New South Wales
Treasury Corporation

Willoughby City Council

Financial Assessment and Benchmarking Report

2 October 2012

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

New South Wales
Treasury Corporation

Disclaimer

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

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

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 Willoughby City Council, the LIRS Assessment Panel and the DLG. TCorp shall not be liable to Willoughby City Council or have any liability to any third party under the law of contract, tort and the principles of restitution or unjust enrichment or otherwise for any loss, expense or damage which may arise from or be incurred or suffered as a result of reliance on anything contained in this report.

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Section 1 Executive Summary

This report provides an independent assessment of Willoughby City Council's (the Council) financial capacity and its ability to undertake additional borrowings. The analysis is based on a review of the historical performance, current financial position, and long term financial forecasts. It also benchmarks the Council against its peers using key ratios.

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

Council has made one application for $2.0m for the Stormwater System Assets Rehabilitation Programme to be repaid over 10 years.

TCorp's approach has been to:

- Review the most recent three years of Council's consolidated financial results
- Conduct a detailed review of the Council's 10 year financial forecasts. The review of the financial forecasts focused on the particular Council fund that was undertaking the proposed debt commitment. As the Council operates only one fund we focused our review on this General Fund.

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

- Council own sourced revenue has been consistently above benchmark each year
- The significant Concourse project has been completed substantially in accordance with plans and budgets
- Council has shown a strong understanding of debt management and tailoring debt products to match their financial needs
- Council recognises that it is a hub, providing services not only for the LGA but for the surrounding region. Examples include the Concourse, and Chatswood library
- Council has shown a forward thinking approach to capital expenditure by combining new assets with revenue generating opportunities as evidenced by their work on the works depot and art studio
- Council's key financial performance indicators have all been above or near benchmark over the last three years

Council's reported Infrastructure Backlog of $50.6m in 2011 represents 11.6% of its infrastructure asset value of $434.4m. Other observations include:

- The required asset renewal and maintenance amounts are not being spent to keep the assets in their current condition, therefore it is likely that the backlog will grow
- Council's capital expenditure priorities in the last three years has been on new assets, in particularly the development of the Concourse

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

- Council has acknowledged that its asset base is unsustainable under the current funding model

- Further efficiencies or revenue generating opportunities are needed for Council to maintain service levels to the standard the community expect, and for the Infrastructure Backlog to be addressed in a significant manner

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:

- Despite the size of the recent Capital Works Program undertaken by Council, debt levels are at a conservative 2.4% of Net Assets

In respect of the Benchmarking analysis TCorp has compared the Council's key ratios with other councils in DLG Group 2. The key observations are:

- Council's financial flexibility as indicated by the Operating Ratio and Own Source Operating Revenue Ratio is sound. The Council's Operating Ratio is above the group's average and benchmark. While Council's Own Source Operating Revenue Ratio is below the group's average it is above the benchmark
- Over the review period, Council was above benchmark DSCR and close to the benchmark for the Interest Cover Ratio but these ratios are forecast to marginally deteriorate in the medium term to be below the benchmark.
- Council has been in a sound liquidity position though it is expected to deteriorate to be below the benchmark in the medium term
- Council's performance in terms of its Asset Maintenance Ratio is close to its peers but below the benchmark. While the Infrastructure Backlog Ratio is lower than the group's average, it would need to reduce significantly to reach the benchmark

Section 2 Introduction

2.1: Purpose of Report

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

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

The key areas focused on are:

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

2.2: Scope and Methodology

TCorp's approach was to:

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

In undertaking its work, TCorp relied on:

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

Benchmark Ratios

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

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

Therefore these benchmarks are intended as a guide to performance.

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

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

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2.3: Overview of the Local Government Area

Willoughby Council LGA	
Locality & Size	
Locality	Inner Sydney
Area	23 km²
DLG Group	2
Demographics	
Population	67,356
% under 20	24.2%
% between 20 and 55	63.4%
% over 65	12.4%
Expected population 2025	76,336
Operations	
Number of employees (FTE)	445
Annual revenue	$84.9m
Infrastructure	
Roads	211 km
Bridges	71
Buildings	130
Infrastructure backlog value	$50.6m
Total infrastructure value	$424.8m

Willoughby City Council Local Government Area (LGA) is located on Sydney's north shore stretching from St Leonards in the south to Roseville and Castle Cove in the north. The LGA is 23 km² in area with over 11 km² of bushland, parks and gardens and 20 km of harbour foreshore.

The LGA also incorporates commercial centres at Chatswood and St Leonards, industrial areas at Artarmon and East Chatswood and a major retail centre at Chatswood.

Statistical trends indicate that the percentage of people in the older age group (60+) will grow over the period from 2006 to 2031.

2011 saw the opening of the Council's Concourse development. The Concourse provides a concert hall, theatre, and rehearsal space. It also provides conference facilities and venues for hire. The Concourse is also home to Chatswood Library which provides over 5,000 m² of space for books, resources and reference materials.

Council recognise that the LGA is a hub for the surrounding area, and its facilities such as the library and the Concourse are used by far more people than just LGA residents.

2.4: LIRS Application

Council has made one LIRS application.

Project: Stormwater System Assets Rehabilitation Programme

Description: Works will include relining, repairing, replacing, and where possible and appropriate amplification. The accelerated expenditure on Council's stormwater system will assist by reducing the Infrastructure Backlog.

Amount of loan facility: $2.0m

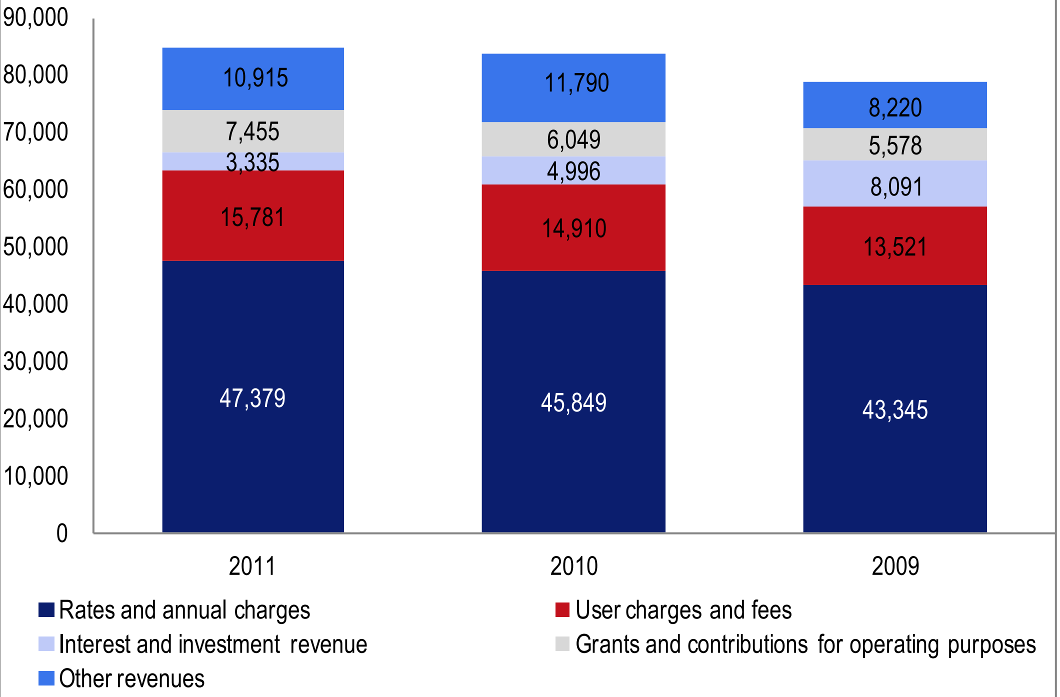
Term of loan facility: 10 years

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)



