Canterbury City Council

Financial Assessment and Benchmarking Report

12 March 2013

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.

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The report has been prepared for Canterbury City Council, the LIRS Assessment Panel and the DLG. TCorp shall not be liable to Canterbury 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 Canterbury 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 LIRS application for the Earlwood Town Centre Revitalisation for $1.8m to be repaid over three years. TCorp's approach has been to:

- Review the most recent four 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.

Historically, the Council has been adequately managed over the review period but TCorp has some concerns over some areas 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) improved marginally each year from $6.0m in 2009 to $8.6m in 2012
- Council's Unrestricted Current Ratio has been near or above benchmark the past four years indicating Council had sufficient liquidity
- Despite the introduction of a SRV to aid infrastructure renewal the Infrastructure Backlog is on an upward trend and Council's forecast liquidity position will not allow for increased asset renewal expenditure
- Council's community consultation process has shown that maintenance of local roads and footpaths are ranked by residents as some of the most important services provided by Council. Despite the increasing backlog, and the feedback from the community, Council has prioritised expenditure such as $9.0m on an indoor sports centre which is operating at a deficit.
- Council's investments assets include $4.0m of CDO assets, and $7.0m of Capital Protected Notes held at face value on which they expect full recovery. Council's expectation of full recovery of the face value of the CDOs is not shared by their auditors or the credit rating agencies. TCorp considers that a more conservative approach from Council to valuing these assets would better enable prudent financial planning

Council's reported Infrastructure Backlog of $81.0m in 2011 represents 13.4% of its infrastructure asset value of $602.5m. Other observations include:

- Council's Infrastructure Backlog is on an upward trend, and Council has been unable to fund the required asset maintenance or asset renewal amounts over the review period
- A significant portion of the backlog (63.1%) is related to roads

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

- Council is forecast to consistently record increasing operating deficits
- While the forecast capital expenditure is sufficient to meet the cost of asset renewals, this level of expenditure is unlikely to occur as Council will not be able to maintain sufficient liquidity. It is likely capital expenditure projects will be deferred due to liquidity constraints
- Council's LTFP includes a plan to apply for a SRV to be introduced in 2014 of at least 5.0% above the rate peg. This would enable greater asset renewal.

In our view, the Council has the capacity to undertake the combined additional borrowings of $1.8m for the LIRS project. This is based on the following analysis:

- The DSCR remains above the benchmark of 2.00x over the three year term of the loan
- The Interest Cover Ratio is well above the benchmark of 4.00x over the three year term of the loan

In respect of the Benchmarking analysis TCorp has compared the Council's key ratios with other councils in DLG group 3. The key observations are:

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

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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 four 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 2011/12)
- Council's financial forecast model
- Council's IP&R documents
- Discussions with Council officers
- Council's submissions to the DLG as part of their LIRS application
- Other publicly available information such as information published on the IPART website

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Benchmark Ratios

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

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

Therefore these benchmarks are intended as a guide to performance.

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

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

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2.3: Overview of the Local Government Area

Canterbury City Council LGA	
Locality & Size	
Locality	Sydney Surrounds
Area	33.4 km²
DLG Group	3
Demographics	
Population as at 2011	137,454
% under 20	25.9%
% between 18 and 59	55.9%
% over 60	18.2%
Expected population 2036	163,657
Operations	
Number of employees (FTE)	531
Annual revenue	$93.0m
Infrastructure	
Roads	325 km
Footpaths	490 km
Infrastructure backlog value	$81.0m
Total infrastructure value	$602.5m

Canterbury City Council Local Government Area (LGA) is located 17 kilometres southwest of Sydney with 18 suburbs covering nearly 33.4 square kilometres. The community is socially, ethnically and culturally diverse with over 43.4% born in non-English speaking countries.

Council maintains 27 sports grounds, two aquatic centres, 95 play grounds, 217 passive open spaces, 114 drainage reserves and four bushland reserves.

Over the past five years, the LGA's population has increased at an average annual rate of 1.3%, marginally higher than the regional average. The population growth rate peaked in 2008, during which the population grew by 2.1% over one year. The LGA's population growth is projected to grow at an average annual rate of 0.5% over the next 20 years, the same as that of the southern Sydney region.

2.4: LIRS Application

Council has made one LIRS application.

Project: Earlwood Town Centre Revitalisation

Description: The program comprises a revitalisation of the Earlwood Town Centre public domain. It will replace ageing footways and infrastructure with new base, new pavers and incorporate landscaping, street furniture and other public amenity improvements.

Amount of loan facility: $1.8m

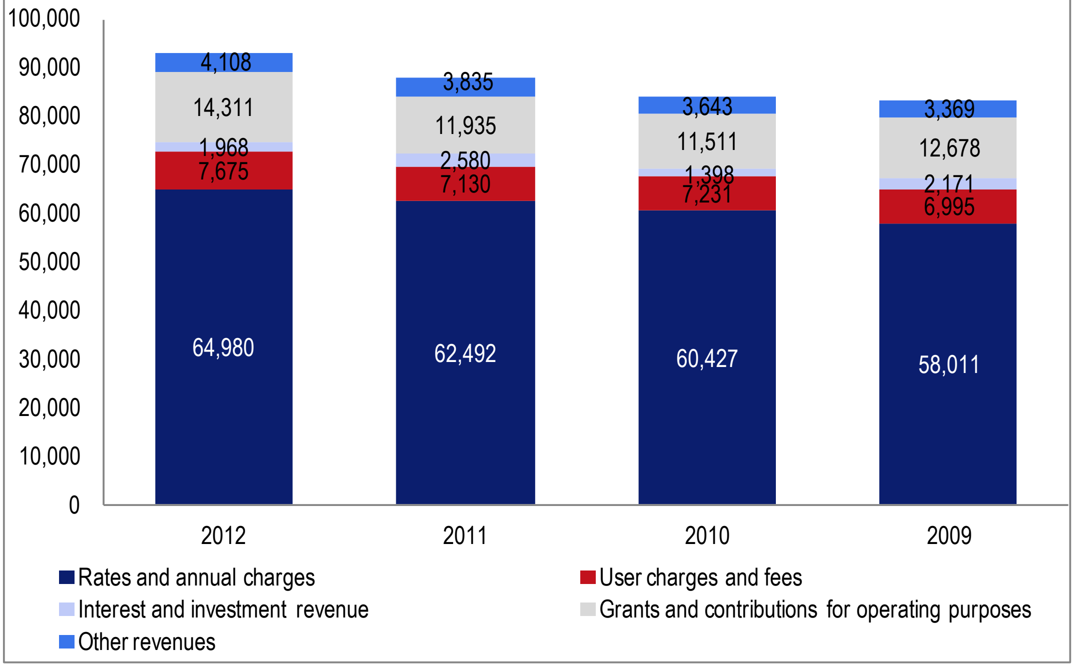
Term of loan facility: Three years

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 2011/12 ($'000s)



Key Observations

- Rates and annual charges have been rising in line with the IPART approved rate peg over the review period. Council revenues have been boosted by the introduction of a 15 year SRV of 7.5% in 2004 to fund infrastructure renewal.
- Council's two aquatic centres generated over $2.3m in revenue in each of the last two years but operated at a net cost to Council of $2.0m in 2012.
- Other revenues consist mainly of rental revenue and parking fines.

