New South Wales
Treasury Corporation

Deniliquin Council

Financial Assessment, Sustainability and Benchmarking Report

1 May 2013

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

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 Deniliquin Council, the DLG and the Independent Local Government Review Panel. TCorp shall not be liable to Deniliquin 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 Deniliquin 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.

The Council has been well managed over the review period based on the following observations:

- Total revenue, excluding capital grants and contributions, increased 23.7% over the four year period to $15.9m in 2012
- Owned Sourced Operating Revenue Ratio has been close to the benchmark over the four year period
- The majority of Council's performance indicators were above benchmark over the four year period

The Council reported $41.2m of Infrastructure Backlog in 2012 which represents 34.6% of its infrastructure asset value of $119.2m. Other observations include:

- Council's total Infrastructure Backlog has reduced in value by $6.5m since 2009
- The majority of Council's backlog is related to sewerage assets
- Benchmark ratios indicate that while Council is spending sufficient amounts on asset maintenance they are not spending the required amount on asset renewal

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

- The forecast shows deficit positions are expected for the majority of the forecast period, when capital grants and contributions are excluded
- The forecast liquidity ratios show that Council will have liquidity problems in the short to medium term
- Council is forecasting strong and improving debt servicing ratios as debt levels reduce and operating results improve
- Council is forecasting a drop in capital expenditure which is well below the benchmark for most of the forecast period

In our view, the Council does not have the capacity to undertake additional borrowings. The very low liquidity ratios preclude any further borrowings until the liquidity position is improved.

In respect of the long term Sustainability of the Council our key observations are:

- Council forecasts operating deficits throughout most of the forecast period with expenses throughout the forecast period being lower than their 2011 levels, leading to downside risks for their forecasts
- The limited size of the Council's rating base makes it difficult for Council to address the forecast operating deficits, manage unforseen financial shocks or any adverse changes in its business
- Council has completed their Asset Management Plan (AMP) and is in the process of updating its LTFP

In respect of the Benchmarking analysis TCorp has compared the Council's key ratios with other councils in DLG group 4. The key observations are:

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

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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, 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

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 agrees with the findings of the report

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

Deniliquin Council LGA	
Locality & Size	
Locality	Central Murray
Area	143.2km^2
DLG Group	4
Demographics	
Population as at 2011	7,120
% under 20	26%
% between 20 and 59	46%
% over 60	28%
Expected population 2021	7,600
Operations	
Number of employees (FTE)	78
Annual revenue	$15.9m
Infrastructure	
Roads	172.4km
Bridges	2
Infrastructure backlog value	$41.2m
Total infrastructure value	$119.2m

Deniliquin Council Local Government Area (LGA) is the third largest centre in the Riverina and is situated along the Edward River, 200kms west of Wagga Wagga.

With both dry-land and irrigated regions within its farming land, Deniliquin is a productive irrigation area in New South Wales. The largest rice mill in the southern hemisphere operates at Deniliquin (the fourth largest rice mill in the world).

Historically, Deniliquin hosted a large sawmill processing industry for the processing of red gum that was felled in the Edward and Murray River floodplains. This industry was altered in 2010 through the designation of approximately 100,000 hectares of River Red Gum reserves in the Murray and Riverina areas as national parks. This range of reserves now forms the largest conservation area of river red gums in the world and will provide a new opportunity for Deniliquin through its appeal to tourists.

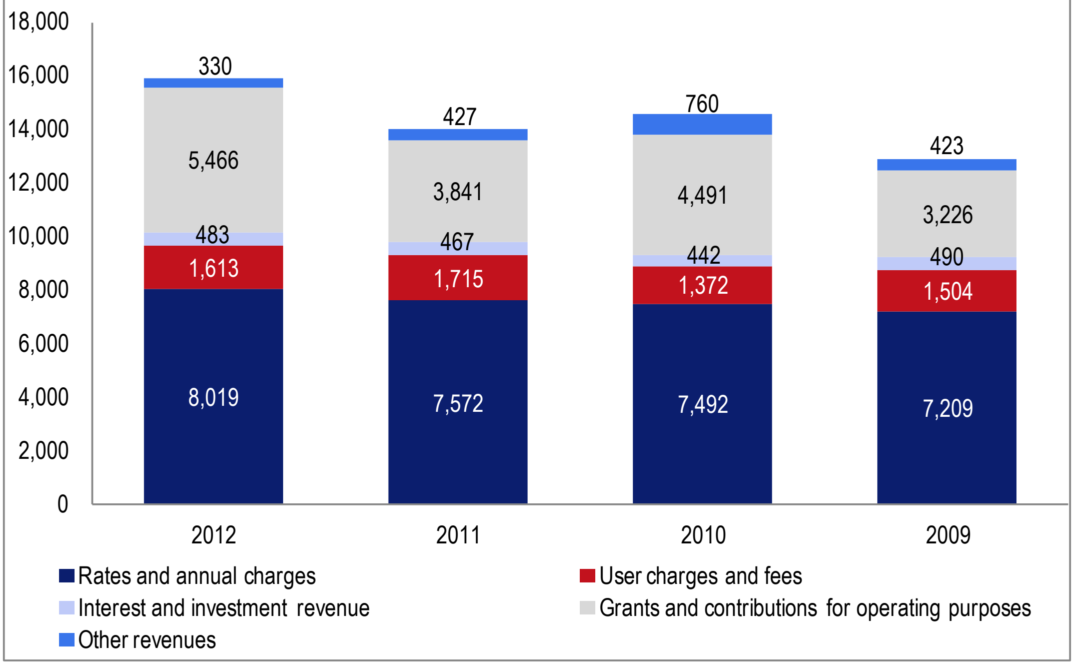
The population is approximately 7,120 with the largest age group being between 25 to 54 years of age. There are 1,115 registered businesses within Deniliquin with the three top occupations being technicians/trade workers, professionals and labourers.

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)

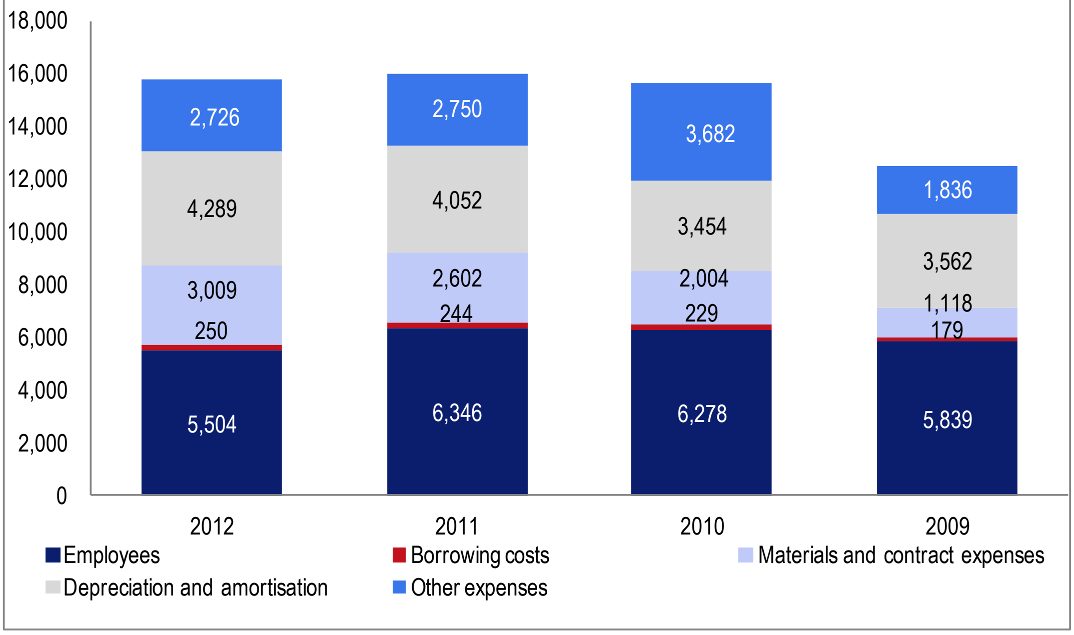


Key Observations

- Total revenue, excluding capital grants and contributions, increased 23.7% over the four year period to $15.9m in 2012.
- Rates and annual charges have increased by 11.2% ($0.8m) since 2009. Rates revenue growth has been in line with standard rate peg. Annual charges have increased at a faster rate driven by increases in water supply charges and sewerage charges.
- User fees and charges have fluctuated over the period with an overall increase of 7.2% ($0.1m) since 2009. This is due to the increases in water supply charges being largely offset by the reduction in saleyard fees.
- Grants and contributions for operating purposes have fluctuated over the period though grown overall with an increase of 69.4% ($2.2m) since 2009. This is due to the prepayment of half the 2013 Financial Assistance Grants (FAG) ($1.1m) in 2012 and large increases in NSW Rural Fire Services (RFS) and transport specific purpose grants.

