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Nambucca Shire Council

Financial Assessment and Benchmarking Report

12 March 2013

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

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Disclaimer

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

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

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

The report has been prepared for Nambucca Shire Council, the LIRS Assessment Panel and the DLG. TCorp shall not be liable to Nambucca 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 Nambucca 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 application for a timber bridge replacement program for $1.3m to be repaid over 10 years.

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. TCorp's review of the financial forecasts usually focuses on the particular Council fund that is undertaking the proposed debt commitment. Whilst Council operates a General Fund, Water Fund, and Sewer Fund Council has only prepared a consolidated LTFP and not separate LTFPs for each fund. Consequently our analysis is on the consolidated LTFP

The Council faces some significant financial challenges and recognises this in their Operational Plan. Council needs to work toward addressing some of the key challenges as set out in this report. Some Council activities appear to have been well managed over the review period but other areas need improvement based on the following observations:

- While Council has incurred operating deficits (excluding grants and contributions for capital purposes), Council's underlying operating results (measured using EBITDA) have improved marginally each year from $5.1m in 2009 to $7.2m in 2011
- Council's Unrestricted Current Ratio has been well above benchmark over the past three years indicating Council had an acceptable level of liquidity
- Council has been proactive in seeking additional income through the IPART SRV process

There are some concerns though:

- Own Source Operating Revenue Ratio has been below the benchmark each year indicating a lack of financial flexibility
- Employee expenses have been increasing at rates well above CPI over the past two years

Council's reported Infrastructure Backlog of $81.7m in 2011 represents 34.4% of its infrastructure asset value of $237.2m. Other observations include:

- The Council's Infrastructure Backlog appears to be on an upward trend, and of a large scale. However, Council has not completed its Asset Management Plans to a level that can provide a high degree of certainty as to the accuracy of the quoted numbers
- Council has been unable to fund the required asset maintenance or asset renewal amounts over the review period

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- A significant portion of the backlog (44%) is related to water and sewerage infrastructure which is an unusually high level for a rural council where roads are normally the predominant backlog area

The key observations from our review of Council's 10 year consolidated forecasts are:

- Council's financial forecast is in real dollars for recurrent items. Whilst not explicit, DLG's Integrated Planning and Reporting Manual states that Council's need to consider and make assumptions about the following areas: demographics of the LGA, economic forecasts, inflation forecasts, and interest rate movements amongst other matters. We would expect Council's approach to include the impacts of inflation.
- Council faces a major challenge to fully fund the renewal of its infrastructure assets
- Council while sustainable in the short to medium term, may be unsustainable in the longer term unless additional revenues can be sourced, further efficiencies found, and/or service levels reviewed

In our view, based on the LTFP submitted to TCorp, the Council has the capacity to undertake the additional borrowings of $1.3m for the LIRS project. This is based on the following analysis:

- The DSCR is near the benchmark of 2.00x in the short term in the 10 year forecast. However less than 35.0% of Council's total outstanding borrowings are attached to the General Fund, which is the Fund to which the LIRS borrowings will be attached
- Council could defer forecast capital expenditure and the related borrowings to enable repayment of the LIRS related loans in a stressed scenario
- Council is well aware of the financial difficulties it faces as its Operational Plan includes proposals to review service levels and assets to seek savings

In respect of the Benchmarking analysis TCorp has compared the Council's key ratios with other councils in DLG group 11. The key observations are:

- Council's financial flexibility as indicated by the Operating is below the group average
- Council's Own Source Operating Revenue Ratio is below average
- Council's DSCR and Interest Cover Ratio are below the group averages and around the benchmark. In the medium term Council's forecast credit ratios are expected to remain around the benchmarks
- Council was in a sufficient liquidity position which is expected to continue in the medium term as indicated by its Unrestricted Current Ratio
- Council's performance in terms of its Infrastructure Backlog Ratio has been weaker than the benchmark and group average. Council's Asset Maintenance Ratio is below the group average. Council's Building and Infrastructure Asset Renewal Ratio and Capital Expenditure Ratio have been in line with the group averages

Section 2 Introduction

2.1: Purpose of Report

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

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

The key areas focused on are:

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

2.2: Scope and Methodology

TCorp's approach was to:

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

In undertaking its work, TCorp relied on:

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

Benchmark Ratios

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

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

Therefore these benchmarks are intended as a guide to performance.

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

Ratio	Benchmark
Operating Ratio	> (4.0%)
Cash Expense Ratio	> 3.0 months
Unrestricted Current Ratio	> 1.50x
Own Source Operating Revenue Ratio	> 60.0%
Debt Service Cover Ratio (DSCR)	> 2.00x
Interest Cover Ratio	> 4.00x
Infrastructure Backlog Ratio	< 0.02x
Asset Maintenance Ratio	> 1.00x
Building and Infrastructure Asset Renewal Ratio	> 1.00x
Capital Expenditure Ratio	> 1.10x

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2.3: Overview of the Local Government Area

Nambucca Shire Council LGA	
Locality & Size	
Locality	Mid North Coast
Area	1,492 km²
DLG Group	11
Demographics	
Population	18,644
% under 20	23.6%
% between 20 and 59	43.7%
% over 60	32.7%
Expected population 2026	22,266
Operations	
Number of employees (FTE)	127
Annual revenue	$28.0m
Infrastructure	
Roads	595 km
Footpaths	38 km
Infrastructure Backlog value	$81.7m
Total infrastructure value	$237.2m

The Nambucca Shire Local Government Area (LGA) is located between Kempsey and Bellingen Shire Councils on the Mid North Coast of NSW, approximately 500km north of Sydney and 480km south of Brisbane.

The LGA has become a growing manufacturing centre in the State, particularly in the area of vehicle body parts. Other industries within the Shire include retail trade, health and community services, agriculture, forestry and fishing, education, construction, accommodation, cafes and restaurants. Emerging growth areas are macadamia processing, construction, oyster farming, steel frame construction and gravel extraction.

Council advised that it has joined with seven neighbouring councils to form the Mid North Coast Strategic Alliance to achieve economies of scale in its common business operations, as well as benefiting from information sharing. One example is the development of a common Information Technology Strategic Plan for all councils within this group. Council also has other arrangements with its two neighbouring councils at Bellingen and Kempsey where it currently shares a section 94 administration officer.

Like many other coastal LGAs, Council's population is growing.

2.4: LIRS Application

Council has made one LIRS application.

Project: Bridge Replacement Program

Description: Replacement of three timber bridges - Touts, Lavertys and Eungai Creek - which have exceeded their nominal design life.

Amount of loan facility: $1.3m

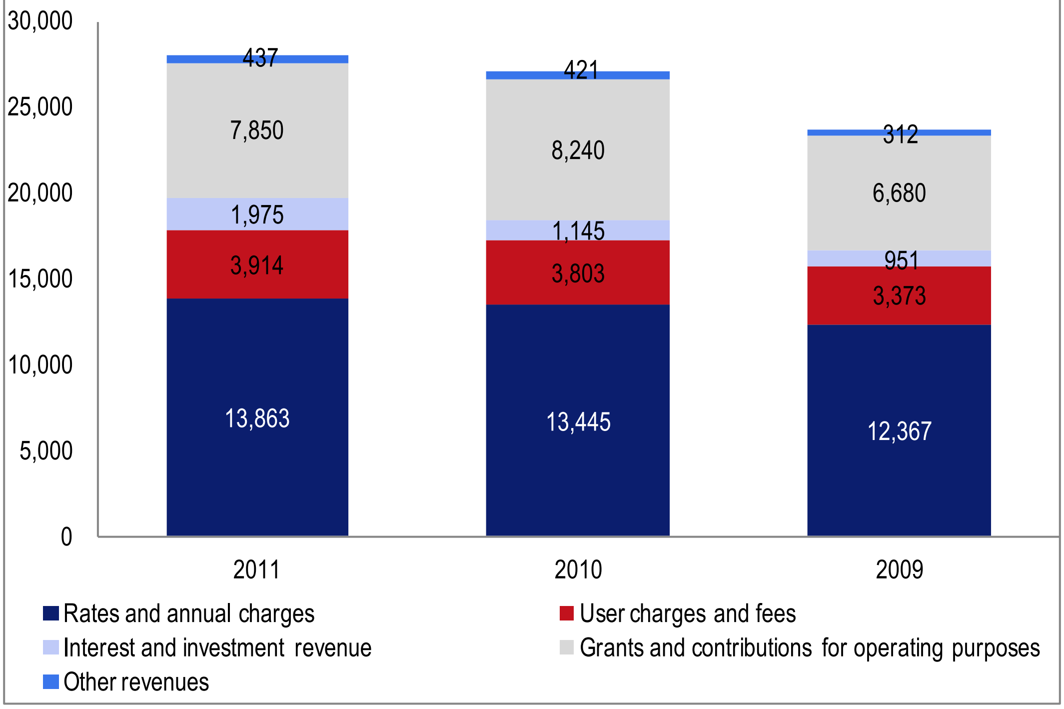
Term of loan facility: 10 years

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)



