New South Wales
Treasury Corporation

Guyra Shire Council

Financial Assessment and Benchmarking Report

22 March 2013

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

Disclaimer

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

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

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

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Section 1 Executive Summary

This report provides an independent assessment of Guyra Shire 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 LIRS application for the Guyra Road Rehabilitation project , which is the pavement rehabilitation and strengthening of a 6.5km section of the Guyra Road (MR135). The projected is expected to cost $2.2m.

TCorp's approach has been to:

- Review the most recent three years of Council's consolidated financial results
- Conduct a detailed review of the Council's 10 year financial forecasts. The review of the financial forecasts focused on the particular Council fund that was undertaking the proposed debt commitment. For the Council, the project is being funded from the General Fund so we focused our review on the General Fund

Management of Council has been satisfactory over the review period based on the following observations:

- Council were granted a 15.0% permanent rate increase in 2008 and an 8.0% increase for 7 years also from 2008. This will improve Council's revenue strength and own sourced revenue capacity
- Financial Management Indicators are positive and Council have achieved year on year improvements in EBITDA and performance ratios in recent years
- Council has been building cash and cash equivalents at a stable rate since 2009, rising from $1.4m to $2.7m in 2011. Council have adopted a policy of keeping maturing investments in cash
- Council had substantial expenses growth in 2011 that was not matched by revenue growth. Council will need to manage expenses growth going forward.

Council's reported infrastructure backlog of $18.0m in 2011 represents 16.3% of its infrastructure asset value of $110.5m. Other observations include:

- 81.1% ($14.6m) relates to public roads and 13.4% ($2.4m) relates to water works
- Compared to benchmark ratios, Council appears to be underspending on asset renewal and capital expenditure
- A continuation of this level of expenditure will likely result in the backlog increasing

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

- The forecast shows deficit positions are expected in all 10 years when capital grants and contributions are excluded. This highlights that over the longer term Council may not be financially sustainable
- Overall, Council's level of fiscal flexibility is constrained as its own sourced revenue is forecast at levels of approximately 35.0% for each year of the forecast
- Debt Service and Interest Coverage Ratios are positive and above benchmark for the forecast
- The key assumptions that underpin the financial forecasts are considered to be reasonable

Based on the financial forecasts provided to us by Council, the Council has the capacity to undertake not only the additional borrowings of $2.2m for the LIRS project, but also an additional $1.7m. This is based on the following analysis:

- Based on a benchmark of DSCR>2.0x, $1.7m could be borrowed in addition to the $2.2m borrowings proposed under LIRS in 2012/13
- This scenario has been calculated by basing borrowing capacity on a 10 year amortising loan at an interest rate of 7.81%

In respect of the Benchmarking analysis TCorp has compared the Council's key ratios with other councils in DLG Group 9. The key observations are:

- Council's financial flexibility as indicated by the Operating Ratio is below the group average and benchmark
- Council's Own Source Operating Revenue Ratio is below average and the benchmark
- Council's DSCR and Interest Cover Ratio are above the benchmarks but below the group averages. In the medium term Council's forecast ratios are expected to remain above the benchmarks
- Council was in a sufficient liquidity position which is expected to improve in the medium term
- Council's performances in terms of its Building and Infrastructure Asset Renewals Ratio and Capital Expenditure Ratio have improved to be above the group average and benchmarks in 2012. Council's Asset Maintenance Ratio declined below the group average and benchmark and the Infrastructure Backlog is higher than the group average

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

Guyra Shire Council	
Locality and Size	
Locality	Northern
Area	4394 km²
DLG Group No.	9
Demographics	
Population	4,397
% under 18	29.7%
% between 18 and 59	46.2%
% over 60	25.1%
Expected population in 2021	4,200
Operations	
Number of employees (FTE)	61
Annual revenue	$10.3m
Infrastructure	
Backlog % Roads	81.1%
Backlog % Water	13.4%
Infrastructure backlog value	$18.0m
Total infrastructure value	$93.6m

Guyra Shire Council Local Government Area (LGA) is located on top of the Northern Tablelands. The council also serves the towns of Tingha and the villages of Black Mountain, Ben Lomond, Ebor and Wandsworth.

Guyra is a small, rural Council that generates approximately 75% of revenues from farmland rates. It is a community dependent on agriculture and produces wool, cattle and lamb, and also has a small potato industry. Since 2004, Guyra's economy has benefited from the development of a Costa Group tomato growing glasshouse complex.

Council serves a population of one person per square kilometre, with approximately 50.0% of the population residing in the town of Guyra. To address this population disparity Council encourages community cooperation in the provision of services, which has seen a number of communities being responsible for the upkeep of their village on a voluntary basis, with Council's support and equipment.

The Council was a member of the New England Strategic Alliance of Councils (NESAC), which was formed in 2004 as an alternative to amalgamation. The Alliance was established to facilitate the provision of shared services, resource sharing and other cooperative arrangements however the Alliance as it was originally contemplated collapsed in 2009 due to governance issues. Guyra and neighbouring council Armidale have continued to share services and have recently submitted an application to the Minister for approval of an alliance between councils that would enable the creation of a more formal board-like structure between the two councils.

2.4: LIRS Application

Council has made one LIRS application.

Project: Guyra Road Rehabilitation

Description: Pavement rehabilitation and strengthening of a 6.5km section of the Guyra Road (MR135)

Amount of loan facility: $2.2m

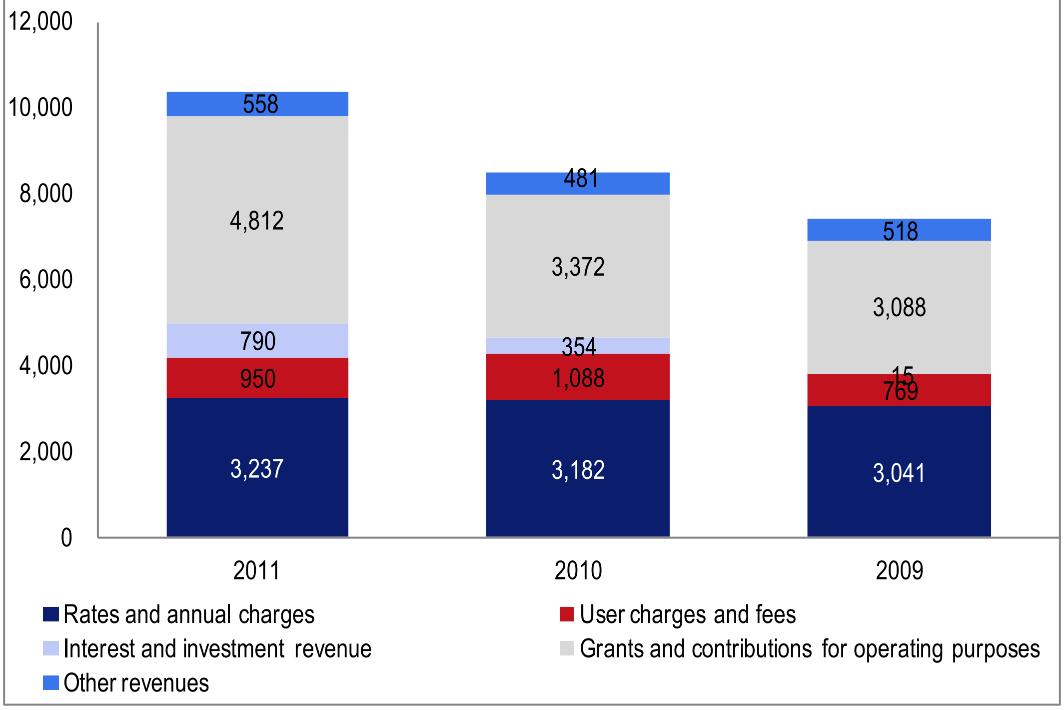
Term of loan facility: 10 years

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

- Council were granted a 15.0% SRV in 2008 to be retained permanently in its rating base. Council also received an 8.0% SRV in the same year for 7 years to fund various road upgrades and reseal projects. Council generates approximately 75% of their rates and annual charges revenues from farmland rates.
- User charges and fees decreased by 12.7% to $1.0 in 2011 following higher rainfall which reduced water supply fees.
- The increase in investment revenue reflects increasing cash reserves.
- The 42.7% increase in grants and contributions in 2011 included a one-off library refurbishment grant, contribution for the truck stop fuel station and higher financial assistance grant support. Council own a truck stop which had been operated by Caltex under a long term lease, which was not renewed in 2011. As a truck stop is non-core business, Council are selling this facility and they expect to generate approximately $1.0m from its sale.
- Council operate an aged care facility. Historically, the facility has been operating at a profit and in 2011 it recorded an operating surplus of $0.1m. This surplus has been deteriorating in recent years due to rising employee costs. In addition, the building is in need of repair and a

