Blayney Shire Council

Financial Assessment and Sustainability report

Date:	5 November 2013

Disclaimer

This report has been prepared by New South Wales Treasury Corporation (TCorp) in accordance with the appointment of TCorp by Blayney Shire Council (the Council) as detailed in TCorp's letter of 10 September 2013.

The report has been prepared based on information provided to TCorp. 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 Council's future Sustainability, within prudent risk parameters and the limits of its financial projections.

The report has been prepared for Blayney Shire Council. 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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1 Executive Summary

In October 2012, TCorp provided Blayney Shire Council (the Council) with a Financial Assessment Report, followed by a Benchmarking Section in March 2013, as part of the work undertaken for the Division of Local Government and the Independent Local Government Review Panel.

In the report TCorp made the following observations:

- Council posted an operating deficit each year of the review period and was forecasting deficits for each year of its financial forecast, when capital grants and the proposed community Special Rate Variation (SRV) were excluded.
- Council maintained their expenses over the review period.
- Council was aware that they needed to apply for an SRV to increase ordinary rates revenue if they wanted to complete the scheduled capital expenditure program. If Council was unsuccessful in their SRV application then their capital expenditure would be reduced to a level that is not adequate to maintain their asset base.
- Council's Infrastructure Backlog increased from \$9.6m in 2009 to \$24.2m in 2011 following the Asset Revaluation process, improvement of Council's Asset Management Plan and analysis of their infrastructure asset condition status.
- Council's Asset Maintenance Ratio, Buildings and Infrastructure Asset Renewal Ratio and Capital Expenditure Ratio were all below benchmark in each year of the review period.

TCorp's report stated that "based on our review of the historic financial information we consider Council to be in a 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."

In April 2013, TCorp provided Council with its assessment of the Financial Sustainability Rating (FSR) and Outlook. Council was assigned an FSR of Moderate with an Outlook of Negative.

Following receipt of the report, Council has updated their LTFP and also completed a revised Asset Management Strategy (AMS).

Council has provided TCorp with two scenarios within their LTFP, a "Maintained Services" scenario and a "Reduced Services" scenario.

The 'Maintained Services' scenario includes the approved Mining SRV and also assumes a permanent 6 year SRV of 15% (including rate peg) between 2015 and 2020. This SRV has not yet been applied for or approved however community consultation has begun with village meetings to begin in October.

The 'Reduced Services' scenario includes the approved Mining SRV only, and highlights the impact on Council's financial position if they are unsuccessful with their additional SRV application.

Our analysis focuses on the General Fund. Council's consolidated position includes a Sewer Fund which operates as an independent entity, and is more able to adjust fees and charges to meet future operating and investing activities.

The key observations from our review of Council's 10 year forecast for its General Fund for the Maintained Services scenario are:

- Council is forecasting to return to a surplus position in 2019, and the operating result is forecast to continue to increase to $2.3m by 2023, when capital grants and contributions are excluded.
- Council has historically had sufficient liquidity levels and this is expected to continue over the forecast period.
- Council's Capital Expenditure Ratio is above benchmark for the entire forecast period as Council proposes to undertake a substantial capital works program, particularly in respect of the road network.
- Council's Interest Cover Ratio and DSCR are well above benchmark and suggest Council has the capacity to undertake additional borrowings in their financial forecast.
- Council would improve its rating base through the SRV which would give Council more financial flexibility.

The key observations from our review of Council's 10 year forecast for its General Fund for the Reduced Services scenario are:

- Council is forecasting operating deficits for the entire forecast period.
- Council is forecasting insufficient capital spending which is likely to lead to their Infrastructure Backlog increasing in the medium to long term.
- Historically Council has had sufficient liquidity levels and this is expected to continue in the medium term.
- Council's Interest Cover Ratio and DSCR are well above benchmark and improving over the period as Council has not forecast any additional borrowings in their LTFP. This indicates Council has the capacity to undertake additional borrowings in their financial forecast.

The updated LTFP and AMS have provided Council with a clear understanding of their current financial position and what their future funding requirements are. As a result Council has outlined their affordable capital projects and are aware that without additional sources of revenue there will be a funding shortfall to complete the required capital works to maintain services at existing levels.

Based on the revised information provided to TCorp and using the scenario of the Maintained Services model, Council is currently assessed to have a FSR of Moderate. Based on the current LTFP, the Outlook for Council is Neutral for the next three years. However given that the SRV is proposed to begin in 2015, it should be noted that the full impact of the proposed SRV will not take effect until the latter part of Council's financial forecast when Council's Outlook is currently expected to improve.

In respect of the long term Sustainability of the Council our key observations for the Maintained Services scenario are:

- Council's operating result, excluding capital grants and contributions, is on an upward trend and is forecasting a surplus position from 2019.
- Council has forecast sufficient liquidity levels for the entire forecast period.
- Council is forecasting capital spending sufficient to address their asset maintenance shortfall and commence addressing their Infrastructure Backlog as well as allow for spending on some new capital works.
- Council's Interest Cover Ratio and DSCR are well above benchmark and suggest Council has the capacity to undertake additional borrowings in their financial forecast.

Based on the revised information provided to TCorp and the Reduced Services scenario, Council is currently assessed to have a FSR of Moderate with a Neutral Outlook for the next three years. While the Outlook improves to Neutral in the short term as a result of the revised LTFP submitted, without additional revenue Council's Outlook will deteriorate to Negative by the end of the financial forecast period as Council is unable to return to an operating surplus, fund the required maintenance and asset renewal or reduce its backlog.

In the event that Council is unsuccessful with its SRV application, the expected impact on the long term sustainability of Council is:

- Council is forecasting operating deficits for the entire forecast period.
- Council is forecasting insufficient capital spending which may lead to their Infrastructure Backlog increasing in the medium to long term with a possible reduction in services.
- Council's Interest Cover Ratio and DSCR are well above benchmark and improving over the period as Council has not forecast any additional borrowing under the Reduced Services scenario. This indicates Council has the capacity to undertake additional borrowings in their financial forecast.

Through their integrated planning and reporting framework, Council has recognised the need to secure additional funding to properly service their infrastructure assets and achieve operating surpluses in the medium to long term.

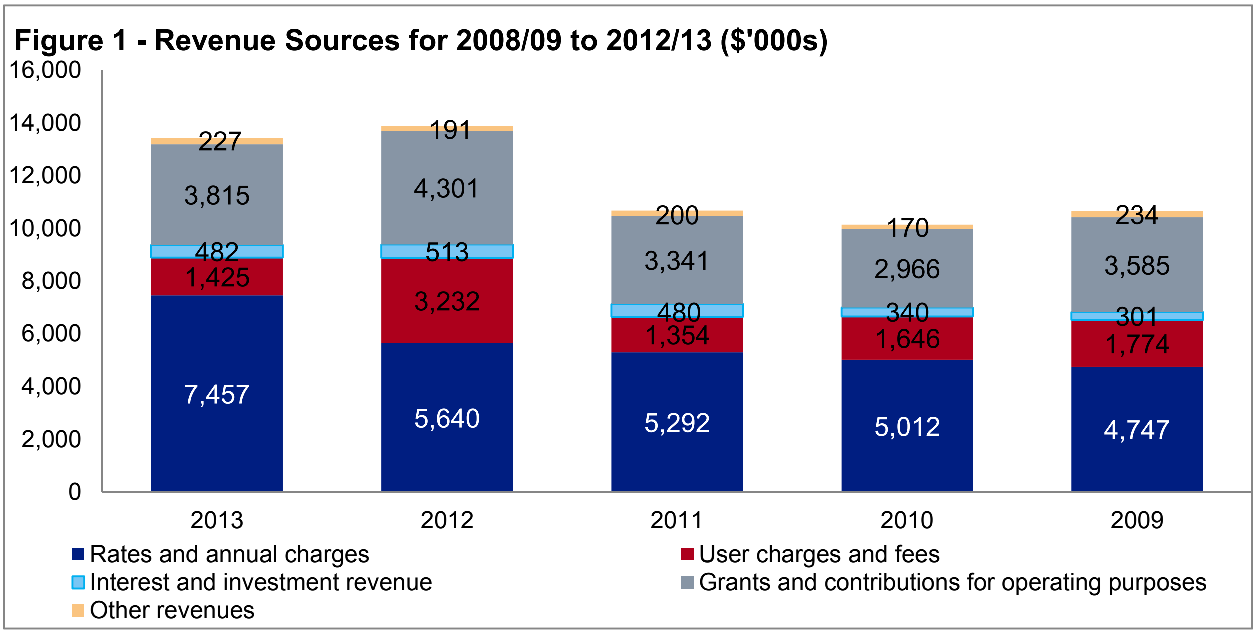
The 'Maintained Services' scenario assumes a six year permanent SRV from 2015 to 2020 inclusive and would allow Council to return to a balanced budget and address some of the Infrastructure Backlog.

The 'Reduced Services' model illustrates the impacts on Council's financial position if Council is unsuccessful in their SRV application which has forecast operating deficits each year of their financial forecast and insufficient funds to complete the required capital works to maintain their existing assets and services. Under this scenario if Council is unable to raise additional funds, services would need to be reduced such as the cessation of the timber bridge program leading to the possible closure of some bridges, reductions in the resealing and rehabilitation of roads and a reduction in the infrastructure renewals program.

