New South Wales
Treasury Corporation

Blayney Shire Council

Financial Assessment and Benchmarking Report

13 March 2013

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

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.

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

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Section 1 Executive Summary

This report provides an independent assessment of Blayney Shire 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 one application for $1.0m for the replacement of timber bridges across the Council's LGA.

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. For the Council, the project is being funded from the General Fund so we focused our review on the General Fund.

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

- Council's underlying operating performance, measured by EBITDA, shows consistent, albeit small positive results over the period
- Council has been able to maintain expenses at a similar level across the three years when depreciation is excluded
- Council has had sound liquidity indicated by a strong Unrestricted Current Ratio
- Council has a conservative debt management policy that has enabled them to manage their borrowing commitments sufficiently

Council's reported Infrastructure Backlog of $24.3m in 2011 represents 15.2% of its infrastructure asset value of $159.6m. Other observations include:

- The Infrastructure Backlog total has increased by 110.0% compared to the 2010 figure of $11.6m following the Asset Revaluations, improvement of Council's Asset Management Plan and analysis of their infrastructure asset condition status
- Council has been unable to reach the benchmark in all three years in relation to the Asset Maintenance, Building and Infrastructure Renewals and Capital Expenditure Ratios. If the current level of spending continues the Infrastructure Backlog is likely to increase further.

The key observations from our review of Council's 10 year forecasts for its General Fund under the 'Mining SRV model scenario' are:

- Operating deficits are expected in all 10 years under the scenario despite the mining SRV permanently boosting rates revenue from 2013
- Overall, Council's level of fiscal flexibility is satisfactory as Own Sourced Operating Revenue Ratio is maintained at levels above 60% for the majority of the forecast

- The forecast capital expenditure program included in this scenario is dependent on Council receiving additional revenue (possibly from an additional SRV) as Council will be unable to fund its forecast capital program from 2018 in the scenario as their cash and investments will have been fully utilised by this point
- Council is able to manage the additional borrowing costs within the forecast if the capital expenditure program is revised downward to improve the liquidity position

In our view, the Council has the capacity to undertake the combined additional borrowings of $1.0m for the LIRS project. This is based on the following analysis:

- Council is aware that they need to apply for an SRV to increase ordinary rates revenue if they are to complete the scheduled capital expenditure program
- If Council is unsuccessful in their SRV application they will need to revise their LTFP as indicated in our alternative scenario (see section 4 for details) to improve their liquidity position. This will also involve amending the operating plan and delivery program so that the planned service delivery and capital expenditure is deferred or revised in order to reduce the budget so that Council is able to their liabilities
- This in turn would result in a reduction in depreciation expense and forecast employee costs as additional employees required to deliver the additional capital expenditure would not be required
- Council's DSCR and Interest Cover Ratio remain above the benchmark in all 10 years highlighting that if the liquidity position is addressed then Council is in a adequate position to service the additional borrowings

In respect of our Benchmarking analysis we have compared the Council's key ratios with other councils in DLG Group 10. Our key observations are:

- Council's financial flexibility as indicated by the Operating Ratio and Own Source Operating Revenue Ratio is varied with a weaker than group average operating performance but a higher than group average ability to generate own source operating revenues
- Council has less relative capacity to utilise further borrowings than the group average as it has a weaker DSCR and Interest Cover Ratio
- Council was in a sufficient liquidity position and was above the group average liquidity level with Council holding the majority of their funds in cash and cash equivalents
- Council's Capital Expenditure Ratio was below the group average but the level of Infrastructure Backlog decreased to benchmark in 2012, significantly below the group average. Asset maintenance and renewals funding has not been adequate, below the benchmark in each year although both have improved above the group average in 2012

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	> 1.50x
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

2.3: Overview of the Local Government Area

Blayney Shire Council LGA	
Locality and Size	
Locality	Central West
Area	1,526 km²
DLG Group No.	10
Demographics	
Population	6,985
% under 20	29%
% between 21 and 60	49%
% over 60	22%
Expected population in 2021	7,200
Operations	
Number of employees (FTE)	63
Annual revenue	$11.1m
Infrastructure	
Roads	727 km
Bridges (Timber)	26
Infrastructure backlog value	$24.3m
Total infrastructure value	$159.6m

Blayney Shire Council Local Government Area (LGA) is located in the Central Tablelands of NSW, approximately three hours west of Sydney.

The LGA comprises of a number of villages including Millthorpe, Carcoar, Mandurama, Lyndhurst, Neville, Newbridge, Hobbys Yards and Barry.

Blayney Shire is predominately rural in nature, supporting primary industries such as the farming of dairy, beef, lamb, wool, viticulture, orchards, potatoes, canola and other grains. Mining is also a key industry and the area supports other industrial activities such as manufacturing, transportation and food processing.

Council manages infrastructure, property, plant and equipment (IPP&E) assets with total value of $179.5m. Within this total there are:

- $124.0m of roads, bridges and footpaths
- $14.5m of sewerage infrastructure
- $4.2m of stormwater drainage infrastructure
- $8.5m of specialised buildings
- $2.1m of non-specialised buildings
- $1.8m of other structures

2.4: LIRS Application

Council has made one LIRS application.

Project: Blayney Bridges Recovery Program

Description: The project aims to replace and/or repair timber bridges across the Council LGA

Amount of loan facility: $1.0m

Term of loan facility: 10 years

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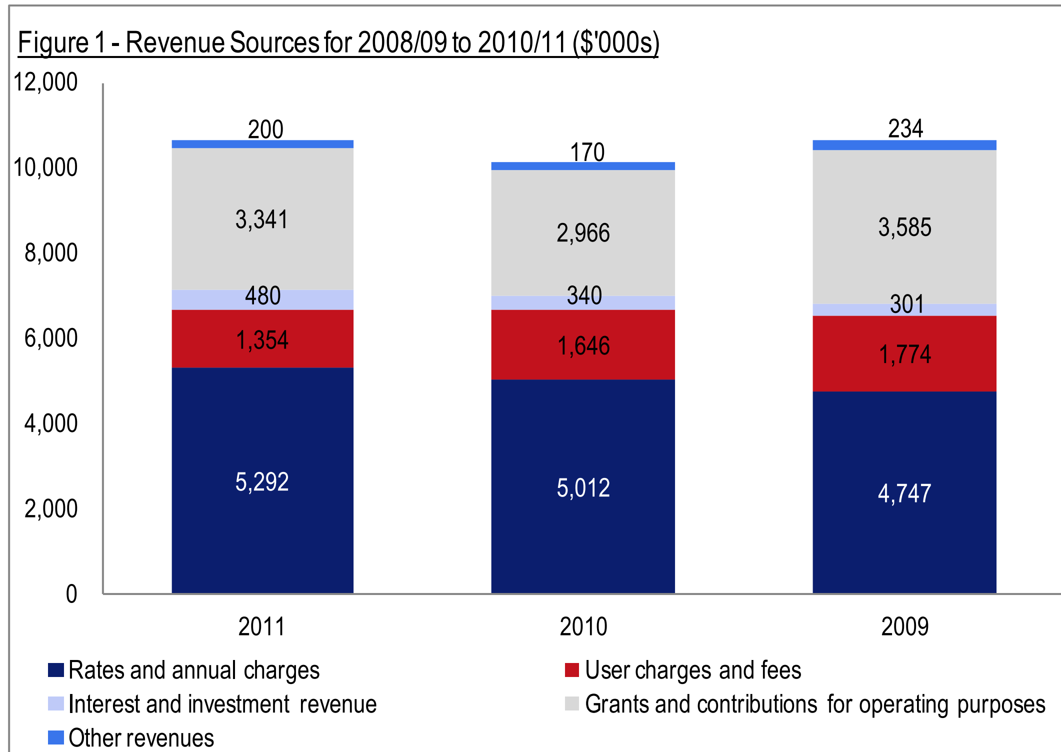
Section 3 Review of Financial Performance and Position

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

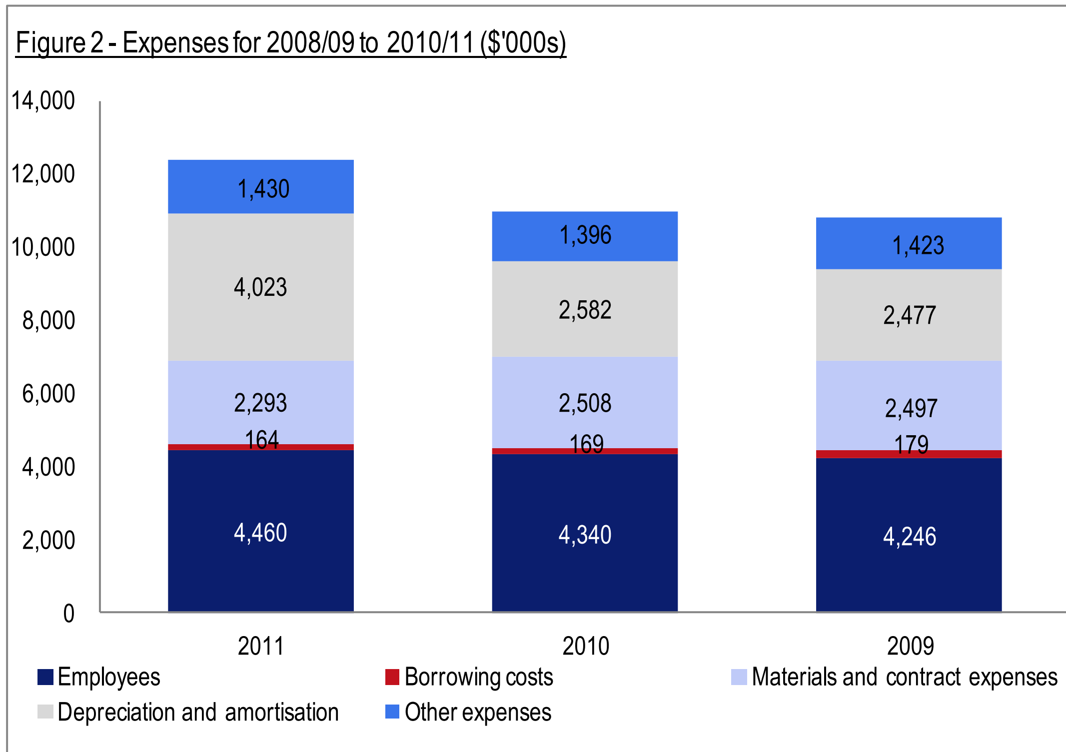
3.1: Revenue



Key Observations

- Total operating revenues have remained static over the period.
- Rates and annual charges have increased steadily by 5.6% p.a. with the increases for ordinary rates being supported by larger increases in both domestic waste management and sewerage service annual charges. Rates are inclusive of a 10 year SRV that began in 2009 with an 8.19% increase for capital improvements to the community centre in Blayney. This is built into the revenue base until 2018.
- User charges and fees have been decreasing over the period with private works, RMS charges and the multipurpose centre charges contributing most to the reduction.
- Council's own source operating revenue (rates and annual charges, and user charge and fees combined) represented 59.9% of total revenue in 2011.
- Operating grants and contributions have been the least consistent over the three years with the reduction in 2010 due to a reduction in the general component of the financial assistance grant. This reduction was purely a timing difference with the first 2010 quarter payment received within 2009. The increase in 2011 was due to a $0.3m specific purpose grant being received for road and bridges transport funding.

