INDEPENDENT PRICING AND REGULATORY TRIBUNAL (IPART)

Special Rate Variation Application

Wollongong City Council 2014-15

Attachment 11
TCorp Report- Wollongong City Council Financial Assessment and Benchmarking Comparison

New South Wales
Treasury Corporation

28 February 2013

Tana Ramsden
Corporate Accounting Unit Manager
Wollongong City Council
41 Burelli Street
Wollongong NSW 2500

Updated Benchmarking Section for the LIRS Assessment Report Dated 4 October 2012

Dear Tana,

Following our Financial and Assessment and Benchmarking Report dated 4 October 2012 which was prepared as a part of the Local Infrastructure Renewal Scheme (LIRS), TCorp has progressed to review all the 152 councils within NSW and have now collected additional data from peers within your Division of Local Government (DLG) Group.

Please find enclosed an updated version of 'Section 5: Benchmarking and Comparisons with Other Councils' including data from the financial year ended 30 June 2012 for all the NSW councils in Group 5.

We hope you find this information useful. Please contact us if you have any questions about this matter.

Yours sincerely,

Jasmine Green

Updated Section 5 Benchmarking and Comparisons with Other Councils

Each council's performance has been assessed against ten key benchmark ratios. This section of the report compares the Council's performance with its peers in the same DLG Group. The Council is in DLG Group 5. There are seven councils in this group and at the time of preparing this report, we have data for all of these councils.

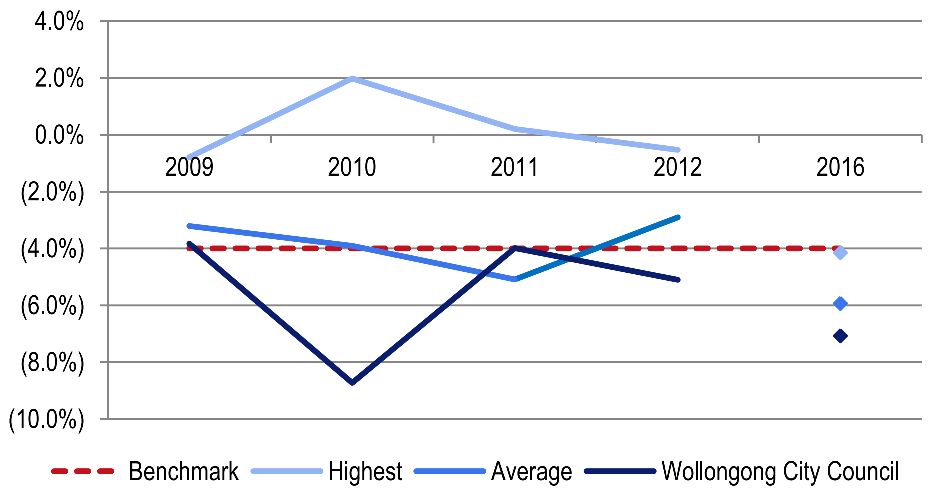
In Figure 15 to Figure 24, the graphs compare the historical performance of Council with the benchmark for that ratio, with the average for the Group, with the highest performance (or lowest performance in the case of the Infrastructure Backlog Ratio where a low ratio is an indicator of strong performance), 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.

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.

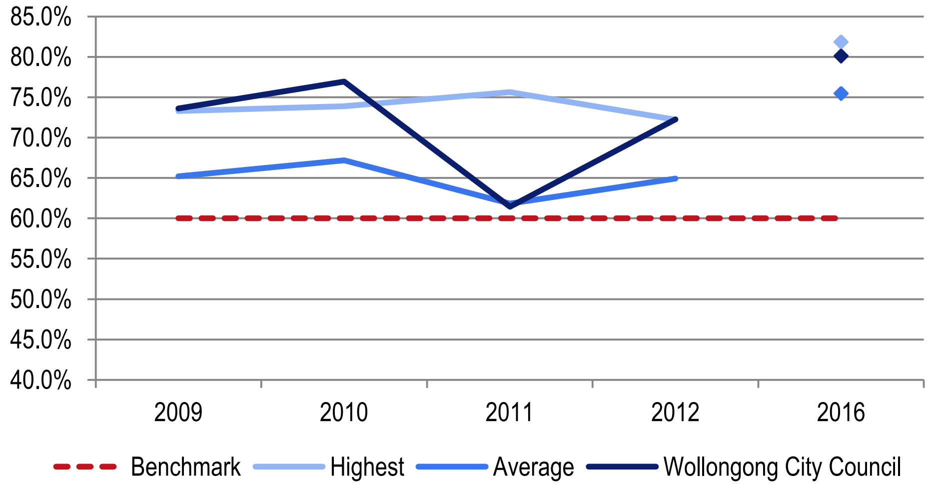
Financial Flexibility

Figure 15 - Operating Ratio Comparison



Council's Operating Ratio was below average and at or below benchmark for most of the review period. The results deteriorated in 2012 and this is forecast to continue in the medium term to be below the group average and benchmark.

Figure 14 - Own Source Operating Revenue Ratio Comparison



Council's Own Source Operating Revenue Ratio has been at or above the group average over the review period and it is above the benchmark. The ratio is forecast to improve in the medium term in line with the group average.

Liquidity

Figure 17 - Cash Expense Ratio Comparison

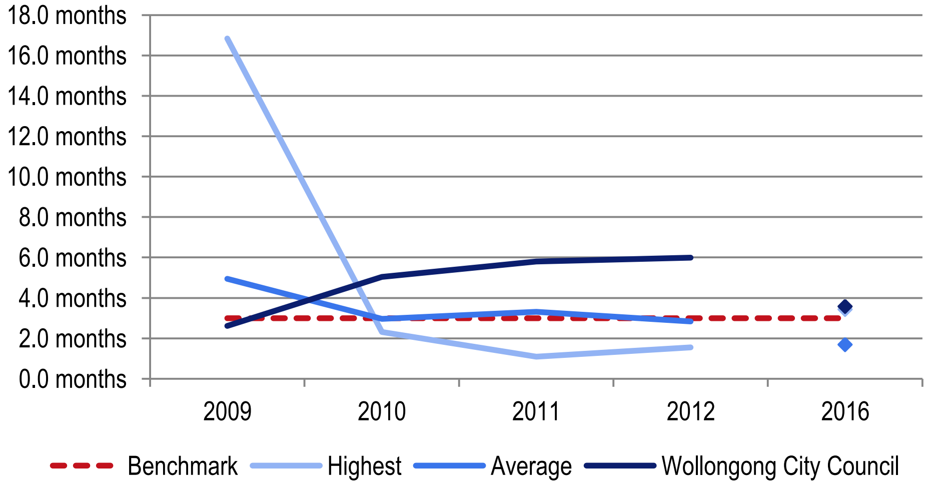
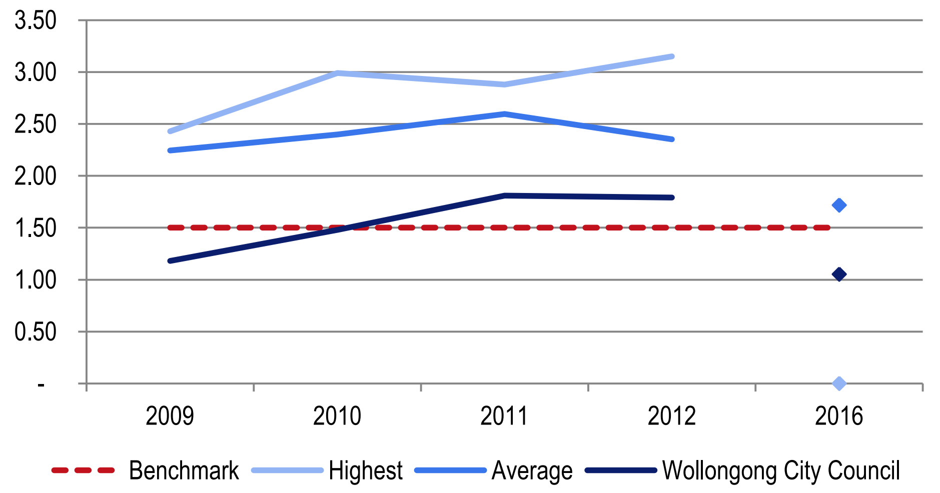


Figure 18 - Unrestricted Current Ratio Comparison



On average over the past four years, the Council's liquidity position has been sufficient though this is forecast to deteriorate from current levels in the medium term.

Debt Servicing

Figure 19 - Debt Service Cover Ratio Comparison

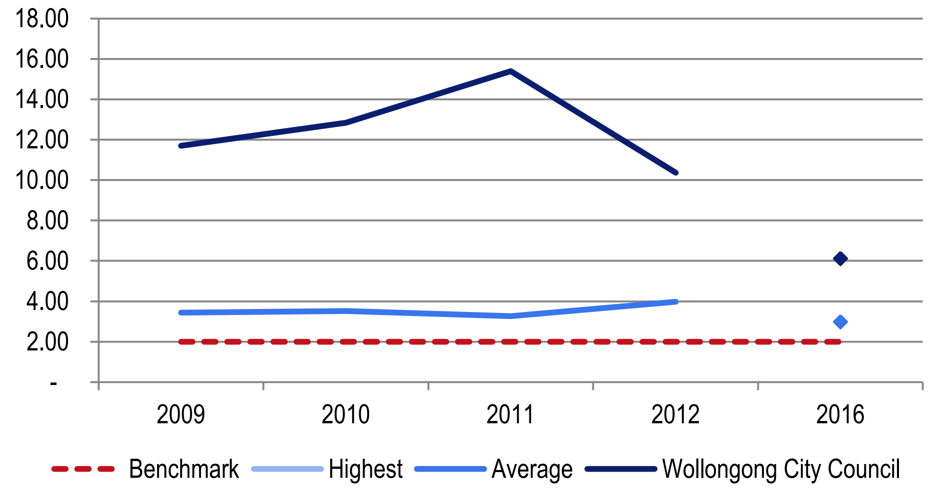
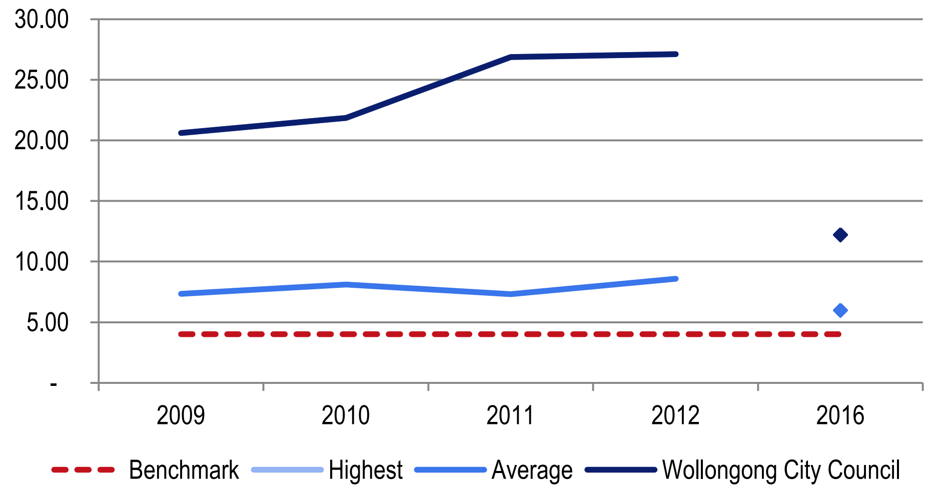


Figure 20 - Interest Cover Ratio Comparison



Council had the best DSCR and Interest Cover Ratio in the group in the past four years. Both ratios are above the group average in the medium term indicating that it will be using less debt funding than other councils in the group.