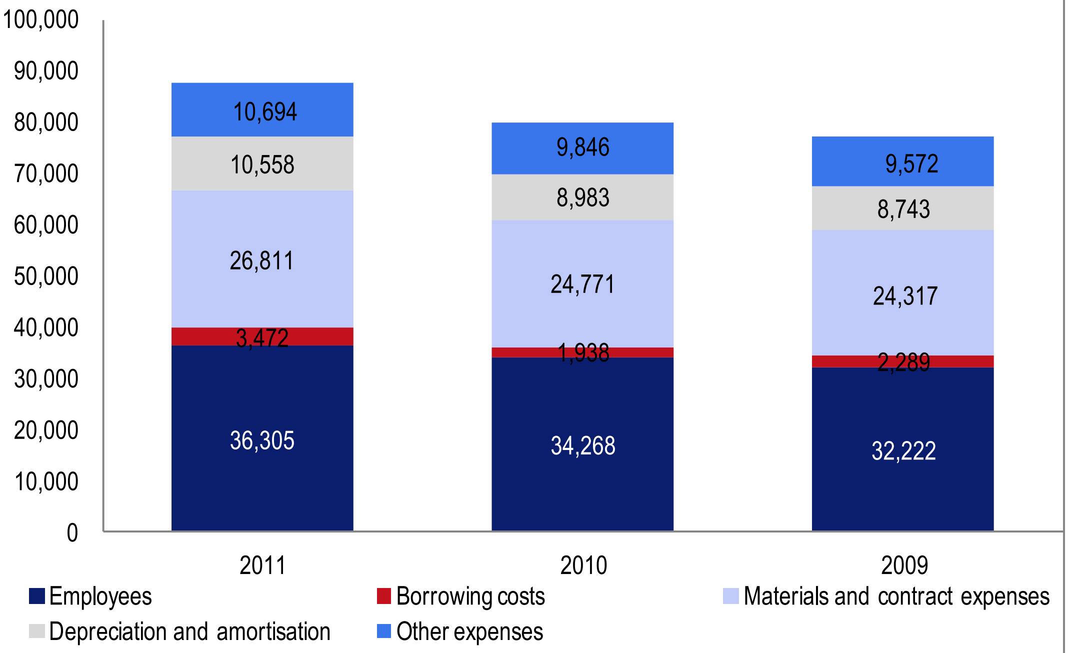
Key Observations

- Rates and annual charges have risen steadily over the last three years boosted by a special stormwater management levy. In June 2012 Council received approval to permanently increase minimum rates from 2012 onwards by 23.6%. The main purpose of the increase was to reduce the gap between minimum rates and those paid by other ratepayers. An increase in minimum rates does not increase the Council's overall rates revenue beyond the rate peg, but rather represents redistribution in the way rates are raised. As a result of the minimum rate increase, most ratepayers not subject to minimum rates will either face a decrease in rates or an increase that is less than the rate peg. With the ongoing residential construction in the LGA, Council estimate that this change will generate over $1.0m extra in rates over the next three years.
- User fees and charges have been increasing due to increases in parking fees, restoration fees, and child care fees. Child care activities posted a deficit in 2011. Council is working towards achieving a breakeven financial outcome for the delivery of quality services at an affordable level but have found recent changes to staffing regulations hamper this process. Parking revenue increased to $3.6m in 2011 from $3.1m in 2009.

- The decrease in interest and investment income has corresponded to the decrease in investments held.
- Other revenues increased in 2010 as rental revenues from Council properties increased from $3.6m in 2009 to $5.2m in 2010. Other revenues fell again in 2011 due to a fair value adjustment to investment properties of $0.6m.

3.2: Expenses

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



Key Observations

- Employee costs increased by 6.3% in 2010, and 5.9% in 2011 to $36.3m. These increases are above average NSW wage indexation rates due in part to increased employee numbers.
- Borrowing costs increased 79.2% in 2011 to $3.4m due to a new $25.0m loan being drawn down. This loan was used to complete the construction of the Concourse, which opened late in 2011. For further information please see section 3.6.
- Materials and contract expenses increased by 8.2% in 2011 due to contractor and consultancy fees increasing by $1.7m to $21.0m reflecting the increases in projects and services. Increased expenses were partly offset by increased operating grants and contributions revenue.
- In 2010, the Asset Revaluations process increased the value of Council's roads, drainage, bridges and footpaths by $130.3m. This resulted in the annual depreciation charge increasing by 17.5% in 2011 to $10.6m.

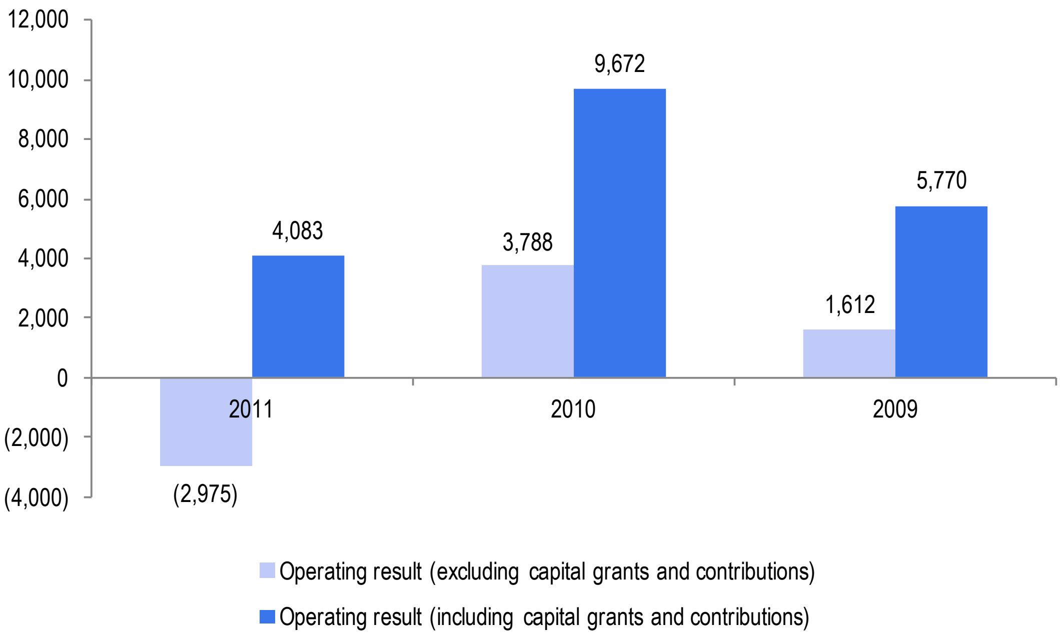
3.3: Operating Results

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 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

- After posting operating surpluses excluding capital grants and contributions in 2009 and 2010, Council posted a deficit in 2011 due to increased employee costs, depreciation charges, and borrowing costs. Total revenue increased by 1.5% while total expenses increased by 10.1%. Council will need to address this imbalance in revenue growth versus expense growth to improve its operating position.
- Council expenses include a non-cash depreciation expense, ($10.6m in 2011), which has increased over the past three years following the Asset Revaluations process. Whilst the non cash nature of depreciation can favourably impact on ratios such as EBITDA 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