3.2: Expenses

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



Key Observations

- Total expenses have grown 25.9% ($3.2m) to $15.8m in 2012. This is mainly due to a large increase in 2010 with relatively stable expenses thereafter.
- Employee costs fell significantly in 2012 to $5.5m, 5.7% below the 2009 level. This is due to falls in salaries and wages, superannuation costs and employee leave entitlements from long term senior employees leaving and new employees being wage employees. The number of employees increased to 78.
- Materials and contract expenses have increased 169.1% ($1.9m) over the four year period to $3.0m in 2012. This is due to increases in raw materials and consumables costs, and contractor and consultancy costs from Council employing a number of contractors and increased maintenance costs. Council has since reversed their trend of employing contractors and is employing permanent staff.
- Depreciation and amortisation expenses have increased 20.4% ($0.7m) over the four year period to $4.3m in 2012. This is mainly due to upward Asset Revaluations of $47.8m since 2009.
- Other expenses increased 100.5% in 2010 due to a $1.7m increase in contributions and levies to other levels of government. Council is the host in RFS zone management which makes them responsible for the distribution of reimbursements and contributions on behalf of other member councils. This has resulted in income and expenditure being duplicated due to its accounting treatment. Other expenses have been declining since 2010 as the reductions in contributions and levies to other levels of government have more than offset increases in other items such as electricity and heating expenses.

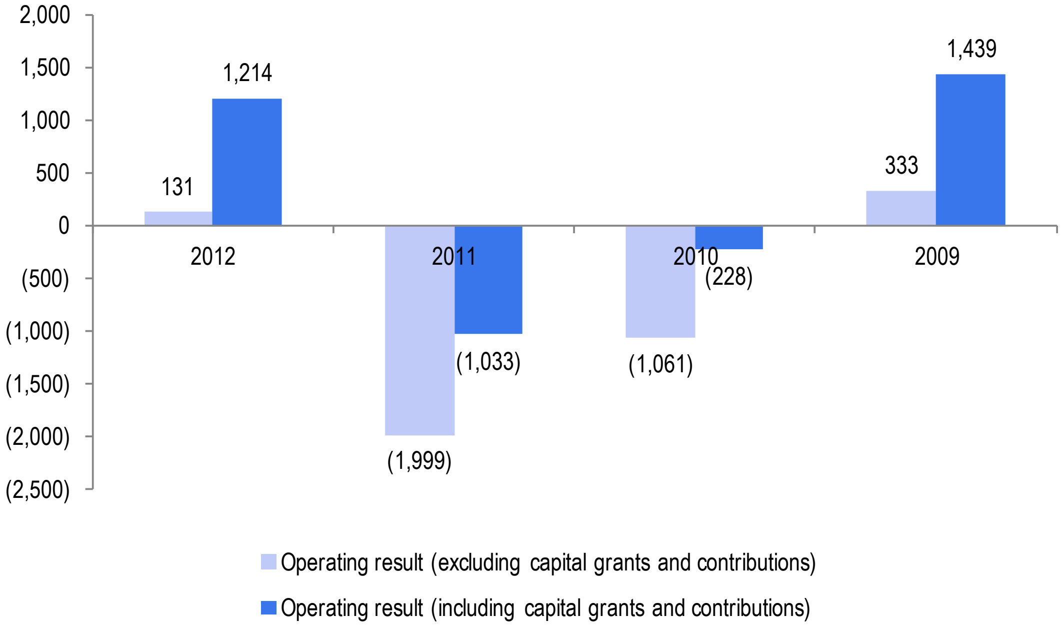
3.3: Operating Results

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 posted deteriorating net operating results excluding capital grants and contributions from 2009 until 2011 with a sharp improvement in 2012.
- The improvement in 2012 is mainly due to a large increase in operating grants and contributions from the prepaid 2013 financial assistance grants, and a large fall in employee expenses.
- Council expenses include a non-cash depreciation expense, ($4.3m in 2012), which has substantially increased since 2009. 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

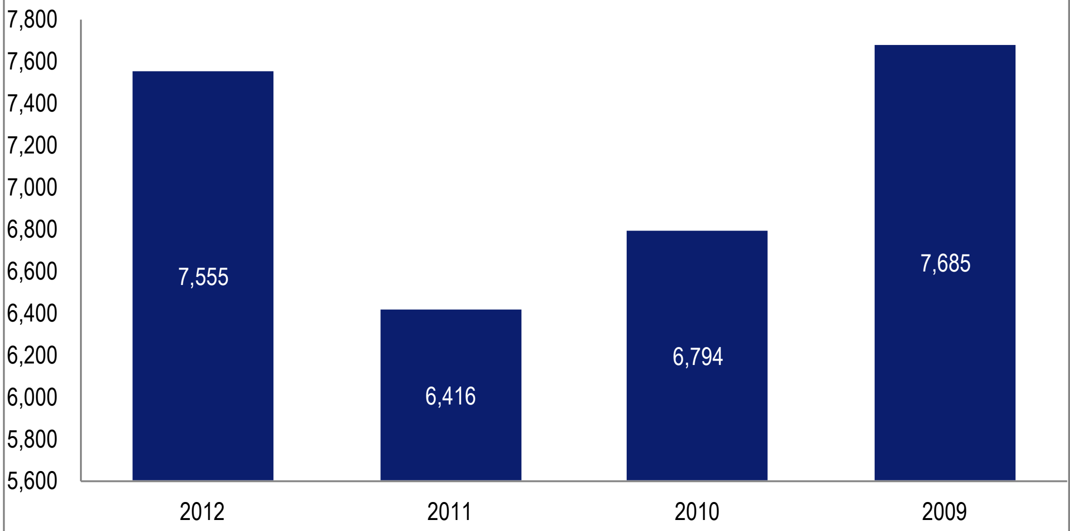
Performance Indicators	Year ended 30 June			
	2012	2011	2010	2009
EBITDA ($'000s)	4,670	2,297	2,622	4,074
Operating Ratio	0.8%	(14.3%)	(7.3%)	2.6%
Interest Cover Ratio	18.68x	9.41x	11.45x	22.76x
Debt Service Cover Ratio	9.61x	2.22x	3.69x	5.37x
Unrestricted Current Ratio	1.61x	1.80x	1.71x	1.54x
Own Sourced Revenue Ratio	56.7%	62.0%	57.5%	62.4%
Cash Expense Ratio	8.1 months	6.6 months	6.8 months	10.5 months
Net assets ($'000s)	134,572	128,911	128,148	85,835

Key Observations

- Council's EBITDA and Operating Ratio deteriorated throughout most of the period with improvements in 2012 due to a reduction in employee costs and increased operating grants and contributions.
- Council's Interest Cover Ratio and Debt Service Cover Ratio were both well above benchmark in all four years indicating Council had flexibility in regard to carrying more debt.
- Council's Unrestricted Current Ratio has been above the benchmark of 1.50x over the past four years, indicating that Council has sufficient liquidity.
- Council's Own sourced revenue has been close to the benchmark of 60% over the last four years indicating Council has some financial flexibility.
- Council's Net Assets have increased by $48.7m over the last four years primarily due to Asset Revaluations which have increased the value of Council's infrastructure assets.
- When the Asset Revaluations are excluded, the underlying trend has been an increase in the infrastructure, property, plant and equipment (IPP&E) asset base with asset purchases being greater than the combined value of disposed assets and annual depreciation. Over the four years this amounted to a $2.0m increase in IPP&E assets.
- Council has total borrowings of $2.6m representing 1.9% of Net Assets.