Asset Renewal and Capital Works

Figure 21 - Capital Expenditure Ratio Comparison

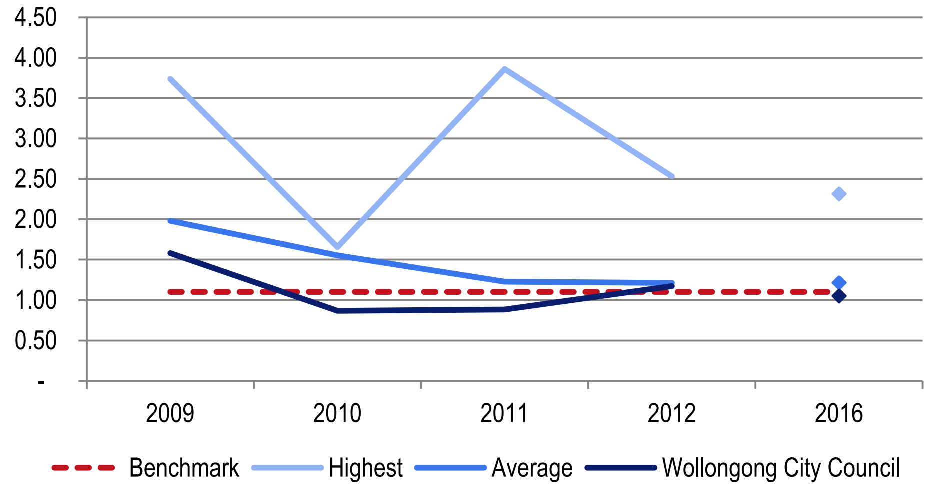


Figure 22 - Asset Maintenance Ratio Comparison

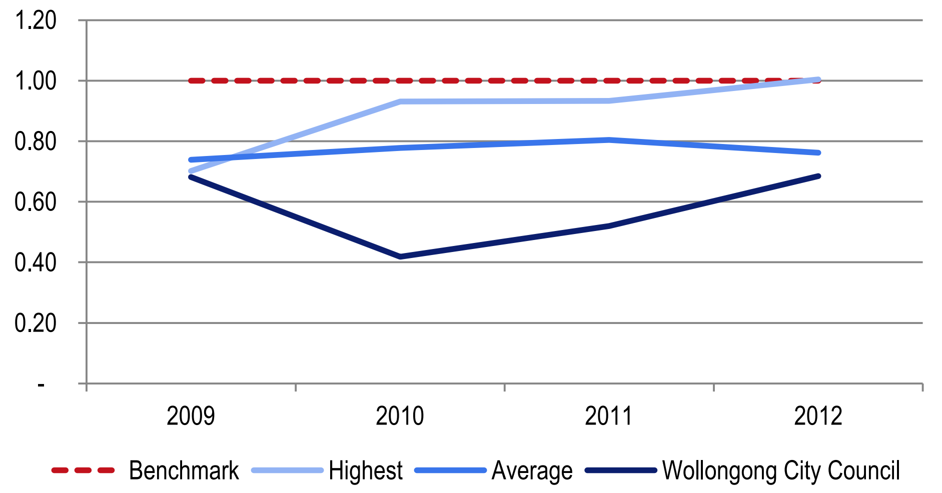


Figure 23- Infrastructure Backlog Ratio Comparison

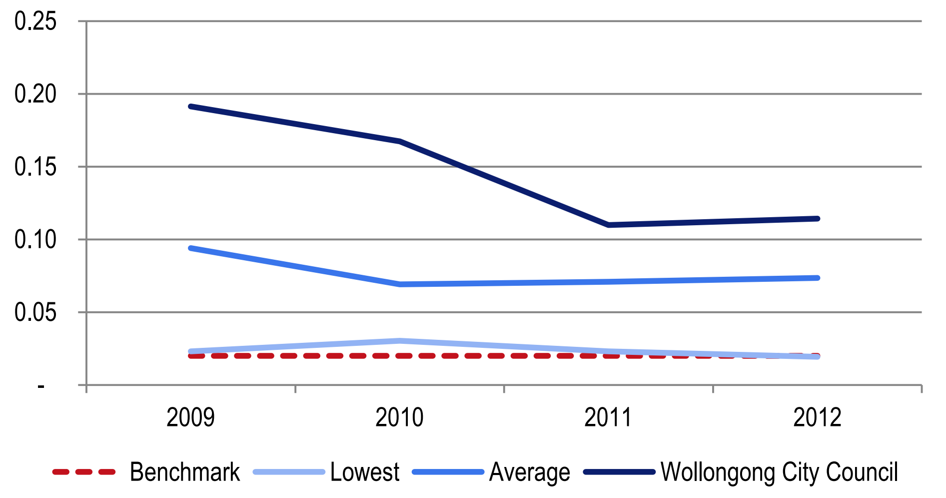
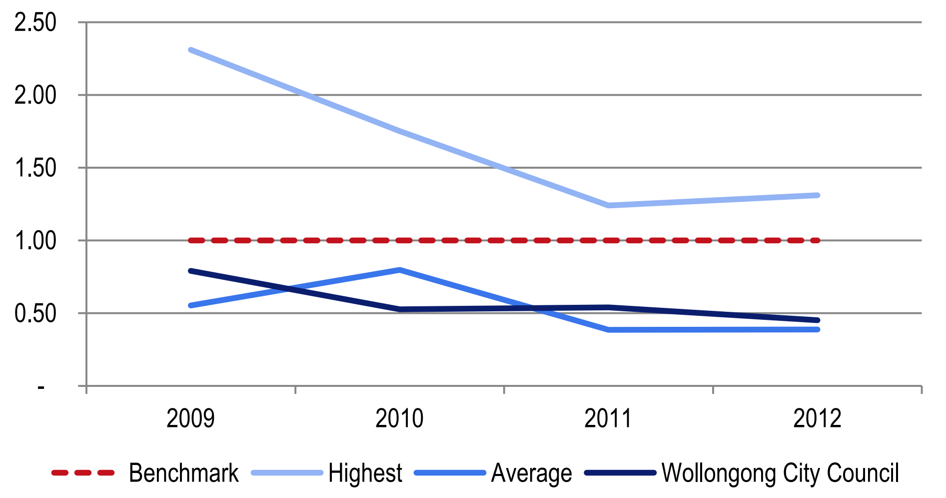


Figure 24 - Building and Infrastructure Asset Renewal Ratio



Overall, Council's performance in respect of asset maintenance, renewals and Backlog was adverse to benchmark.

Council's capital expenditure was below the group average for most of the period and the Asset Maintenance Ratio was below the group average and the benchmark. Council's Building and Infrastructure Asset Renewal Ratio was around the group average but below the benchmark.

Council's Infrastructure Backlog is higher than the group average.

Wollongong City Council

Financial Assessment and Benchmarking Report

4 October 2012

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

New South Wales
Treasury Corporation

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 Wollongong City Council, the LIRS Assessment Panel and the DLG. TCorp shall not be liable to Wollongong 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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Section 1 Executive Summary

This report provides an independent assessment of Wollongong 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 for the Citywide Footpaths and Shared Path Renewal and Missing Links Construction Program for $38.6m to be partly funded by a loan of $20.0m.

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:

- While the Council has incurred operating deficits (excluding grants and contributions for capital purposes), Council's underlying cash result (measured using EBITDA) has improved to $53.1m in 2011
- Approximately 71% of the Council's revenue base is derived from own sourced revenue (annual charges, and user charges and fees). They can rely upon these revenue streams on an ongoing basis for financial flexibility
- Operating expenses are generally well managed. Depreciation and amortisation expenses have increased due to changing accounting policies to fair value accounting

Administrators were appointed to Council in 2008 to act as Lord Mayor and elected Councillors following allegations of corrupt conduct by a number of staff, councillors and developers in relation to the assessment of development applications and a range of other matters. Council is now out of administration and new Councillors have been elected.

Council's reported infrastructure backlog of $143.2m in 2011 represents 11.0% of its infrastructure asset value of $1,303.0m. Other observations include:

- The infrastructure backlog has reduced since 2009 due to refinements of the valuation model used by Council and aligning the service level requirements to the asset management plan
- Council has spent less than required on maintenance in the last three years
- Council's capital expenditure is being distorted by the West Dapto release area and the Footpaths project. If these projects are excluded, capital expenditure is below the required level over the forecast period, though the shortfall in spending improves throughout the period

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

- The forecast shows operating deficits that improve over the forecast period to be close to the benchmark in the final years of the forecast when capital grants and contributions are excluded
- The 10 year financial forecasts include a capital expenditure program that includes the West Dapto release area and the Footpaths project. Once these projects are completed capital expenditure reduces to more normal levels and is below the benchmark. The impact of this lower level of capital investment is that other areas such as cash and investment balances improve over time as investments are not made into new or renewal assets though a portion of the increase in investment balances is due to increases in external restrictions
- Overall it appears that the Council will have adequate liquidity throughout the next 10 year period to service all short term liabilities and currently scheduled capital expenditure and related long term liabilities
- Council's level of fiscal flexibility is sound as own source revenue is maintained at levels around 80% for most of the forecast period
- With the exception of our comments regarding the future capital program, other key assumptions within the financial forecasts are considered to be reasonable

In our view, the Council has the capacity to undertake the combined additional borrowings of $20.0m for the LIRS project. This is based on the following analysis:

- The DSCR remains well above a benchmark of 2.0x in the 10 year forecast
- The Interest Cover Ratio is well above the benchmark of 4.0x in the 10 year forecast
- Council's liquidity is adequate

In respect of the Benchmarking analysis TCorp has compared the Council's key ratios with other councils in DLG Group 5. The key observations are:

- Council's financial flexibility as indicated by the Operating Ratio and Own Source Operating Revenue Ratio are generally above the group's average
- Council currently has a lower level of gearing to its peers with its DSCR and Interest Cover Ratio above the group average and whilst in the medium term the forecast ratios decline, they remain above the group average and benchmark
- Council was in a sufficient liquidity position which on average is below the group's average liquidity level
- Council performs below its peers in terms of its comparatively high level of Infrastructure Backlog and is below its group's average for capital expenditure and asset maintenance

Section 2 Introduction

2.1: Purpose of Report

This report provides the Council with an independent assessment of their financial capacity and performance measured against a peer group of councils which will complement their internal due diligence, and the IP&R system of the Council and the DLG.

