New South Wales
Treasury Corporation

Gwydir Shire Council

Financial Assessment, Sustainability and Benchmarking Report

09 April 2013

Prepared by NSW Treasury Corporation for Gwydir Shire Council, the Division of Local Government and the Independent Local Government Review Panel.

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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 to assist the DLG and the Independent Local Government Review Panel in its consideration of the Sustainability of each local government area in NSW.

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, and Council's future Sustainability, within prudent risk parameters and the limits of its financial projections.

The report has been prepared for Gwydir Shire Council, the DLG and the Independent Local Government Review Panel. TCorp shall not be liable to Gwydir 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 Gwydir Shire Council's (the Council) financial capacity, and its future Sustainability. 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.

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, with a particular focus on a council's General Fund. Where a council operates a Water or other Fund the financial capacity of these other Funds may be reviewed where considered necessary.

Council's financial position has been weak over the review period, with consecutive operating deficits when capital grants and contributions are included or excluded. Some other observations include:

- Council's underlying operating performance, measured by EBITDA, has increased from \$3.1m in 2009 to \$4.6m in 2012 although this has been mainly due to advance Financial Assistance Grant payments being received in 2011 and 2012
- The Unrestricted Current Ratio and Council's level of cash and investments indicate that it had sufficient liquidity throughout the period
- The DSCR and Interest Cover Ratio demonstrate that Council has been able to repay its debt obligations, although borrowings have increased in each year, limiting future borrowing capacity
- Council relies on grants and contributions to boost revenues, as indicated by an Own Source Operating Revenue Ratio below the benchmark throughout the review period, highlighting their limited financial flexibility

The Council reported \$53.6m of Infrastructure Backlog in 2012 which represents 33.0% of its infrastructure asset value of \$162.6m. Other observations include:

- The backlog has increased over the review period by \$11.9m with the major backlog asset category of public roads increasing by \$10.5m to \$37.7m
- Council has been unable to sufficiently fund asset maintenance, renewals and expenditure in each review year as indicated by the Asset Maintenance, Buildings and Infrastructure Asset Renewal and Capital Expenditure Ratios being below their respective benchmarks and this has contributed to the Infrastructure Backlog increase

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

- Without a reduction in current service levels or obtaining new or additional sources of revenue, the General Fund is forecast to become insolvent within the 2014 financial year
- Council has completed their LTFP in real terms and the impact of inflation has therefore not been included. There is the potential that the current forecast operating deficits are not accurate as they may not take into account differing rates of change in revenues and expenses

- Council is expecting operating deficits to continue in each year of the review period at levels significantly lower than the negative 4% benchmark for the Operating Ratio
- Council will continue to be unable to fund sufficient asset renewals and capital expenditure over the forecast period which will lead to a further deterioration of the asset base as indicated by the Net Asset position deteriorating from $173.0m in 2012 to $103.3m in 2022

In our view, the Council does not have the capacity to undertake additional borrowings within the General Fund, once the $3.9m is utilised in 2013 for bridge works and the Naroo aged care facility. This is based on the following analysis:

- Council's DSCR and Interest Cover Ratio are forecast to be below their respective 2.00x and 4.00x benchmarks in each year of the forecast period
- The continuing operating deficits are undermining Council's financial position

Based on the information provided to TCorp for its review, Council is unsustainable. Our key observations are:

- Council is not in a financial position to continue to operate the General Fund at the service levels that are currently in place
- Council is forecast to run out of funds in 2014 within the General Fund highlighting the inability of Council to meet their ongoing expenses within the short term
- Council recognises that there are shortfalls within their IP&R documentation following the completion of these documents for the first time. Once the AMP and LTFP are refined in future versions then the financial position may provide positive improvements from the initial versions. Council has indicated that the liquidity position may appear worse in the forecast than the likely position due to a problem with their LTFP modelling program
- We recommend that future versions of the LTFP are completed in nominal terms in line with the majority of other councils to provide a more complete projection of Council's future financial position

In respect of the Benchmarking analysis TCorp has compared the Council's key ratios with other councils in DLG Group 10. The key observations are:

- The Council has weak financial flexibility with the Operating Ratio below both the benchmark and the group's average. Council has significant forecast deficits
- The Council has a marginal level of liquidity at present with the Unrestricted Current Ratio above the benchmark but trending downwards. Should this continue, it may pose liquidity problems in future
- The Council has debt capacity that can sustain its current borrowings but cannot support any additional debts in the future
- Should the downward trend of under-expenditure in capital expenditure, assets maintenance and renewals continue, the Infrastructure Backlog will continue to grow in the future

Section 2 Introduction

2.1: Purpose of Report

This report provides the Council with an independent assessment of their financial capacity, Sustainability and performance measured against a peer group of councils. It will complement Council's internal due diligence, the IP&R system of the Council and the DLG, together with the work being undertaken by the Independent Local Government Review Panel.

The report is to be provided to the DLG and the Independent Local Government Review Panel.

The key areas focused on are:

- The financial capacity of the Council
- The long term Sustainability of the Council
- 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 Council's General Fund
- Identify significant changes to future financial forecasts from existing financial performance and highlight risks associated with such forecasts, including those that could impact Council's Sustainability
- 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 and achieve long term Sustainability
- Conduct a high level review of the Council's IP&R documents for factors which could impact the Council's financial capacity, performance and Sustainability

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
- Other publicly available information such as information published on the IPART website

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In completing the report, TCorp worked closely with Council management to analyse and understand the information gathered. The Council was given a draft copy of the report for their review and comment. Based on our discussions with Council:

- Council has acknowledged TCorp's comments but has stated that it expects improvements in their IP&R processes, data and results to significantly improve in the short to medium term

Definition of Sustainability

In conducting our reviews, TCorp has relied upon the following definition of sustainability to provide guidance:

"A local government will be financially sustainable over the long term when it is able to generate sufficient funds to provide the levels of service and infrastructure agreed with its community."

Benchmark Ratios

In conducting our review of the Councils' financial performance, forecasts and Sustainability 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
Building and Infrastructure Backlog Ratio	< 0.02x
Asset Maintenance Ratio	> 1.00x
Building and Infrastructure Asset Renewal Ratio	> 1.00x
Capital Expenditure Ratio	> 1.10x

2.3: Overview of the Local Government Area

Gwydir Shire Council	
Locality and Size	
Locality	Northern
Area	9,274 km²
DLG Group No.	10
Demographics	
Population	4,965
% under 20	25%
% between 20 and 59	45%
% over 60	30%
Expected population in 2021	4,900
Operations	
Number of employees (FTE)	169
Annual revenue	$24.4m
Infrastructure	
Roads	2,094 km
Bridges	53
Infrastructure backlog value	$53.6m
Total infrastructure value	$162.6m

Gwydir Shire Council Local Government Area (LGA) is located in northern NSW, approximately 8 hours drive north of Sydney and 6 hours south-west of Brisbane. The LGA was created in March 2004 following the amalgamation of Yallaroi and Bingara Councils and part of the former Barraba Council.

The northern part of the LGA is just south of the Queensland border with Inverell to the east, Moree to the west and Tamworth to the south.

Agriculture remains the dominant industry within the LGA however the industry is subject to significant change due to the ageing of the farming population, market changes and the possible effects of climate change. The LGA has been declared a natural disaster area twice in the last 13 months due to flooding.

The LGA also has the broader issues occurring in rural areas such as a declining population as younger generations head to urban centres for employment opportunities.

Within Council's Infrastructure, Property, Plant and Equipment (IPP&E) as at 30 June 2012 there was:

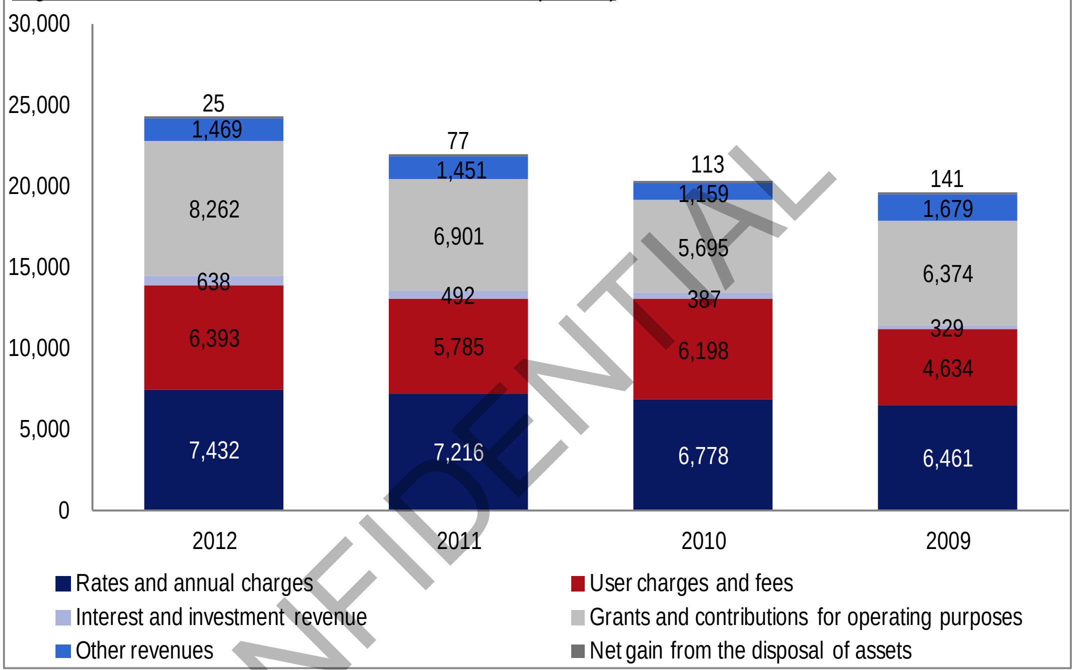
- $123.9m of roads, bridges and footpaths
- $13.4m of non specialised buildings, $8.6m of specialised buildings
- $9.9m of water supply infrastructure, $4.5m of sewerage infrastructure
- $2.4m of other structures, $1.4m of stormwater drainage