3.2: Expenses



Key Observations

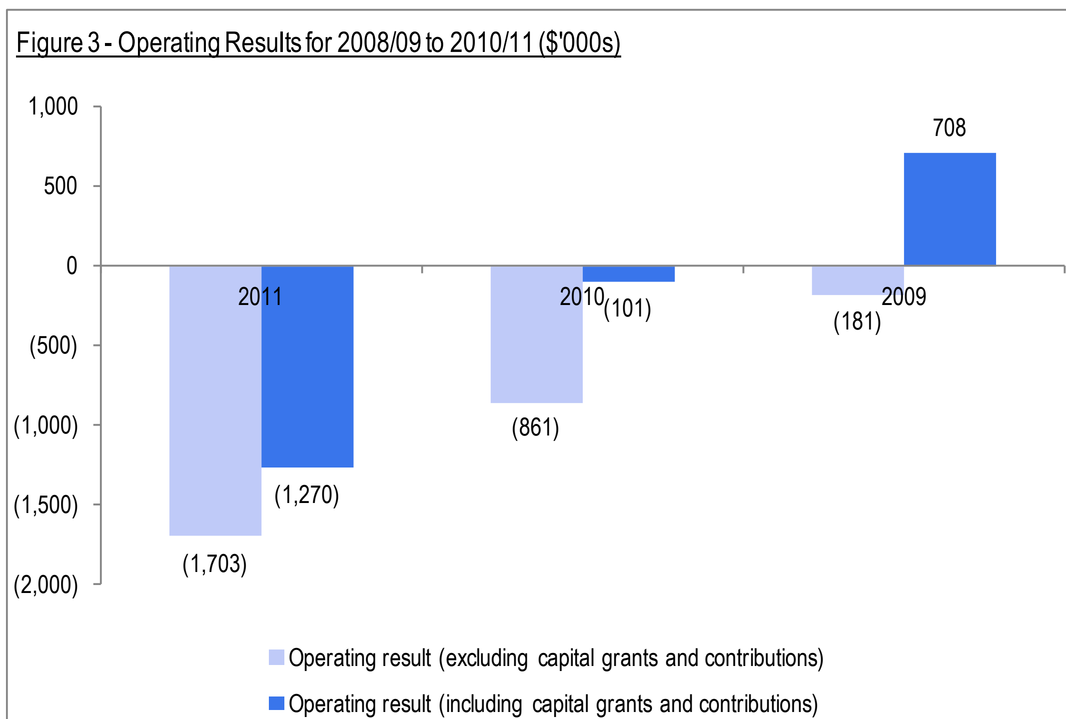
- Total expenses have increased by $1.5m to $12.4m over the three year period
- Employee expenses have increased by 2.2% in 2010 and 2.8% in 2011. These rates are below the average NSW wage indexation rates. The number of equivalent full time employees reduced slightly from 65 in 2009 to 63 in 2011.
- Materials and contract expenses reduced in 2011 due to a $0.3m reduction in raw materials and consumables to $2.1m.
- Depreciation increased by 55.8% in 2011 to $4.0m. The $1.4m increase is related to an increase in the value of roads, bridges and footpath infrastructure following the Asset Revaluations in 2010.
- Other expenses have remained static with the largest components in 2011 being electricity and heating costs of $0.3m, donations, contributions and assistance to other organisations at $0.3m, and insurance of $0.2m.
- Council is committed to the Strategic Alliance with Wellington, Cabonne and Central Tablelands Water County Councils to review work practices and investigate resource sharing and this aims to assist Council to minimise the increase in expenses where possible.

3.3: Operating Results

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

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

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



Key Observations

- Council's operating results have been on a downward trend across the three year period as expenses have grown faster than revenues. This has led to an increasing deficit position over the period when capital grants and contributions are excluded.
- Council expenses include a non-cash depreciation expense, ($4.0m in 2011), which has increased by $1.5m 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

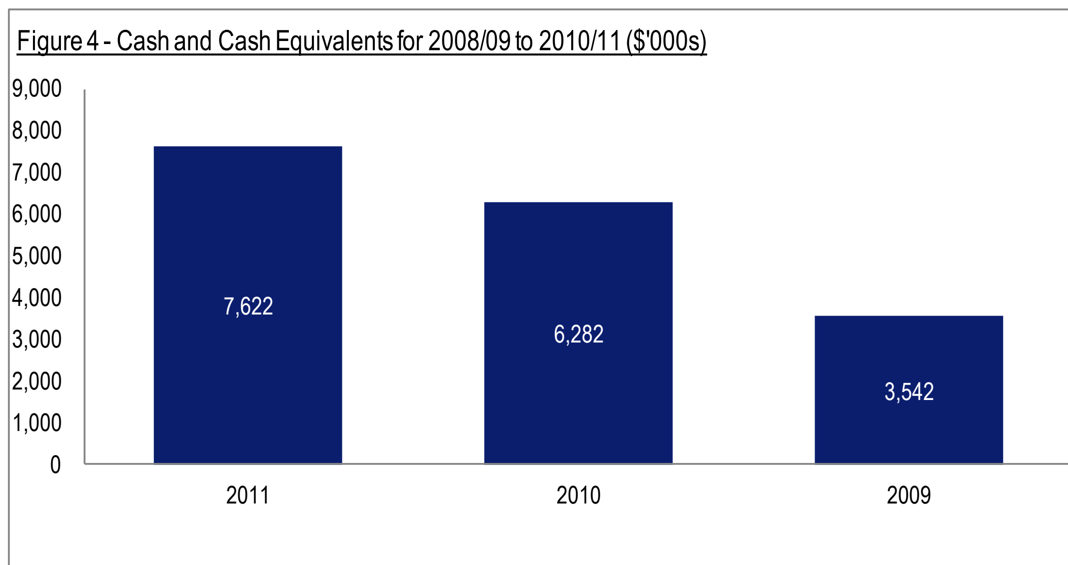
Performance Indicators	Year ended 30 June		
	2011	2010	2009
EBITDA ($'000s)	2,484	1,890	2,475
Operating Ratio	(16.0%)	(8.5%)	(1.7%)
Interest Cover Ratio	15.15x	11.18x	13.83x
Debt Service Cover Ratio	10.18x	6.47x	7.26x
Unrestricted Current Ratio	4.32x	4.12x	3.62x
Cash Expense Ratio	11.2 months	9.1 months	5.2 months
Own Source Operating Revenue Ratio	59.9%	61.1%	56.6%
Net assets ($'000s)	185,923	178,718	77,513

Key Observations

- EBITDA, a measure of Council's underlying performance, recorded a similar result each year, with a minor decrease in 2010 related to lower operating grants and contributions.
- The Operating Ratio has declined due to the lower grant revenue in 2010 and the increased depreciation charge in 2011. The ratio has been below benchmark in the last two years indicating an unsustainable trend.
- The Interest Cover Ratio and DSCR indicate that over the three year period Council has had sufficient capacity to manage their debt commitments.
- Council has total borrowings of $2.0m in 2011 compared to $2.2m in 2009. The 2011 figure represents 1.1% of Net Assets.
- The Unrestricted Current Ratio has been above the benchmark of 1.5x in all three years and has been on an upward trend indicating that Council did not have liquidity issues and was able to meet all short term liabilities when they fall due.
- The Cash Expense Ratio has increased over the period in line with the increase in cash and cash equivalents. The Ratio is well above benchmark and Council could consider investing excess cash in approved term deposits to achieve higher investment returns.
- The Own Source Operating Revenue Ratio in 2011 is below the benchmark in two of the last three years. This ratio will likely improve in the future as Council benefits from an SRV from 2013. Please see Section 4.1 for further information.
- Net Assets have increased in each year due to the Asset Revaluations process. In 2010 there was a $100.5m increase in the value of infrastructure assets while in 2011 there was an $8.5m increase in the value of community land, land improvements and other structures. Consequently, in the short term the value of Net Assets is not necessarily an informative indicator of performance. In the medium to long term however, this is a key indicator of a Council's capacity to add value to its operations. Over time, Net Assets should increase at least in line with inflation plus an allowance for increased population and/or improved or increased services. Declining Net Assets is a key indicator of the Council's assets not being able to sustain the ongoing operations of a Council.

- When excluding the Asset Revaluations, Council's IPP&E asset base decreased by $3.4m over the review period, with asset purchases being lower than the combined value of disposed assets and depreciation.

