New South Wales
Treasury Corporation

Inverell Shire Council

Financial Assessment and Benchmarking Report

7 March 2013

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

Disclaimer

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

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

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

The report has been prepared for Inverell Shire Council, the LIRS Assessment Panel and the DLG. TCorp shall not be liable to Inverell 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 Inverell Shire Council's (the Council) financial capacity and its ability to undertake additional borrowings. The analysis is based on a review of the historical performance, current financial position, and long term financial forecasts. It also benchmarks the Council against its peers using key ratios.

The report is primarily focused on the financial capacity of the Council to undertake additional borrowings as part of the Local Infrastructure Renewal Scheme (LIRS).

Council has made one application for the Ashford Water Treatment Plant Renewal Project for $3.3m. The loan amount for the project is $2.0m.

TCorp's approach has been to:

- Review the most recent three years of Council's consolidated financial results
- Conduct a detailed review of the Council's 10 year financial forecasts. The review of the financial forecasts focused on the particular Council fund that was undertaking the proposed debt commitment. For the Council, the project is being funded from the Water Fund so we focused our review on the Water Fund

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

- Council has had operating surpluses (excluding capital grants and contributions) over the review period
- While expenses have grown quickly over the period they have remained below revenue
- Council has a very low level of borrowings of $0.7m (all of which are in the Water Fund) which has resulted in very high debt servicing ratios on a consolidated basis
- Council has sound liquidity

Council's reported infrastructure backlog of $87.5m in 2011 represents 24.9% of its infrastructure asset value of $352.0m. Other observations include:

- The backlog increased by almost $73m in 2011 mainly due to road related assets
- Council has spent less than required on maintenance in two of the last three years
- The majority of the backlog is from road related assets

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

- While the Water Fund shows operating deficit positions are expected over the entire forecast period when capital grants and contributions are excluded, the deficits reduce over the period and are above benchmark in the last three years of the forecast
- Overall it appears that the Water Fund will have sufficient liquidity throughout the next 10 year period to service all short term liabilities and currently scheduled capital expenditure and related long term liabilities
- The key assumptions used by Council appear to be reasonable

In our view, the Council has the capacity to undertake the combined additional borrowings of $2.0m for the LIRS project. This is based on the following analysis:

- While we generally use a benchmark of 2.0x for the Debt Service Cover Ratio, for the Water Fund we consider a lower ratio acceptable because Council has the ability to increase rates and charges accordingly to ensure the ongoing viability of the Water Fund. The Debt Service Cover Ratio for the Water Fund improves over the period and the Water Fund has sufficient investments to cover the shortfall in earnings to make principal and interest payments in the early years of the forecast period
- The Interest Cover Ratio remains above the benchmark of 4.0x over the forecast period
- Council's Water Fund liquidity is satisfactory

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

- Council's financial flexibility has been acceptable with the Operating Ratio above the group average and Own Source Operating Revenue Ratio marginally below 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 sound liquidity position which is expected to continue in the medium term
- Council's performance in terms of its Building and Infrastructure Asset Renewal Ratio and Infrastructure Backlog Ratio have been weaker than the benchmarks. Asset renewal performance has improved in recent years to be above the group average. Council's Asset Maintenance Ratio and Capital Expenditure Ratio have been in line with the group averages and benchmarks

Section 2 Introduction

2.1: Purpose of Report

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

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

The key areas focused on are:

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

2.2: Scope and Methodology

TCorp's approach was to:

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

In undertaking its work, TCorp relied on:

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

Benchmark Ratios

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

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

Therefore these benchmarks are intended as a guide to performance.

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

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

2.3: Overview of the Local Government Area

Inverell Shire Council LGA	
Locality & Size	
Locality	Northern
Area	8,606km^2
DLG Group	11
Demographics	
Population	16,075
% under 20	28%
% between 20 and 59	46%
% over 60	26%
Expected population 2021	15,900*
Operations	
Number of employees (FTE)	198
Annual revenue	$34.3m
Infrastructure	
Water Supply schemes	3
Water Supply asset value	$46.5m
Infrastructure backlog value	$87.5m
Total infrastructure value	$352.0m

Inverell Shire Council Local Government Area (LGA) is located in the New England North West region of NSW and is a commercial and service centre. It is situated in a valley beside the Macintyre River. Inverell is around 490km South of Brisbane and 675km North West of Sydney.

Inverell provides around 80% of the world's sapphires. Bauxite, lead, silver and diamonds have also been mined.

Inverell is a mixed farming district, where the main crops are wheat, oats, barley, grain, sorghum and oilseed crops. Sheep and cattle graze mostly on natural pastures, supplemented with lucerne and forage crops.

*Inverell's population has been growing and the ABS is expecting growth to continue at around 0.8% p.a. which is comparable to other growing regional centres. The population estimate in the table is from the Department of Planning and we have been informed that this forecast is being reviewed.

2.4: LIRS Application

Council has made one LIRS application.

Project: Ashford Water Treatment Plant Renewal Project

Description: This project is the complete replacement of the Ashford Water Treatment Plant.

Amount of loan facility: $2.0m

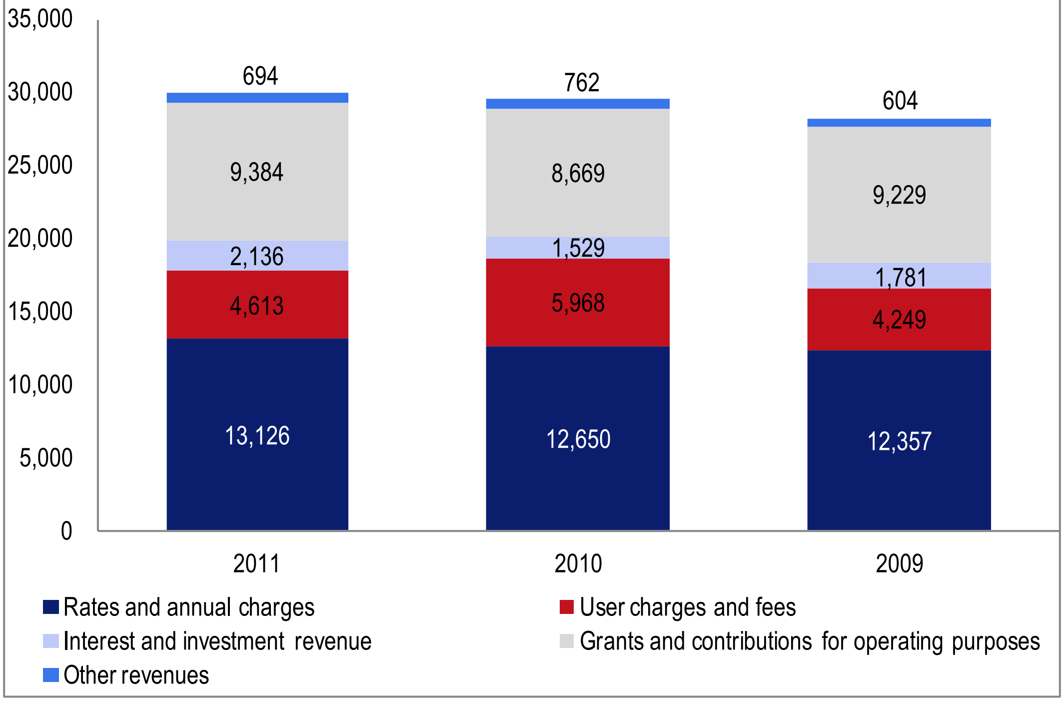
Term of loan facility: 10 years

Section 3 Review of Financial Performance and Position

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

3.1: Revenue

Figure 1 - Revenue Sources for 2008/09 to 2010/11 ($'000s)