2 Review of Financial Performance and Position

TCorp has updated its review to include the 2013 annual audited accounts of the Council

2.1 Revenue



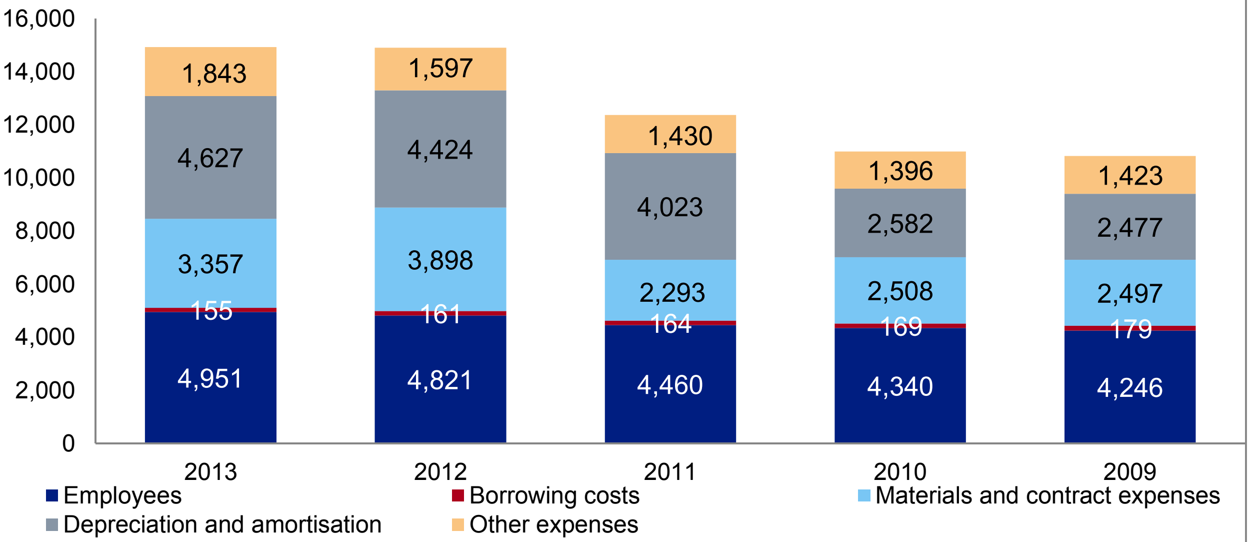
Key Observations

- Council's annual revenue has increased by 39.2% since 2009, to $14.8m in 2013.
- Rates and annual charges increased by 6.6% and 32.2% in 2012 and 2013 respectively. In 2012 ordinary rates increased by 6.3% due to rate peg, catch up from the previous year and increases in domestic waste management charges.
- In 2013 Council was approved for an SRV of 40.7% (including rate peg) to be retained permanently in Council's income base. This SRV applied to property used by Newcrest Mining Limited only. The income from this SRV will be used for maintenance and improvements to roads and bridges servicing the Cadia Valley mine, a community infrastructure program and a community contributions program.
- In 2009 a single year SRV of 11.4% was approved, inclusive of rate peg, to repay a loan for the redevelopment of Blayney Community Centre. The SRV is to be retained in Councils General Fund income for 10 years, until 2018. As a result of project costs being below originally anticipated as well as a volunteer program in place, less borrowings were required and as a result the SRV completion date has been brought forward to 2017 and Council feel they may be in a position to bring it forward to 2016.
- User fees and charges peaked at $3.2m in 2012 as a result of increased RMS works for the maintenance of state roads and this accounted for an additional $1.7m in user fees and charges that year. The decrease in 2013 was primarily as a result of a decrease in RMS works.

- Operating grants and contributions decreased by 11.3% ($0.5m) in 2013. The Financial Assistance Grant (FAG) has been prepaid for a number of years. In 2011 one quarter of the 2012 FAG was prepaid, in 2012 half the 2013 FAG was prepaid, and in 2013 half the 2014 FAG was prepaid. As a result, 1.25 years of FAG payments were accounted for in 2012 while only 1.0 year of FAG payment was accounted for in 2013 with a decrease reflected in the operating grants in the 2013 accounts.

2.2 Expenses

Figure 2 - Expenses for 2008/19 to 2012/13 ($'000s)



Key Observations

- Council annual expenses have increased by 38.0% since 2009 to $14.9m in 2013.
- Following an increase of 8.1% ($0.4m) in 2012, employee expenses increased by 2.7% in 2013. In 2012 the number of equivalent full time employee increased from 63 to 70. Council's Sport and Leisure Centre had previously been run under a company structure (Centre Point Blayney Limited). This company was dissolved and the Centre was placed under Council management with Council staff and as a result staff numbers increased in 2012.
- Materials and contracts expenses increased by 70.0% ($1.6m) in 2012 due to increased maintenance on Council roads. Capital works increased in 2013 as Council received an additional $0.9m in capital grants. The main contributor was $0.6m in RMS grant funding for the Belubula Way Road and this resulted in a reduction in materials and contracts expense in 2013.

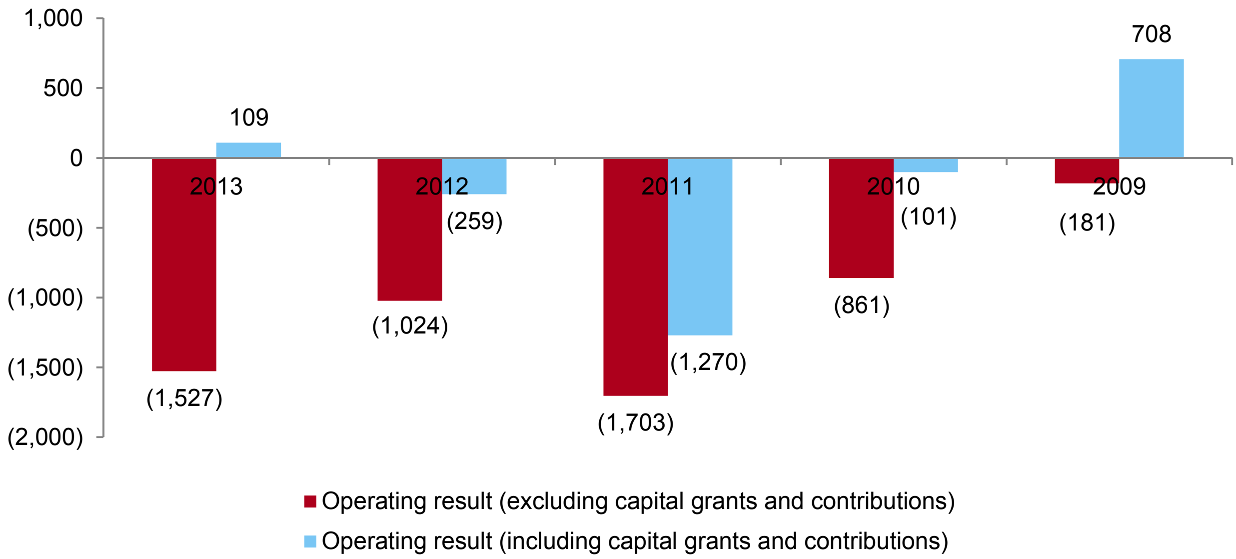
2.3 Operating Results

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

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

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

Figure 3 - Operating Results for 2008/09 to 2012/13 ($'000s)



Key Observations

- Following an increased deficit position in 2011 as a result of increased depreciation expense, Council's operating result improved in 2012 due to increased operating grants and user fees and charges. The result deteriorated again in 2013 following reductions in both these revenue items.

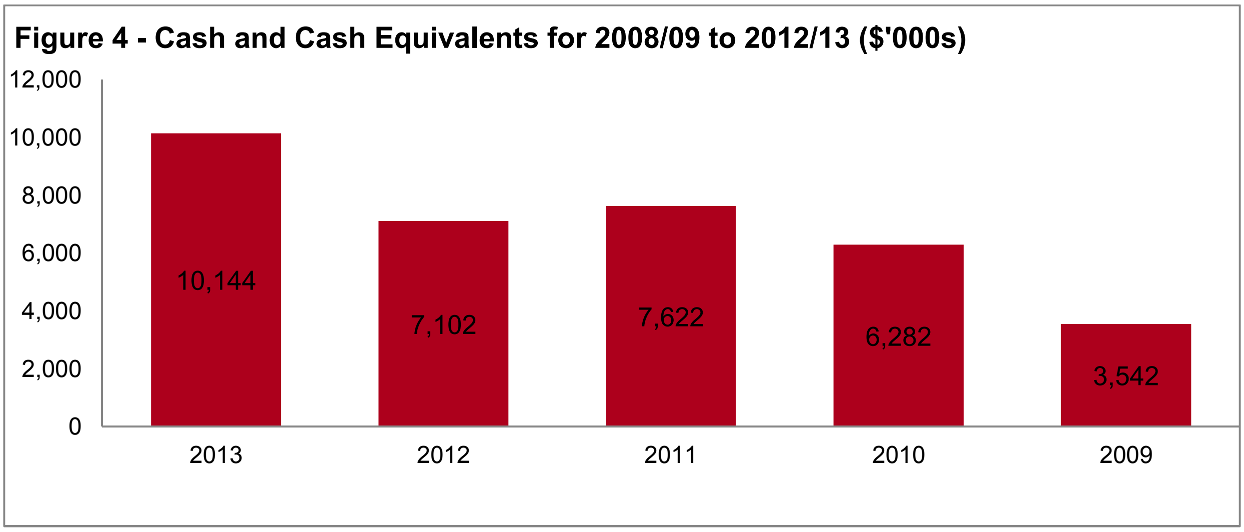
2.4 Financial Management Indicators

Performance Indicators	Year ended 30 June				
	2013	2012	2011	2010	2009
EBITDA ($'000s)	3,255	3,561	2,484	1,890	2,475
Operating Ratio	(11.4%)	(7.4%)	(16.0%)	(8.5%)	(1.7%)
Interest Cover Ratio	21.00x	22.12x	15.15x	11.18x	13.83x
Debt Service Cover Ratio	13.13x	14.48x	10.18x	6.47x	7.26x
Unrestricted Current Ratio	6.94x	4.77x	4.32x	4.12x	3.62x
Own sourced revenue	59.0%	60.6%	59.9%	61.1%	56.6%
Cash expense ratio	12.0 months	8.3 months	11.2 months	9.1 months	5.2 months
Net assets ($'000s)	365,734	364,302	356,799	346,072	144,911

Key Observations

- Council's EBITDA has increased by $0.8m since 2009 to $3.3m in 2013. EBITDA has moved in line with Council's operating result over the past two years.
- Council's Interest Cover Ratio and Debt Service Cover Ratios are both well above their respective benchmarks which reflects Council's low level of borrowings. In 2013, Council had total borrowings of $1.8m which represents 1.0% of Council's Net Assets.
- The Unrestricted Current Ratio has been well above benchmark each year of the review period indicating Council did not have any liquidity issues and was able to meet all its short term liabilities when they fall due. The ratio improved in 2013 primarily as a result of the introduction of the mining SRV.
- Council's Own Source Revenue Ratio has been maintained at benchmark levels over the review period. In 2013 while Council benefited from an SRV, capital grants doubled with increased roads and bridges funding resulting in a slight decrease in the ratio on the previous year.
- Council's Cash Expense Ratio has been well above benchmark for the entire forecast period.
- Council's Net Assets increased by $2.8m in 2013 to $193.3m. In 2013 when excluding Asset Revaluations, Council's IPP&E asset base decreased by $1.8m. Since 2009, when excluding Asset Revaluations, Council's asset base has decreased by $6.2m with depreciation expense exceeding asset additions each year of the review period.
- At $4.6m Council's depreciation expense is currently 2.4% of Council's Net Assets. Council's infrastructure renewals ratio has been very low over the review period which Council advise is purely as a result of lack of funding. It is Council's intent to address this issue by spending more funds than the depreciation on infrastructure to address their Infrastructure Backlog. Under the Maintained Services scenario it is anticipated that the infrastructure renewals ratio will increase significantly as there will be no significant new asset purchases relating to the SRV income.