3.5: Statement of Cashflows



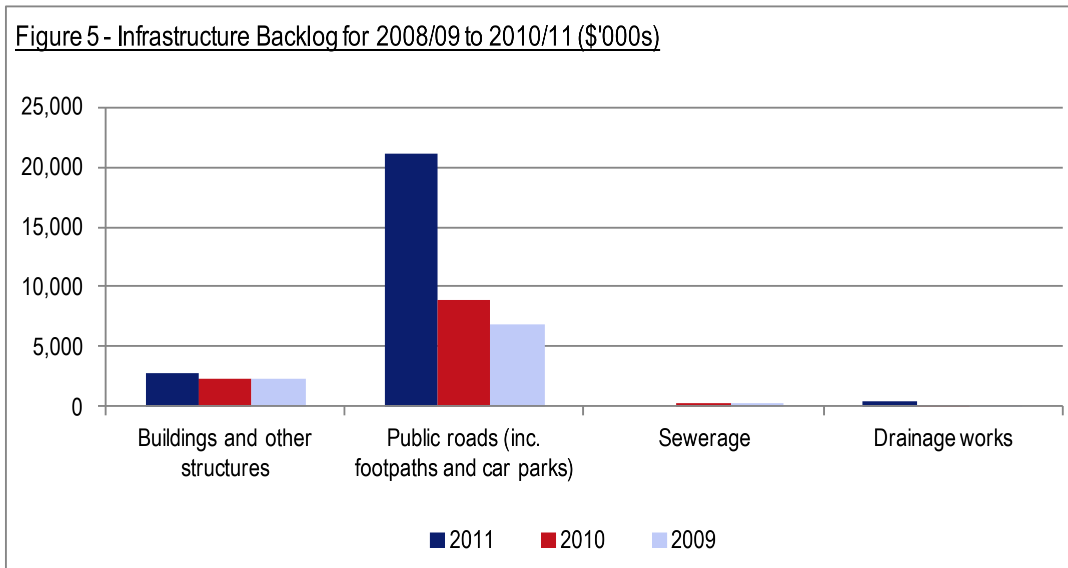
Key Observations

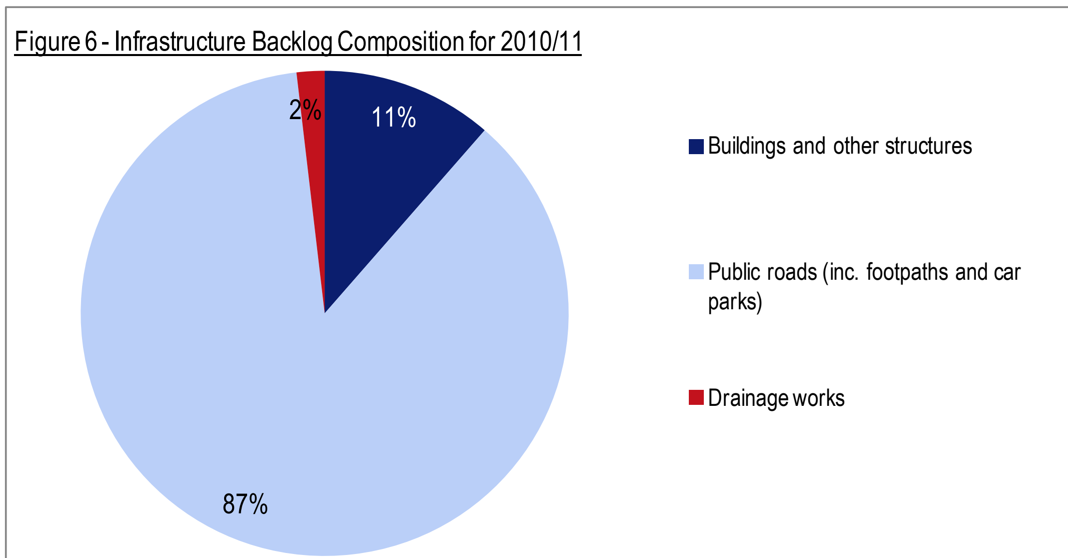
- Council's cash and cash equivalents have been on an upward trend over the three year period.
- Overall cash and cash equivalents, and investments have increased from $6.2m in 2009 to $8.2m in 2011. Of the $8.2m, $4.8m is externally restricted, $3.4m is internally restricted and a small remainder is unrestricted.
- The investments portfolio value as at 30 June 2011 of $0.6m is made up entirely of CDOs, with $0.4m classified as current and $0.2m as non-current. Council has confirmed that the $0.4m CDO was realised at a value of $0.5m during 2012 and the last remaining CDO is expected to be redeemed at the value stated within the accounts.
- The levels of cash and investments along with the above benchmark Unrestricted Current Ratio highlights that the Council has satisfactory liquidity.

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





Consistent with many councils, the Infrastructure Backlog is dominated by public roads assets that make up $21.0m of the $24.3m total in 2011.

The Infrastructure Backlog has increased each year with the public roads backlog increasing 137.4% in 2011 following the Asset Revaluations. This coincided with the completion of Council's Asset Management Plan which has improved the analysis of their infrastructure assets' quality and the estimated cost to renew them to a satisfactory standard.

3.6(b): Infrastructure Status

Infrastructure Status	Year ended 30 June		
	2011	2010	2009
Bring to satisfactory standard ($'000s)	24,260	11,555	9,571
Required annual maintenance ($'000s)	2,754	2,243	2,080
Actual annual maintenance ($'000s)	1,740	1,583	1,778
Total value of infrastructure assets ($'000s)	159,573	155,987	60,471
Total assets ($'000s)	190,260	183,206	82,019
Building and Infrastructure Backlog Ratio	0.16x	0.07x	0.16x
Asset Maintenance Ratio	0.63x	0.71x	0.85x
Building and Infrastructure Renewals Ratio	0.16x	0.45x	0.53x
Capital Expenditure Ratio	0.29x	0.82x	0.98x

The Infrastructure Backlog has increased year on year but this is offset by the increased value of its infrastructure assets with the Buildings and Infrastructure Backlog Ratio remaining at 0.16x. This is considerably higher than the benchmark of 0.02x.

The Asset Maintenance Ratio, Building and Infrastructure Renewals Ratio, and Capital Expenditure Ratio have been below the benchmarks in all three years indicating that Council has not invested sufficiently in asset maintenance, renewal or new assets.

These three ratios are declining over the period while Council has accumulated cash reserves. This indicates that Council could have allocated further resources to asset renewal and maintenance while remaining within the benchmark liquidity limits.

3.6(c): Capital Program

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

Capital Program ($'000s)	Year ended 30 June		
	2011	**2010**	**2009**
New capital works	35	218	220
Replacement/refurbishment of existing assets	2,370	202	941
Total	**2,405**	**420**	**1,161**

The main focus of Council's capital program is road infrastructure improvement with other projects including:

- New barbeque and picnic facilities in Neville, Carcoar and Lyndhurst
- New playground equipment in Newbridge
- Resurfacing of Blayney Netball Courts
- Construction of a Sewerage Treatment Plant Lab and Amenities building

3.7: Specific Risks to Council

- Mining expansion. While the LGA should benefit economically from the jobs created by the expanding mining industry, Council has to manage the infrastructure and housing development that is required to accommodate the increase in road usage and demand for community services. Council is aware of the pressure that the mining expansion creates and understands the positive factors that it can provide. Council has successfully applied for a specific mining SRV to charge the main mining company Newcrest Mining Ltd (NML) additional rates to invest in infrastructure. Council did this with the full co-operation of NML.
- High staff turnover. Council have an average staff turnover of over 20% p.a. in the three year period although this did reduce to 17.5% in 2011. The majority of the employees that have left have been due to resignations as opposed to retirement. Council is focused on retaining its workforce and identifying particular issues that are contributing to employees' resignations. This includes developing a training program that will enable employees to develop additional skills and attributes that is likely to improve employee morale.
- Limited workforce resources. Council aims to deliver community service expectations however to do so they have identified that a further 14 operational roles are required. This issue was highlighted within the CSP.
- Environmental disasters. The LGA has been declared a natural disaster zone on three occasions in the last three years due to bushfires in November 2009 and floods in November/December 2010 and February/March 2012. Council has to manage the impact of these events on a limited budget and relies upon Federal and State grant funding to assist with this.
- Limited medical facilities access. Council needs a doctor to operate the existing emergency centre. If these facilities are not used then the Council will have to rely on neighbouring LGA's medical facilities.

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 $1.0m loan without any LIRS subsidy.

The LIRS loan relates to the General Fund, therefore we have focused our financial analysis solely upon this Fund. Council's consolidated position includes a Sewer Fund however this is operated as an independent entity, which unlike the General Fund is more able to adjust the appropriate fees and charges to meet all future operating and investing expenses.

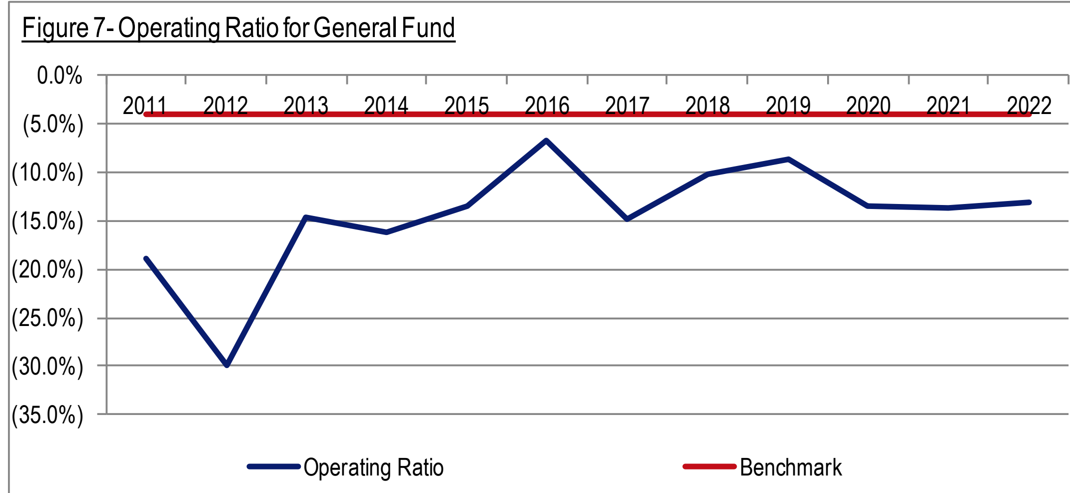
Council has provided TCorp with three scenarios within their LTFP. TCorp has based its analysis on the current operating position, stated as the 'Mining SRV model' within the LTFP, that is inclusive of a specific mining SRV that was approved by IPART in June 2012. This scenario has the same capital expenditure program as the 'Mining and Community SRV' described below.

As part of our analysis we adjusted the Mining SRV scenario to create a new scenario with the capital expenditure reduced by an equal value to the community SRV rate revenues included within the 'Mining and Community SRV model', with these funds added back into cash and cash equivalents. Figures 9, 11 and 16 illustrate the impact of the new scenario to the relevant ratios. This improves the operating performance when compared to the 'Mining SRV model' however we acknowledge that this amendment is not entirely accurate as associated depreciation, employee and maintenance costs of the proposed capital expenditure remain within the operating expenses.

The scenario stated as the 'Mining and Community SRV model' includes a SRV of 7.0% above an assumed rate peg of 3.35% p.a. between 2014 and 2021. Council has proposed to apply for this in 2013, to begin in 2014 that will further boost their ordinary rates revenue to fund the scheduled capital expenditure program. There is no certainty that this SRV will be approved by IPART.

The final scenario stated as the 'No SRV model' indicated the scenario if Council had not been successful with the mining SRV that has now been approved.