3.5: Statement of Cashflows

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



Key Observations

- Cash and cash equivalents have fluctuated over the period and declined by $0.1m since 2009 to $7.6m in 2012. The increase in 2012 is due to an increase in cash from operating activities.
- Of the $9.3m in cash and investments in 2012, $6.7m is externally restricted, $2.5m is internally restricted and $0.1m is unrestricted.
- Council had $1.7m in investments at 30 June 2012. This includes $1.7m in NCDs and FRNs, $0.02m in CDOs. Some of these investments are no longer prescribed by the ministerial investment order and will be disposed of when financially advantageous to the Council.

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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)

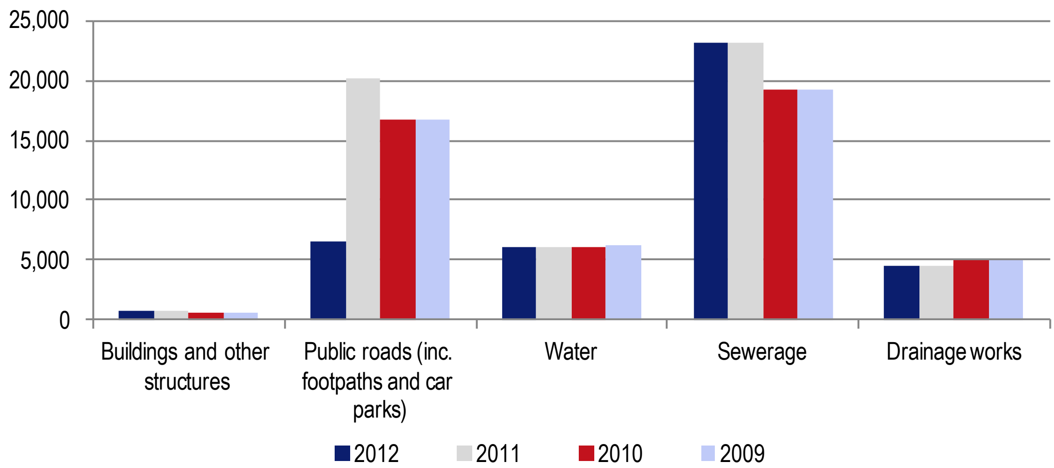
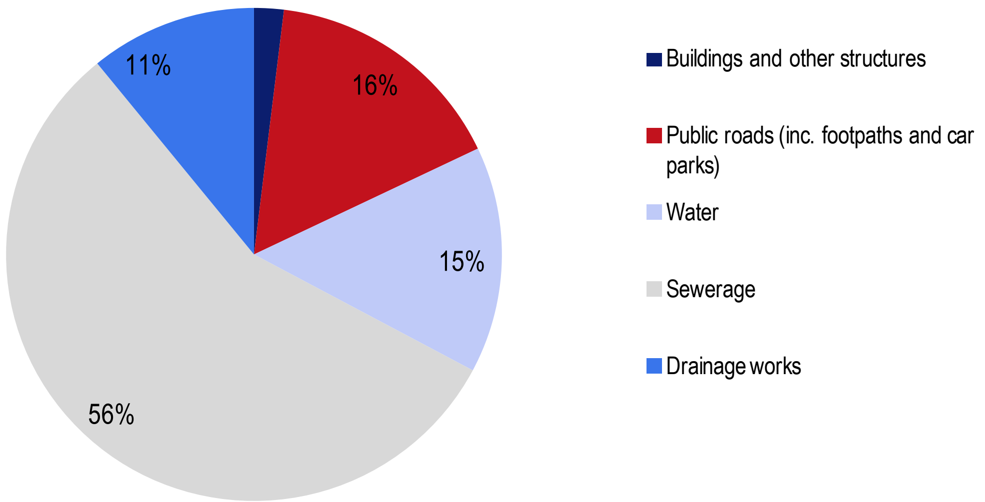


Figure 6 - Infrastructure Backlog Composition for 2011/12



Council reported a $41.2m Infrastructure Backlog in 2012, of which 56.3% ($23.2m) relates to sewerage assets, 16.0% ($6.6m) relates to public roads and 14.8% ($6.1m) relates to water assets.

The Infrastructure Backlog has reduced since 2009. Council stated that they increased the road resealing program and major road reconstructions which has reduced the Backlog value for roads. Council has also undertaken a review of the condition of their assets rather than relying on the age of the assets to determine their condition which has led to a lower Infrastructure Backlog.

3.6(b): Infrastructure Status

Infrastructure Status	Year ended 30 June			
	2012	**2011**	**2010**	**2009**
Bring to satisfactory standard ($'000s)	41,200	54,700	47,620	47,720
Required annual maintenance ($'000s)	2,730	2,730	2,461	2,506
Actual annual maintenance ($'000s)	2,730	2,730	4,131	4,191
Total value of infrastructure assets ($'000s)	119,233	102,037	100,954	58,075
Total assets ($'000s)	140,713	135,280	133,967	92,518
Building and Infrastructure Backlog Ratio	0.35x	0.54x	0.47x	0.82x
Asset Maintenance Ratio	1.00x	1.00x	1.68x	1.67x
Building and Infrastructure Asset Renewals Ratio	0.89x	0.75x	0.86x	0.69x
Capital Expenditure Ratio	1.15x	1.04x	1.39x	0.96x

The Building and Infrastructure Backlog Ratio was significantly above the benchmark of 0.02x and the Asset Maintenance Ratio was at benchmark in 2011 and 2012.

Council's Building and Infrastructure Asset Renewals Ratio has been below the benchmark of 1.0x for the past four years.

The Capital Expenditure Ratio, which takes into account assets which improve performance or capacity, was above the benchmark in two of the last four years. The years above benchmark are due to increases in capital works in progress, and plant and equipment.

Based on these figures, the quality of the existing asset base is likely to deteriorate unless additional funds are spent on the renewal of existing assets.

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	2,000	0	2,421	1,045
Replacement/refurbishment of existing assets	3,200	4,488	2,391	2,349
Total	**5,200**	**4,488**	**4,812**	**3,394**

Special Schedule 8 shows that Council has increased its capital program over the last four years.

Recent major capital works include:

- Rehabilitation of the existing sewer mains $1.5m

- Completion of a flood levee $0.8m
- Rehabilitation of the airport runway $0.4m
- Stormwater reconstruction $0.2m
- Installation of meters on raw water pump stations $0.1m

3.7: Specific Risks to Council

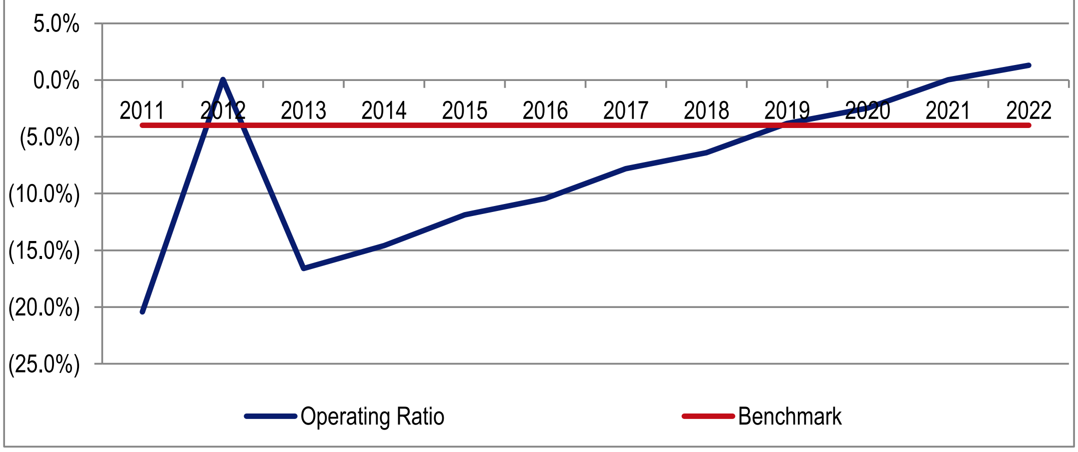
- Increasing demand for services. Requests from communities for expanded services have increased beyond those traditionally provided by local government. The demand for expanded services is not always matched by revenue streams and improved operational efficiencies. Council's strategy is to resolve any issues in community consultation. In 2011, Council conducted consultations, surveys and meetings to shape their Community Strategic Plan.
- Deterioration of infrastructure assets. The ageing infrastructure network is increasing the cost of maintenance. Over the last four years Council has spent less than required on building and infrastructure renewals and if this trend continues buildings and infrastructure will continue to deteriorate.