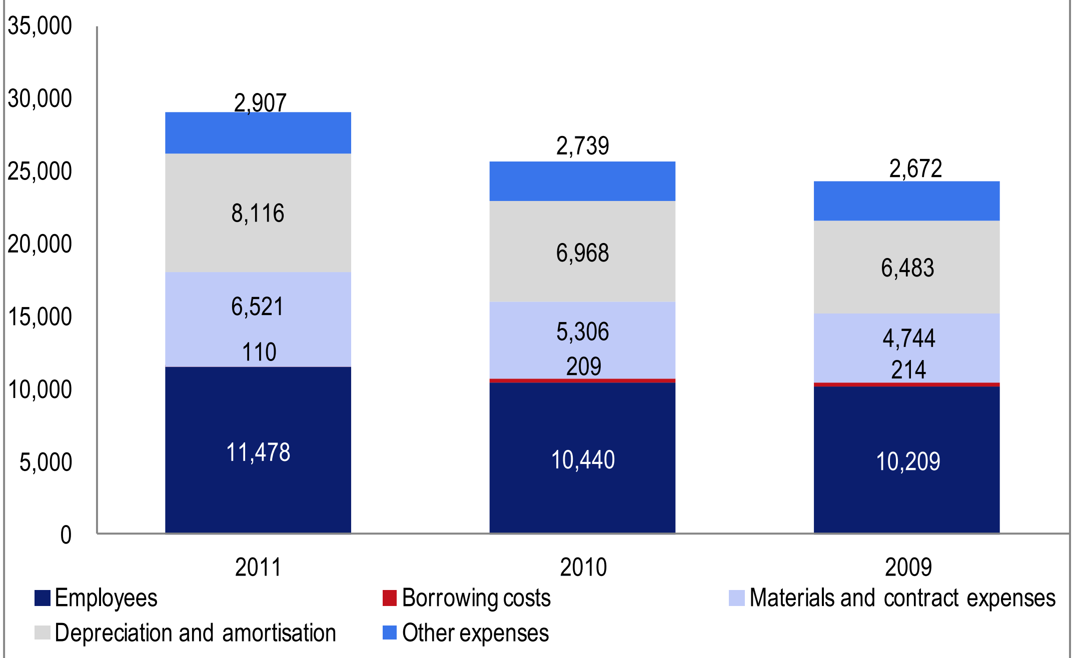


Key Observations

- Rates and annual charges have been increasing by an average of 3.1% p.a. over the period.
- User fees and charges spiked in 2010 due to increases in RMS works, water supply services, and saleyard fees which were substantially reversed in 2011.
- Council's Own Sourced Operating Revenue Ratio of 50% to 56% has been below the benchmark of 60% over the period, indicating that Council is heavily reliant on grants and contributions.
- Interest and investment revenue has been trending higher over the period in line with increasing cash and investment balances. The dip in 2010 is due to a $0.6m write-off of CDO investments.
- Grants and contributions for operating purposes have trended higher over the period, though there was a dip in 2010. The drop in 2010 was due to a timing difference with a $0.9m decline in financial assistance grants due to the first instalment for 2010 being received in 2009.

3.2: Expenses

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



Key Observations

- Employee costs growth accelerated to 9.9% in 2011 after growth of 2.3% in 2010. This growth has been driven by reduced capitalisation of employee costs following the completion of projects and increased salaries and wages in 2011. Other cost increases that impacted on Council include increases in defined benefits scheme superannuation contributions, workers compensation costs and a number of retiring staff claiming entitlements. If capitalisation of employee costs is excluded, employee costs have been growing at 2.1% p.a. The number of employees has varied over the period though trended higher. The increase in staff numbers relates to community services including connections disability services and programs with the NSW Attorney Generals department.
- Materials and contract expenses have been growing by an average of 17.4% p.a. over the period mainly due to an overall $1.5m increase in raw materials and consumables. The increases are due to flood damage works, bridge works and electricity prices.
- Borrowing costs are a small component of expenses and have been falling over the period as debt is repaid.
- Depreciation and amortisation expenses have been increasing by an average of 12.0% p.a. over the period mainly due to increasing depreciation of roads and drainage infrastructure following $53.2m and $8.2m revaluation increments respectively.
- Total expenses have been growing over the period due to large increases in the expense categories of employees, materials and contracts, and depreciation and amortisation.

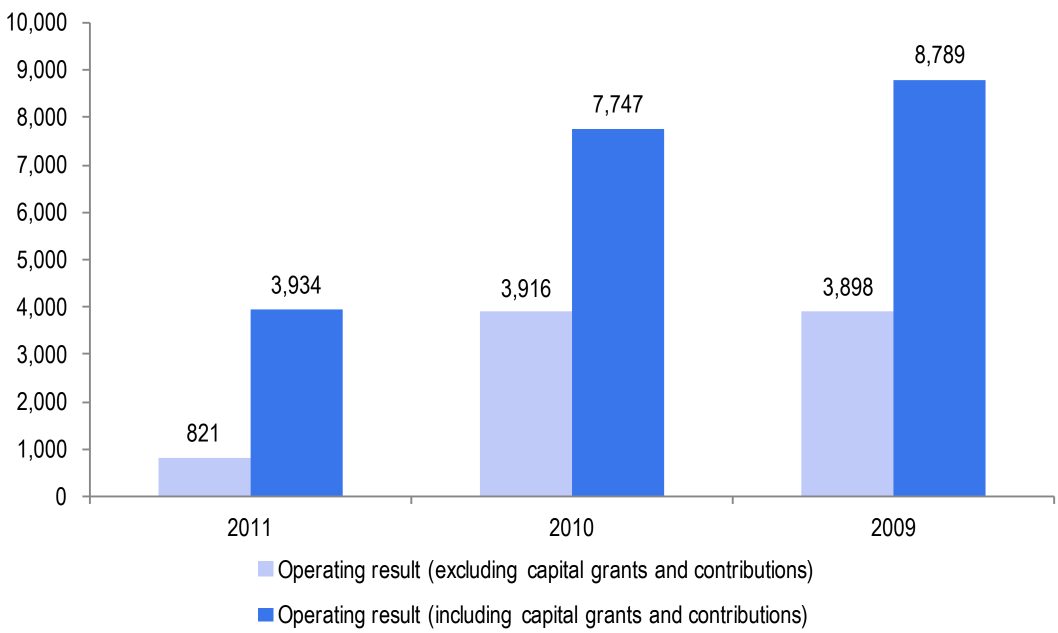
3.3: Operating Results

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

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

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

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



Key Observations

- The Council has posted net operating surpluses excluding capital grants and contributions over the period, though results deteriorated in 2011 primarily due to increases in expenses outstripping revenue growth. Materials and contracts and depreciation and amortisation expenses were the main drivers of expenses growth.

3.4: Financial Management Indicators

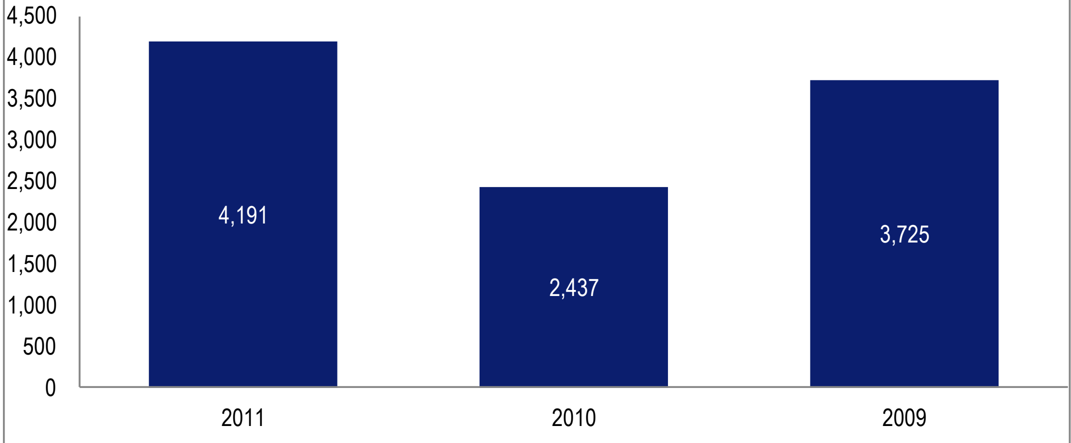
Performance Indicators	Year ended 30 June		
	2011	2010	2009
EBITDA ($'000s)	9,047	11,093	10,595
Operating Ratio	2.7%	13.2%	13.8%
Interest Cover Ratio	82.25x	53.08x	49.51x
Debt Service Cover Ratio	27.58x	26.92x	26.16x
Unrestricted Current Ratio	9.07x	7.43x	7.82x
Own Source Operating Revenue Ratio	53.6%	55.7%	50.2%
Cash Expense Ratio	2.4 months	1.6 months	2.5 months
Net assets ($'000s)	509,066	501,222	459,371

Key Observations

- The Council's EBITDA has deteriorated in 2011 in line with Council's overall operating result.
- Both the Interest Cover Ratio and Debt Service Cover Ratio are well above benchmark and trending higher over the period indicating the Council has the ability to carry more debt.
- The Operating Ratio has been above the benchmark of negative 4.0% over the period, though it has dropped in 2011.
- The Unrestricted Current Ratio has been well above the benchmark of 1.50x over the period and has been increasing, indicating that Council has sound liquidity.
- The cash expense ratio is below the benchmark of 3.0 months because Council invests surplus cash. Cash and investments have been increasing over the period.
- Net assets have been increasing over the period due to profits and revaluations to Infrastructure, Property, Plant and Equipment of $32.3m and $2.6m in 2010 and 2011 respectively.
- When revaluations are excluded, Infrastructure, Property, Plant and Equipment assets have been increasing over the period. Since 2009 this amounts to a $6.6m increase in Infrastructure, Property, Plant and Equipment assets.
- Council has total borrowings of $0.7m representing a total debt level of 0.1% of net assets.