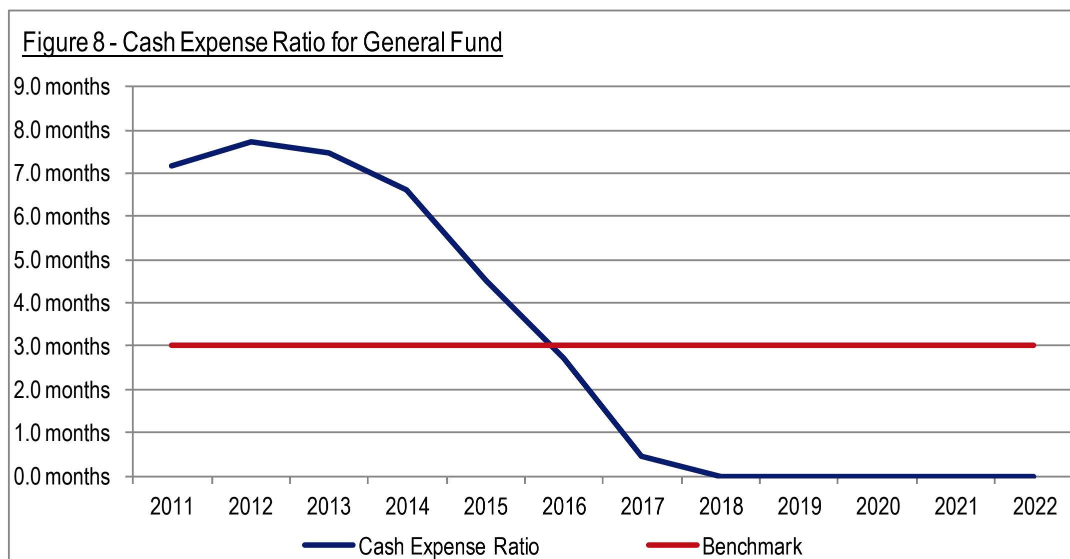
4.1: Operating Results



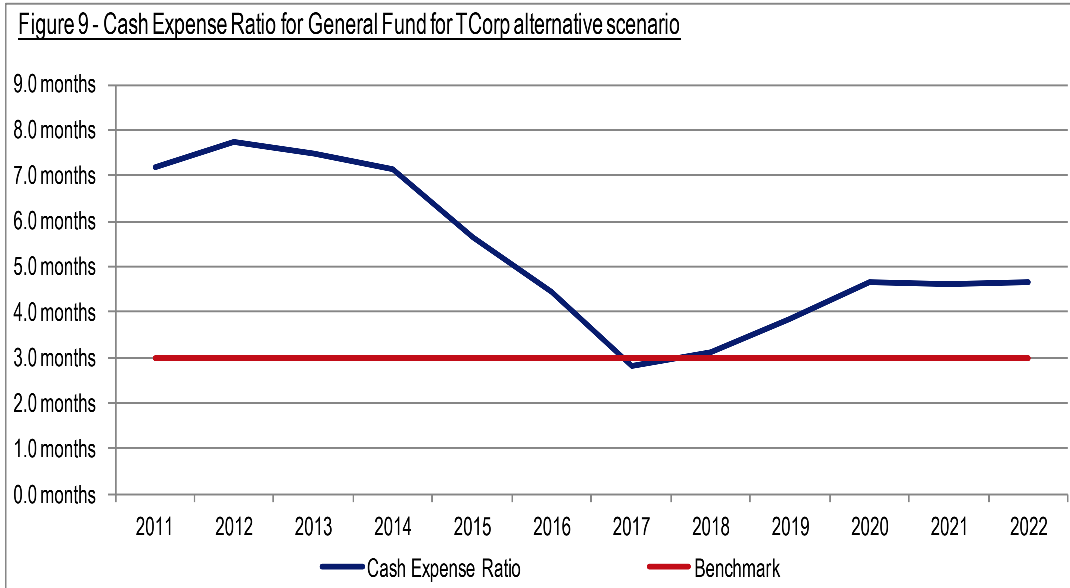
Council has forecast operating deficits in all 10 years. The mining SRV relating specifically to NML was for a one-off permanent increase of 37.1% above the rate peg in rates revenue in 2013 that does not affect the general rate payers. This SRV is to fund road maintenance and improvements along with community facilities for a total of $18.1m between 2013 and 2021. This increase is visible in the graph by the large improvement between 2012 and 2013. The mining SRV on its own is not a sufficient increase to total revenues to enable Council to achieve a sustainable operating position as the revenue received has to be spent on the specific capital expenditure stated within the SRV application. This is confirmed by the Operating Ratio remaining below benchmark for all 10 years of the forecast.

4.2: Financial Management Indicators

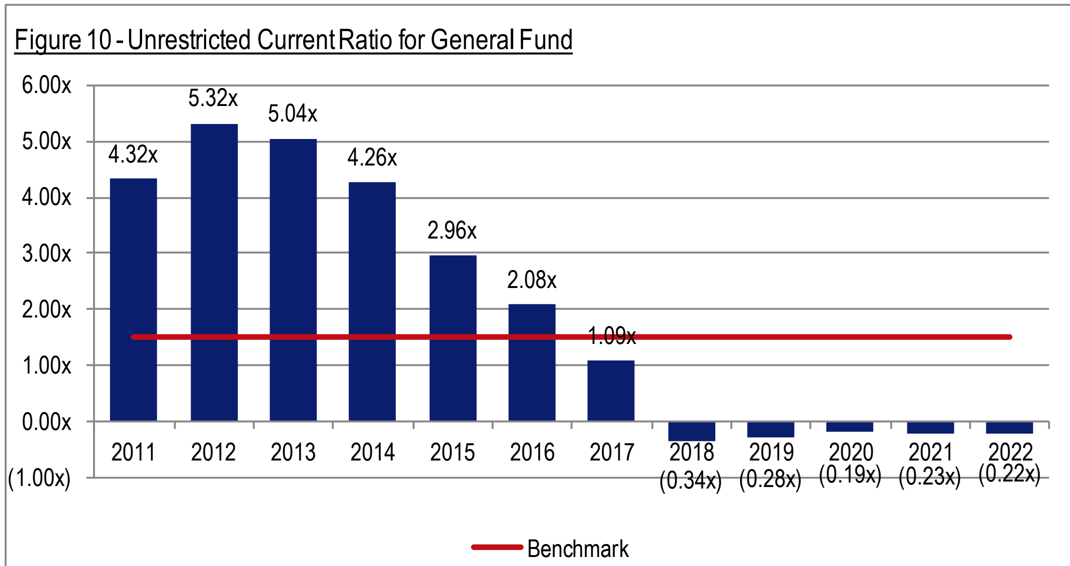
Liquidity Ratios



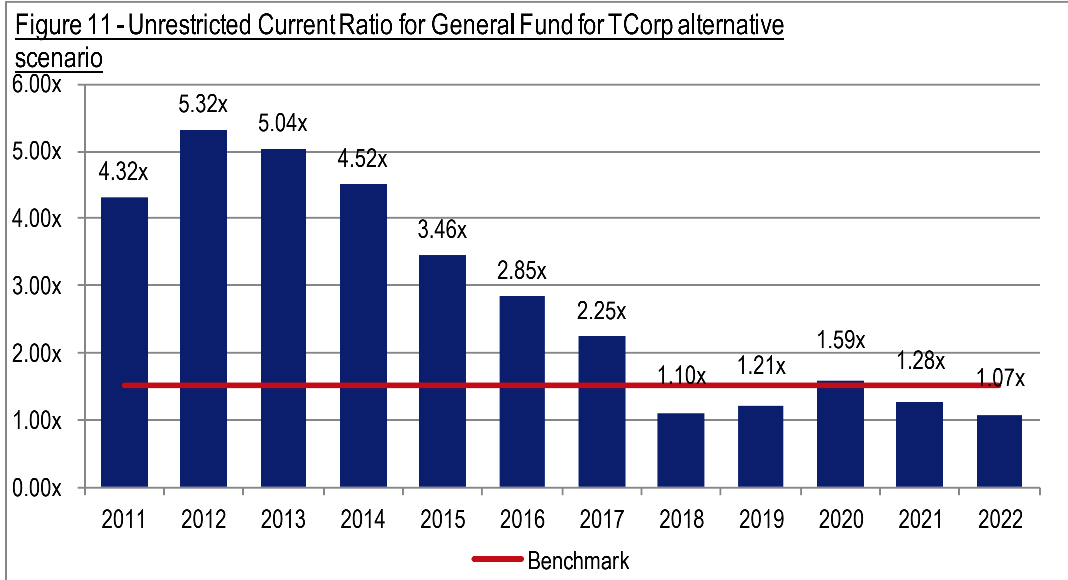
Council forecast that their Cash Expense Ratio deteriorates from its peak in 2012, and by 2018 the ratio is at zero due to the fact that Council has forecast the need for an overdraft facility from this date onwards under this scenario. Council will be forced to cut their capital expenditure before allowing their cash reserves to deteriorate to this extent.



When the cumulative funds of $22.7m for the proposed community SRV are added back to cash and cash equivalents the Cash Expense Ratio shows that Council will remain above the benchmark in every year excluding 2017 when they decrease marginally below at 2.8 months.

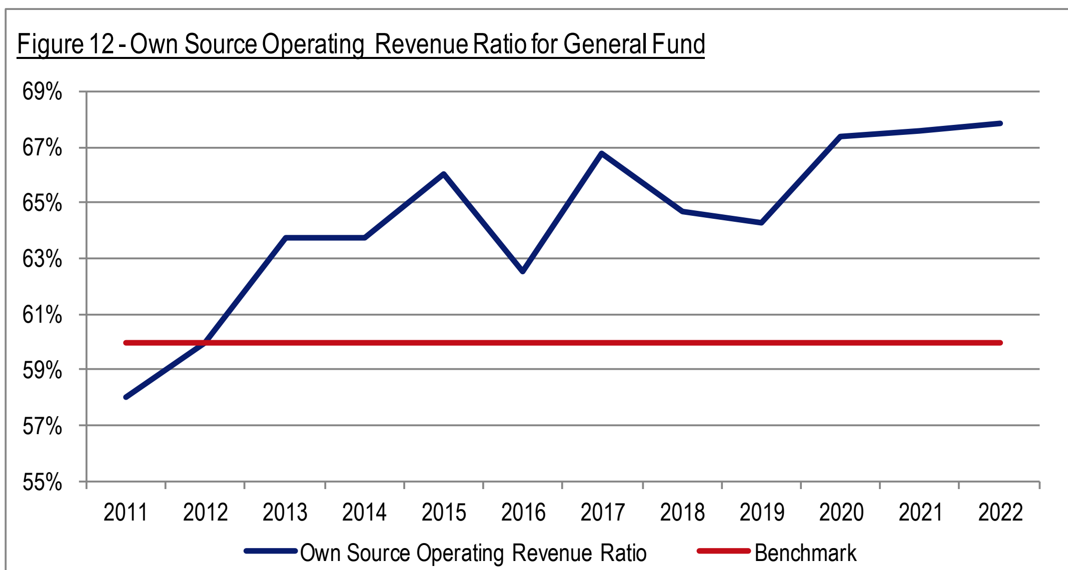


In line with the Cash Expense Ratio, the Unrestricted Current Ratio deteriorates from 2012 and is negative once the overdraft position is operational.