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 some 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.

4.1: Operating Results

Figure 7- Operating Ratio for General Fund



The overall trend in operating results is improving over the forecast period, though it is not expected to reach the benchmark until 2019.

Revenue falls in the first few years of the forecast and then grows by an average 2.5% p.a. from 2015 onwards. This growth is mainly driven by growth in rates and annual charges, user fees and charges and operating grants.

Expenses also fall in the first years of the forecast period and then grow by an average of 0.7% p.a. from 2015 onwards. This low level of expense growth is driven by employee costs growing by an average of 0.9% p.a. and falling borrowing costs offsetting the average 7.3% p.a. growth in materials and contract expenses from 2015. Council has stated that there will be a staff review with the aim to seek savings in employee costs. Changes in the level of staff will require contractors in the future which is why materials and contract expenses increase at 7.3% p.a. from 2015.

4.2: Financial Management Indicators

Liquidity Ratios

Figure 8 - Cash Expense Ratio for General Fund

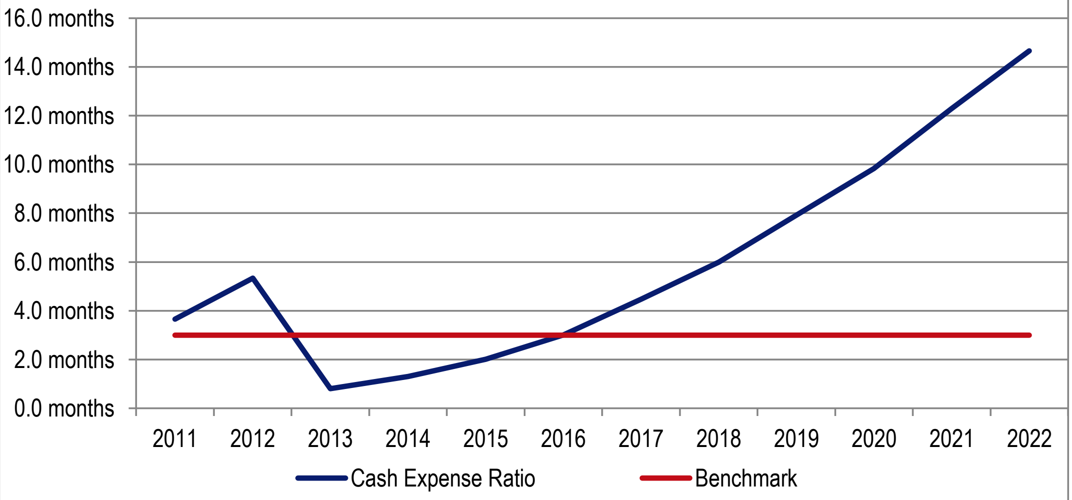
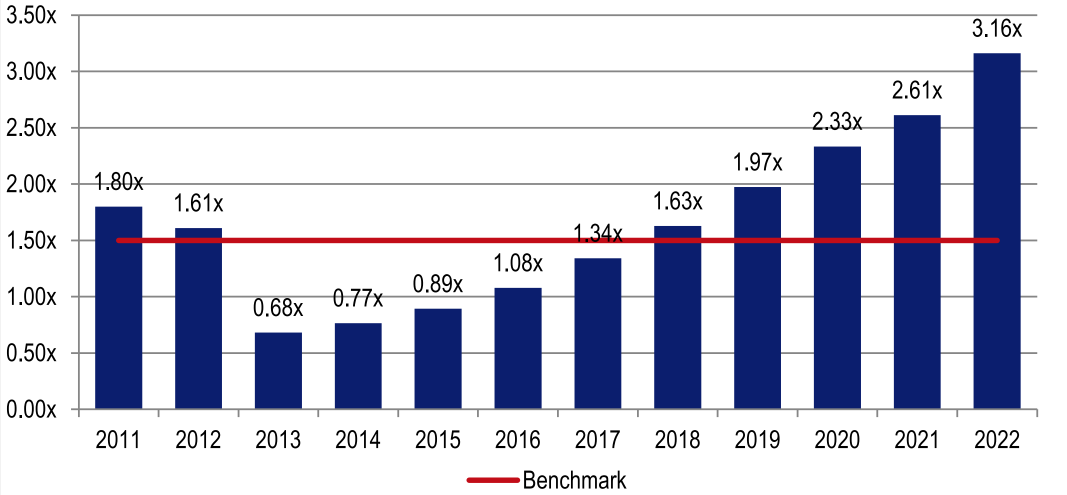


Figure 9 - Unrestricted Current Ratio for General Fund



Both the Cash Expense Ratio and Unrestricted Current Ratio are below the benchmarks from 2013 until at least 2016 due to the staff restructure bringing forward employee leave entitlements. During this time Council may have a liquidity problem and will be heavily reliant on operating cashflows being sufficient to service short term liabilities. Council may need to consider using an overdraft facility to cover short term cash shortfalls. The ratios improve over time due to increasing cash levels from improving profitability.

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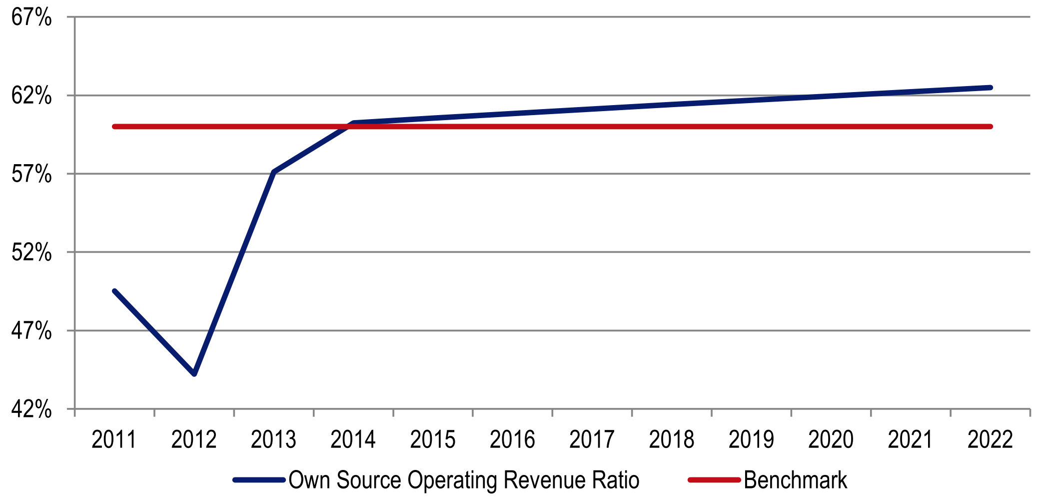
This indicates that Council is not forecasting sufficient liquidity levels over the forecast period.

