campbelltown
city council

Appendix 9

TCorp Financial Assessment and Benchmarking Report

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Campbelltown City Council

Financial Assessment and Benchmarking Report

05 April 2013

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

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Disclaimer

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

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

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

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

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Index

Section 1 Executive Summary

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

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

Council has made one application relating to their road infrastructure backlog renewal program for $5.0m.

TCorp's approach has been to:

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

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

- Council's underlying performance, as measured by EBITDA, has improved between 2009 and 2011
- Council has satisfactory liquidity as indicated by an Unrestricted Current Ratio above the benchmark in all three years
- Council's Own Source Operating Revenue Ratio is above 60% in all three years indicating Council has a sufficient level of fiscal flexibility

Council's reported Infrastructure Backlog of $31.8m in 2011 represents 3.7% of its infrastructure asset value of $864.8m. Other observations include:

- The backlog has reduced over the review period from $54.0m in 2009 due to the refinement of Council's Asset Management System
- Public roads make up the majority of the backlog at $23.9m, 75.3% of the total 2011 backlog value
- In 2011, Council has not spent sufficiently on asset renewal, maintenance or upgrades as indicated by the Building and Infrastructure Asset Renewal, Asset Maintenance and Capital Expenditure Ratios being below benchmark

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

- The LTFP assumes the level of services and operations remain stable or in some cases slightly increased from the 2012 budget.
- Operating deficits are forecast in all 10 years when capital grants and contributions are excluded

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- Council's liquidity is forecast to remain above the benchmark and improve over the forecast period
- Council's level of fiscal flexibility is sound as own source revenue is maintained at levels above 70%
- The forecast capital expenditure is at levels lower than required to maintain assets in a satisfactory condition. Council has stated that there is an annual asset maintenance and renewal funding gap of $1.4m p.a in 2013 and $3.9 p.a. in each year to 2022
- While Council is in a sound financial position over the short to medium term, the Net Assets position is forecast to decrease by approximately $65m over the forecast period. This indicates that Council will face increasing pressure on its assets and ability to deliver services at current levels. If not addressed this can lead to financial sustainability issues in the long term

In our view, based on the financial forecasts provided to TCorp, the Council has the capacity to undertake the combined additional borrowings of $5.0m for the LIRS project. This is based on the following analysis:

- The DSCR is forecast to be above the 2.00x benchmark in all 10 years
- The Interest Cover Ratio is forecast to be above the 4.00x benchmark in all 10 years
- Council has the capacity to manage the additional scheduled borrowings of $22.5m in addition to the LIRS facility currently included in Council's LTFP
- Council also has the capacity to utilise a further $18.9m in borrowings in 2013 before their DSCR reduces to the 2.00x benchmark

In respect of the Benchmarking analysis TCorp has compared the Council's key ratios with other councils in DLG Group 7. The key observations are:

- Council's financial flexibility has declined from prior years with the Operating Ratio falling below the benchmark and the group average in the medium term
- Council has sound liquidity with both the Cash Expense Ratio and the Unrestricted Current Ratio above the average and benchmark by 2016
- Council has sound debt capacity with the DSCR and Interest Cover Ratio above the benchmark and the average. This would allow the Council to support further debt borrowings if required in the future
- Council's asset maintenance and renewal are both below benchmark and the group average. Should this trend continue, assets may not be maintained at the level required to deliver its services and could lead to a higher Infrastructure Backlog in the future

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

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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

Campbelltown City Council	
Locality and Size	
Locality	Outer Sydney
Area	312 km²
DLG Group No.	7
Demographics	
Population (as at 30 June 2011)	145,967
% under 20	30%
% between 20 and 59	55%
% over 60	15%
Expected population in 2021	184,500
Operations	
Number of employees (FTE)	630
Annual revenue	$125.6m
Infrastructure	
Roads	5.8m m²
Bridges	31
Infrastructure backlog value	$31.8m
Total infrastructure value	$864.8m

Campbelltown City Council Local Government Area (LGA) is located 50 minutes from the Sydney CBD and within easy reach of major road and rail links to the Southern Highlands, Canberra, the Blue Mountains and the South Coast beaches.

Campbelltown City continues to develop into a major centre for employment, transport, education, retail, health and community services. Campbelltown City Centre has been identified as a densification area in the NSW State Government's Metropolitan Strategy.

Within Council's infrastructure, property, plant and equipment (IPP&E) at 30 June 2011 there was:

- $439.1m of roads, bridges and footpaths
- $169.4m of stormwater drainage
- $149.9m of specialised buildings
- $79.5m of other structures
- $14.9m of non specialised buildings
- $12.1m of depreciable land movements

2.4: LIRS Application

Council has made one LIRS application.

Project: Road Infrastructure Backlog Renewal Program

Description: To complete pavement and surfacing renewal treatments for 25 road segments to reduce the current road infrastructure renewal backlog (currently approximately $14.0m). The project aims to rehabilitate road surfaces identified as critical to Campbelltown City Council's LGA.

Amount of loan facility: $5.0m

Term of loan facility: 10 years

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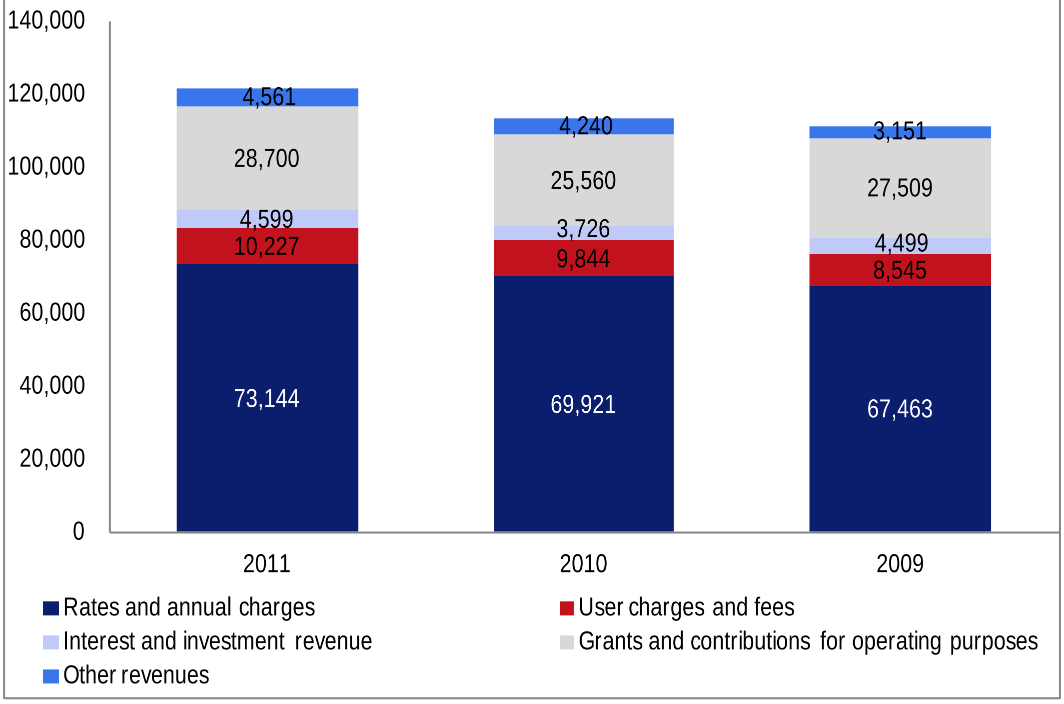
Section 3 Review of Financial Performance and Position