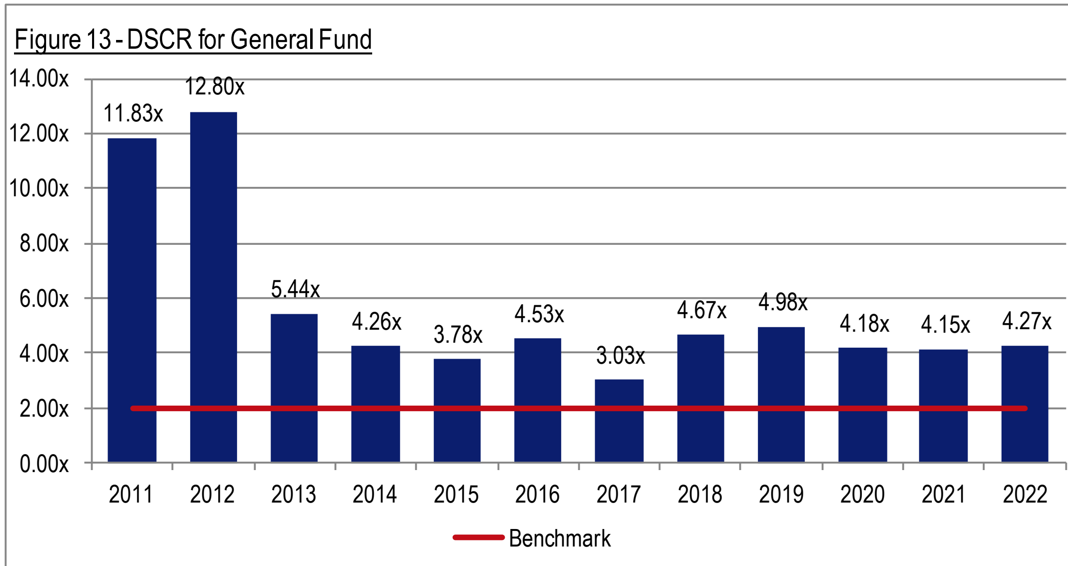


When the cumulative funds of $22.7m for the proposed community SRV are added back the Unrestricted Current Ratio improves but remains below the benchmark in four years. It does however remain above 1.00x indicating that Council would be able to meet all forecast current liabilities and therefore remain liquid.

Fiscal Flexibility Ratios

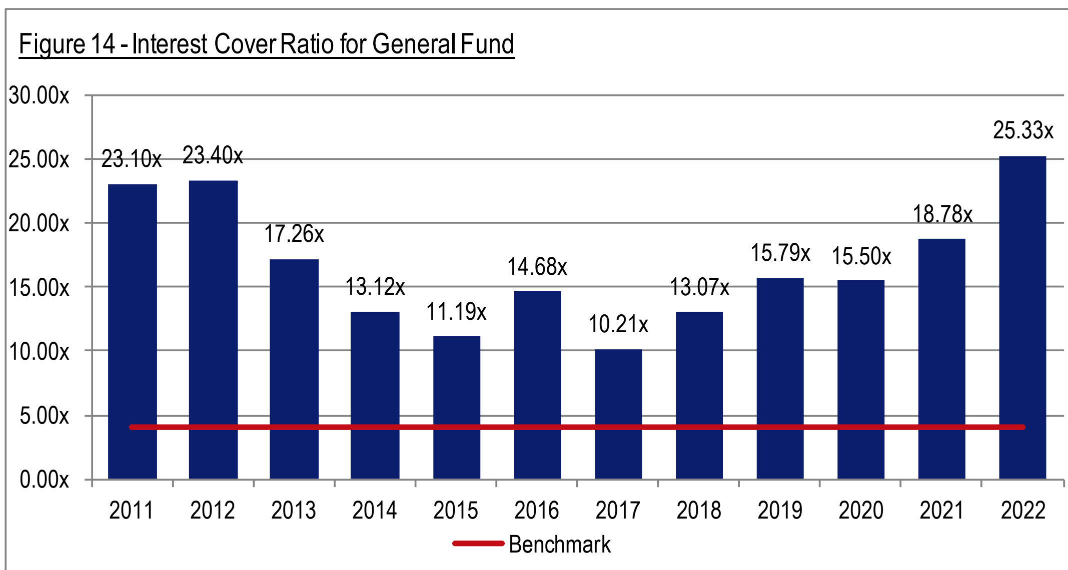


Council has historically been below the benchmark due to the reliance on operating grants and contributions to boost the total revenue due to the small population within the LGA, and limited revenue generating opportunities. The mining SRV has increased the rates revenue from 2013 and in turn has increased the Own Source Operating Revenue Ratio above the benchmark from that year onwards to a high of 68% in 2021 and 2022. The ratio reduces in 2016, 2018 and 2019 due to increased operating grants and contributions forecast in these years.



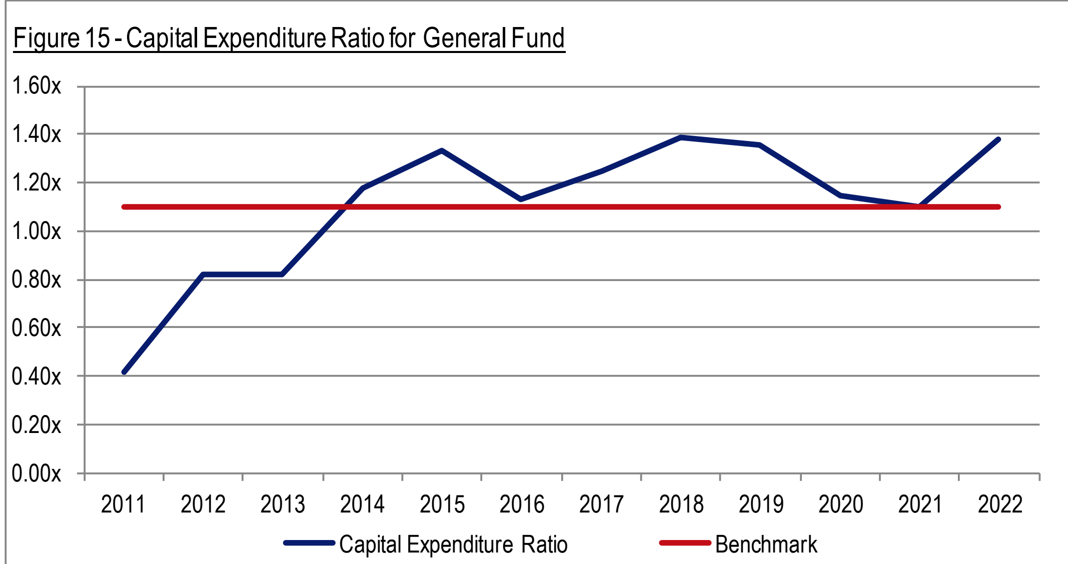
Council has forecast the DSCR to be above the benchmark in all 10 years with the sharp decrease in 2013 linked to the larger debt service costs as Council borrows $1.1m in 2012, $1.0m for the LIRS facility in 2013 and plans to borrow a further $3.5m over four years from 2014 within the General Fund.

This is a significant increase from the total borrowings of $2.0m for the consolidated position in 2011. The General Fund borrowings peak in both 2015 and 2017 at $4.1m for both years.

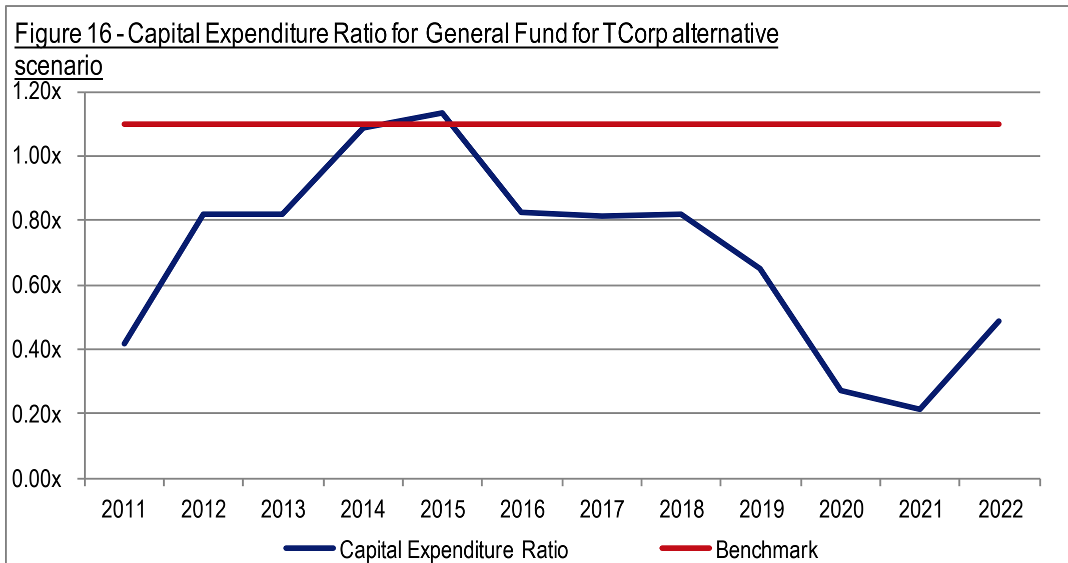


The Interest Cover Ratio, similar to the DSCR, shows the Council has sufficient capacity to service scheduled debt commitments, including the LIRS loan. There is capacity to service further debt interest costs before the Council's ratio decreases to the 4.00x benchmark.