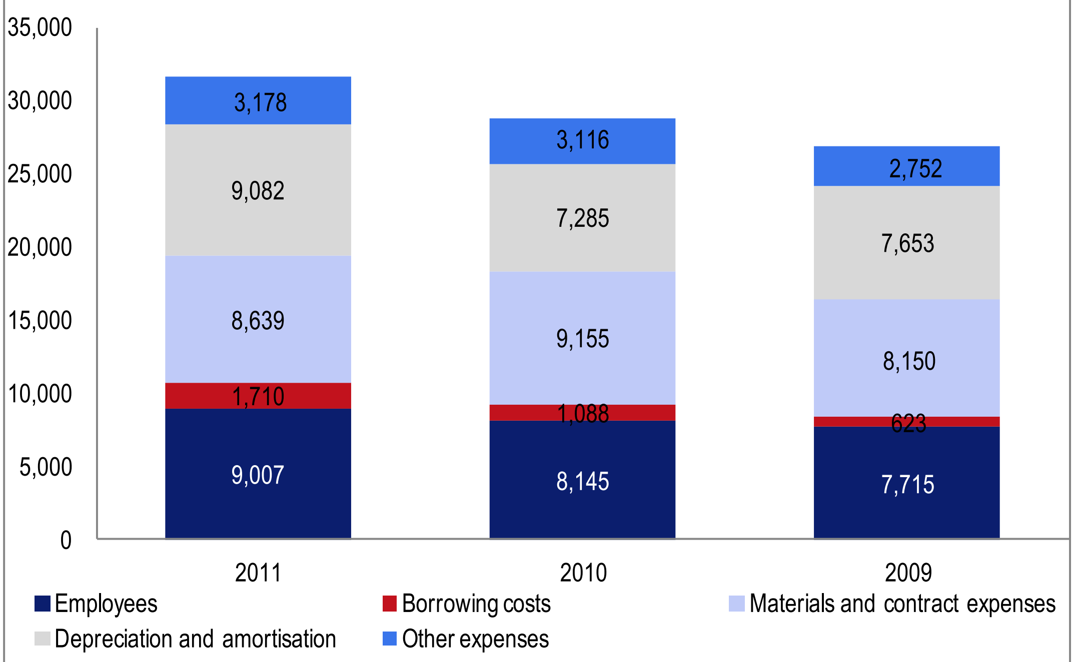
Key Observations

- Rates and annual charges increased by 8.7% in 2010 and a further 3.1% in 2011 to $13.9m. The increase in 2010 above the IPART approved rate peg was due to increases in waste management services revenue. This increased revenue has been offset by the introduction of the NSW waste levy.
- Council received approval from IPART for a SRV of 10.0% inclusive of the rate peg of 3.6% for 2013. This is a one off permanent SRV and will replace an existing environmental levy which was due to expire in 2012. IPART approved the SRV as Council demonstrated that it needed the funds for a program of environmental works including important flood related purposes, and a need for road and bridge works to maintain an adequate level of service in this area.
- User fees and charges were boosted in 2010 by a 15.9% increase in specific use domestic waste management services to $1.9m.

- Grants and contributions increased in 2010 and 2011 through RMS contributions totalling $2.6m and $2.1m respectively in response to the flood events in recent years which affected the LGA road network.

3.2: Expenses

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



Key Observations

- Employee expenses rose by 5.6% in 2010 and 10.6% in 2011 to $9.0m. Employee costs rose due to the number of staff increasing over the review period, award increases and pay scale adjustments.
- Materials and contracts expenses increased due to the flood events in 2010 and 2011. This is partly offset by the increase in operating grants and contributions.
- In 2010, the Asset Revaluations process increased the value of Council's infrastructure assets. This resulted in the annual depreciation charge increasing by 24.7% in 2011 to $9.1m.

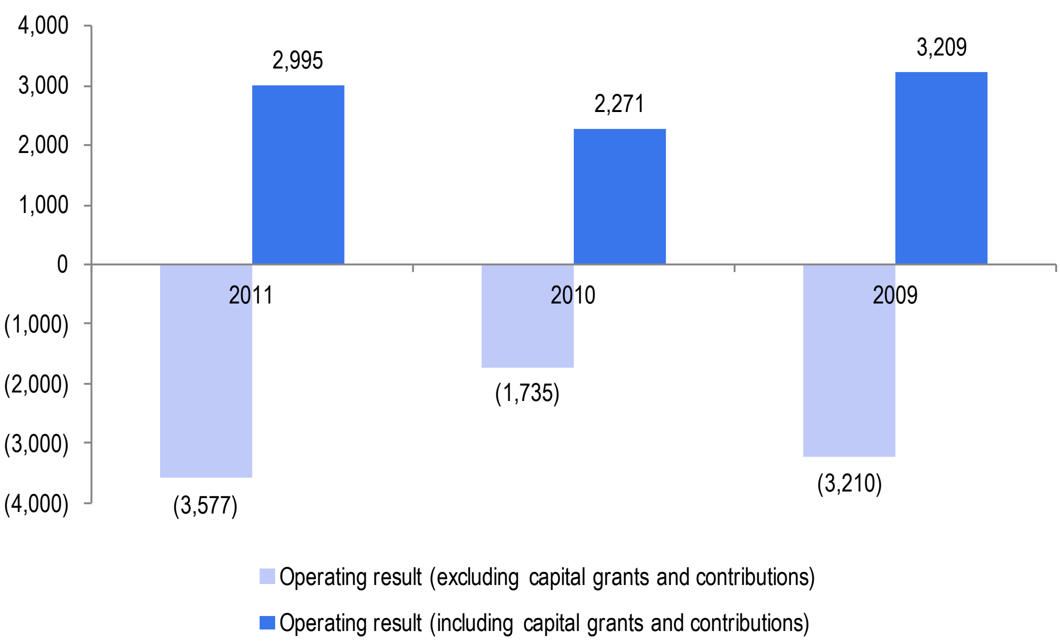
3.3: Operating Results

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

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

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

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



Key Observations

- Council's operating results excluding capital grants and contributions have been marginally declining principally due to higher depreciation charges, and increased costs due to flood damage.
- Council expenses include a non-cash depreciation expense, ($9.1m in 2011), which has increased 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, 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 ($'000s)	7,215	6,638	5,066
Operating Ratio	(12.8%)	(6.4%)	(13.6%)
Interest Cover Ratio	4.22x	6.10x	8.13x
Debt Service Cover Ratio	1.96x	3.86x	4.42x
Unrestricted Current Ratio	2.30x	3.93x	2.12x
Own Source Operating Revenue Ratio	51.4%	55.5%	52.3%
Cash Expense Ratio	0.5 months	0.0 months	1.9 months
Net Assets ($'000s)	314,833	295,399	275,338

Key Observations

- Council's EBITDA has marginally increased over the three year period.
- Council's Interest Cover Ratio and DSCR indicate that Council had flexibility in regard to carrying more debt. Both the DSCR and the Interest Cover ratio have been declining over the review period with the DSCR below benchmark in 2011. Council had $26.5m in outstanding borrowings in June 2011, being 8.3% of Net Assets.
- The Unrestricted Current Ratio has been near or above the benchmarks in all three years indicating liquidity is sufficient. Most cash is held in term deposits and not included in the calculation of the Cash Expense Ratio.
- The Own Source Operating Revenue Ratio has been below benchmark in all three years, reflecting Council's dependence on operating grants and contributions.
- Net Assets have increased by $39.5m between 2009 and 2011 due to the consecutive Asset Revaluations in 2010 and 2011, which increased the value of Council's infrastructure assets and community land.
- 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 an expanding Infrastructure, Property, Plant and Equipment (IPP&E) asset base with asset purchases being larger than the combined value of disposed assets and annual depreciation. Over the last three years this amounted to a $19.3m net increase in IPP&E.