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

3.1: Revenue

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

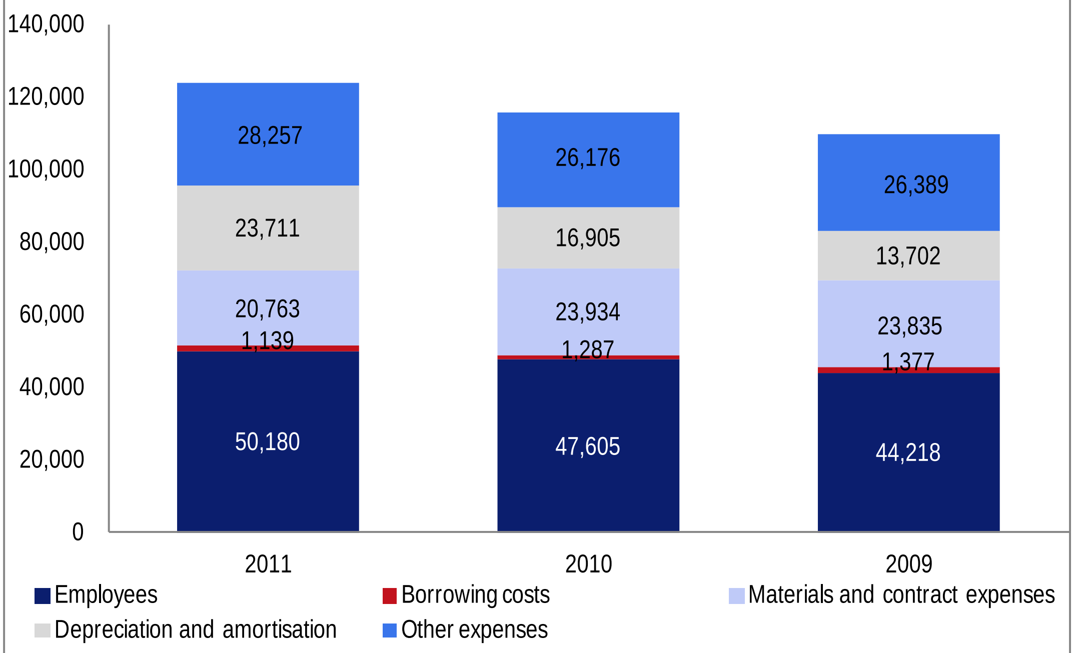


Key Observations

- Total operating revenues have increased by $10.1m over the period, representing an annual increase of 4.5% p.a.
- Rates and annual charges are the largest revenue source at 60.3% of the total in 2011. They have increased each year, 3.6% in 2010 and 4.6% in 2011, in line with the IPART approved rate increases for general rates and an expansion in the rating base as more residential properties have been developed within the LGA.
- User charges and fees increased in both years with the 15.2% increase in 2010 attributable to a $0.6m property rental income and $0.3m child care fee increase.
- Council's own source operating revenue (rates and annual charges, and user charge and fees combined) equated for 66.6% of total revenue in 2011.
- Operating grants decreased in 2010 due to the first quarterly payment for the financial assistance grant being received in 2009 while the increase in 2011 was due to a number of new infrastructure related grants and contributions being received.
- Other revenues were boosted in 2010 and 2011 by land sales relating to a redevelopment at Minto that contributed $0.9m and $1.2m respectively.

3.2: Expenses

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



Key Observations

- Total expenses have increased by $14.5m over the period, representing an annual increase of 6.6% p.a.
- Employee costs have increased by 7.7% in 2010 and 5.4% in 2011. The 2010 increase was attributable to salaries and wage increases of $1.8m as well as increased defined benefit scheme superannuation payments by $1.1m. The 2011 increase was due to the annual pay award increment alongside an increase in full time employees from 608 to 630.
- Materials and contracts have decreased over the period and specifically dropped in 2011 as Council completed works of approximately $7m relating to the Campbelltown Sports Stadium in 2010.
- Depreciation expense has increased by 73.0% over the period. The increases have been in line with the Asset Revaluations with a $2.5m increase in 2010 relating to buildings and a $7.9m increase in 2011 relating to infrastructure asset depreciation.
- Other expenses rose in 2011 by $2.1m due to a variety of factors, the largest being tipping fees that increased by $0.5m.

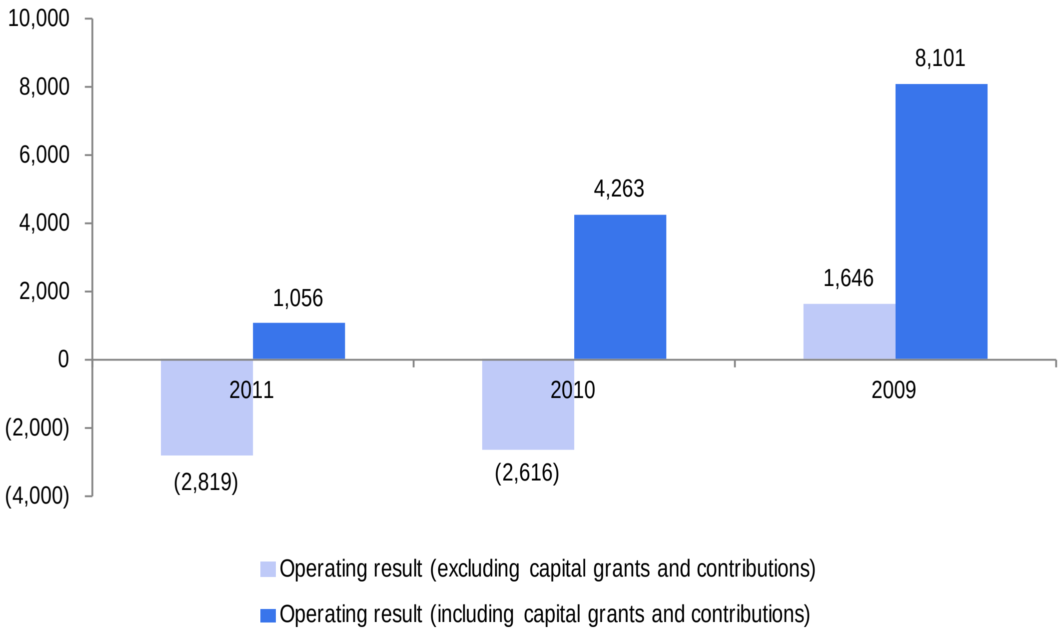
3.3: Operating Results

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

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

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

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



Key Observations

- Council'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 a deficit position for 2010 and 2011 when capital grants and contributions are excluded.
- Council expenses include a non-cash depreciation expense, ($23.7m in 2011), which has increased substantially by $10.0m 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 ($'000s)	22,031	15,576	16,725
Operating Ratio	(2.3%)	(2.3%)	1.5%
Interest Cover Ratio	19.34x	12.10x	12.15x
Debt Service Cover Ratio	3.96x	2.85x	3.27x
Unrestricted Current Ratio	3.06x	2.42x	2.29x
Cash Expense Ratio	0.3 months	0.3 months	0.3 months
Own Source Operating Revenue Ratio	66.6%	66.4%	64.6%
Net assets ($'000s)	1,822,906	1,476,528	1,238,874

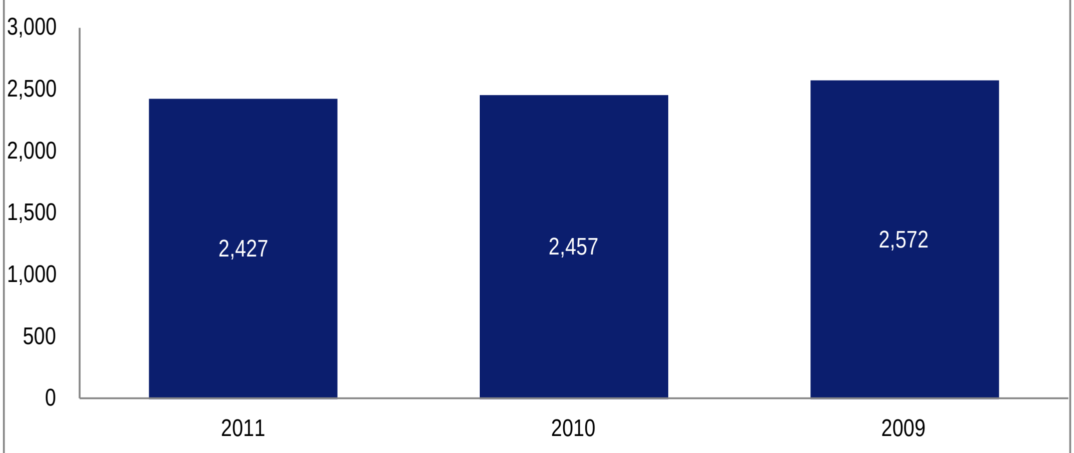
Key Observations

- EBITDA, a measure of Council's underlying trading performance was strongest in 2011, and this was reflected in the strongest Interest Cover Ratio and DSCR in that year. In all three years these ratios were above the benchmark indicating that Council had sufficient capacity to manage their debt commitments. The results also indicate further borrowings could be accommodated.
- Council had total borrowings of $20.6m in 2011 compared to $19.7m in 2009. The 2011 figure represents 1.1% of Net Assets.
- The Operating Ratio was negative in 2010 and 2011 in line with the operating deficits that were posted however remains above the benchmark for both years.
- The Unrestricted Current Ratio has been above the benchmark of 1.50x in all three years and has been on an upward trend indicating that Council has had no liquidity issues and has been able to meet all short term liabilities when they fall due.
- The Cash Expense Ratio remains below the benchmark in all three years as the majority of Council funds are held in current investments as detailed in Section 3.5.
- Council's Own Source Operating Revenue Ratio has been above the benchmark in all three years and has been marginally trending upwards. Council therefore have a large enough base to allow a sufficient level of fiscal flexibility, in the event of being in a financial situation where it is required.
- Net Assets have increased in each year due to the Asset Revaluations process. In 2010 there was a $223.0m increase in infrastructure assets while in 2011 there was a $345.3m increase in community land, land under roads, other structures and assets. 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 has marginally increased the IPP&E asset base by $3.0m over the review period, with asset purchases being higher than the combined value of disposed assets and depreciation.