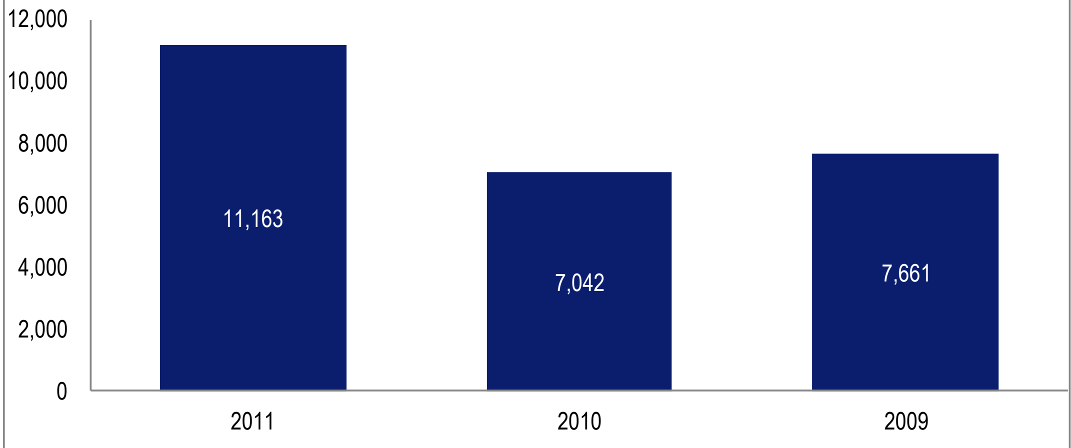
Performance Indicators	Year ended 30 June		
	2011	2010	2009
EBITDA ($'000s)	11,055	14,709	12,644
Operating Ratio	(3.5%)	4.5%	2.0%
Interest Cover Ratio	3.18x	7.59x	5.52x
Debt Service Cover Ratio	2.37x	5.46x	4.19x
Unrestricted Current Ratio	3.51x	2.90x	6.51x
Own Sourced Operating Revenue Ratio	68.7%	67.9%	68.6%
Cash Expense Ratio	1.8 months	1.2 months	1.4 months
Net assets ($'000s)	2,657,634	2,557,144	2,399,600

Key Observations

- Council's EBITDA has remained stable over the three year period. Council's Interest Cover Ratio and DSCR indicate that they had some flexibility in regard to carrying more debt. The DSCR has been above the benchmark of 2.00x over the past three years. Debt level increases are due to new loans to complete The Concourse.
- The Unrestricted Current Ratio has been above the benchmark of 1.50x over the past three years indicating Council had sound liquidity.
- Net Assets have increased by over $258.0m between 2009 and 2011 due to the consecutive Asset Revaluations in 2010 in 2011 that increased the value of roads, bridges, footpaths, drainage assets, and community land.
- The Asset Revaluations over the last three years has resulted in steady growth in Net Assets over this period. In the medium to long term, 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. Increasing Net Assets is a key indicator of the Council's assets being able to sustain the ongoing operations of a Council.
- When the Asset Revaluations are excluded, the underlying trend in all three years has been an expanding infrastructure, property, plant, and equipment (IPP&E) asset base with asset purchases being larger than the combined value of disposed assets and annual depreciation. Over the three years this amounted to a $162.6m increase in IPP&E assets, driven by the construction of the Concourse.
- Council had total borrowings of $62.7m in 2011, being 2.4% of Net Assets.

3.5: Statement of Cashflows

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



Key Observations

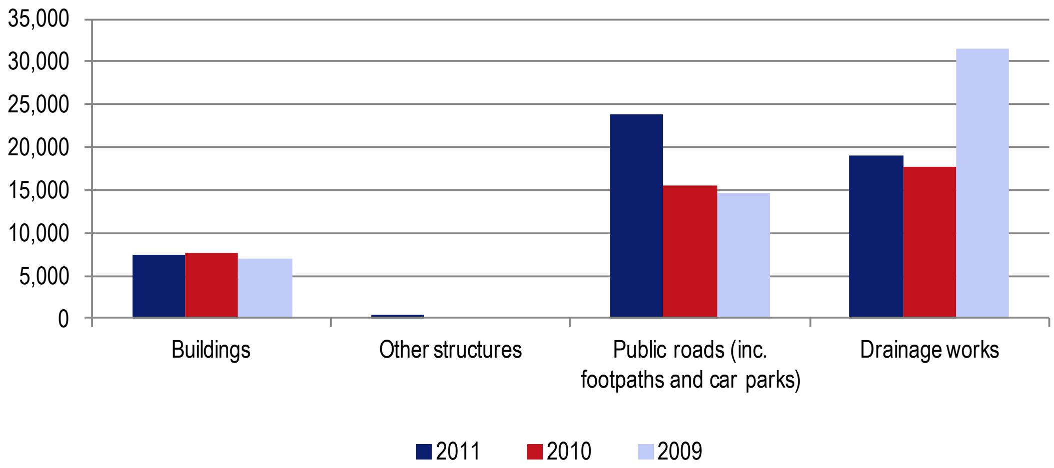
- Cash and cash equivalents have increased over the three year period.
- Total cash and investments have decreased from $116.2m in 2009 to $35.5m in 2011 as Council have funded a substantial part of the Concourse project from its reserves.
- The cash reserves, along with the Unrestricted Current Ratio, suggest the Council was comfortable in meeting their day to day obligations.
- Council held total cash and investments of $35.5m in 2011 including $0.6m in CDOs, and $2.7m in equity linked notes. These CDOs had a face value of $1.5m but have been written down in value to $0.6m. Due to recent market developments Council now expect to recover more than $0.6m.

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.

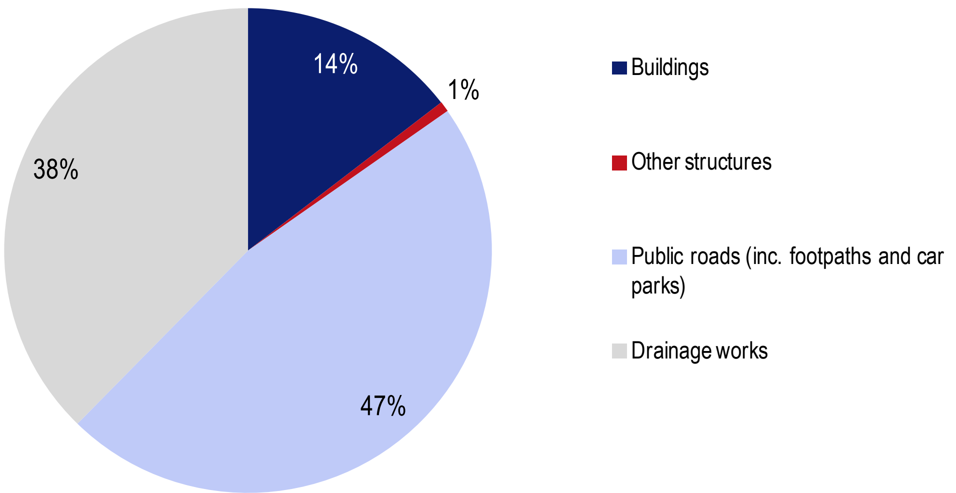
3.6(a): Infrastructure Backlog

Figure 5 - Infrastructure Backlog for 2008/09 to 20010/11 ($'000's)



The Council reported a $50.6m backlog in 2011 up from a reported backlog of $40.8m in 2010. Consistent with many other councils, the backlog is largely road related (47.1%) and 37.6% of the backlog is related to drainage assets. Discussions with council officers indicate that this figure is likely to be amended as increased use of technology such as CCTV examination of the drainage network, will provide a more precise estimate of the backlog. To-date, there has not been a material change in Council's backlog over the past three years.