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)

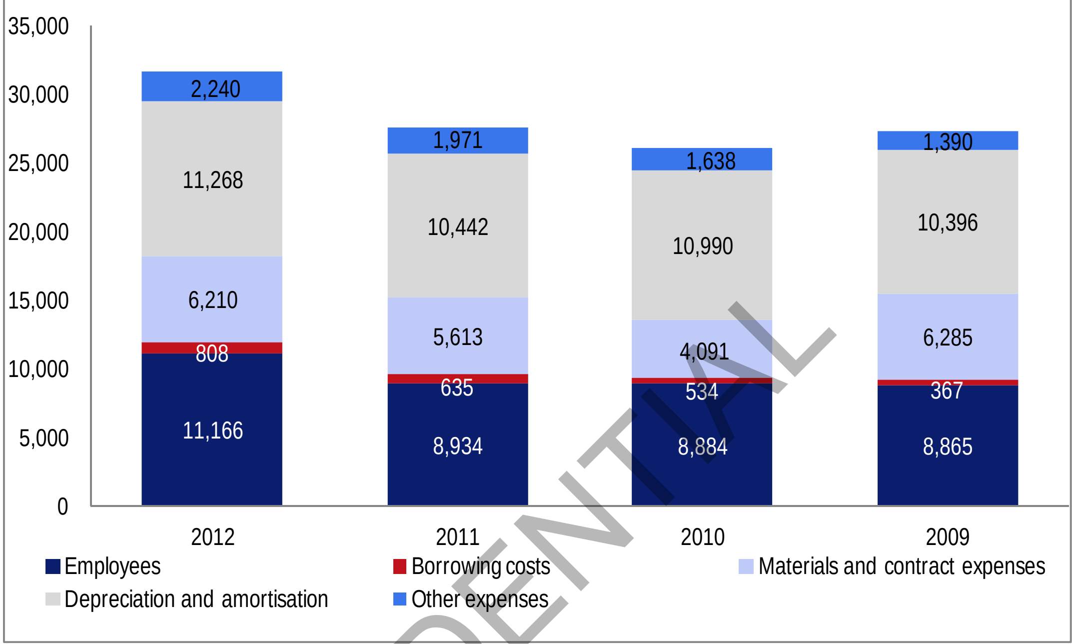


Key Observations

- Total operating revenues have increased by $4.6m (23.5%) over the review period to $24.2m in 2012.
- Rates and annual charges have been on an upward trend with the largest annual increase in 2011 of $0.6m driven by an increase in residential ordinary rates and domestic waste management services annual charges.
- User charges and fees have also been on an upward trend however the large increase in 2010 was due to a reclassification of the medical centre ($0.9m) and quarry ($0.5m) revenues from other revenues. In 2012 the increase was from higher RMS charges for state managed roads that increased by $0.9m to $4.4m.
- Operating grants and contributions have generally been on an upward trend but have fluctuated due to the timing differences of the general purpose Financial Assistance Grants (FAG) with some years receiving five or six quarterly payments.
- Other revenues have decreased from the 2009 high due to the reclassification of the medical centre and quarry revenues mentioned above.
- Gains from the disposal of assets have been included as Council has included this as recurring revenue within their LTFP forecast. The gains relate to the disposal of plant and equipment.

3.2: Expenses

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



Key Observations

- Total operating expenses have increased by $4.4m (16.1%) over the review period to $31.7m in 2012.
- Employee costs remained relatively static over the period until 2012 when they increased by 25.0%. This large increase was partly related to an increase in equivalent full time employees by 11 to 169 and also a $1.6m increase in employee leave entitlements due to improved data and methodologies along with a lower discount rate used in the NPV calculations for this liability. The increase in FTE was predominantly due to the creation of a number of trainee positions in such areas as plant operation, environment and sustainability, parks and gardens, and labouring.
- Materials and contract expenses have fluctuated during the review period but the 2012 amount is similar to the 2009 figure. The fluctuations relate to the amount of infrastructure works completed and capitalised in each year.
- Depreciation expenses have increased over the period but have experienced fluctuations that have been driven by changes in road, bridge and footpath depreciation. The fluctuations have occurred as Council has obtained improved data. The accuracy of the depreciation expenses are expected to continue to improve following the next Revaluation of these assets.
- Other expenses have been on an upward trend with electricity and heating now the largest expense at $0.6m in 2012 while insurance was $0.5m.

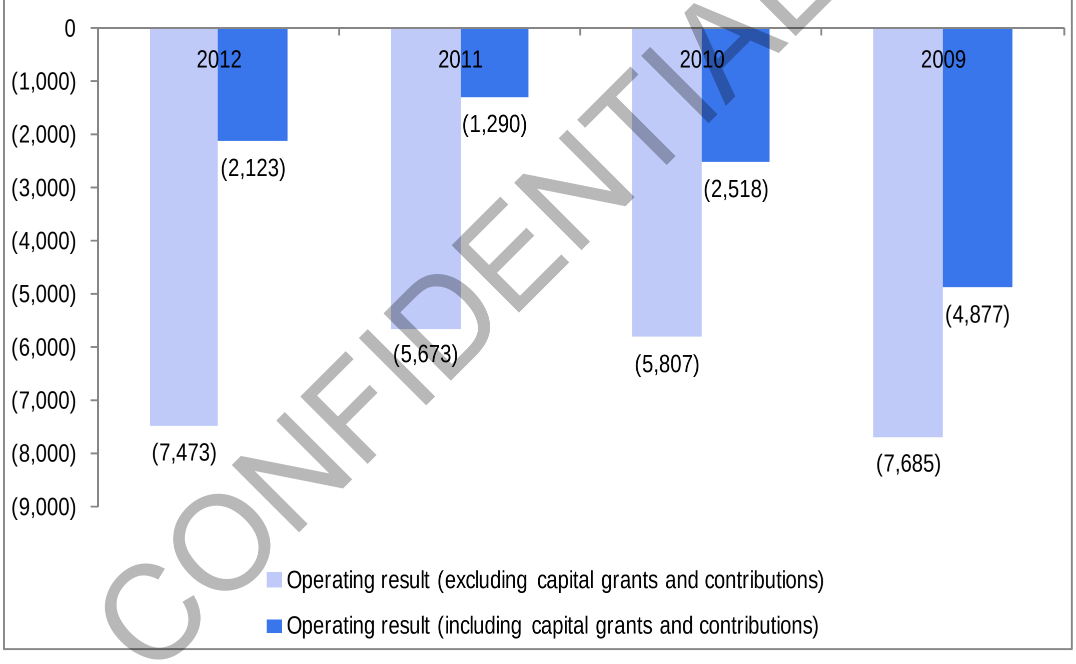
3.3: Operating Results

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

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

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

Figure 3 - Operating Results for 2008/09 to 2011/12 ($'000s)



Key Observations

- Council has posted operating deficits including and excluding capital grants and contributions in all four years. The deficit excluding capital grants and contributions improved in 2010 and 2011 but deteriorated in 2012.
- The increase in employee expenses and depreciation were the main drivers of the increased deficit in 2012.

3.4: Financial Management Indicators

Performance Indicators	Year ended 30 June			
	2012	2011	2010	2009
EBITDA ($'000s)	4,603	5,404	5,717	3,078
Operating Ratio	(30.9%)	(25.9%)	(28.6%)	(39.2%)
Interest Cover Ratio	5.70x	8.51x	10.71x	8.39x
Debt Service Cover Ratio	3.06x	4.13x	4.85x	3.28x
Unrestricted Current Ratio	2.50x	3.49x	2.72x	1.69x
Own Source Operating Revenue Ratio	46.8%	49.4%	54.9%	49.5%
Cash Expense Ratio	0.5 months	2.0 months	2.2 months	2.8 months
Net assets ($'000s)	192,335	196,850	184,411	174,271

Key Observations

- Council's underlying operating performance, measured by EBITDA, has increased over the review period although it has declined in the last two years as all operating expenses have seen double digit growth in those years.
- The Operating Ratio has been significantly below the benchmark of negative 4% in each year and the poor operating results highlight that if the current trend continues then Council will face increasing Sustainability issues.
- The DSCR and Interest Cover Ratio have been above their benchmark in each year although both are at their lowest in 2012. This has resulted from increased net borrowings over the review period from $5.8m in 2009 to $10.5m in 2012. This represents 5.5% of Net Assets in 2012.
- The Unrestricted Current Ratio has been above the 1.50x benchmark in all four years although it did decrease in 2012 due to an increase in Council's current liabilities less specific purpose liabilities in 2012.
- The Own Source Operating Revenue Ratio has remained below the 60.0% benchmark due to Council's reliance on grants and contributions to boost their total revenues.
- The Cash Expense Ratio has been below the 3.0 months benchmark in each review year due to Council utilising term deposits to maximise their return on investment. These products are classified as investments as opposed to cash and cash equivalents and this is why this ratio is below the benchmark but overall does not indicate a liquidity issue.
- Council's Net Assets have increased over the review period due to the Asset Revaluations. In 2010 and 2011 Council revalued their infrastructure assets which added $19.0m while an accounting adjustment relating to community land increased the value of land by $7.1m in 2011.
- When the Asset Revaluations are excluded there has been a $14.5m decrease in the IPP&E asset base over the three year period, compared to the written down value of disposed assets and depreciation.