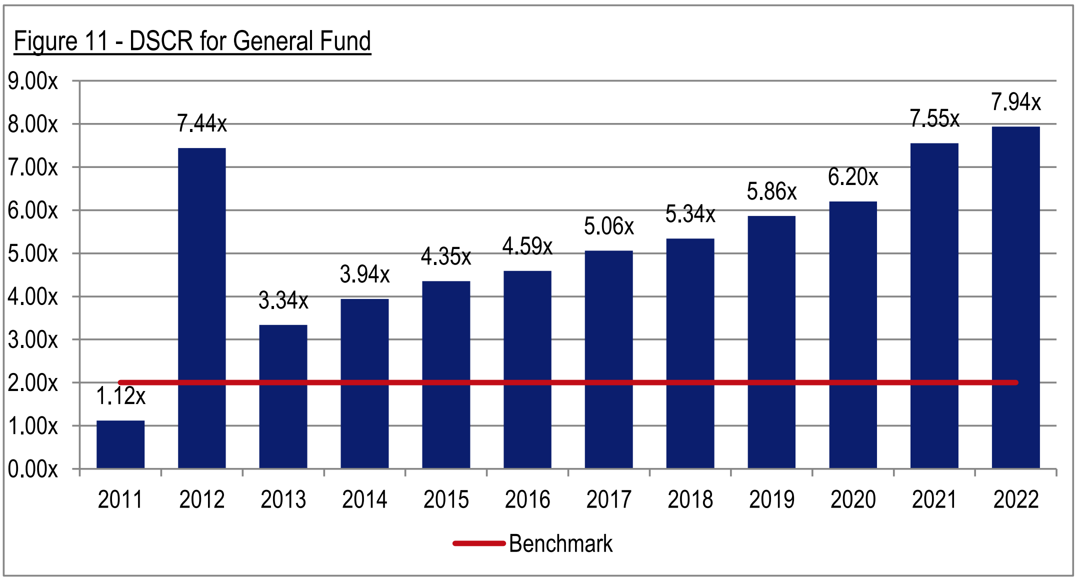
Fiscal Flexibility Ratios

Figure 10 - Own Source Operating Revenue Ratio for General Fund

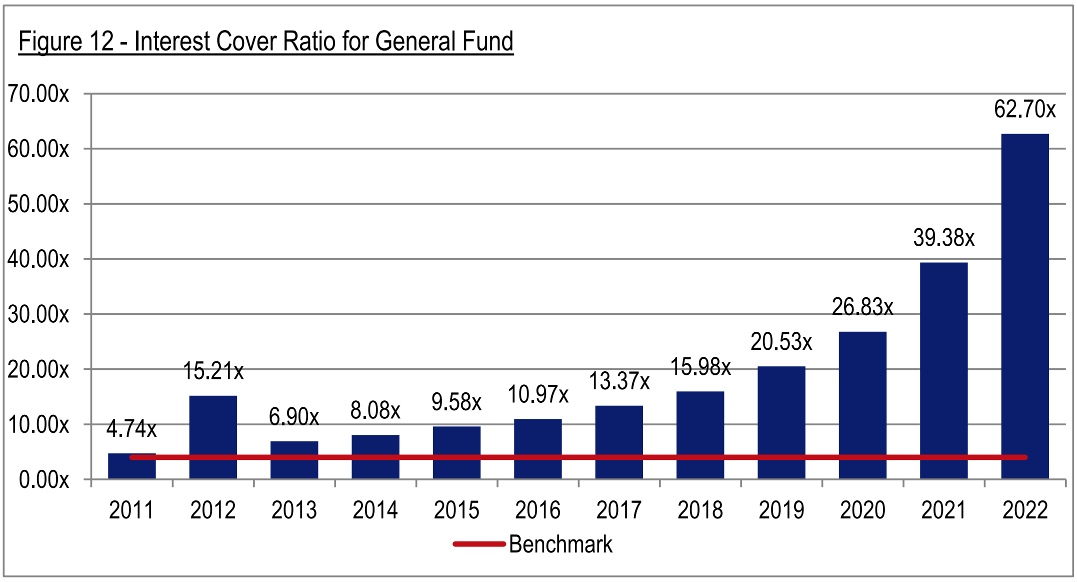


Council's Own Source Operating Revenue Ratio improves significantly in 2013 and 2014 due to falling grants and contributions for operating and capital purposes, falling interest and investment revenue and other revenues, while rates and annual charges and user fees and charges are growing.

From 2015, Council's Own Source Operating Revenue Ratio increases at a slower rate as the growth in rates and annual charges and user fees and charges are growing more quickly than other revenue items.



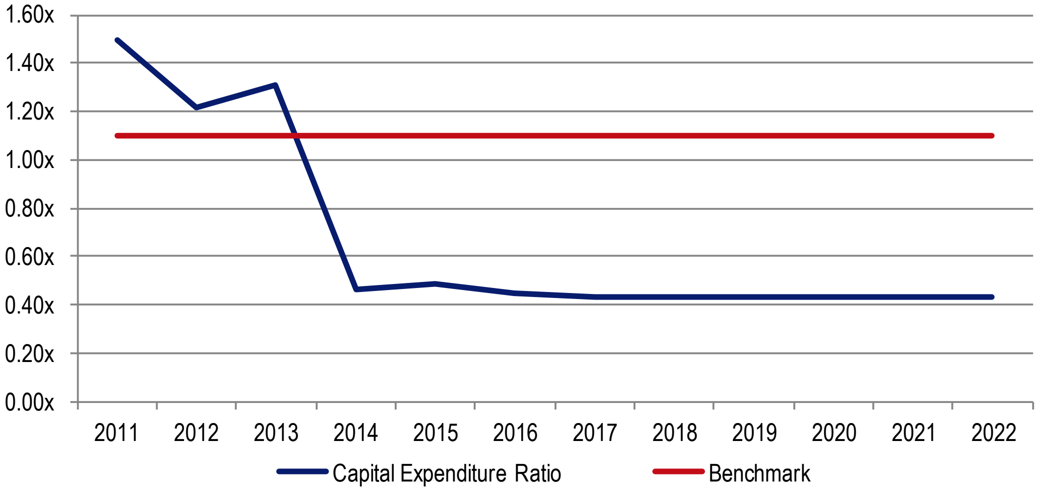
The DSCR is above the benchmark and improving over the forecast period. This is due to both reducing debt levels and improving EBITDA. The spike in 2012 is due to the prepaid FAG increasing EBITDA.



The Council's Interest Cover Ratio is above the benchmark of 4.00x and improves over the forecast period as profitability improves and interest costs reduce as debt is repaid. The spike in 2012 is due to the prepaid FAG increasing EBITDA.

4.3: Capital Expenditure

Figure 13 - Capital Expenditure Ratio for General Fund



The Capital Expenditure Ratio is well below benchmark from 2014 onwards for the remaining forecast period. These forecast levels of capital expenditure will increase pressure on existing assets.

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 stated that current service levels are being maintained.
- TCorp has based its analysis on the actual figures for 2011 and 2012 as well as the projections for the period between 2013 and 2022.
- Rates and annual charges increase by 3% p.a. in all years except 2014 where there is no growth.
- User fees and charges increase 15.1% in 2013 and then 3% p.a. thereafter. The increase in 2013 is due to higher liquid trade waste and stormwater charges.
- Interest and investment revenue grows by an average of 0.3% p.a. when cash and investment balances are increasing by an average of 23.7% p.a. from 2014 onwards. It appears as though interest and investment revenue is overstated in the early forecast years and then understated in the latter years of the forecast. Council will review their assumptions in the next forecast.
- Operating grants and contributions fall 23.3% in 2013 with the adjustment of the prepaid FAG, and then grow by an average of 1.9% p.a. thereafter.
- Capital grants and contributions fall 46.5% and 78.2% in 2013 and 2014 respectively and then remain at $0.1m thereafter.
- Employee cost growth averages 0.9% p.a. well below the benchmark growth of 3.5% p.a.
- Materials and contract expenses fall 14.0% and 21.3% in 2013 and 2014 respectively and then grow by an average of 7.3% p.a. thereafter. Council is expecting asset additions and maintenance levels to fall in the short term.
- Depreciation and amortisation expenses increase by 9.2% in 2013 and then remain steady thereafter.
- Given the large increases in revenue and large decreases in expense items in 2013 and 2014 and some below expected expenses growth thereafter, it may be difficult to achieve the results forecast. We also note that the forecast capital expenditure is very low in comparison to the benchmarks and we would suggest that it needs to be reviewed.

- Council has acknowledged that there are some errors in their forecasts and are currently in the process of updating their LTFP

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 its existing debt facilities. The very low liquidity ratios forecast preclude any further borrowings until the liquidity position is improved.

4.6: Sustainability

TCorp believes Council is in a moderate but deteriorating financial position. Council forecasts operating deficits throughout most of the forecast period. TCorp also has reservations about the reasonableness of its LTFP expenses assumptions which throughout most of the forecast are lower than their 2011 and 2012 levels. There is a risk that operating deficits will be higher than forecast if Council is unable to contain their expenses as they have projected. Council is also reliant on operating grants and contributions. Any material changes in these grants could further undermine Council's financial situation.