3.5: Statement of Cashflows

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



Key Observations

- Council's cash and cash equivalents have remained consistent throughout the three year period. Council's funds are mainly held in term deposit accounts classified under current investments.
- Overall cash and cash equivalents, and investments have increased from $71.8m in 2009 to $77.2m in 2011. Of the $77.2m, $24.0m is externally restricted, $45.5m is internally restricted and $7.8m is unrestricted.
- Within the investments portfolio of $74.8m, $41.0m is invested in current term deposit accounts, $4.9m is held with TCorp, $12.3m in managed funds, $16.0m in floating rate notes and $0.6m in bills of exchange.
- The levels of cash and investments combined along with the Unrestricted Current Ratio above the benchmark highlights an adequate liquidity position with Council likely to have the capacity to manage most irregular financial events that may impact the Council's cash position.

3.6: Capital Expenditure

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

3.6(a): Infrastructure Backlog

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

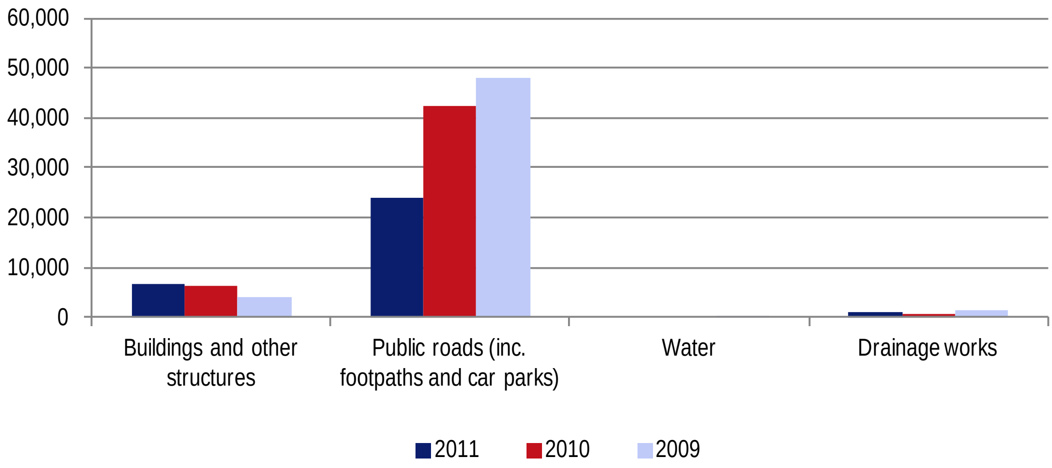
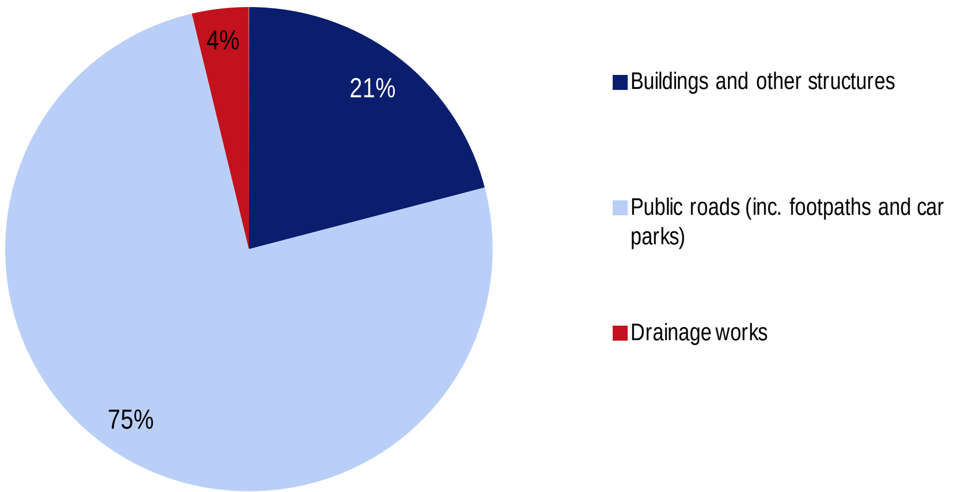


Figure 6 - Infrastructure Backlog Composition for 2010/11



Council's Infrastructure Backlog is dominated by public roads that make up $23.9m of the $31.8m total in 2011.

The Infrastructure Backlog has reduced each year with the public roads backlog reducing over the period by approximately 50% while buildings and other structures increased by $2.6m. The reason for the decrease is a refined Asset Management System that has allowed the backlog figure to be more accurately represented. Council will continue to refine this system with a view to developing a strategy to eliminate the Infrastructure Backlog.

3.6(b): Infrastructure Status

Infrastructure Status	Year ended 30 June		
	2011	2010	2009
Bring to satisfactory standard ($'000s)	31,799	49,610	53,976
Required annual maintenance ($'000s)	18,299	16,256	13,108
Actual annual maintenance ($'000s)	9,981	13,818	8,174
Total value of infrastructure assets ($'000s)	864,781	797,772	569,454
Total assets ($'000s)	1,873,658	1,530,673	1,287,410
Building and Infrastructure Backlog Ratio	0.04x	0.06x	0.09x
Asset Maintenance Ratio	0.55x	0.85x	0.62x
Building and Infrastructure Renewals Ratio	0.42x	1.03x	0.71x
Capital Expenditure Ratio	0.66x	1.41x	1.30x

The Building and Infrastructure Backlog Ratio has reduced in both years due to the combination of a reduced backlog figure and an increase in the total value of infrastructure assets. The reduction in the backlog figure is mainly due to improved and more detailed valuation techniques.

The Asset Maintenance Ratio has been below the benchmark in all three years indicating that Council are not investing enough to keep their assets operating at their current standard.

The Building and Infrastructure Renewals Ratio has been above the benchmark in 2010 however overall it indicates that Council are not investing enough to renew their assets.

The Capital Expenditure Ratio has been above the benchmark in 2009 and 2010 but has dropped below in 2011. The ratio in 2011 was impacted by the increase in depreciation of $6.8m along with a reduction in the asset purchases by $6.8m compared to 2010.

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	0	0	7,300
Replacement/refurbishment of existing assets	0	0	0
Total	0	0	7,300

Council has spent approximately $11m on new assets in 2011 however none of these are classified as major non-recurrent projects.

3.7: Specific Risks to Council

- Expansion of the Campbelltown CBD. Campbelltown City Centre has been identified as an area for densification in the State Government's Metropolitan Strategy and Council is required to manage the planned expansion of buildings and infrastructure to maximise the economic benefits of the planned development. Two of Council's five objectives within their Community Strategic Plan (CSP) focus on the local economy and infrastructure therefore Council plan to manage this risk and utilise it to their benefit.
- Expansion of the South West Growth Centre. The South West Growth Centre, comprising 18 Precincts, is approximately 17,000 hectares and has capacity for around 110,000 new dwellings for 300,000 people. This will place significant additional pressures to Council's infrastructure including roads and the upgrade and expansion of Campbelltown public hospital to provide medical facilities for the increased population.
- Ageing population. As the population ages per national trends, Council will have a larger number of aged residents who require additional services. This will provide further pressures to Council's infrastructure and service levels.
- Redevelopment of public housing estates. While the redevelopment of these estates is expected to provide a better community mix and a safer environment, the relocation throughout the LGA of existing residents will provide challenges to the continuation of community service delivery levels. Again within Council's CSP fifth objective: 'a safe, healthy and connected community' focuses on this issue with Council liaising with both state and federal government agencies to manage the situation.
- Compulsory land acquisitions. Council is the acquisition authority for a significant amount of open space, riparian and environmental corridors related to new release areas. These areas include public housing developments and developer funded areas. This will place a financial burden on Council both in terms of acquisition and maintenance. Council is currently in the process of determining the land values, the infrastructure costs and maintenance costs. Preliminary financial modelling performed by the Council indicates that developer contributions will be insufficient to fund the necessary land acquisitions and infrastructure required. To fund these costs, Council will seek to enter into Voluntary Planning Agreements, where developers contribute a greater amount than the capped rate.