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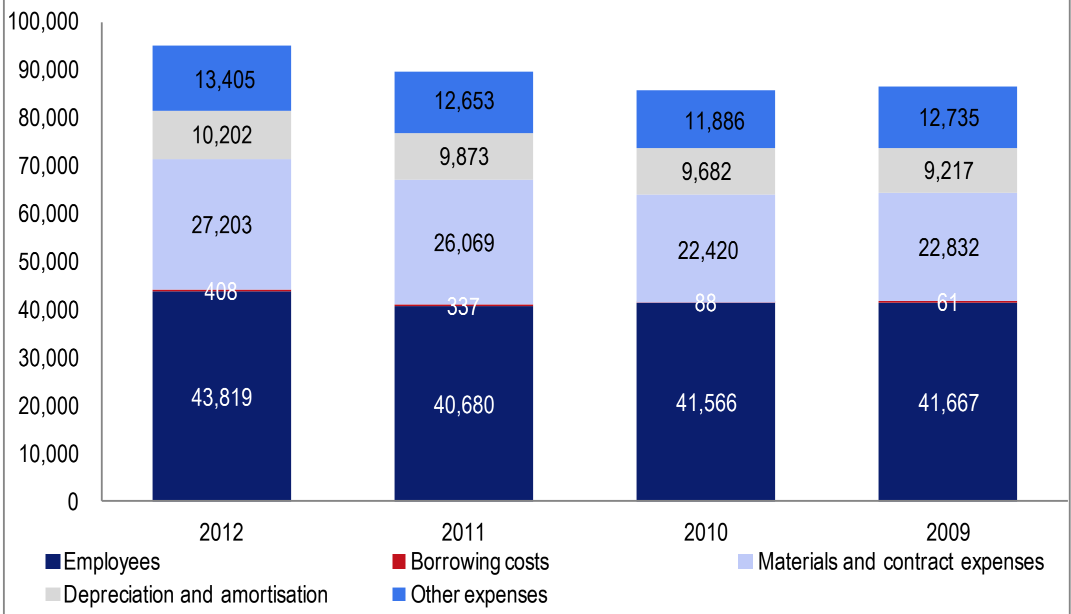
3.2: Expenses

Figure 2 - Expenses for 2008/09 to 2011/12 ($'000s)



Key Observations

- Full time equivalent employee numbers decreased from 550 to 531 over the review period, while employee expenses increased by 7.7% to $43.8m in 2012.
- Materials and contract expenses increased by 16.3% in 2011 and 4.3% in 2012 to $27.2m in aided by waste disposal costs increasing to $13.2m in 2012.
- Despite the Asset Revaluations process increasing the value of Council's infrastructure assets, the depreciation expense has remained relatively consistent due to a review of the useful life of the assets.
- Other expenses include street lighting which increased by 29.0% over the review period to $1.9m due to increased energy prices.

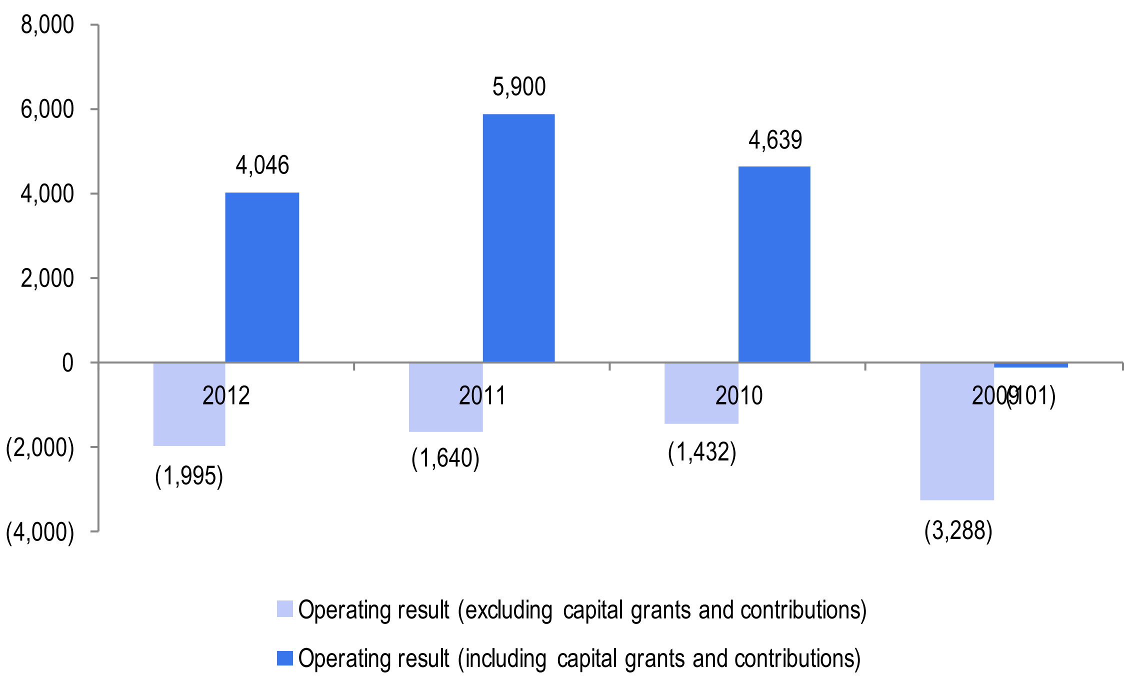
3.3: Operating Results

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 2011/12 ($'000s)



Key Observations

- Council's operating deficit has reduced since 2009 as revenues increased and expenditure on items such as employee costs did not increase at the same rate.
- Council expenses include a non-cash depreciation expense, ($10.2m in 2012). Whilst the non cash nature of depreciation can favourably impact on ratios such as EBITDA that focus on cash, depreciation is an important expense as it represents the allocation of the value of an asset over its useful life.

3.4: Financial Management Indicators

Performance Indicators	Year ended 30 June			
	2012	2011	2010	2009
EBITDA ($'000s)	8,615	8,570	8,338	5,990
Operating Ratio	(2.1%)	(1.9%)	(1.7%)	(4.0%)
Interest Cover Ratio	21.12x	25.43x	94.75x	98.20x
Debt Service Cover Ratio	7.32x	9.09x	22.84x	21.24x
Unrestricted Current Ratio	2.09x	1.88x	1.52x	1.46x
Own Source Operating Revenue Ratio	73.3%	72.9%	74.9%	75.2%
Cash Expense Ratio	1.8 months	1.6 months	3.8 months	2.7 months
Net Assets ($'000s)	828,133	823,914	759,057	489,768

Key Observations

- Council's EBITDA increased over the four year period. Council's Interest Cover Ratio and DSCR indicate that they had flexibility in regard to carrying more debt. Both ratios have been above their benchmarks over the past three years.
- The Unrestricted Current Ratio has been above the benchmark of 1.50x over the past three years. The Cash Expense Ratio has decreased below the benchmark in 2011, and corresponds with increased capital expenditure and a shift of funds from short term deposits to long term deposits which are not captured in the Cash Expense Ratio.
- Net Assets have increased by over $338.4m between 2009 and 2012 due to the consecutive Asset Revaluations in 2010 and 2011 that increased the value of roads, bridges, footpaths, drainage assets, and community land assets. Despite these substantial revaluations, depreciation expense has not increased materially as Council has reviewed and extended the useful life of some of its assets.
- The Asset Revaluations over the last four years have resulted in a high level of volatility in Net Assets over this period. Consequently, in the short term the value of Net Assets is not necessarily an informative indicator of performance. In the medium to long term however, this is a key indicator of a Council's capacity to add value to its operations. Over time, Net Assets should increase at least in line with inflation plus an allowance for increased population and/or improved or increased services. Declining Net Assets is a key indicator of the Council's assets not being able to sustain the ongoing operations of a Council.
- When 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 three years this amounted to a $36.5m increase in IPP&E assets.
- Council had total borrowings of $8.2m in 2011, being less than 1.0% of Net Assets.

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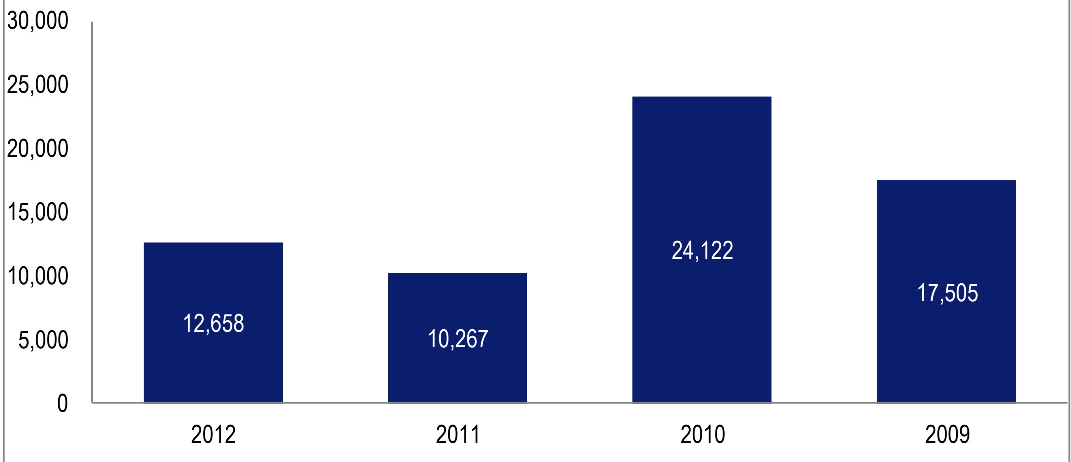
3.5: Statement of Cashflows

Figure 4 - Cash and Cash Equivalents for 2008/09 to 2011/12 ($'000s)



Key Observations

- In total, the Council had cash and investments of $47.7m ($12.7m in cash and equivalents) in 2012, down from $49.0m in 2009.
- Within total cash and investments $29.5m is externally restricted, $16.1m is internally restricted and $2.1m is unrestricted.
- As at 30 September 2012, Council had $52.5m in total cash and investments. Included are $4.0m in CDO assets, $7.0m of Capital Protected Notes, and $2.0m in floating rate notes and the balance of $39.5m in cash and long term deposits.
- $1.0m of floating rates notes, $1.5m of CDOs, and all $7.0m of the Capital Protected Notes were not earning any investment revenue. Council have decided to hold these investments until maturity. Council has advised that they expect full recovery of all their investments including the face value of both the CDOs and the Capital Protected Notes.
- Council's auditors issued a qualified audit opinion in each year over the review period due to their inability to obtain sufficient evidence to satisfy themselves of the value and recoverability of Council's CDO assets. $2.5m of Council's CDO assets are rated between CC and CCC-. This rating is described by the ratings agencies as vulnerable and dependent on favourable economic conditions to meet its commitments. Council's expectation of full recovery of the face value of the CDO assets is not shared by either their auditors or the credit rating agencies.