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

The key areas focused on are:

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

2.2: Scope and Methodology

TCorp's approach was to:

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

In undertaking its work, TCorp relied on:

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

Benchmark Ratios

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

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

Therefore these benchmarks are intended as a guide to performance.

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

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

2.3: Overview of the Local Government Area

Wollongong City Council LGA	
Locality & Size	
Locality	Illawarra
Area	684km^2
DLG Group	5
Demographics	
Population	192,418
% under 20	25%
% between 20 and 59	53%
% over 60	22%
Expected population 2021	215,700
Operations	
Number of employees (FTE)	981
Annual revenue	$270.7m
Infrastructure	
Roads	897km
Road and Pedestrian Bridges	117
Infrastructure backlog value	$143.2m
Total infrastructure value	$1,303.0m

Wollongong City Council Local Government Area (LGA) is located 80km south of Sydney on a narrow coastal strip bordered by the Royal National Park to the north, Lake Illawarra to the south, the Tasman Sea to the east, and the Illawarra Escarpment to the west. Towns within the LGA include Bulli, Helensburgh, Austinmer, Port Kembla, Thirroul, Dapto and Figtree.

The key economic sectors are in manufacturing, education, technology research & development, coal mining, retail services, tourism, port activities, health and community services.

Council has a sizable infrastructure to manage, including over 700 buildings, 87km of cycle ways, 419km of foot paths / walkways, 897km of local roads, 620km of stormwater pipes and 1,531 hectares of open space maintained for sports and recreation.

2.4: LIRS Application

Council has made one LIRS application.

Project: Citywide Footpaths and Shared Path Renewal and Missing Links Construction Program

Description: design and construction of missing links in the existing footpath network to improve the connectivity of the network. Upgrade and renewals of sections of the existing footpath and shared path network throughout the LGA which have already been identified as being in poor or very poor condition and below the target service level standard.

Project cost: $38.6m

Amount of loan facility: $20.0m

Term of loan facility: 10 years

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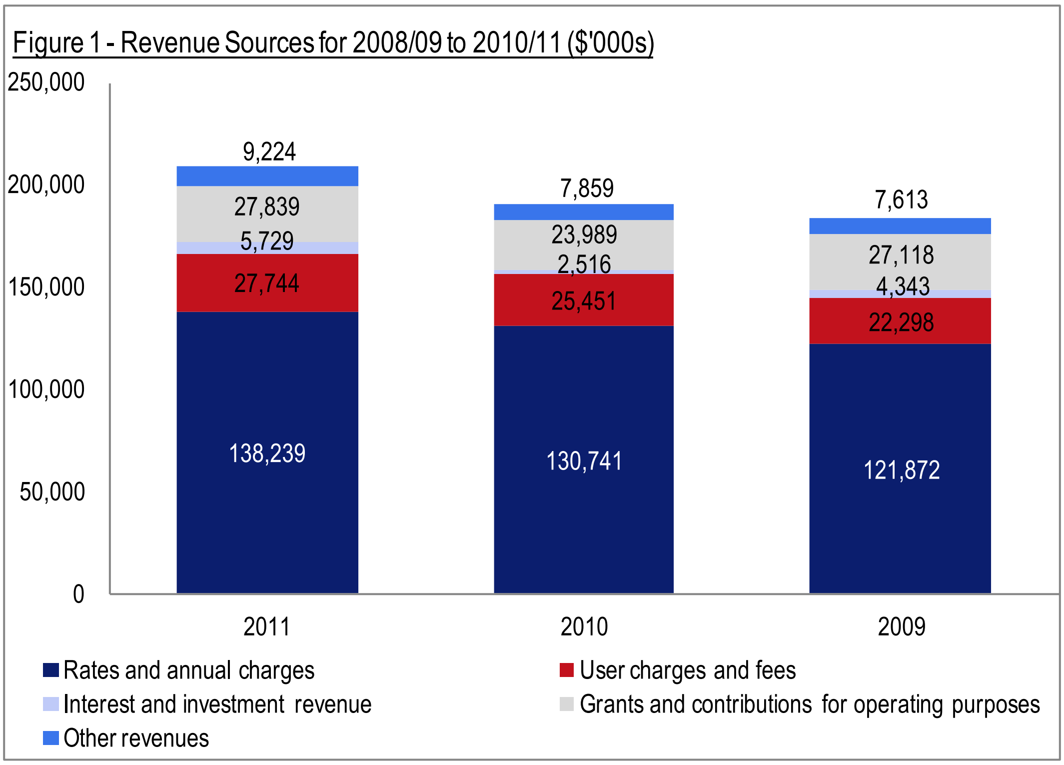
Section 3 Review of Financial Performance and Position

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

3.1: Revenue

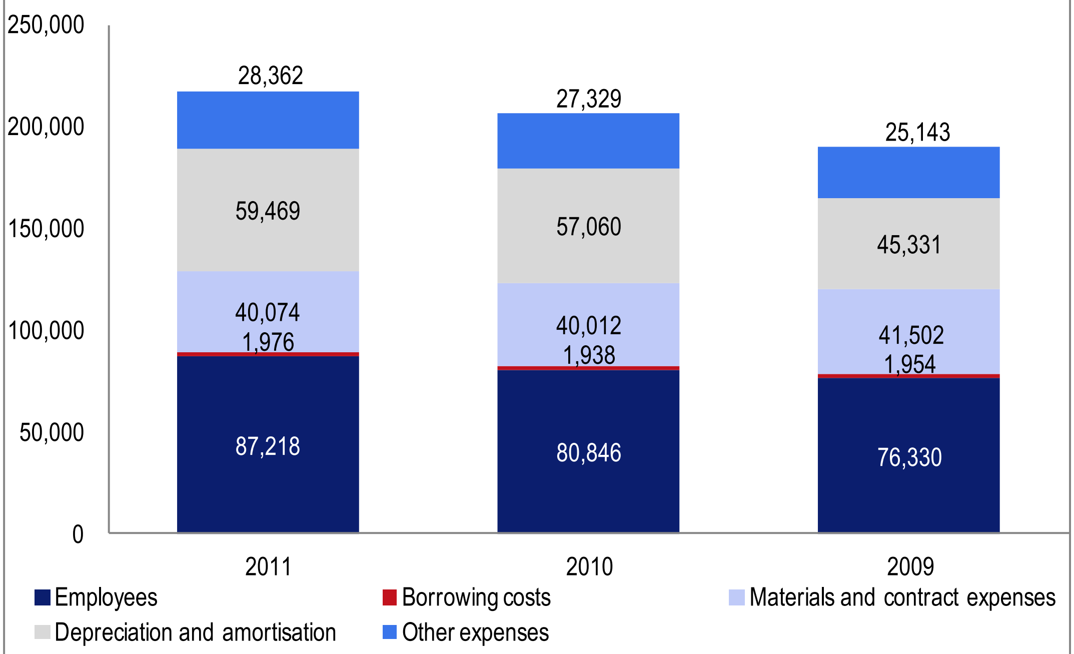


Key Observations

- Rates and annual charges have been increasing by an average of 6.5% p.a. over the review period. This growth is primarily driven by around 20% p.a. growth in domestic waste management services charges.
- User charges and fees have been increasing by an average of 11.6% p.a. over the period primarily due to increases in non-domestic waste management services charges and parking meter fees.
- Council's own sourced revenue averaged 71% over the period which is above the benchmark of 60%.
- Interest and Investment revenue dipped in 2010 even though cash and investments have been increasing over the period. This is due to a $26m interest free loan received on 29 June 2010 skewing the cash and investment balances which were lower in 2010 over most of the year.
- Grants and contributions for operating purposes dipped in 2010 due to a fall in general purpose grants. They have been trending higher over the period due to increasing specific purpose grants and operating contributions.

3.2: Expenses

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



Key Observations

- Employee costs have been growing by an average of 6.9% p.a. over the period. This growth is driven by increases in salaries and wages from increased resourcing for some projects and increased overtime, increased superannuation expenses from increased defined benefits scheme contributions; and increased workers compensation provisions. The total number of employees has fallen since 2009.
- Materials and contract expenses fell modestly over the period. While contractor and consultancy costs fell $12.5m and raw materials and consumables costs fell $2.0m, the $10.6m fall in capitalised costs largely offset the falls. The falls are largely due to an abnormally high spending level in 2009.
- Borrowing costs are a small component of expenses and have remained relatively flat over the period.
- Depreciation and amortisation expenses increased by $11.7m in 2010 primarily due to increases in drainage, roads and buildings infrastructure depreciation following revaluations and adjustments of $307.1m, $139.7m and $42.2m respectively. The increase in 2011 is primarily due to an increase of $2.0m in roads depreciation following a further $21.1m adjustment.
- Total expenses have grown by an average of 6.8% p.a. over the period.