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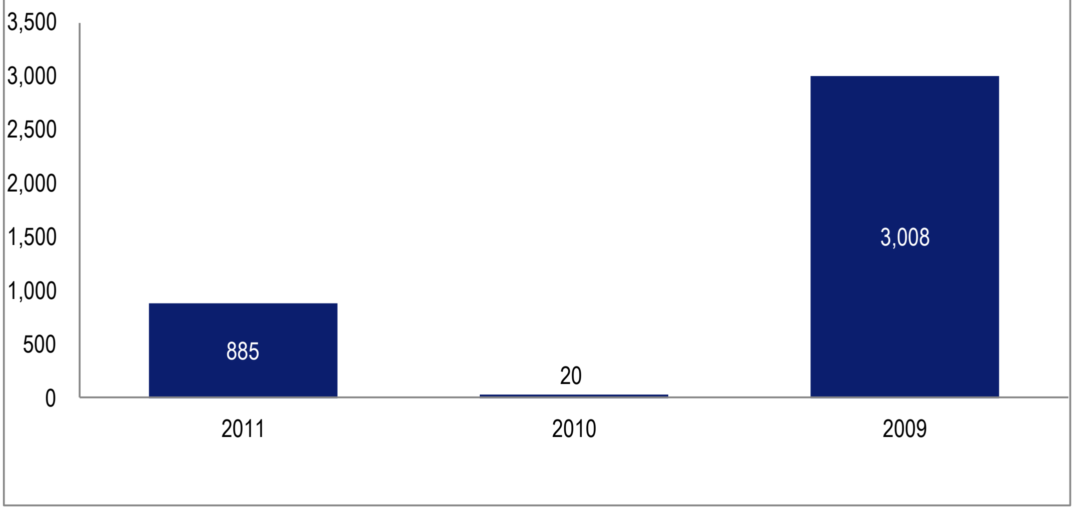
3.5: Statement of Cashflows

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



Key Observations

- Cash and cash equivalents have decreased over the review period, but total cash and investments have increased over the same period to $33.8m in 2011.
- The Unrestricted Current Ratio indicates Council had sufficient liquidity
- Council had $33.8m in total cash and investments in 2011 of which $0.9m was held in cash, and $26.5m in term deposits, $4.0m in managed funds, $1.0m in equity linked notes, $0.4m in constant proportion portfolio insurance (CPPI) notes, and $1.0m in TCorp products.
- In 2010 Council had less than $0.1m in cash yet had over $33.4m in long term deposits, and unrestricted cash of $1.7m
- Within the $33.8m in total cash and investments, $28.7m was externally restricted, $4.4m was internally restricted and $0.7m was unrestricted.
- Council aims to balance its liquidity position ensuring they have adequate funds to assist with unforseen emergency expenditure such as natural disaster claims and storm events, but also to ensure it allocates funds to address the Infrastructure Backlog.
- The CPPI notes matured and have been repaid by August 2012.

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)

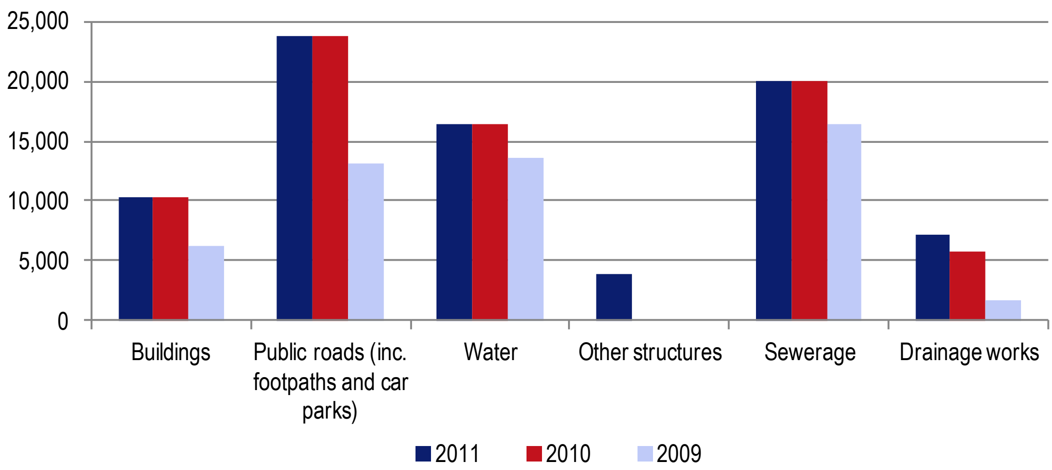
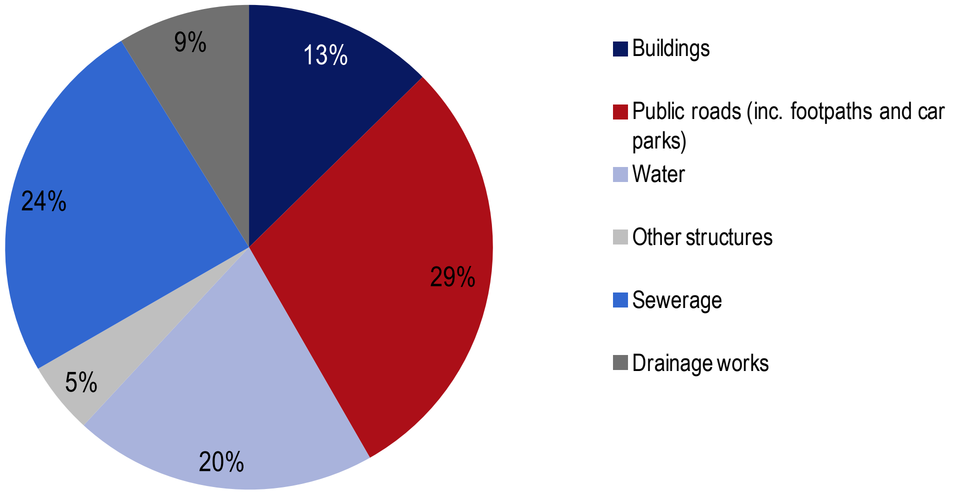


Figure 6 - Infrastructure Backlog Composition for 2010/11



The level of Infrastructure Backlog reported is the result of modelling using high level and reasonably generic assumptions based on typical engineering practice and anticipated community attitudes regarding levels of service expectations.

As Council progresses development of Asset Management Plans for infrastructure assets, more accurate models for forecasting the backlog will be developed. Council believes this may well reduce the Infrastructure Backlog valuation although it is possible the backlog valuation may increase.

In recent years Council have transferred assets to numerous local organisations and charities for nominal amounts. The "assets" referred to are community facilities and community land which have been transferred to "not for profit" or "charitable" organisations which had typically managed the asset on behalf of Council as a Section 355 Committee. In 2007, Council owned 21 community buildings and halls. In Bowraville alone the Council owned or were responsible for two halls, a pre-school, a museum, as well as a further three halls in the rural hinterland to the west of the town. In June 2007, the Council considered an extensive report on the age and condition of all of its building assets. The report recommended that Council look to opportunities to rationalise asset stock that no longer provides the intended service to the community taking into account on-going maintenance and compliance costs.

Council has subsequently transferred assets to community groups including the Bowraville Pioneer Community Centre, Macksville Showground, Short Street, Macksville, and the old Council works depot, Macksville.

The value of the assets transferred was:

- Bowraville Pioneer Community Centre – between $167,000 and $183,000
- Macksville Showground – No valuation was obtained
- Short Street, Macksville – Between $46,000 and $63,000
- Old Council Works Depot – Rateable value of $57,300

Of the transfers which have been undertaken or committed to, the transfer of the Pioneer Community Centre in Bowraville in 2010 saved approximately $0.1m on an upgrade to address fire safety problems and approximately $15,000 p.a. in maintenance costs. The transfer of the Macksville Showground and Saleyards will save Council approximately $0.1m p.a. for 10 years. There is also a financial risk with the Showground in relation to new regulatory requirements requiring capital investment and increased operating costs. The new owners of Short Street have agreed to upgrade drainage at a cost of $66,300. In summary, the assets disposed of so far will have little impact on Council's Infrastructure Backlog. However all of the initiatives have a significant impact on financing the renewal of Council's assets. Other measures identified by Council that may help it reduce its expenditure on infrastructure assets include:

- Reduce the service level of bridges, with bridges going from two lane to single lane where possible
- Reduce the number of public amenities managed by Council, and reduce the size of new amenities
- Transfer Council halls to incorporated committees, which would have ownership or trusteeship for their halls
- Transfer Senior Citizens Centres to incorporated committees
- Seek expressions of interest for the purchase of the Macksville Memorial Aquatic Centre at the end of the current lease
- Sell or lease the Visitor Information Centre and provide visitor information from Council's office

- Transfer pre-school buildings at Valla Beach and Eungai to their management committees
- Transfer parks and gardens to community groups where possible
- Transfer tennis clubs and other sporting clubs to their relevant committees
- Examine Council library operations and see if costs can be minimised through reduced hours or maintaining only one library.

In the community consultation undertaken for the Community Strategic Plan, the maintenance of the infrastructure and the Infrastructure Backlog is consistently identified as a priority by the community. The perceived key priority areas include sealed roads, estuary management, environmental monitoring, public toilets, stormwater drains and bridges. However capital expenditure on water infrastructure is Council's focus due to Council's Integrated Water Cycle Management Strategy (IWCM). The IWCM is a best practice strategic planning requirement from the Office of Water and predates the Community Strategic Plan. It is effectively an integrated 30 year capital works program for Council's management of the water cycle. Following an extended drought in 2001-2002 when the Nambucca Valley was within three weeks of exhausting all potable water, the Council initiated an options report for the augmentation of its water supply. This then became part of the IWCM which commenced in 2007 and completed in 2010. The IWCM is supported by a strategic business plan.