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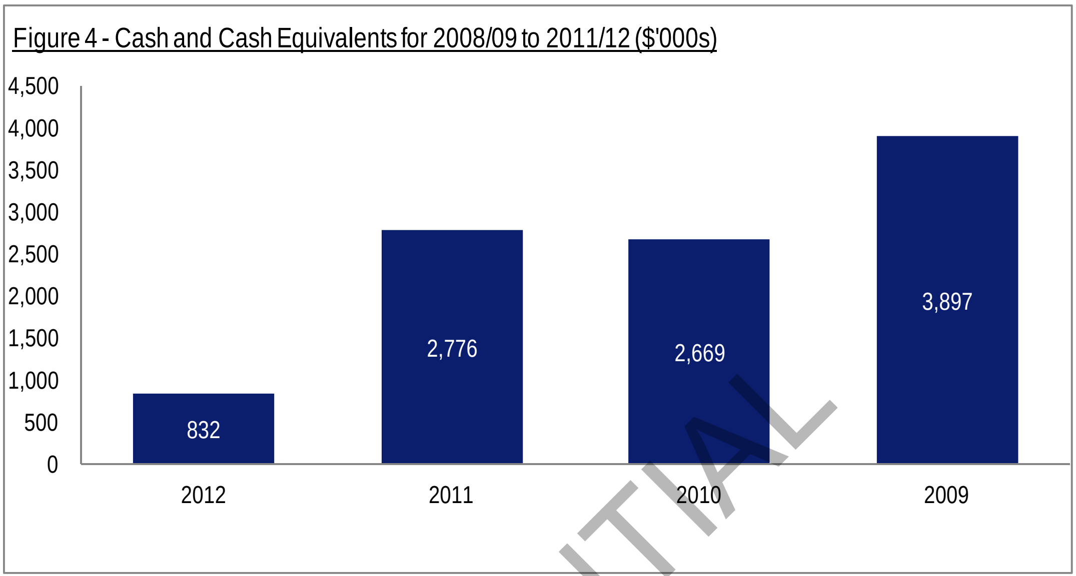
3.5: Statement of Cashflows



Key Observations

- While Council's cash and cash equivalents have been on a downward trend, when investments are included there has been a $4.6m increase from $6.5m in 2009 to $12.1m in 2012.
- Of the $12.1m total, $5.6m is externally restricted and $4.9m is internally restricted while $1.6m is unrestricted.
- The investments portfolio of $11.3m consists entirely of term deposits.
- Council's management of their cash and investments, along with an Unrestricted Current Ratio above the benchmark indicates that they have maintained adequate liquidity over the period.

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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)

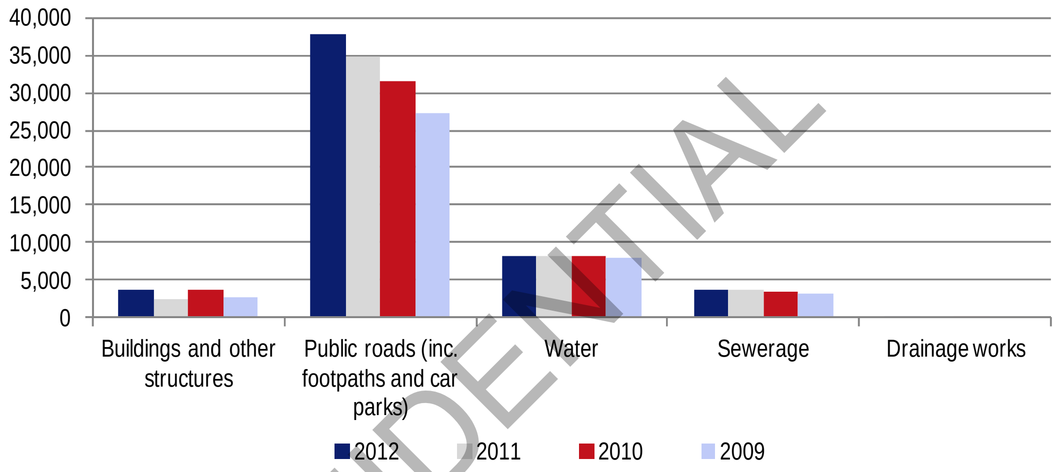
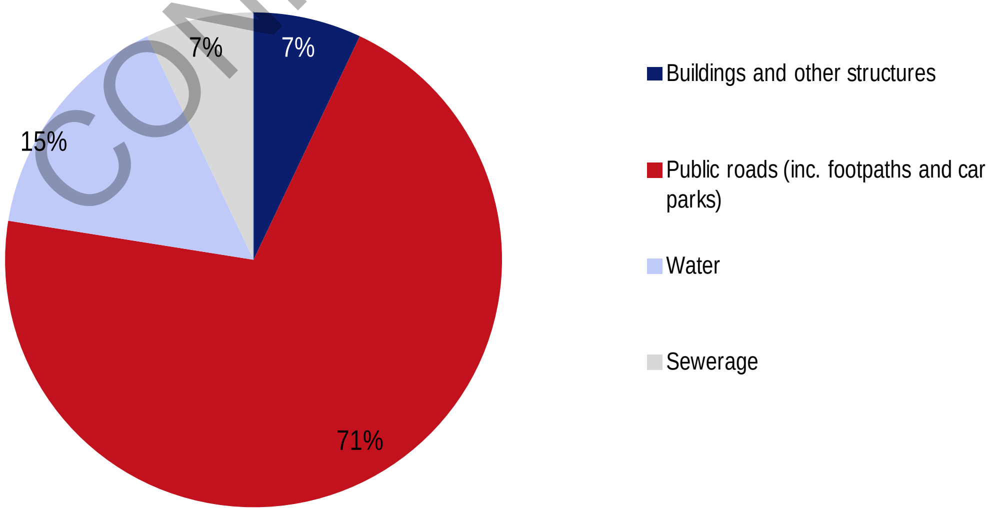


Figure 6 - Infrastructure Backlog Composition for 2011/12



Council's Infrastructure Backlog has grown year on year from $41.7m in 2009 to $53.6m in 2012. This is predominantly due to the public roads Infrastructure Backlog increasing from $27.2m in 2009 to $37.7m in 2012.

The Infrastructure Backlog has increased over the period due to Council's inability to fund the necessary infrastructure works as shown within the ratios below.

The accuracy of the backlog is expected to improve as Council refine their Asset Management Plan within the IP&R documentation in future years.

3.6(b): Infrastructure Status

Infrastructure Status	Year ended 30 June			
	2012	2011	2010	2009
Bring to satisfactory standard ($'000s)	53,626	49,623	47,052	41,670
Required annual maintenance ($'000s)	9,886	9,011	8,871	5,514
Actual annual maintenance ($'000s)	6,692	5,711	3,489	3,651
Total value of infrastructure assets ($'000s)	162,639	171,953	168,952	161,820
Total assets ($'000s)	210,881	212,243	197,904	186,781
Building and Infrastructure Backlog Ratio	0.33x	0.29x	0.28x	0.26x
Asset Maintenance Ratio	0.68x	0.63x	0.39x	0.66x
Building and Infrastructure Renewals Ratio	0.35x	0.52x	0.43x	0.63x
Capital Expenditure Ratio	0.58x	0.95x	0.68x	0.56x

The Building and Infrastructure Backlog Ratio has been on an upward trend in line with the increased backlog each year. At 0.33x in 2012 this is a significant figure that Council will find extremely difficult to reduce given their current and forecast operating performance.

Each of the Asset Maintenance Ratio, Building and Infrastructure Renewals Ratio and Capital Expenditure Ratio have been below the benchmark in all four years highlighting the inability of Council to maintain, renew or expand their Net Asset position. This is contributing to the asset base deteriorating below the satisfactory standard.

