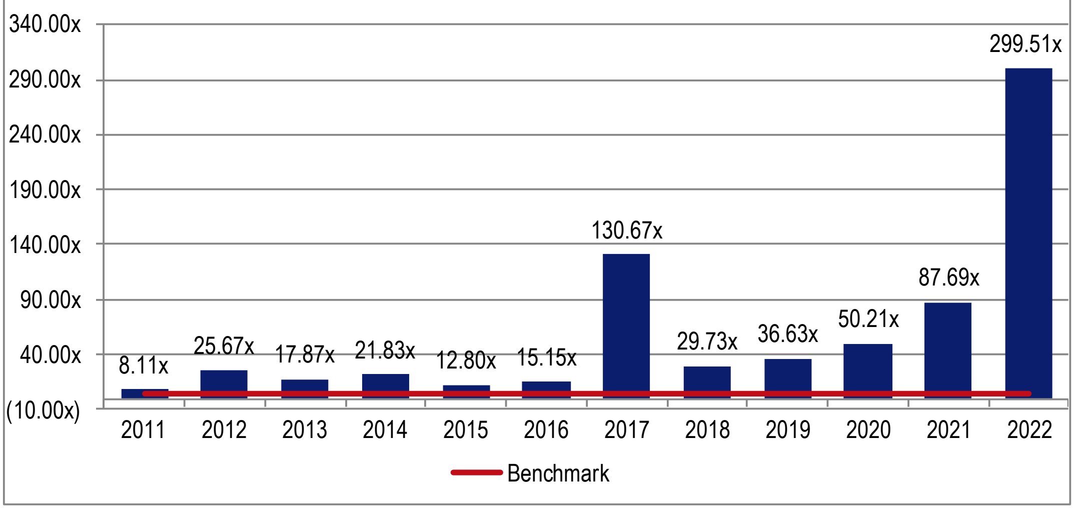
With the exception of 2012 and 2017, the Own Source Operating Revenue Ratio remains above the benchmark for every other year. It dips below the benchmark in 2012 and 2017 due to high gains from the disposals of assets in those years. Otherwise the ratio is rising over the lifetime of the forecast due to capital grants and contributions, and net gains from the disposal of assets, being forecast lower than the historic operating results.



The DSCR is above the benchmark of 2.00x for the full 10 years of the model. The DSCR indicates a decreased capacity to borrow as time moves on because of the $9.0m due to be borrowed in 2016 for construction of a land subdivision, with land sales of $18.0m the following year repaying the borrowings in full, increasing the borrowing capacity again. Overall the DSCR indicates that the Council has the capacity to manage the additional debt costs that the LIRS applications relate to.

The increase in the DSCR between 2011 and 2012 is due to the exceptionally high principal repayments in 2011.

Figure 12 - Interest Cover Ratio



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

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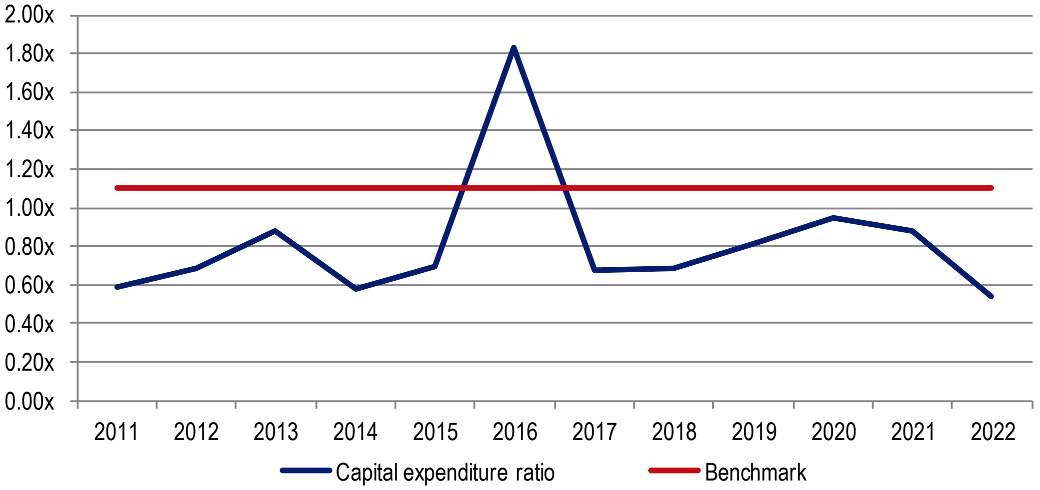
4.3: Capital Expenditure

Figure 13 - Capital Expenditure Ratio



With the exception of 2016, capital expenditure does not meet the benchmark in any other year. The total deficit for capital expenditure versus depreciation across the 10 year period amounts to $185.8m in nominal terms.