2.5 Statement of Cashflows



Key Observations

- Cash and cash equivalents increased by $3.0m in 2013 to $10.1m, of which $9.5m was held in short term deposits.
- Of the $11.3m in cash, cash equivalents and investments, $4.8m was externally restricted and $6.4m was internally restricted. Council had $0.003m in unrestricted funds.
- In 2013, Council had $1.0m in long term deposits and $0.2m in CDO's.

2.6 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.

2.6.1 Infrastructure Backlog

Figure 5 - Infrastructure Backlog for 2008/09 to 2012/13($'000s)

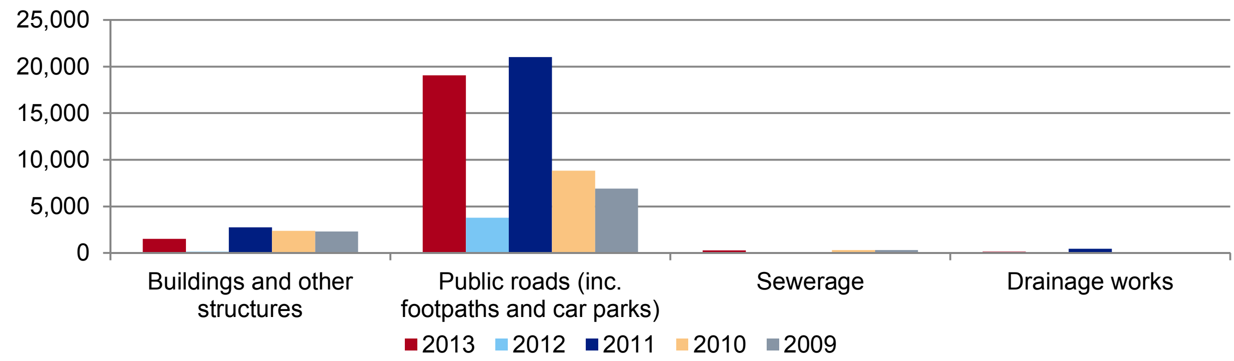
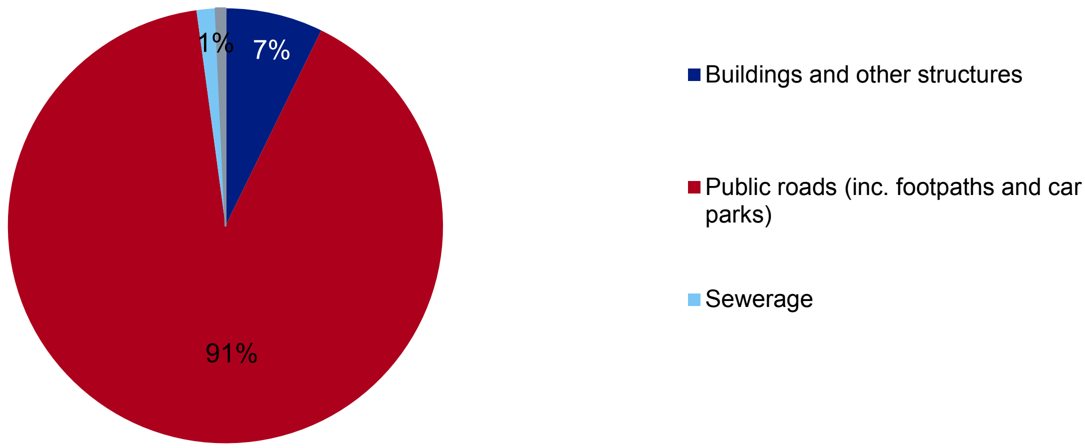


Figure 6 - Infrastructure Backlog Composition for 2012/13



In 2012 Council reported Infrastructure Backlog of $3.9m, a reduction of $20.3m on the previous year. Council has advised that the 2012 number was an error. The 2013 accounts report a backlog figure of $21.0m which is more accurate. Of this, 91.0% ($19.0m) relates to roads infrastructure, 7.0% ($1.5m) relates to building and other structures, and 1.0% ($0.3m) relates to sewerage infrastructure.

2.6.2 Infrastructure Status

Infrastructure status	Year ended 30 June				
	2013	2012	2011	2010	2009
Bring to satisfactory standard ($'000s)	21,417	3,947	24,260	11,555	9,571
Required annual maintenance ($'000s)	4,809	2,176	2,754	2,243	2,080
Actual annual maintenance ($'000s)	3,320	1,736	1,740	1,583	1,778
Total value infrastructure assets ($'000s)	165,045	163,335	159,573	155,987	60,471
Total assets ($'000s)	197,565	195,054	190,260	183,206	82,019
Infrastructure Backlog Ratio	0.13x	0.02x	0.15x	0.07x	0.16x
Asset Maintenance Ratio	0.69x	0.80x	0.63x	0.71x	0.85x
Building and infrastructure asset renewal ratio	0.71x	0.97x	0.16x	0.45x	0.53x
Capital Expenditure Ratio	0.60x	0.77x	0.29x	0.82x	0.98x

Council's Infrastructure Backlog Ratio was above the benchmark in 2013 however the ratio has improved slightly since 2011.

Council's Asset Maintenance Ratio has been well below benchmark over the entire review period.

The Building and Infrastructure Asset Renewals Ratio improved in 2012 as a result of on-going roads capital works and the rebuilding of Blayney Shire Community Centre. While the ratio fell in 2013 due to the completion of the Community Centre, it remains higher than historic levels due to works undertaken as a result of the mining SRV.

Council's Capital Expenditure Ratio also peaked in 2012 as a result of the rebuilding of the Community Centre.

2.6.3 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				
	2013	2012	2011	2010	2009
New capital works	0	300	35	218	220
Replacement/refurbishment of existing assets	3,483	2,562	2,370	202	941
Total	3,483	2,862	2,405	420	1,161

Main Capital Projects 2012/2013

Roads Maintenance and Upgrades	$0.8m
Belubula Way Road Rehabilitation	$0.6m
Hobbys Yard Rehabilitation	$0.3m
Forests Reefs Road Rehabilitation	$0.3m
Marshalls Lane Reconstruction	$0.2m

Major Capital Works for the Maintained Services Scenario 2014-2023

Rural Road Rehabilitation	$27.9m
Sealed Roads Maintenance	$10.3m
Unsealed Roads Maintenance	$8.2m
Rural Roads Reseal	$4.7m
Urban Roads Reseal	$2.9m
Bridges Renewal	$4.8m
Regional Roads Renewals	$3.5m

In their updated AMS from March 2013, Council recognises that with current funding they will be unable to fund infrastructure costs and maintain current levels of service over the next 10 years.

Council estimate that they will be able to provide approximately 90.0% p.a. of the cost required to provide the existing levels of service to the community and acknowledge that if they are unable to fund the shortfall they will have to reduce service levels in some areas.

Council is proposing $63.8m in capital works over the next 10 years, which are primarily roads related projects, to maintain services at their existing levels. The ‘Maintained Services’ financial forecast, which assumes a 6 year permanent SRV from 2015-2020, forecasts $54.9m in capital spending over the 10 year forecast period. This indicates a funding shortfall of approximately $8.9m in Council’s capital works program even with the proposed SRV.

The ‘Reduced Services’ forecast, which shows the impact on Council’s financial position if they are unsuccessful in obtaining the proposed SRV, forecasts $33.6m in capital spending. This means there would be a significant funding shortfall for Council’s proposed capital works program and as a result services would likely be affected.

3 Review of Financial Forecasts

The revised financial forecast model shows the projected financial statements and assumptions for the next 10 years. We have focused our financial analysis upon the General Fund as although Council's consolidated position includes a Sewer Fund 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 two scenarios within their LTFP, a "Maintained Services" scenario and a "Reduced Services" scenario.

The 'Maintained Services' scenario incorporates the Mining SRV and also assumes a permanent 6 year SRV of 15% (including rate peg) between 2015 and 2020. This SRV has not yet been applied for or approved.

The 'Reduced Services' scenario incorporates the IPART approved Mining SRV and the impact of Council's financial position without the assistance of any further SRV.