3.6(b): Infrastructure Status

Infrastructure Status	Year ended 30 June		
	2011	2010	2009
Bring to satisfactory standard ($'000s)	81,683	76,433	50,926
Required annual maintenance ($'000s)	8,661	8,399	7,951
Actual annual maintenance ($'000s)	4,568	4,329	6,949
Total value of infrastructure assets ($'000s)	237,163	230,585	217,614
Total assets ($'000s)	347,849	328,548	299,092
Building and Infrastructure Backlog Ratio	0.34x	0.33x	0.23x
Asset Maintenance Ratio	0.53x	0.52x	0.87x
Building and Infrastructure Renewals Ratio	0.84x	0.76x	0.60x
Capital Expenditure Ratio	2.11x	1.73x	1.48x

The value of the Infrastructure Backlog has increased at a higher rate than the value of the infrastructure assets. The Capital Expenditure Ratio has been above benchmark because of the construction of new assets such as the Nambucca Heads Sewerage Treatment Plant. The Building and Infrastructure Renewals Ratio and Asset Maintenance Ratio both indicate that Council has not been spending the required amounts on asset renewal and maintenance. A continuation of this level of spending will likely see an increase in the Infrastructure Backlog. While the Capital Expenditure Ratio would indicate that Council prioritised new assets ahead of asset renewal, the availability of grant funding influences Council's investment decisions.

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	12,320	10,152	N/A
Replacement/refurbishment of existing assets	7,956	4,706	N/A
Total	**20,276**	**14,858**	**N/A**

- 2012 saw the completion of Council's largest ever infrastructure contract, the upgrade of the Nambucca Heads Sewerage Treatment Plant at a cost of $19.0m. Council secured a 10 year interest free loan from the NSW local infrastructure fund for $12.8m to assist with this project. The overall capacity of the plant has been increased to cater for an extra 5,000 people.
- Another major project completed was the reopening of Deep Creek Bridge in August 2011. The demolition and construction of this new bridge was undertaken after extensive flood damage. The project cost $0.5m and was fully funded by Council.

Council recently decided to proceed with the Bowraville Off River Water Storage Project. This project was set up with the aim of providing a means for the LGA water supply to be secured against drought and is expected to cost $54.0m. The sources of funding for this project are:

- Country Towns Water and Sewerage Program (State) $14.8m
- National Water Security Program (Federal) $10.0m
- Reserves $14.7m
- Borrowing $14.5m

3.7: Specific Risks to Council

- Ensuring adequate water and sewerage services. Council has in place an Integrated Water Cycle Management Strategy. The total capital and renewal cost of the proposed strategy over the projected 40 year period is estimated to be $79.4m for water supply and $100.1m for sewerage. Council faces the challenge of funding these significant works and will need assistance from both the State and Federal Governments.
- Climate change. Council has a large sea frontage and rising sea levels will impact as well as potential increased storm and rainfall events. The proceeds from Council's SRV which replaced the environmental levy will aid flood mitigation.
- Natural disasters. The LGA has been declared a natural disaster area four times in the last three years. As a result Council have had to prioritise repair work at the expense of other projects which are deferred in Council's delivery program.
- Insurance liabilities. For periods of time between 1988 and 1993 Council were insured for public liabilities through HIH insurance. This group has since gone into liquidation. Council

may have to defend itself against public liability claims made throughout this period and settle any judgements.

- Asset Management Plans. Council has not completed its Asset Management Plans to a level sufficient to provide certainty as to the future financial obligations of Council. Council is working on these plans and once completed needs to build the funding requirements into its LTFP.

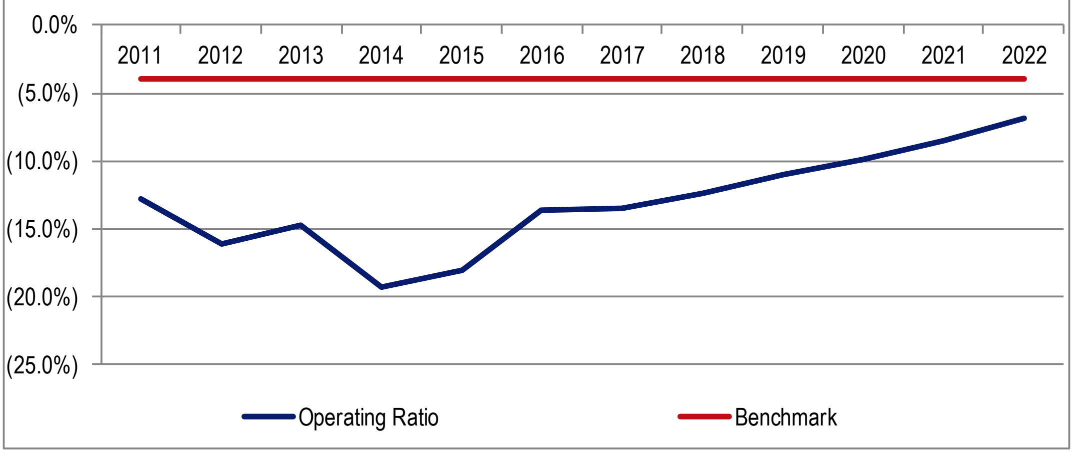
Section 4 Review of Financial Forecasts

The financial forecast model shows the projected financial statements and assumptions for the next 10 years. The model includes the $1.3m loan without any LIRS subsidy.

The LIRS loan relates to the General 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 usually more able to adjust the appropriate fees and charges to meet all future operating and investing expenses. As Council has not prepared its LTFP split into the various Funds we have based our analysis on the consolidated forecast.

4.1: Operating Results

Figure 7 - Operating Ratio



Council's operating performance is forecast to improve gradually from 2014 onwards as revenue such as rates increase by between 2.0% and 5.0% p.a. while employee expenses remain static. Council revenues are also boosted by the introduction of a permanent SRV in 2013 of 6.4% above the rate peg of 3.6%.

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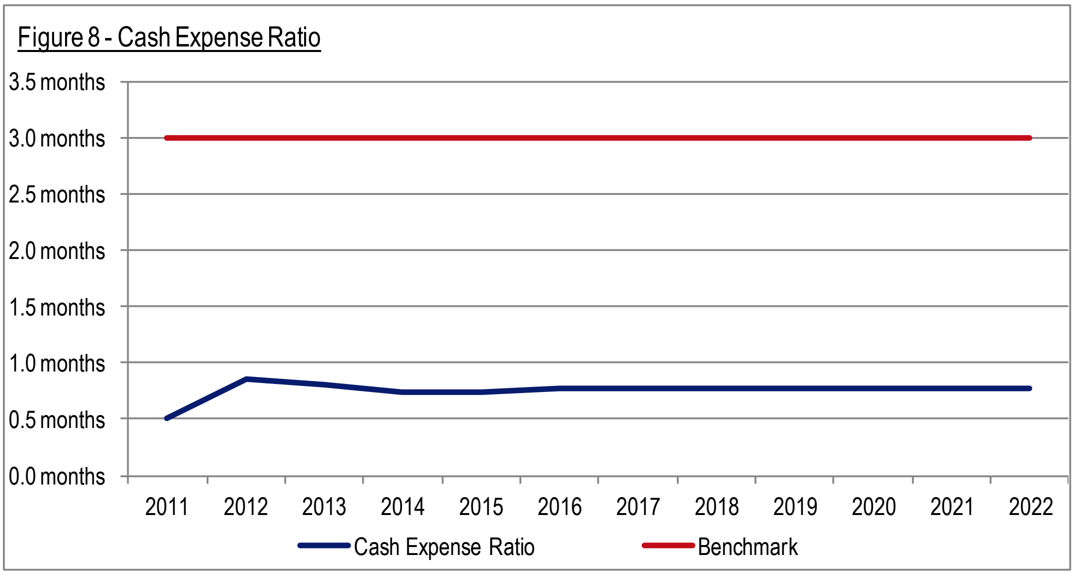
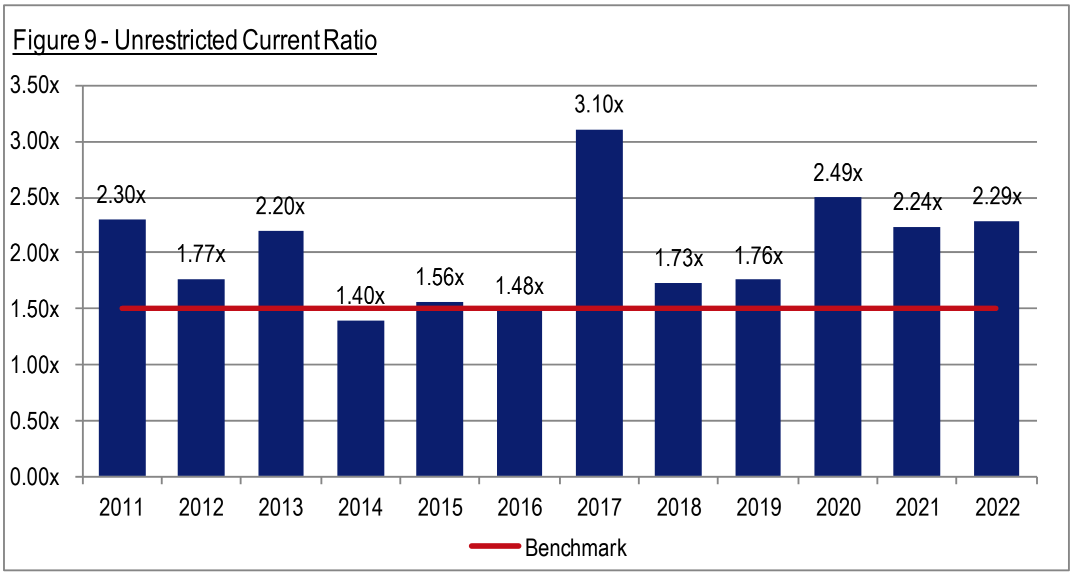
4.2: Financial Management Indicators

Liquidity Ratios



Council's Cash Expense Ratio is consistent with historic results. Total cash and investments fall to a low of $16.4m in 2014. The decrease in cash and investments is due to reserves being utilised for the water storage project. Cash and investments then rise gradually to $25.4m in 2022. Investments in 2011 consisted mainly of term deposits.