3.5: Statement of Cashflows

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



Key Observations

- Council's cash and cash equivalents has been trending higher over the period primarily due to the level of spending on investing activities generally being lower than operating cashflows. Council appears to use most of its excess cash to purchase investments.
- In total, Council has cash and investments of $35.3m in 2011 of which $10.6m is externally restricted, $15.2m is internally restricted and $9.5m is unrestricted. The majority of external restrictions relate to water, sewerage and unexpended specific purpose grants.
- Within the investment portfolio of $31.1m, Council has term deposits of $28.8m, CDOs of $1.8m and floating rate notes of $0.5m. The CDO investments have been written down to their current market value and based on advice from their investment advisor, Council intends to hold these investments until maturity or sell the investments if it becomes financially advantageous to do so.

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.

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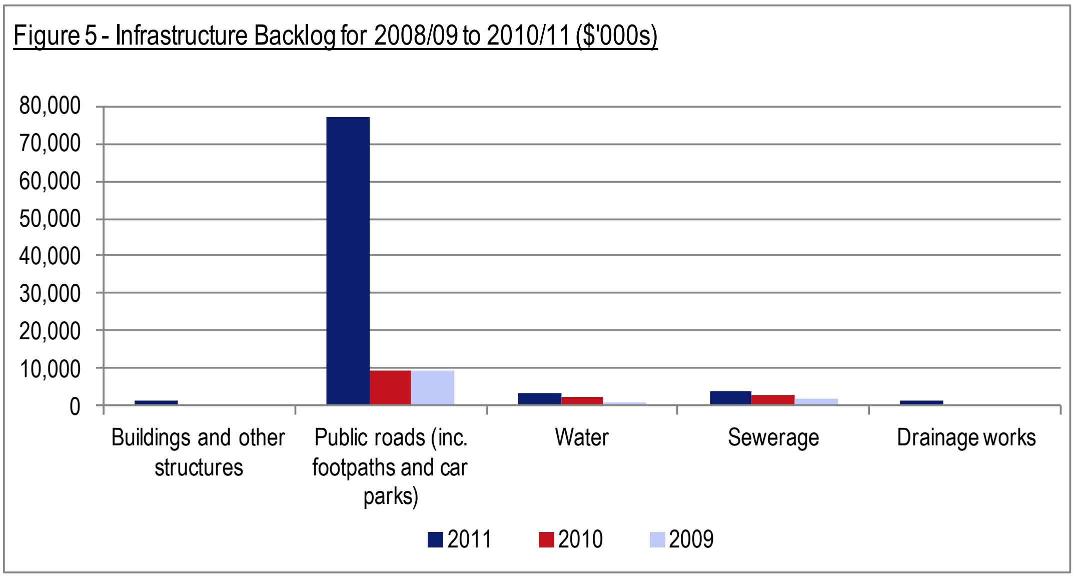
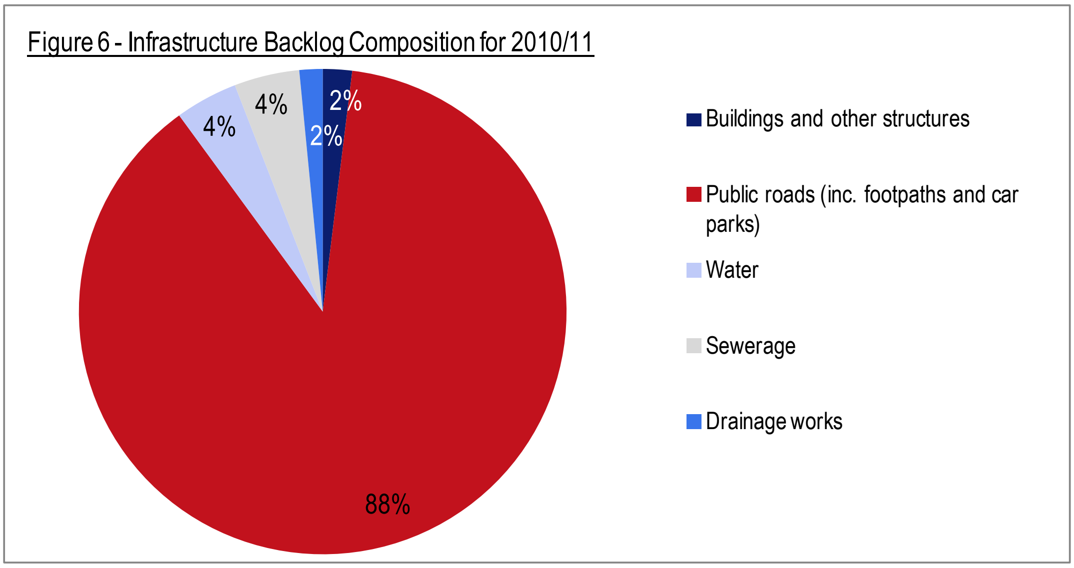
3.6(a): Infrastructure Backlog





The Council reported an $87.5m backlog in 2011 that is mainly related to roads (88%).

The infrastructure backlog has increased considerably in 2011 primarily due to the increased backlog in sealed and unsealed roads. The increased roads backlog is a result of a desktop audit conducted by Council and is expected to be a worst case scenario. Council is considering undertaking a full independent audit of their roads conditions and TCorp supports this plan as it will provide an excellent source of information in terms of this major asset class.

Council has recently invested in new machinery that is expected to reduce the rehabilitation costs of roads and they have expanded their maintenance program to address the backlog.

3.6(b): Infrastructure Status

Infrastructure Status	Year ended 30 June		
	2011	2010	2009
Bring to satisfactory standard ($'000s)	87,485	14,695	12,230
Required annual maintenance ($'000s)	7,518	5,779	5,243
Actual annual maintenance ($'000s)	7,675	4,984	5,068
Total value of infrastructure assets ($'000s)	352,038	365,962	298,376
Total assets ($'000s)	516,301	509,354	468,442
Building and Infrastructure Backlog Ratio	0.25x	0.04x	0.04x
Asset Maintenance Ratio	1.02x	0.86x	0.97x
Building and Infrastructure Renewals Ratio	0.89x	0.50x	0.04x
Capital Expenditure Ratio	1.21x	1.62x	2.10x

Council's backlog increased considerably in 2011 to 0.25x from 0.04x in previous years.

The Council's Asset Maintenance Ratio has been close to the benchmark of 1.0x over the period.

The Council's Building and Infrastructure Renewal Ratio has been below the benchmark of 1.0x over the period although the ratio has been improving rapidly over the period.

Council's Capital Expenditure Ratio has been above the benchmark of 1.1x over the period, though the ratio has been falling over the period.

Overall, the Council has spent an increasing amount on asset maintenance and renewal but the infrastructure backlog is still increasing.

3.6(c): Capital Program

The following figures are sourced from the Council's Annual Financial Statements at Special Schedule No. 8 and are not audited. New capital works are major non-recurrent projects.

Capital Program ($'000s)	Year ended 30 June		
	2011	2010	2009
New capital works	4,540	3,210	6,750

Council's spending on new capital works has trended lower over the period.

Over the last few years capital works included:

- Replacement of six timber bridges $2.3m
- Redevelopment of Council's Administration centre $2.2m
- Gravel resheeting of roads $3.8m
- Bitumen road resealing $3.4m

- Bitumen road and street renewal/rehabilitation/enhancements $9.8m
- CBD Redevelopment and Expansion Project $3.3m
- New 10ML water reservoir $2.0m
- Flood damage restoration program $1.7m
- New concrete cycleways and footpaths $1.2m

3.7: Specific Risks to Council

- Environmental and natural disasters. Inverell has had four natural disaster declarations in the last three years. They have had three floods and a bushfire. Council's management of this risk is substantially reliant on being able to receive both State and Federal funding under various "natural disaster" funds.
- Deterioration of Council infrastructure assets. Over the last three years the infrastructure backlog has increased considerably. If this trend continues it may be reflected in lower quality infrastructure assets. Council has spent an increasing amount on asset maintenance and renewal in an attempt to reverse this trend.
- Expenses growth. Council had substantial expenses growth in 2011 that was not matched by revenue growth. Given Council is subject to the rate peg, it is unlikely that revenue will be able to grow in line with expenses growth. Therefore, Council will need to manage expenses growth going forward.