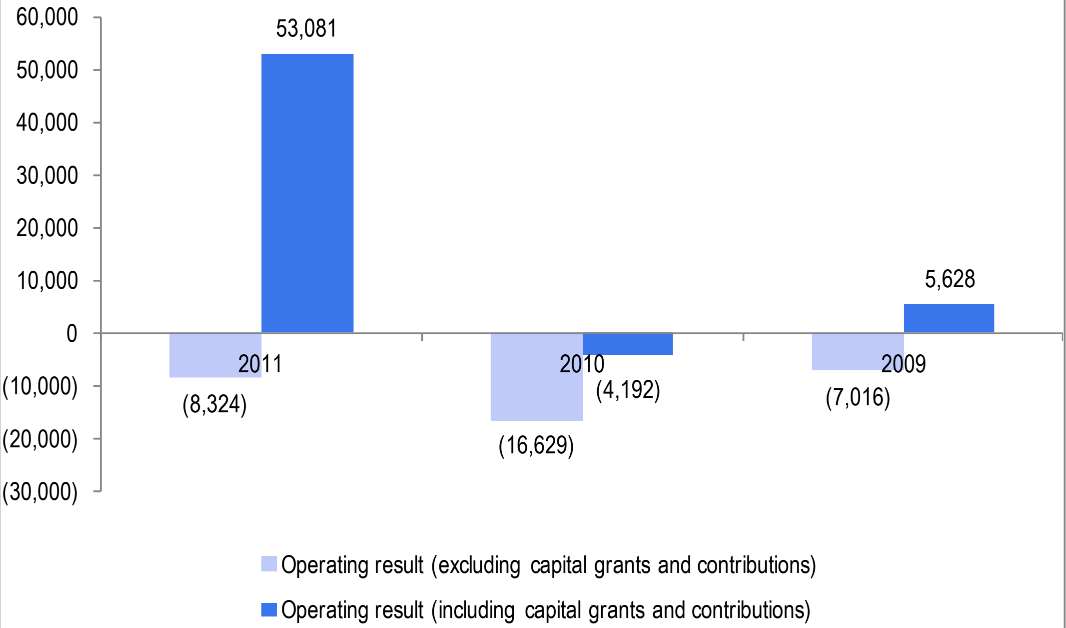
3.3: Operating Results

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

- The Council has posted net operating deficits excluding capital grants and contributions over the period, with operating results trending lower.
- The deteriorating results are primarily due to increasing depreciation and amortisation expenses.

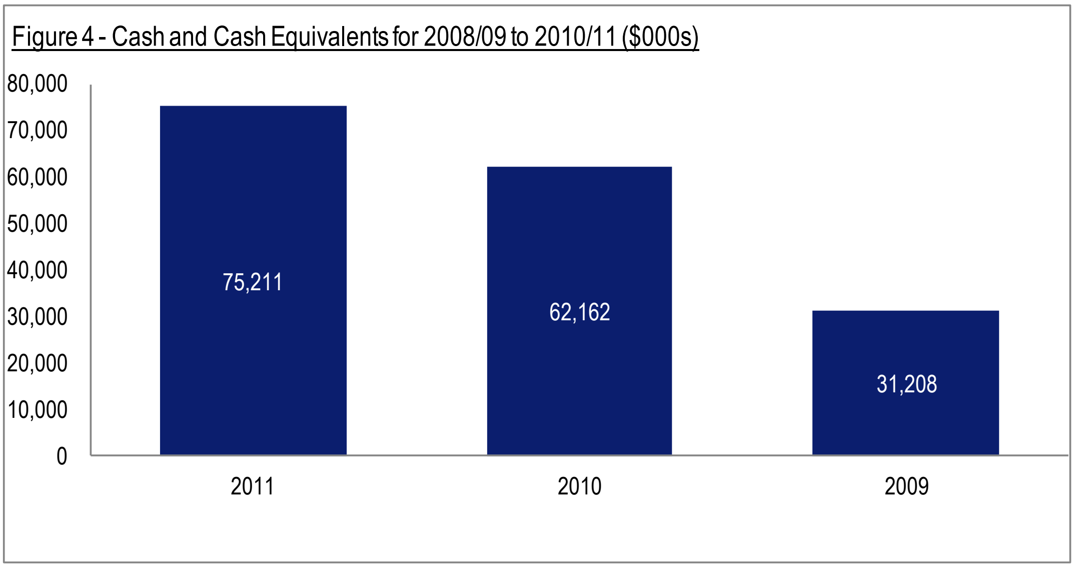
3.4: Financial Management Indicators

Performance Indicators	Year ended 30 June		
	2011	2010	2009
EBITDA ($'000s)	53,121	42,369	40,269
Operating Ratio	(4.0%)	(8.7%)	(3.8%)
Interest Cover Ratio	26.88x	21.86x	20.61x
Debt Service Cover Ratio	15.40x	12.85x	11.70x
Unrestricted Current Ratio	1.81x	1.48x	1.18x
Own Source Operating Revenue Ratio	61.4%	76.9%	73.6%
Cash Expense Ratio	5.8 months	5.0 months	2.6 months
Net assets ($'000s)	2,242,643	2,049,333	1,561,901

Key Observations

- The Council's EBITDA has trended higher over the period as the deteriorating operating result is largely due to non cash items.
- Both the Interest Cover and Debt Service Cover ratios have been strong and increasing over the period.
- The Operating Ratio has been around or below the benchmark of negative 4.0% over the period and is trending lower.
- The Unrestricted Current Ratio has increased over the period to be above the benchmark of 1.50x and is expected to continue to increase in the future.
- The Cash Expense Ratio is above the benchmark of 3.0 months in the most recent two years.
- Net assets have increased significantly in 2010 and 2011 due to revaluations and adjustments to Infrastructure, Property, Plant and Equipment of $481.2m and $143.2m respectively.
- When revaluations and adjustments are excluded, Infrastructure, Property, Plant and Equipment have increased $40.5m over the period.
- Council has total borrowings of $18.3m. This represents a total debt level of 0.8% of net assets.

3.5: Statement of Cashflows



Key Observations

- Council's cash and cash equivalents have been increasing over the period primarily due to increasing net operating cashflows and new borrowings.
- In total, Council has cash and investments of $84.4m in 2011 of which $40.7m is externally restricted, $17.3m is internally restricted and $26.4m is unrestricted. The majority of external restrictions relate to unexpended loans, developer contributions and specific purpose unexpended grants.
- Within the investments portfolio of $9.2m, Council has negotiable certificates of deposit and floating rate notes of $3.0m, other long term financial assets of $2.6m, mortgage backed securities of $2.5m and managed funds of $1.1m.
- Overall the cash balances along with the Unrestricted Current Ratio suggest the Council was able to meet their day to day obligations

3.6: Capital Expenditure

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

3.6(a): Infrastructure Backlog

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

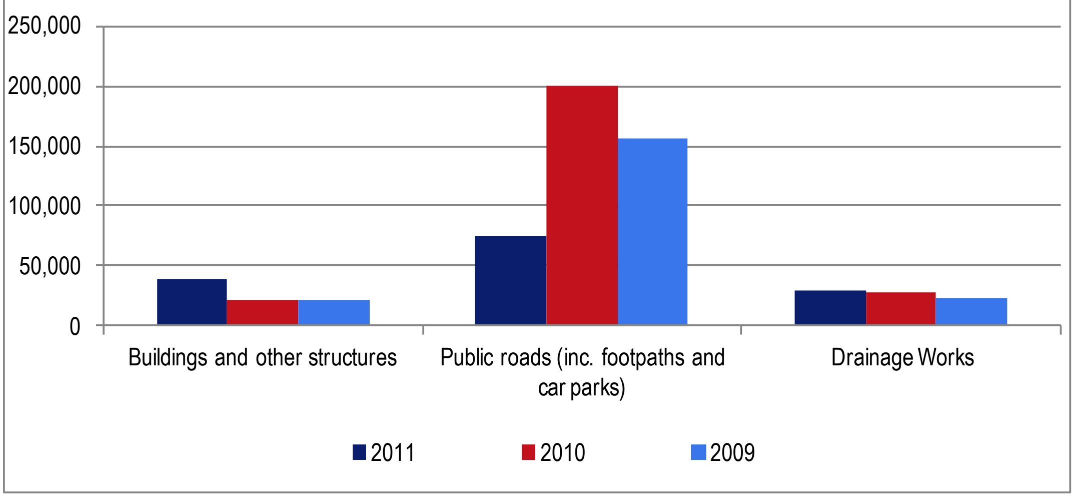
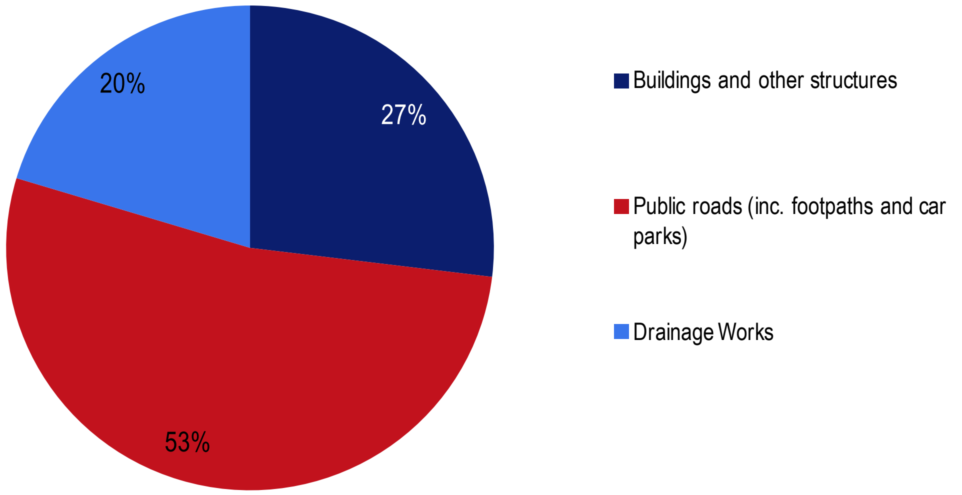


Figure 6 - Infrastructure Backlog Composition for 2010/11



The Council reported a $143.2m backlog in 2011 that is mainly related to roads (53%) and buildings and other structures (27%).

The infrastructure backlog dropped substantially in 2011 due to a $124.4m reduction in roads backlog. This is due to a refinement of the valuation model used by Council and aligning the service level requirements to the asset management plan.

3.6(b): Infrastructure Status

Infrastructure Status	Year ended 30 June		
	2011	2010	2009
Bring to satisfactory standard ($'000s)	143,171	249,517	202,915
Required annual maintenance ($'000s)	18,569	20,089	19,870
Actual annual maintenance ($'000s)	9,657	8,402	13,548
Total value of infrastructure assets ($'000s)	1,302,979	1,490,600	1,060,042
Total assets ($'000s)	2,356,736	2,154,833	1,655,304
Building and Infrastructure Backlog Ratio	0.11x	0.17x	0.19x
Asset Maintenance Ratio	0.52x	0.42x	0.68x
Building and Infrastructure Renewals Ratio	0.54x	0.53x	0.79x
Capital Expenditure Ratio*	0.89x	0.87x	1.58x

*The capital expenditure ratio excludes contributed assets.

The Infrastructure Backlog Ratio has fallen over the period due to the backlog value trending lower as asset management planning improved and the value of infrastructure assets trending higher.

Council has spent less on asset maintenance than required over the period and the maintenance gap is trending higher. The Buildings and Infrastructure Renewals Ratio has been below the benchmark of 1.0x and has trended lower over the period.