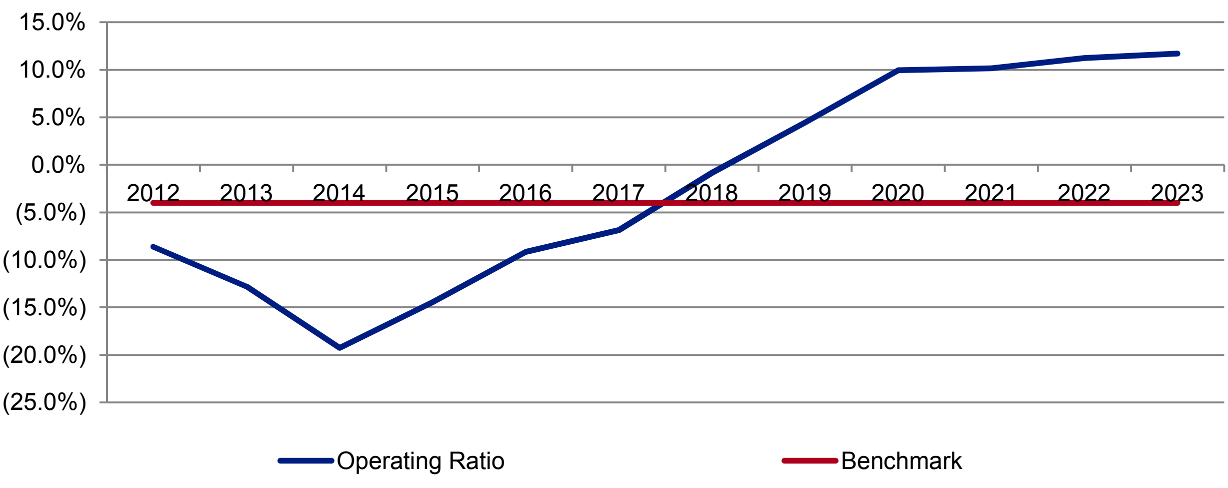
Section 3a is based on the 'Maintained Services' scenario and Section 3b is based on the 'Reduced Services' scenario.

3a Maintained Services Scenario

The 'Maintained Services' model incorporates the Mining SRV and also assumes a permanent 6 year SRV of 15% (including rate peg) between 2015 and 2020. This SRV has not yet been applied for or approved.

3.1a Operating Results

Figure 7- Operating Ratio for General Fund (MS)



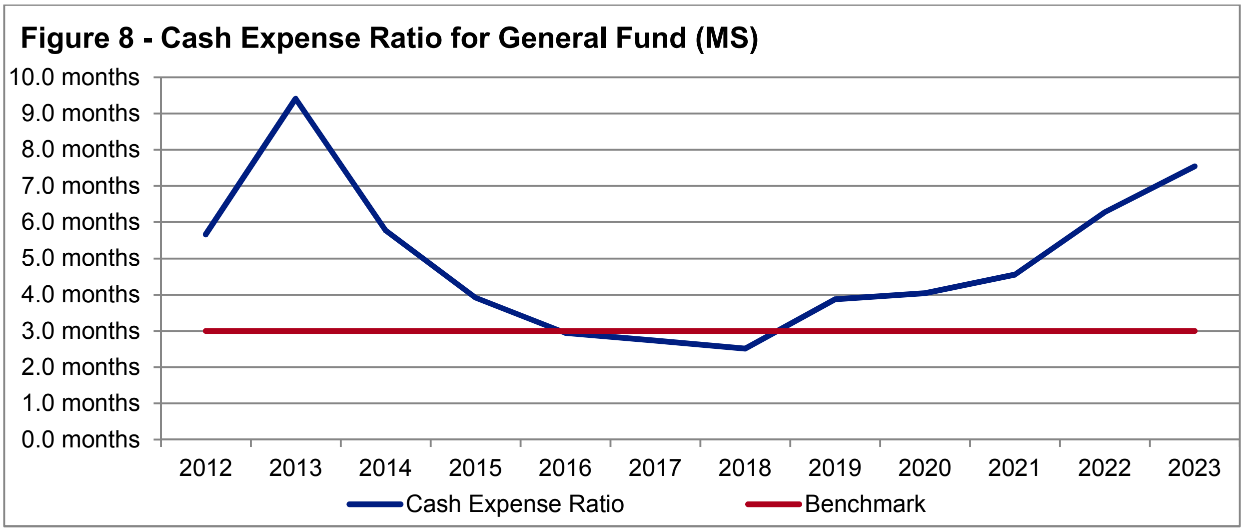
The Maintained Services scenario forecasts a gradual improvement in Council's Operating Ratio over the forecast period, when capital grants and contributions are excluded. The result increases from negative 19.4% ($2.1m) in 2014 to positive 11.7% ($2.4m) in 2023. The ratio dips in 2014 due to decreases in operating grants following the prepayment of half the 2014 FAG in 2013, a forecast decrease in user fees as a result of mining activity slowing, and increased employee expenses. It is also lower in 2017 as a result of the completion of the existing Community Centre SRV.

From 2015, the ratio improves based on the assumption that revenue will increase by an average of 6.7% p.a. as a result of the proposed SRV as well as a new waste contract which will attract higher charges from 2016, while operating expenses are assumed to increase by an average of 3.2% p.a. (compared to 9.1% p.a. historically) over the same period.

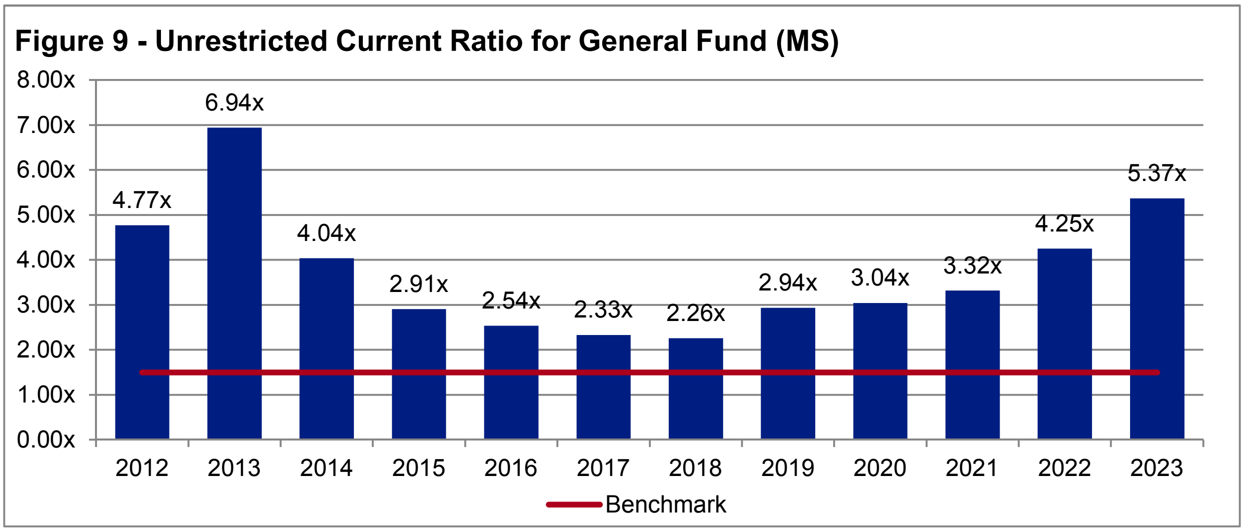
It is noted that historic expenses are skewed as a result of increased depreciation expense in 2011 and significantly increased materials and contracts expense in 2012.

3.2a Financial Management Indicators

Liquidity Ratios



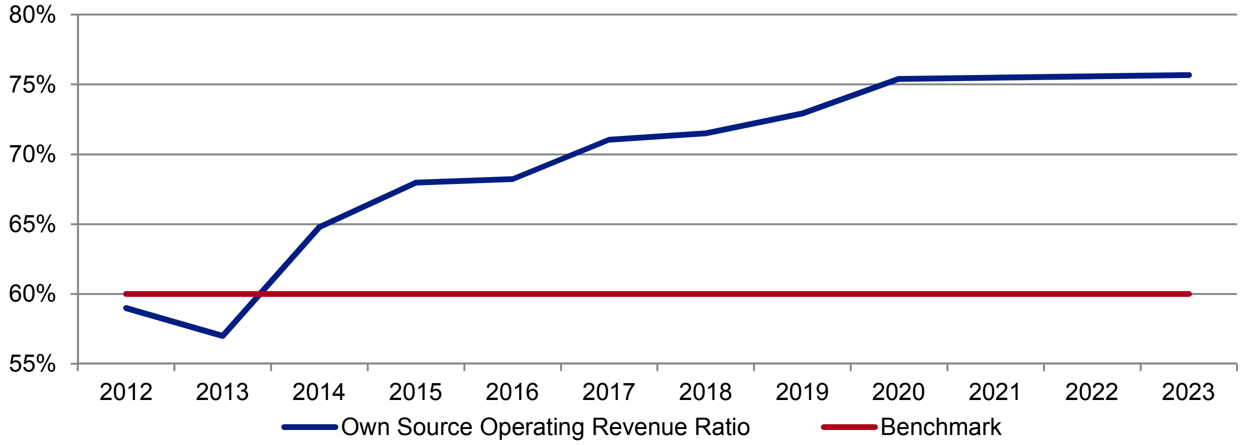
Council has forecast decreasing cash and cash equivalents over the forecast period and this causes the ratio to fall below benchmark between 2016 and 2018. From 2019 the ratio increases above benchmark as a result of additional borrowing that year and continues to improve in line with the forecast improved operating result.



Council's Unrestricted Current Ratio is also on a downward trend until 2018 but remains above benchmark each year of the forecast period. This indicates that Council is forecasting sufficient liquidity levels over the period.