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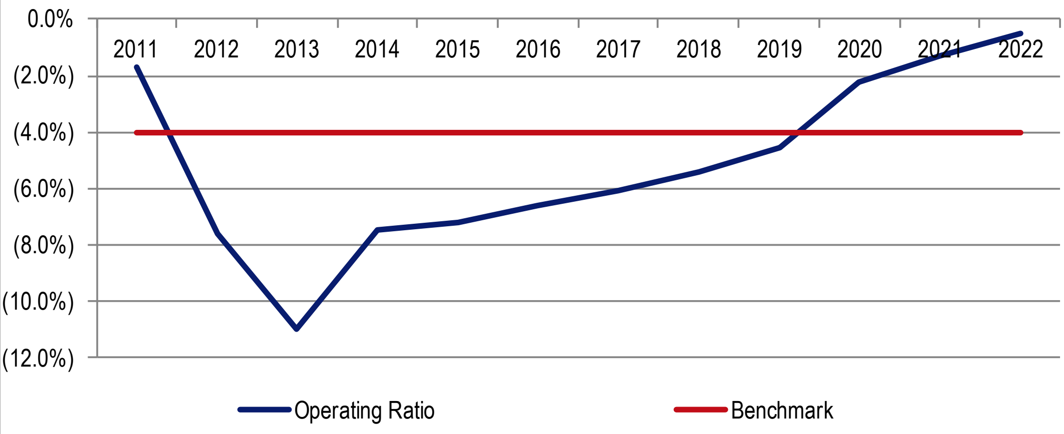
Section 4 Review of Financial Forecasts

The financial forecast model shows the projected financial statements and assumptions for the next 10 years. The model includes the $2m loan without any LIRS subsidy.

The LIRS loan relates to the Water Fund, therefore we have focused our financial analysis solely upon this Fund. Council's Water Fund is operated as an independent entity, which unlike the General Fund is not subject to rate pegging.

4.1: Operating Results

Figure 7- Operating Ratio for Water Fund



The Operating Ratio is negative throughout the forecast period with a low in 2013 of negative $0.4m. The main reason for the deterioration in 2012 is a $1.2m increase in materials and contract expenses which remains over the forecast period. This increase is due to increased maintenance of assets. In 2013 the further deterioration is mainly due to an increase in depreciation expenses.

The improvement from 2014 is due to slower expense growth averaging 2.2% p.a. while revenue growth averages 3.4% p.a. The reduced expenses growth is due to a number of programs implemented by Council to reduce costs such as a staff restructure, IT programs, energy efficiency programs and improving asset maintenance processes.

Given that Council is able to increase charges to cover increasing costs, Council could increase charges more quickly in the early years of the forecast period to eliminate the operating ratio deficits.

4.2: Financial Management Indicators

The financial management indicators are linked to the utilisation of debt in early years and improve over time as the amortising debt reduces and operating deficits also improve.

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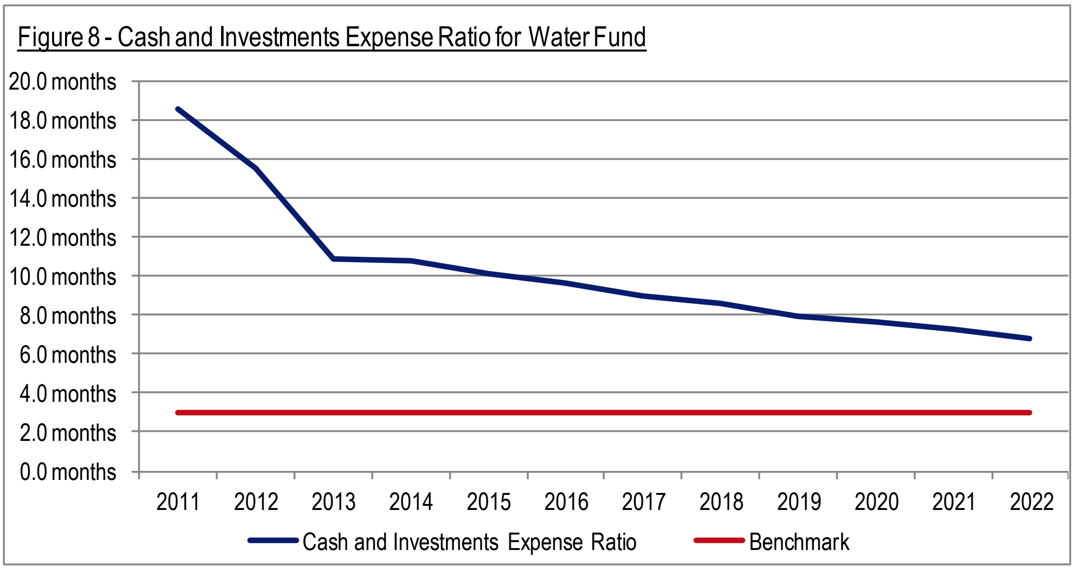
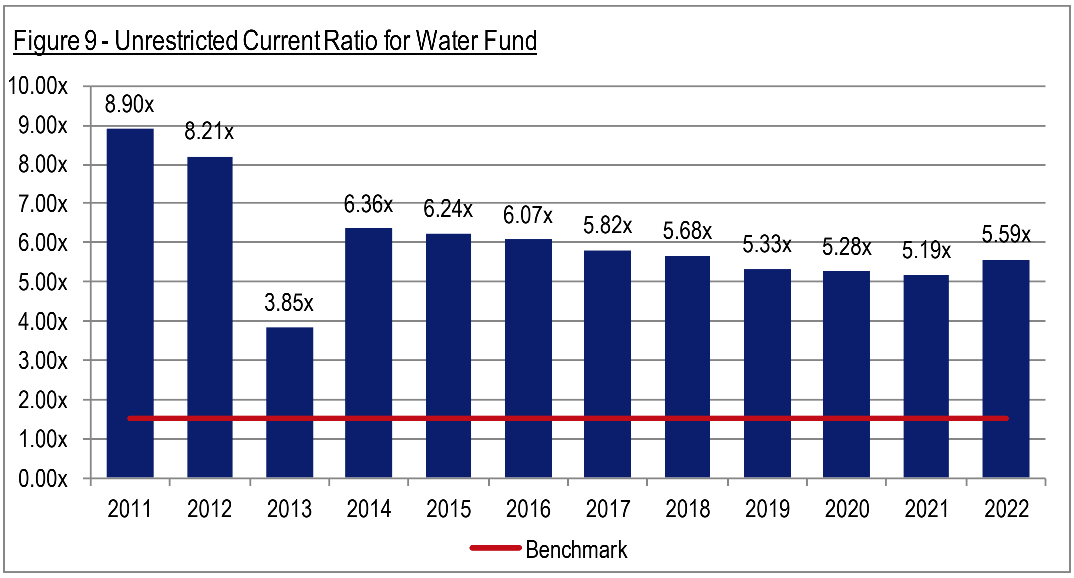
Liquidity Ratios





Due to an error in the forecast model where cash becomes negative instead of investments reducing, we have included cash and investments in the calculation of the Cash Expense Ratio.

The Cash and Investments Expense Ratio deteriorates over the forecast period, though it remains above the benchmark of three months. Council will need to review this position in the future if the trend continues.

The Unrestricted Current Ratio is above the benchmark of 1.5x over the forecast period.

This indicates that Council is forecasting sound liquidity levels over the forecast period.