Figure 6 - Infrastructure Backlog Composition for 2010/11



3.6(b): Infrastructure Status

Infrastructure Status	Year ended 30 June		
	2011	2010	2009
Bring to satisfactory standard ($'000's)	50,551	40,793	53,147
Required annual maintenance ($'000's)	9,113	9,825	7,752
Actual annual maintenance ($'000's)	7,207	6,575	5,345
Total value infrastructure assets ($'000's)	434,412	451,491	321,175
Total assets ($'000's)	2,746,280	2,625,880	2,461,377
Infrastructure Backlog Ratio	0.12x	0.09x	0.17x
Asset Maintenance Ratio	0.79x	0.67x	0.69x
Building and Infrastructure Asset Renewal Ratio	0.67x	0.86x	0.77x
Capital Expenditure Ratio	5.03x	9.14x	6.36x

The Asset Maintenance Ratio, and Building and Infrastructure Asset Renewal Ratio show that Council is spending at levels below the benchmark on asset renewal and asset maintenance. The Capital Expenditure Ratio, which takes into account assets which improve performance or capacity, indicates Council has invested a significant amount over the last three years on new assets and enhanced assets (e.g. Concourse project) instead of renewal assets. Both the Concourse and new Depot can be classified as renewal and upgrade as they replaced existing facilities.

If this level of capital expenditure continues the asset base will expand, however if the priority remains expenditure on new assets rather than asset renewal, the Infrastructure Backlog is likely to increase.

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 ($'000's)	Year ended 30 June		
	2011	2010	2009
New capital works	55,237	77,609	61,303
Replacement/refurbishment of existing assets	6,982	4,840	7,327
Total	**62,219**	**82,449**	**68,630**

Council's capital works program in the last three years has been dominated by the construction of new assets specifically the Concourse. In the 2011 accounts the Concourse had a value of $169.0m.

The Concourse was planned and constructed after Council found that their existing public facilities such as their library and Civic Centre were no longer able to meet the needs of the LGA community, and the ever-growing number of regional users. The Concourse opened in late 2011 with facilities including the Theatre, the Concert Hall, the Studio and the Civic Pavilion all part of the Performing Arts

Centre on The Concourse, as well as Chatswood Library and a variety of support facilities, and retail stores.

Council has budgeted to underwrite the venue operations for $1.0m p.a. for the next five years, and performance to date has been better than budget, albeit not yet at a profitable level. Surplus revenues from the Concourse are to be appropriated to a sinking fund and held in reserve to repay the debt and fund future capital upgrades.

Council expect the Concourse venue operations will be self sufficient and operating without any Council subsidy within five years given current growth trends.

Council also hope to have a hotel developed on a site next to the Concourse which should help further enhance the Concourse's conference business. A previous hotel development proposed for the site did not proceed due to problems with the developer and resulted in a $13.0m deposit being retained by Council. Council expect the site to be returned to them shortly unencumbered. The LGA is currently served by just two hotels so they are confident there will be market demand for further hotel facilities.

Besides the Concourse, Council aims to combine new capital works with revenue generating operations as they have done in the recent past, combining the new Council depot with commercial space, and the art studio with a cafe.

3.7: Specific Risks to Council

- Council has $2.7m of capital guaranteed equity linked notes which are no longer prescribed under the state investment policy. As at July 2012, $2.0m was outstanding, with $1.0m to mature in December 2012, and $1.0m to mature in September 2014.
- $0.6m of Council's investments are held in CDOs. While Council expect to receive more than the $0.6m back, this is not certain. Further losses on the CDOs could result in fewer funds for existing services.
- The stormwater levy introduced by the state government in 2006 generated $0.7m in 2011 for Council. If this levy was revoked by state policy, revenues to fund flood mitigation would have to be found from elsewhere in Council's resources.
- Council has budgeted to subsidise $1.0m p.a. on venue operations of the Concourse for the next five years. If the hotel development does not go ahead, and the current business plan is not successful, the risk is that Council could be required to continue subsidising the operations or have to contribute at a higher level. This project needs to be closely managed and current Council management has a strong focus on the day to day management of this major asset.

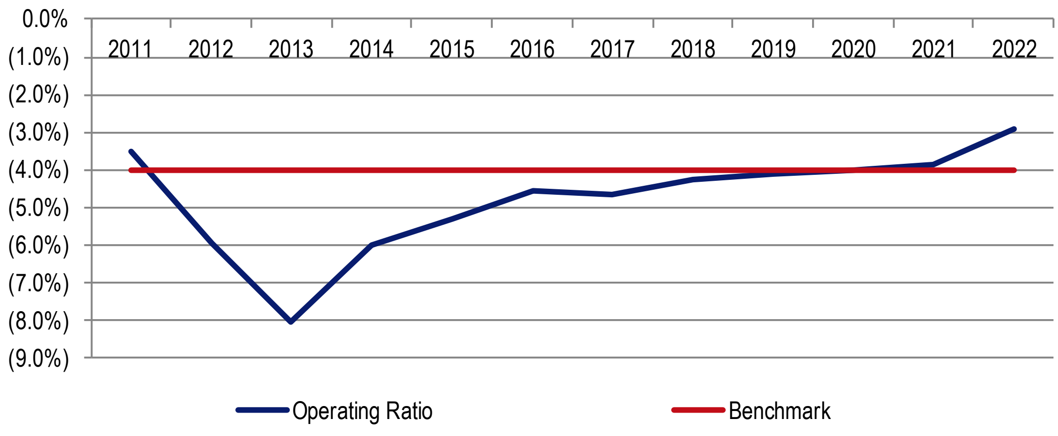
Section 4 Review of Financial Forecasts

The financial forecast model shows the projected financial statements and assumptions for the next 10 years. The model includes the $2.0m loan without any LIRS subsidy.

Council operates one General Fund covering all activities.

4.1: Operating Results

Figure 7- Operating Ratio for General Fund



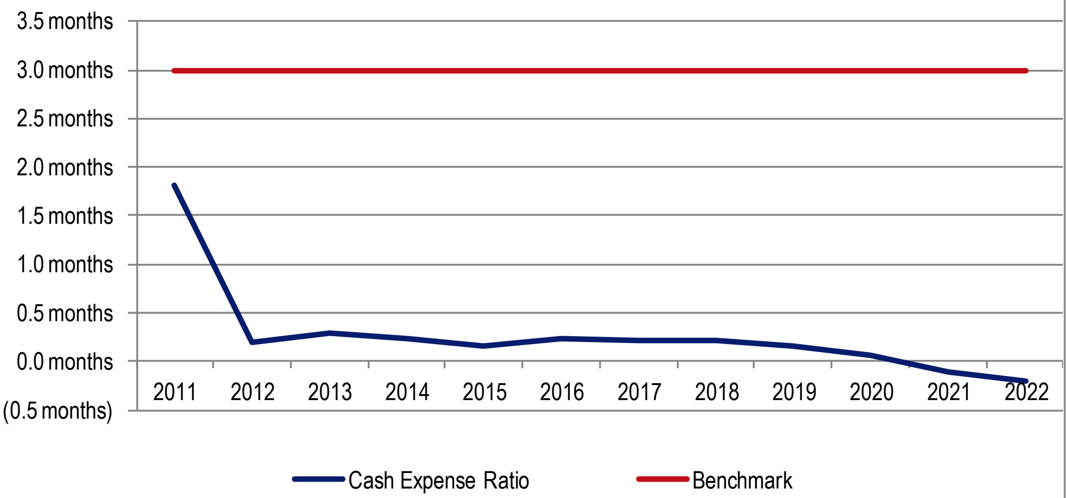
The Operating Ratio declines in 2013 due to it being the first full year the Concourse will be open, with deprecation expenses increasing significantly. The ratio improves gradually from 2013 onwards as the increases in revenue outstrip the increases in expenses. Council revenues are forecast to be boosted by increases in rates due to population increases, and increased revenue from waste services.