3.6(c): Capital Program

Council's capital works program in 2011 and 2012 included:

- $5.7m spent on road replacements and upgrades
- $3.8m spent on water supply upgrades including Bingara water treatment plant and reservoir
- $2.2m spent on three new trade training centres
- $0.3m on sewerage infrastructure replacements and upgrades

3.7: Specific Risks to Council

- Small population. With an approximate population of 5,000 within the community, spread over a relatively large geographical area, Council have to manage a large proportion of infrastructure assets while receiving a low level of annual rates revenue. This provides additional financial pressure on Council as the costs to maintain the asset base are not sufficiently covered from Council's own source operating revenues.
- Declining population. The population has been on a downward trend over the last 10 years and this is forecast to continue across the next 20 years. The declining population is in line with the general trend of both neighbouring LGAs Narrabri and Moree Plains. Young people are leaving the area for education and employment opportunities. This leads to a trend of declining population and flow on effect to the local economy.
- Ageing workforce. Over 56% of Council's employees are over 45. At the same time 35% of employees have been employed for under three years. Council therefore needs to manage the ageing of the workforce with the ongoing skills development of the newer employees. Council is providing traineeship and apprenticeship opportunities to provide training and employment, specifically in areas where older staff are moving towards retirement.
- Inability to reduce Infrastructure Backlog. With Council unable to achieve an operating surplus at current service levels it leaves insufficient funds available for asset renewals and maintenance. Council is aware of this issue and have ruled out the possibility of an SRV as it will not be supported by the community and will not provide sufficient funds to make a worthwhile impact to the backlog total. It therefore appears that service levels will need to be reduced unless additional grant funding can be raised. In this regard Council has been a key stakeholder in the founding of the Australian Rural Roads Group (ARRG) that includes approximately 100 Councils nationally, with the focus of lobbying for additional State and Federal Government grant funding to assist with the maintenance and renewal of the rural roads. These roads support the rural communities and businesses that provide nearly 50% of Australia's total agricultural output and 24% of Australia's roads by length.
- Underfunded operational programs. On top of the capital programs having to be amended and reduced due to a lack of funding, Council also does not have the financial capacity to fully fund all operational programs, highlighting the inability of Council to continue with the same level of service.
- Natural disasters. The LGA has been declared a natural disaster area twice in the past 13 months, due to flooding. This vulnerability to environmental disasters is another factor that impacts Council's ability to maintain the affected infrastructure to a satisfactory standard.

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Section 4 Review of Financial Forecasts

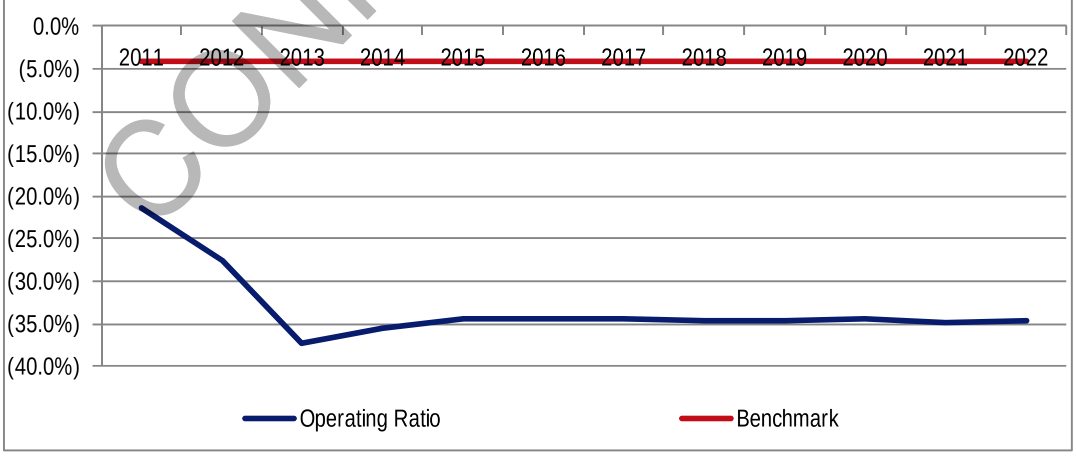
The financial forecast model shows the projected financial statements and assumptions for the next 10 years. We have focused our financial analysis upon the General Fund as although Council's consolidated position includes both a Water and Sewer Fund these are operated as independent entities, which unlike the General Fund are more able to adjust the appropriate fees and charges to meet all future operating and investing expenses.

This is the first version of Council's LTFP and it is recognised that it will improve year by year as Council refine its projection methodology. The LTFP forecast has been completed in real dollar terms with the effects of inflation not included. The scenario analysed is the 'proposed' forecast that follows Council's best estimate regarding expected outcomes. There are three alternative scenarios – business as usual, best and worst case.

The 'proposed' scenario has been adopted by Council as they hope to secure additional grant funding to assist the capital works program while utilising an additional $3.9m borrowings in 2013 to fund bridge works and the Naroo aged care facility upgrade works. They recognise that changes will need to be made given the negative results indicated below. TCorp understands that in the event that the additional borrowings are not secured, then Council will be unable to fund the bridge upgrade works (i.e. revenues and expenses would then both decrease) so that the overall net position of Council's finances would remain relatively unchanged from the forecasts shown.

4.1: Operating Results

Figure 7- Operating Ratio for General Fund



The Operating Ratio is projected to remain in deficit for the full forecast period, at a lower ratio than achieved historically. The ratio is predicted to be at its weakest in 2013 with a negative result of 37.3% (negative $9.8m) although if the forecast was completed in nominal terms then the negative Operating Ratio would likely continue on a downward trend over time.

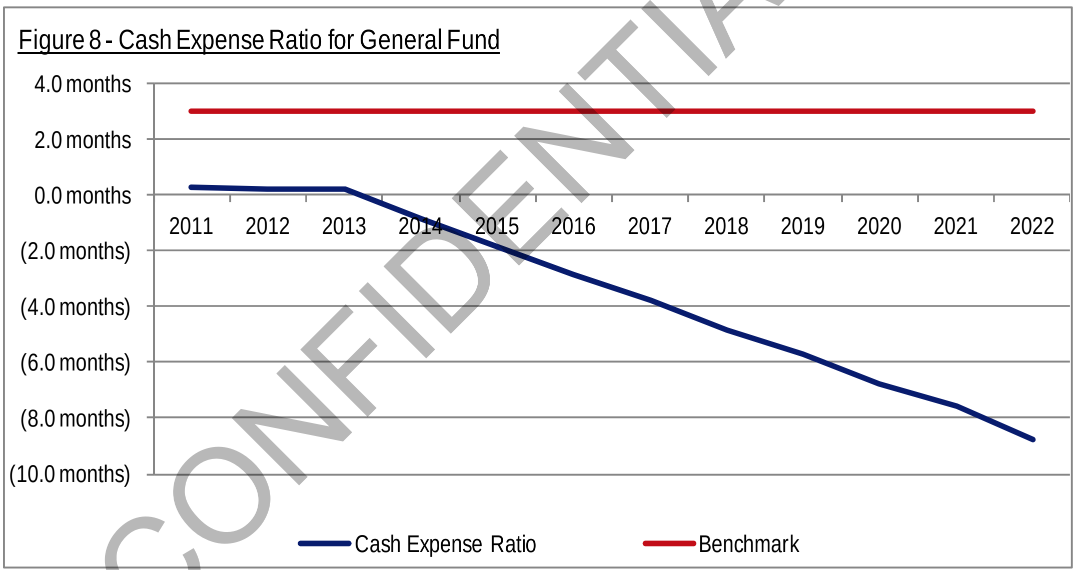
The ratio reduces in 2013 due to a lower level of operating grants and contributions being forecast with the timing differences of the Financial Assistance Grants levelling out and also that one-off grants have not been forecast as they are specific in nature.

User charges and fees are forecast to decrease by $1.0m to $5.0m in 2013 before increasing marginally annually until 2016, also contributing to the larger deficit.

An ongoing operating deficit at these levels is of concern in terms of the medium to long term Sustainability of Council. Council believes that the possibility of applying for a SRV is not an option as they do not believe that the community has the financial capacity to pay higher rates. It therefore appears that the only way that Council will be able to achieve a break even position is if they receive significant additional grant funding or reduce service levels.

4.2: Financial Management Indicators

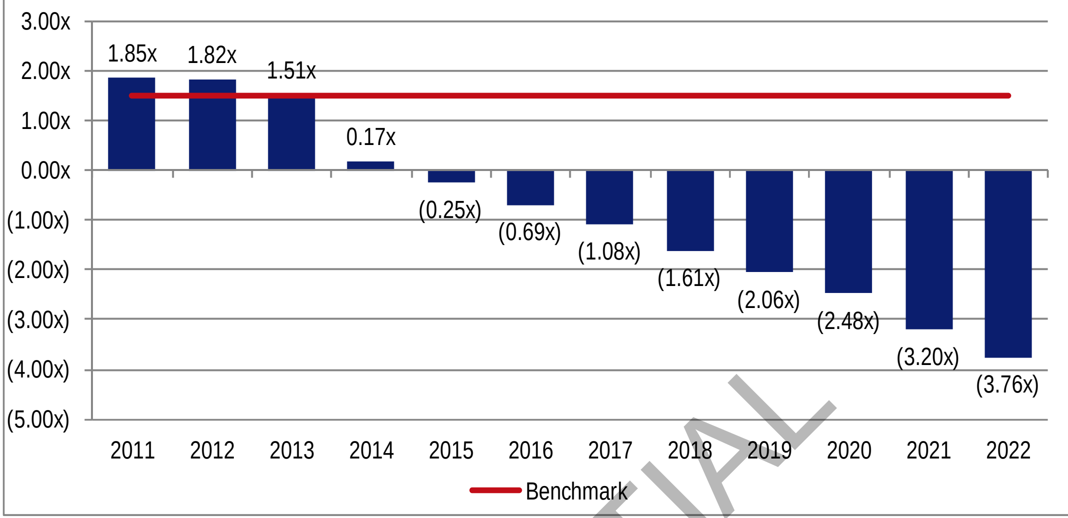
Liquidity Ratios



The Cash Expense Ratio is forecast to remain slightly above zero at 0.2 months in 2013 before Council expect cash and cash equivalents to turn negative in 2014 and for the position to become progressively worse each year as Council utilises more cash than they have at their disposal.