Council proposes to develop a subdivision on land it owns at Spring Creek Kiama (subject to the State Rail quarry closing). The development is planned for 2016 with the land sales to occur in 2017. The proposed development has the potential for at least 60 residential blocks. The development costs of approximately $9.0m will be financed from loan funds with potential land sale figures of $18.0m. If this land development does not occur successfully as planned, then capital expenditure or services will have to decrease.

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%
- 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>

- The LTFP has the objective over the next ten years to:
  1. Maintain a good cash position
  2. Maintain the existing service levels while also introducing efficiencies
  3. Maintain a balanced annual budget
  4. Maintain council's asset base at a satisfactory level
- Gains from the disposal of assets depend on property market conditions at the time of the proposed development at Spring Creek and the closure of a quarry in accordance with current planned timing.
- Repayment of borrowings of $9.0m in 2016 depends on the successful sale of land.
- Other revenues are forecast to fall from $4.6m in 2012 to $1.2m in 2016 due to decreased capital contributions from the Blue Haven retirement facility.
- Employee expenses are forecast to grow at around 2.5% p.a., which is lower than historical results.
- With the exception of the above comments, TCorp consider the majority of assumptions reasonable.

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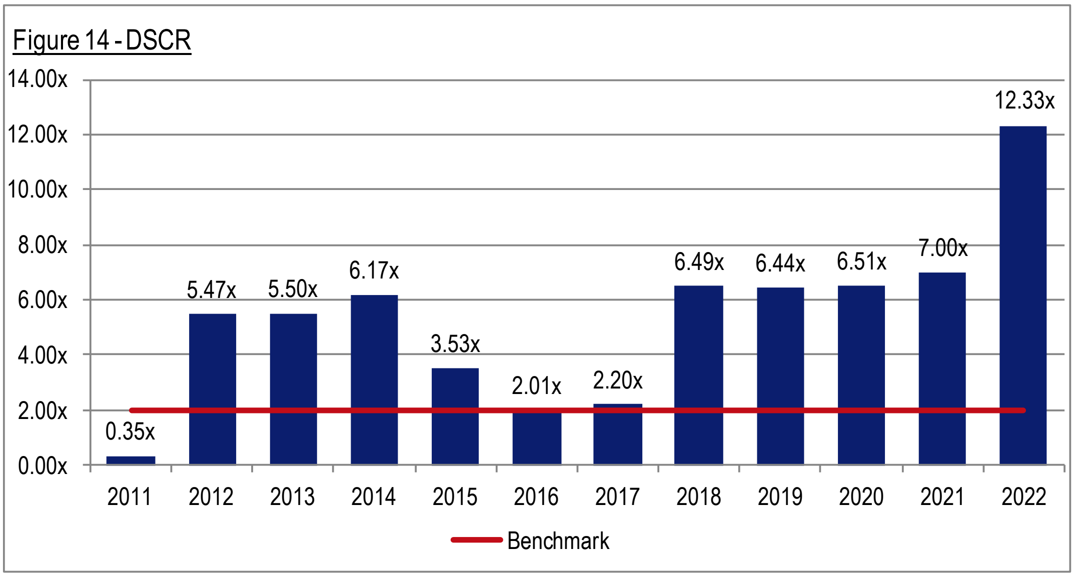
4.5: Borrowing Capacity

When analysing the financial capacity of the Council we believe Council will be able to incorporate additional loan funding in addition to the LIRS loan facilities. Some comments and observations are:



- Figure 14 is the same as Figure 11
- If the Council continue with their land development strategy, based on a benchmark of DSCR>2.00x, the $9.0m forecast to be borrowed in 2016 can also be incorporated. Once that developed land is sold, Council could be in a position to undertake further borrowings subject to the Council's actual financial performance over time

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Section 5 Benchmarking and Comparisons with Other Councils

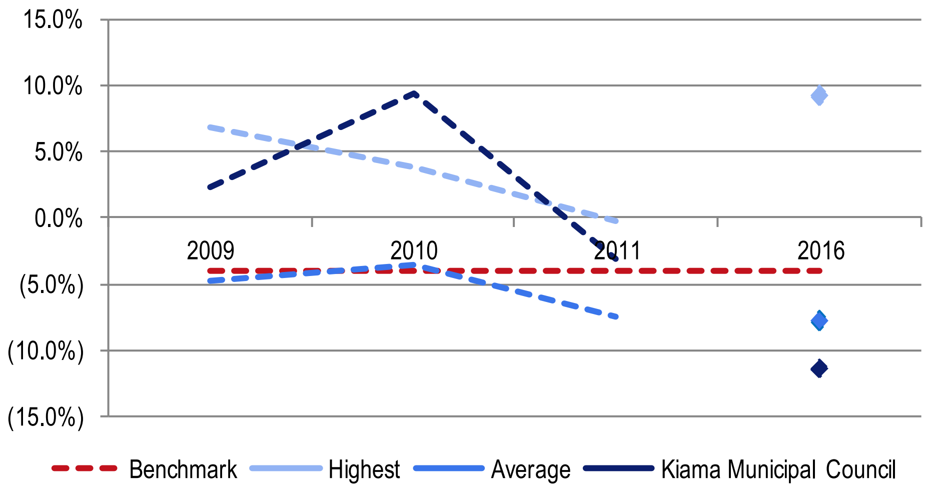
As discussed in section 2 of this report, each council's performance has been assessed against ten key benchmark ratios. The benchmarking assessment has been conducted on a consolidated basis (that is, for councils that operate more than one fund, the results of all funds are included). This section of the report compares the Council's performance with its peers in the same DLG Group. The Council is in DLG Group 4. There are 32 councils in this group and at the time of preparing this report, we have data for 19 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.

Financial Flexibility

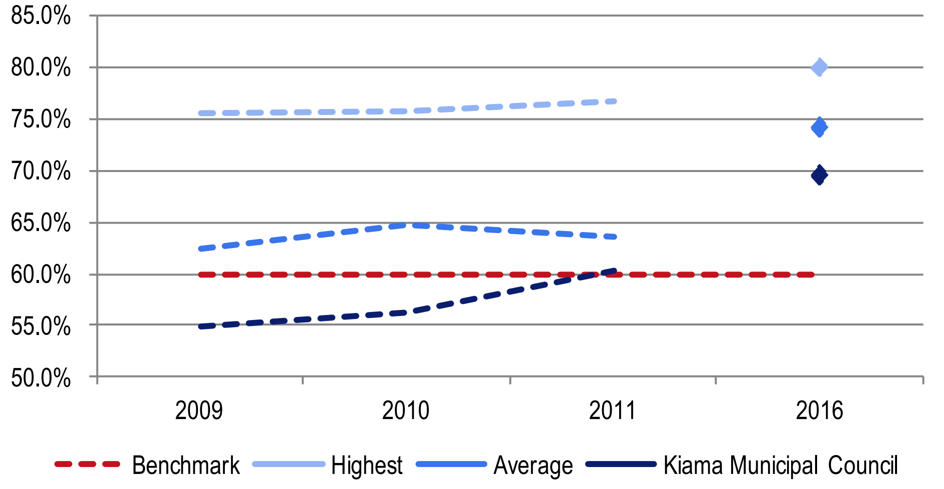
Figure 15 - Operating Ratio Comparison



Council's Operating Ratio fluctuated over the review period but remained above benchmark and above the group's average. Consistent with other councils in the group, it experienced a decline in operating results in 2011 due to increased operating expenses including increased depreciation.

The results are forecast to deteriorate over the medium term to below average and benchmark.

Figure 16 - Own Source Operating Revenue Ratio Comparison



Council's Own Source Operating Revenue was below benchmark in 2009-2010, but improved in 2011 to slightly above the benchmark level. Council's own source revenue is forecast to improve further over the medium term.