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 2011/12($'000s)

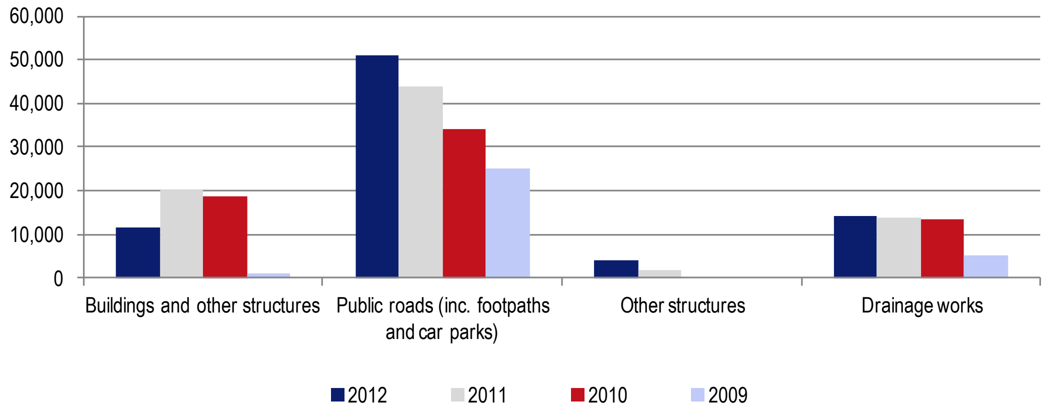
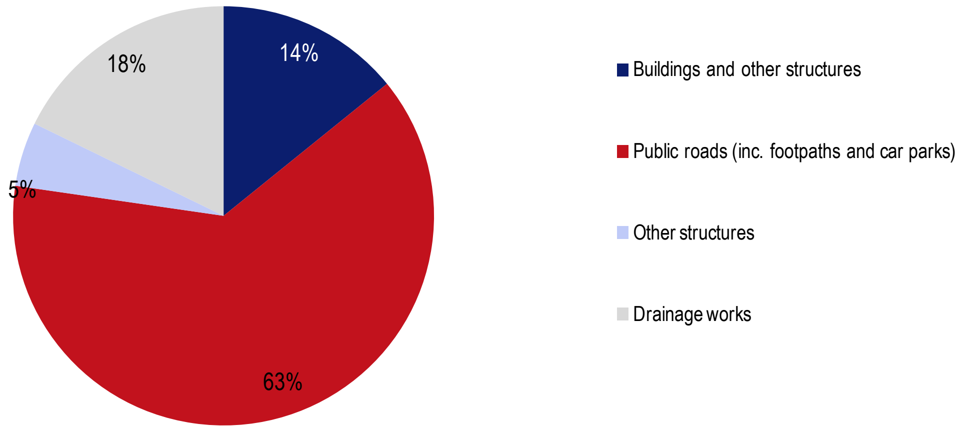


Figure 6 - Infrastructure Backlog Composition for 2011/12



The Infrastructure Backlog is 63.1% road related. This is an unusually high level of roads related backlog for an urban council and the backlog is trending higher each year. Council's backlog of Buildings and Stormwater assets has increased significantly following the refinement of their asset management plans in 2009.

3.6(b): Infrastructure Status

Infrastructure Status	Year ended 30 June			
	2012	**2011**	**2010**	**2009**
Bring to satisfactory standard ($'000s)	81,029	79,650	65,937	31,471
Required annual maintenance ($'000s)	19,932	12,647	9,809	6,648
Actual annual maintenance ($'000s)	3,622	2,689	3,783	8,076
Total value of infrastructure assets ($'000s)	602,452	600,505	587,641	318,842
Total assets ($'000s)	868,799	858,758	795,981	521,750
Building and Infrastructure Backlog Ratio	0.13x	0.13x	0.11x	0.10x
Asset Maintenance Ratio	0.18x	0.21x	0.39x	1.21x
Building and Infrastructure Renewals Ratio	0.98x	0.71x	0.72x	1.13x
Capital Expenditure Ratio	1.89x	2.21x	1.54x	2.15x

Council has refined their data and valuation methodology since 2009 causing the value of the Infrastructure Backlog to increase significantly. The increase is a result of improved data collection and the impact of the Asset Revaluations on the infrastructure assets. The increase in the annual maintenance costs are also a direct result of refining the data, methodology and cost information.

Since 2010 Council has not been spending sufficient amounts on asset maintenance and asset renewals. If this trend continues it is likely that the Infrastructure Backlog may increase.

A 2010 community survey identified "maintenance of local roads" as the second most important service that Council provides, and with the largest gap between importance and satisfaction. As part of this survey residents were also asked what would make life better in the LGA in the future and "better maintained roads" was the second most mentioned item.

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			
	2012	**2011**	**2010**	**2009**
New capital works	5,754	9,457	3,300	5,300
Replacement/refurbishment of existing assets	9,088	12,130	11,800	15,600
Total	**14,842**	**21,587**	**15,100**	**20,900**

Examples of capital expenditure in recent years include:

- $2.8m raised through the SRV was spent on the renewal of roads, footpaths, and town centres in 2011.

- Construction was completed in 2011 on the new $9.0m Morris Iemma Indoor Sports Centre. The centre gained 1,000 members in the first three months of operation. The centre was funded by Council and is operated under a lease agreement with the YMCA Sydney. The centre was fully funded from Government Grants and developer contributions. The centre had a deficit in 2011 of $0.2m in its first year of operation.. While the centre is on Council's balance sheet, all revenue and expenses are borne by the management company, and profits will be shared with Council. Any operating losses are borne by the YMCA.
- In 2011 work commenced on stage one of the $8.5m redevelopment of Belmore Sports Ground. Funding came from a variety of sources, with nearly $5.0m from the Federal Government, more than $2.5m from the State government and $1.0m from the Canterbury Bulldogs Rugby Club and the Council.
- Since 2004 Council has worked on transforming the Riverwood Wetlands from an old and underused paddock into a recreational area for all residents. The area now contains new cycle/ pedestrian paths, a children's playground, barbecue facilities, landscaping and a picnic area.

3.7: Specific Risks to Council

- Service demands. Council believes a key challenge is providing increasing levels of services or commencing new services without the corresponding increases in operating revenues. Council's delivery program outlines a number of activities that Council is engaging in to meet the diversity of peoples' needs as the population expands, such as a language aide program, disabilities access inspections, and Families NSW meeting support.
- Ageing population. Similarly to the rest of NSW, the LGA is forecast to have a growing population of senior citizens. This will increase demand for facilities for seniors. Council already provides five senior citizens centres, and reviewed and updated its senior citizens centres policy in December 2011.
- Investment Portfolio. As at September 2012 Council held $2.0m of floating rates notes, $7.0m of Capital Protected Notes and $4.0m of CDOs. Council's auditors were unable to obtain sufficient evidence to satisfy themselves to the recoverability of the face value of the assets and issued a qualified audit opinion each year over the review period. The impact of the global financial crisis on these investments has resulted in much of these assets no longer earning any investment revenue. A review of these investments in February 2012 reconfirmed Council's "hold-to-maturity" strategy. If Council were not to receive the full face value of these investments at their maturity it would affect Council's liquidity and ability to invest in asset renewal.