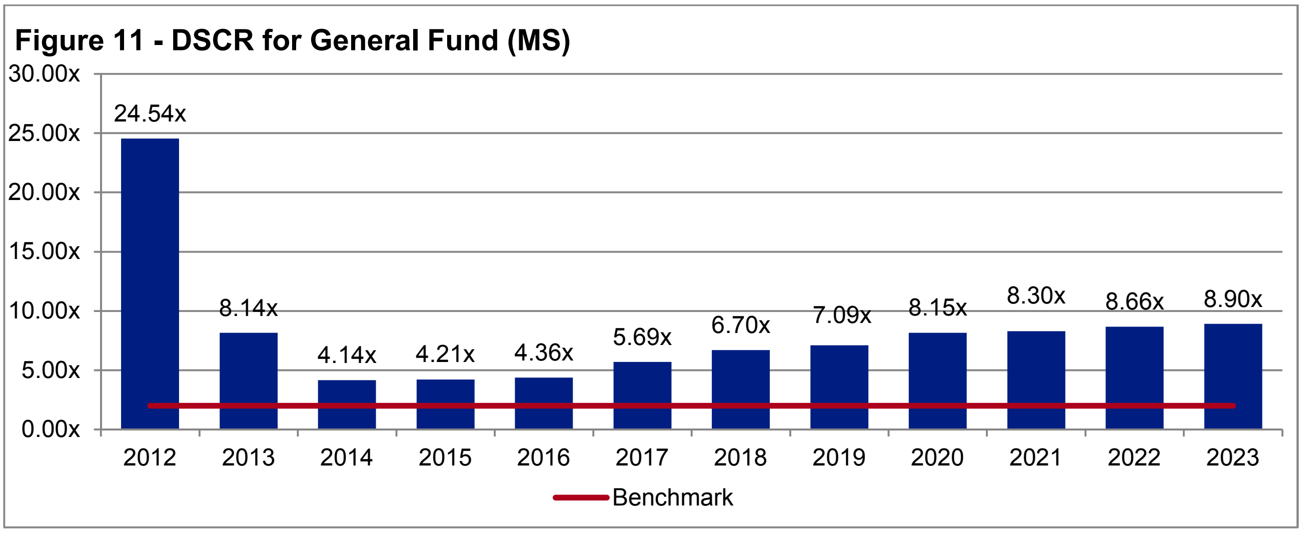
Fiscal Flexibility Ratios

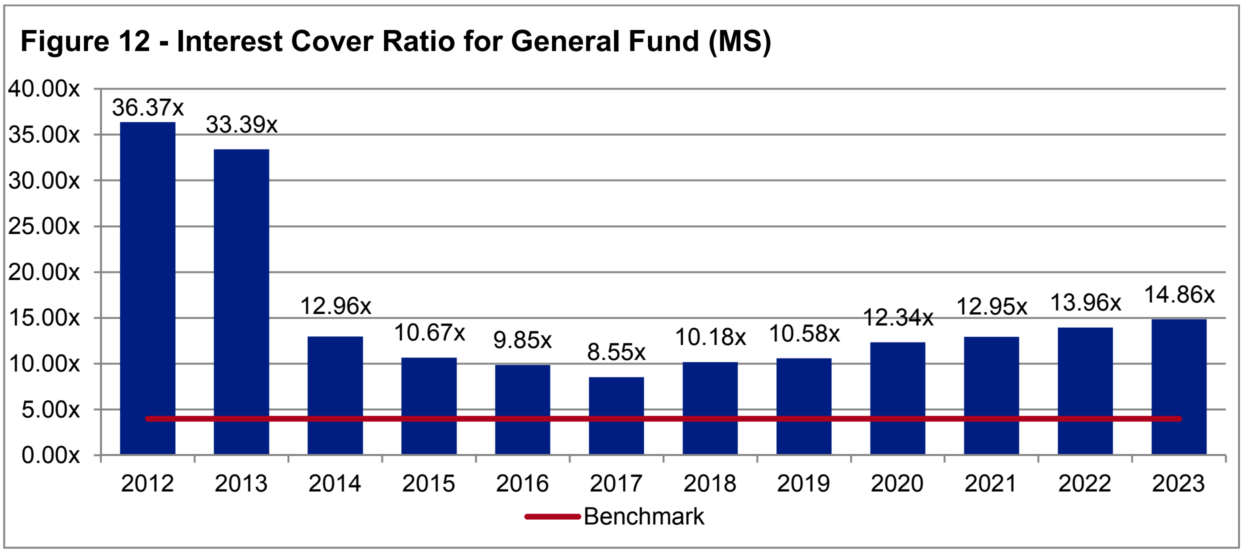
Figure 10 - Own Source Operating Revenue Ratio for General Fund (MS)



Council's Own Source Operating Ratio is forecast to improve over the period as a result of the proposed SRV revenue and forecast decreases in capital grants in 2014 and 2015. From 2020, when the proposed 6 year SRV ends the ratio is maintained at 76%.

In the Maintained Services scenario Council has forecast an increase in capital grants in 2016, 2018 and 2019. The forecast increases are linked to projects Council propose to complete under the Maintained Services scenario. Council are proposing that these will be part funded by the RMS Repair program where the RMS will provide 50% of the estimated cost of the project. The projects include Hobby's Yard Road ($0.8m) in 2016, Belubula Way ($0.4m) in 2018 and Hobby's Yard Road ($0.5m) in 2019.





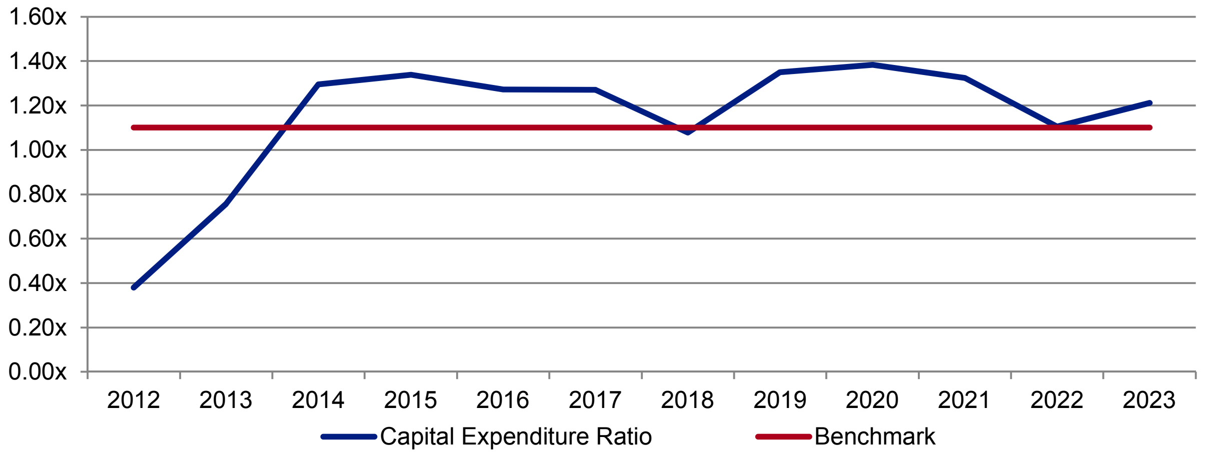
Council's DSCR and Interest Cover Ratio are well above benchmark each year of the forecast period. This indicates that Council has the capacity to service their existing borrowings and their proposed borrowings.

Council's current borrowings in the General Fund are $1.7m. Of this approximately $1.0m is an internal loan from the Sewer Fund which is not required to be reported in Note 21 in the consolidated accounts. The internal loan has been included in Council's LTFP.

Council has also included a loan for $1.0m in their 2013 financial forecast. This is the LIRS Round 2 loan which will now be drawn in 2014 and as a result is not reported in the 2013 accounts. When the LIRS 2 loan is included, Council's forecast additional borrowings for the General Fund in the Maintained Services model are $8.6m. With both the DSCR and Interest Cover Ratios well above benchmark and increasing, this suggests that Council would be able to service additional debt over the forecast period.

3.3a Capital Expenditure

Figure 13 - Capital Expenditure Ratio for General Fund (MS)



Under the Maintained Services scenario Council's Capital Expenditure Ratio is forecast at or above benchmark for the entire forecast period. Council has forecast $59.9m in capital expenditure which will assist in maintenance and renewal. The majority of the forecast capital expenditure relates to roads maintenance and rehabilitation. A slight reduction is forecast in roads rehabilitation in 2018 that causes the ratio to dip that year.

3.4a Financial Model Assumption Review

Council has 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, 2.8% in 2012, and 3.6% in 2013. In November 2012 IPART announced that the rate peg to apply in the 2013/14 financial year will be 3.4%. Beyond 2014 TCorp has assessed a general benchmark for rates and annual charges to increase by mid-range LGCI annual increases of 3.0%
- Interest and investment revenue: annual return of 5%
- All other revenue items: the estimated annual CPI increase of 2.5%
- Employee costs: 3.5% (estimated CPI+1%)
- All other expenses: the estimated annual CPI increase of 2.5%

Key Observations and Risks

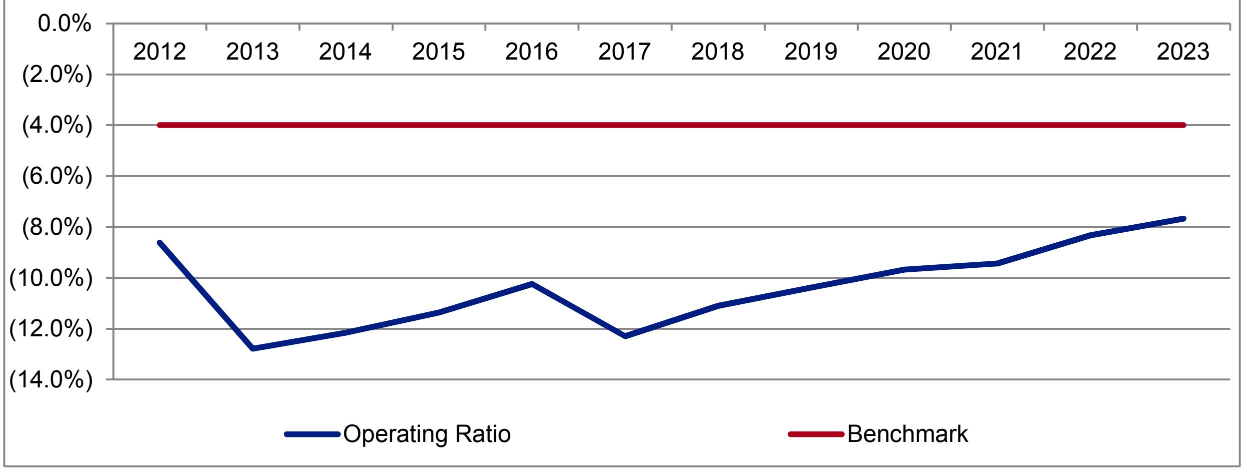
- The Maintained Services scenario forecasts maintaining current services and current service levels.
- Rates and annual charges are forecast to increase by an average of 11.3% p.a. between 2015 and 2020 due to the proposed SRV and 3.4% p.a. for the remainder of the forecast.
- User fees and charges have been forecast to decrease by 26.7% in 2014 as a result of a decrease in private works as well as a decrease in income generated from Council's Inala Units complex due to a regional slowdown in demand for accommodation. From 2015 user fees and charges increase by 4.0% p.a.
- Employee expenses are forecast to increase by 8.3% ($0.4m) in 2014 while materials and contracts expenses are forecast to decrease by 17.3% ($0.5m). Council has advised that they are unable to provide an accurate split between materials and wages from their corporate operating system and that it is difficult to calculate the split between capitalised wages and operating expenses. However these amounts should offset each other. From 2015 employee expenses are forecast to increase by an average of 3.9% p.a. which is in line with historic levels.
- In 2014 Council has forecast a decrease in materials and contracts expenses. With the exception of a peak in 2016, materials and contracts expenses have been forecast to increase by 2.9% p.a. compared to 15.4% historically. Council has forecast an increase in capital expenditure primarily for road related maintenance and rehabilitation and as a result forecast materials and contracts expenses should increase at a rate lower than historical increases. This assumption appears to be reasonable.
- Depreciation expense averages 1.0% p.a. growth from 2015. As the SRV income is to be used for infrastructure projects we consider this assumption reasonable.
- While Council has included the impacts of the proposed SRV income in their operating revenue which increases by an average of 6.5% p.a. from 2015, expenses are forecast to increase by an average of 3.2% p.a. for the same period and may be understated.