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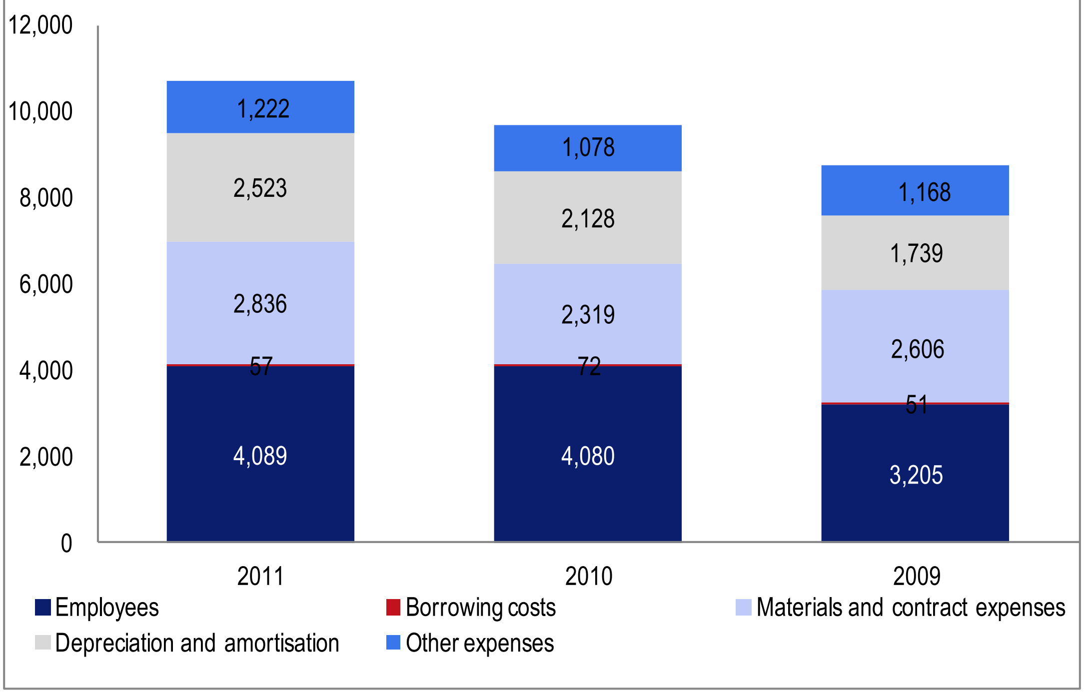
Council plan to redevelop the existing facility as residential units and rehouse residents into a new aged care facility to be built next to the existing medical centre.

3.2: Expenses

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



<u>Key Observations</u>

- Total expenses have increased by 10.9% in 2011 and 10.4% in 2010.
- Following the breakdown of NESAC, Council took control of a childcare centre and aged care facility which was the main driver of a 27.3% increase in employee costs in 2010 as Full Time Employees (FTEs) increased from 51 to 61. Employee costs remained static in 2011.
- Materials and contracts expenses increased by 22.3% in 2011, mainly as a result of increased infrastructure maintenance work. Flood events forced Council to focus on repair works and defer capital works programmes.
- The depreciation expense has been increasing due to the impact of Asset Revaluations over the past three years which increased the value of infrastructure assets by $11.0m, resulting in a 22.4% increase in depreciation in 2010 followed by an 18.6% increase in 2011 to $2.5m.

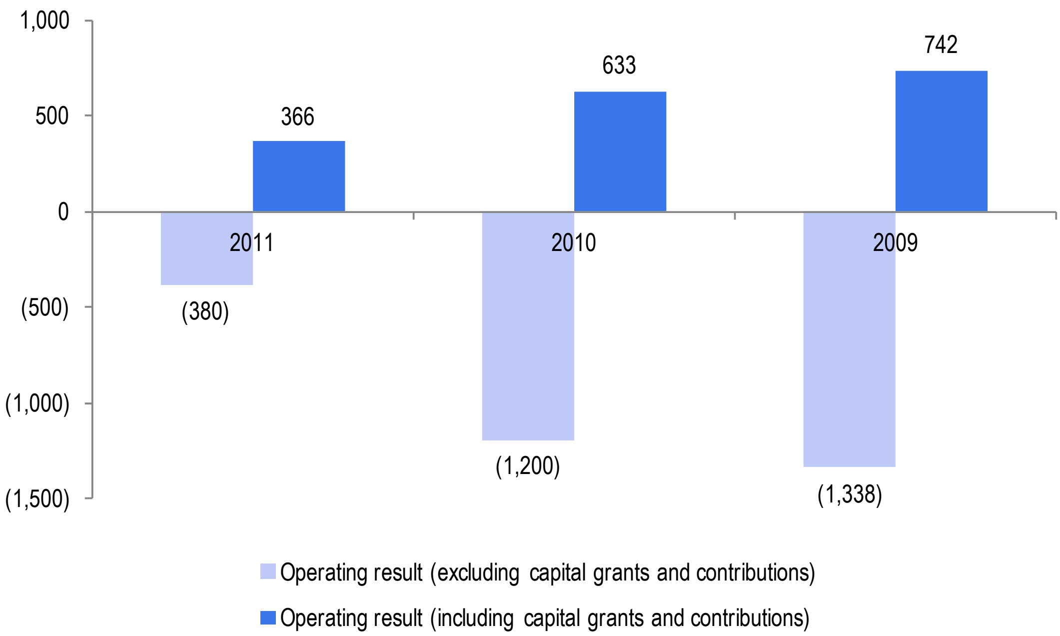
3.3: Operating Results

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 has consistently posted operating deficits (excluding capital grants and contributions) over the review period, however the deficits have been declining due to increased operating grants, investment revenue, and user fees and charges.
- Council expenses include a large non-cash depreciation expense ($2.5m in 2011), which has increased substantially over the past three years following the Asset Revaluations process. Whilst the non cash nature of depreciation can favourably impact on ratios such as EBITDA that focus on cash, depreciation is an important expense as it represents the allocation of the value of an asset over its useful life.

3.4: Financial Management Indicators

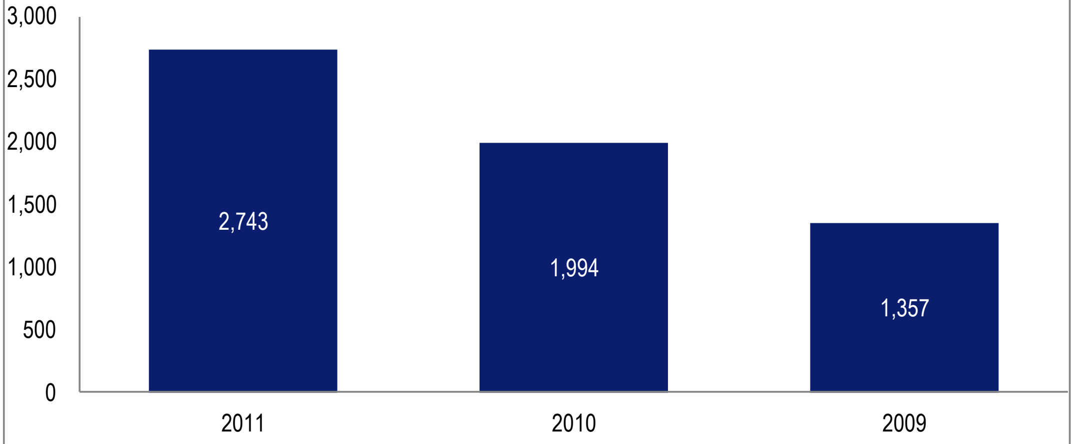
Performance Indicators	Year ended 30 June		
	2011	2010	2009
EBITDA ($'000s)	2,200	1,000	452
Operating Ratio	(3.7%)	(14.2%)	(18.0%)
Interest Cover Ratio	38.60x	13.89x	8.86x
Debt Service Cover Ratio	6.47x	3.10x	2.37x
Unrestricted Current Ratio	3.61x	4.09x	3.39x
Own Sourced Revenue	37.7%	41.4%	40.1%
Cash Expense Ratio	4.0 months	3.2 months	2.3 months
Net Assets ($'000s)	277,308	275,599	264,543

Key Observations

- Council's EBITDA increased over the three year period. The DSCR and Interest Cover Ratios, have been above benchmark for the previous three years indicating Council has further flexibility to carry more debt.
- The Unrestricted Current Ratio has been above benchmark over the review period indicating liquidity is sufficient.
- Own Sourced Revenue is below benchmark for all reporting years. Council relies upon successfully attracting grant funding from both the State and Federal Government to supplement their own source operating revenues.
- Councils Net Assets increased by $11.1m in 2010 as a result of Asset Revaluations, which had followed revaluations of $154.3m in 2009. When the Asset Revaluations are excluded, the underlying trend in all three years has been a static infrastructure, property, plant, and equipment (IPP&E) asset base with asset purchases being marginally greater than the combined value of disposed assets and annual depreciation.
- Net Assets have increased by $165.4m between 2008 and 2011 due to the consecutive Asset Revaluations over the reporting period that increased the value of roads, bridges, and drainage infrastructure, and community land assets. Community land assets increased by $0.5m, bulk earthworks by $133.3m while the value of infrastructure assets increased by $21.0m.
- The Asset Revaluations over the last three years have resulted in some volatility in Net 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 Council.
- When the Asset Revaluations are excluded, the underlying trend in all three years has been a marginally expanding IPP&E asset base.