The Unrestricted Current Ratio remains near or above the benchmark each year of the forecast. This ratio indicates that Council will have sufficient liquidity to meet its short term obligations

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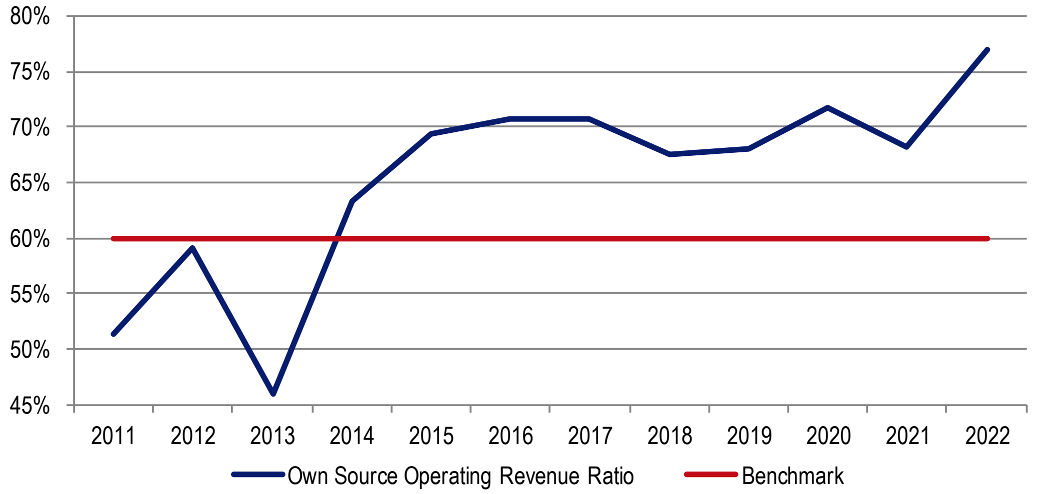
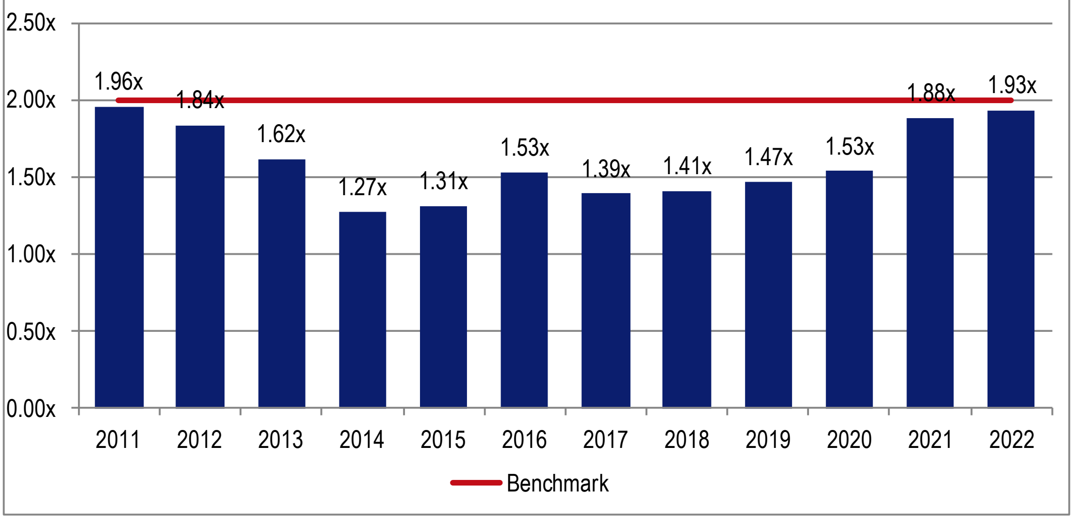
Fiscal Flexibility Ratios

Figure 10 - Own Source Operating Revenue Ratio



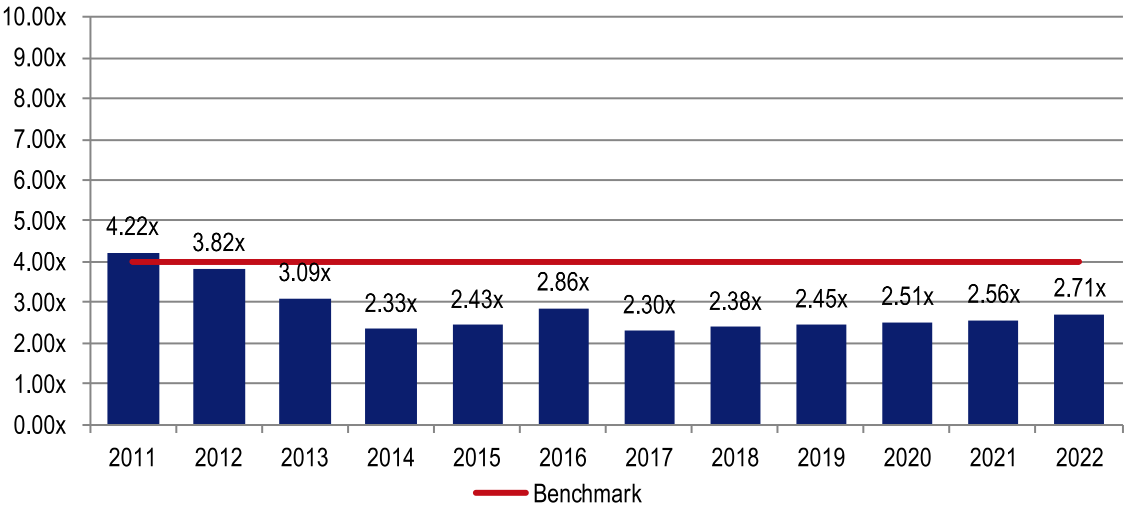
From 2015 onwards, capital grants are forecast to be significantly reduced. This skews the proportion of the Own Source Operating Revenue Ratio. The ratio is at the lowest point in 2013 due to higher than normal capital grants for the Bowraville Off River Water Storage project

Figure 11 - DSCR



Total borrowings outstanding increase from $26.2m in 2011 to $59.2m in 2022. The borrowings have increased to fund infrastructure projects such as timber bridge replacement which is to be partly funded through the LIRS scheme) and the $54.0m Bowraville Off River Water Storage Project. The ratio indicates Council have the capacity to undertake the borrowings relating to the LIRS projects and can defer further borrowings in the future if necessary such as borrowings proposed for the development of the Valla Beach and Scotts Head urban growth areas in 2017. The DSCR benchmark indicates that Council does not have the capacity to undertake further borrowings beyond what is already incorporated into the model in the medium term at least

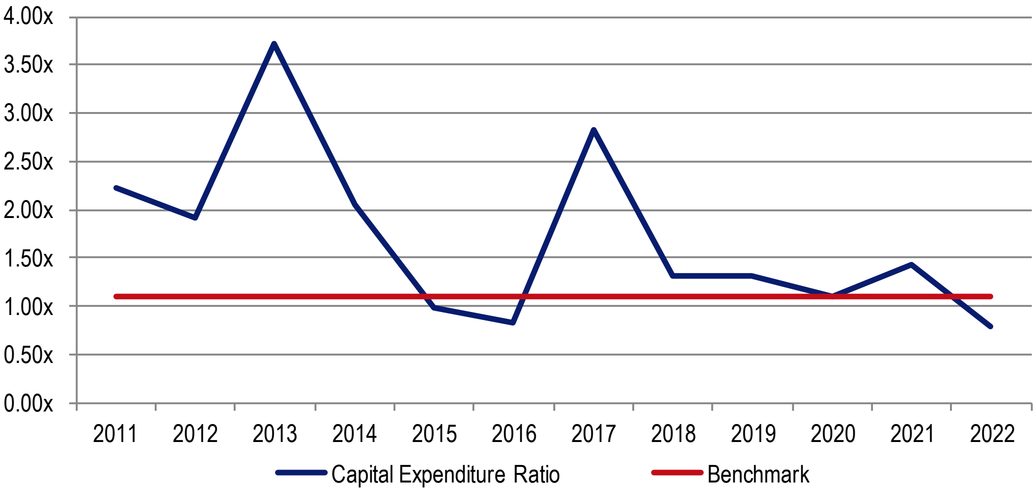
Figure 12 - Interest Cover Ratio



The Interest Cover Ratio, similar to the DSCR, shows the Council has limited capacity to service debt beyond the borrowings already incorporated into the LTFP including the LIRS borrowings.