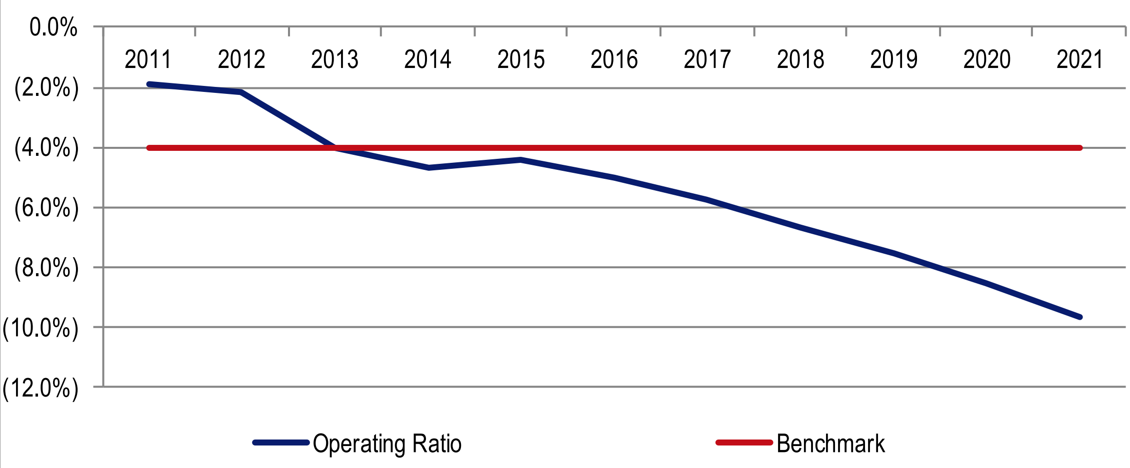
Section 4 Review of Financial Forecasts

The financial forecast model shows the projected financial statements and assumptions for the next 10 years. The model includes the $1.8m loan without any LIRS subsidy.

Council operates a General Fund only.

4.1: Operating Results

Figure 7 - Operating Ratio for General Fund

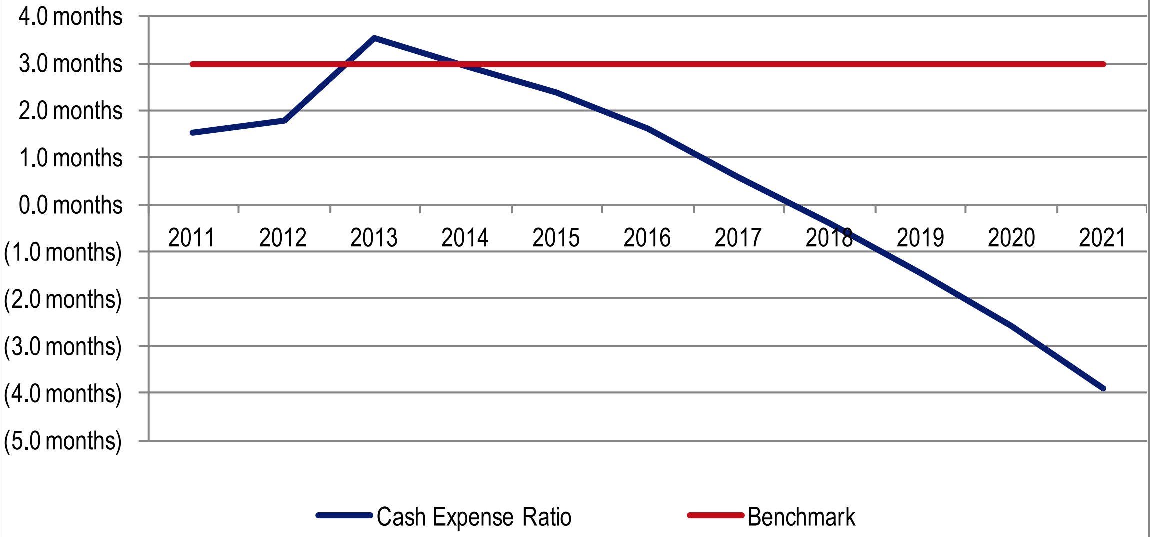


Council consistently reports operating deficits excluding capital grants and contributions below the benchmark from 2014 onwards. The deficit gets progressively larger due to expenses such as materials and contracts, and employees, increasing at a higher rate than revenue.

4.2: Financial Management Indicators

Liquidity Ratios

Figure 8 - Cash Expense Ratio for General Fund



This ratio indicates Council will have liquidity issues from the medium term. This ratio is already below benchmark, and if this trend continues Council may have to reduce expenses and review the provision of some services.

However this ratio does not take into account Council's level of investments. When investments are considered, this shows that Council will not actually face liquidity issues until 2021 when the Cash Expense Ratio will fall below the benchmark. By that point Council feels that in reality their deficit issues will have been addressed as Council will not allow itself to get to this illiquid stage. However, a large part of the current investments are in CDOs and Capital Protected Notes which may not be recoverable in full at maturity. Strategies to improve its liquidity position need to be considered in the short term to address the forthcoming liquidity issues and to allow for the situation where the investments may not be recovered.

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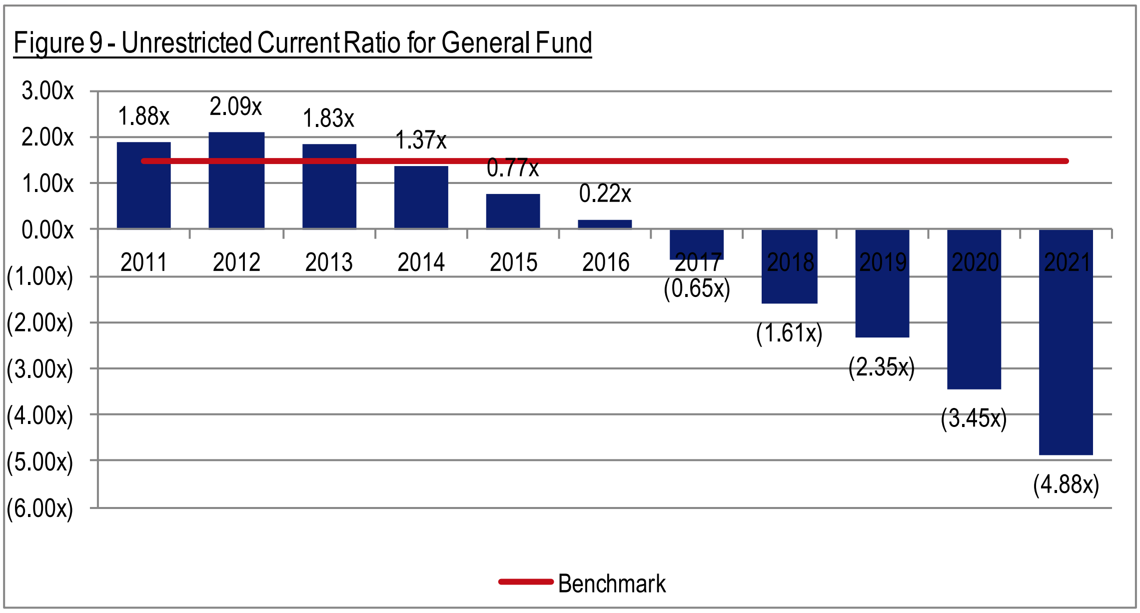
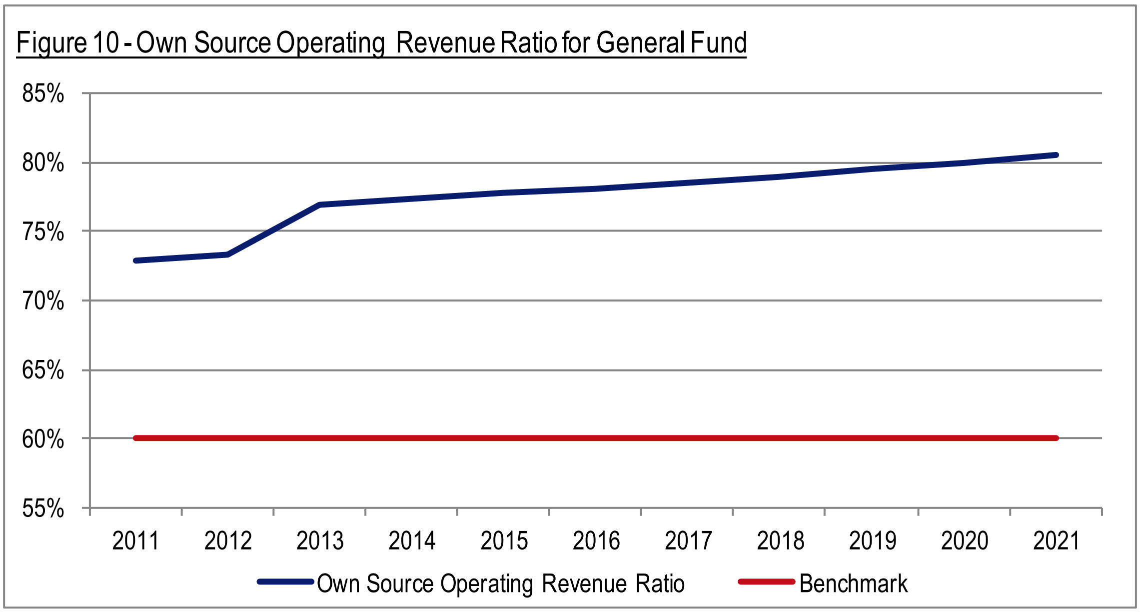