3b Reduced Services Forecast

The 'Reduced Services' scenario incorporates the IPART approved Mining SRV and the impact of Council's financial position without the assistance of any further SRV.

3.1b: Operating Results

Figure 14 - Operating Ratio for General Fund (RS)



The Reduced Services scenario forecasts an operating deficit, excluding capital grants and contributions, for the entire forecast period. The result deteriorated in 2013 due to a decrease in operating grants and user fees and charges. Council has forecast rates and annual charges to increase by 8.3% ($0.6m) in 2016 which includes rate peg increases as well as a new waste contract which will attract higher charges. Rates and annual charges are forecast to decrease by 0.3% in 2017 as a result of the completion of a 10 year Community Centre SRV.

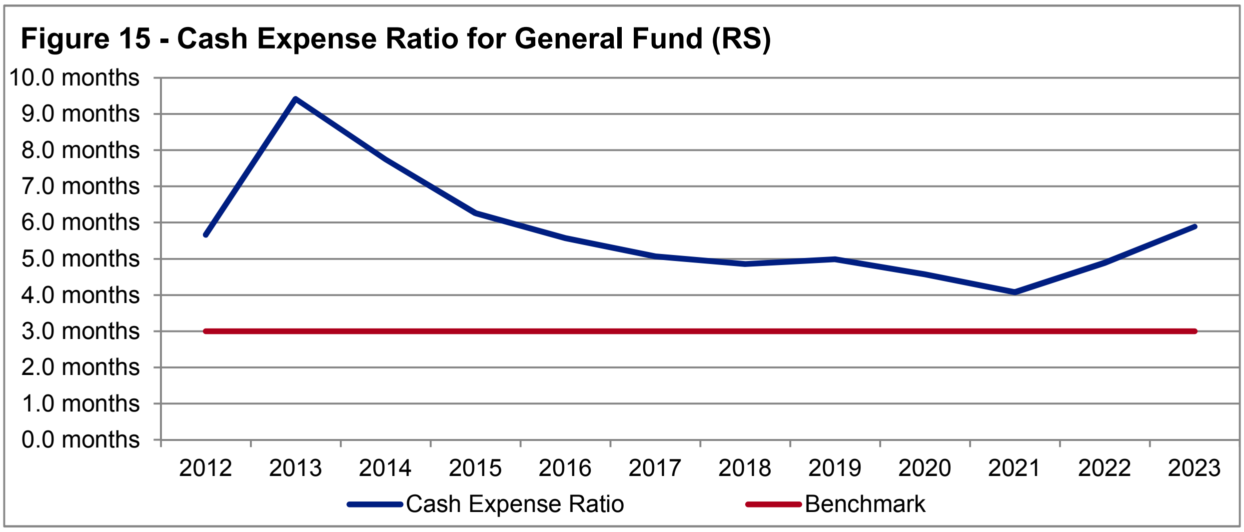
From 2015, Council's operating revenue has been assumed to increase by an average of 3.4% p.a. (compared to 6.8% p.a. historically) while operating expenses are forecast to increase by 2.9% p.a. (compared to 9.1% p.a. historically) and this causes the ratio to improve marginally over the period.

It is noted that historic results are skewed due to increased operating grants and user fees and charges in 2012, increased depreciation expense in 2011 and significantly increased materials and contracts expense in 2012. However an average increase of 2.9% p.a. in future operating expenses would seem optimistic.

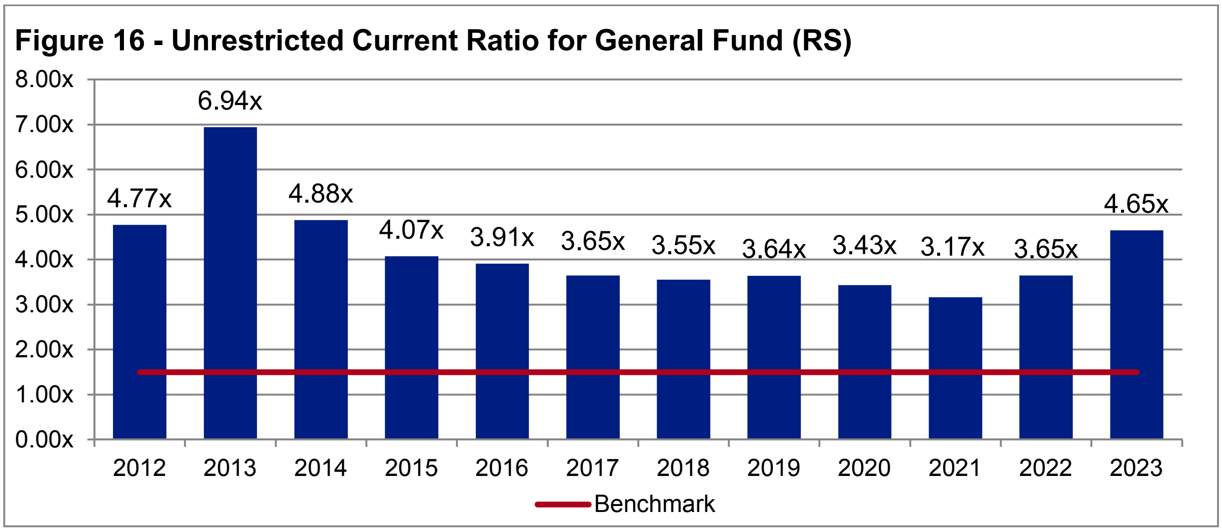
3.2b: Financial Management Indicators

The financial indicators are linked to the utilisation of debt in early years and the use of cash for capital works projects. The indicators remain static over time as the amortising debt reduces, operating deficits improve and cash is allocated to capital expenditure.

Liquidity Ratios



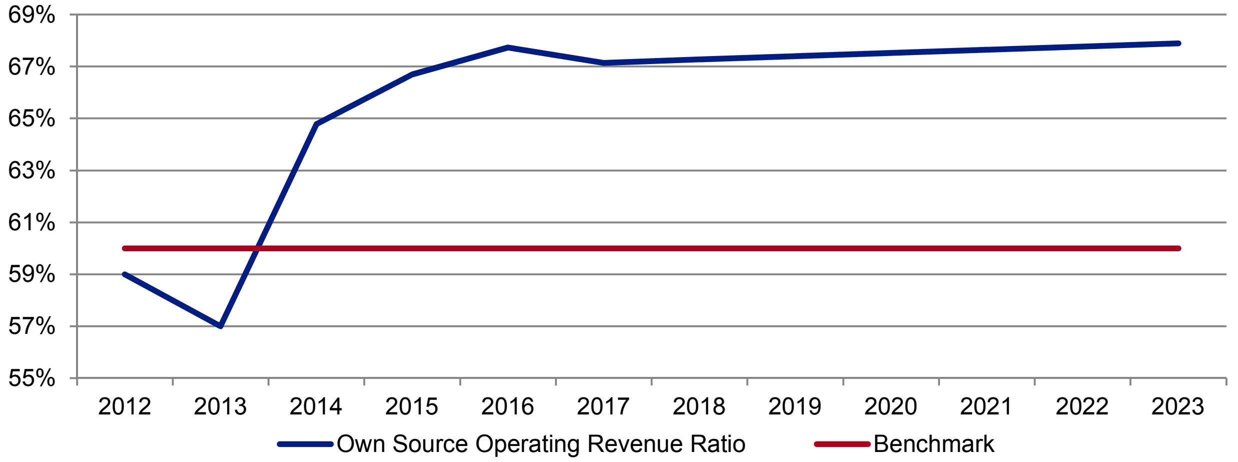
Council's Cash Expense Ratio is above benchmark for the entire forecast period. The ratio peaks in 2013 as a result of increased rates and capital grants revenue. Council has forecast the ratio to decline steadily until 2022 when a forecast decrease in IPP&E purchases in 2022 causes the ratio to increase again.



Council's Unrestricted Current Ratio is well above benchmark for the entire forecast period. This indicates Council should not face liquidity issues.

Fiscal Flexibility Ratios

Figure 17 - Own Source Operating Revenue Ratio for General Fund (RS)



Council's Own Source Operating Ratio falls below benchmark in 2013 as a result of decreased user fees and charges and an increase in roads related capital grants. The ratio increases above benchmark in 2014 as capital grants decrease in line with historic levels. The ratio peaks in 2016 due to increased income forecast from a new waste contract commencing in 2016.