Overall, Council's financial flexibility is sufficient.

Liquidity

Figure 17 - Cash Expense Ratio Comparison

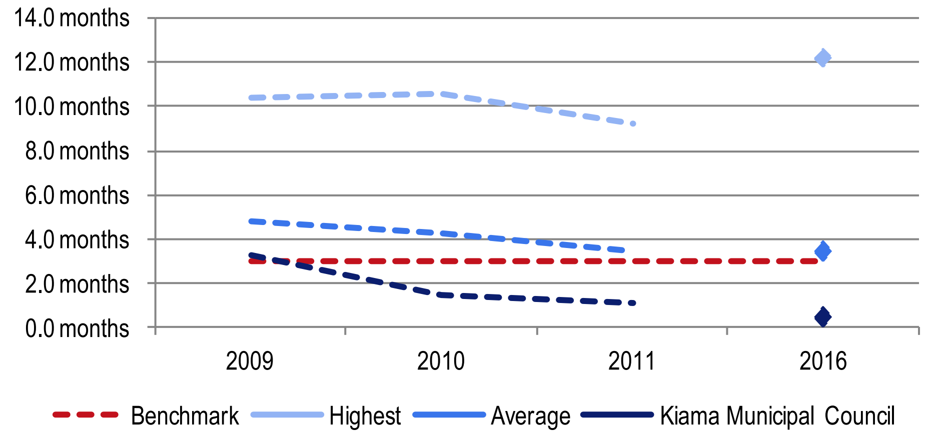
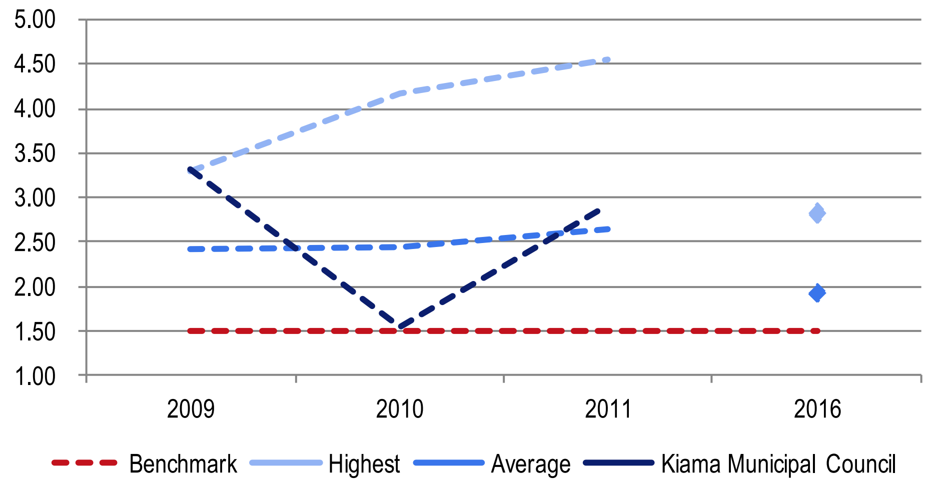


Figure 18 - Unrestricted Current Ratio Comparison



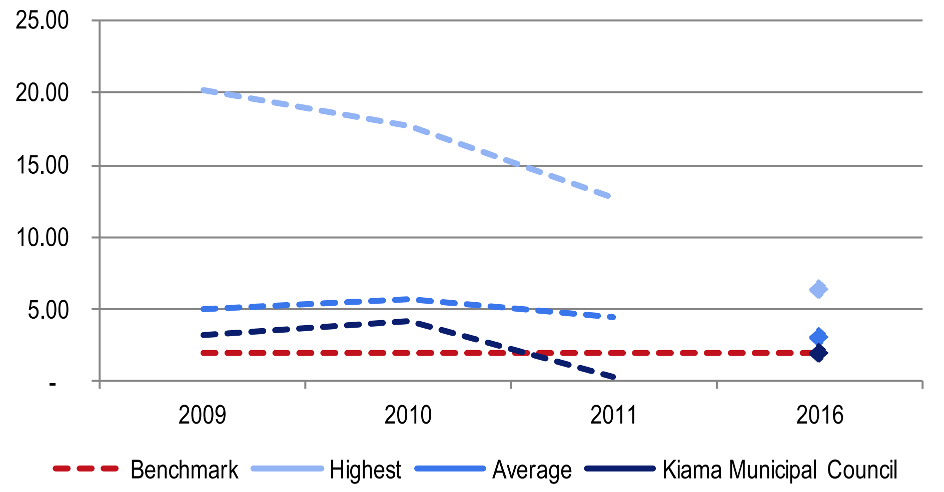
Council's Cash Expense Ratio was below the group's average in the past three years, below benchmark in the past two years, and is forecast to remain low over the medium term.