Council has detailed that the draft copy of the forecast did not project cash and cash equivalents to decline into negative figures and that there has been an issue with the transfer from the draft to final versions. This needs to be corrected by Council.

Figure 9 - Unrestricted Current Ratio for General Fund

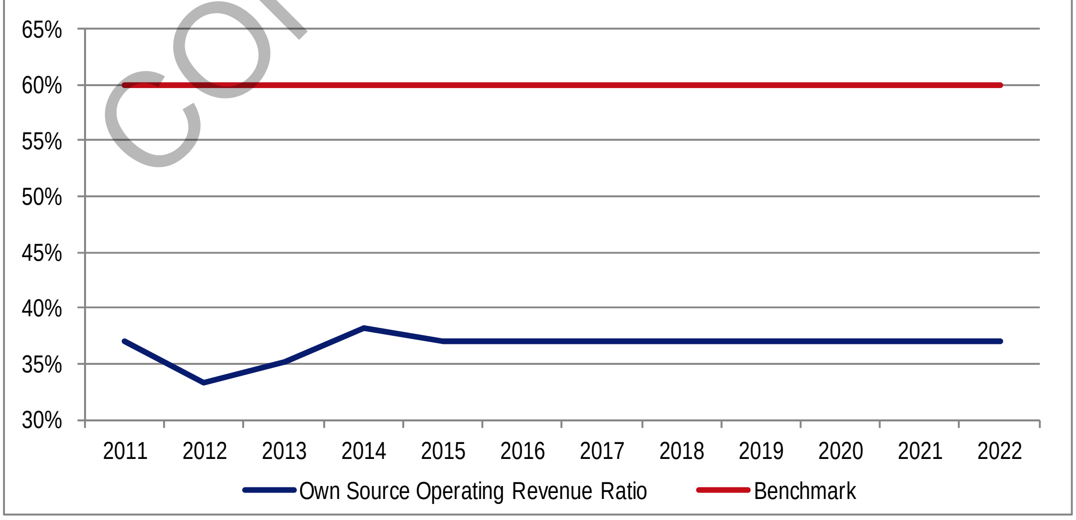


The Unrestricted Current Ratio highlights the liquidity issues that Council expect to experience by 2014. This ratio follows a similar trend to the Cash Expense Ratio with Council unable to meet their ongoing liabilities in 2014 as the current service levels utilise more cash than Council have available.

Both of the liquidity ratios highlight that Council is unable to continue operating on an ongoing basis with the current levels of service provided.

Fiscal Flexibility Ratios

Figure 10 - Own Source Operating Revenue Ratio for General Fund



Council has historically relied upon grants and contributions to assist meeting their liabilities and this is forecast to continue with the Own Source Operating Revenue Ratio remaining a long way below the 60% benchmark.

With a population below 5,000 it is very difficult for Council to generate a sufficient level of own source operating revenues that could provide financial flexibility.

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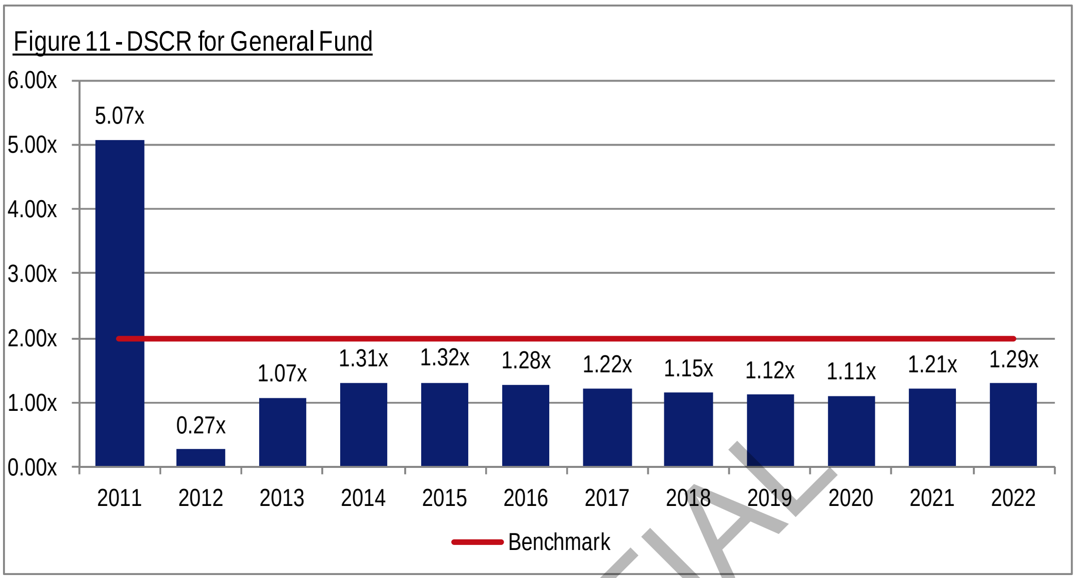
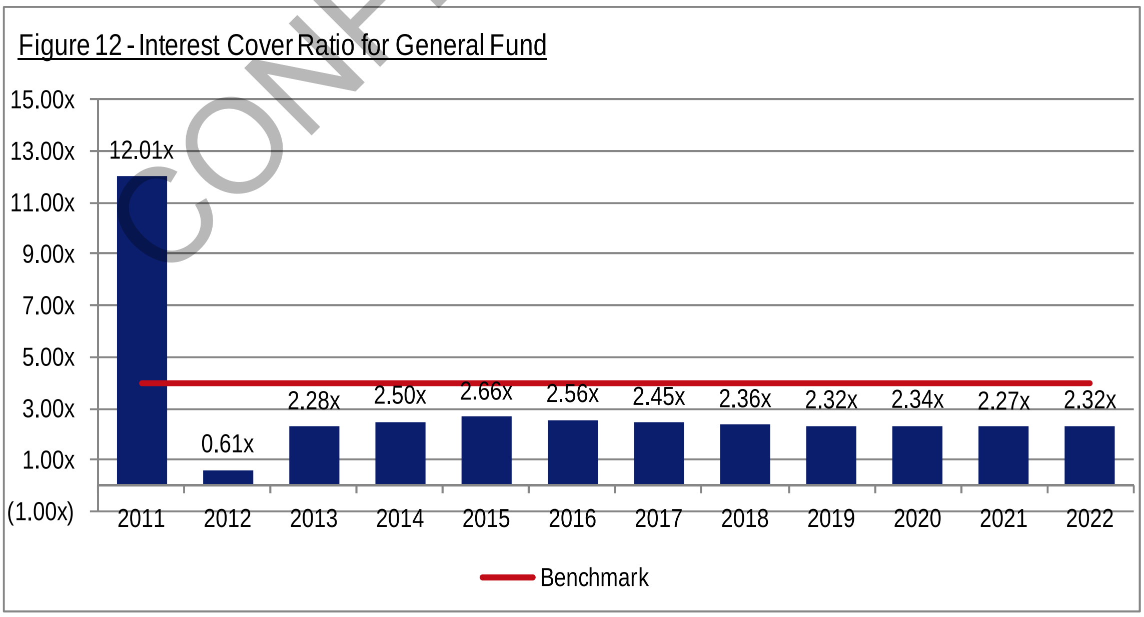


The DSCR is projected to increase from the low of 2012 when Council were unable to meet their debt repayments from EBITDA and had to utilise reserves to meet the liability. The ratio is projected to remain below the 2.00x benchmark for the full forecast although it remains above 1.00x, indicating that Council should be able to meet the current level of borrowings and the $3.9m scheduled to be utilised in 2013 for capital works relating to bridge and aged care assets. A ratio below the 2.00x benchmark indicates that there would be limited financial flexibility if Council experience any adverse financial events.

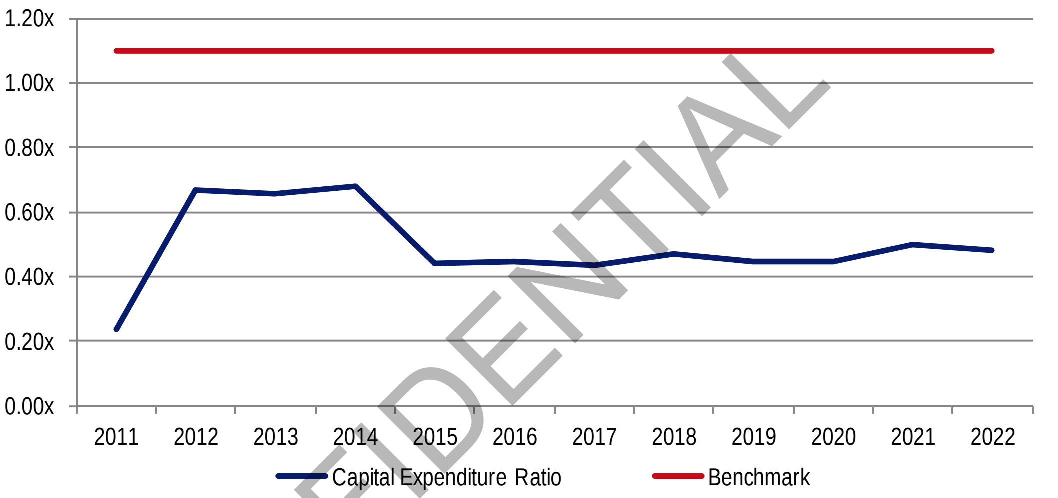


Similar to the DSCR, the Interest Cover Ratio highlights Council is forecast to be unable to meet their interest costs from EBITDA in 2012 and will have to utilise cash reserves to meet their interest liabilities. The forecast indicates that the ratio will improve from 2012 however it will remain below the 4.00x benchmark over the forecast period.