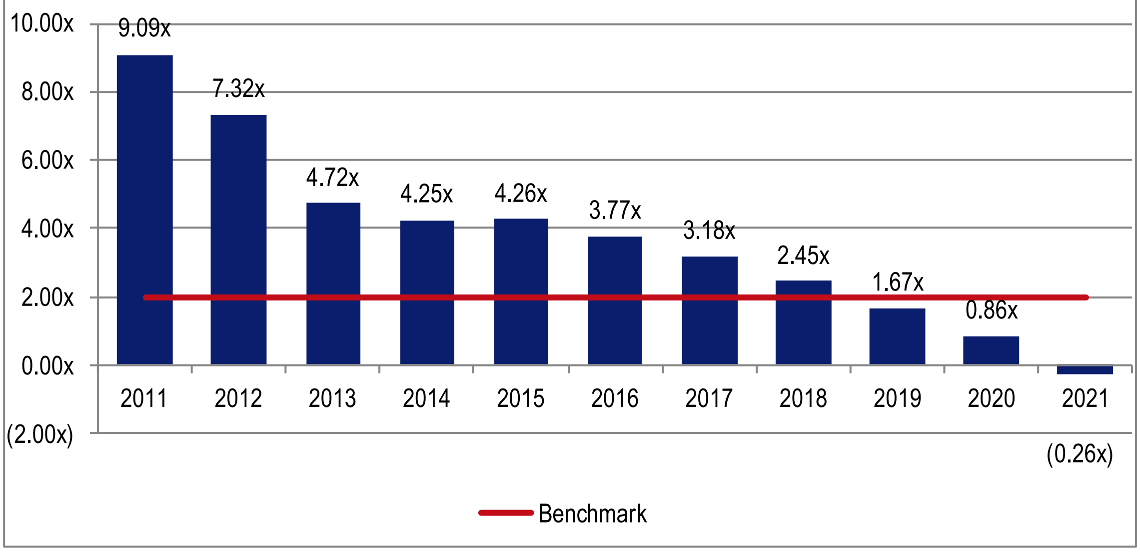
Similarly to the Cash Expense Ratio, the Unrestricted Current Ratio shows that Council has a declining liquidity position from 2013 onwards. Council will have to defer capital expenditure, review services, or find new efficiencies to maintain liquidity.

Fiscal Flexibility Ratios



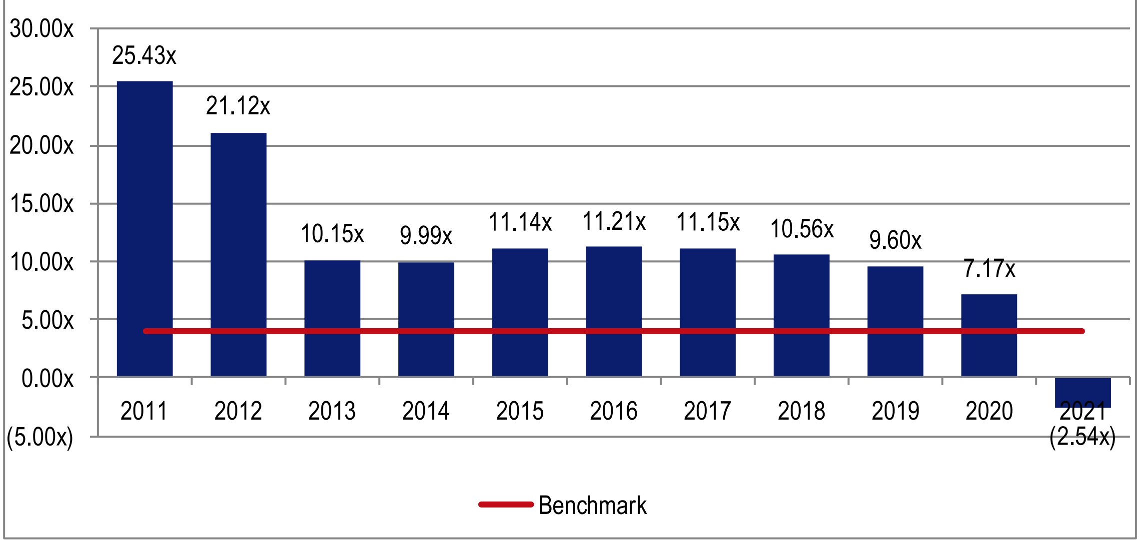
Council's Own Source Revenue Ratio improves over the lifetime of the forecast due to user fees and charges increasing from parking revenue, plus capital grants and contributions being forecast less than historically received.

Figure 11 - DSCR for General Fund



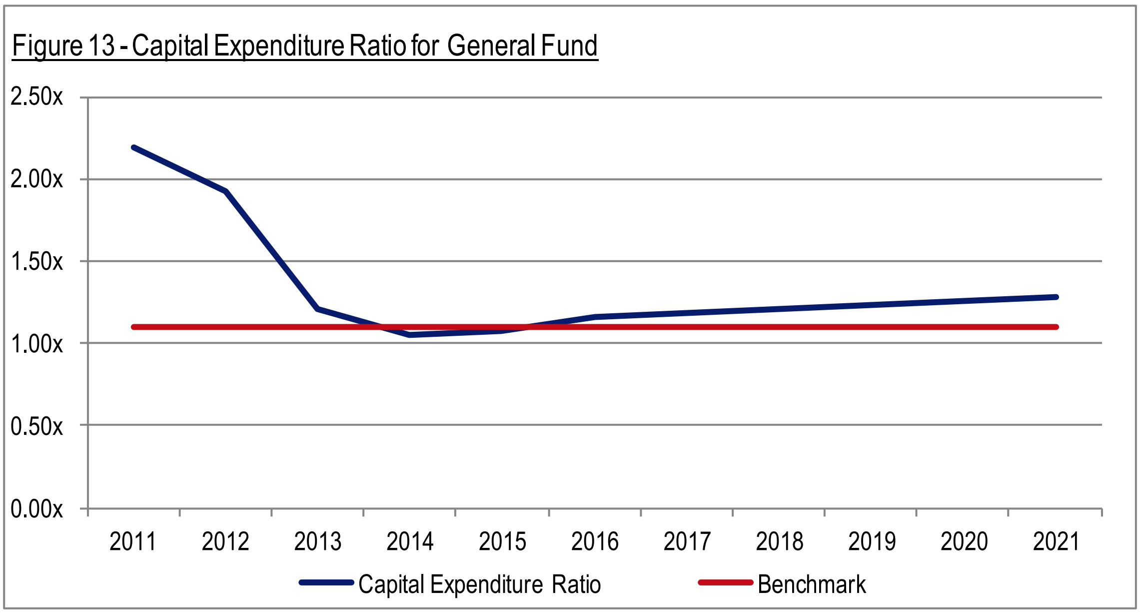
Considering the DSCR, Council has capacity to service the LIRS borrowings over the three year term of the loan. Over the longer term increasing operating deficits and a worsening liquidity position will constrain Council's capacity to undertake any further borrowings.

Figure 12 - Interest Cover Ratio for General Fund



The Interest Cover Ratio, similar to the DSCR, shows the Council has sufficient capacity to service scheduled debt commitments, including the LIRS loan. There is capacity to service further debt interest costs before the Council's ratio decreases to the 4.00x benchmark. However the Council is constrained by its forecast liquidity position.

4.3: Capital Expenditure



Capital expenditure peaks in 2011 and reduces to a level around the benchmark from 2012 onwards.

The total value of capital expenditure ($112.2m) forecast for the future years is greater than the accumulated depreciation ($94.5m), indicating that Council is expected to marginally expand its asset base.