4.3: Capital Expenditure



Council has forecast an improved Capital Expenditure Ratio with the ratio above the benchmark from 2014 onwards. Council's Capital Expenditure Ratio will meet or exceed the benchmark in nine out of 10 years. However Council needs to consider their capital expenditure program in view of their liquidity position. The planned amount of capital expenditure in this model is based on the successful addition of the community SRV in 2014 that increases rates revenue by $22.7m across the period from 2014 to 2021.



With the Community SRV funding removed from the scheduled capital expenditure program the Capital Expenditure Ratio is significantly impacted and reduces to a low of 0.21x in 2021. This indicates the importance of an SRV to Council's proposed capital expenditure program and long term financial sustainability.

4.4: Financial Model Assumption Review

Councils have used their own assumptions in developing their forecasts.

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

TCorp's benchmarks:

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

Key Observations and Risks

- The LTFP assumes current service levels will be maintained at a minimum or improved.
- TCorp believes the majority of the assumptions behind the forecast to be reasonable.
- Employee costs are forecast to increase by 18.8% in 2013 as there is a requirement for additional employees to provide the increased service provision and capital works. This increase would see the Council's full time equivalent staff increase to 78 from 63 in 2011.
- Council has forecast that the Roads to Recovery Program grants that are due to finish in 2014 will continue indefinitely due to the reliance on this grant throughout NSW.
- User charges and fees are forecast to reduce by 37.0% in 2012 from $1.3m to $0.8m. Council has stated that the actual 2012 user charges and fees has increased to $3.2m as a result of several RMS contracts being awarded to Council during 2011.
- Other revenues are forecast to reduce by 37.9% in 2012 from $0.18m to $0.11m. This decrease is due to insurance rebates and claim recoveries being received in 2011 that are not forecast to be received in future years.
- Other expenses are forecast to increase by 34.0% in 2012 however this is due to an incorrect allocation between materials and contracts and other expenses for the 2011 figures.
- Council has completed the LTFP with the 'Mining and Community SRV model' as their base case despite the fact that it includes an SRV that has not yet been applied for or approved. This leads to the current position, stated as the 'Mining SRV', to show an illiquid position from 2018 onwards as it has the identical capital expenditure program as the 'Mining and Community SRV model'. This led TCorp to develop an alternative scenario with the additional capital expenditure from the community SRV removed and added to cash and cash equivalents in each year from 2014.
- Council has highlighted the requirement for the community SRV to increase the general rates by an amount above the rate peg in order to assist achieving financial sustainability and deliver the proposed capital expenditure program. Council's management are aware of how

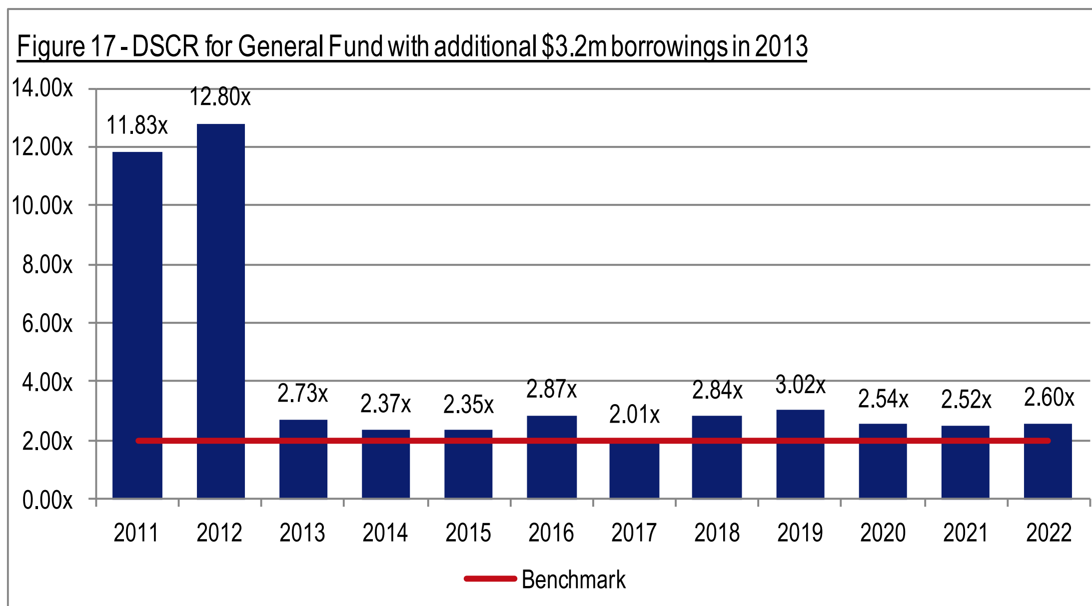
beneficial this application is, however this would have to be adopted by the incoming Council and it is therefore not certain that this will proceed as forecast by the management team.

4.5: Borrowing Capacity

When analysing the financial capacity of the Council TCorp believes Council will not be able to incorporate additional loan funding in addition to the LIRS loan facilities and other planned borrowings of $3.5m when reviewing the 'Mining SRV model' scenario. This is because the Council will become illiquid in 2018 if they continued with the forecast capital expenditure program.

If Council reduce their capital expenditure program by the $22.7m that the community SRV is forecast to provide as per our scenario then they will be able to remain in a liquid position.

If this was to occur then Council would be in a position to manage additional borrowings of $3.2m in 2013 based on a benchmark of DSCR>2.00x.



Section 5 Benchmarking and Comparisons with Other Councils

Each council's performance has been assessed against ten key benchmark ratios. The benchmarking assessment has been conducted on a consolidated basis for councils operating more than one fund. This section of the report compares the Council's performance with its peers in the same DLG Group. The Council is in DLG Group 10. There are 25 councils in this group and at the time of preparing this report, we have data for all of these councils.

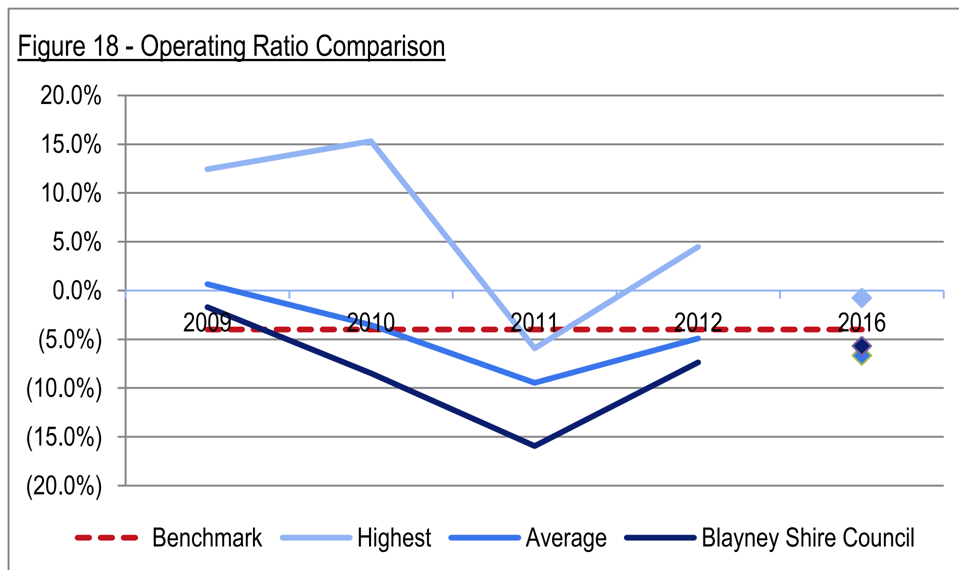
In Figure 18 to Figure 24, the graphs compare the historical performance of Council with the benchmark for that ratio, with the average for the Group, with the highest performance (or lowest performance in the case of the Infrastructure Backlog Ratio where a low ratio is an indicator of strong performance), and with the forecast position of the Council as at 2016 (as per Council's LTFP). Figures 25 to 27 do not include the 2016 forecast position as those numbers are not available.

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

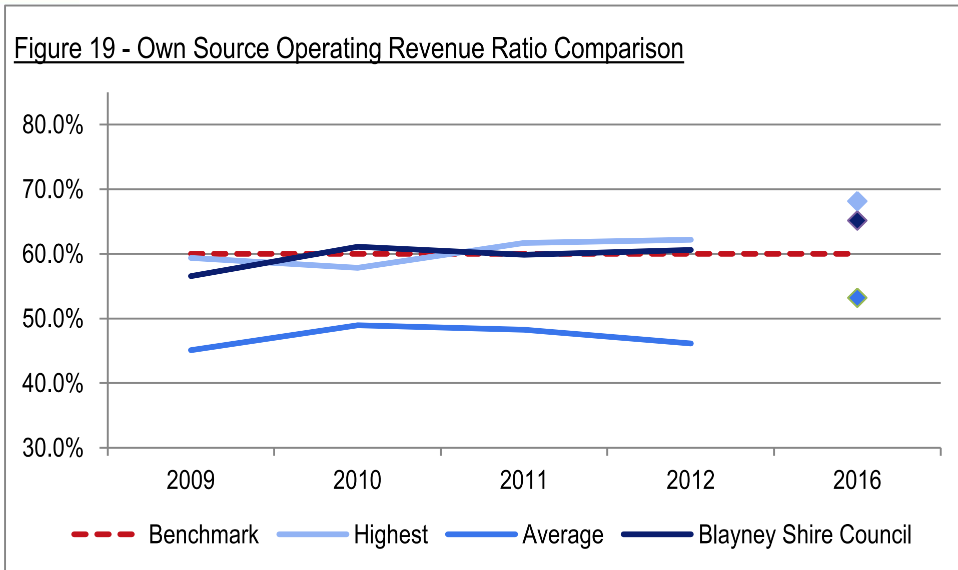
This section has been completed at a later date to the rest of the report and therefore is inclusive of the 2012 data. The rest of the report has not been amended to include analysis of the 2012 figures.