3.5: Statement of Cashflows

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



Key Observations

- Cash reserves have been increasing year on year.
- Within Councils, cash, cash equivalents, and investments of $9.6m, $5.6m was externally restricted, $3.0m internally restricted, and $1.0m was unrestricted.
- Total cash and investment securities were $9.6m in 2011, $6.8m of which being held as investment securities. Council are exposed to CDOs ($0.4m), FRNs ($0.5m) and equity linked notes ($0.4m). Council expect to recoup $0.5m from these exposures, subject to ongoing UK/US litigation ending in favour of Council.

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)

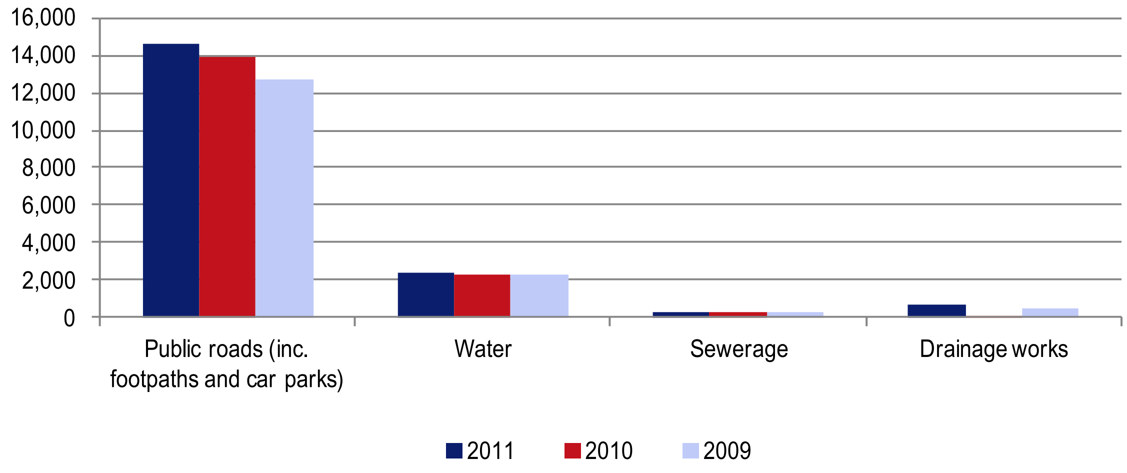
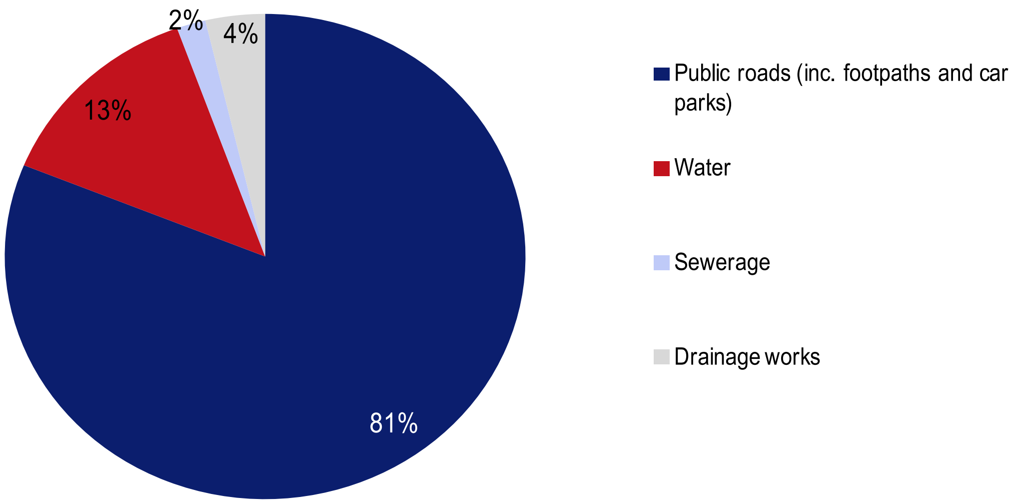


Figure 6 - Infrastructure Backlog Composition for 2010/11



Council reported an $18.0m infrastructure backlog in 2011, of which 81.1% ($14.6m) relates to public roads and 13.4% ($2.4m) relates to water works. Council's recently implemented SRV was used to address some part of the infrastructure backlog and Council is seeking to address part of their road backlog in their LIRS project, however this is a significant challenge given councils limited rate base versus assets under management (approx $3m versus $283m).

3.6(b): Infrastructure Status

Infrastructure Status	Year ended 30 June		
	2011	2010	2009
Bring to satisfactory standard ($'000s)	17,977	16,553	15,696
Required annual maintenance ($'000s)	1,855	1,519	1,385
Actual annual maintenance ($'000s)	1,616	1,444	1,655
Total value infrastructure assets ($'000s)	110,504	109,471	99,607
Total assets ($'000s)	283,114	281,367	268,699
Infrastructure Backlog Ratio	0.16x	0.15x	0.16x
Asset Maintenance Ratio	0.87x	0.95x	1.19x
Building and infrastructure asset renewal ratio	0.64x	0.83x	1.08x
Capital Expenditure Ratio	1.24x	0.95x	0.90x

The Infrastructure Backlog Ratio has been static over the review period. Council have not been spending the requisite amount on maintenance, as indicated by the Asset Maintenance Ratio above, which is on a downward trend and declined below benchmark in 2010.

The Building and Infrastructure Asset Renewal Ratio also indicates the Council is spending at levels below the benchmarks on asset renewal.

The Capital Expenditure Ratio takes into account capital expenditures which improve performance or capacity and indicates Council has spent a sufficient amount on capital expenditure over the three year period.

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	0
Replacement/refurbishment of existing assets	5,000	5,000	3,000
Total	5,000	5,000	3,000

The most significant capital works in 2011 was the construction of a 52 lot subdivision on Council land. Funding assistance was provided by the NSW Local Infrastructure Fund with a $1.6m zero interest loan. Wet weather delayed construction and progress and the final works continued into 2012.

3.7: Specific Risks to Council

- Low fiscal flexibility. Council relies upon successfully attracting grant funding from both the State and Federal Government to supplement their own source operating revenues. As Council is reliant on this funding they have a higher risk than many Councils if the State or Federal Government amends their funding practices or policies in future years.
- Deterioration of Council infrastructure assets. Over the last three years the infrastructure backlog has been growing and Council performance against other asset benchmarks has been declining. If this trend continues it may be reflected in lower quality infrastructure assets. Council needs to spend an increasing amount on asset maintenance and renewal in an attempt to reverse this trend.
- Aging population. Guyra is an aging community, with a forecast marginal decline in population, and an increasing demand for aged care services is forecast. This is being actively managed through committee planning and the development of Kolora aged care facility.
- CDO recovery. $1.2m of Council's CDOs cannot be accurately estimated. The potential negative impact on the operating result and Net Assets is the carrying amount of these investments. Council expect to recoup $0.5m from these exposures, subject to ongoing UK/US litigation ending in the favour Council.