However due to continuing operating deficits and worsening liquidity, it is unlikely that this level of capital expenditure will occur, and planned capital expenditure may likely end up being deferred. Council will need to review its capital program, taking into consideration its liquidity constraints or review its capital grants and contributions from external sources.

4.4: Financial Model Assumption Review

Councils have used their own assumptions in developing their forecasts.

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

TCorp's benchmarks:

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

<u>Key Observations and Risks</u>

- The financial model outlines future funding requirements in order to deliver the facilities and services expected by the community
- Rates and annual charges are forecast to increase at 2.8% p.a.
- Employee expenses are forecast to increase at 3.0% p.a.
- Materials and contracts expenses are forecast to increase at 5.5% p.a.
- User fees and charges are forecast to increase at 5.0% p.a. Council feels this growth is achievable through initiatives to increase user fees to match the market and identify new opportunities through a service review program
- User fees and charges increase in 2015 due to the inclusion of $0.8m revenue from Pay for Parking. A report recommending a Pay for Parking scheme will be presented to Council in 2013.
- TCorp finds the majority of the assumptions underpinning the LTFP reasonable, with the exception of the increases in materials and contract expenses which are well above affordable levels. The outcome of these assumptions is a deteriorating financial position which urgently needs reviewing in the short term to ensure the forecast liquidity problems are addressed.

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4.5: Borrowing Capacity

When analysing the financial capacity of the Council we believe Council will not be able to incorporate additional loan funding in addition to the LIRS loan facilities. Some comments and observations are:

- Council needs to revisit and refine its LTFP to a position where Council can maintain sufficient liquidity throughout the forecast period

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 3. There are 17 councils in this group and at the time of preparing this report, we have data for all of these councils.

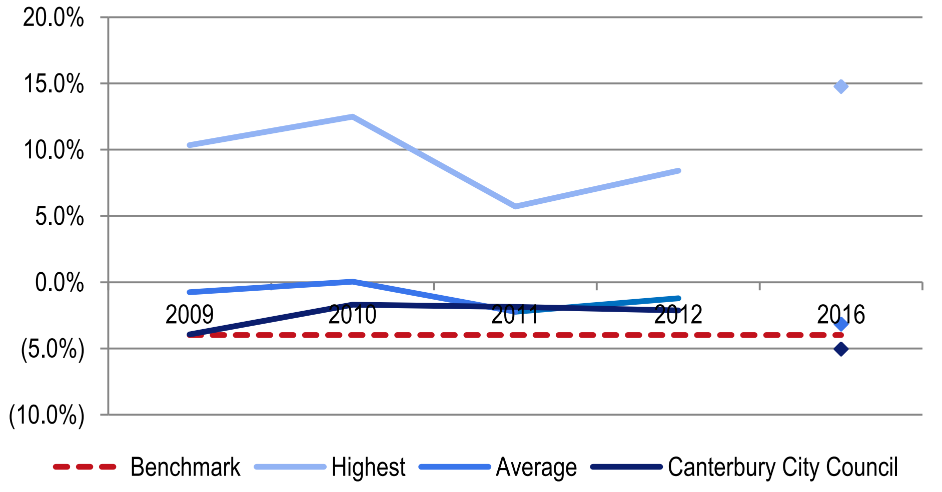
In Figure 14 to Figure 23, the graphs compare the historical performance of Council with the benchmark for that ratio, with the average for the Group, with the highest performance (or lowest performance in the case of the Infrastructure Backlog Ratio where a low ratio is an indicator of strong performance), 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.

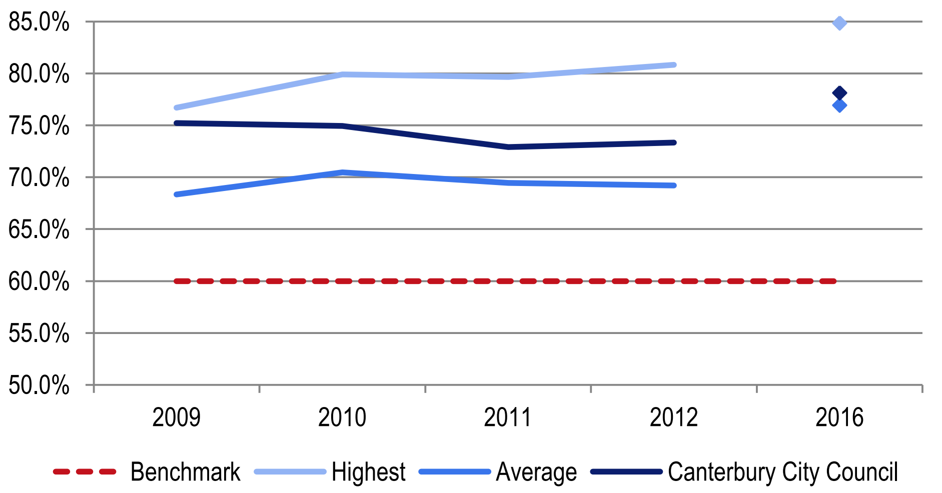
Financial Flexibility

Figure 14 - Operating Ratio Comparison



Council's Operating Ratio was close to the group average in the past four years. The results are forecast to marginally deteriorate in the medium term to be below the group's average and benchmark.

Figure 15 - Own Source Operating Revenue Ratio Comparison



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

Liquidity

Figure 16 - Cash Expense Ratio Comparison

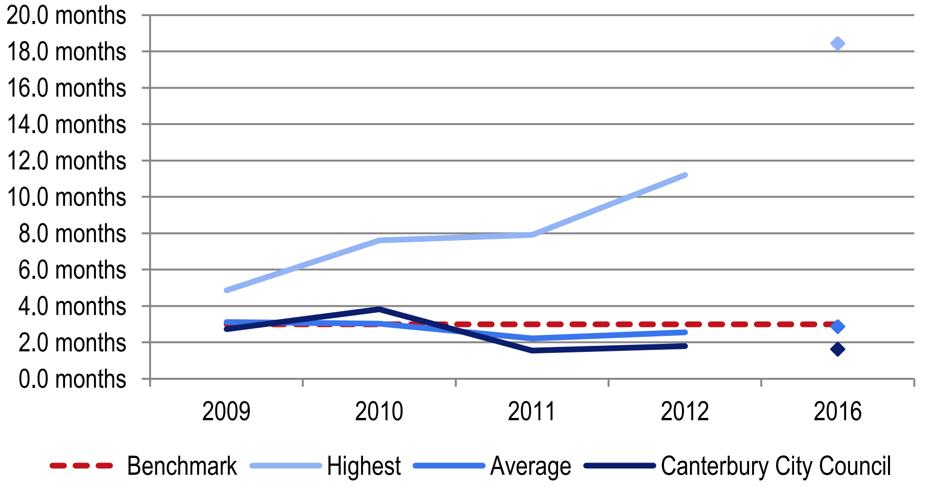
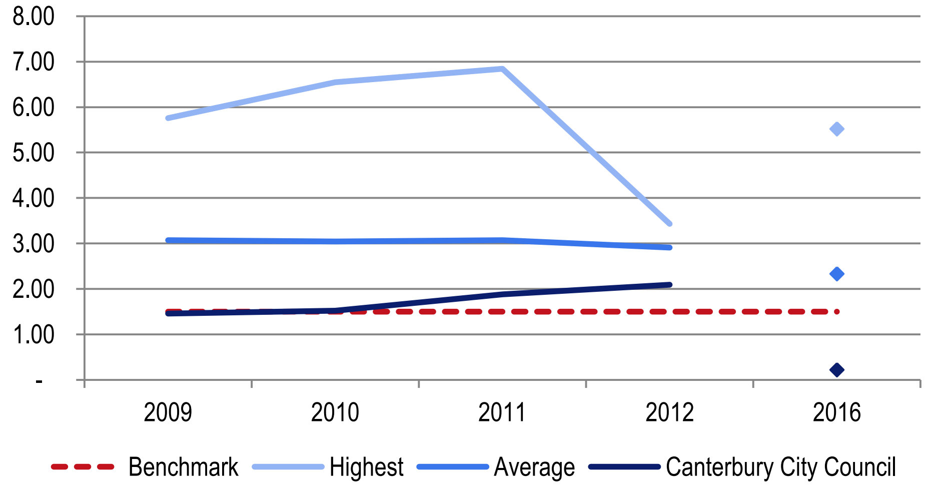


Figure 17 - Unrestricted Current Ratio Comparison



Council's Cash Expense Ratio was around the group average and at or below the benchmark over the review period. The ratio has marginally deteriorated over the past four years and is forecast to continue to marginally deteriorate in the medium term.