Financial Flexibility

Figure 18 - Operating Ratio Comparison

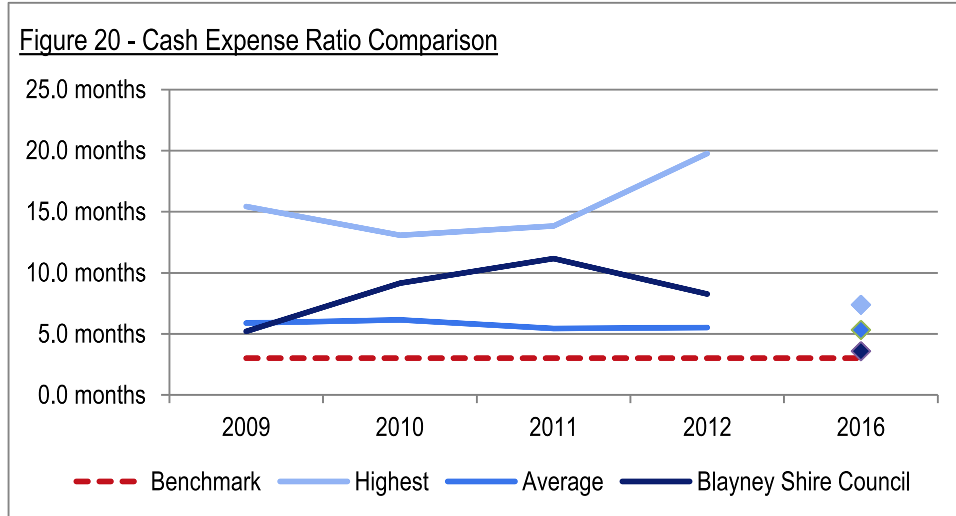


Council's Operating Ratio was below average in the past four years. Consistent with other councils in the group, it experienced a decline in operating results in 2011 due to increased depreciation expense with the improvement in 2012 assisted by the prepayment of the first half of the 2013 FAG. The results are forecast to improve slightly in the medium term, above the group's average but still below the benchmark.

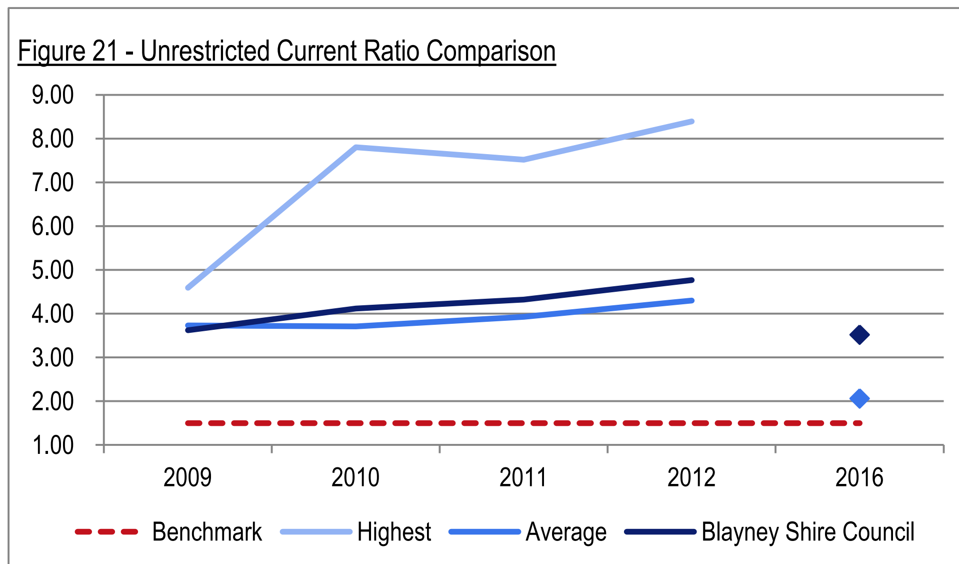


Council's Own Source Operating Revenue Ratio was above the group average and benchmark in 2010 but decreased marginally in 2011 and 2012. Overall, Council's financial flexibility is above the group's average and is forecast to remain above the average and the benchmark.

Liquidity

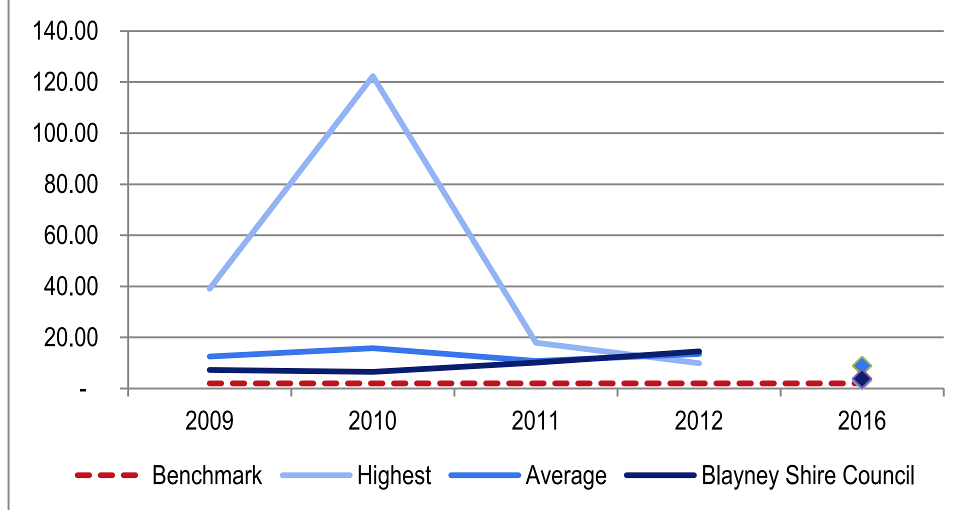


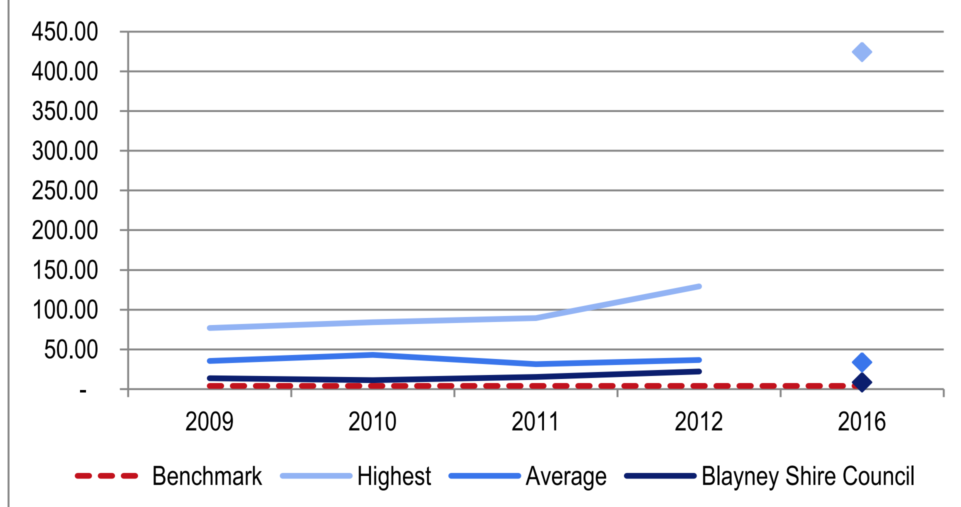
Council's Cash Expense Ratio has been above the benchmark in each year and the group average in the past three years. The forecast is projected to decrease below historical levels and the group average but remain above the benchmark.



Over the past four years, the Council's liquidity position has been sound and this is forecast to continue and remain above the group average.

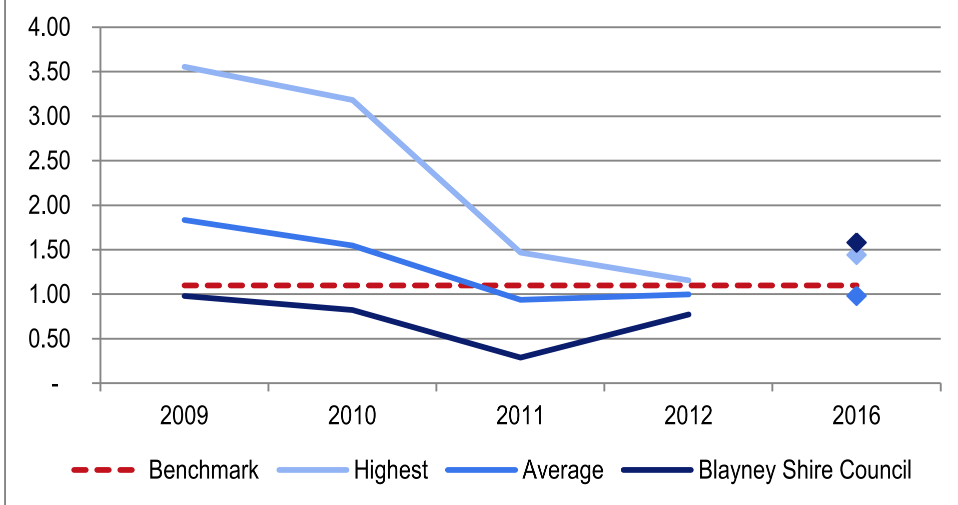
Debt Servicing

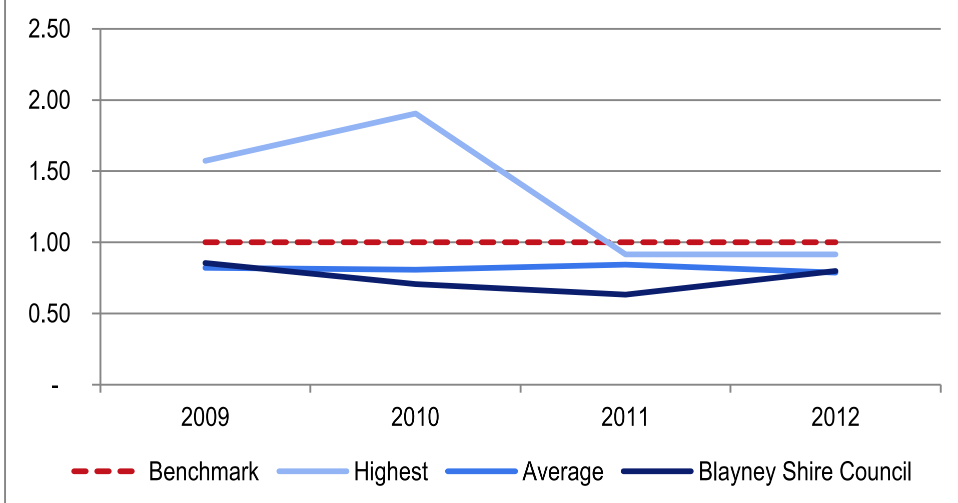




Council had above benchmark DSCR and Interest Cover Ratio in the past and this is forecast to continue although the ratios reduce in the forecast. Both ratios are below the group average for most of the years of the ratios indicating that proportionally Council has less capacity than its peers to utilise further borrowings.