Council's Capital Expenditure Ratio was well above the benchmark of 1.10x in 2009, though capital spending was unusually high in 2009 due to the commencement of a strategy to use available funds for capital.

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	72,130*	25,847	29,077
Replacement/refurbishment of existing assets	38,647	28,363	44,500
Total	110,777	54,210	73,577

*Includes $53.2m of contributed assets that was excluded from the capital expenditure ratio.

Total capital expenditure has trended higher over the period. Council's expenditure on new capital works has been trending higher, while expenditure on replacement/refurbishment works has trended lower. If the unusual spending in 2009 is excluded, expenditure on replacement/refurbishment works has trended higher.

Council measures their ability to fund asset renewals using a measure of operational funds available for capital budget. Council has improved this measure over the period and expects to continue to improve the measure in the future.

In 2011 major capital works included:

- Roads and bridges $12.4m
- Non commercial buildings $11.1m
- West Dapto project $6.8m
- Footpaths and cycleways $5.4m
- Parks, gardens and sports fields $2.9m
- Stormwater and floodplain management $2.9m

3.7: Specific Risks to Council

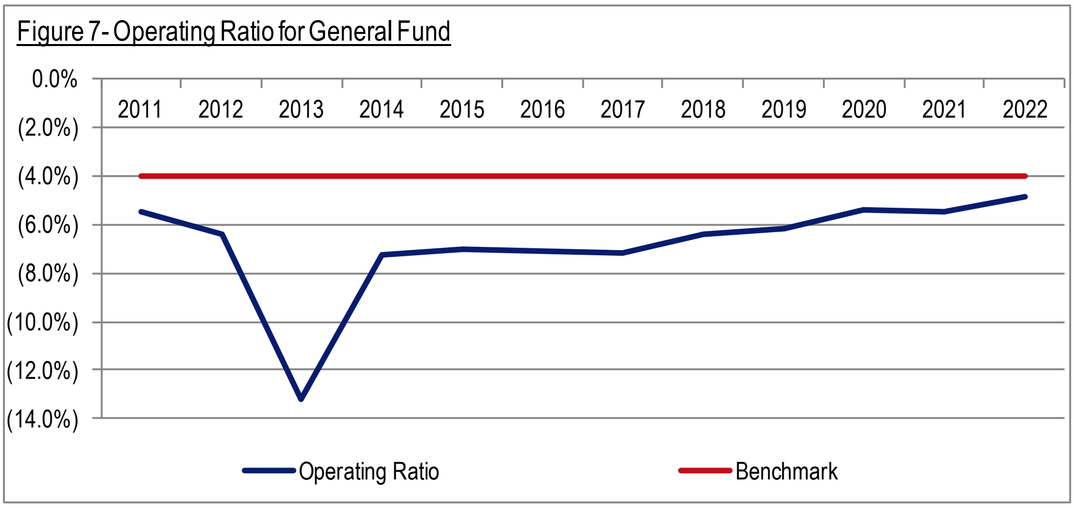
- Council being taken out of administration. The newly elected councillors have to take over from the administrator and be able to immediately manage the ongoing pressures and operational issues that the Council faces.
- Ageing workforce. Council has an average workforce age of 44 years and 53% of the workforce is over the age of 45. Council, as part of their Workforce Management Plan, are focused on the retention of knowledge and skills within their staff base while also being in a position to attract suitably qualified and experienced new employees.
- Environmental and natural disasters. Wollongong has had three natural disaster declarations in the last three years. Council's management of this risk is substantially reliant on being able to receive both State and Federal funding under various "natural disaster" funds.

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 $20.0m loan with the LIRS subsidy. The LIRS subsidy has been included because Council would need to change their capital program if the subsidy is excluded, and Council has received approval subject to this report being satisfactory.

The LIRS loan relates to the General Fund, therefore we have focused our financial analysis solely upon this Fund.

4.1: Operating Results



The overall trend in operating results is improving over the forecast period. The improving operating results are due to revenue increases being higher than expense increases. Revenue increases are driven by user fees and charges and rates and annual charges. Expense growth slowing is due to reductions in borrowing costs and the recurrent savings targets of $1m - $1.5m each year. Council has a number of areas they will be targeting to deliver the forecast savings.

The dip in 2013 is due to an early payment of two instalments of the revenue sharing grant for 2013 in 2012.

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

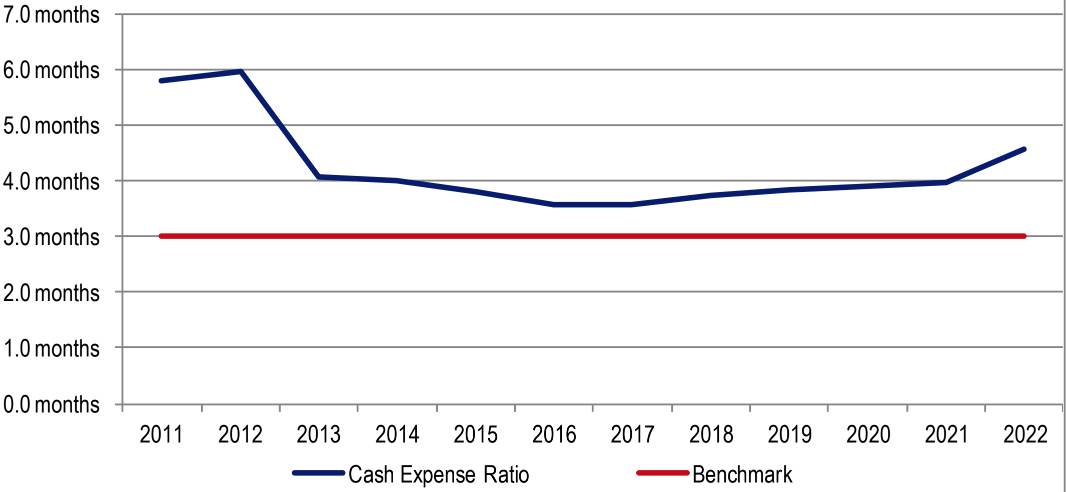
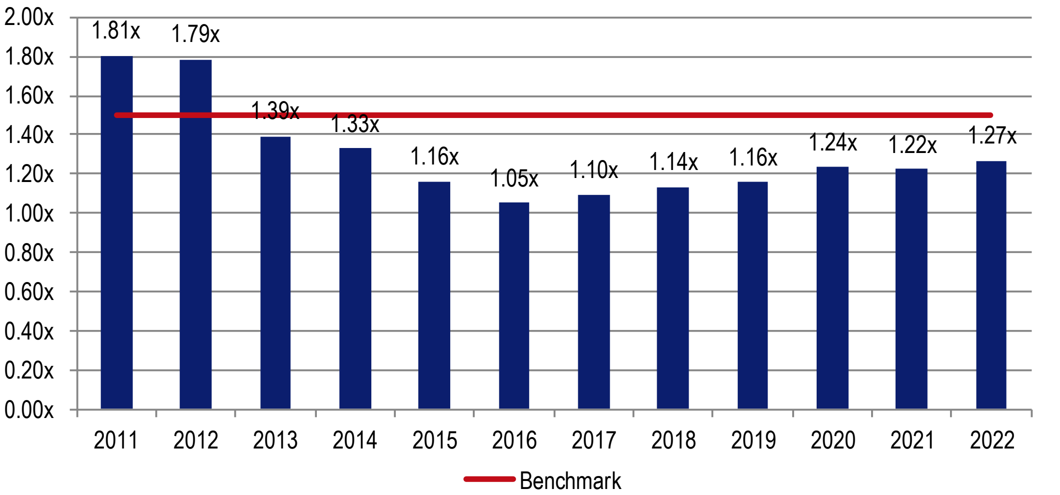


Figure 9 - Unrestricted Current Ratio for General Fund

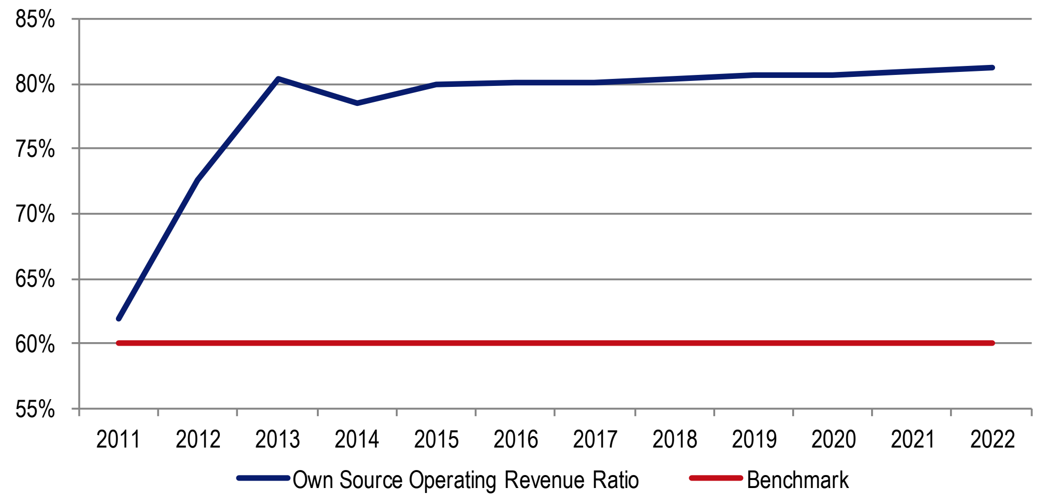


The Cash Expense Ratio remains above benchmark over the forecast period.

Council's Unrestricted Current Ratio is forecast to be below benchmark for the majority of the forecast period. For their internal purposes, Council use a benchmark of 1.00x as opposed to our 1.50x. While this is not unreasonable, Council should have in place a contingency plan should an event cause an adverse impact on unrestricted current assets or liabilities.