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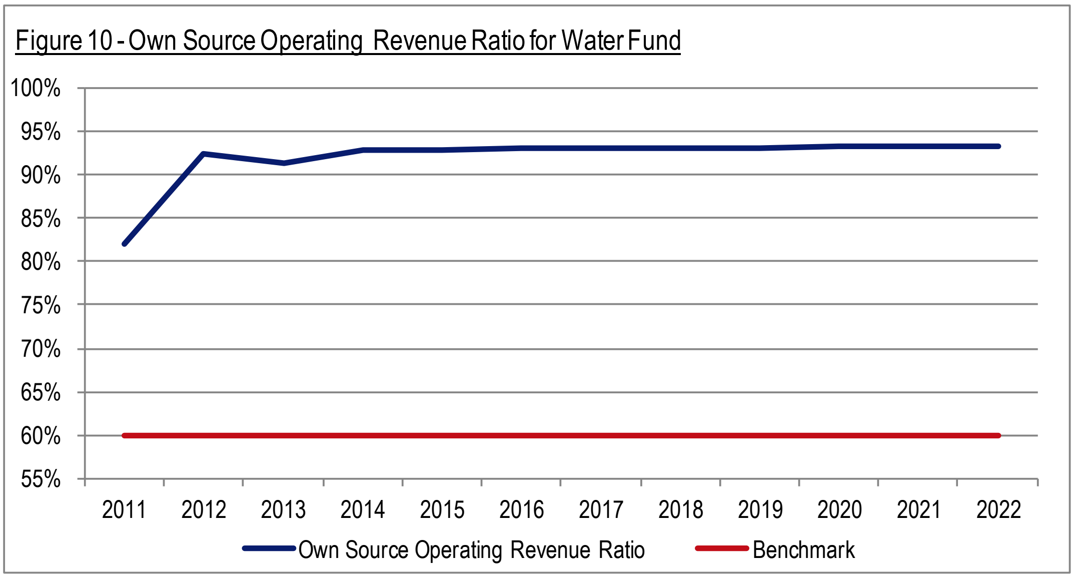
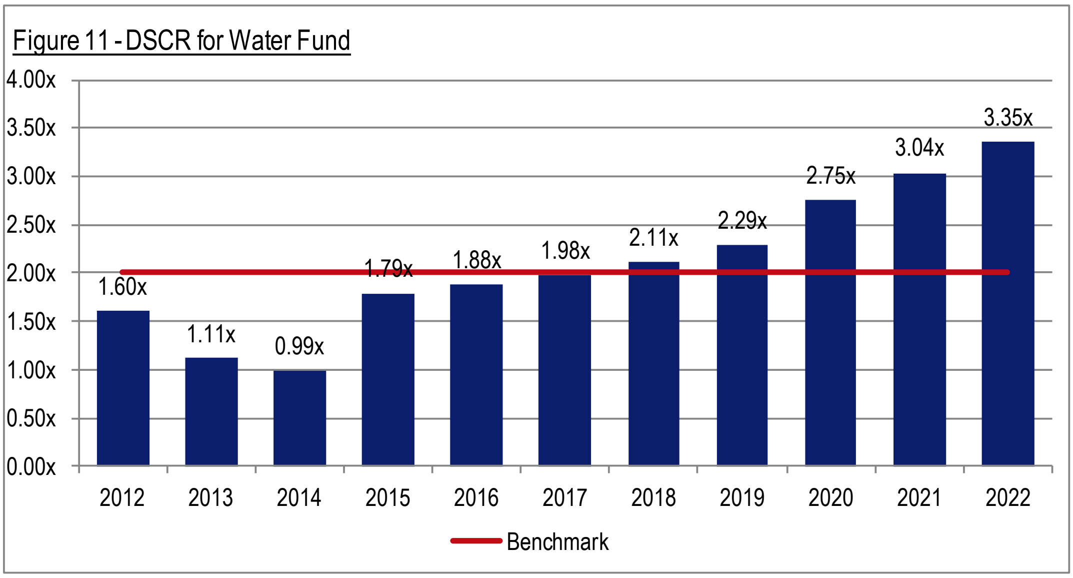
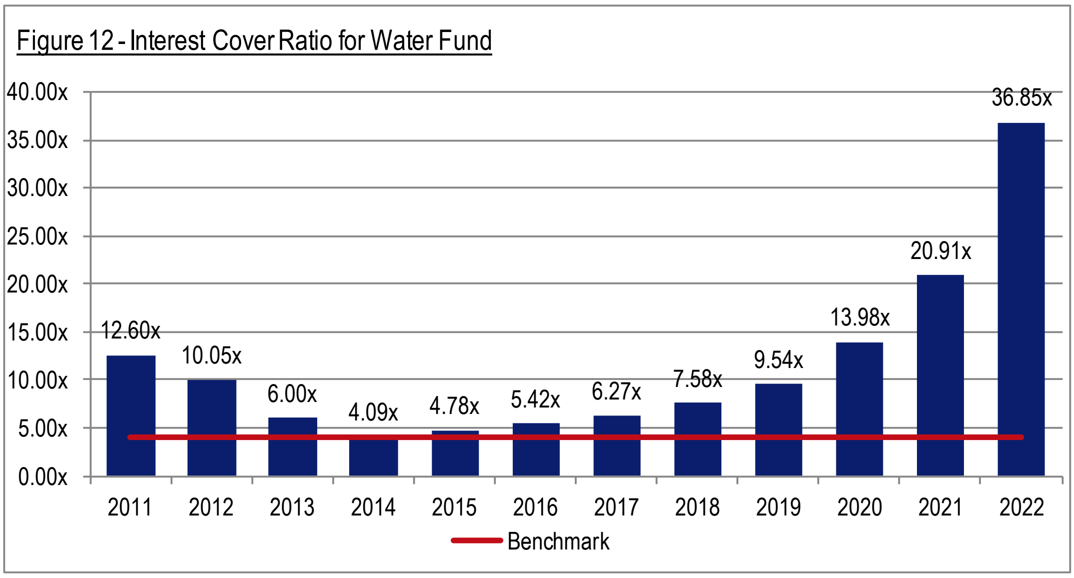
Fiscal Flexibility Ratios



The Own Source Operating Revenue Ratio for the Water Fund is very high as we would expect because this is a self sustaining fund.

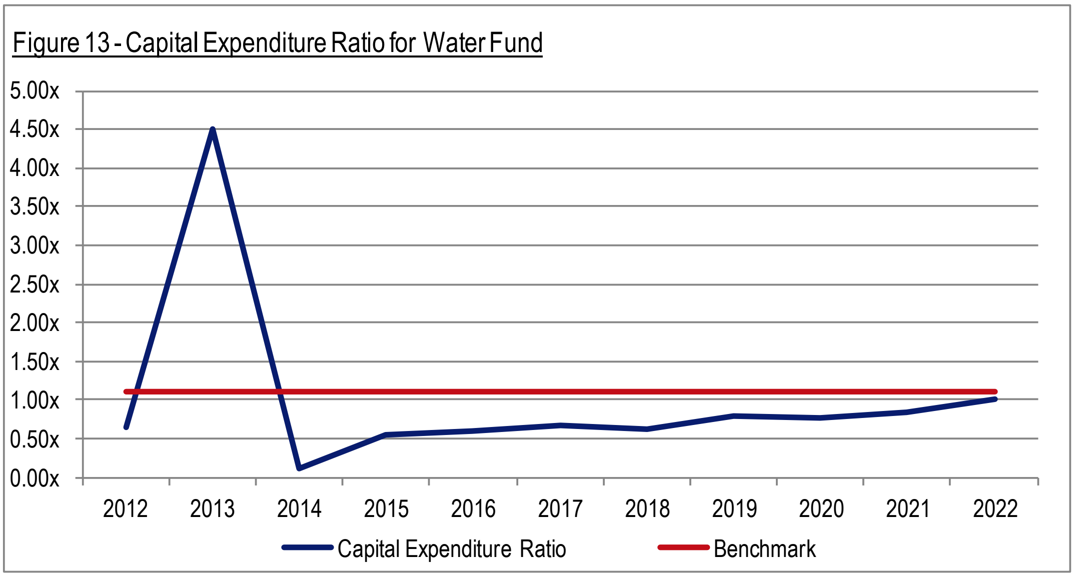


While we generally use a benchmark of 2.0x for the Debt Service Cover Ratio, for the Water Fund we consider a lower ratio acceptable because Council has the ability to increase rates and charges accordingly to ensure the ongoing viability of the Fund. The Debt Service Cover Ratio for the Water Fund improves over the period and Council has sufficient investments to cover the shortfall in earnings to make principal and interest payments in the early years of the forecast period. The results in the first three years of the forecast period are impacted by large principal repayments to fully repay the existing $0.7m debt in the Water Fund excluding the LIRS loan.



The Council's Interest Cover Ratio is above the benchmark of 4.00x and improves from 2015 for the remaining forecast period as profitability improves and interest costs reduce as debt is repaid.

4.3: Capital Expenditure



While there is a high Capital Expenditure Ratio in 2013 due to the Ashford Water Treatment Plant Renewal project, the ratio is low over the rest of the forecast period. The volatility of the capital expenditure profile appears to be consistent with the cyclical nature of capital investment in a water utility.

4.4: Financial Model Assumption Review

Councils have used their own assumptions in developing their forecasts.

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

TCorp's benchmarks:

- Rates and annual charges: TCorp notes that rates increased by 3.4% in the year to September 2011, and in December 2011, IPART announced that the rate peg to apply in the 2012/13 financial year will be 3.6%. Beyond 2013 TCorp has assessed a general benchmark for rates and annual charges to increase by mid-range LGCI annual increases of 3.0%. TCorp has not prepared a benchmark for Water Fund increases as councils have flexibility in terms of setting these rates and charges
- Interest and investment revenue: annual return of 5%
- All other revenue items: the estimated annual CPI increase of 2.5%
- Employee costs: 3.5% (estimated CPI+1%)
- All other expenses: the estimated annual CPI increase of 2.5%

Key Observations and Risks

- Council has rates and annual charges on the Water Fund increasing at an average of 3.6% p.a. and this is not subject to a rate peg.
- Council has user fees and charges increasing at an average of 4.3% p.a.
- Council has interest and investment revenue remaining the same at $50,000 p.a. from 2012 when cash and investments levels are reducing. While this assumption appears to be incorrect, the impact is immaterial.
- Grants and contributions for capital purposes spike to $150,000 in 2013 then return to $100,000 in 2014 and then growth averages 1.4% p.a. from 2015.
- All other revenue items increase by an average of 3% p.a.
- Employee costs average 3.7% p.a. over the forecast period, which is in line with TCorp's assumption.
- Borrowing costs increase and then reduce in line with debt levels.
- Materials and contract expenses increase $1.2m in 2012 and then average 3% p.a. over the remaining forecast period.
- Depreciation and amortisation expenses remain stable over the forecast period as Council is reviewing and in some cases extending the useful lives of assets based on expert advice.
- Other expenses drop $0.9m in 2012 and then growth averages 2.2% p.a. over the remaining forecast period.
- Overall, the assumptions used by Council appear to be reasonable.