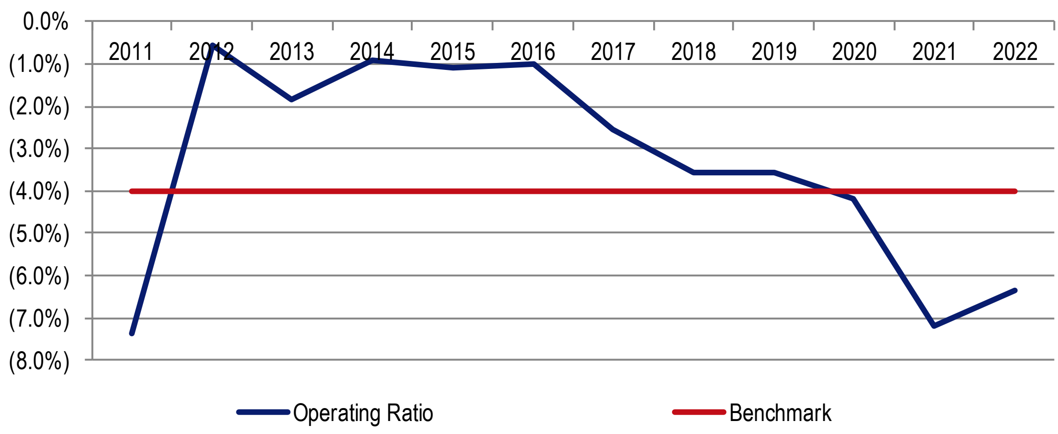
Section 4 Review of Financial Forecasts

The financial forecast model shows the projected financial statements and assumptions for the next 10 years. The model includes the $2.2m loan without any LIRS subsidy.

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

4.1: Operating Results

Figure 7- Operating Ratio for General Fund



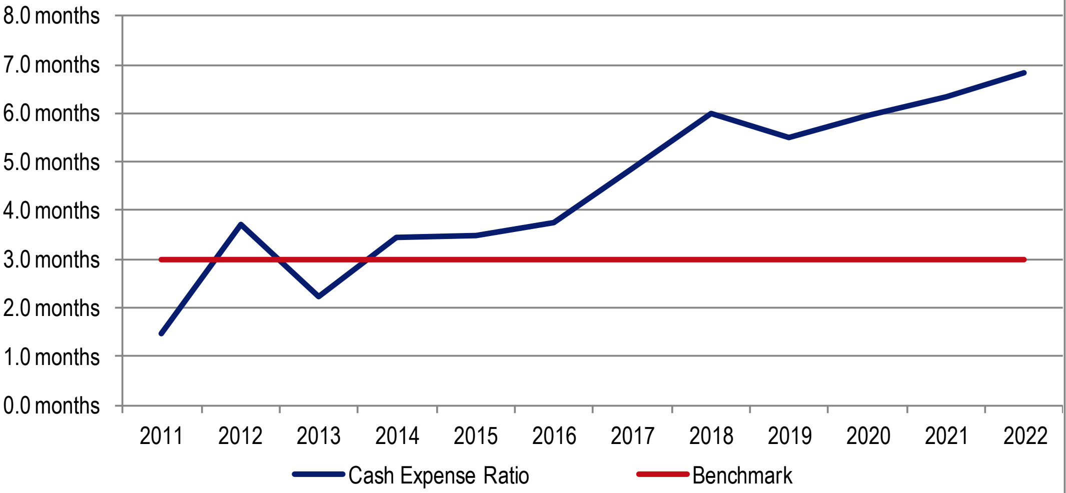
Operating Ratio for General Fund is forecast to continue to improve from negative 7.4% to negative 0.6% in 2012 as Council benefit from the 8% SRV which will continue until 2015.The Ratio is forecast to decline when the SRV expires.

4.2: Financial Management Indicators

The financial management indicators are linked to the utilisation of debt in early years and improve over time as the amortising debt reduces and operating deficits also improve.

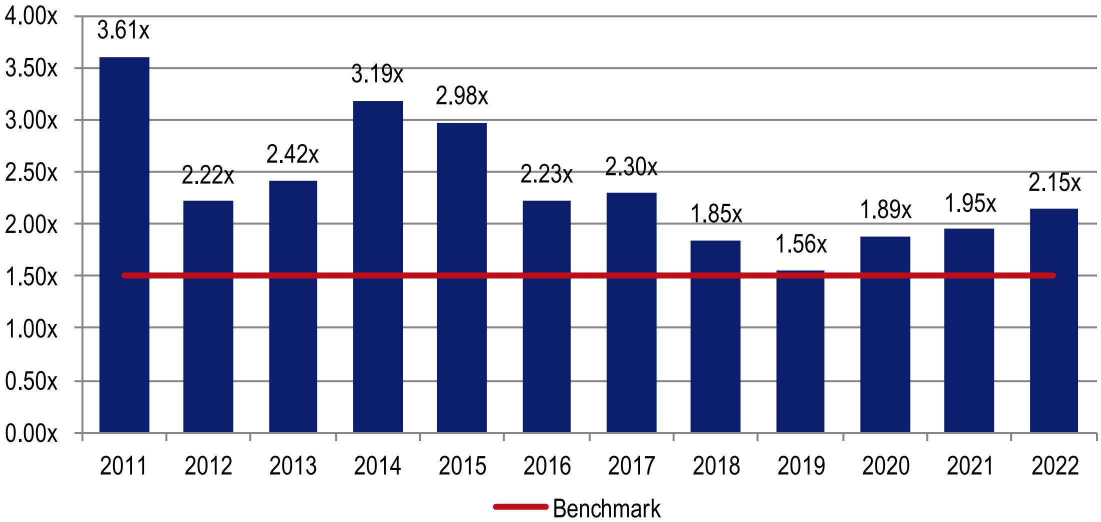
Liquidity Ratios

Figure 8 - Cash Expense Ratio for General Fund



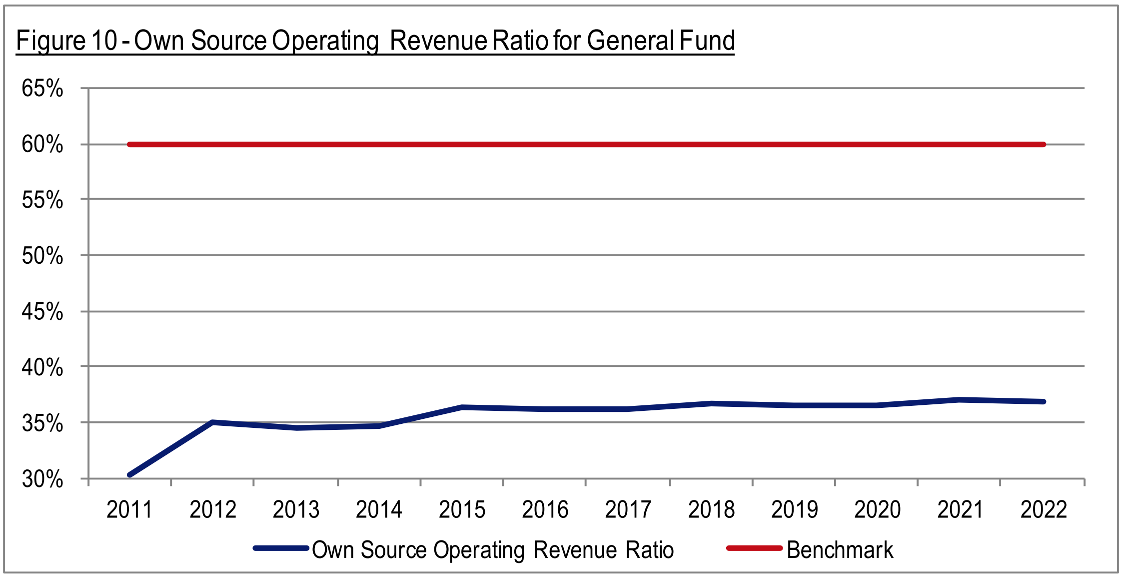
The Cash Expense Ratio is forecast to improve over the LTFP and remain above benchmark from 2014, indicating that council should have sufficient liquidity.