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Section 4 Review of Financial Forecasts

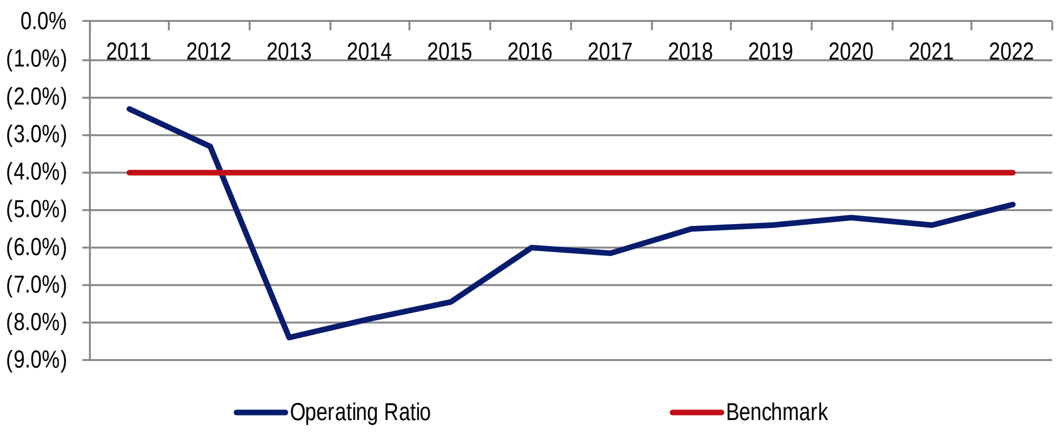
The financial forecast model shows the projected financial statements and assumptions for the next 10 years. The model includes the $5.0m loan with the LIRS subsidy. We have therefore amended the forecast model and added the LIRS interest saving back so that we are able to accurately compare the Council with its peers. The forecast also combines cash and investments and therefore it provides a very strong Cash Expense Ratio as shown in Section 4.2.

Council's LTFP considers two scenarios with Scenario 1 excluding the LIRS facility and replacing it with a $2.5m facility in 2013, and Scenario 2 including the $5.0m LIRS facility. It is therefore Scenario 2 that forms the basis of our analysis. Both scenarios propose borrowings of $2.5m p.a. from 2014 to 2022.

Council only operates a General Fund therefore our financial analysis is focused solely upon this fund.

4.1: Operating Results

Figure 7- Operating Ratio



Council is forecasting a weaker Operating Ratio than the 2011 historical result in 2013 with the deficit growing to 8.4% of operating revenue for that year. The decline in the Ratio from 2011 to 2012 is mainly due to higher materials and contracts cost, higher employee cost and a slight decline in user fees and charges revenue. The dip in the Ratio in 2013 is mainly due to lower than forecast operating grants and contributions compared to 2011 and 2012. Materials and contracts cost is also forecast to increase substantially from 2014.

The ratio then steadily improves over the remainder of the forecast however does not reach the benchmark. These continuous deficits are likely to impact on Council's long term financial sustainability.

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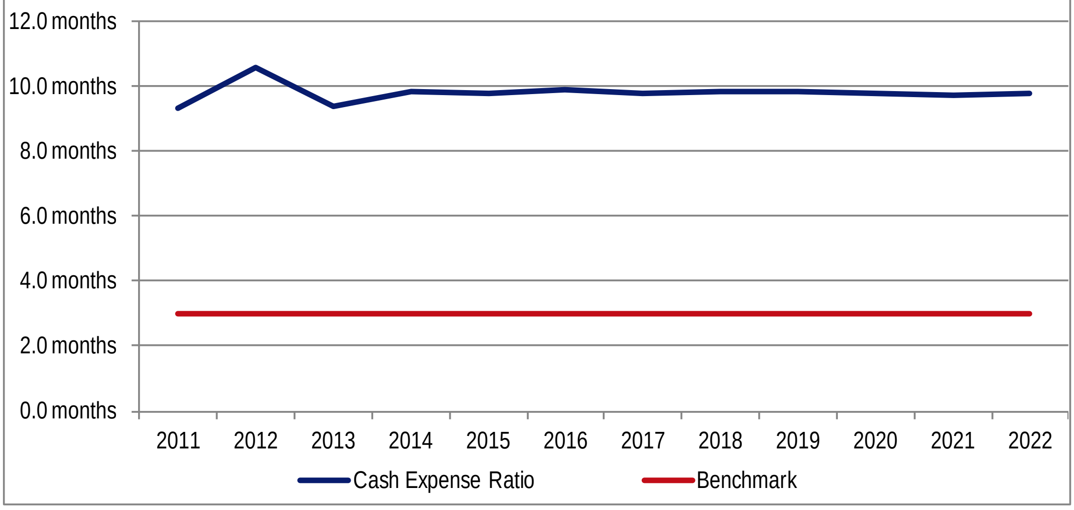
4.2: Financial Management Indicators

Liquidity Ratios

Figure 8 - Cash Expense Ratio inc. Current Investments

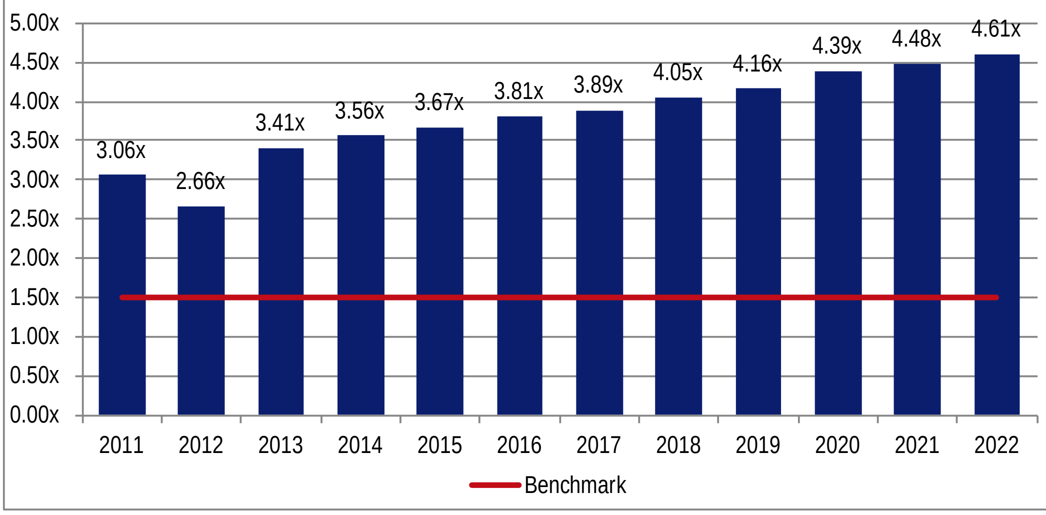


Council's forecast has combined cash and cash equivalents with current investments and Council has not been able to split these categories. The above graph therefore includes current investments and highlights that Council are well above the benchmark in all years of the forecast.

Historically a third of these funds have been externally restricted however this would still leave the ratio more than twice the benchmark figure.

Historically Council do keep the majority of their funds in term deposits that are classified as current investments and not cash and cash equivalents.

Figure 9 - Unrestricted Current Ratio

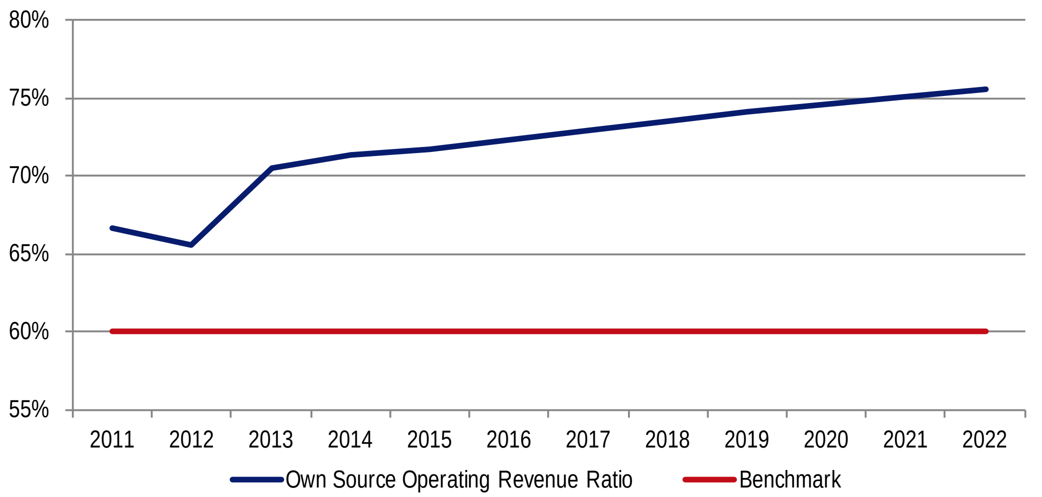


Council has forecast the Unrestricted Current Ratio to be above the benchmark in all 10 years. The forecast from 2013 onwards is above the historical result and is linked to Council's assumption that their combined cash and investments will grow from $85.0m in 2013 to $133.8m in 2022.