Council states within the LTFP that the General Fund could comfortably borrow a further $10m, however from our analysis we do not believe this to be the case, unless Council reduces expenses in other areas. Our analysis of Council's capacity to incorporate further borrowings is included within Section 4.5.

4.3: Capital Expenditure

Figure 13 - Capital Expenditure Ratio for General Fund



The Capital Expenditure Ratio remains significantly below the 1.10x benchmark throughout the forecast period, highlighting Council's inability to renew the asset base and maintain the Net Asset value.

Over the total review period, Council's cumulative capital expenditure is 50.0% ($53.0m) of the cumulative depreciation total ($106.0m) highlighting the likely decline in the asset base.

The Net Asset position within the General Fund is forecast to reduce from $173.0m in 2012 to $103.3m in 2022.

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 5.0%
- All other revenue items: the estimated annual CPI increase of 2.5%
- Employee costs: 3.5% (estimated CPI+1.0%)
- All other expenses: the estimated annual CPI increase of 2.5%

<u>Key Observations and Risks</u>

- Council has completed the LTFP forecast in real dollar terms, not including the likely impact of inflation on revenues and expenses.
- Service levels are forecast to remain at the current level for all scenarios.
- The 'adopted' scenario forecasts a larger deficit position in each year than the 'business as usual' scenario. This is due to issues when Council transferred their draft forecast to a finalised format. The 'adopted' scenario states that Council is unlikely to be eligible for the Roads to Recovery grants in future, with this and a reduction in the FAG as the advance payments cease, being the reasons for the $2.9m decrease in operating grants and contributions in 2013.
- The adopted scenario has included an additional $1m p.a. from 2014 that Council is confident the ARRG will be successful in lobbying additional grant funding for.
- Depreciation and amortisation is forecast at a level higher than historically stated within the General Fund. The 2013 figure of $10.5m is higher than the 2012 figure of $7.6m however it is similar to the 2012 figure inclusive of impairments that equated to $10.6m.
- Council has predicted that they will receive additional grant funding via the FAG of 15% in 2014 following a review of how the grant is calculated that is expected to be completed by December 2013. Council has advised TCorp that they understand that the FAG distribution will be amended to boost the revenues of rural councils at the possible expense of their metropolitan counterparts. TCorp is not able to comment on the accuracy of this assumption other than to say that we are not aware of any announcement by government that supports this assumption.
- As Council's forecast has been completed in real dollar terms it is not possible to analyse all of the underlying assumptions for accuracy against TCorp's expected nominal annual increments.
- Council's assumptions of increased grants are subject to approval and may be optimistic.

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4.5: Borrowing Capacity

When analysing the financial capacity of the Council we believe they will not be able to incorporate additional loan funding in addition to its existing debt facilities and the forecast $3.9m borrowings in 2013.

This is because Council is forecast to be below the respective 2.00x and 4.00x benchmarks for the DSCR and Interest Cover Ratio in each year of the forecast period.

In the event that Council is able to reduce expenses below current forecast levels or secure additional revenue sources, managing additional borrowings may be possible.

4.6: Sustainability

Based on its historical performance and the current LTFP, Council is unsustainable in the medium and long term when continuing to provide the current service levels. The historic operating deficits are forecast to continue over the 10 year LTFP forecast period, leading to a negative cash position and a reducing Net Asset position over time.

As stated within the LTFP, Council believes that the only option to continue to operate is by reducing service levels, indicating that the road network will have to be allocated longer effective lives and lower average quality standards as Council cannot fund the maintenance and renewals for their road infrastructure assets.

The relatively low population does not provide Council with a large own source operating revenue base to service the assets within the large geographical area. Council has been proactive and has played an integral part in creating the ARRG and through their continued lobbying they hope to obtain additional grant funding for rural LGAs to assist with the maintenance of the rural road infrastructure network.

Section 5 Benchmarking and Comparisons with Other Councils

Each council's performance has been assessed against ten key benchmark ratios. The benchmarking assessment has been conducted on a consolidated basis for councils operating more than one fund. This section of the report compares the Council's performance with its peers in the same DLG Group. The Council is in DLG Group 10. There are 25 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 20, 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.

Financial Flexibility

Figure 14 - Operating Ratio Comparison

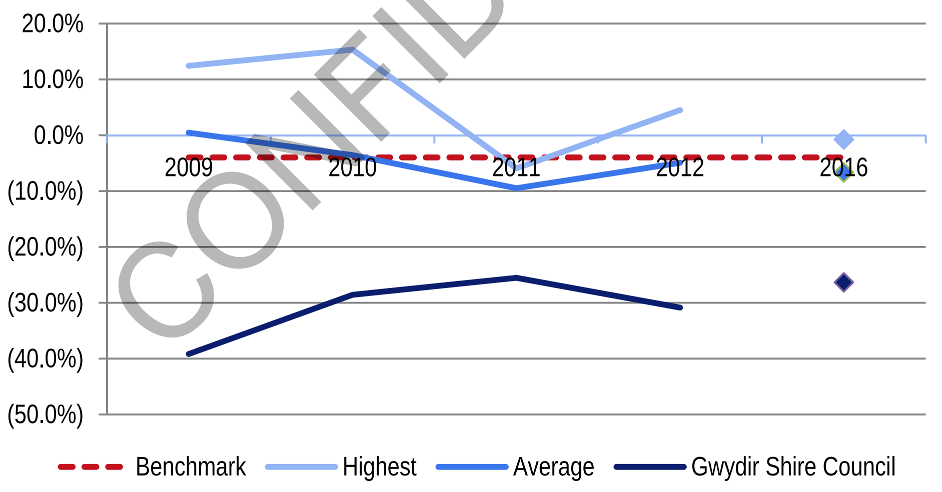
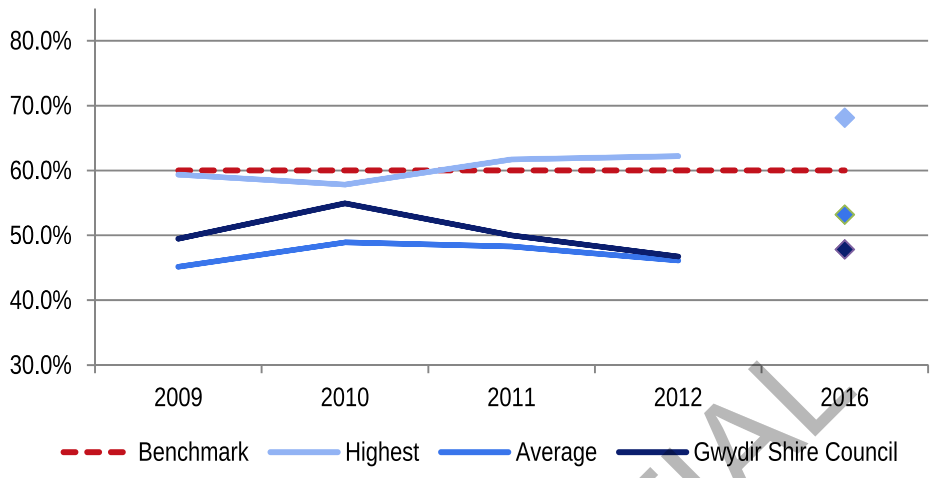


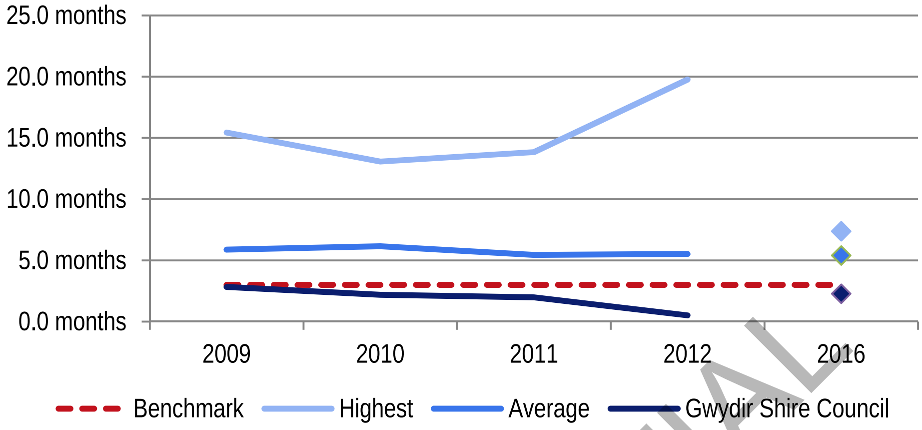
Figure 15- Own Source Operating Revenue Ratio Comparison



Council has a low level of financial flexibility with the Operating Ratio and the Own Source Operating Revenue Ratio below the benchmark over the review period. Although its Own Source Operating Revenue Ratio is above the group's average, it is in decline indicating an increasing reliance on operating grants. Council needs additional revenue, cost control measures together with a review of service levels to improve its operating performance.