Figure 9 - Unrestricted Current Ratio for General Fund



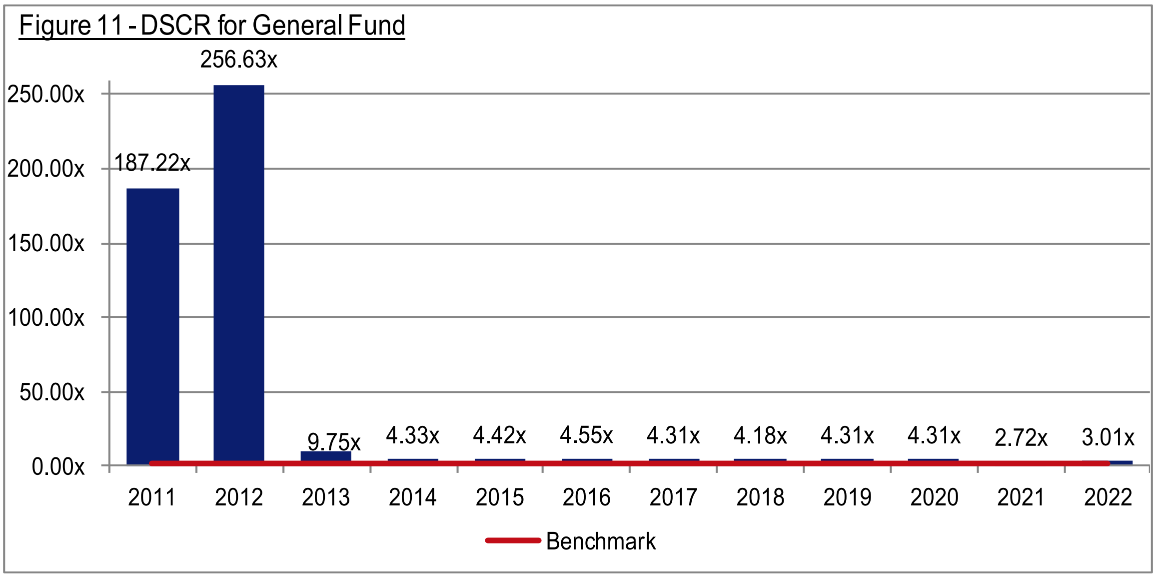
The Unrestricted Current Ratio is above benchmark for all forecast years, indicating that Council have sufficient liquidity in the next 10 year period to service all short term liabilities, currently scheduled capital expenditure and related long term liabilities.

Fiscal Flexibility Ratios



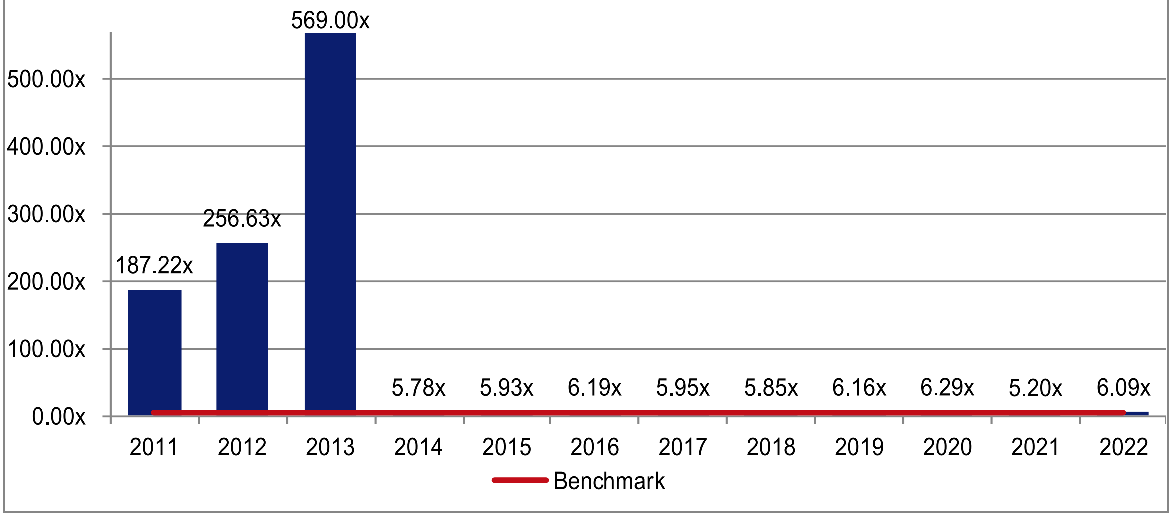
The Own Source Operating Revenue Ratio is below benchmark for the entire forecast period.

Overall this performance indicates Council does not have diverse income streams and is reliant on operating grants.



The DSCR is well above the benchmark of 2.00x for the 10 years of the forecast. This indicates that Council has the capacity to manage the additional debt cost that the LIRS applications relate to.

Figure 12 - Interest Cover Ratio for General Fund



The Interest Cover Ratio, similarly to the DSCR, shows the Council has sufficient capacity to service scheduled debt commitments, including the LIRS loans.

This ratio indicates there is capacity to service further debt interest costs before the Council's ratio decreases to the 4.00x benchmark.

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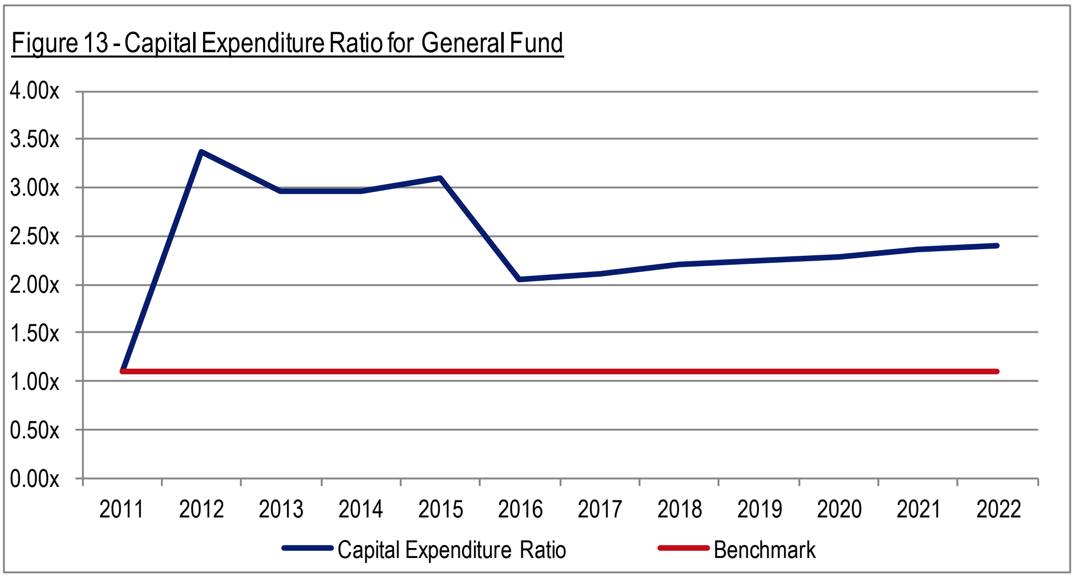
4.3: Capital Expenditure



Capital Expenditure for the general fund is forecast to be above the benchmark of 1.10x for the LTFP, with levels above 3.0x expected for 2012 to 2016 as Council completes the LIRS project and the Kolora home extension.

4.4: Financial Model Assumption Review

Councils have used their own assumptions in developing their forecasts.

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

TCorp's benchmarks:

- Rates and annual charges: TCorp notes that the LGCI increased by 3.4% in the year to September 2011, and in December 2011, IPART announced that the rate peg to apply in the 2012/13 financial year will be 3.6%. Beyond 2013 TCorp has assessed a general benchmark for rates and annual charges to increase by mid-range LGCI annual increases of 3.0%
- Interest and investment revenue: annual return of 5%
- All other revenue items: the estimated annual CPI increase of 2.5%
- Employee costs: 3.5% (estimated CPI+1%)
- All other expenses: the estimated annual CPI increase of 2.5%

<u>Key Observations and Risks</u>

- Council have forecast an average rise in expenses (4.4%) greater than the average rise in rate revenue (2.9%).
- A 54.0% increase in user charges and fees is forecast in 2015 due to the increase of Kolora aged care facility doubling in size from a 20 place facility to a 50 place facility. The general forecast trend is an approximate 2.0% annual rise in user charges and fees.
- Materials and contracts are forecast to increase by 13.8% in 2013 as Council complete the LIRS project works, with annual 4.4% growth thereafter.
- Both operating grants and capital grants are forecast to grow at a rate of 2.5%. Given the low level of own sourced operating revenue (approximately 35.0%) Council may require a more substantial level of grants to ensure their ongoing sustainability.
- The borrowings of $2.2m for the LIRS facility and $3.0m for the Kolora aged care facility and associated principal and interest repayments have been included in the LTFP.