Both of these ratios indicate that Council will have sound liquidity throughout the forecast period to meet all short term liabilities.

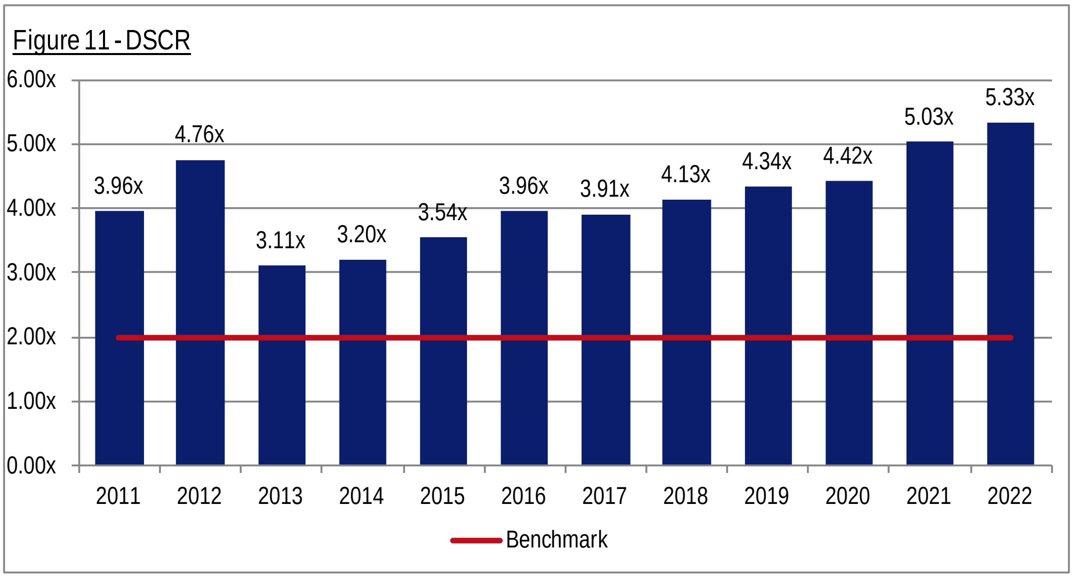
Fiscal Flexibility Ratios

Figure 10 - Own Source Operating Revenue Ratio



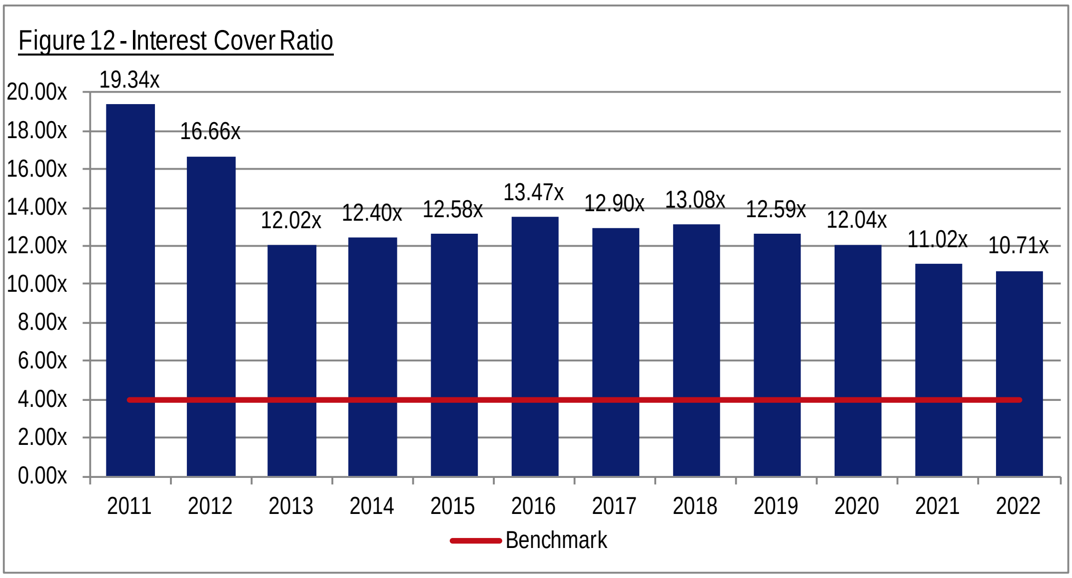
Council has historically been above the benchmark and the forecast shows that this is expected to continue with the Own Source Operating Revenue Ratio expected to be higher than 70% in 2013 and increase to 76% by 2022.

The increase over the forecast period is due to lower forecast capital grants and contributions that Council are unable to forecast accurately and this skews the ratio upwards.



The DSCR is forecast to remain above the benchmark for all 10 years. The forecast includes the $5.0m LIRS facility in 2013 and also $2.5m p.a. in additional new borrowings from 2014. The $2.5m p.a. drawdowns are used to fund asset renewal and maintenance.

This indicates that Council has sufficient capacity to manage the total forecast borrowings of $27.5m over the forecast period.



The Interest Cover Ratio is forecast to be comfortably above the benchmark in all 10 years. As per the DSCR it indicates that Council should have sufficient capacity to manage the total interest costs over the 10 year forecast period, including the $27.5m additional borrowings currently forecast.

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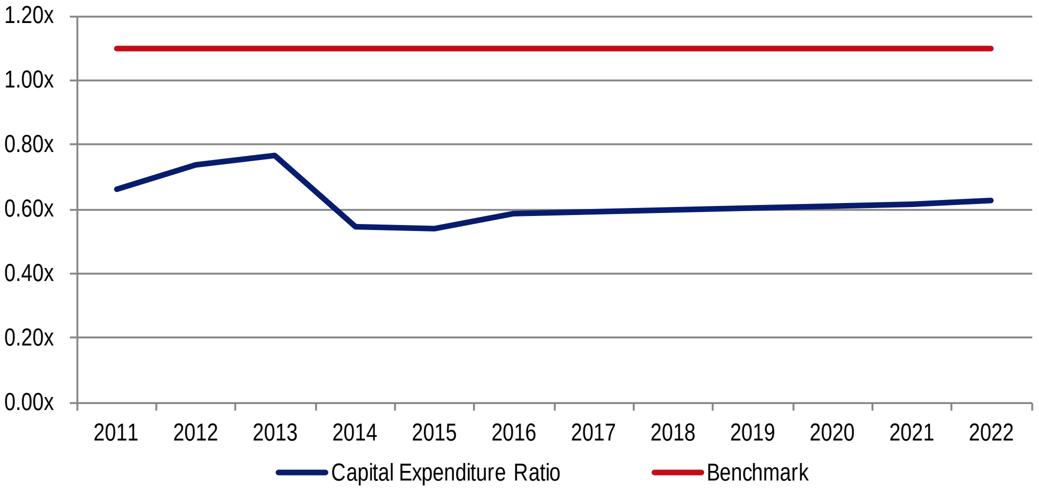
4.3: Capital Expenditure

Figure 13 - Capital Expenditure Ratio



Council's Capital Expenditure Ratio decreased below the benchmark in 2011 and Council has forecast the ratio to remain below the benchmark for the duration of the forecast.

The ratio is below the benchmark due to a combination of a marginal reduction in scheduled capital expenditure and a depreciation expense that has increased strongly following the asset revaluations.

This is highlighted within Council's LTFP document which indicates that the Council is forecast to have an asset renewal and maintenance funding gap of $1.4m in 2013 and $3.9m p.a. in each year thereafter.

The result of this ratio being below benchmark is that over the 10 year period Council's Net Asset position is forecast to reduce from $1,835.6m in 2013 to $1,770.3m in 2022 indicating that Council is not renewing or maintaining its assets to a level that would support Council's long term sustainability.

With a DSCR and Interest Cover Ratio above the benchmark and the Cash Expense Ratio, and Unrestricted Current Ratio indicating Council has sufficient liquidity, Council should review their capital expenditure program with a view to increasing it either via utilising cash reserves or through further borrowings.

In discussions with Council they have indicated that further refinement of their Asset Management Plan (AMP) will continue other the next two years that may provide increased accuracy of the quality of assets and their depreciation expense.