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.

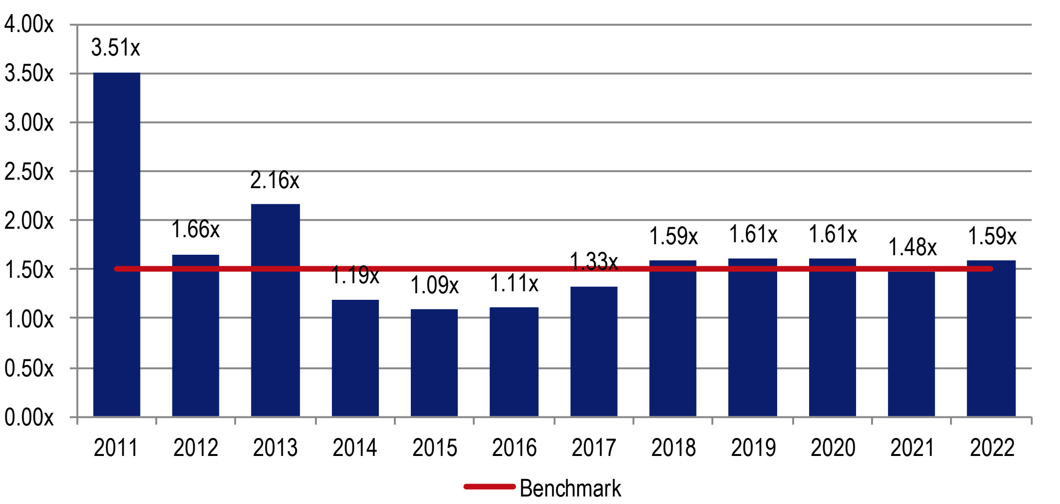
Liquidity Ratios

Figure 8 - Cash Expense Ratio for General Fund



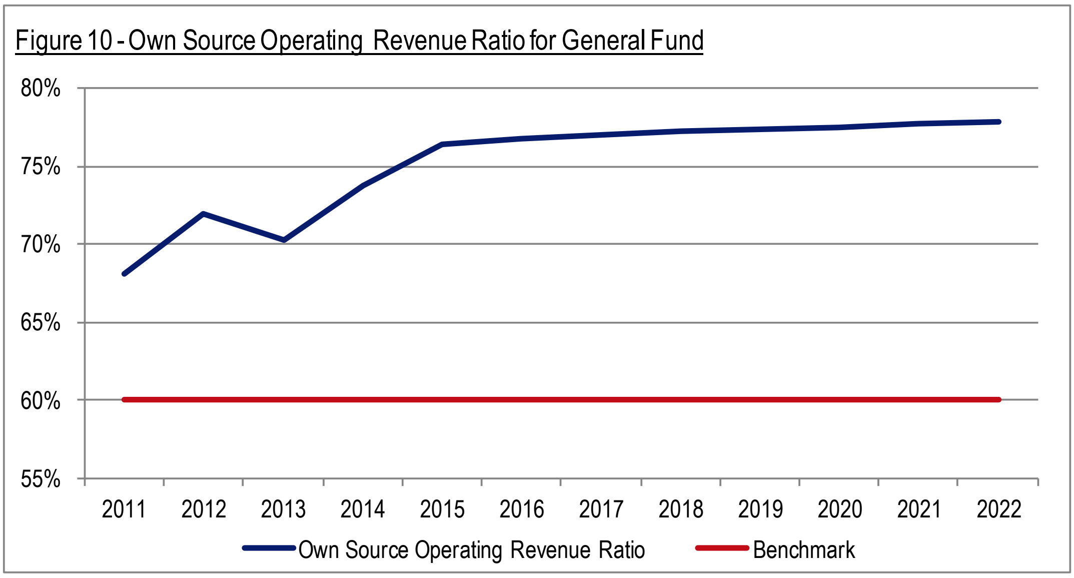
Council's Cash Expense Ratio is well below benchmark although Council has investment reserves of over $30.0m for the majority of the forecast period. Included in the investment reserves in 2011 were $13.0m in long term deposits.

Figure 9 - Unrestricted Current Ratio for General Fund



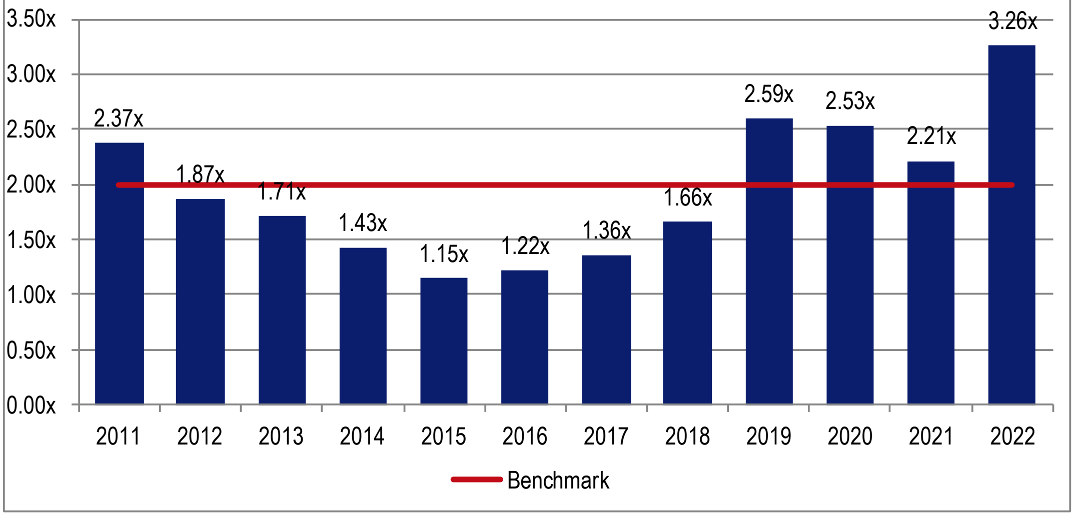
Council set their Unrestricted Current Ratio benchmark at 1.00x rather than the 1.50x benchmark favoured by the DLG. Council conducts regular reviews of operational and capital programs to ensure their benchmark is met by prioritising the capital projects on a funds available basis. Achieving the benchmarks in this area would provide additional financial security for Council, although the lower levels forecast are within Council's approved policy targets.

Fiscal Flexibility Ratios



The Own Source Operating Revenue Ratio remains above the benchmark for each year. The ratio is rising over the lifetime of the forecast due to capital grants and contributions forecast being lower than the historically received. This skews the proportion of Own Source Revenue Ratio.