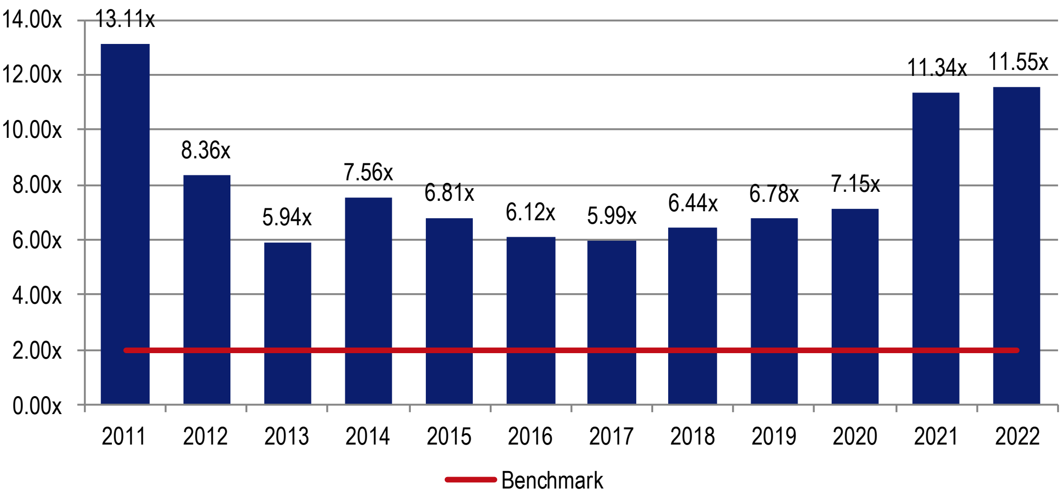
Fiscal Flexibility Ratios

Figure 10 - Own Source Operating Revenue Ratio for General Fund

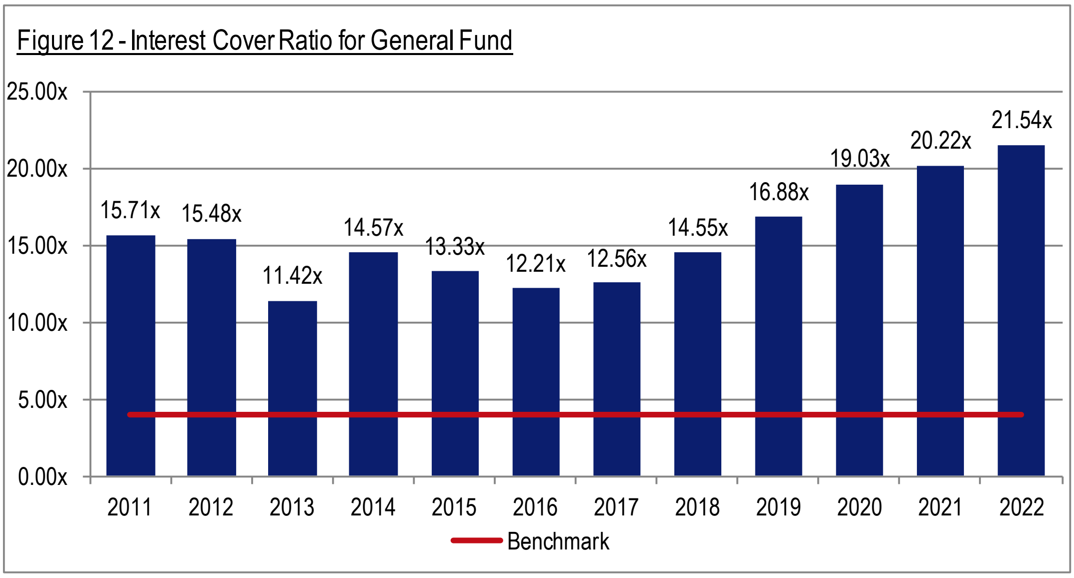


Council's Own Source Operating Revenue Ratio increases over the forecast period due to increasing rates and annual charges; and user fees and charges while capital grants and contributions are decreasing.

Figure 11 - DSCR for General Fund



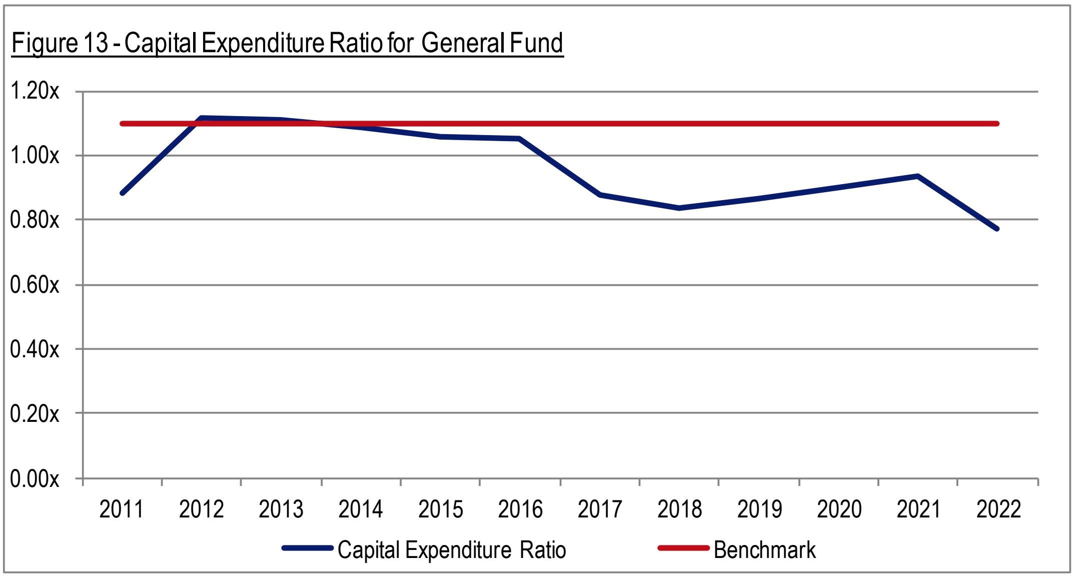
The Debt Service Cover Ratio is well above benchmark over the forecast period.



The Council's Interest Cover Ratio is above the benchmark of 4.00x and improves over the forecast period as profitability improves and interest costs reduce as debt is repaid.

With both the DSCR and Interest Cover Ratios being strong and increasing, this suggests that the Council would be able to service substantially higher levels of debt over the forecast period than is currently included in the forecast.

4.3: Capital Expenditure



The West Dapto release area and footpaths projects have skewed the capital expenditure ratio in the early years of the forecast. If these projects are excluded, the capital expenditure ratio improves over the forecast period though it remains below the benchmark. This suggests that the infrastructure backlog may increase. This issue may be compounded if service level demands increase over the forecast period, which could occur with forecast increases in population over the period.

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 rates 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%

Key Observations and Risks

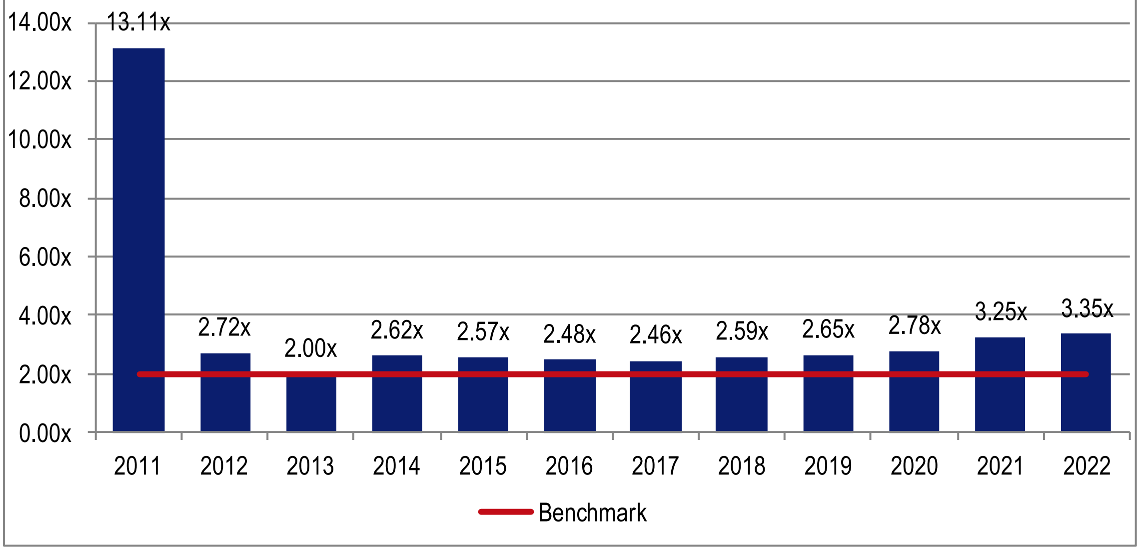
- Council has assumed CPI at 2.5% p.a. with the exception of 2014 and 2015 when it is 2.9% and 2.6% respectively.
- Increases in rates and annual charges average 3.4% p.a. over the forecast period which is in line with TCorp's estimate given there is an assumed 0.4% growth due to the increase in population.
- Council has forecast user fees and charges to increase at an average 4.4% p.a.
- Interest and Investment Revenue moves in line with cash and investment balances over the forecast period.
- Other revenue items average below the assumed CPI over the forecast period.
- Council's forecast employee cost increases average 2.9%p.a. which is below our estimate of 3.5%p.a. Council's labour cost projections are 3.3%p.a. but expected reductions in defined benefits plan premiums has reduced the overall increases.
- Council's forecast borrowing rate is 7.5% p.a. except for the LIRS loan which includes the 4% subsidy.
- Council has forecast materials and contract expenses to increase by an average of 5.7% p.a.
- Other expense items average around the assumed CPI over the forecast period.
- Apart from the comments on the capital expenditure program overall, the assumptions used by Council appear to be reasonable.

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>2x, $85.9m could be borrowed in addition to the $20m borrowings proposed under LIRS from 2013 to 2017.
- Given that Council is targeting a lower Unrestricted Current Ratio, we would suggest Council have higher levels of reserves in place if undertaking any significant additional borrowings.
- This scenario has been calculated by basing borrowing capacity on a 10 year amortising loan at an interest rate of 7.39%.

Figure 14 - DSCR for General Fund with additional borrowings



Section 5 Benchmarking and Comparisons with Other Councils

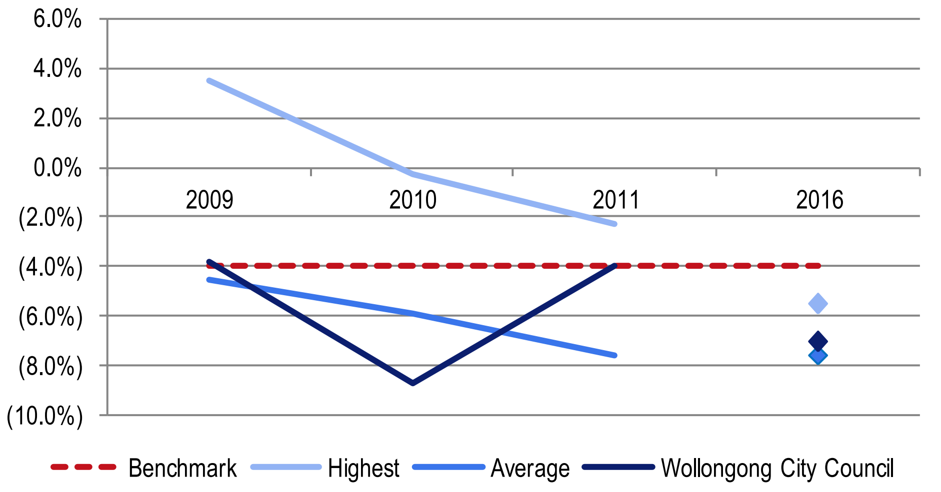
As discussed in section 2 of this report, each council's performance has been assessed against ten key benchmark ratios. This section of the report compares the Council's performance with its peers in the same DLG Group. The Council is in DLG Group 5 and there are six councils in this group.