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 approved rate increase 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%

<u>Key Observations and Risks</u>

- The forecast reviewed by TCorp is Scenario 2 within the LTFP document and is the preferred scenario for Council as it includes increased expenditure on the renewal and maintenance of assets possible by the utilisation of the $5.0m LIRS facility.
- The LTFP also assumes that borrowings of $2.5m are drawn down every year to fund asset renewal.
- The LTFP assumes the level of services and operations remain stable or in some cases slightly increased from the 2012 budget.
- The forecast population growth within the LGA is measured on the number of additional dwellings that Council predict to be available ranging from 375 in 2014 to 760 in 2022.
- An impact of this is rates and annual charges are forecast to increase by 5.2% and 5.9% between 2013 and 2022, above the historical increases of 4.6% in 2011 and 3.6% in 2010.
- Materials and contracts expenses are forecast to increase between 6.2% and 8.8% p.a. in eight of the 10 years. The underlying costs are forecast to increase by 2.5% p.a. but additional expenditure is expected for asset maintenance and growth from new release areas.
- Overall we believe that the underlying assumptions used by Council are reasonable.

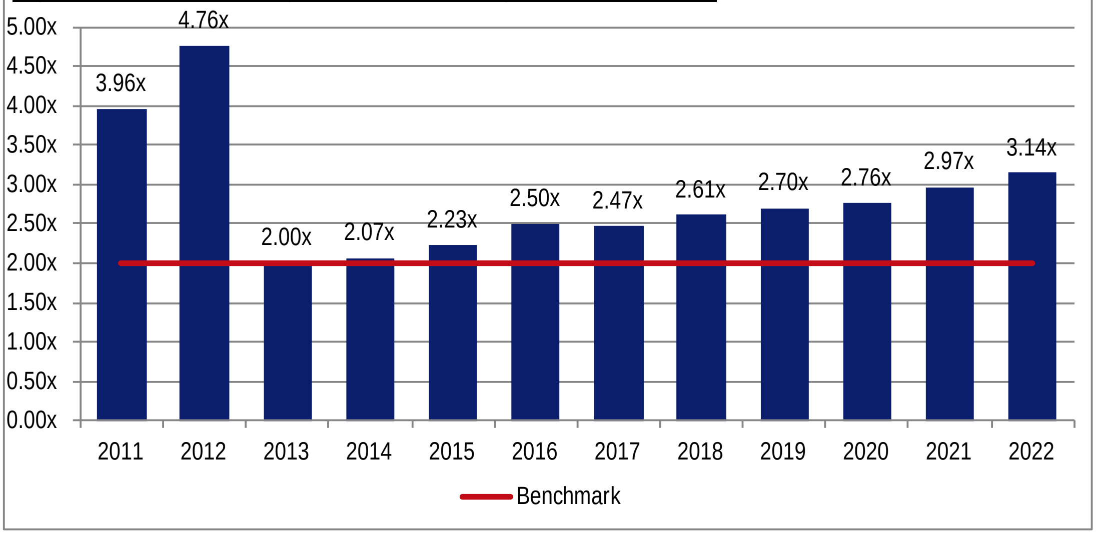
New South Wales Treasury Corporation

4.5: Borrowing Capacity

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

- Based on a benchmark of DSCR>2.00x, $18.9m could be borrowed in addition to the $5.0m borrowings proposed under LIRS in 2013 and the $2.5m p.a. scheduled borrowings from 2014 and 2022
- The Council's capacity to borrow additional funds increases after 2014 as additional cashflow is forecast to become available for debt service
- This scenario has been calculated by basing borrowing capacity on a 10 year amortising loan at an interest rate of 7.0%

Figure 14 - DSCR including additional borrowings of $18.9m in 2013



New South Wales Treasury Corporation

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 7. There are 8 councils in this group and at the time of preparing this report, we have data for all of these councils.

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

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

Please note that this section of the report has been prepared separately to the LIRS financial assessment and includes the latest information at the time of preparation which includes data from the 2012 financial year.

Financial Flexibility

Figure 15 - Operating Ratio Comparison

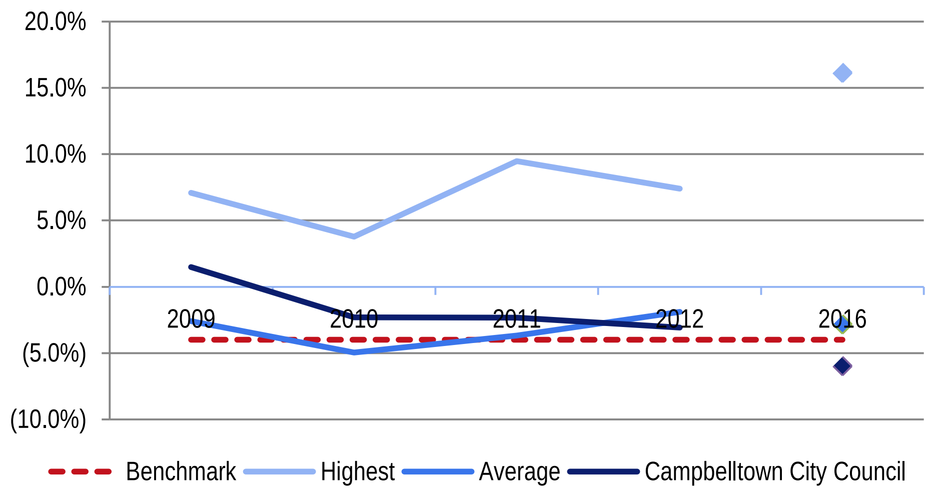
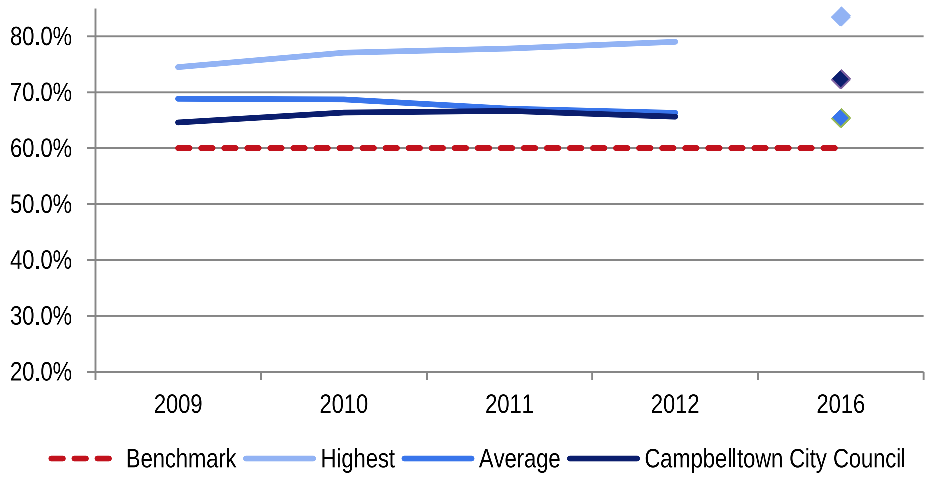


Figure 16 - Own Source Operating Revenue Ratio Comparison



Council has moderate financial flexibility with an Operating Ratio that was above benchmark and the group average in the past three years before declining in 2012 to below the group's average and will continue to decline to below benchmark by 2016. This is attributed to a forecast of lower grants revenue and higher materials and contracts cost. Lower forecast grants will result in owned source revenue representing a greater portion of operating revenue in the future.

Liquidity

Figure 17 - Cash Expense Ratio Comparison

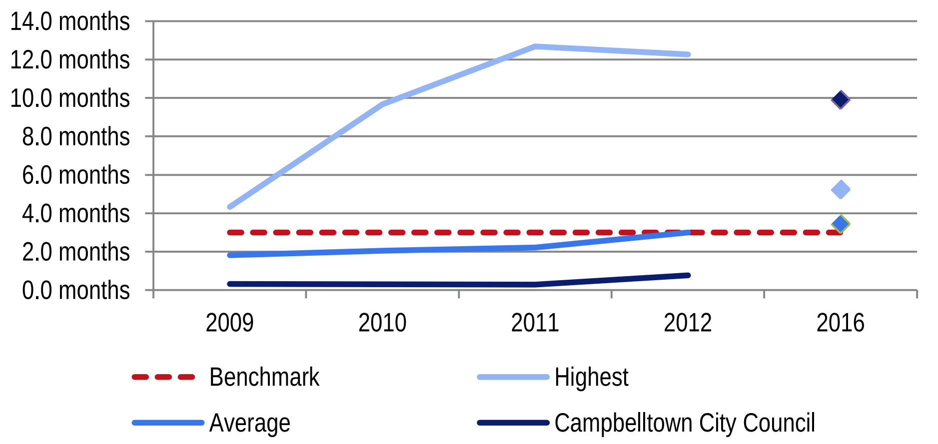
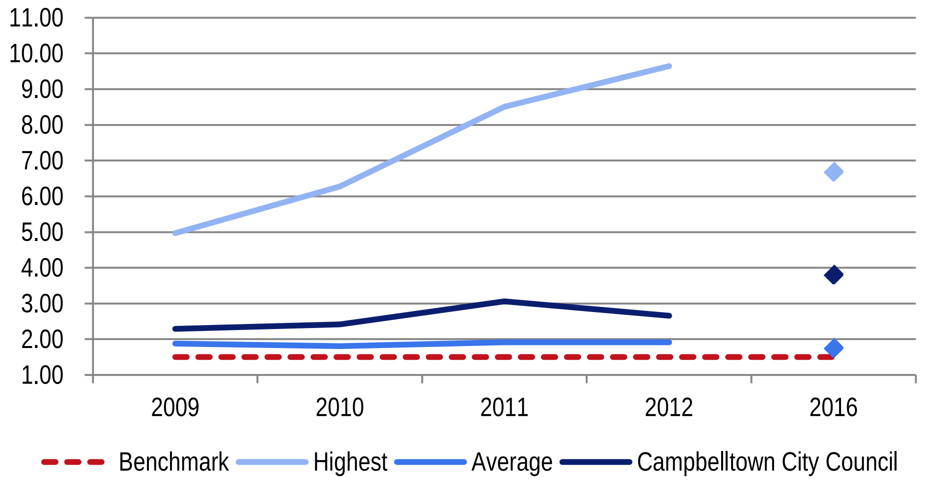