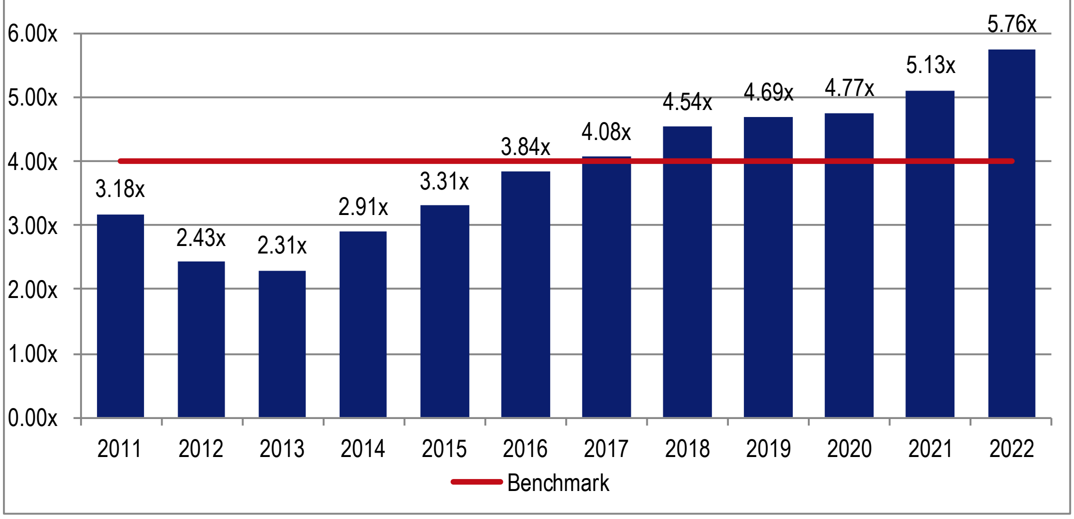
Figure 11 - DSCR for General Fund



Council's capacity for borrowing is limited due to existing borrowings for the Concourse development. Within Council's outstanding borrowings of $62.7m, $53.1m relates to the Concourse. Between 2014 and 2018 Council has principal repayments of at least $3.0m each year.

Council has demonstrated financial aptitude in borrowing a $30m CPI linked 30 year loan to partially fund the Concourse construction. The repayment profile of this loan is forecast to mirror the increasing revenue profile of the project into the future.

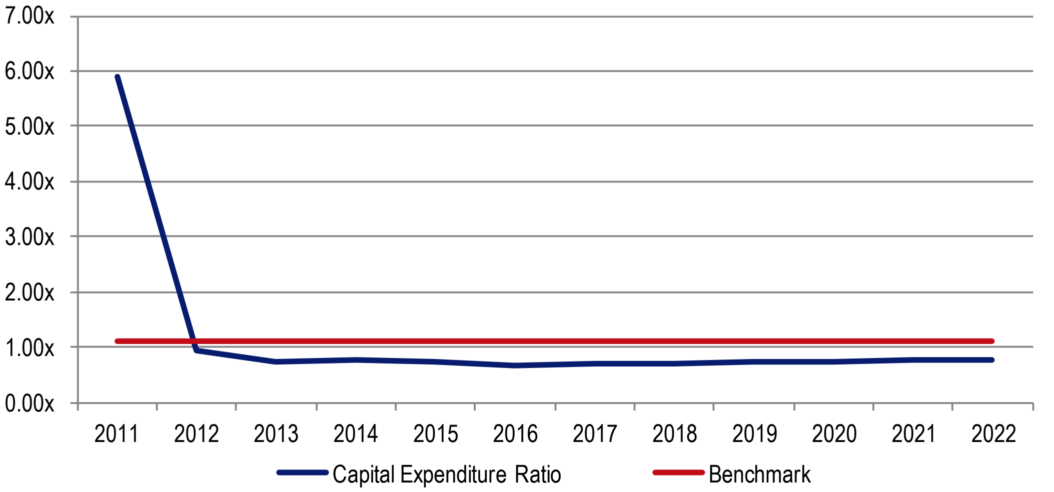
Figure 12 - Interest Cover Ratio for General Fund



The Interest Cover Ratio, similarly to the DSCR, shows the Council has limited capacity to service scheduled further debt commitments, beyond the LIRS loan. There is capacity to service further debt interest costs when the Council's ratio increases to the 4.00x benchmark from 2017 onwards.

4.3: Capital Expenditure

Figure 13 - Capital Expenditure Ratio for General Fund



Council's capital expenditure is marginally below the benchmark each year. Council's base case LTFP does not address reducing the Infrastructure Backlog at the level required to reduce it to nil. With this forecast level of capital expenditure there is potential for the backlog to grow.

With an ageing population putting further strain on the demand for services, Council will struggle to fund further plans to reduce the backlog. To maintain a sustainable Council, maintain current services, and address the Infrastructure Backlog, additional funding or efficiencies will be required.

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%
- 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%)
- Utilities, waste disposal and fire brigade/ emergency services levy estimated to increase by up to15.0%
- All other expenses: the estimated annual CPI increase of 2.5%

<u>Key Observations and Risks</u>

- The LTFP represents "business as usual", with the existing level of services to be continued.
- Based on this base case funding model, Council consider its own asset base unsustainable.
- Rates and annual charges are forecast to increase by between 3.0% and 5.0% p.a. These increases are driven by forecast population growth and increases in domestic waste management charges.
- Employee costs are forecast to increase by between 3.0% and 5.0% each year due to wage agreements plus regrades.
- TCorp consider the assumptions underpinning the LTFP reasonable.

4.5: Borrowing Capacity

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

- Based on Council meeting both the respective benchmarks for the DSCR and Interest Cover Ratio, Council will not be in a position to borrow further until 2019. Accelerated principal reductions may bring this date forward
- We would recommend further analysis be conducted over the next two years so that the performance of the Concourse can be assessed. Should this project meet or exceed expectations, then additional borrowings to address the Infrastructure Backlog may be affordable

Section 5 Benchmarking and Comparisons with Other Councils

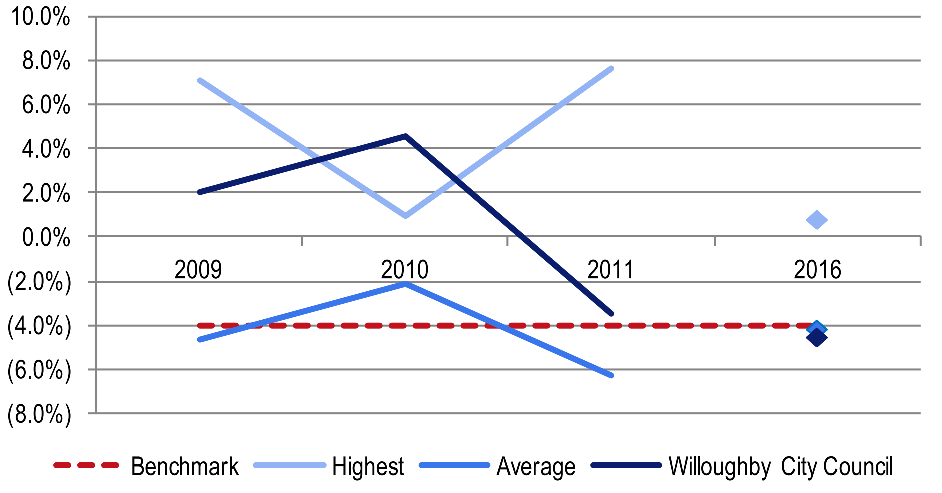
As discussed in section 2 of this report, each council's performance has been assessed against ten key benchmark ratios. This section of the report compares the Council's performance with its peers in the same DLG Group. The Council is in DLG Group 2. There are 15 councils in this group and at the time of preparing this report, we have data for nine 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.