4.5: Borrowing Capacity

When analysing the financial capacity of the Water Fund we believe Council will not be able to incorporate additional loan funding in addition to the LIRS loan facilities in their Water Fund in the short term. This is due to its low forecast DSCR and Interest Cover Ratio while it is servicing existing debt commitments excluding the LIRS loan. This position can be reviewed again in the medium to long term when DSCR and Interest Cover Ratio are above benchmark levels.

It is noted that as Council can adjust rates and charges within the Water Fund, further borrowings could be supported should rates and charges be increased to a level sufficient to service any additional debt repayments.

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

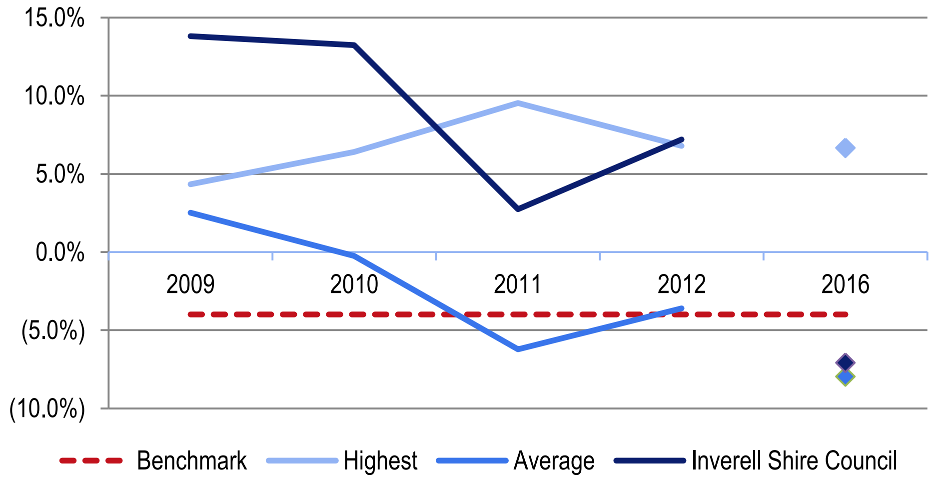
In Figure 14 to Figure 23, the graphs compare the historical performance of Council with the benchmark for that ratio, with the average for the Group, with the highest performance (or lowest performance in the case of the Infrastructure Backlog Ratio where a low ratio is an indicator of strong performance), and with the forecast position of the Council as at 2016 (as per Council's LTFP). Figures 21 to 23 do not include the 2016 forecast position as those numbers are not available.

Where no highest line is shown on the graph, this means that Council is the best performer in its group for that ratio. For the Interest Cover Ratio and Debt Service Cover Ratio, we have excluded from the calculations, councils with very high ratios which are a result of low debt levels that skew the ratios.

Please note that this section of the report has been prepared separately to the LIRS financial assessment and includes the latest information at the time of preparation which includes data from the 2012 financial year.

Financial Flexibility

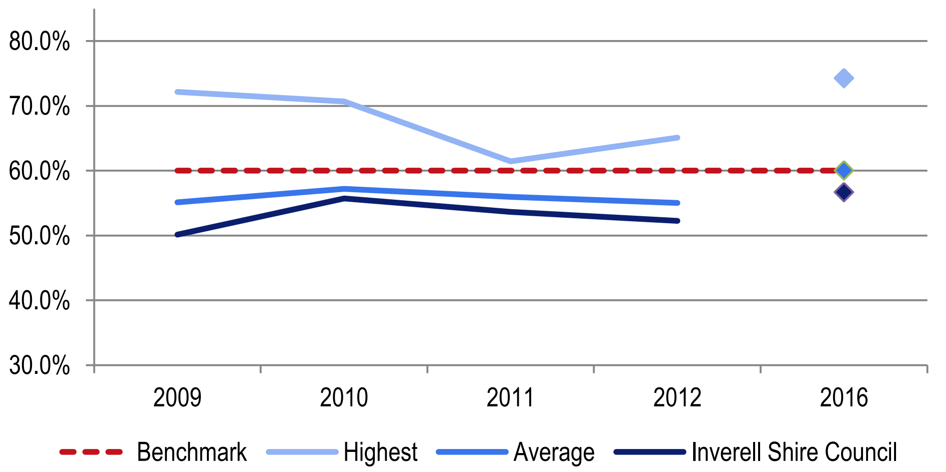
Figure 14 - Operating Ratio Comparison



Council's Operating Ratio was above the group average and benchmark over 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 though they are forecast in the medium term to deteriorate below the benchmark and to around the group average.

New South Wales
Treasury Corporation

Figure 15 - Own Source Operating Revenue Ratio Comparison



Council's Own Source Operating Revenue Ratio was below the benchmark and group average over the last four years. The ratio is forecast to marginally improve in the medium term but remains below the benchmark and group average.

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

Liquidity

Figure 16 - Cash Expense Ratio Comparison

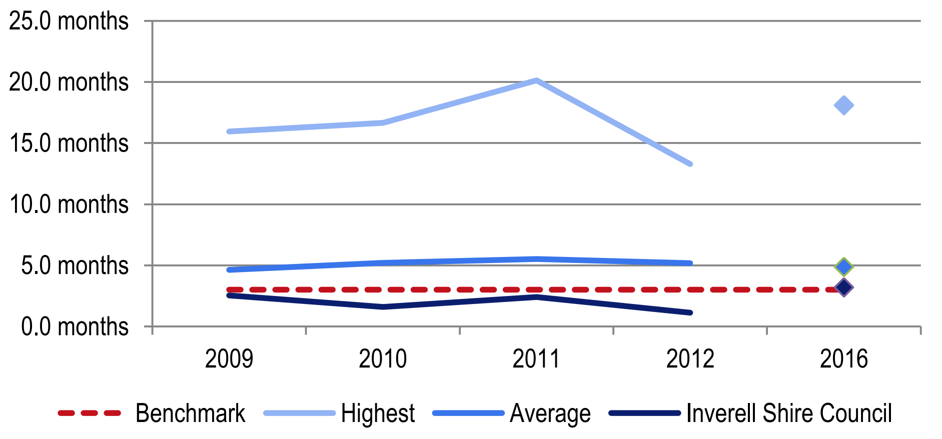
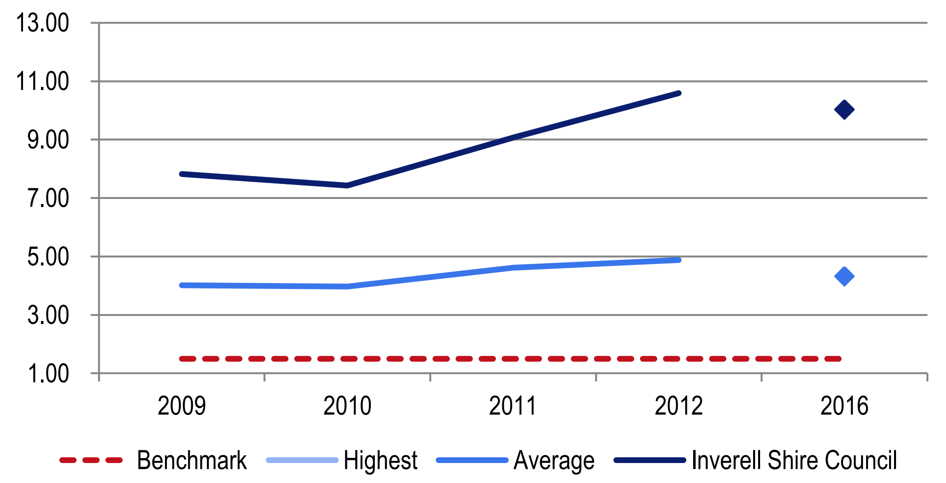


Figure 17 - Unrestricted Current Ratio Comparison



On average over the last four years, the Council's liquidity position has been sound and this is forecast to continue in the medium term.