Figure 18 - Unrestricted Current Ratio Comparison



Council has maintained their sound liquidity position with the Unrestricted Current Ratio above both the benchmark and the group average since 2009 and is forecast to remain so until 2016. The Cash Expense Ratio should be viewed in conjunction with investments as Council holds the majority of its funds in term deposits. Council does not segregate these funds in its forecasts and the major improvement in the Ratio is a result of including investments as part of the calculation.

Debt Servicing

Figure 19 - Debt Service Cover Ratio Comparison

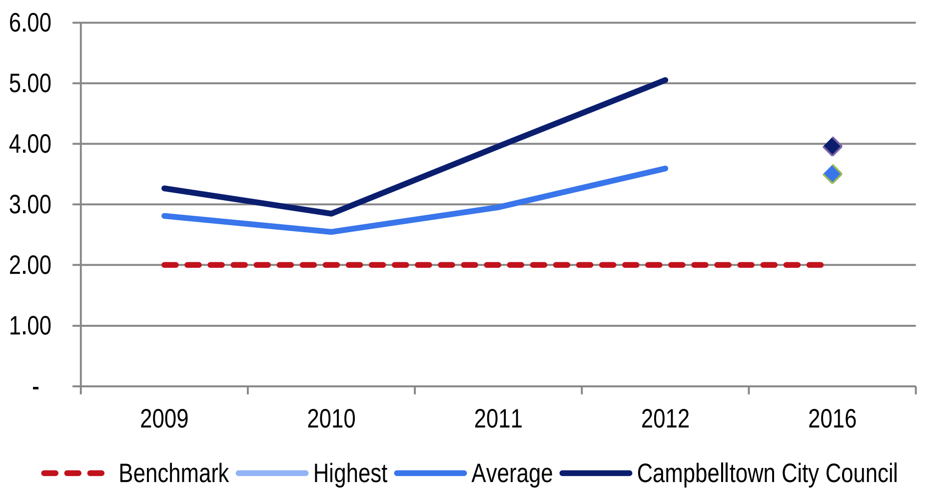
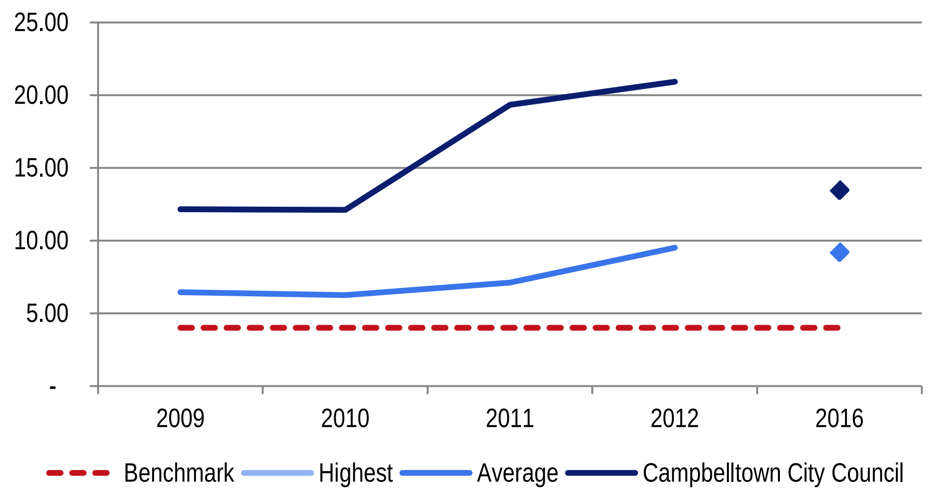


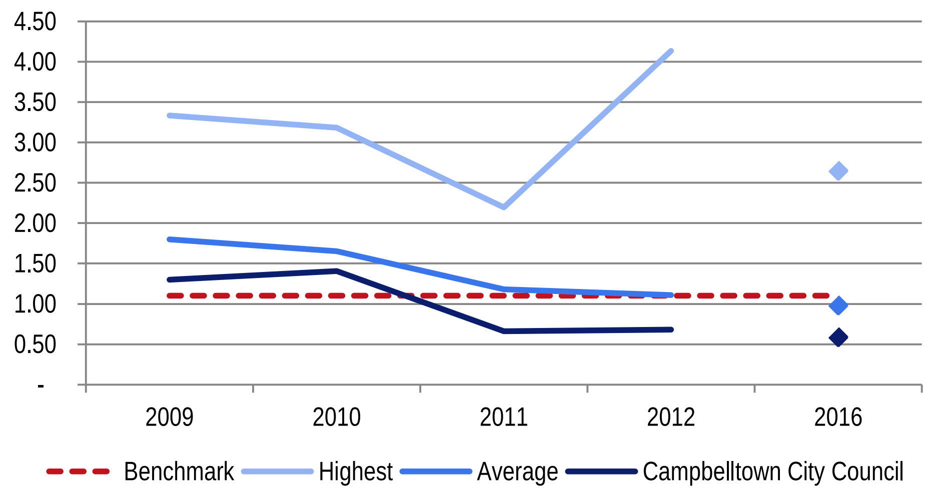
Figure 20 - Interest Cover Ratio Comparison



Council has sound debt servicing capacity. Both the DSCR and Interest Cover Ratio have been above average and benchmark and this is forecast to continue. Its debt servicing capacity will remain sound with additional borrowings forecast in the medium term.

Asset Renewal and Capital Works

Figure 21 - Capital Expenditure Ratio Comparison



Council's Capital Expenditure Ratio was above benchmark in 2009 and 2010 but this has declined to below benchmark and will continue to decline until 2016 as a result of reductions in capital expenditure programs and increased depreciation due to asset revaluations.