Figure 18 - DSCR for General Fund (RS)

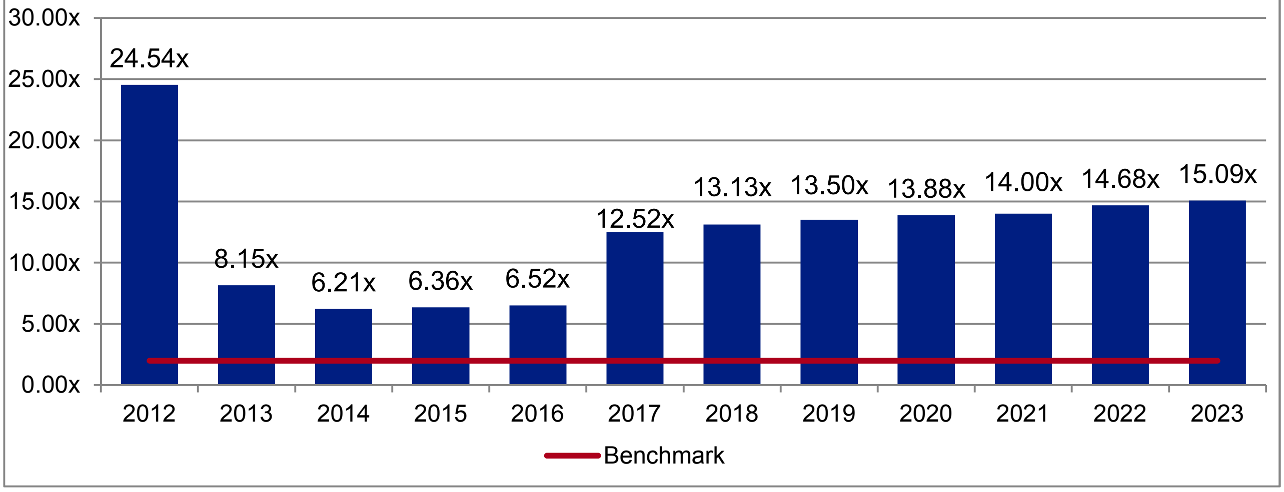
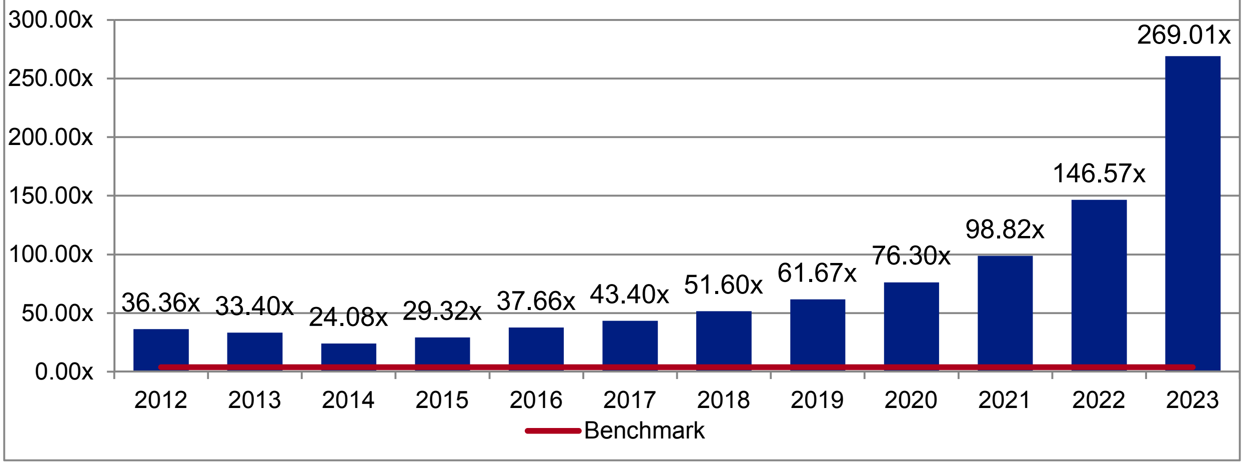


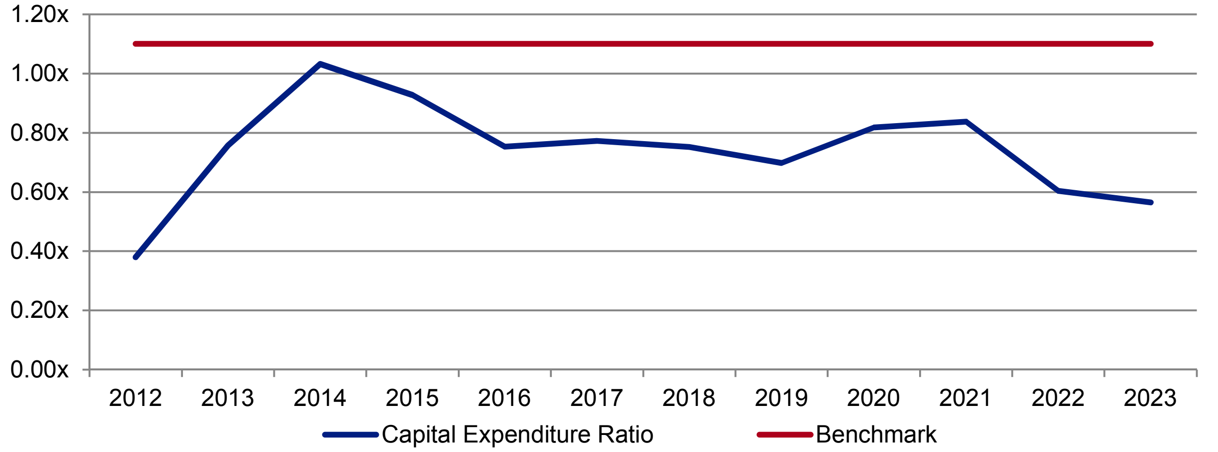
Figure 19 - Interest Cover Ratio for General Fund (RS)



Council's projected DSCR and Interest Cover Ratio are well above benchmark each year of the forecast period. This indicates that Council has the capacity to service their existing borrowings of approximately $1.7m (as discussed previously) and $1.0m forecast in their General Fund Reduced Services financial model.

3.3b: Capital Expenditure

Figure 20 - Capital Expenditure Ratio for General Fund (RS)



Based on the forecast expenditure in the General Fund Reduced Services financial model, Council's Capital Expenditure Ratio is below benchmark for the entire forecast period. The ratio peaks in 2014 and 2020 as a result of anticipated replacement of large items of plant, which is fully funded through plant hire.

The ratio highlights the fact that under the Reduced Services model Council will be unable to maintain their assets at the levels required.

3.4b: Financial Model Assumption Review

Council has 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, 2.8% in 2012, and 3.6% in 2013. In November 2012 IPART announced that the rate peg to apply in the 2013/14 financial year will be 3.4%. Beyond 2014 TCorp has assessed a general benchmark for rates and annual charges to increase by mid-range LGCI annual increases of 3.0%
- Interest and investment revenue: annual return of 5%
- All other revenue items: the estimated annual CPI increase of 2.5%
- Employee costs: 3.5% (estimated CPI+1%)
- All other expenses: the estimated annual CPI increase of 2.5%

Key Observations and Risks

- The Reduced Services scenario is based on the assumption that without the assistance of an SRV services will need to be reduced.
- Rates and annual charges are forecast to increase by 8.4% in 2016 and decrease by 0.3% in 2017 as discussed previously. From 2018 they are forecast to increase by 3.4% p.a.
- User fees and charges have been forecast to decrease by 26.7% in 2014 as a result of a decrease in private works as well as a decrease in income generated from Council's Inala Units complex due to a slowdown in mining activity. From 2015 user fees and charges increase by 4.0% p.a.
- Operating grants decrease in 2013 and are forecast to decrease again in 2014 as a result of the prepayments of the FAG in 2012 and 2013. From 2015 they are forecast to increase by 2.9% p.a.
- Employee expenses are forecast to decrease by 7.3% in 2014 based on the assumption that if Council were not to get SRV approval all positions currently vacant in their salary structure will be taken out permanently. From 2015 they are forecast increase by 4.0% p.a. which is in line with the historic average increase since 2009.
- Materials and contracts expenses are forecast to fluctuate until 2017 due to wage classification as discussed above as well as the timing of various projects. After this they are forecast to increase by 2.9% p.a.
- Depreciation expense is forecast to increase by only 0.5% in 2014 and 1.0% p.a. from 2015 for the remainder of the forecast period. Given that depreciation increased by 2.8% in 2013 and the Reduced Services scenario will result in a reduction in asset maintenance this may be understated.
- With the exception of Council's depreciation expense we find the assumptions reasonable.

3.5: Sustainability

Based on the information received and the revised LTFP for the Maintained Services scenario, TCorp believes the Council to be in a Moderate Sustainability position.

Should an additional SRV be approved, in considering the longer term Sustainability of the Council we make the following comments:

- Council is forecasting to return to a surplus position in 2019 and the operating result is forecast to continue to improve for the remainder of the forecast period.
- Council will improve its rating base through the SRV which will give Council more financial flexibility in the future.
- Council has historically had sufficient liquidity levels and this is expected to continue in the medium term.
- Council is forecasting capital spending sufficient to address their asset maintenance and Infrastructure Backlog and allow for some new capital spend.
- Council's Interest Cover Ratio and DSCR are well above benchmark and suggest Council has the capacity to undertake additional borrowings in their financial forecast.

If an additional SRV is not obtained, the impact on the long term Sustainability of Council is:

- Council is forecasting operating deficits for the entire forecast period.
- Council has historically had sufficient liquidity levels and this is expected to continue in the medium term.
- Council is forecasting insufficient capital spending which may lead to their Infrastructure Backlog increasing in the medium to long term.
- Council's Interest Cover Ratio and DSCR are well above benchmark and improving over the period as Council has not forecast any additional borrowing under the Reduced Services scenario. This indicates Council has the capacity to undertake additional borrowings in their financial forecast.

4 Conclusion and Recommendations

Based on our review of both the historic financial information and the 10 year financial forecasts within Council's LTFPs we consider Council to be in a moderate financial position.

We base our conclusion on the following key points.