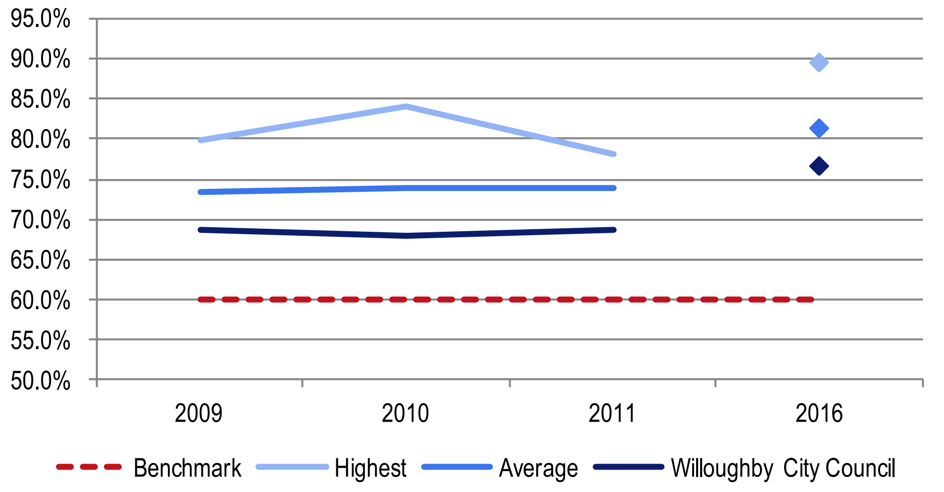
Financial Flexibility

Figure 14 - Operating Ratio Comparison



Council's Operating Ratio was above average and benchmark in the past three years. Consistent with other councils in the group, it experienced a decline in operating results in 2011 due to increased depreciation expense. The results are forecast to deteriorate in the medium term and to be marginally below the group's average and benchmark.

Figure 15 - Own Source Operating Revenue Ratio Comparison



Council's Own Source Operating Revenue Ratio was below the group average, though it is above the benchmark. The ratio is forecast to improve in the medium term though it remains below the group average.

Overall, Council's financial flexibility is satisfactory at levels near or above the benchmarks.

Liquidity

Figure 16 - Cash Expense Ratio Comparison

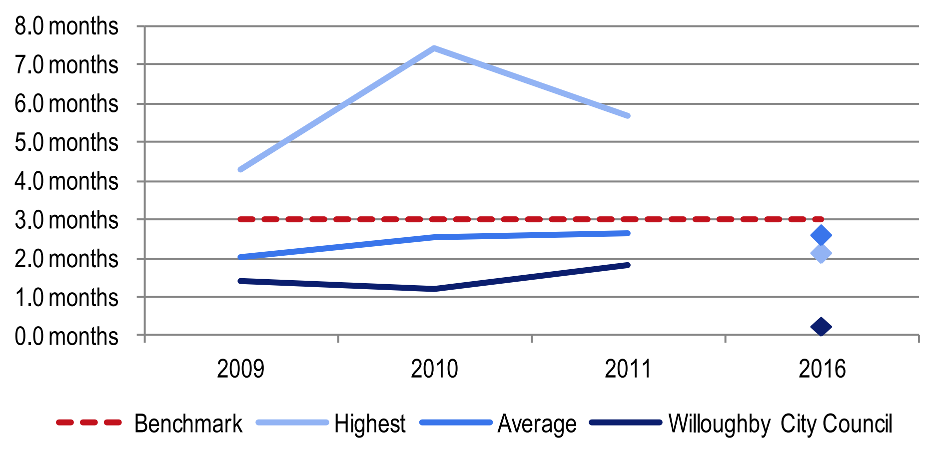
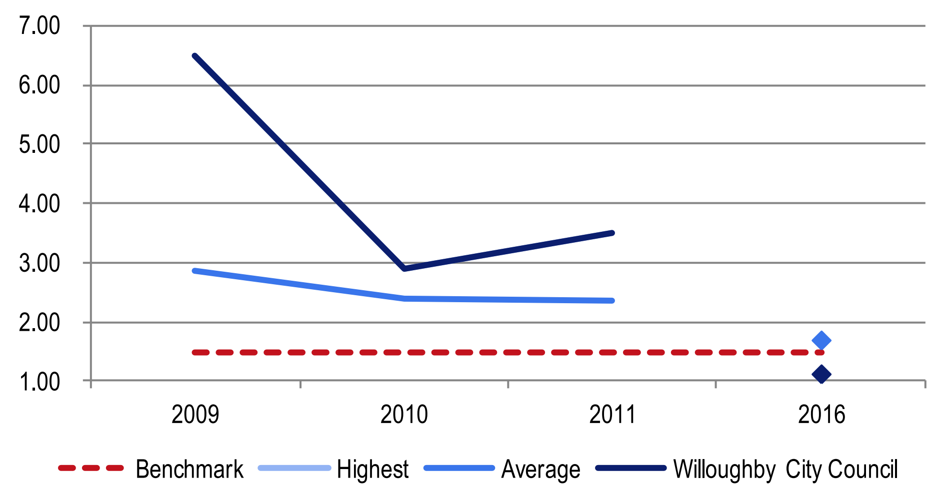


Figure 17 - Unrestricted Current Ratio Comparison



On average over the past three years, the Council's liquidity position has been sound though this is forecast to deteriorate in the medium term.

Debt Servicing

Figure 18 - Debt Service Cover Ratio Comparison

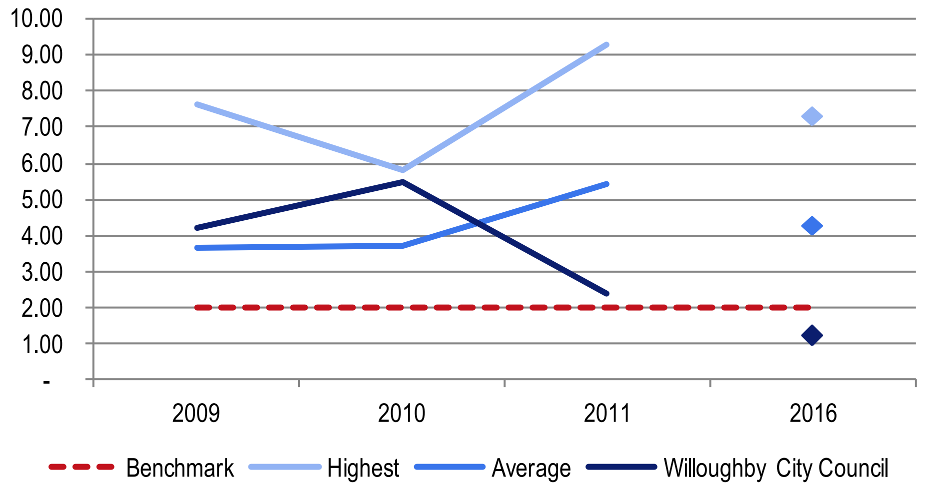
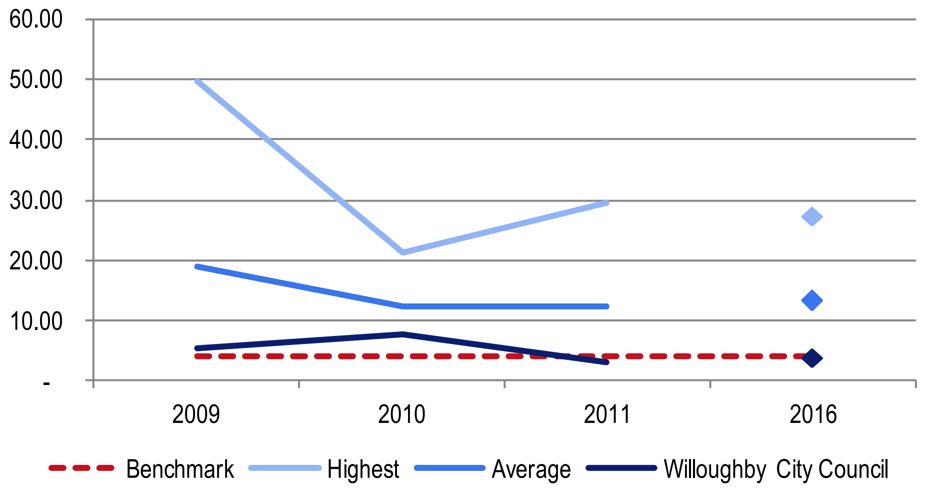


Figure 19 - Interest Cover Ratio Comparison



Over the review period, Council was above benchmark DSCR and close to the benchmark for the Interest Cover Ratio but these ratios are forecast to marginally deteriorate in the medium term to be below the benchmark.