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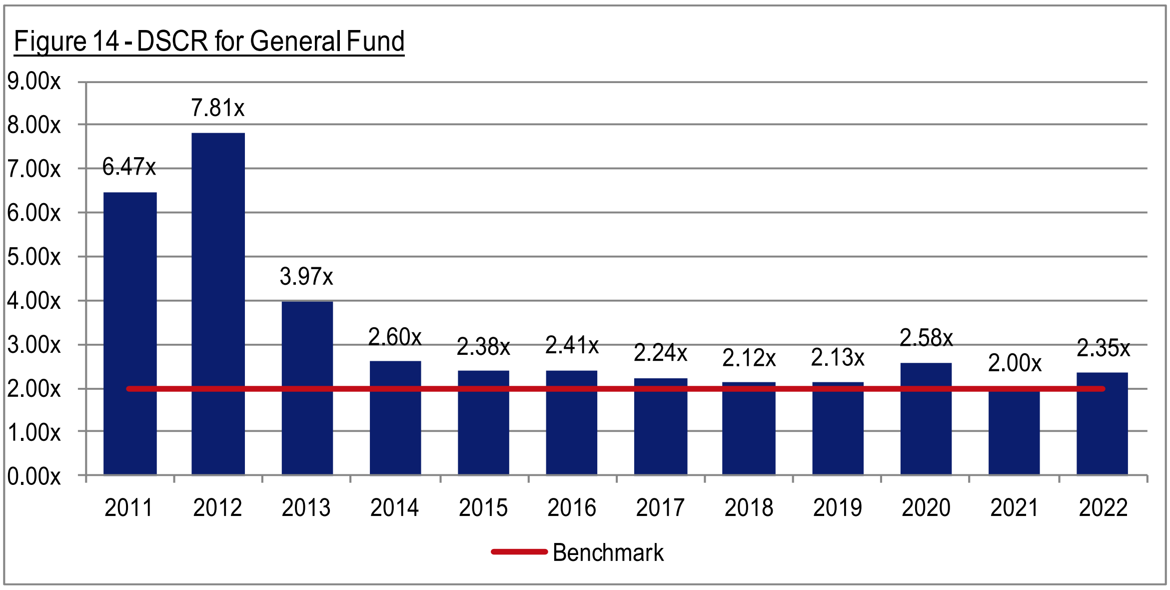
4.5: Borrowing Capacity

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



Based on a benchmark of DSCR>2.0x, $1.7m could be borrowed in addition to the $2.0m borrowings proposed under LIRS and the $3.0m for the Kolora extension

This scenario has been calculated by basing borrowing capacity on a 10 year amortising loan at an interest rate of 7.81%

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 9. There are 21 councils in this group and at the time of preparing this report, we have data for all of these councils.

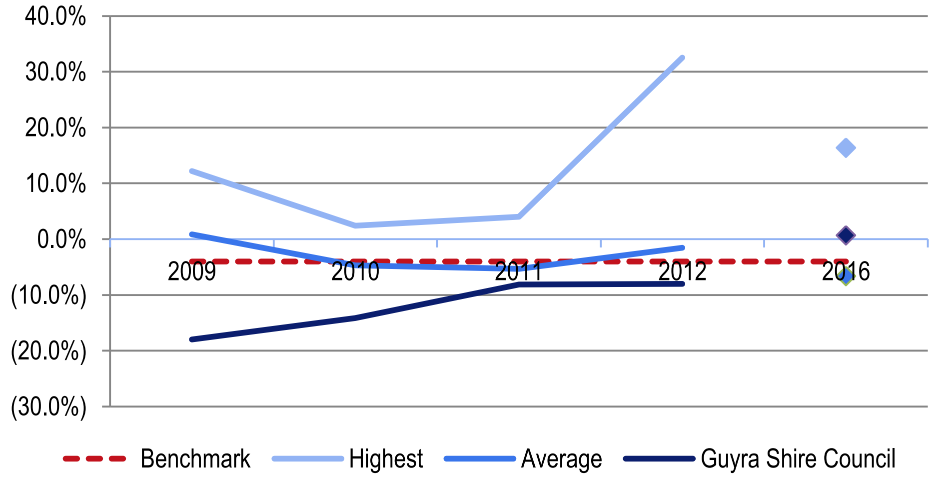
In Figure 15 to Figure 24, the graphs compare the historical performance of Council with the benchmark for that ratio, with the average for the Group, with the highest performance (or lowest performance in the case of the Infrastructure Backlog Ratio where a low ratio is an indicator of strong performance), and with the forecast position of the Council as at 2016 (as per Council's LTFP). Figures 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.

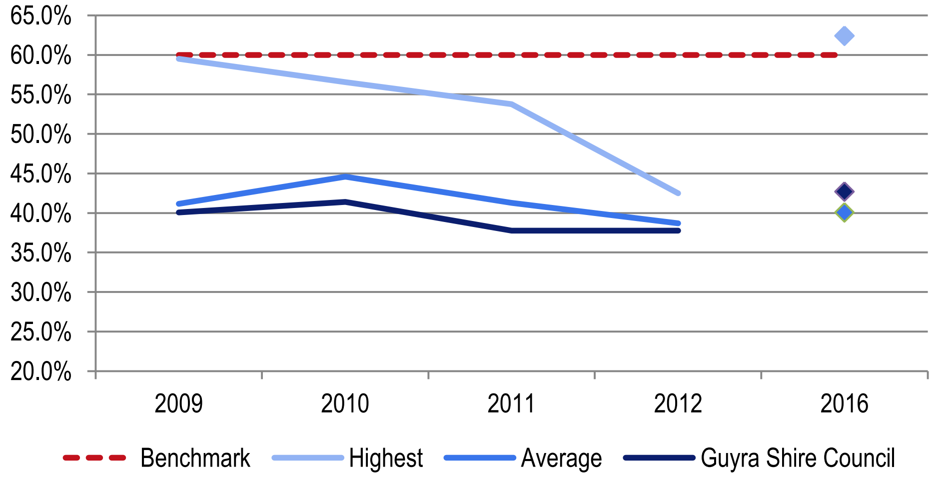
Financial Flexibility

Figure 15 - Operating Ratio Comparison



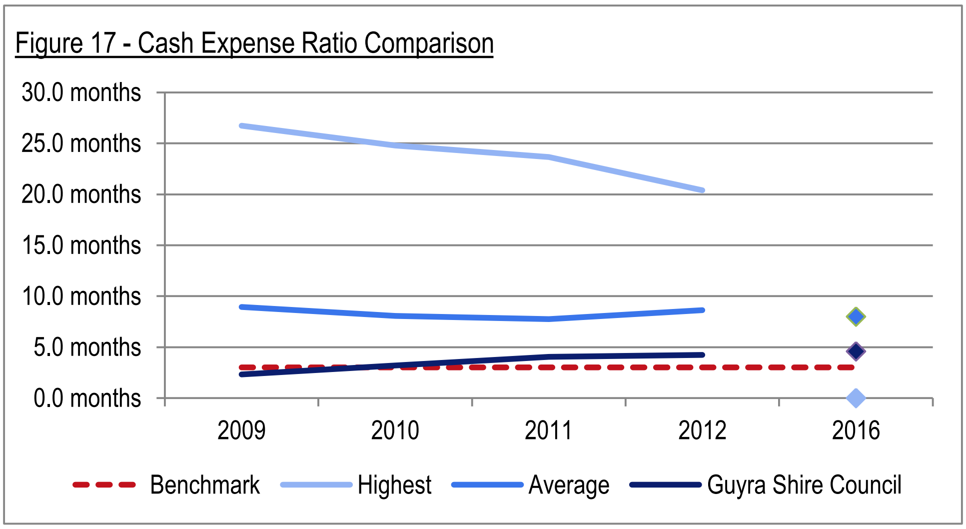
Council's Operating Ratio was below the group average and benchmark over the last four years. The results are forecast to improve in the medium term to be above the group average and benchmark.

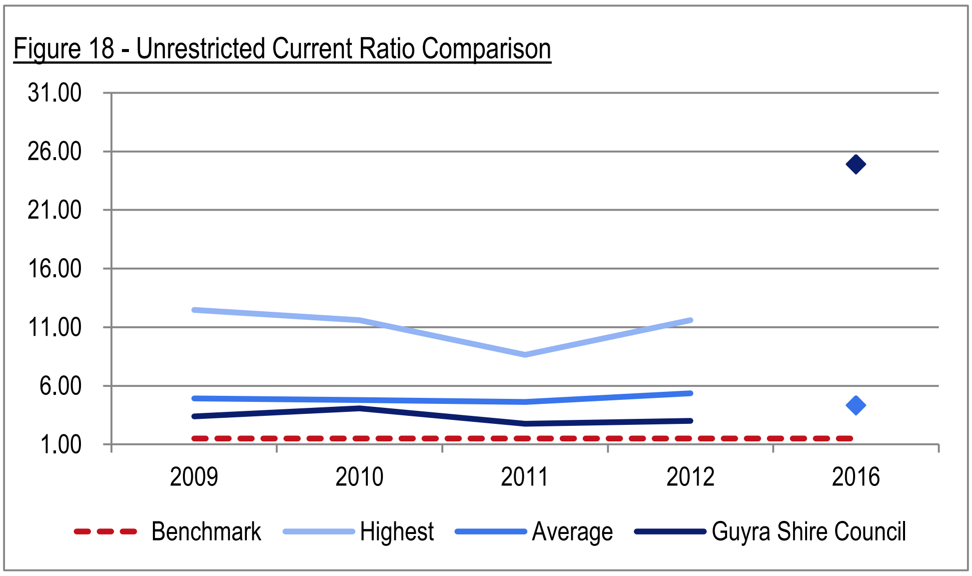
Figure 16 - Own Source Operating Revenue Ratio Comparison



Council's Own Source Operating Revenue Ratio was below the group average and benchmark. The ratio is forecast to improve in the medium term to be above the group average but remains below the benchmark.