Debt Servicing

Figure 18 - Debt Service Cover Ratio Comparison

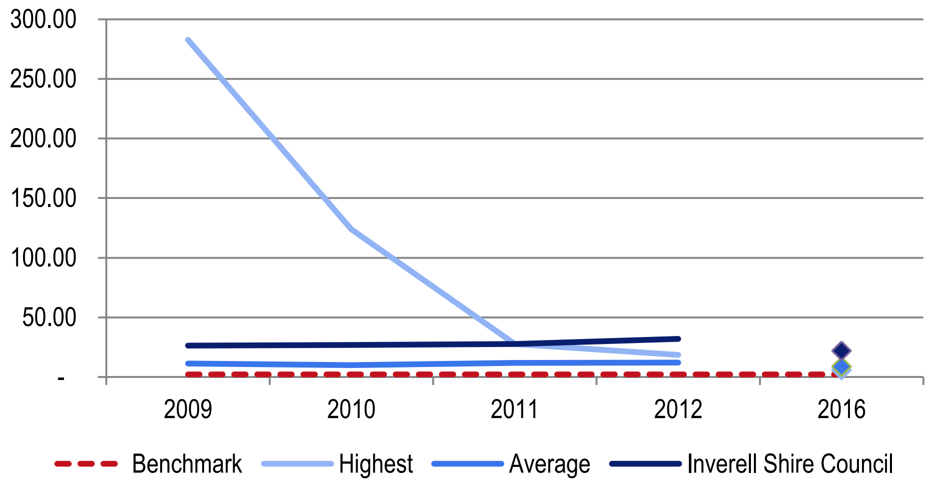
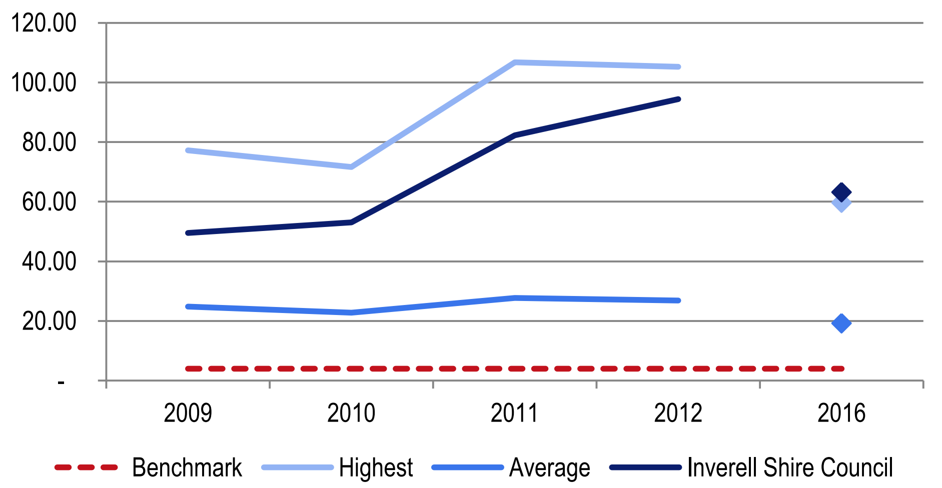
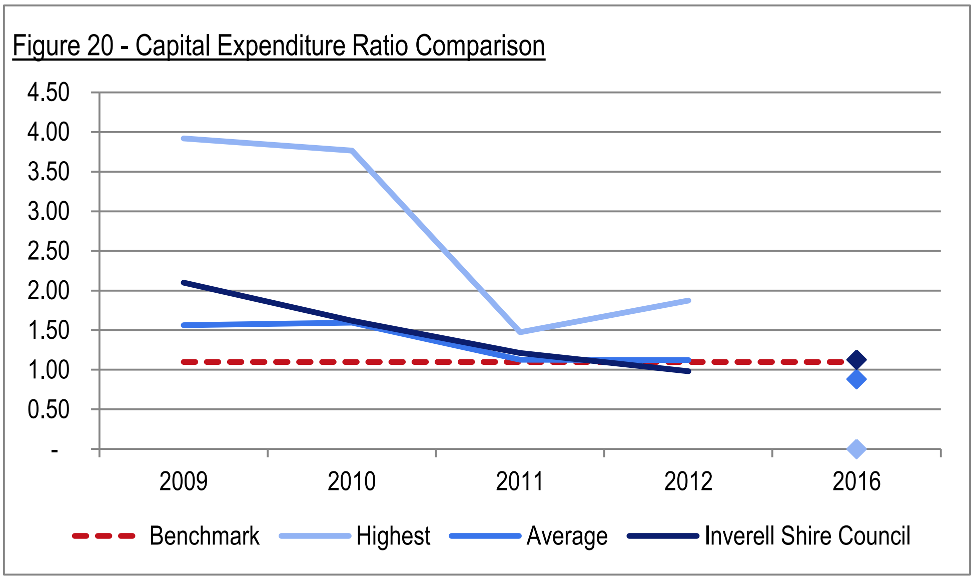


Figure 19 - Interest Cover Ratio Comparison



Over the review period, Council was above the benchmarks and group averages. These ratios are forecast to marginally decline in the medium term but remain above the benchmarks and group averages.

Asset Renewal and Capital Works



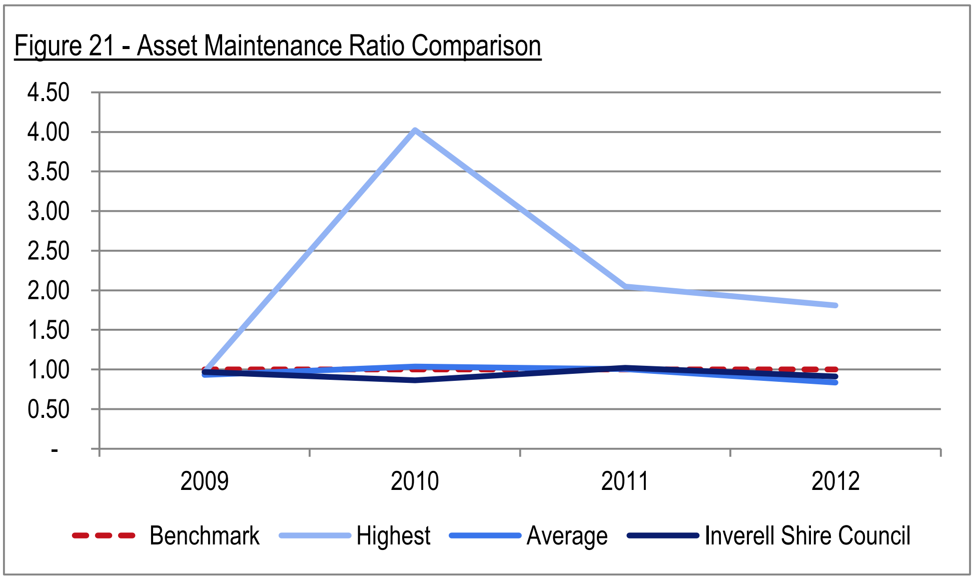


Figure 22 - Infrastructure Backlog Ratio Comparison

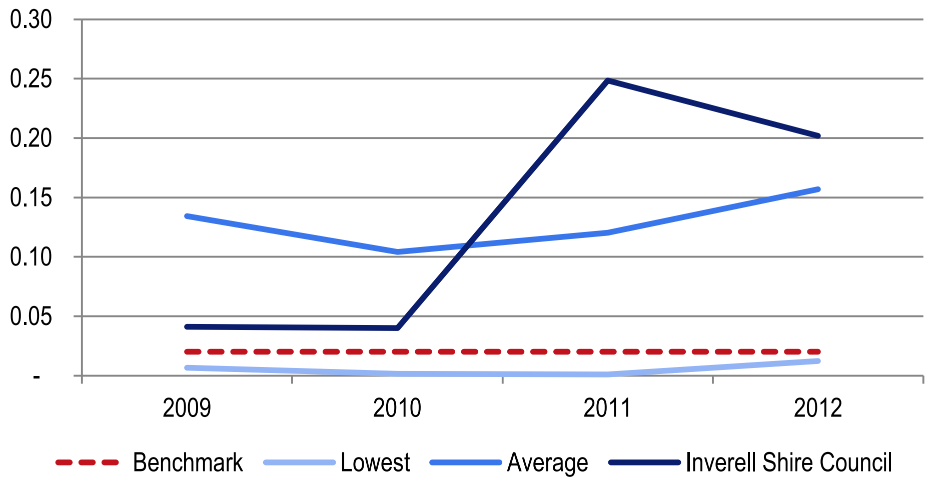
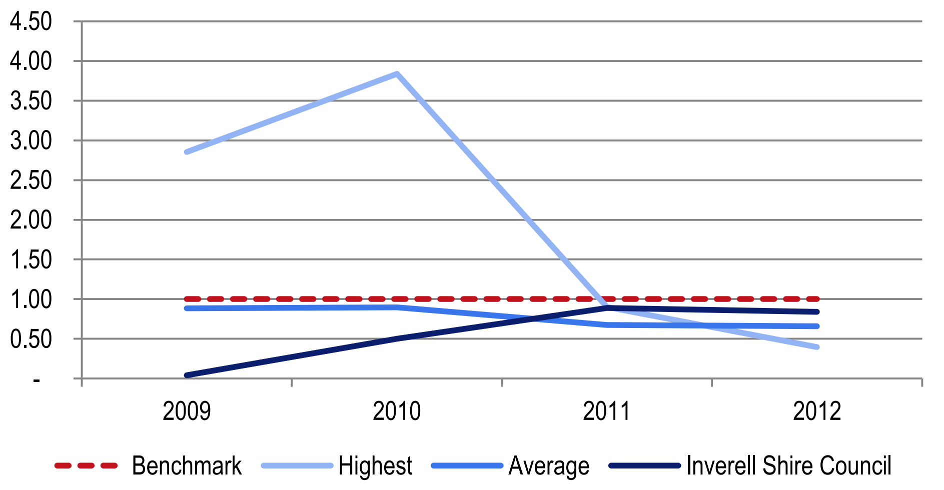