In considering the long term Sustainability of the Council, we make the following comments:

- The limited size of the Council's rating base makes it difficult for Council to address the forecast operating deficits, manage unforseen financial shocks or any adverse changes in its business
- Based on Council's current LTFP, Council is likely to have short to medium term liquidity problems
- In recent years, Council has not spent enough on asset renewals. Based on the current LTFP, this trend will continue which could lead to a reduction in the quality of the assets and ultimately service standards
- Council needs to review its LTFP, including expenses and capital expenditure program, to ensure that the LTFP provides an accurate picture of Council's future funding requirements
- Council has recently completed its AMP and this poses a downside risk to the LTFP as the new AMP may identify higher costs. Council is in the process of updating its LTFP to incorporate its capital expenditure and asset maintenance requirements.

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Section 5 Benchmarking and Comparisons with Other Councils

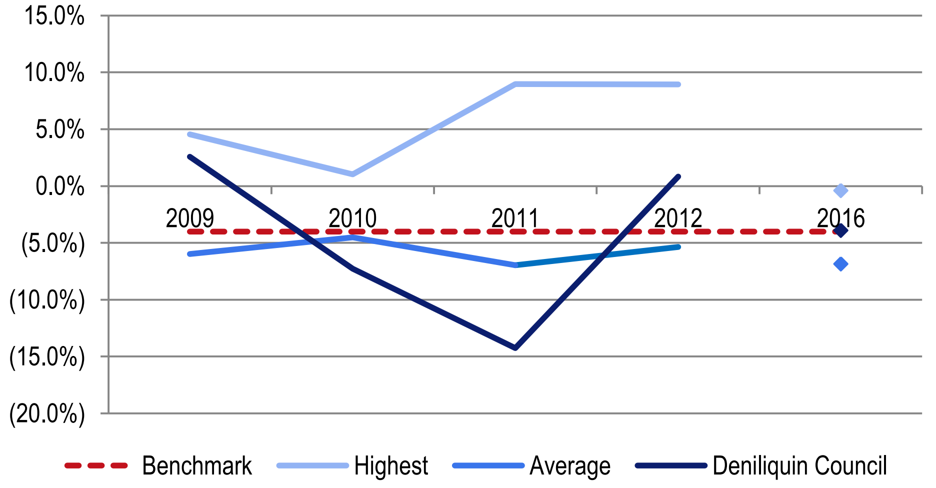
As discussed in section 2 of this report, each council's performance has been assessed against ten key benchmark ratios. This section of the report compares the Council's performance with its peers in the same DLG Group. The Council is in DLG Group 4. There are 31 councils in this group and at the time 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.

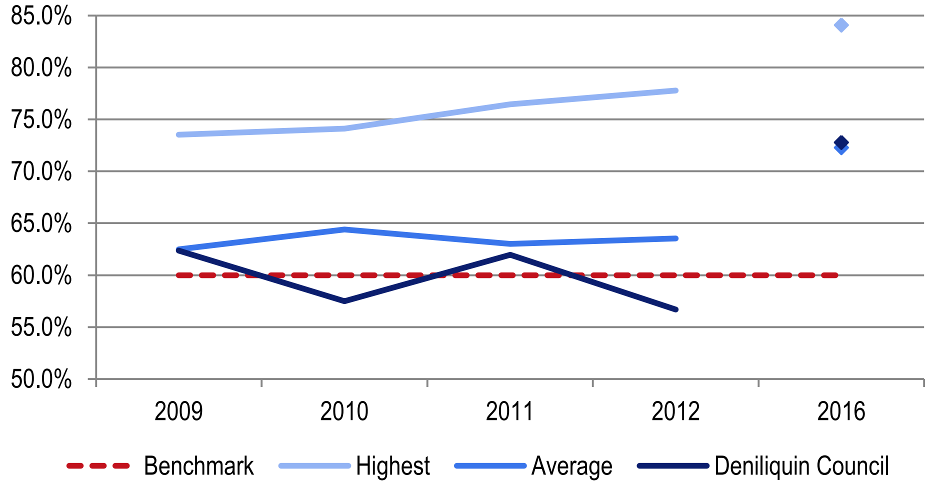
Financial Flexibility

Figure 14 - Operating Ratio Comparison



Council's Operating Ratio was above the benchmark and group average in two of the last four years. Consistent with other councils in the group, it experienced a decline in operating results in 2011 due to increased depreciation expense. The results improved in 2012 and are forecast in the medium term to be around the benchmark and above the group average.

Figure 15 - Own Source Operating Revenue Ratio Comparison



Council's Own Sourced Operating Revenue Ratio has been below the group average and close to the benchmark over the last four years. The ratio is forecast to improve in the medium term to be above the benchmark and around the group average. This is mainly due to conservative forecasts of grants and contributions which skew the ratio upwards.

Overall, Council's financial flexibility is around the benchmark and slightly below the group average.

Liquidity

Figure 16 - Cash Expense Ratio Comparison

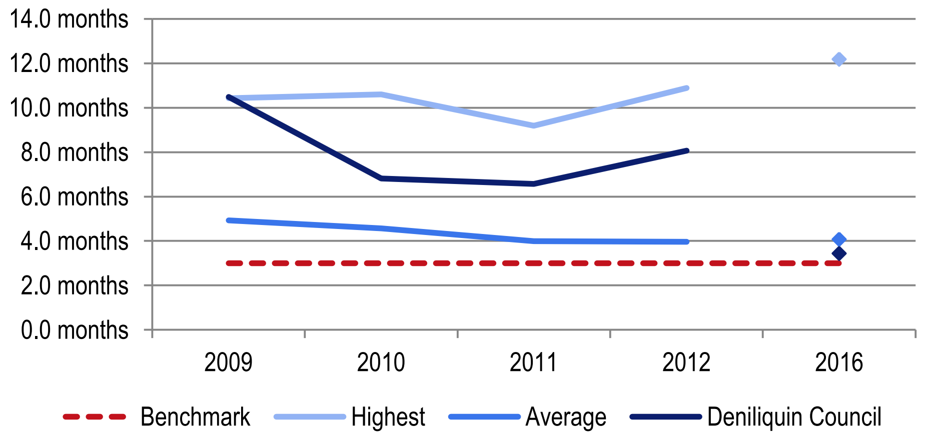
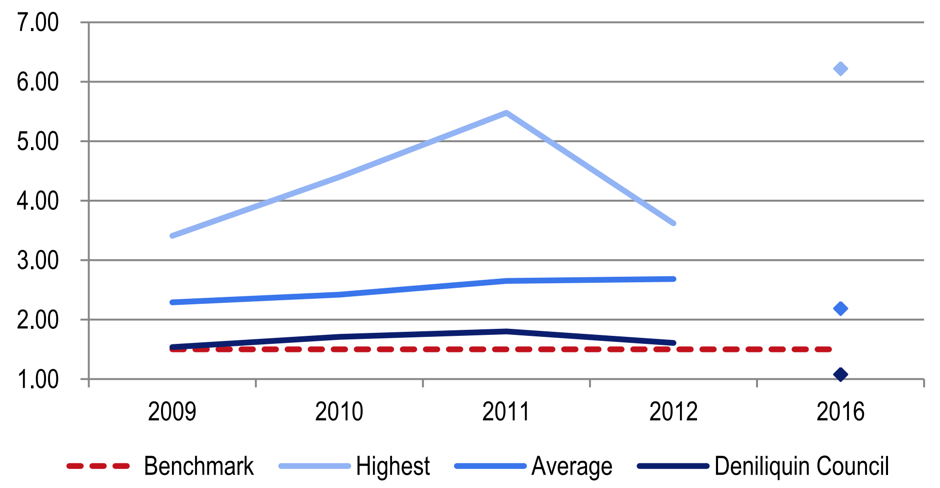


Figure 17 - Unrestricted Current Ratio Comparison



On average over the last four years Council's liquidity position has been sufficient though it is forecast to marginally deteriorate in the medium term to be at or below benchmark.