4.3: Capital Expenditure

Figure 13 - Capital Expenditure Ratio



Council's capital expenditure program is weighted towards the first half of the forecast as Council has prepared a four year operational plan outlining capital expenditure. Water and sewage projects to ensure adequate water and sewerage services take priority. Council cannot self fund this level of capital expenditure and will need State and Federal assistance. If this assistance is not forthcoming it is likely that capital expenditure will be deferred.

Council's operational plan outlines how "*a balanced budget in 2013 is only achieved through not replacing staff, additional borrowings and the deferral of required capital expenditure. This is an unsustainable financial strategy*". Council does not borrow to fund operating costs.

Inadequate funding of depreciation of the infrastructure is a challenge for Council. If the problem is left unresolved, Council could be unable to provide physical access to properties if Council do not have the resources to adequately renew road and bridge assets

Capital expenditure peaks in 2013 due to work on the Bowraville Off Water Storage Project, and is forecast to spike again in 2017 due to development of the Valla Beach and Scotts Head urban growth areas. These areas have been earmarked for future development in Council's 20 year structure plan.

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 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>

- The LTFP has been prepared as a "business as usual" scenario with the exception of infrastructure spending which is based on Council's current asset management plans.
- In forecasting their results, Council have forecast all revenues and costs in real dollars.
- After the SRV in 2013, rates are annual charges are forecast to increase by 2.0% p.a. for the majority of the forecast in relation to growth in assessments and funding expenditure requirements in Waste Management, Water Supply and Sewerage Services
- From 2013 user fees and charges are forecast to increase by over 7.0% p.a. for three successive years. Increases in water usage, and domestic waste user charges are forecast to drive these increases.
- Council expect staffing numbers to remain static
- Materials and contracts costs peak in 2015 before gradually declining

- $2.0m and $4.0m in property revenue is predicted for 2015 and 2017 respectively in relation to land development work occurring in 2015 and 2016.
- Council's financial forecast is in real dollars for recurrent items. Whilst not explicit, DLG's Integrated Planning and Reporting Manual states that Council's need to consider and make assumptions about the following areas: demographics of the LGA, economic forecasts, inflation forecasts, and interest rate movements amongst other matters. We would expect Council's approach to include the impacts of inflation.
- The problem with presenting or analysing forecasts in real dollars is in situations where revenues and expenses are not increasing at the same or similar rates. For example, in the case of Council, in 2011 revenues increased by 3.6%, whilst expenses have increased by 9.8%. If this disparity in growth rates is projected over the 10 year financial forecast period, Council's financial results will be considerably worse than the position shown. This issue needs to be addressed by Council so that a clearer picture of Council's likely financial position can be seen.

4.5: Borrowing Capacity

When analysing the financial capacity of the Council we believe Council will not be able to undertake any additional loan funding in addition to the LIRS loan facilities and the borrowings already incorporated into the LTFP. Some comments and observations are:

- Based on a benchmark of DSCR>2.00x there is no further capacity to borrow
- TCorp would like to examine the LTFP currently in preparation for publication in 2013 before considering Council's capacity to undertake further borrowings

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

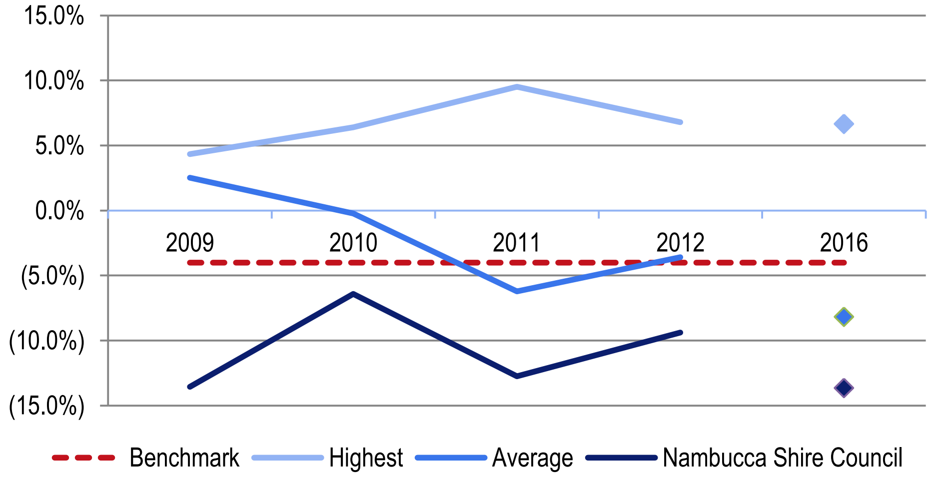
In Figure 14 to Figure 23, the graphs compare the historical performance of Council with the benchmark for that ratio, with the average for the Group, with the highest performance (or lowest performance in the case of the Infrastructure Backlog Ratio where a low ratio is an indicator of strong performance), and with the forecast position of the Council as at 2016 (as per Council's LTFP). Figures 21 to 23 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.

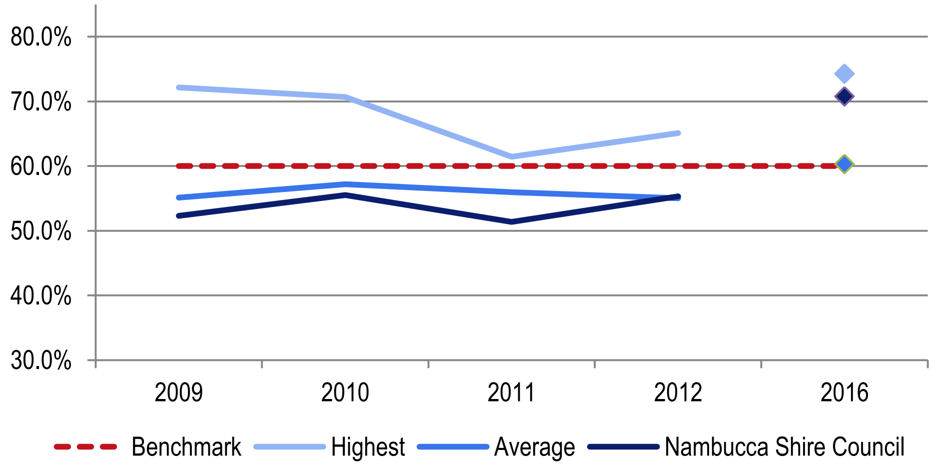
Financial Flexibility

Figure 14 - Operating Ratio Comparison



Council's Operating Ratio was below the group average and benchmark in the last four years. Consistent with other councils in the group, it experienced a decline in operating results in 2011 due to increased depreciation expense and an increase in 2012 due to the prepaid Financial Assistance Grant. The results are forecast to decline in the medium term and remain below the group average and benchmark.

Figure 15 - Own Source Operating Revenue Ratio Comparison



Council's Own Source Operating Revenue Ratio has improved to be in line with the group average in 2012 though it remains below the benchmark. The ratio is forecast to improve to be above the group average and benchmark in the medium term.

Liquidity

Figure 16 - Cash Expense Ratio Comparison

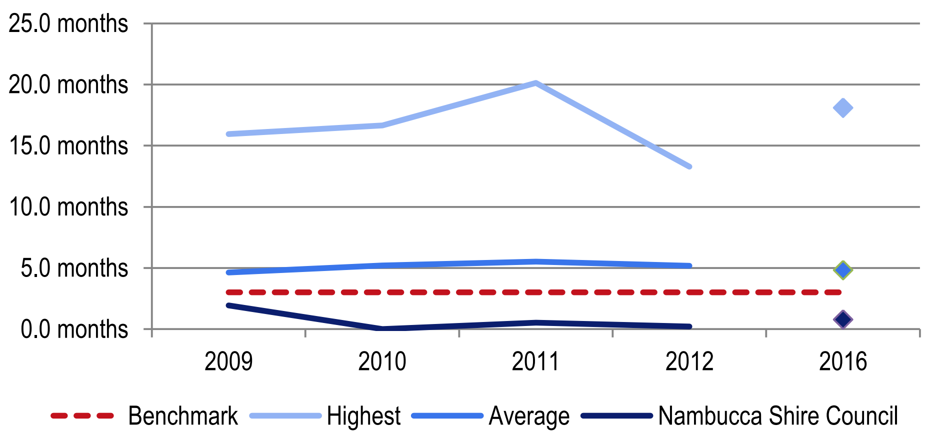
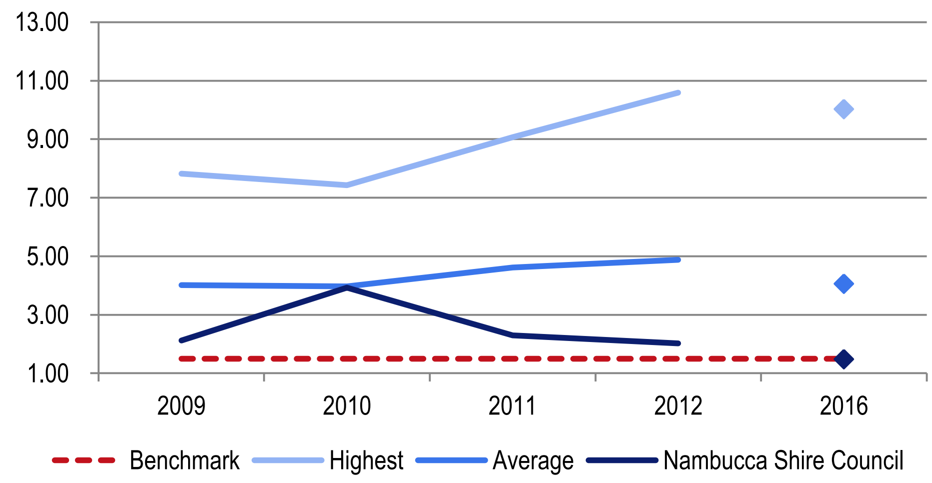