Based on the Maintained Services Scenario:

- Council forecasts a surplus position in the medium term with the operating result increasing in the long term.
- Council's rating base will improve which gives Council more financial flexibility in the future.
- Council forecasts capital spend sufficient to address their asset maintenance and infrastructure backlogs as well as some new capital spend.
- In the Outlook period of the next three years, Council's Outlook is Neutral. Impact of the SRV should be evident in the long term in improving the Sustainability Outlook for the Council.

Based on the Reduced Services scenario:

- Council forecasts operating deficits averaging 10.3% p.a. over the forecast period.
- Council is forecasting insufficient capital spending which will likely lead to their infrastructure backlog increasing in the medium to long term.
- Council's Interest Cover Ratio and DSCR are well above benchmark for the entire forecast period which indicates Council has the capacity to undertake additional borrowings.
- In the Outlook period of the next three years, Council's Outlook remains Neutral under this scenario. However, the deterioration in operating performance will lead to a reduction in services in the medium to long term. If this situation continues without rectification, it is likely that Council's Outlook will become Negative in the medium to long term.

Appendix A Historical Financial Information Tables

Table 1-Income Statement

Income statement	Year ended 30 June					% annual change			
	2013	2012	2011	2010	2009	2013	2012	2011	2010
Revenue									
Rates and annual charges	7,457	5,640	5,292	5,012	4,747	32.2%	6.6%	5.6%	5.6%
User charges and fees	1,425	3,232	1,354	1,646	1,774	(55.9%)	138.7%	(17.7%)	(7.2%)
Interest and investment revenue	482	513	480	340	301	(6.0%)	6.9%	41.2%	13.0%
Grants and contributions for operating purposes	3,815	4,301	3,341	2,966	3,585	(11.3%)	28.7%	12.6%	(17.3%)
Other revenues	227	191	200	170	234	18.8%	(4.5%)	17.6%	(27.4%)
Total revenue	**13,406**	**13,877**	**10,667**	**10,134**	**10,641**	**(3.4%)**	**30.1%**	**5.3%**	**(4.8%)**
Expenses									
Employees	4,951	4,821	4,460	4,340	4,246	2.7%	8.1%	2.8%	2.2%
Borrowing costs	155	161	164	169	179	(3.7%)	(1.8%)	(3.0%)	(5.6%)
Materials and contract expenses	3,357	3,898	2,293	2,508	2,497	(13.9%)	70.0%	(8.6%)	0.4%
Depreciation and amortisation	4,627	4,424	4,023	2,582	2,477	4.6%	10.0%	55.8%	4.2%
Other expenses	1,843	1,597	1,430	1,396	1,423	15.4%	11.7%	2.4%	(1.9%)
Total expenses	**14,933**	**14,901**	**12,370**	**10,995**	**10,822**	**0.2%**	**20.5%**	**12.5%**	**1.6%**
Operating result (excluding capital grants and contributions)	**(1,527)**	**(1,024)**	**(1,703)**	**(861)**	**(181)**	(49.1%)	39.9%	(97.8%)	(375.7%)
Operating result (including capital grants and contributions)	**109**	**(259)**	**(1,270)**	**(101)**	**708**	142.1%	79.6%	(1157.4 %)	(114.3%)

Table 2 - Items excluded from Income Statement

Excluded items					
Grants and contributions for capital purposes	1,636	765	433	760	889
Net gain/(loss) from the disposal of assets	(24)	(277)	4	169	330

Table 3 – Balance Sheet

Balance Sheet ($'000s)	Year Ended 30 June					% annual change			
	2013	2012	2011	2010	2009	2013	2012	2011	2010
Current assets									
Cash and cash equivalents	10,144	7,102	7,622	6,282	3,542	42.8%	(6.8%)	21.3%	77.4%
Investments	1,233	0	380	0	2000	0.0%	(100.0%)	0.0%	(100.0%)
Receivables	642	2,974	1,107	1,130	1,325	(78.4%)	168.7%	(2.0%)	(14.7%)
Inventories	900	854	1,000	891	755	5.4%	(14.6%)	12.2%	18.0%
Other	149	160	166	137	132	(6.9%)	(3.6%)	21.2%	3.8%
Total current assets	13,068	11,090	10,275	8,440	7,754	17.8%	7.9%	21.7%	8.8%
Non-current assets									
Investments	0	233	233	613	613	(100.0%)	0.0%	(62.0%)	0.0%
Receivables	61	178	219	224	399	(65.7%)	(18.7%)	(2.2%)	(43.9%)
Infrastructure, property, plant & equipment	184,436	183,553	179,533	173,929	73,253	0.5%	2.2%	3.2%	137.4%
Total non-current assets	184,497	183,964	179,985	174,766	74,265	0.3%	2.2%	3.0%	135.3%
Total assets	**197,565**	**195,054**	**190,260**	**183,206**	**82,019**	**0.3%**	**2.5%**	**3.9%**	**123.4%**
Current liabilities									
Payables	762	1,106	787	817	765	(31.1%)	40.5%	(3.7%)	6.8%
Borrowings	98	92	85	80	123	6.5%	8.2%	6.3%	(35.0%)
Provisions	1,233	1,174	1,135	1,210	1,158	5.0%	3.4%	(6.2%)	4.5%
Total current liabilities	2,093	2,372	2,007	2,107	2,046	(11.8%)	18.2%	(4.7%)	3.0%
Non-current liabilities									
Borrowings	1,710	1,809	1,901	1,986	2,066	(5.5%)	(4.8%)	(4.3%)	(3.9%)
Provisions	506	459	429	395	394	10.2%	7.0%	8.6%	0.3%
Total non-current liabilities	2,216	2,268	2,330	2,381	2,460	(2.3%)	(2.7%)	(2.1%)	(3.2%)
Total liabilities	**4,309**	**4,640**	**4,337**	**4,488**	**4,506**	**(7.1%)**	**7.0%**	**(3.4%)**	**(0.4%)**
Net assets	**193,256**	**190,414**	**185,923**	**178,718**	**77,513**	**1.5%**	**2.4%**	**4.0%**	**130.6%**

Table 4-Cashflow

Cash Flow Statement ($'000s)	Year ended 30 June				
	2013	**2012**	**2011**	**2010**	**2009**
Cash flows from operating activities	6,775	2,809	2,429	2,486	2,834
Cash flows from investing activities	(3,640)	(3,244)	(1,009)	377	(3,118)
Proceeds from borrowings and advances	0	0	0	0	0
Repayment of borrowings and advances	(93)	(85)	(80)	(123)	(162)
Cash flows from financing activities	(93)	(85)	(80)	(123)	(162)
Net increase/(decrease) in cash and equivalents	**3,042**	**(520)**	**1,340**	**2,740**	**(446)**
Cash and equivalents	0	233	233	613	613

TCorp

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.

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.

[1] IPART “Revenue Framework for Local Government” December 2009 p.83
[2] DLG “Recognition of certain assets at fair value” March 2009

Grants and Contributions for Capital Purposes

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

Grants and Contributions for Operating Purposes

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

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

Independent Commission Against Corruption (ICAC)

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

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

Independent Pricing and Regulatory Tribunal (IPART)

IPART has four main functions relating to the 152 local councils in NSW. Each year, IPART determines the rate peg, or the allowable annual increase in general income for councils. They also review and determine council applications for increases in general income above the rate peg, known as "Special Rate Variations". They approve increases in council minimum rates.

They also review council development contributions plans that propose contribution levels that exceed caps set by the Government.

Infrastructure Backlog

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

Integrated Planning and Reporting (IP&R) Framework

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

Local Government Cost Index (LGCI)

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

Net Assets

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

Roads and Maritime Services (RMS)

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

Section 64 Contribution

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

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

Section 94 Contribution

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

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

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

Special Rate Variation (SRV)

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

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

The applications are reviewed and approved by IPART.

Sustainability

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

Ratio Explanations

Asset Maintenance Ratio

Benchmark = Greater than 1.0x

Ratio = actual asset maintenance / required asset maintenance

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

Building and Infrastructure Renewals Ratio

Benchmark = Greater than 1.0x

Ratio = Asset renewals / depreciation of building and infrastructure assets

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

Cash Expense Cover Ratio

Benchmark = Greater than 3.0 months

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

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

Capital Expenditure Ratio

Benchmark = Greater than 1.1x

Ratio = annual capital expenditure / annual depreciation

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

Debt Service Cover Ratio (DSCR)

Benchmark = Greater than 2.0x

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

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

Building and Infrastructure Backlog Ratio

Benchmark = Less than 0.02x

Ratio = estimated cost to bring assets to a satisfactory condition (from Special Schedule 7) / total infrastructure assets (from Special Schedule 7)

This ratio shows what proportion the backlog is against total value of a council's infrastructure.

Interest Cover Ratio

Benchmark = Greater than 4.0x

Ratio = EBITDA / interest expense (from the income statement)

This ratio indicates the extent to which a council can service its interest bearing debt and take on additional borrowings. It measures the burden of the current interest expense upon a council's operating cash.

Operating Ratio

Benchmark = Better than negative 4%

Ratio = (operating revenue excluding capital grants and contributions – operating expenses) / operating revenue excluding capital grants and contributions

This ratio measures a council's ability to contain operating expenditure within operating revenue.

Own Source Operating Revenue Ratio

Benchmark = Greater than 60%

Ratio = rates, utilities and charges / total operating revenue (inclusive of capital grants and contributions)

This ratio measures the level of a council's fiscal flexibility. It is the degree of reliance on external funding sources such as operating grants and contributions. A council's financial flexibility improves the higher the level of its own source revenue.

Unrestricted Current Ratio

Benchmark = 1.5x (taken from the IPART December 2009 Revenue Framework for Local Government report)

Ratio = Current assets less all external restrictions / current liabilities less specific purpose liabilities

Restrictions placed on various funding sources (e.g. Section 94 developer contributions, RMS contributions) complicate the traditional current ratio because cash allocated to specific projects are restricted and cannot be used to meet a council's other operating and borrowing costs. The Unrestricted Current Ratio is specific to local government and is designed to represent a council's ability to meet debt payments as they fall due.

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