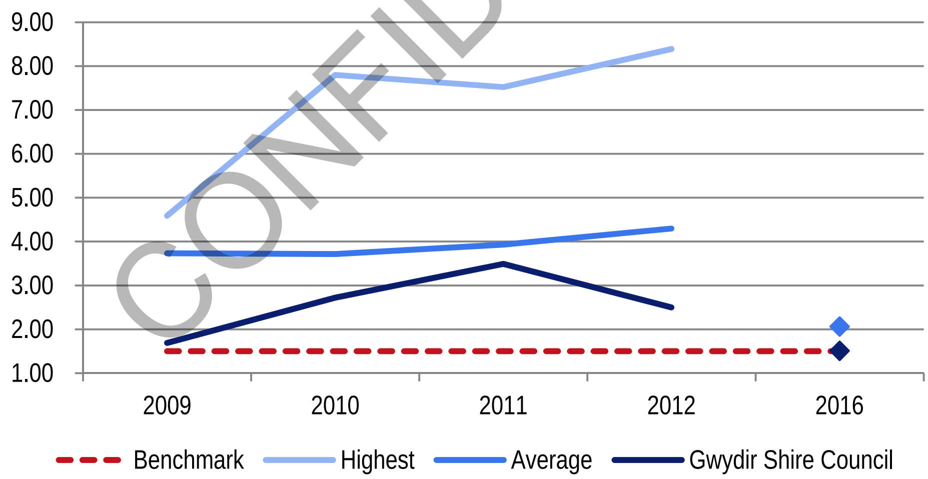
Liquidity

Figure 16 - Cash Expense Ratio Comparison



The Council's Cash Expense Ratio has been below benchmark and average since 2009 and will remain so until 2016. This ratio is low because it does not include Council's investments which are mostly term deposits.

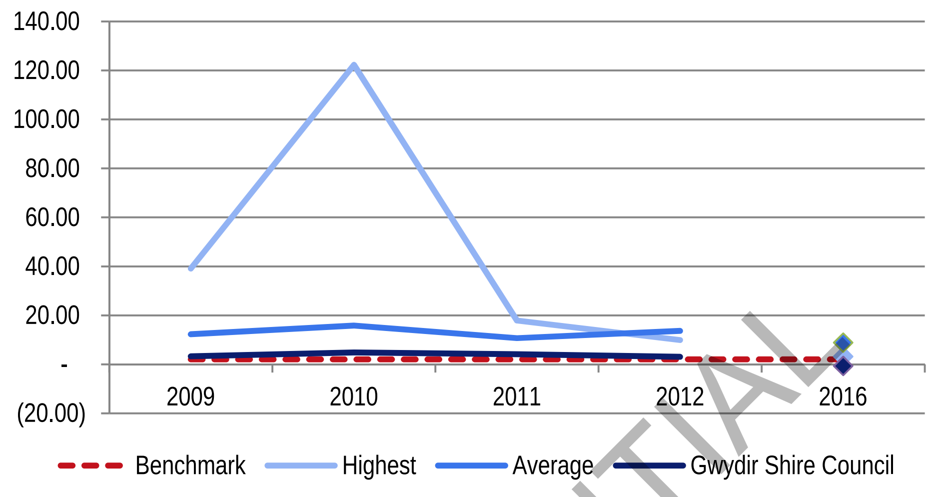
Figure 17 - Unrestricted Current Ratio Comparison



Council's liquidity position is currently marginal with the Unrestricted Current Ratio above benchmark but below the group's average since 2009. However, the ratio is in decline and will be at benchmark level by 2016. The Cash Expense Ratio is forecast to increase to nearer the benchmark in 2016 however Council will remain below the group average.

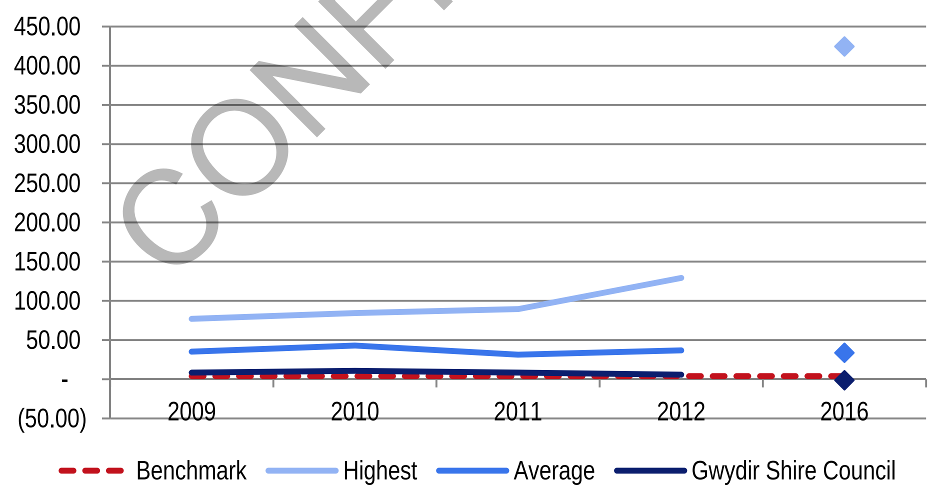
Debt Servicing

Figure 18- Debt Service Cover Ratio Comparison



The Council has moderate debt capacity with the DSCR below the group's average but around benchmark level since 2009. Council has the capacity to service its current borrowings but will not have the capacity to take on further borrowings as the ratio falls below benchmark by 2016.

Figure 19 - Interest Cover Ratio Comparison



Like the DSCR, the Interest Cover Ratio is at benchmark level but below the group's average. Due to Council's forecast decrease in performance, similar to the DSCR the ratio deteriorates in 2016.