Debt Servicing

Figure 18 - Debt Service Cover Ratio Comparison

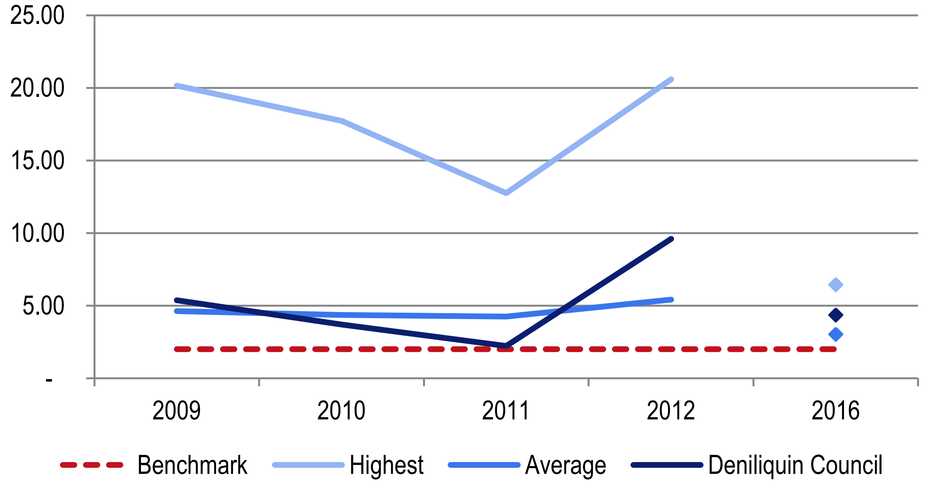
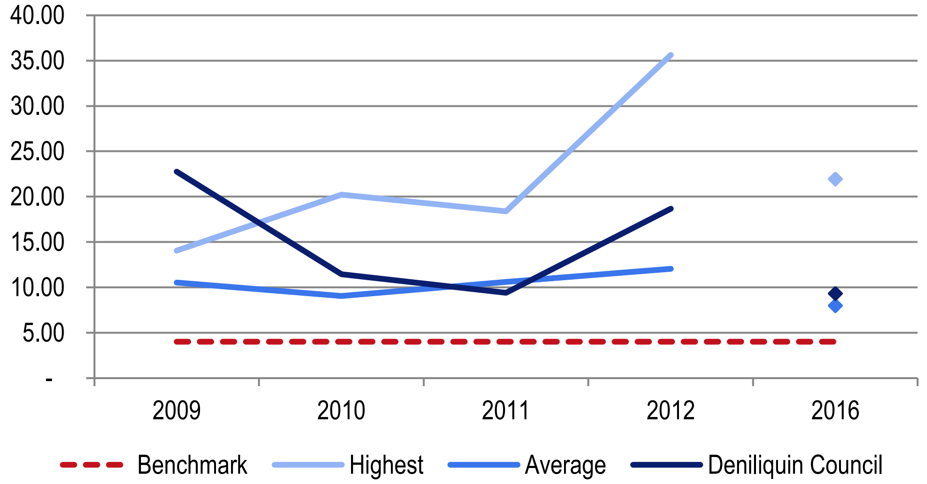


Figure 19 - Interest Cover Ratio Comparison



Over the review period, Council's debt servicing ratios were above the benchmarks and around or above the group average. These ratios are forecast to marginally decline in the medium term but remain above the benchmark and group average.

Asset Renewal and Capital Works

Figure 20 - Capital Expenditure Ratio Comparison

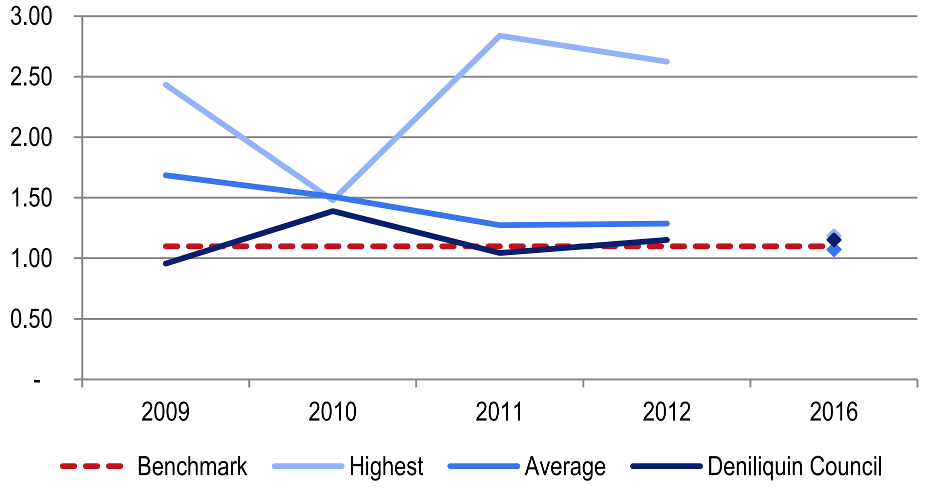
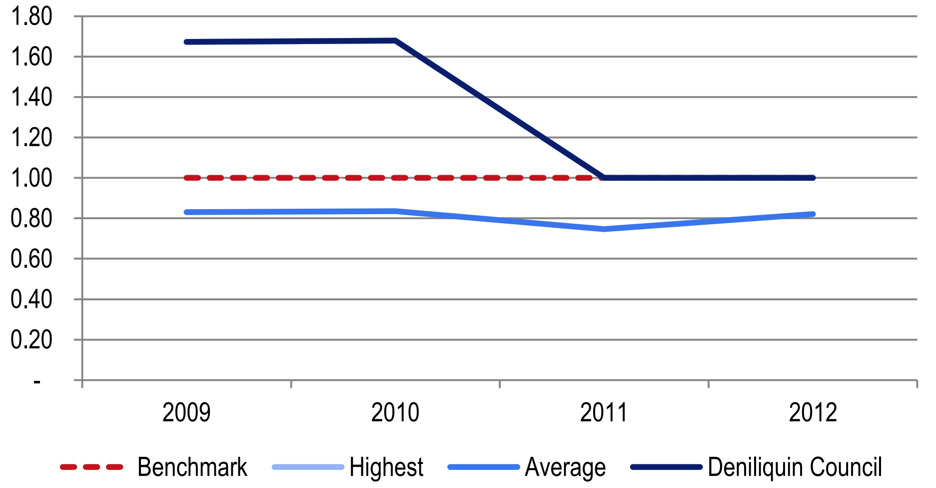
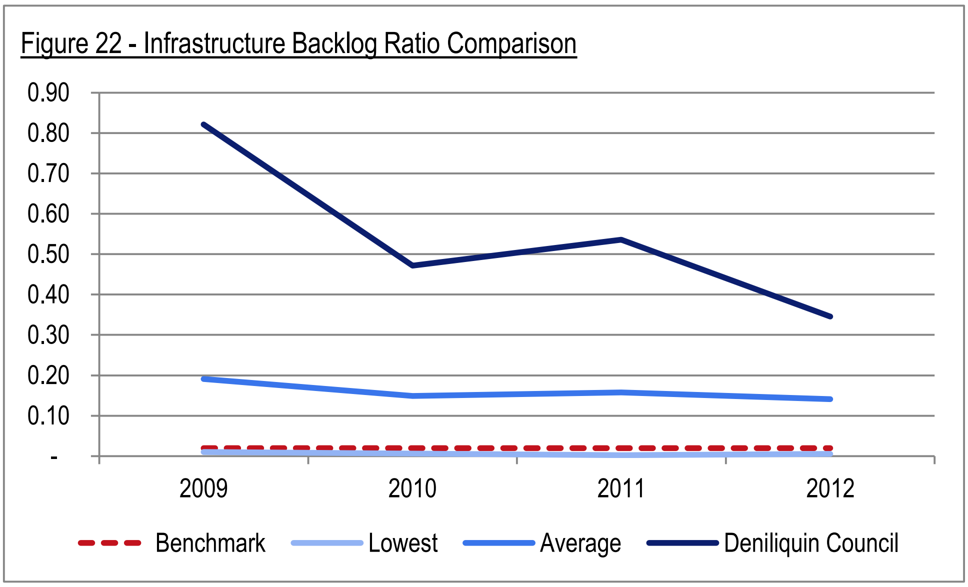
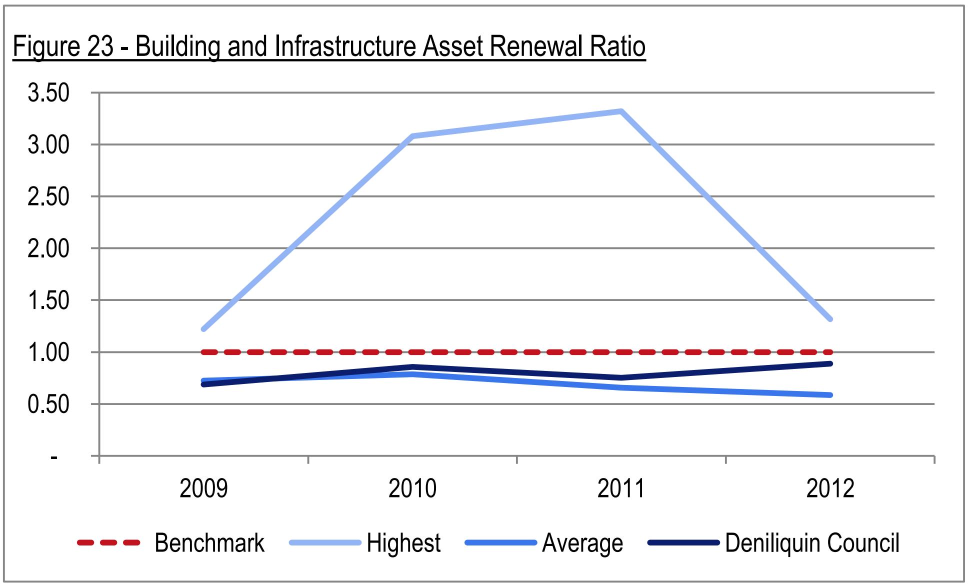