Figure 22 - Asset Maintenance Ratio Comparison

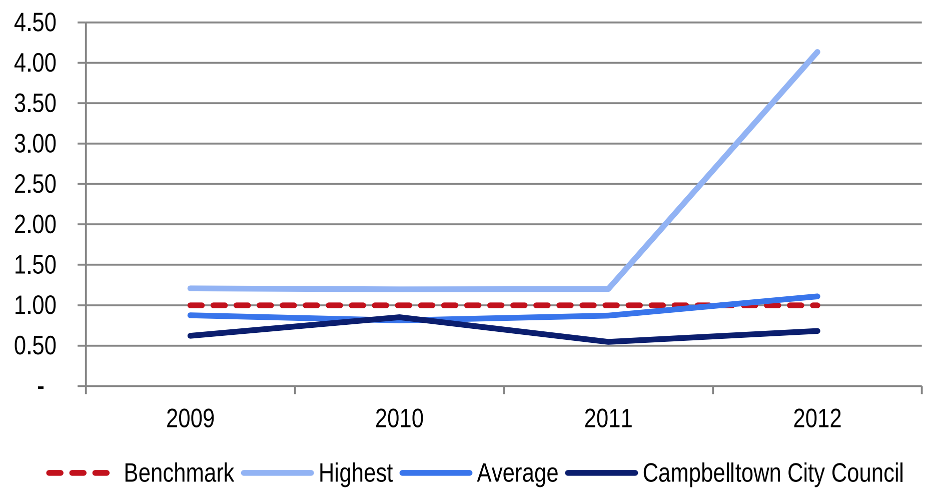
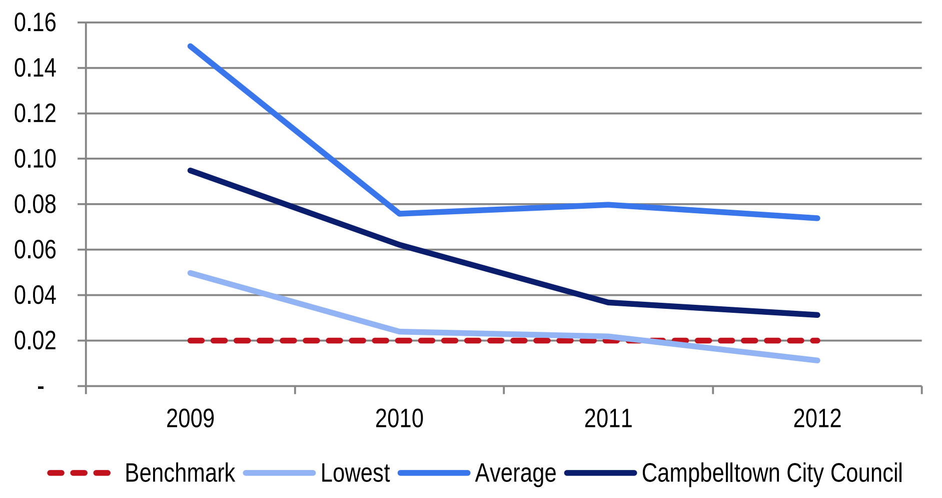
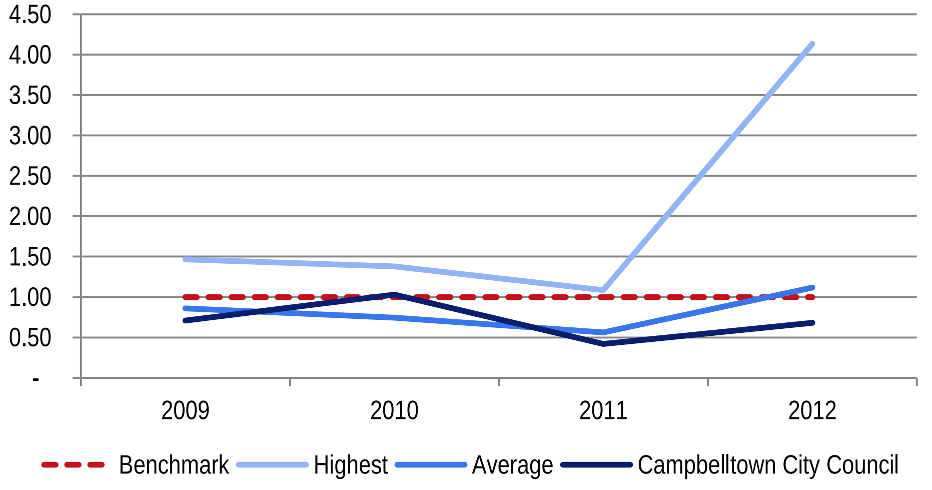


Figure 23 - Infrastructure Backlog Ratio Comparison



New South Wales Treasury Corporation

Figure 24 - Building and Infrastructure Asset Renewal Ratio



Both the Asset Maintenance Ratio and Building and Infrastructure Asset Renewal Ratio have mainly remained below average and benchmark since 2009. This indicates assets are not being renewed or maintained to the required level and should this trend continue, it could increase the Council's Infrastructure Backlog.

Section 6 Conclusion and Recommendations

Based on our review of both the historic financial information and the 10 year financial forecast within Council's long term financial plan we consider Council to be in a sound financial position historically and also over the short to medium term. We therefore recommend that Council is approved for the LIRS facility.

We base our recommendation on the following key points:

- Councils underlying performance measured by EBITDA has improved over the review period
- Council has adequate liquidity as indicated by an Unrestricted Current Ratio above the benchmark in both historic and future years
- Council has sufficient capacity to manage the additional borrowings as indicated by a DSCR and Interest Cover Ratio above the benchmark in both historic and future years
- Council's Own Source Operating Revenue Ratio is above 60% in all three years indicating Council has a sufficient level of fiscal flexibility and is forecast to remain above the benchmark in all forecast years
- Council currently has a low level of borrowings of $20.6m or 1.1% of Net Assets

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

- When analysing Council's long term financial sustainability the challenge of maintaining the quality of council's infrastructure assets is forecast to be an issue. Council has identified that they will be unable to maintain their capital expenditure against depreciation expense. This leads a decreasing Net Asset position over the forecast period, and strategies to reverse this trend should be investigated. Council has indicated that the refinement of their AMP may well provide more accurate figures in this regard that may reduce the annual depreciation expense
- As previously stated, with a DSCR and Interest Cover Ratio above the benchmark and the Cash Expense Ratio, and Unrestricted Current Ratio indicating Council has sufficient liquidity, Council may be able to review their capital expenditure program with a view to increasing it either via utilising cash reserves or through further additional borrowings

New South Wales Treasury Corporation

Appendix A Historical Financial Information Tables

Table 1- Income Statement

Income Statement ($'000)	Year ended 30 June			% annual change	
	2011	2010	2009	2011	2010
Revenue					
Rates and annual charges	73,144	69,921	67,463	4.6%	3.6%
User charges and fees	10,227	9,844	8,545	3.9%	15.2%
Interest and investment revenue	4,599	3,726	4,499	23.4%	(17.2%)
Grants and contributions for operating purposes	28,700	25,560	27,509	12.3%	(7.1%)
Other revenues	4,561	4,240	3,151	7.6%	34.6%
Total revenue	121,231	113,291	111,167	7.0%	1.9%
Employees	50,180	47,605	44,218	5.4%	7.7%
Borrowing costs	1,139	1,287	1,377	(11.5%)	(6.5%)
Materials and contract expenses	20,763	23,934	23,835	(13.2%)	0.4%
Depreciation and amortisation	23,711	16,905	13,702	40.3%	23.4%
Other expenses	28,257	26,176	26,389	8.0%	(0.8%)
Total expenses	124,050	115,907	109,521	7.0%	5.8%
Operating result	(2,819)	(2,616)	1,646	7.8%	(258.9%)

Table 2 - Items excluded from Income Statement

Excluded items ($'000)			
	2011	2010	2009
Grants and contributions for capital purposes	3,875	6,879	6,455
Gain on recognition of interest-free loan	0	1,651	0
Unwinding of interest free loan expense	419	0	0
Increase in the fair value of investment properties	0	3,955	0
Gain on disposal of assets	538	0	52
Loss on disposal of assets	0	1,189	0

Table 3 - Balance Sheet

Balance Sheet ($'000)	Year Ended 30 June			% annual change	
	2011	2010	2009	2011	2010
Current assets					
Cash and equivalents	2,427	2,457	2,572	(1.2%)	(4.5%)
Investments	74,820	74,089	69,267	1.0%	7.0%
Receivables	10,361	7,724	8,895	34.1%	(13.2%)
Inventories	367	383	354	(4.2%)	8.2%
Other	0	0	30	N/A	(100.0%)
Total current assets	87,975	84,653	81,118	3.9%	4.4%
Non-current assets					
Inventories	4,810	4,810	4,810	0.0%	0.0%
Infrastructure, property, plant & equipment	1,772,820	1,433,283	1,197,389	23.7%	19.7%
Investment property	8,053	7,927	4,093	1.6%	93.7%
Total non-current assets	1,785,683	1,446,020	1,206,292	23.5%	19.9%
Total assets	1,873,658	1,530,673	1,287,410	22.4%	18.9%
Current liabilities					
Payables	8,036	10,318	8,631	(22.1%)	19.5%
Borrowings	3,441	4,992	4,179	(31.1%)	19.5%
Provisions	19,691	18,771	17,450	4.9%	7.6%
Total current liabilities	31,168	34,081	30,260	(8.5%)	12.6%
Non-current liabilities					
Borrowings	17,204	17,158	15,551	0.3%	10.3%
Provisions	2,380	2,906	2,725	(18.1%)	6.6%
Total non-current liabilities	19,584	20,064	18,276	(2.4%)	9.8%
Total liabilities	50,752	54,145	48,536	(6.3%)	11.6%
Net assets	1,822,906	1,476,528	1,238,874	23.5%	19.2%

Table 4-Cashflow

Cashflow Statement ($'000)	Year ended 30 June		
	2011	2010	2009
Cashflows from operating activities	20,258	25,533	20,944
Cashflows from investing activities	(18,363)	(29,719)	(30,876)
Proceeds from borrowings and advances	2,500	8,250	2,500
Repayment of borrowings and advances	(4,425)	(4,179)	(3,745)
Cashflows from financing activities	(1,925)	4,071	(1,245)
Net increase/(decrease) in cash and equivalents	(30)	(115)	(11,177)
Cash and equivalents	2,427	2,457	2,572

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.