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

Where no highest line is shown on the graph, this means that Council is the best performer in its group for that Ratio.

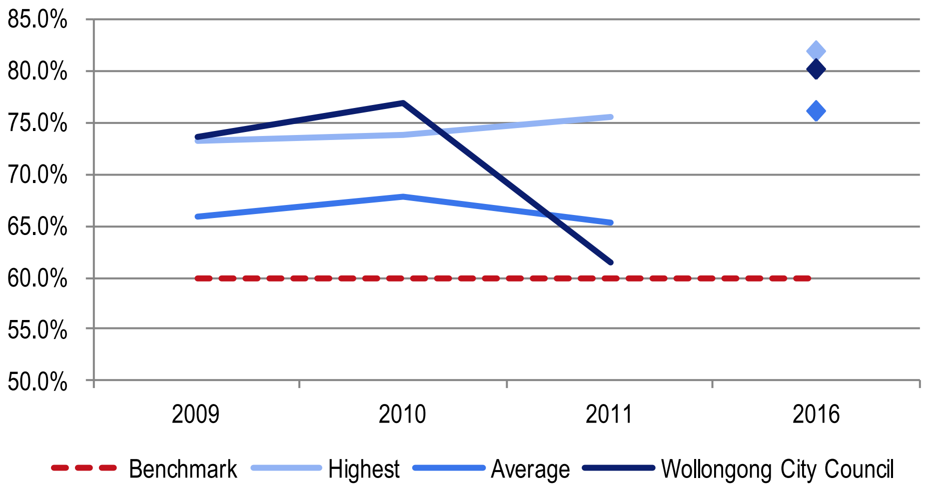
Financial Flexibility

Figure 15 - Operating Ratio Comparison



Council's Operating Ratio was above average and at benchmark in two of the past three years. The results are forecast to deteriorate in the medium term and to be marginally below the group's average and benchmark.

Figure 16 - Own Source Operating Revenue Ratio Comparison



Council's Own Source Operating Revenue Ratio deteriorated to be below the group average in 2011, though it is above the benchmark. The ratio is forecast to improve in the medium term in line with the group average.

Overall, Council's financial flexibility is satisfactory at levels around the group average.

Liquidity

Figure 17 - Cash Expense Ratio Comparison

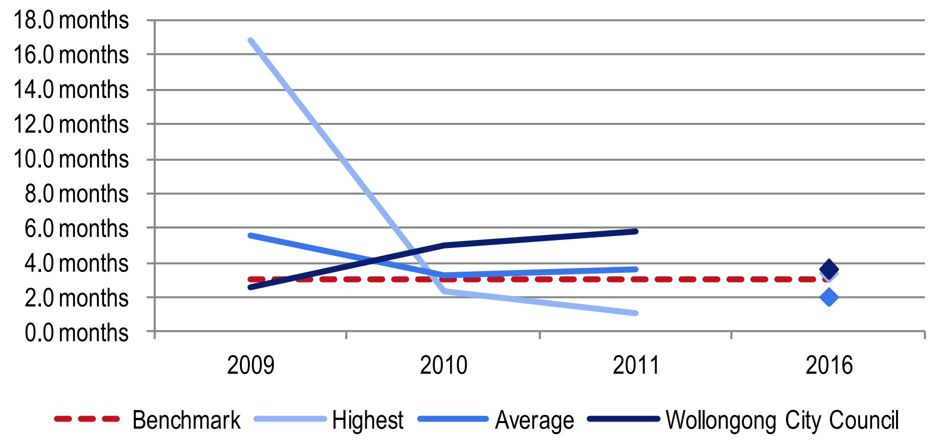
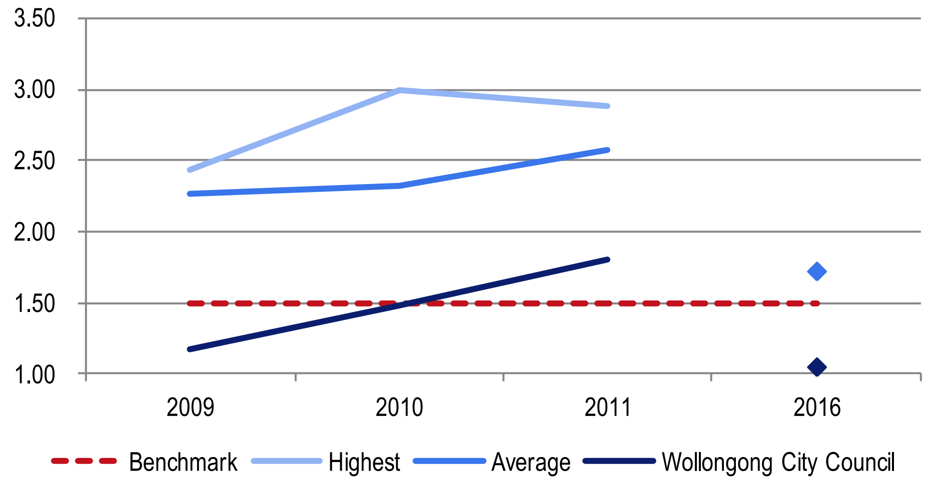


Figure 18 - Unrestricted Current Ratio Comparison



On average over the past three years, the Council's liquidity position has been sufficient though this is forecast to deteriorate in the medium term.

Debt Servicing

Figure 19 - Debt Service Cover Ratio Comparison

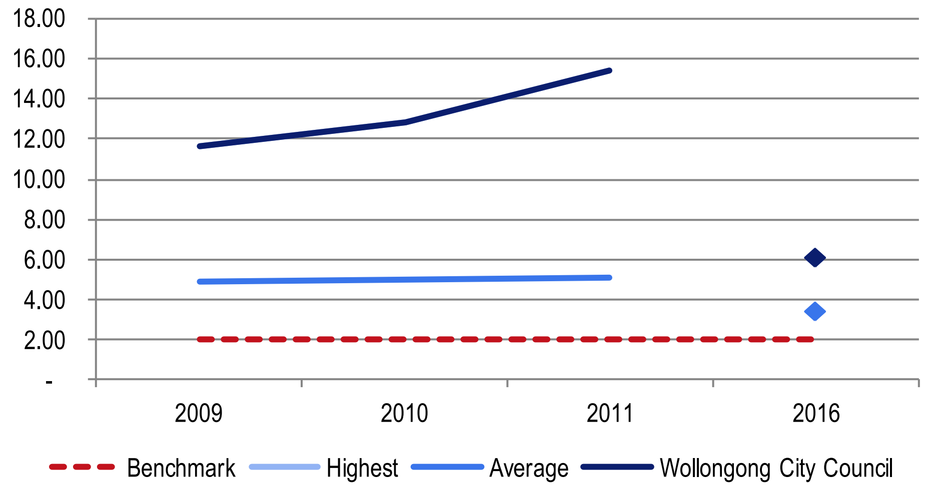
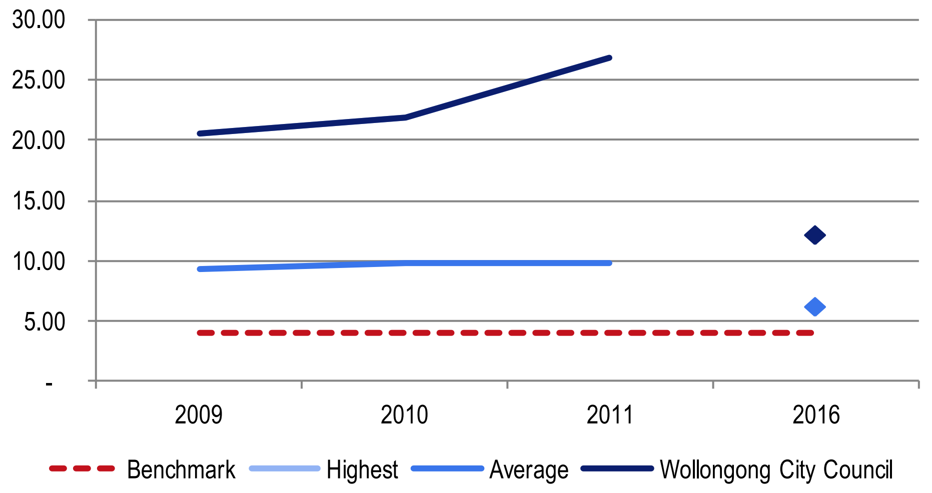


Figure 20 - Interest Cover Ratio Comparison



Council had the best DSCR and Interest Cover Ratio in the group in the past three years. Both ratios are above the group average in the medium term indicating that it will be less highly leveraged than other councils in the group.