Council's Unrestricted Current Ratio was below the group average and at or above the benchmark in the review period. The ratio is expected to decline to be below the benchmark in the medium term.

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

Debt Servicing

Figure 18 - Debt Service Cover Ratio Comparison

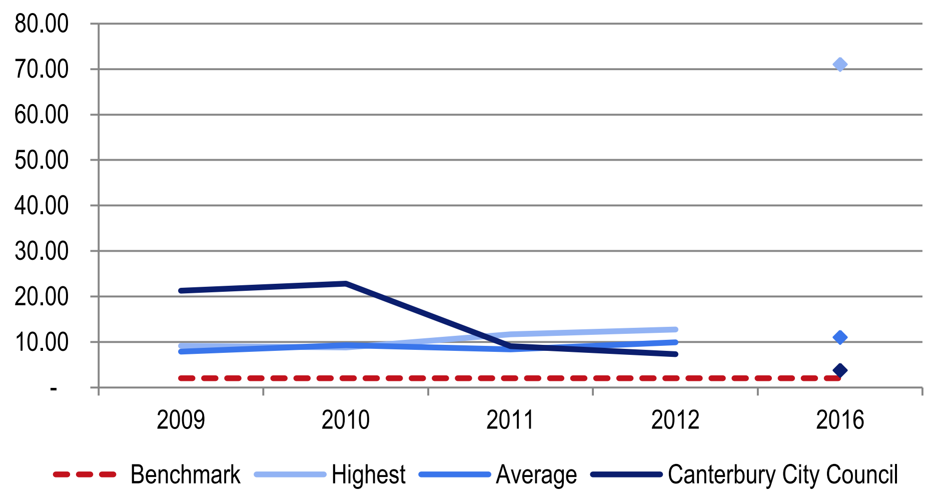
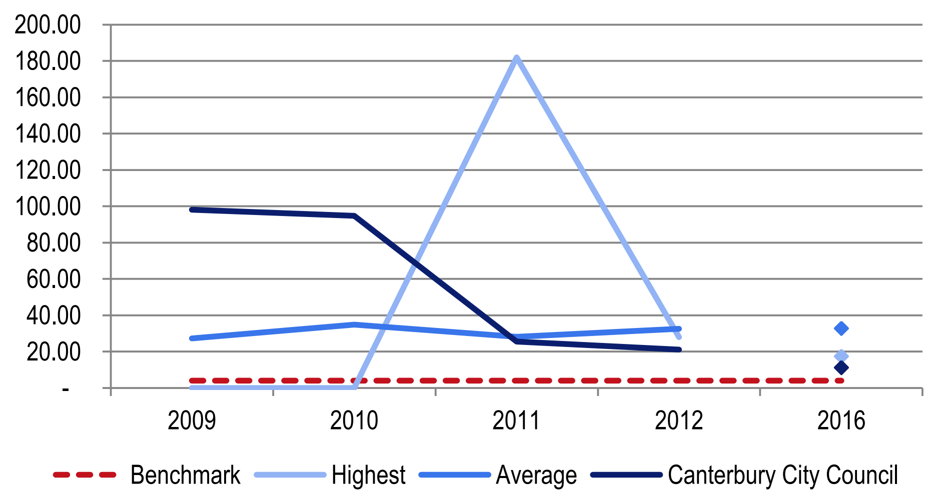


Figure 19 - Interest Cover Ratio Comparison



Over the review period, Council's credit metrics declined to be below the group average but above the benchmark DSCR and Interest Cover Ratios. The ratios are forecast to continue to marginally decline in the medium term.

Asset Renewal and Capital Works

Figure 20 - Capital Expenditure Ratio Comparison

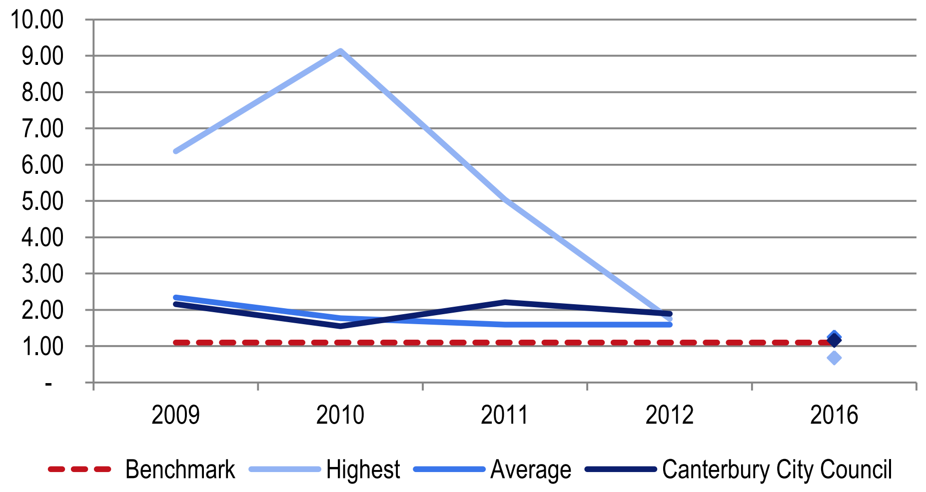
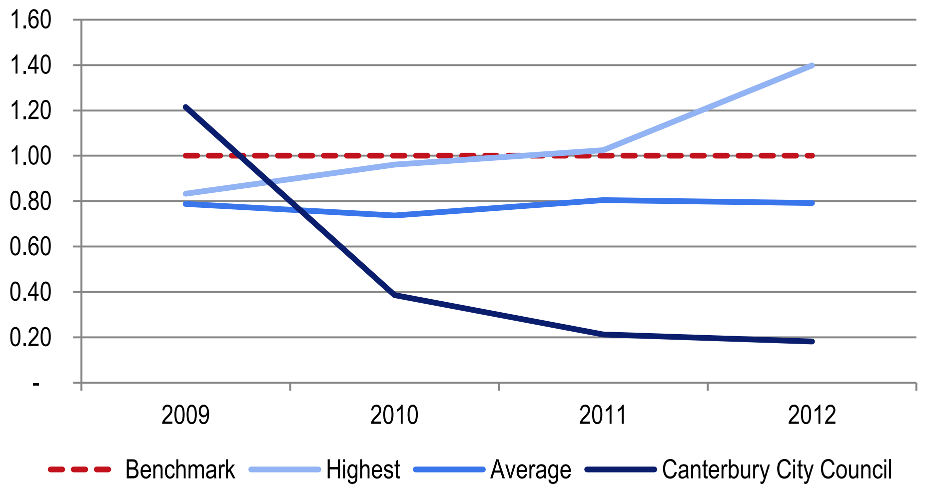
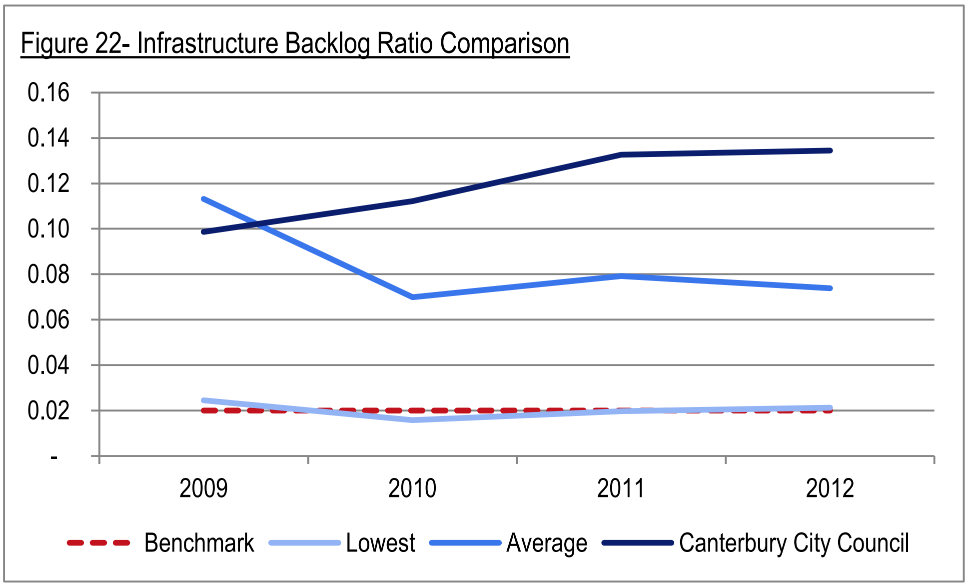
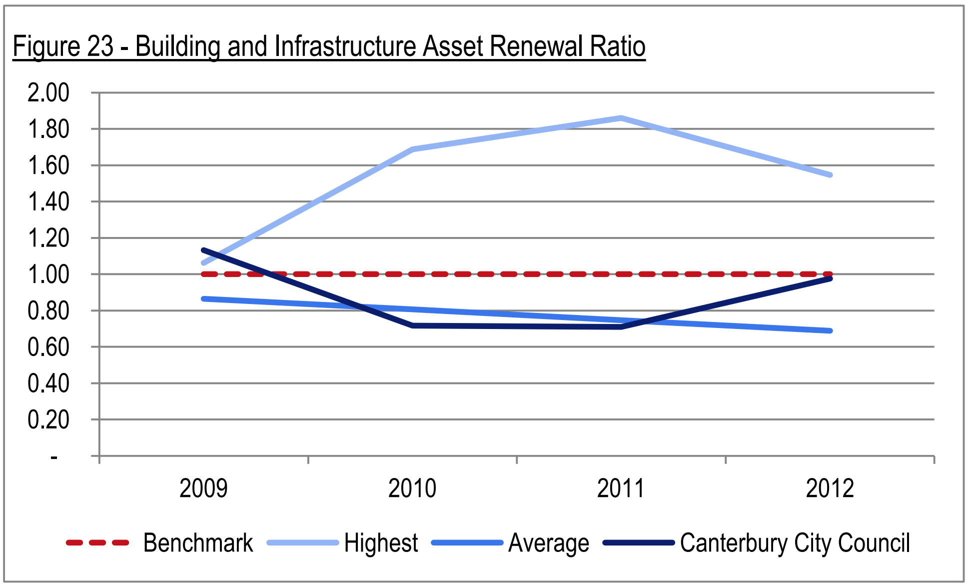