Figure 17 - Unrestricted Current Ratio Comparison



Both Council's Cash Expense Ratio and Unrestricted Current Ratio have been below the group average. On average over the past four years, the Council's liquidity position has been sufficient and this is forecast to continue in the medium term as indicated by the Unrestricted Current Ratio.

Debt Servicing

Figure 18 - Debt Service Cover Ratio Comparison

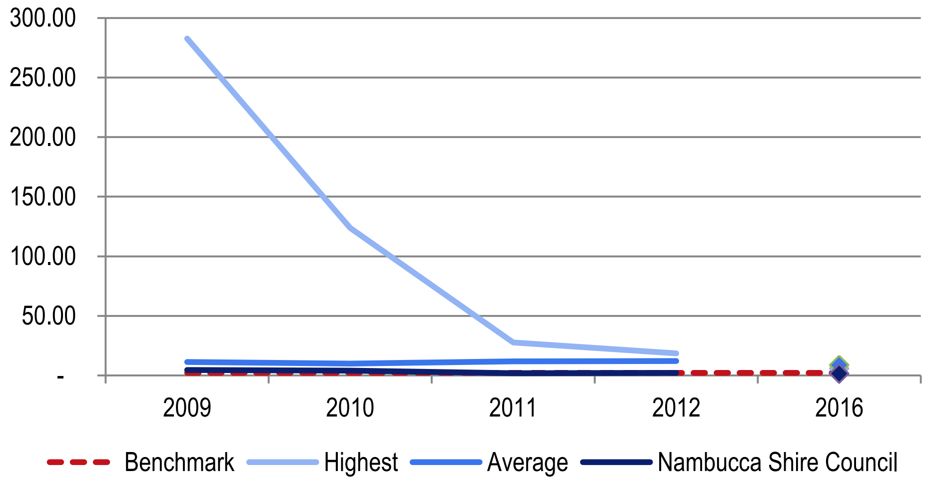
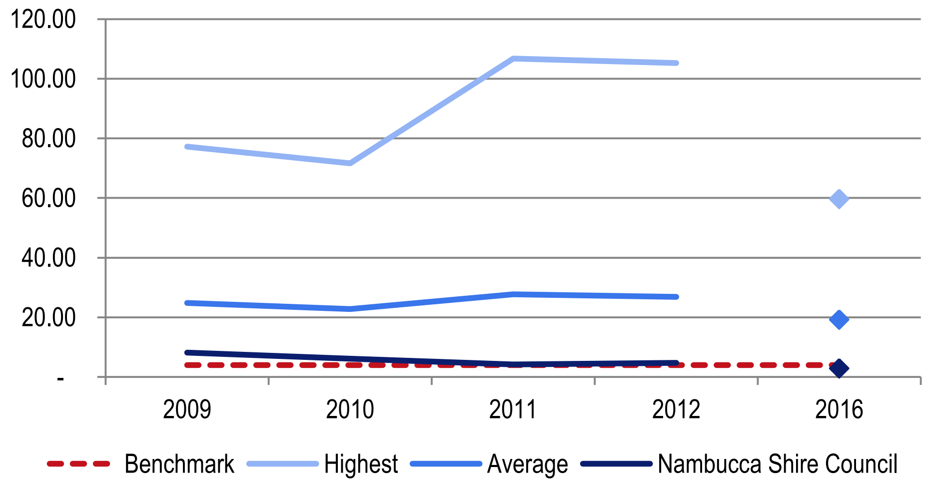


Figure 19 - Interest Cover Ratio Comparison



Over the review period, Council was on or around the benchmark DSCR and Interest Cover Ratio and these ratios are forecast to continue to be around the benchmarks in the medium term.