Figure 23 - Building and Infrastructure Asset Renewal Ratio



Overall, Council had a higher Infrastructure Backlog Ratio than other councils in the group for the last two years and it was significantly higher than the benchmark. Council's Asset Maintenance Ratio and Capital Expenditure Ratio were in line with the group averages and at or above the benchmarks. Council's Building and Infrastructure Asset Renewal Ratio was above the group average and close to benchmark in the last two years.

Section 6 Conclusion and Recommendations

Based on our review of both the historic financial information and the 10 year financial forecast within Council's long term financial plan we consider Council to be in a satisfactory financial position. While the Water Fund position is satisfactory, the consolidated position is marginally stronger.

Notwithstanding the low Debt Service Cover Ratio in the early part of the forecast period due to high principal repayments, both past performance and the financial forecasts support our findings that Council has sufficient financial capacity to service the additional borrowings proposed under its LIRS applications.

As noted in our report, the forecast analysis has been focused on the Water Fund where the LIRS application relates, whereas the historical analysis has focused on the consolidated audited accounts.

We base our recommendation on the following key points:

- Council has sufficient capacity to repay the additional $2m debt. While the DSCR is low during the initial years of the forecast, the Water Fund has sufficient cash and investments to service the debt during this period.
- The Water Fund has ample liquidity to manage their short term liabilities during the 10 year forecast period.
- The consolidated funds position has a relatively low level of borrowings at $0.7m (all of which are in the Water Fund), only 0.1% of net assets.

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

- Council's consolidated funds expenses growth has accelerated to 13.5% p.a. in 2011. Council will need to manage expenses in order to meet their forecast of no expenses growth in their consolidated results in 2012.
- Council has a relatively large infrastructure backlog at $87.5m that equates to 24.9% of total infrastructure, property, plant and equipment assets. The backlog increased rapidly in 2011 and this trend is not sustainable.
- For the Water Fund, operating deficits excluding capital grants and contributions are expected over the entire forecast period. This is an issue that could impact the long term financial sustainability of the Water Fund. We recommend Council considers its options for improving its performance in this area, either by further and on-going cost controls, or securing new or additional revenue in future years.

Appendix A Historical Financial Information Tables

Table 1- Income Statement

Income Statement ($'000s)	Year ended 30 June			% annual change	
	2011	2010	2009	2011	2010
Revenue					
Rates and annual charges	13,126	12,650	12,357	3.8%	2.4%
User charges and fees	4,613	5,968	4,249	(22.7%)	40.5%
Interest and investment revenue	2,136	1,529	1,781	39.7%	(14.1%)
Grants and contributions for operating purposes	9,384	8,669	9,229	8.2%	(6.1%)
Other revenues	694	762	604	(8.9%)	26.2%
Total revenue	**29,953**	**29,578**	**28,220**	**1.3%**	**4.8%**
Employees	11,478	10,440	10,209	9.9%	2.3%
Borrowing costs	110	209	214	(47.4%)	(2.3%)
Materials and contract expenses	6,521	5,306	4,744	22.9%	11.8%
Depreciation and amortisation	8,116	6,968	6,483	16.5%	7.5%
Other expenses	2,907	2,739	2,672	6.1%	2.5%
Total expenses	**29,132**	**25,662**	**24,322**	**13.5%**	**5.5%**
Operating result	**821**	**3,916**	**3,898**	**(79.0%)**	**0.5%**

Table 2 - Items excluded from Income Statement

Excluded items ($'000s)			
	2011	2010	2009
Grants and contributions for capital purposes	3,113	3,831	4,891
Fair value adjustments of investments	123	505	(613)
Amortisation of interest free loan	1	1	9
Net gain on disposal of assets	1,151	157	30

Table 3 - Balance Sheet

Balance Sheet ($'000s)	Year Ended 30 June			% annual change	
	2011	**2010**	**2009**	**2011**	**2010**
Current assets					
Cash and equivalents	4,191	2,437	3,725	72.0%	(34.6%)
Investments	24,094	25,299	19,162	(4.8%)	32.0%
Receivables	4,167	3,340	3,473	24.8%	(3.8%)
Inventories	546	527	616	3.6%	(14.4%)
Other	356	230	342	54.8%	(32.7%)
Non-current assets classified as held for sale	279	279	279	0.0%	0.0%
Total current assets	33,633	32,112	27,597	4.7%	16.4%
Non-current assets					
Investments	7,000	6,000	5,997	16.7%	0.1%
Receivables	33	41	651	(19.5%)	(93.7%)
Infrastructure, property, plant & equipment	472,906	468,472	431,427	0.9%	8.6%
Investment property	2,729	2,729	2,770	0.0%	(1.5%)
Total non-current assets	482,668	477,242	440,845	1.1%	8.3%
Total assets	**516,301**	**509,354**	**468,442**	**1.4%**	**8.7%**
Current liabilities					
Payables	1,954	2,491	2,253	(21.6%)	10.6%
Borrowings	232	218	204	6.4%	6.9%
Provisions	3,255	3,396	3,358	(4.2%)	1.1%
Total current liabilities	5,441	6,105	5,815	(10.9%)	5.0%
Non-current liabilities					
Borrowings	507	739	956	(31.4%)	(22.7%)
Provisions	1,287	1,288	2,300	(0.1%)	(44.0%)
Total non-current liabilities	1,794	2,027	3,256	(11.5%)	(37.7%)
Total liabilities	**7,235**	**8,132**	**9,071**	**(11.0%)**	**(10.4%)**
Net assets	**509,066**	**501,222**	**459,371**	**1.6%**	**9.1%**

Table 4-Cashflow

Cashflow Statement ($'000s)	Year ended 30 June		
	2011	**2010**	**2009**
Cashflows from operating activities	10,530	15,387	15,585
Cashflows from investing activities	(8,558)	(16,472)	(14,519)
Proceeds from borrowings and advances	0	0	0
Repayment of borrowings and advances	(218)	(203)	(191)
Cashflows from financing activities	(218)	(203)	(191)
Net increase/(decrease) in cash and equivalents	**1,754**	**(1,288)**	**875**
Cash and equivalents	4,191	2,437	3,725

Appendix B Glossary

Asset Revaluations

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

Collateralised Debt Obligation (CDO)

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

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

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

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

Division of Local Government (DLG)

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

Depreciation of Infrastructure Assets

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

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

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

EBITDA

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

Grants and Contributions for Capital Purposes

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

Grants and Contributions for Operating Purposes

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

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

Independent Commission Against Corruption (ICAC)

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

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

Independent Pricing and Regulatory Tribunal (IPART)

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

Infrastructure Backlog

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

Integrated Planning and Reporting (IP&R) Framework

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

Local Government Cost Index (LGCI)

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

Net Assets

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

Roads and Maritime Services (RMS)

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

Section 64 Contribution

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

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

Section 94 Contribution

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

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

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

Special Rate Variation (SRV)

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

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

The applications are reviewed and approved by IPART.

Ratio Explanations

Asset Maintenance Ratio

Benchmark = Greater than 1.0x

Ratio = actual asset maintenance / required asset maintenance

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

Building and Infrastructure Renewals Ratio

Benchmark = Greater than 1.0x

Ratio = Asset renewals / depreciation of building and infrastructure assets

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

Cash Expense Cover Ratio

Benchmark = Greater than 3.0 months

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

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

Capital Expenditure Ratio

Benchmark = Greater than 1.1x

Ratio = annual capital expenditure / annual depreciation

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

Debt Service Cover Ratio (DSCR)

Benchmark = Greater than 2.0x

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

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

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.