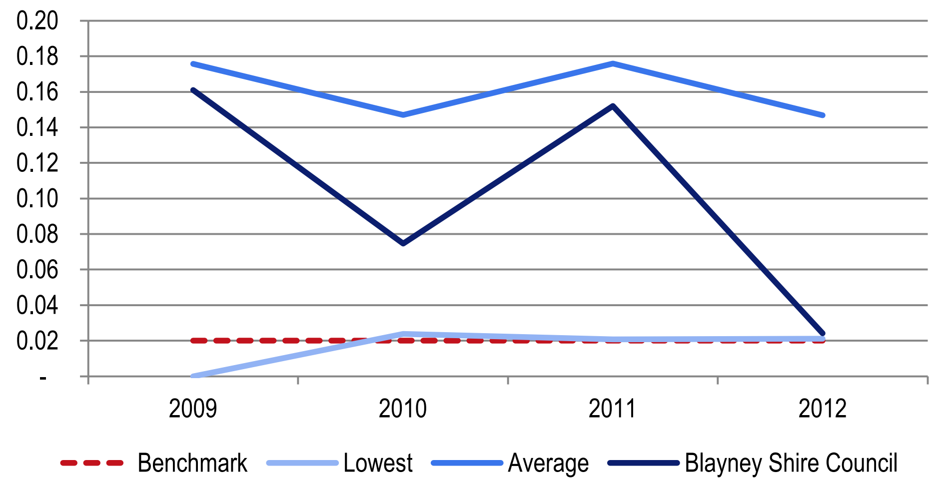
Asset Renewal and Capital Works

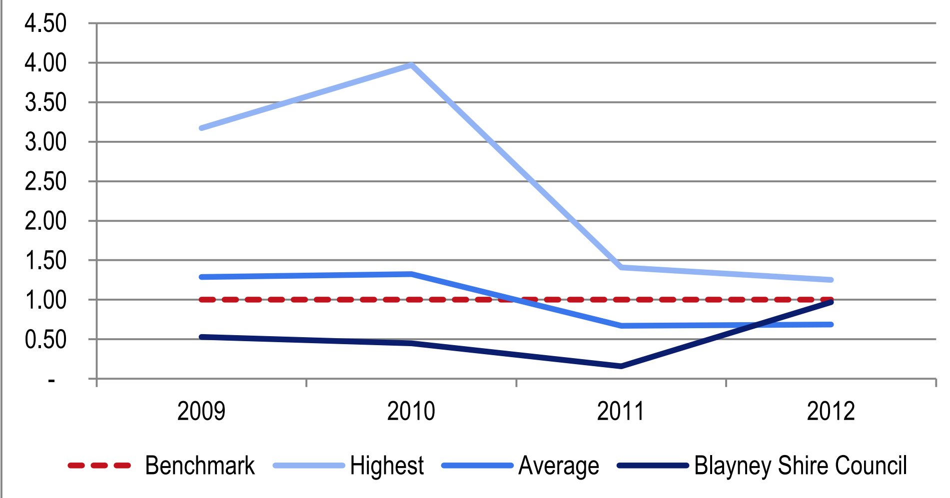




Council's Capital Expenditure Ratio has decreased over the review period and remains below the group average and the benchmark although the 2016 forecast shows a projected increase to above the group average and benchmark.

Council has been weak in terms of relative spending on asset maintenance, being below the benchmark in each year, although there was an improvement to the group average in 2012.





Council's Infrastructure Backlog has decreased rapidly in 2012 to be at benchmark.

The Building and Infrastructure Asset Renewal Ratio was low and beneath the group average and benchmark until 2012 when it improved above the average and marginally below the benchmark. Over the period Council has not spent a sufficient amount on asset renewal.

Overall the Council has not kept its existing assets well maintained compared to the group average but its Infrastructure Backlog value is low following the large decrease in 2012. Council's forecast capital expenditure investment appears ambitious when compared to the historical performance.

Section 6 Conclusion and Recommendations

Based on our review of the historic financial information we consider Council to be satisfactory financial position. Council has acted in a responsible manner when analysing their financial performance and has managed their expenses well over the historical period.

However, the 10 year financial forecast position deteriorates in the medium term in the 'Mining SRV model' when forecast cash reserves are depleted and an overdraft is required due to the scheduled capital expenditure program.

The alternative scenario completed by TCorp indicates how the liquidity position improves if the additional capital expenditure from the 'Mining and Community SRV model' is deferred and added back into cash and cash equivalents.

We recommend that Council receives the LIRS subsidy subject to improvements in their liquidity position as illustrated within our scenario. We base our recommendation on the following key points:

- The current LTFP forecast has been completed to highlight the requirement of the community SRV to achieve the scheduled capital expenditure program
- Council does have sufficient capacity to repay the borrowings as indicated by the DSCR and Interest Cover Ratio above the benchmark for all 10 years
- Council management is aware of the fiscal limitations that Council is faced with and is focused on improving their financial position to achieve sustainability over the long term

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

- Under the Mining SRV model scenario, Council will not be able to achieve the scheduled capital expenditure program with their current revenue base without impacting their financial sustainability. TCorp's alternative scenario therefore provides a more realistic position of what would occur on an 'as is' basis
- Council cannot currently commit to the scheduled capital expenditure program as this requires the additional rates revenue from a future SRV not yet applied for or approved
- If Council is unable to secure the community SRV then they will have to revisit their LTFP and four year Delivery Program for 2013-2017 to amend the timeframes for the capital expenditure to be completed and to complete a revised LTFP that is more in line with our alternative scenario

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	5,292	5,012	4,747	5.6%	5.6%
User charges and fees	1,354	1,646	1,774	(17.7%)	(7.2%)
Interest and investment revenue	480	340	301	41.2%	13.0%
Grants and contributions for operating purposes	3,341	2,966	3,585	12.6%	(17.3%)
Other revenues	200	170	234	17.6%	(27.4%)
Total revenue	**10,667**	**10,134**	**10,641**	**5.3%**	**(4.8%)**
Employees	4,460	4,340	4,246	2.8%	2.2%
Borrowing costs	164	169	179	(3.0%)	(5.6%)
Materials and contract expenses	2,293	2,508	2,497	(8.6%)	0.4%
Depreciation and amortisation	4,023	2,582	2,477	55.8%	4.2%
Other expenses	1,430	1,396	1,423	2.4%	(1.9%)
Total expenses	**12,370**	**10,995**	**10,822**	**12.5%**	**1.6%**
Operating result	**(1,703)**	**(861)**	**(181)**	**(97.8%)**	**(375.7%)**

Table 2 - Items excluded from Income Statement

Excluded items ($'000s)			
	2011	2010	2009
Grants and contributions for capital purposes	433	760	889
Net gain on disposal of assets	4	169	330

Table 3 - Balance Sheet

Balance Sheet ($'000s)	Year Ended 30 June			% annual change	
	2011	2010	2009	2011	2010
Current assets					
Cash and equivalents	7,622	6,282	3,542	21.3%	77.4%
Investments	380	0	2,000	N/A	(100.0%)
Receivables	1,107	1,130	1,325	(2.0%)	(14.7%)
Inventories	1,000	891	755	12.2%	18.0%
Other	166	137	132	21.2%	3.8%
Total current assets	10,275	8,440	7,754	21.7%	8.8%
Non-current assets					
Investments	233	613	613	(62.0%)	0.0%
Receivables	219	224	399	(2.2%)	(43.9%)
Infrastructure, property, plant & equipment	179,533	173,929	73,253	3.2%	137.4%
Total non-current assets	179,985	174,766	74,265	3.0%	135.3%
Total assets	**190,260**	**183,206**	**82,019**	**3.9%**	**123.4%**
Current liabilities					
Payables	787	817	765	(3.7%)	6.8%
Borrowings	85	80	123	6.3%	(35.0%)
Provisions	1,135	1,210	1,158	(6.2%)	4.5%
Total current liabilities	2,007	2,107	2,046	(4.7%)	3.0%
Non-current liabilities					
Borrowings	1,901	1,986	2,066	(4.3%)	(3.9%)
Provisions	429	395	394	8.6%	0.3%
Total non-current liabilities	2,330	2,381	2,460	(2.1%)	(3.2%)
Total liabilities	**4,337**	**4,488**	**4,506**	**(3.4%)**	**(0.4%)**
Net assets	**185,923**	**178,718**	**77,513**	**4.0%**	**130.6%**

Table 4-Cashflow

Cashflow Statement ($'000s)	Year ended 30 June		
	2011	**2010**	**2009**
Cashflows from operating activities	2,429	2,486	2,834
Cashflows from investing activities	(1,009)	377	(3,118)
Proceeds from borrowings and advances	0	0	0
Repayment of borrowings and advances	(80)	(123)	(162)
Cashflows from financing activities	(80)	(123)	(162)
Net increase/(decrease) in cash and equivalents	**1,340**	**2,740**	**(446)**
Cash and equivalents	7,622	6,282	3,542

Appendix B Glossary

Asset Revaluations

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

Collateralised Debt Obligation (CDO)

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

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

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

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

Division of Local Government (DLG)

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

Depreciation of Infrastructure Assets

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

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

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

EBITDA

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

Grants and Contributions for Capital Purposes

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

Grants and Contributions for Operating Purposes

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

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

Independent Commission Against Corruption (ICAC)

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

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

Independent Pricing and Regulatory Tribunal (IPART)

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

Infrastructure Backlog

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

Integrated Planning and Reporting (IP&R) Framework

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

Local Government Cost Index (LGCI)

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

Net Assets

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

Roads and Maritime Services (RMS)

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

Section 64 Contribution

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

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

Section 94 Contribution

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

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

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

Special Rate Variation (SRV)

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

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

The applications are reviewed and approved by IPART.

Ratio Explanations

Asset Maintenance Ratio

Benchmark = Greater than 1.0x

Ratio = actual asset maintenance / required asset maintenance

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

Building and Infrastructure Renewals Ratio

Benchmark = Greater than 1.0x

Ratio = Asset renewals / depreciation of building and infrastructure assets

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

Cash Expense Cover Ratio

Benchmark = Greater than 3.0 months

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

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

Capital Expenditure Ratio

Benchmark = Greater than 1.1x

Ratio = annual capital expenditure / annual depreciation

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

Debt Service Cover Ratio (DSCR)

Benchmark = Greater than 2.0x

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

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

Infrastructure Backlog Ratio

Benchmark = Less than 0.02x

Ratio = estimated cost to bring assets to a satisfactory condition (from Special Schedule 7) / total infrastructure, building, other structures and depreciable land improvement assets (from note 9a)

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.