Asset Renewal and Capital Works

Figure 20 - Capital Expenditure Ratio Comparison

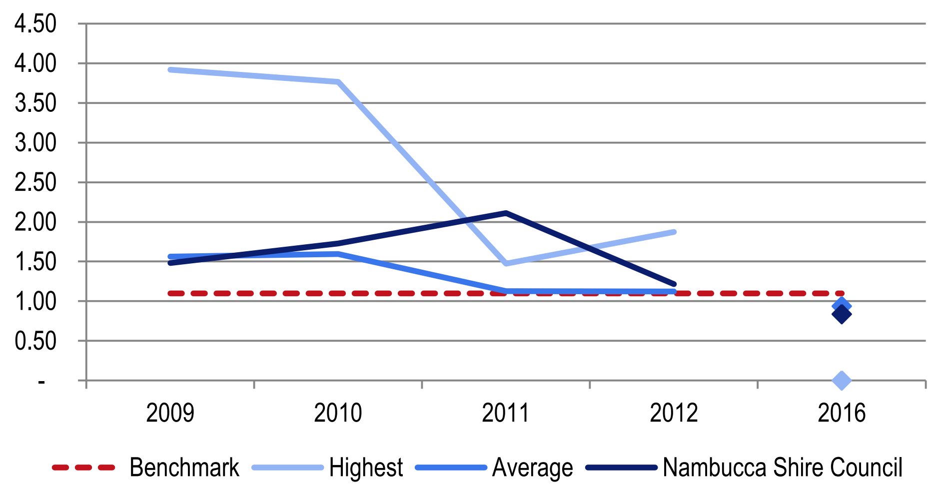


Figure 21 - Asset Maintenance Ratio Comparison

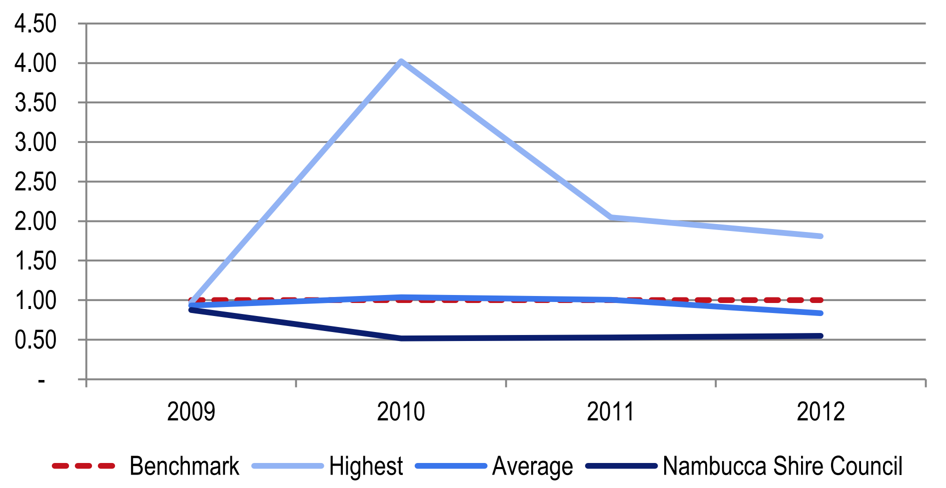


Figure 22 - Infrastructure Backlog Ratio Comparison

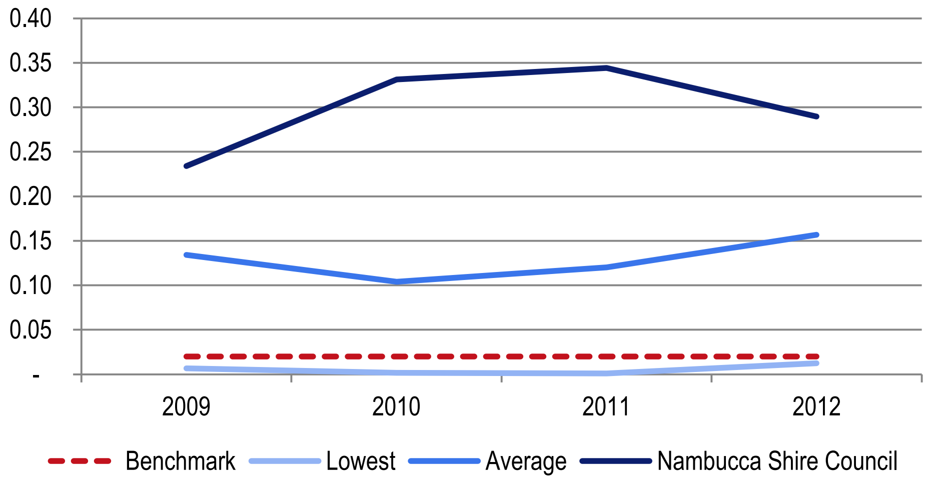
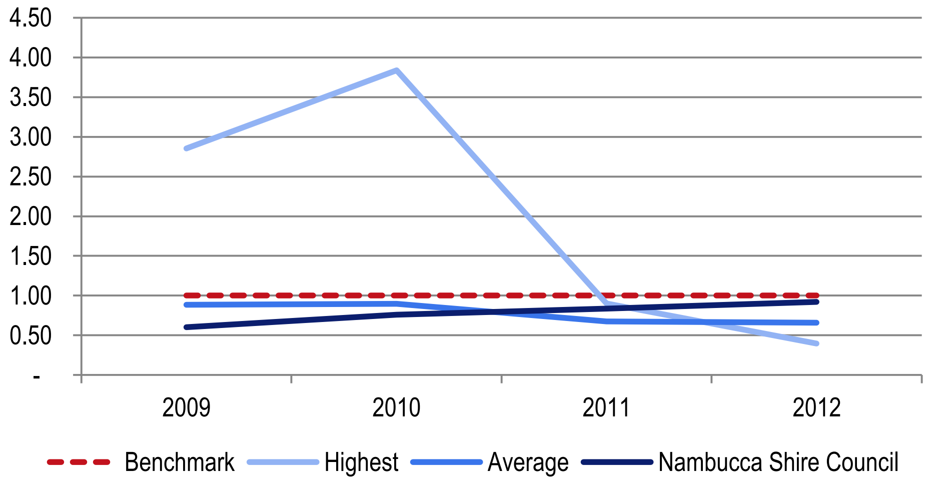


Figure 23 - Building and Infrastructure Asset Renewal Ratio



Overall, the Council has a higher Infrastructure Backlog Ratio than other councils in the group. It is below the group average and benchmark in terms of spending on asset maintenance. The Council's Capital Expenditure Ratio and Building and Infrastructure Asset Renewal Ratio were around the group averages over the review 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 an adequate financial position.

We base our recommendation on the following key points:

- While Council has incurred operating deficits (excluding grants and contributions for capital purposes), Council's underlying operating results (measured using EBITDA) have marginally improved each year from $5.1m in 2009 to $7.2m in 2011
- Council's Unrestricted Current Ratio has been well above benchmark the past three years indicating Council had sufficient liquidity
- Council has the financial capacity to service the LIRS related loan
- In a stressed scenario Council would be able to defer capital expenditure projects such as the Valla Beach and Scotts Head urban growth areas, which is to be funded through borrowings of $16.5m in 2017

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

- Own Source Operating Revenue Ratio has been below the benchmark each year indicating a lack of financial flexibility. Council should continue to explore additional revenue generating opportunities
- Council has indicated that they believe that inadequate funding of infrastructure such as roads and bridge assets could lead to it failing in its core function of providing physical access to all properties. Council have the difficult task of balancing sufficient liquidity, with spending as much as possible on an already considerable Infrastructure Backlog. We believe that Council should, in the short term, focus on developing strategies to resolve this long term forecast position
- Council is currently preparing an integrated LTFP and Asset Management Plan for 2013. TCorp would need to examine these plans and the 2012 audited accounts before recommending if Council can undertake any additional borrowings beyond those currently forecast.

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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	13,863	13,445	12,367	3.1%	8.7%
User charges and fees	3,914	3,803	3,373	2.9%	12.7%
Interest and investment revenue	1,975	1,145	951	72.5%	20.4%
Grants and contributions for operating purposes	7,850	8,240	6,680	(4.7%)	23.4%
Other revenues	437	421	312	3.8%	34.9%
Total revenue	**28,039**	**27,054**	**23,683**	**3.6%**	**14.2%**
Expenses					
Employees	9,007	8,145	7,715	10.6%	5.6%
Borrowing costs	1,710	1,088	623	57.2%	74.6%
Materials and contract expenses	8,639	9,155	8,150	(5.6%)	12.3%
Depreciation and amortisation	9,082	7,285	7,653	24.7%	(4.8%)
Other expenses	3,178	3,116	2,752	2.0%	13.2%
Total expenses	**31,616**	**28,789**	**26,893**	**9.8%**	**7.1%**
Operating result (excluding capital grants and contributions)	**(3,577)**	**(1,735)**	**(3,210)**	**(106.2%)**	**46.0%**
Operating result (including capital grants and contributions)	**2,995**	**2,271**	**3,209**	**31.9%**	**(29.2%)**

Table 2 - Items excluded from Income Statement

Excluded items ($'000s)			
	2011	2010	2009
Grants and contributions for capital purposes	6,572	4,006	6,419
Interest revenue/ (losses)	498	945	(854)
Interest free loan received	0	3,366	0
Net gain/ (loss) from the disposal of assets	(612)	(2,065)	(1,629)

Table 3 - Balance Sheet

Balance Sheet ($'000s)	Year Ended 30 June			% annual change	
	2011	2010	2009	2011	2010
Current assets					
Cash and cash equivalents	885	20	3,008	4325.0%	(99.3%)
Investments	32,886	40,879	28,079	(19.6%)	45.6%
Receivables	3,654	3,808	3,388	(4.0%)	12.4%
Inventories	924	889	772	3.9%	15.2%
Other	354	354	306	0.0%	15.7%
Total current assets	38,703	45,950	35,553	(15.8%)	29.2%
Non-current assets					
Receivables	0	166	173	(100.0%)	(4.0%)
Inventories	41	41	23	0.0%	78.3%
Infrastructure, property, plant & equipment	309,105	282,391	263,343	9.5%	7.2%
Total non-current assets	309,146	282,598	263,539	9.4%	7.2%
Total assets	**347,849**	**328,548**	**299,092**	**5.9%**	**9.8%**
Current liabilities					
Payables	2,071	1,901	2,558	8.9%	(25.7%)
Borrowings	1,984	1,980	1,821	0.2%	8.7%
Provisions	3,323	3,273	3,049	1.5%	7.3%
Total current liabilities	7,378	7,154	7,428	3.1%	(3.7%)
Non-current liabilities					
Borrowings	24,260	24,716	13,923	(1.8%)	77.5%
Payables	615	497	540	23.7%	(8.0%)
Provisions	763	782	1,863	(2.4%)	(58.0%)
Total non-current liabilities	25,638	25,995	16,326	(1.4%)	59.2%
Total liabilities	**33,016**	**33,149**	**23,754**	**(0.4%)**	**39.6%**
Net Assets	**314,833**	**295,399**	**275,338**	**6.6%**	**7.3%**

Table 4-Cashflow

Cash Flow Statement ($'000s)	Year ended 30 June		
	2011	**2010**	**2009**
Cash flows from operating activities	10,956	8,801	7,448
Cash flows from investing activities	(9,086)	(25,966)	(14,273)
Proceeds from borrowings and advances	975	15,998	8,305
Repayment of borrowings and advances	(1,980)	(630)	(524)
Cash flows from financing activities	(1,005)	15,368	7,781
Net increase/(decrease) in cash and equivalents	**865**	**(1,797)**	**956**
Cash and equivalents	885	20	3,008

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Appendix B Glossary

Asset Revaluations

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

Collateralised Debt Obligation (CDO)

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

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

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

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

Division of Local Government (DLG)

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

Depreciation of Infrastructure Assets

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

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

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

EBITDA

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

Grants and Contributions for Capital Purposes

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

Grants and Contributions for Operating Purposes

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

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

Independent Commission Against Corruption (ICAC)

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

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

Independent Pricing and Regulatory Tribunal (IPART)

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

Infrastructure Backlog

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

Integrated Planning and Reporting (IP&R) Framework

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

Local Government Cost Index (LGCI)

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

Net Assets

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

Roads and Maritime Services (RMS)

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

Section 64 Contribution

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

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

Section 94 Contribution

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

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

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

Special Rate Variation (SRV)

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

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

The applications are reviewed and approved by IPART.

Ratio Explanations

Asset Maintenance Ratio

Benchmark = Greater than 1.0x

Ratio = actual asset maintenance / required asset maintenance

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

Building and Infrastructure Renewals Ratio

Benchmark = Greater than 1.0x

Ratio = Asset renewals / depreciation of building and infrastructure assets

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

Cash Expense Cover Ratio

Benchmark = Greater than 3.0 months

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

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

Capital Expenditure Ratio

Benchmark = Greater than 1.1x

Ratio = annual capital expenditure / annual depreciation

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

Debt Service Cover Ratio (DSCR)

Benchmark = Greater than 2.0x

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

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

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Building and Infrastructure Backlog Ratio

Benchmark = Less than 0.02x

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