Asset Renewal and Capital Works

Figure 21 - Capital Expenditure Ratio Comparison

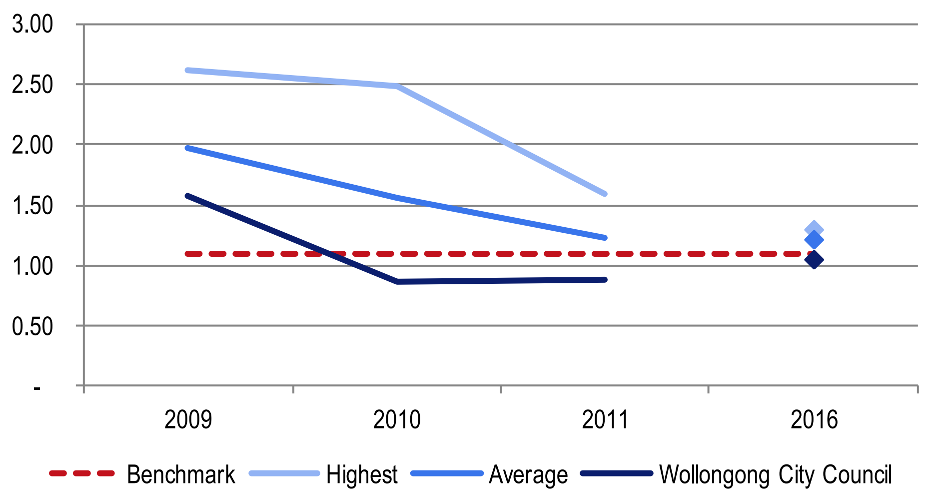


Figure 22 - Asset Maintenance Ratio Comparison

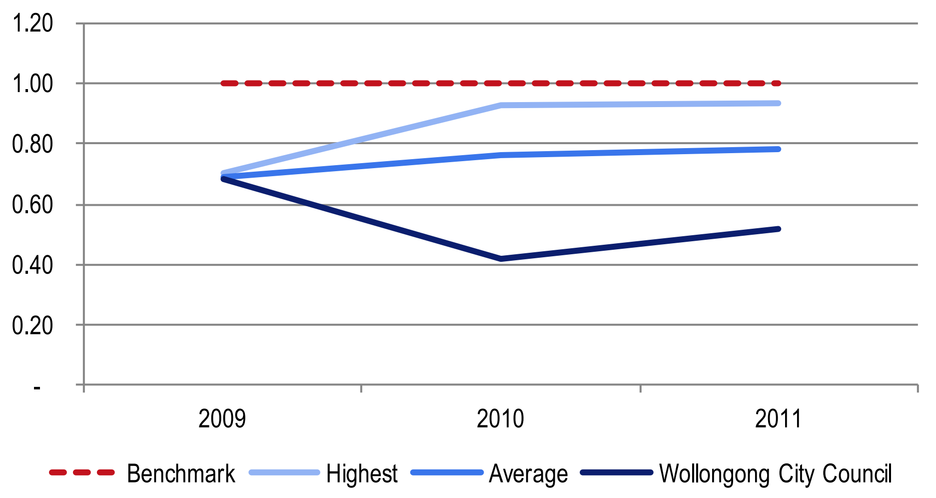


Figure 23- Infrastructure Backlog Ratio Comparison

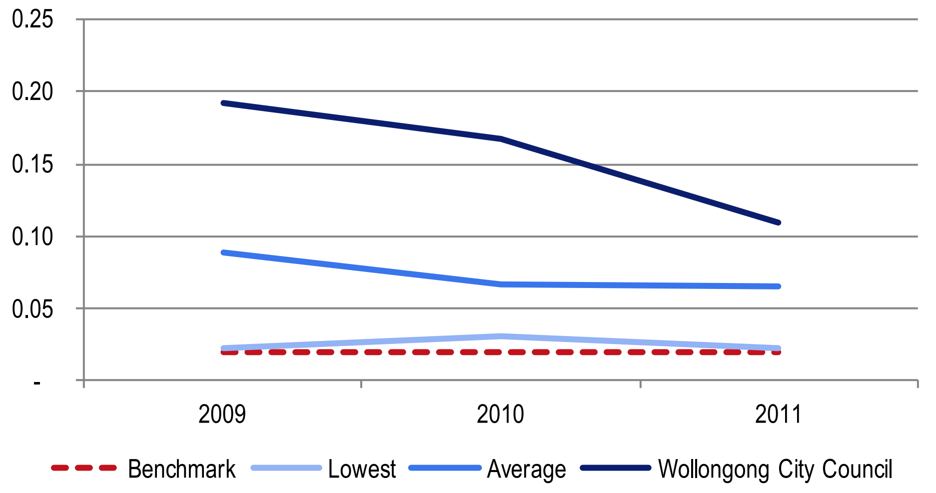
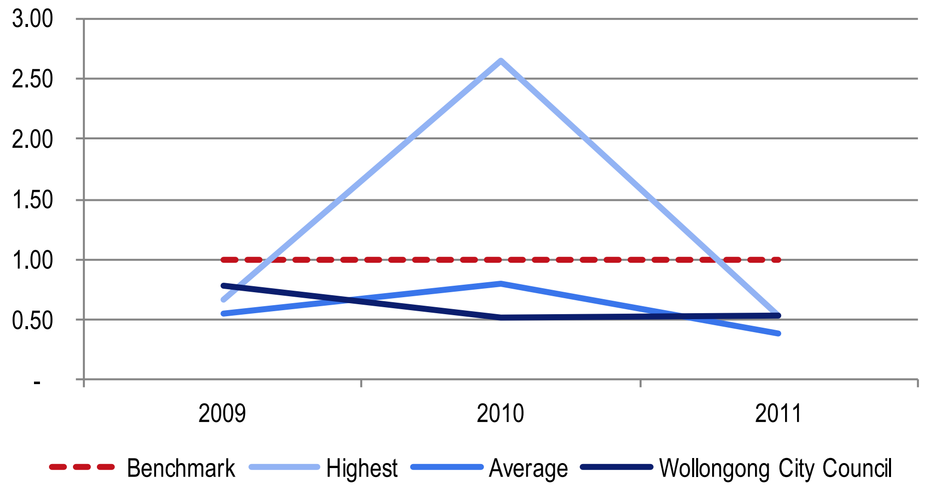


Figure 24 - Building and Infrastructure Asset Renewal Ratio



Overall, the Council's Infrastructure Backlog is higher than the group average. The Council's capital expenditure was below the group average in two of the last three years and the Asset Maintenance Ratio was below the group average and the benchmark.

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.

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

We base our recommendation on the following key points:

- Council has sufficient capacity to manage the additional $20.0m debt supported by a DSCR and Interest Cover Ratio above the benchmarks in all 10 years of its financial forecast. Based on its financial forecasts, Council also has the capacity to service additional debt of up to $85.9m, providing adequate reserves are in place
- Council has sufficient liquidity to manage their short term liabilities during the 10 year forecast period
- Council has maintained control of expenses in the past three years
- Council has a relatively low level of borrowings at $18.3m, only 0.8% of net assets

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

- Operating deficit results excluding capital grants and contributions are forecast over the entire forecast period. These operating deficit results improve to be close to the benchmark of negative 4% in the final year. 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 in future years
- Whilst depreciation is fully funded by sufficient capital expenditure in the first few years of the financial forecasts, it appears that for the remaining years of the forecast a much lower level of capital expenditure has been forecast. We would therefore recommend these figures be reviewed by Council and would recommend ongoing analysis to verify them in the future

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	138,239	130,741	121,872	5.7%	7.3%
User charges and fees	27,744	25,451	22,298	9.0%	14.1%
Interest and investment revenue	5,729	2,516	4,343	127.7%	(42.1%)
Grants and contributions for operating purposes	27,839	23,989	27,118	16.0%	(11.5%)
Other revenues	9,224	7,859	7,613	17.4%	3.2%
Total revenue	**208,775**	**190,556**	**183,244**	**9.6%**	**4.0%**
Employees	87,218	80,846	76,330	7.9%	5.9%
Borrowing costs	1,976	1,938	1,954	2.0%	(0.8%)
Materials and contract expenses	40,074	40,012	41,502	0.2%	(3.6%)
Depreciation and amortisation	59,469	57,060	45,331	4.2%	25.9%
Other expenses	28,362	27,329	25,143	3.8%	8.7%
Total expenses	**217,099**	**207,185**	**190,260**	**4.8%**	**8.9%**
Operating result	**(8,324)**	**(16,629)**	**(7,016)**	**49.9%**	**(137.0%)**

Table 2 - Items excluded from Income Statement

Excluded items ($'000s)			
	2011	2010	2009
Grants and contributions for capital purposes	61,405	12,437	12,644
Other income from entities using the equity method	141	0	0
Gain on recognition of interest-free loan	0	8,781	0
Interest applicable on interest-free loan	1,297	0	0
Amortisation of premiums/(discounts)	4	4	3
Increase (Decrease) in the fair value of investments	197	1,583	(2,230)
Increase/(decrease) in the fair value of investment properties	150	(113)	(1,138)
Net gain/(loss) on disposal of assets	(2,183)	209	(20)

Table 3 - Balance Sheet

Balance Sheet ($'000s)	Year Ended 30 June			% annual change	
	2011	2010	2009	2011	2010
Current assets					
Cash and equivalents	75,211	62,162	31,208	21.0%	99.2%
Investments	9,207	13,992	17,384	(34.2%)	(19.5%)
Receivables	16,743	13,013	15,430	28.7%	(15.7%)
Inventories	8,826	8,857	8,873	(0.4%)	(0.2%)
Other	1,026	1,353	1,549	(24.2%)	(12.7%)
Non-current assets classified as held for sale	0	0	2,329	N/A	(100.0%)
Total current assets	111,013	99,377	76,773	11.7%	29.4%
Non-current assets					
Receivables	3,316	3,031	3,449	9.4%	(12.1%)
Infrastructure, property, plant & equipment	2,238,391	2,048,850	1,571,394	9.3%	30.4%
Investments accounted for using the equity method	291	0	0	N/A	N/A
Investment property	3,725	3,575	3,688	4.2%	(3.1%)
Total non-current assets	2,245,723	2,055,456	1,578,531	9.3%	30.2%
Total assets	**2,356,736**	**2,154,833**	**1,655,304**	**9.4%**	**30.2%**
Current liabilities					
Payables	21,912	17,490	25,808	25.3%	(32.2%)
Borrowings	1,843	1,473	1,365	25.1%	7.9%
Provisions	33,545	31,611	29,359	6.1%	7.7%
Total current liabilities	57,300	50,574	56,532	13.3%	(10.5%)
Non-current liabilities					
Borrowings	16,504	17,051	1,249	(3.2%)	1265.2%
Provisions	40,289	37,875	35,622	6.4%	6.3%
Total non-current liabilities	56,793	54,926	36,871	3.4%	49.0%
Total liabilities	**114,093**	**105,500**	**93,403**	**8.1%**	**13.0%**
Net assets	**2,242,643**	**2,049,333**	**1,561,901**	**9.4%**	**31.2%**

Table 4-Cashflow

Cashflow Statement ($'000s)	Year ended 30 June		
	2011	**2010**	**2009**
Cashflows from operating activities	59,746	53,735	53,654
Cashflows from investing activities	(45,223)	(47,472)	(41,835)
Proceeds from borrowings and advances	0	26,050	0
Repayment of borrowings and advances	(1,474)	(1,359)	(1,489)
Cashflows from financing activities	(1,474)	24,691	(1,489)
Net increase/(decrease) in cash and equivalents	**13,049**	**30,954**	**10,330**
Cash and equivalents	75,211	62,162	31,208

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

New South Wales Treasury Corporation

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 assets (from Special Schedule 7)

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

Interest Cover Ratio

Benchmark = Greater than 4.0x

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

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

Operating Ratio

Benchmark = Better than negative 4%

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

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

Own Source Operating Revenue Ratio

Benchmark = Greater than 60%

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

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

Unrestricted Current Ratio

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

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

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