Council's Unrestricted Current Ratio was above benchmark in the past three years, however no forecast has been provided for the medium term.

Overall, Council's cash inflows appear to be inadequate to support a strong liquidity position. However, when investments are considered in the Cash Expense Ratio, Council's liquidity compares well with its peers and is forecast to remain sufficient over the medium term.

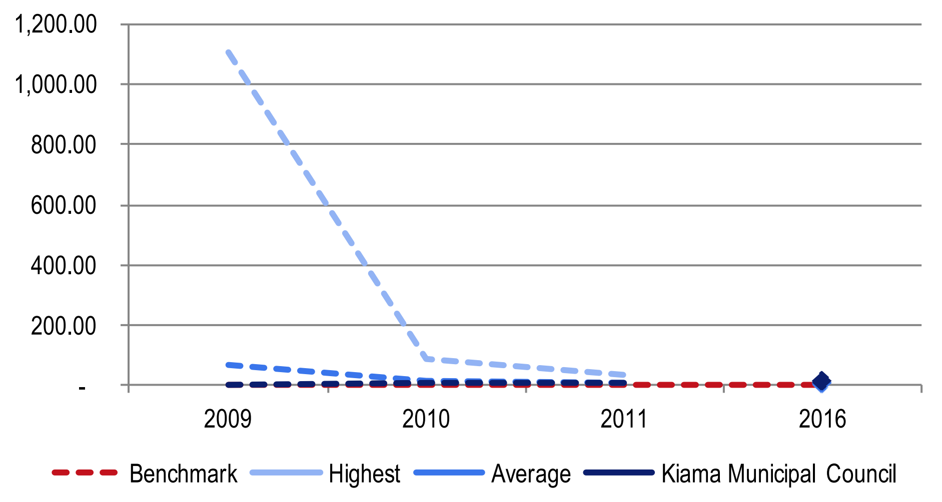
Debt Servicing

Figure 19 - Debt Service Cover Ratio Comparison



New South Wales Treasury Corporation

Figure 20 - Interest Cover Ratio Comparison



Council's DSCR was below the group's average in the past three years and above benchmark in two of the past three years, falling below benchmark in 2011. DSCR is forecast to return to benchmark levels over the medium term. Council's Interest Cover Ratio was under the group's average but above benchmark in the past three years, and is forecast to improve significantly in future years.

Overall, Council has sufficient debt servicing but at lower levels than other councils in the group, indicating that it is more highly geared than its peers.