Figure 21 - Asset Maintenance Ratio Comparison







Overall, the Council has a higher Infrastructure Backlog Ratio than other councils in the group. It is also below the group average and benchmark in terms of spending on asset maintenance. Council's Building and Infrastructure Asset Renewal Ratio has been above the group average and at or below the benchmark over the review period.

The Council's Capital Expenditure Ratio was around the group average and above 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 currently be in a satisfactory financial position, but this is forecast to deteriorate in the medium term.

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) improved each year from $6.0m in 2009 to $8.6m in 2012
- Council's Unrestricted Current Ratio has been near or above benchmark the past four years indicating Council has had sufficient liquidity
- Council have the capacity to repay the $1.8m in borrowings under the LIRS scheme over the next three years

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

- Council has been unable to fund the required asset maintenance or asset renewal amounts over the review period, and a continuation of this level of spending will likely see the Infrastructure Backlog grow.
- The LTFP needs to be revisited and developed further to show what level of services, asset renewals and capital expenditure are affordable while maintaining sufficient liquidity to maintain its operations
- A large part of Council's investments are in Capital Protected Notes and CDOs where the recoverability is uncertain. Both Council's auditors and the credit ratings agencies believe that full recovery of the face value of these assets is far from certain. A more conservative approach from Council to valuing these assets would better enable prudent financial planning
- Major Capital Expenditure is matched to the needs and wants of the community. The community consultation process in 2010 showed areas such as waste collection, and maintenance of local roads and footpaths were ranked amongst the most important service areas provided by Council.

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Appendix A Historical Financial Information Tables

Table 1- Income Statement

Income Statement ($'000s)	Year ended 30 June				% annual change		
	2012	2011	2010	2009	2012	2011	2010
Revenue							
Rates and annual charges	64,980	62,492	60,427	58,011	4.0%	3.4%	4.2%
User charges and fees	7,675	7,130	7,231	6,995	7.6%	(1.4%)	3.4%
Interest and investment revenue	1,968	2,580	1,398	2,171	(23.7%)	84.5%	(35.6%)
Grants and contributions for operating purposes	14,311	11,935	11,511	12,678	19.9%	3.7%	(9.2%)
Other revenues	4,108	3,835	3,643	3,369	7.1%	5.3%	8.1%
Total revenue	**93,042**	**87,972**	**84,210**	**83,224**	**5.8%**	**4.5%**	**1.2%**
Expenses							
Employees	43,819	40,680	41,566	41,667	7.7%	(2.1%)	(0.2%)
Borrowing costs	408	337	88	61	21.1%	283.0%	44.3%
Materials and contract expenses	27,203	26,069	22,420	22,832	4.3%	16.3%	(1.8%)
Depreciation and amortisation	10,202	9,873	9,682	9,217	3.3%	2.0%	5.0%
Other expenses	13,405	12,653	11,886	12,735	5.9%	6.5%	(6.7%)
Total expenses	**95,037**	**89,612**	**85,642**	**86,512**	**6.1%**	**4.6%**	**(1.0%)**
Operating result (excluding capital grants and contributions)	**(1,995)**	**(1,640)**	**(1,432)**	**(3,288)**	**(21.6%)**	**(14.5%)**	**56.4%**
Operating result (including capital grants and contributions)	**4,046**	**5,900**	**4,639**	**(101)**	**(31.4%)**	**27.2%**	**4693.1%**

Table 2 - Items excluded from Income Statement

Excluded items ($'000s)				
	2012	2011	2010	2009
Grants and contributions for capital purposes	6,041	7,540	6,071	3,187
Gain/ (Loss) on disposal of assets	173	749	931	659

Table 3 - Balance Sheet

Balance Sheet ($'000s)	Year Ended 30 June				% annual change		
	2012	2011	2010	2009	2012	2011	2010
Current assets							
Cash and cash equivalents	12,658	10,267	24,122	17,505	23.3%	(57.4%)	37.8%
Investments	22,000	17,000	5,000	4,000	29.4%	240.0%	25.0%
Receivables	4,739	5,346	7,162	4,225	(11.4%)	(25.4%)	69.5%
Inventories	229	271	231	236	(15.5%)	17.3%	(2.1%)
Other	358	990	230	72	(63.8%)	330.4%	219.4%
Total current assets	39,984	33,874	36,745	26,038	18.0%	(7.8%)	41.1%
Non-current assets							
Investments	13,000	18,000	22,000	27,500	(27.8%)	(18.2%)	(20.0%)
Receivables	1,256	1,328	1,266	1,236	(5.4%)	4.9%	2.4%
Infrastructure, property, plant & equipment	814,517	805,496	735,970	466,976	1.1%	9.4%	57.6%
Intangible assets	42	60	0	0	(30.0%)	N/A	N/A
Total non-current assets	828,815	824,884	759,236	495,712	0.5%	8.6%	53.2%
Total assets	**868,799**	**858,758**	**795,981**	**521,750**	**1.2%**	**7.9%**	**52.6%**
Current liabilities							
Payables	11,952	10,788	10,788	10,816	10.8%	0.0%	(0.3%)
Borrowings	746	741	585	277	0.7%	26.7%	111.2%
Provisions	20,194	17,715	20,645	19,436	14.0%	(14.2%)	6.2%
Total current liabilities	32,892	29,244	32,018	30,529	12.5%	(8.7%)	4.9%
Non-current liabilities							
Borrowings	7,434	5,208	4,470	1,055	42.7%	16.5%	323.7%
Provisions	340	392	436	398	(13.3%)	(10.1%)	9.5%
Total non-current liabilities	7,774	5,600	4,906	1,453	38.8%	14.1%	237.6%
Total liabilities	**40,666**	**34,844**	**36,924**	**31,982**	**16.7%**	**(5.6%)**	**15.5%**
Net assets	**828,133**	**823,914**	**759,057**	**489,768**	**0.5%**	**8.5%**	**55.0%**

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Table 4-Cashflow

Cash Flow Statement ($'000s)	Year ended 30 June			
	2012	**2011**	**2010**	**2009**
Cash flows from operating activities	19,573	13,794	12,242	13,365
Cash flows from investing activities	(19,413)	(28,543)	(9,347)	(143)
Proceeds from borrowings and advances	3,000	1,500	4,000	560
Repayment of borrowings and advances	(769)	(606)	(277)	(221)
Cash flows from financing activities	2,231	894	3,723	339
Net increase/(decrease) in cash and equivalents	**2,391**	**(13,855)**	**6,618**	**13,561**
Cash and equivalents	12,658	10,267	24,122	17,505

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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.

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

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

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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.

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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

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.

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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.