Asset Renewal and Capital Works

Figure 20 - Capital Expenditure Ratio Comparison

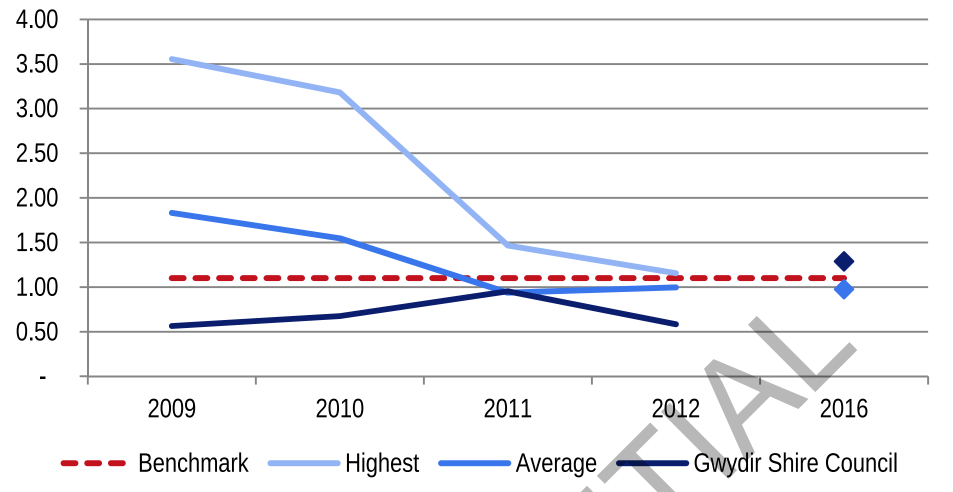


Figure 21 - Asset Maintenance Ratio Comparison

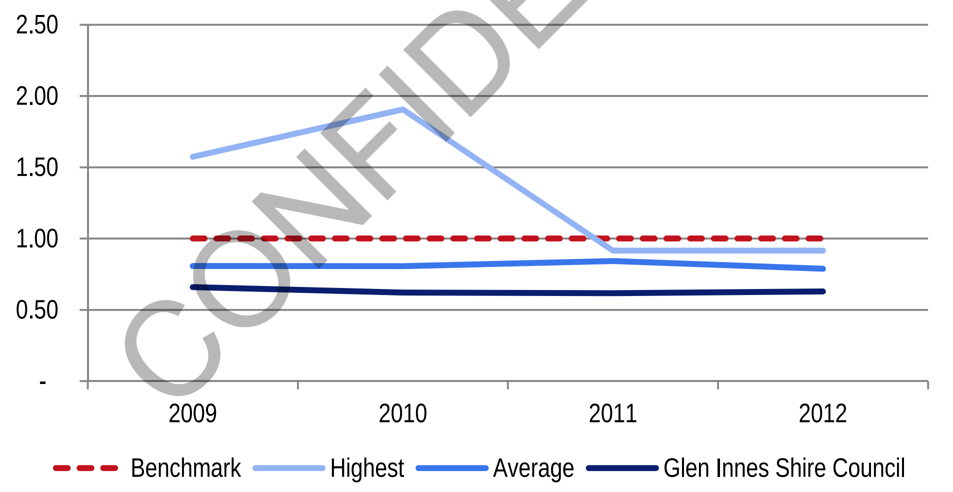


Figure 22 - Infrastructure Backlog Ratio Comparison

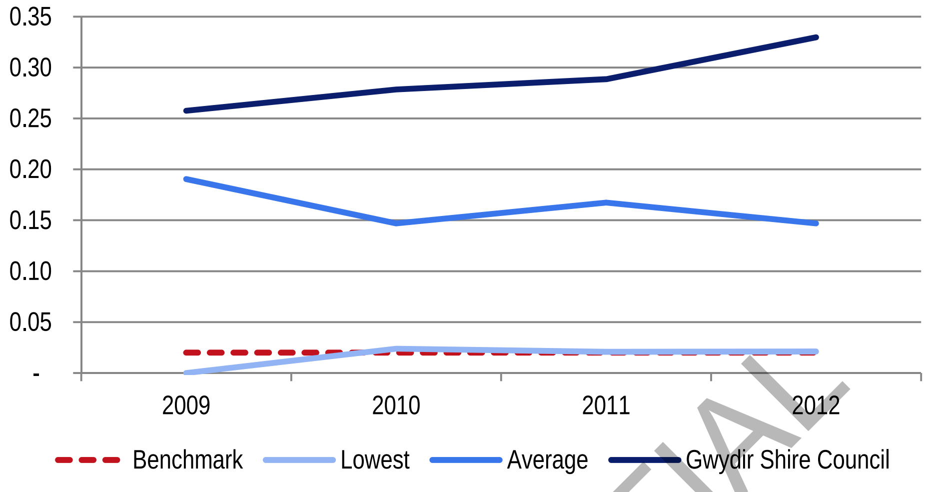
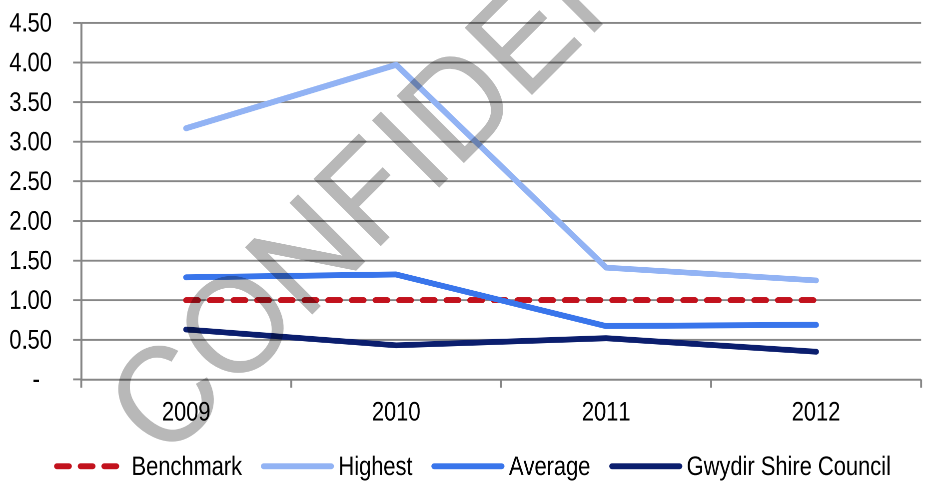


Figure 23 - Building and Infrastructure Asset Renewal Ratio



Council's Capital Expenditure Ratio, Asset Maintenance Ratio and the Building and Infrastructure Asset Renewal Ratio have been below benchmark and the group's average since 2009. Should this trend continue, Council's assets may not be maintained at a level required to deliver its services and will add to an Infrastructure Backlog that has been above the group's average and benchmark and is continuing to grow.

Section 6 Conclusion and Recommendations

Based on our review of both the historic financial information and the 10 year financial forecast within Council's LTFP we consider Council to be unsustainable if current service levels are continued within the General Fund.

We base our recommendation on the following key points:

- Large operating deficits are forecast to continue throughout the forecast period with Council unable to raise sufficient revenues to meet their ongoing expenses
- The General Fund is projected to run out of cash by 2014, indicating Council's lack of liquidity
- Council is unable to fund the ongoing maintenance and renewals costs required to manage their infrastructure assets leading to a likely increase in the Infrastructure Backlog
- Council's Net Assets are projected to reduce from \$173.0m in 2012 to \$103.3m in 2022 within the General Fund highlighting Council's inability to maintain their assets at the current standard

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

- Council has completed their IP&R documentation for the first time and recognise that the accuracy of the data can be improved in future versions, providing more realistic documents that may improve the forecast position. Council has indicated that the liquidity position may appear worse in the forecast than the likely position due to a problem with their LTFP modelling program
- We recommend that future versions of the LTFP are completed in nominal terms to factor in the effect of inflation to enable a more complete forecast financial position to be analysed

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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	7,432	7,386	6,778	6,461	0.6%	9.0%	4.9%
User charges and fees	6,393	5,925	6,198	4,634	7.9%	(4.4%)	33.8%
Interest and investment revenue	638	492	387	329	29.7%	27.1%	17.6%
Grants and contributions for operating purposes	8,262	6,901	5,695	6,374	19.7%	21.2%	(10.7%)
Other revenues	1,469	1,451	1,159	1,679	1.2%	25.2%	(31.0%)
Gain from the disposal of assets	25	77	113	141	(67.5%)	(31.9%)	(19.9%)
Total revenue	24,219	22,232	20,330	19,618	8.9%	9.4%	3.6%
Expenses							
Employees	11,166	8,934	8,884	8,865	25.0%	0.6%	0.2%
Borrowing costs	808	635	534	367	27.2%	18.9%	45.5%
Materials and contract expenses	6,210	6,003	4,091	6,285	3.4%	46.7%	(34.9%)
Depreciation and amortisation	11,268	10,442	10,990	10,396	7.9%	(5.0%)	5.7%
Other expenses	2,240	1,891	1,638	1,390	18.5%	15.4%	17.8%
Total expenses	31,692	27,905	26,137	27,303	13.6%	6.8%	(4.3%)
Operating result	(7,473)	(5,673)	(5,807)	(7,685)	(31.7%)	2.3%	24.4%

Table 2 - Items excluded from Income Statement

Excluded items ($'000s)				
	2012	2011	2010	2009
Grants and contributions for capital purposes	5,350	4,383	3,289	2,808
Reduced interest loan from Federal Government	192	0	0	0

New South Wales Treasury Corporation

Table 3 - Balance Sheet

Balance Sheet ($'000s)	Year Ended 30 June				% annual change		
	2012	2011	2010	2009	2012	2011	2010
Current assets							
Cash and equivalents	832	2,776	2,669	3,897	(70.0%)	4.0%	(31.5%)
Investments	11,250	5,500	5,000	2,600	104.5%	10.0%	92.3%
Receivables	3,813	3,563	3,162	2,301	7.0%	12.7%	37.4%
Inventories	235	249	218	212	(5.6%)	14.2%	2.8%
Other	5	0	0	0	N/A	N/A	N/A
Total current assets	16,135	12,088	11,049	9,010	33.5%	9.4%	22.6%
Non-current assets							
Receivables	311	160	94	110	94.4%	70.2%	(14.5%)
Infrastructure, property, plant & equipment	194,435	199,995	186,761	177,661	(2.8%)	7.1%	5.1%
Total non-current assets	194,746	200,155	186,855	177,771	(2.7%)	7.1%	5.1%
Total assets	210,881	212,243	197,904	186,781	(0.6%)	7.2%	6.0%
Current liabilities							
Payables	1,854	1,298	852	1,608	42.8%	52.3%	(47.0%)
Borrowings	730	654	649	527	11.6%	0.8%	23.1%
Provisions	2,945	2,126	2,203	2,264	38.5%	(3.5%)	(2.7%)
Total current liabilities	5,529	4,078	3,704	4,399	35.6%	10.1%	(15.8%)
Non-current liabilities							
Borrowings	9,759	8,531	6,811	5,228	14.4%	25.3%	30.3%
Provisions	3,258	2,784	2,978	2,883	17.0%	(6.5%)	3.3%
Total non-current liabilities	13,017	11,315	9,789	8,111	15.0%	15.6%	20.7%
Total liabilities	18,546	15,393	13,493	12,510	20.5%	14.1%	7.9%
Net assets	192,335	196,850	184,411	174,271	(2.3%)	6.7%	5.8%

Table 4-Cashflow

Cashflow Statement ($'000s)	Year ended 30 June			
	2012	2011	2010	2009
Cashflows from operating activities	10,538	8,661	6,522	7,162
Cashflows from investing activities	(13,786)	(10,279)	(9,455)	(8,575)
Proceeds from borrowings and advances	2,000	2,400	2,350	915
Repayment of borrowings and advances	(696)	(675)	(645)	(571)
Cashflows from financing activities	1,304	1,725	1,705	344
Net increase/(decrease) in cash and equivalents	(1,944)	107	(1,228)	(1,069)
Cash and equivalents	832	2,776	2,669	3,897

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.

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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.

Sustainability

A local government will be financially sustainable over the long term when it is able to generate sufficient funds to provide the levels of service and infrastructure agreed with its community

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

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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 assets (from Special Schedule 7)

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

Interest Cover Ratio

Benchmark = Greater than 4.0x

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

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

Operating Ratio

Benchmark = Better than negative 4%

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

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

Own Source Operating Revenue Ratio

Benchmark = Greater than 60%

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

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

Unrestricted Current Ratio

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

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

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