Asset Renewal and Capital Works

Figure 21 - Capital Expenditure Ratio Comparison

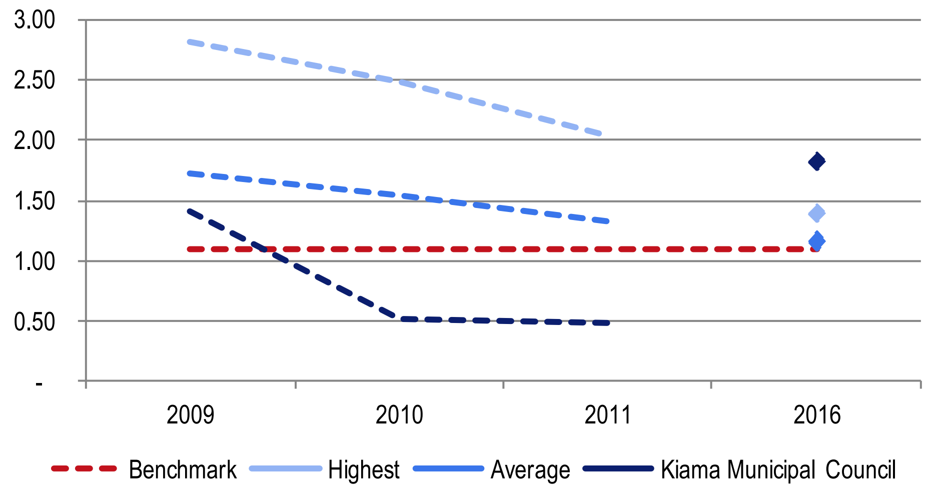


Figure 22 - Asset Maintenance Ratio Comparison

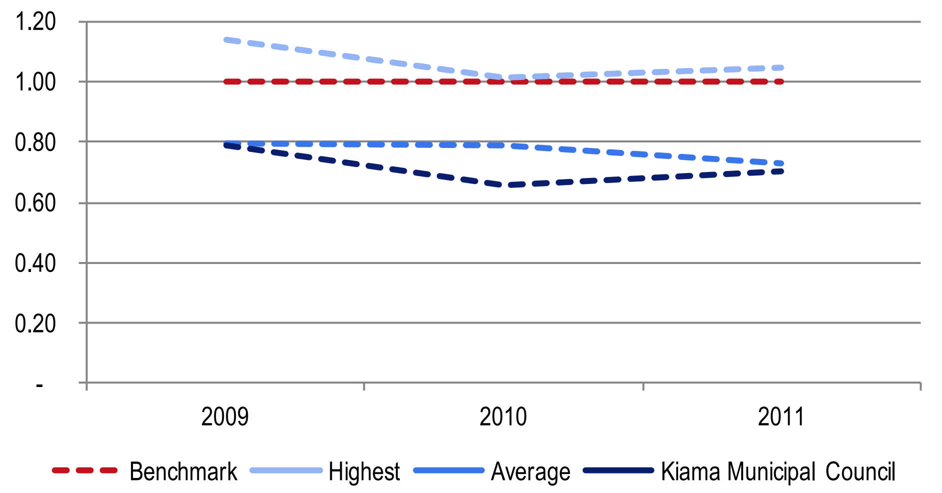


Figure 23- Infrastructure Backlog Ratio Comparison

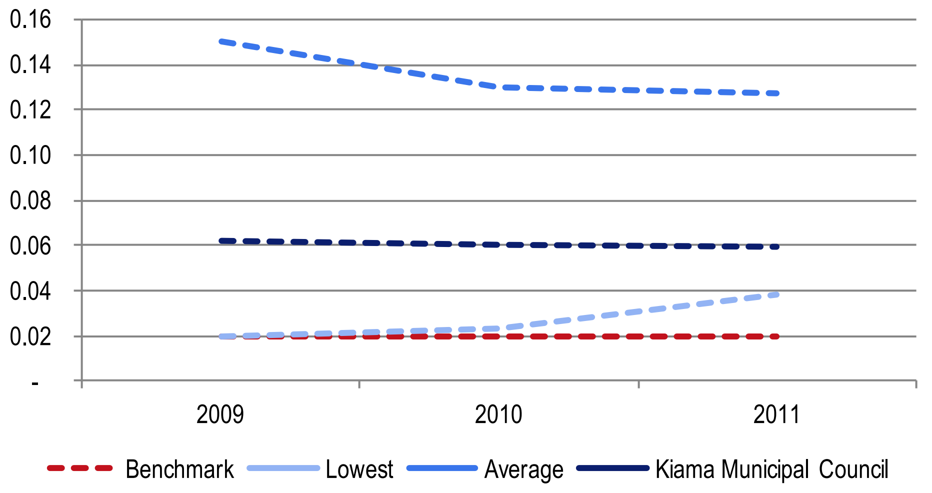
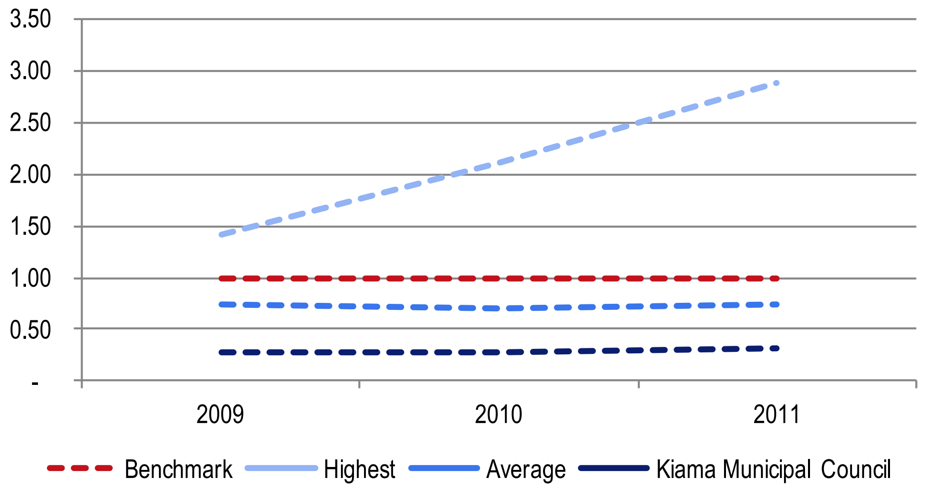