Figure 21 - Asset Maintenance Ratio Comparison







Council's Infrastructure Backlog Ratio has been higher than the group average and benchmark over the last four years. Council's Capital Expenditure Ratio has been around the benchmark but below the group average over the last four years and is forecast to be around the benchmark and the group average in the medium term. Council's Asset Maintenance Ratio has been above the group average and at or above the benchmark over the last four years. Council's Building and Infrastructure Asset Renewal Ratio has been at or above the group average but below benchmark in the last four years.

Overall, Council has reduced their Infrastructure Backlog in value but requires further improvement to meet the group average and benchmark in the future.

Section 6 Conclusion and Recommendations

Based on our review of both the historic financial information and the 10 year financial forecast within Council's long term financial plan we consider Council to be in a moderate but deteriorating financial position.

We base our recommendation on the following key points:

- While Council had operating surpluses in two of the last four years, it is forecasting operating deficits throughout most of the forecast period.
- Council has strong Interest Cover and Debt Service Cover Ratios and this is forecast to continue
- While Council had strong liquidity ratios historically, it is forecasting weak liquidity ratios in the short to medium term.
- Council is dependent on external revenue sources such as State and Federal grants. Any material adverse change to the levels of grants receivable could weaken Council finances.
- While the value of the Infrastructure Backlog has marginally declined over the review period and asset maintenance and capital spending has been sufficient, Council is forecasting reducing levels of capital expenditure which will lead to a deteriorating quality of its infrastructure assets
- Council's current LTFP requires review and Council is in the process of updating their LTFP following the completion of its AMP. In particular, expenses need to be updated to reflect more reasonable assumptions and the AMP requirements need to be incorporated

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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	8,019	7,572	7,492	7,209	5.9%	1.1%	3.9%
User charges and fees	1,613	1,715	1,372	1,504	(5.9%)	25.0%	(8.8%)
Interest and investment revenue	483	467	442	490	3.4%	5.7%	(9.8%)
Grants and contributions for operating purposes	5,466	3,841	4,491	3,226	42.3%	(14.5%)	39.2%
Other revenues	330	427	760	423	(22.7%)	(43.8%)	79.7%
Net Share of JVs using the equity method	0	0	29	15	N/A	(100.0%)	93.3%
Total revenue	**15,911**	**14,022**	**14,586**	**12,867**	**13.5%**	**(3.9%)**	**13.4%**
Expenses							
Employees	5,504	6,346	6,278	5,839	(13.3%)	1.1%	7.5%
Borrowing costs	250	244	229	179	2.5%	6.6%	27.9%
Materials and contract expenses	3,009	2,602	2,004	1,118	15.6%	29.8%	79.2%
Depreciation and amortisation	4,289	4,052	3,454	3,562	5.8%	17.3%	(3.0%)
Other expenses	2,726	2,750	3,682	1,836	(0.9%)	(25.3%)	100.5%
Net Share of JVs using the equity method	2	27	0	0	(92.6%)	N/A	N/A
Total expenses	15,780	16,021	15,647	12,534	(1.5%)	2.4%	24.8%
Operating result	131	(1,999)	(1,061)	333	106.6%	(88.4%)	(418.6%)

Table 2 - Items excluded from Income Statement

Excluded items ($'000s)				
	2012	2011	2010	2009
Grants and contributions for capital purposes	1,083	966	833	1,106
Interest and Investment reversals/(losses)	175	699	818	(788)
Net gain/(loss) on disposal of assets	88	(204)	74	(401)

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	7,555	6,416	6,794	7,685	17.8%	(5.6%)	(11.6%)
Investments	1,005	481	414	203	108.9%	16.2%	103.9%
Receivables	1,783	1,870	1,350	1,488	(4.7%)	38.5%	(9.3%)
Inventories	0	74	98	188	(100.0%)	(24.5%)	(47.9%)
Other	488	323	278	360	51.1%	16.2%	(22.8%)
Total current assets	10,831	9,164	8,934	9,924	18.2%	2.6%	(10.0%)
Non-current assets							
Investments	716	1,565	1,933	2,426	(54.2%)	(19.0%)	(20.3%)
Receivables	0	13	12	95	(100.0%)	8.3%	(87.4%)
Inventories	0	0	0	0	N/A	N/A	N/A
Infrastructure, property, plant & equipment	128,937	124,307	122,830	79,837	3.7%	1.2%	53.9%
Investments accounted for using the equity method	229	231	258	236	(0.9%)	(10.5%)	9.3%
Total non-current assets	129,882	126,116	125,033	82,594	3.0%	0.9%	51.4%
Total assets	140,713	135,280	133,967	92,518	4.0%	1.0%	44.8%
Current liabilities							
Payables	1,906	1,472	868	975	29.5%	69.6%	(11.0%)
Borrowings	442	240	786	718	84.2%	(69.5%)	9.5%
Provisions	1,551	2,082	1,891	1,931	(25.5%)	10.1%	(2.1%)
Total current liabilities	3,899	3,794	3,545	3,624	2.8%	7.0%	(2.2%)
Non-current liabilities							
Payables	102	0	0	0	N/A	N/A	N/A
Borrowings	2,137	2,575	2,274	3,059	(17.0%)	13.2%	(25.7%)
Provisions	3	0	0	0	N/A	N/A	N/A
Total non-current liabilities	2,242	2,575	2,274	3,059	(12.9%)	13.2%	(25.7%)
Total liabilities	6,141	6,369	5,819	6,683	(3.6%)	9.5%	(12.9%)
Net assets	134,572	128,911	128,148	85,835	4.4%	0.6%	49.3%

Table 4-Cashflow

Cashflow Statement ($'000s)	Year ended 30 June			
	2012	**2011**	**2010**	**2009**
Cashflows from operating activities	5,732	3,299	3,193	4,814
Cashflows from investing activities	(4,357)	(3,432)	(3,617)	(2,803)
Proceeds from borrowings and advances	0	545	15	1,679
Repayment of borrowings and advances	(236)	(790)	(482)	(580)
Cashflows from financing activities	(236)	(245)	(467)	1,099
Net increase/(decrease) in cash and equivalents	**1,139**	**(378)**	**(891)**	**3,110**
Cash and equivalents	7,555	6,416	6,794	7,685

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.

<u>Unrestricted Current Ratio</u>

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.