Liquidity





On average over the past four years, the Council's liquidity position has been sufficient as indicated by an above benchmark Unrestricted Current Ratio and this is forecast to improve in the medium term.

New South Wales Treasury Corporation

Debt Servicing

Figure 19 - Debt Service Cover Ratio Comparison

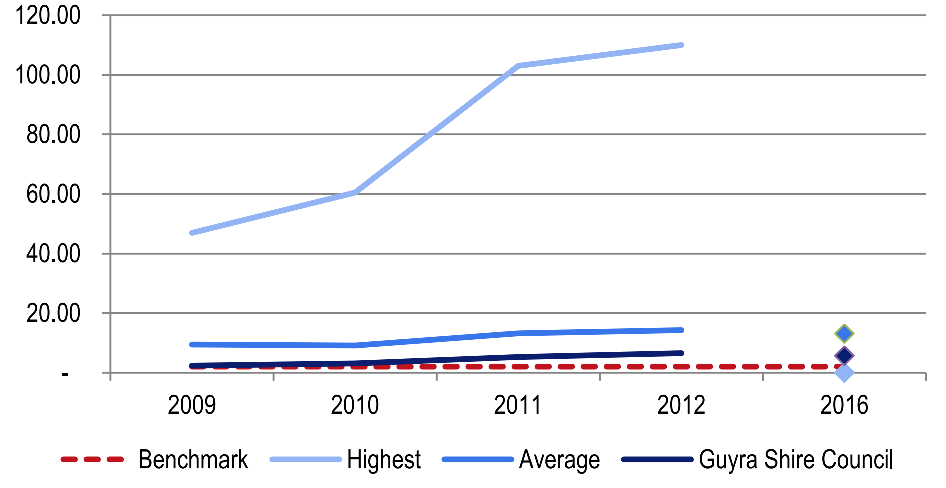
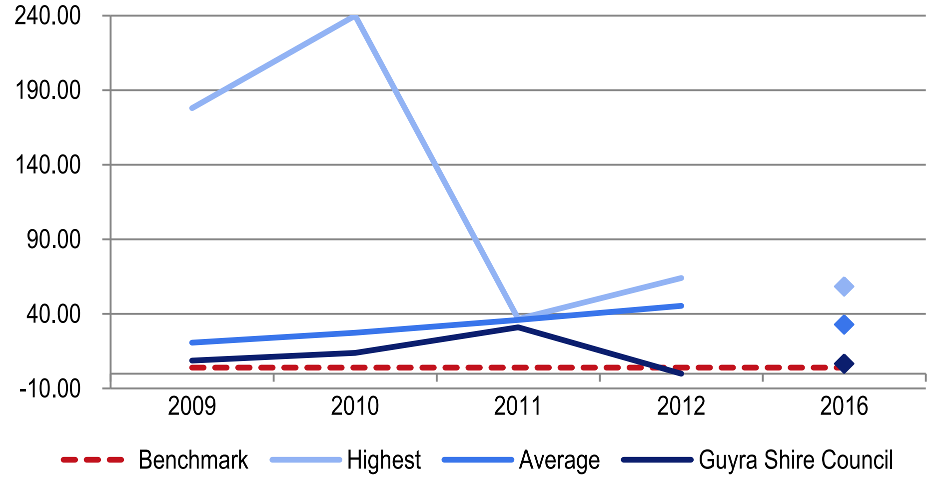


Figure 20 - Interest Cover Ratio Comparison



Over the review period, Council had above benchmark DSCR and Interest Cover Ratio and these ratios are forecast to remain above the benchmarks and group averages in the medium term. The Interest Cover Ratio is zero in 2012 because Council incurred no net interest costs.

Asset Renewal and Capital Works

Figure 21 - Capital Expenditure Ratio Comparison

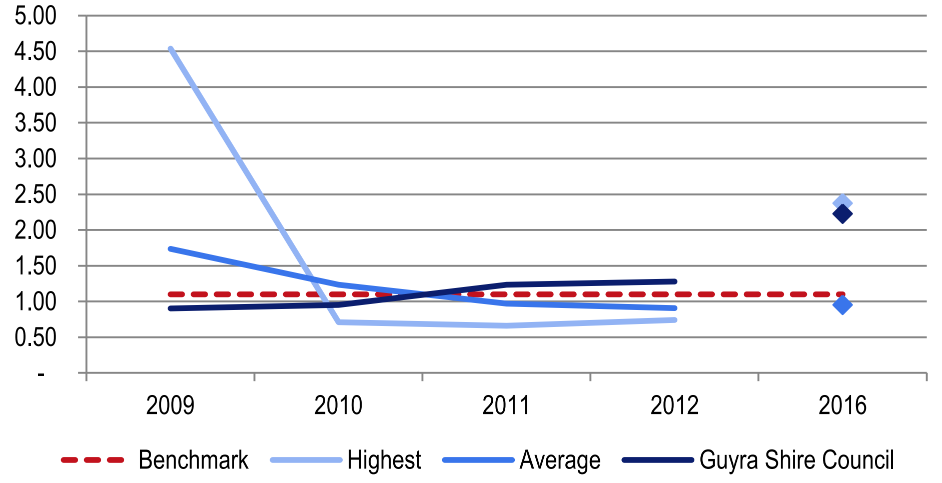
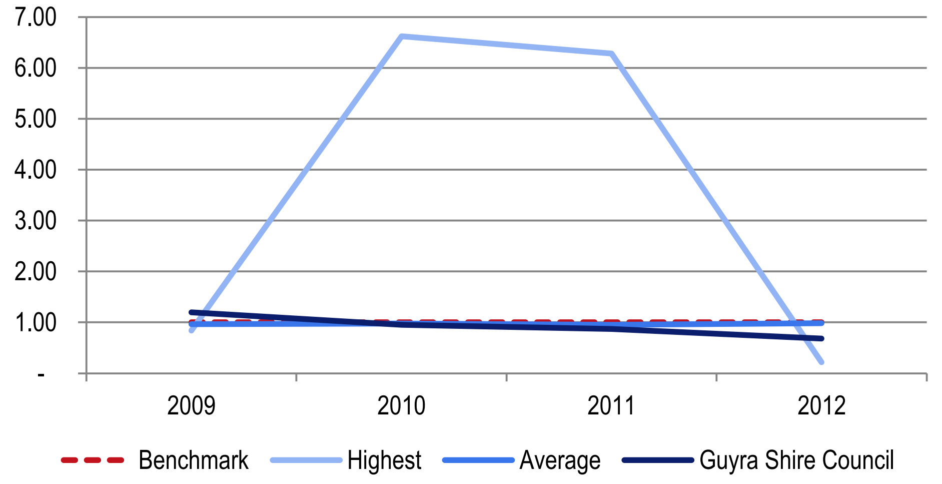
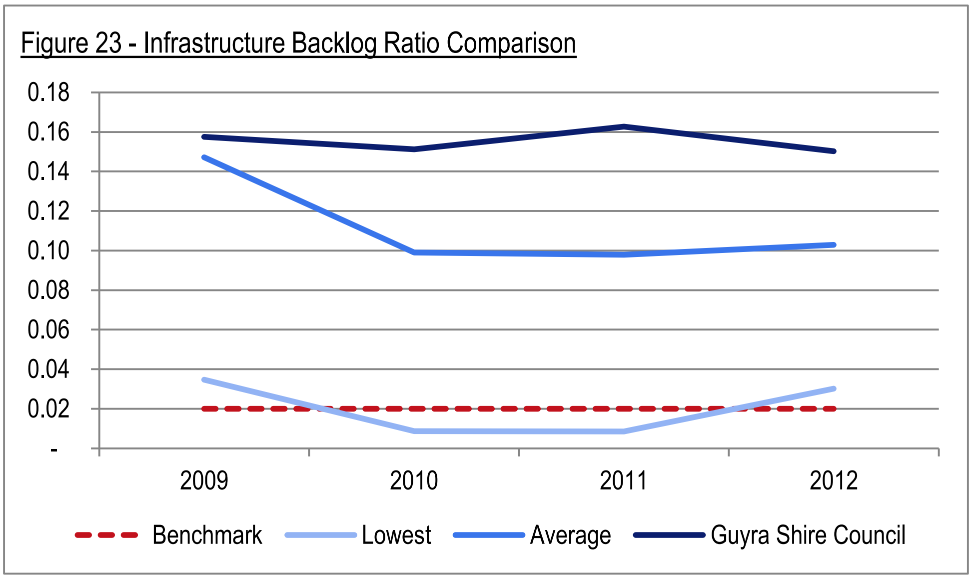
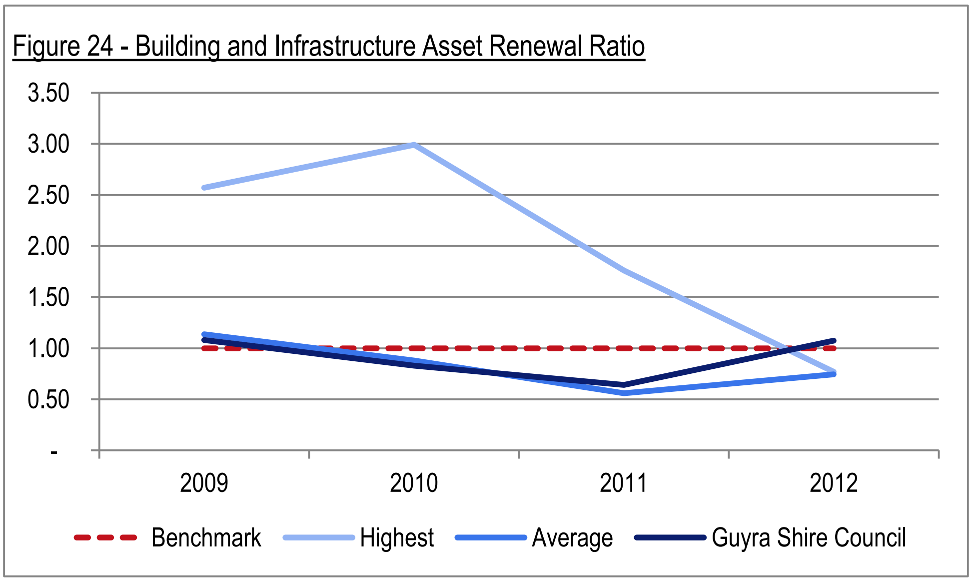