Figure 24 - Building and Infrastructure Asset Renewal Ratio



Overall, Council had a much lower Infrastructure Backlog than the average council in the group. However, Council's capital expenditure, asset maintenance, and building and infrastructure renewal spending compares unfavourably with its peers, indicating that it has spent an insufficient amount on capital works and maintenance in recent years.

Overall, Council's infrastructure backlog was above benchmark levels over the review period, and underspending on asset maintenance and renewal will likely result in the backlog continuing to grow.

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 long term financial plan we consider Council to be in a sound financial position. Council revenues have been boosted through property development; however there is a finite amount of land development that they can engage in.

Both past performance and the financial forecasts support our findings that Council has sufficient financial capacity to service the additional borrowings proposed under its LIRS application.

We base our recommendation on the following key points:

- Council has sufficient financial capacity to repay the additional $2.6m debt highlighted by a DSCR and Interest Cover Ratio above the benchmarks in all 10 years of its financial forecast
- Council has maintained control of expenses in the past three years, especially employee costs
- Council currently has a low level of borrowings at $5.7m, being 1.8% of net assets

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

- Council should consider other revenue generating opportunities and manage their associated risks, as property development income is forecast to decrease over time. Council have indicated that they are setting up a committee made up of two councillors and the general manager, to explore other commercial opportunities to improve the revenue base. Where such opportunities are not available (within acceptable risk parameters), Council will need to examine options to increase its traditional own sourced revenue sources
- Capital expenditure has been below benchmark levels in the last three years, and is not forecast to be at or above benchmark for the next 10 years. Based on these forecasts, the asset base will continue to decline and Council will need to focus on improving this if the backlog is to reduce and the current service levels are to be maintained.
- Continued forecast operating deficits will place pressure on Council to maintain services levels.

New South Wales Treasury Corporation

Appendix A Historical Financial Information Tables

Table 1- Income Statement

Income Statement ($'000's)	Year ended 30 June			% annual change	
	2011	2010	2009	2011	2010
Revenue					
Rates and annual charges	14,732	13,839	12,975	6.5%	6.7%
User charges and fees	13,787	12,015	11,585	14.7%	3.7%
Interest and investment revenue	1,856	2,237	2,581	(17.0%)	(13.3%)
Grants and contributions for operating purposes	10,125	9,272	8,777	9.2%	5.6%
Other revenues	4,583	4,558	3,702	0.5%	23.1%
Net gain from disposal of assets	821	3,191	2,224	(74.3%)	43.5%
Total revenue	**45,904**	**45,112**	**41,844**	**1.8%**	**7.8%**
Expenses					
Employees	20,016	19,333	18,619	3.5%	3.8%
Borrowing costs	847	1,560	1,467	(45.7%)	6.3%
Materials and contract expenses	15,247	12,964	12,295	17.6%	5.4%
Depreciation and amortisation	7,450	5,841	5,633	27.5%	3.7%
Other expenses	3,771	1,154	2,877	226.8%	(59.9%)
Total expenses	**47,331**	**40,852**	**40,891**	**15.9%**	**(0.1%)**
Operating result (excluding capital grants and contributions)	**(1,427)**	**4,260**	**953**	**(133.5%)**	**347.0%**
Operating result (including capital grants and contributions)	**(109)**	**5,079**	**3,812**	**(102.1%)**	**33.2%**

Table 2 - Items excluded from Income Statement

Excluded items ($'000)			
	2011	2010	2009
Grants and contributions for capital purposes	1,318	819	2,859
Increase (Decrease) in the fair value of investments	454	382	(965)

Table 3 - Balance Sheet

Balance Sheet ($'000's)	Year Ended 30 June			% annual change	
	2011	2010	2009	2011	2010
Current assets					
Cash and equivalents	3,563	4,026	9,205	(11.5%)	(56.3%)
Investments	22,265	36,240	20,571	(38.6%)	76.2%
Receivables	1,732	1,990	1,551	(13.0%)	28.3%
Inventories	3,553	2,040	1,776	74.2%	14.9%
Other	276	276	10	0.0%	2660.0%
Assets held for sale	296	296	0	0.0%	N/A
Total current assets	31,685	44,868	33,113	(29.4%)	35.5%
Non-current assets					
Receivables	753	734	467	2.6%	57.2%
Inventories	0	0	933	N/A	(100.0%)
Infrastructure, property, plant & equipment	281,909	256,130	218,760	10.1%	17.1%
Intangible assets	2,400	2,400	2,400	0.0%	0.0%
Investment property	76,768	77,454	75,556	(0.9%)	2.5%
Total non-current assets	361,830	336,718	298,116	7.5%	12.9%
Total assets	**393,515**	**381,586**	**331,229**	**3.1%**	**15.2%**
Current liabilities					
Payables	64,274	63,842	2,780	0.7%	2196.5%
Borrowings	1,121	18,644	1,226	(94.0%)	1420.7%
Provisions	5,519	5,296	7,000	4.2%	(24.3%)
Total current liabilities	70,914	87,782	11,006	(19.2%)	697.6%
Non-current liabilities					
Borrowings	0	0	1,000	N/A	(100.0%)
Provisions	4,558	5,679	24,324	(19.7%)	(76.7%)
Provisions	0	0	52,393	N/A	(100.0%)
Total non-current liabilities	4,558	5,679	77,717	(19.7%)	(92.7%)
Total liabilities	**75,472**	**93,461**	**88,723**	**(19.2%)**	**5.3%**
Net assets	**318,043**	**288,125**	**242,506**	**10.4%**	**18.8%**

Table 4-Cashflow

Cashflow Statement ($'000)	Year ended 30 June		
	2011	**2010**	**2009**
Cashflows from operating activities	7,301	10,440	9,059
Cashflows from investing activities	10,882	(20,373)	(24,401)
Proceeds from borrowings and advances	0	5,980	4,367
Repayment of borrowings and advances	(18,644)	(1,226)	(1,051)
Cashflows from financing activities	(18,644)	4,754	3,316
Net increase/(decrease) in cash and equivalents	**(461)**	**(5,179)**	**(12,026)**
Cash and equivalents	3,563	4,026	9,205

New South Wales Treasury Corporation

Appendix B Glossary

Asset Revaluations

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

Collateralised Debt Obligation (CDO)

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

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

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

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

Division of Local Government (DLG)

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

Depreciation of Infrastructure Assets

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

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

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

EBITDA

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

Grants and Contributions for Capital Purposes

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

Grants and Contributions for Operating Purposes

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

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

Independent Commission Against Corruption (ICAC)

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

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

Independent Pricing and Regulatory Tribunal (IPART)

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

Infrastructure Backlog

Infrastructure backlog is defined as the estimated cost to bring 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.

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.

New South Wales Treasury Corporation

Ratio Explanations

Asset Maintenance Ratio

Benchmark = Greater than 1.0x

Ratio = actual asset maintenance / required asset maintenance

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

Building and Infrastructure Renewals Ratio

Benchmark = Greater than 1.0x

Ratio = Asset renewals / depreciation of building and infrastructure assets

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

Cash Expense Cover Ratio

Benchmark = Greater than 3.0 months

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

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

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.