Figure 22 - Asset Maintenance Ratio Comparison







Council's Infrastructure Backlog Ratio was above the group average and benchmark.

Council's Capital Expenditure Ratio improved to be above the group average and benchmark over the review period and it is forecast to continue to improve in the medium term. Council's Building and Infrastructure Asset Renewal Ratio was above the group average and benchmark in 2012. Council's Asset Maintenance Ratio declined below the group average and benchmark over the period.

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 satisfactory financial position.

We base our recommendation on the following key points:

- Council has sufficient capacity to manage the additional $2.2m LIRS debt highlighted by a DSCR and Interest Cover Ratio above the benchmarks in all 10 years of its financial forecast
- Council has attracted a major employer to the area with the Costa facility and are in the process of developing a 52 lot subdivision to cater for the demand for housing as a result of the increased employment
- Council had a relatively low level of borrowings in 2011 at $2.6m, 0.1% of net assets

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

- Council has an infrastructure backlog of $17.9m that equates to 16% of total IPP&E, and this backlog has been growing in recent years
- Operating deficit results excluding capital grants and contributions are forecast to remain for the 10 year forecast period. These operating deficit results are all substantially below the benchmark target of (4%). This is a significant issue that could impact the long term financial sustainability of the Council. We recommend Council considers its options for improving its performance in this area, either by further and on-going cost controls, or securing new or additional revenue
- Own Source Revenues are below benchmark and Council relies heavily on grants and contributions for operations. Without these ongoing grants Council's financial position would be severely weakened

Appendix A Historical Financial Information Tables

Table 1- Income Statement

Income Statement ($'000s)	Year ended 30 June			% annual change	
	2011	2010	2009	2011	2010
Revenue					
Rates and annual charges	3,237	3,182	3,041	1.7%	4.6%
User charges and fees	950	1,088	769	(12.7%)	41.5%
Interest and investment revenue	790	354	15	123.2%	2260.0%
Grants and contributions for operating purposes	4,812	3,372	3,088	42.7%	9.2%
Other revenues	558	481	518	16.0%	(7.1%)
Total revenue	**10,347**	**8,477**	**7,431**	**22.1%**	**14.1%**
Expenses					
Employees	4,089	4,080	3,205	0.2%	27.3%
Borrowing costs	57	72	51	(20.8%)	41.2%
Materials and contract expenses	2,836	2,319	2,606	22.3%	(11.0%)
Depreciation and amortisation	2,523	2,128	1,739	18.6%	22.4%
Other expenses	1,222	1,078	1,168	13.4%	(7.7%)
Total expenses	**10,727**	**9,677**	**8,769**	**10.9%**	**10.4%**
Operating result (excluding capital grants and contributions)	**(380)**	**(1,200)**	**(1,338)**	68.3%	10.3%
Operating result (including capital grants and contributions)	**366**	**633**	**742**	(42.2%)	(14.7%)

Table 2 - Items excluded from Income Statement

Excluded items					
Grants and contributions for capital purposes	746	1,833	2,080	(59.3%)	(11.9%)
Net gain (loss) from the disposal of assets	(3)	94	422	(103.2%)	(77.7%)

Table 3 - Balance Sheet

Balance Sheet ($'000s)	Year Ended 30 June			% annual change	
	2011	2010	2009	2011	2010
Current assets					
Cash and cash equivalents	2,743	1,994	1,357	37.6%	46.9%
Investments	6,840	7,343	5,360	(6.9%)	37.0%
Receivables	1,068	1,193	996	(10.5%)	19.8%
Inventories	630	542	195	16.2%	177.9%
Other	0	76	0	(100.0%)	N/A
Total current assets	11,281	11,148	7,908	1.2%	41.0%
Non-current assets					
Receivables	15	15	3	0.0%	400.0%
Infrastructure, property, plant & equipment	271,818	270,204	260,788	0.6%	3.6%
Total non-current assets	271,833	270,219	260,791	0.6%	3.6%
Total assets	**283,114**	**281,367**	**268,699**	0.6%	4.7%
Current liabilities					
Payables	2,028	1,679	1,836	20.8%	(8.6%)
Borrowings	315	305	134	3.3%	127.6%
Provisions	1,177	1,368	985	(14.0%)	38.9%
Total current liabilities	3,520	3,352	2,955	5.0%	13.4%
Non-current liabilities					
Borrowings	1,874	2,190	896	(14.4%)	144.4%
Provisions	412	226	305	82.3%	(25.9%)
Total non-current liabilities	2,286	2,416	1,201	(5.4%)	101.2%
Total liabilities	**5,806**	**5,768**	**4,156**	0.7%	38.8%
Net assets	**277,308**	**275,599**	**264,543**	0.6%	4.2%

Table 4-Cashflow

Cash Flow Statement ($'000s)	Year ended 30 June		
	2011	2010	2009
Cash flows from operating activities	3,253	3,015	2,971
Cash flows from investing activities	(2,221)	(3,727)	(2,634)
Proceeds from borrowings and advances	0	1,600	12
Repayment of borrowings and advances	(283)	(251)	(140)
Cash flows from financing activities	(283)	1,349	(128)
Net increase/(decrease) in cash and equivalents	**749**	**637**	**209**
Cash and equivalents	2,743	1,994	1,357

Appendix B Glossary

Asset Revaluations

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

Collateralised Debt Obligation (CDO)

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

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

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

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

Division of Local Government (DLG)

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

Depreciation of Infrastructure Assets

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

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

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

EBITDA

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

Grants and Contributions for Capital Purposes

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

Grants and Contributions for Operating Purposes

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

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

Independent Commission Against Corruption (ICAC)

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

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

Independent Pricing and Regulatory Tribunal (IPART)

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

Infrastructure Backlog

Infrastructure backlog is defined as the estimated cost to bring 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.