Asset Renewal and Capital Works

Figure 20 - Capital Expenditure Ratio Comparison

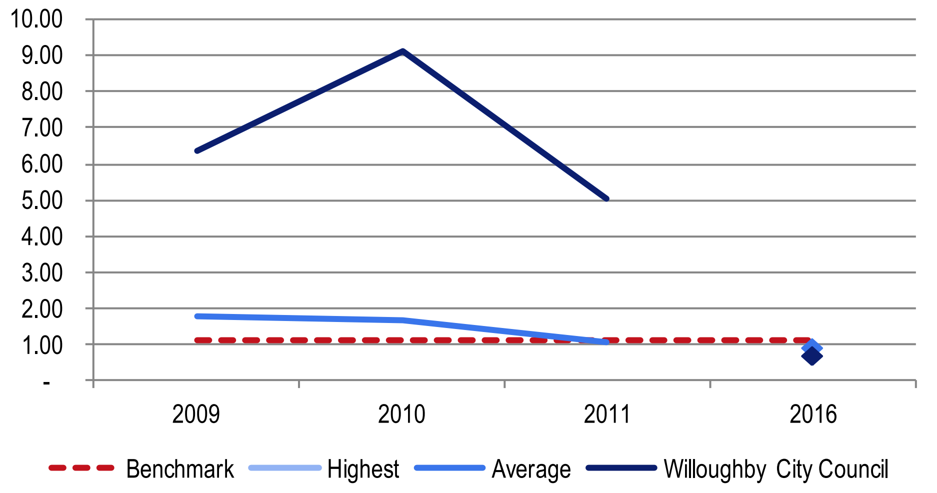


Figure 21 - Asset Maintenance Ratio Comparison

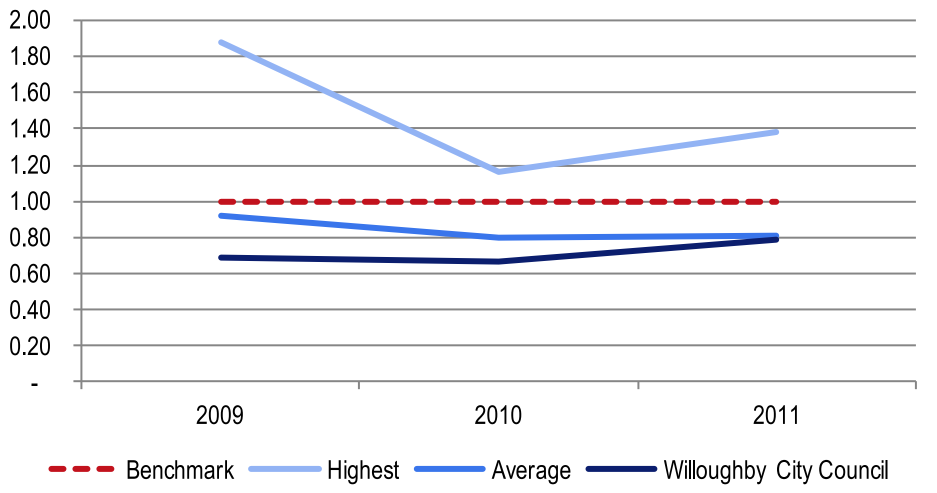


Figure 22 - Infrastructure Backlog Ratio Comparison

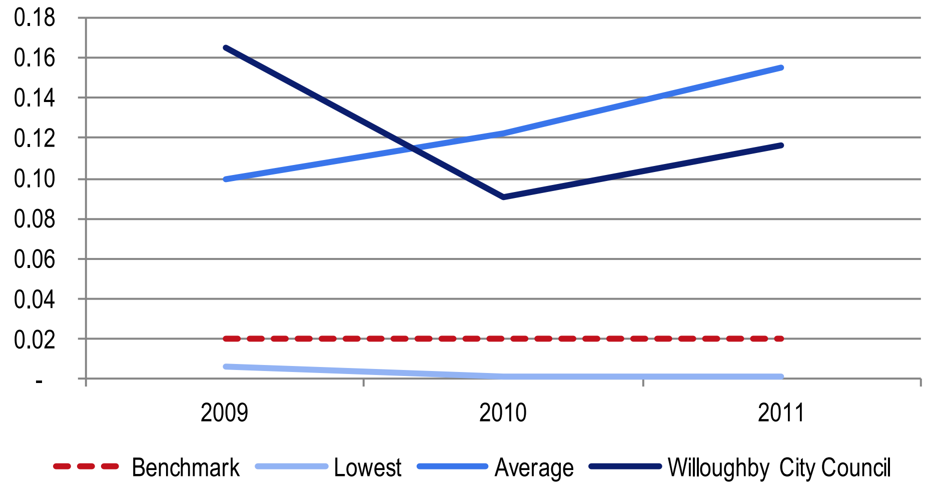
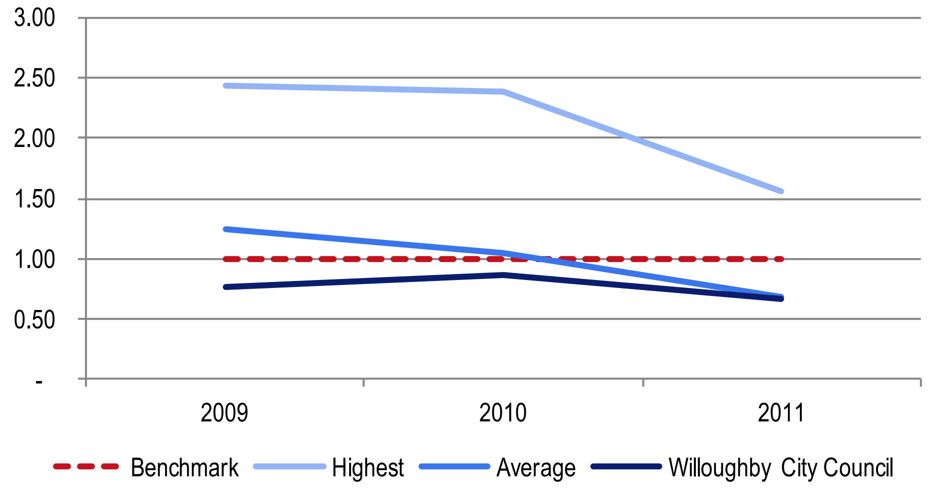


Figure 23 - Building and Infrastructure Asset Renewal Ratio



Overall, the Council has a lower Infrastructure Backlog (on average) than other councils in the group although the backlog would have to reduce significantly to reach the benchmark. It is below the group average and benchmark in terms of spending on asset maintenance. The Council's Building and Infrastructure Asset Renewal Ratio has declined against benchmark over the review period. The Council's Capital Expenditure Ratio has been very high over the last three years due to the new concourse which includes the Theatre, the Concert Hall, the Studio and the Civic Pavilion all part of the Performing Arts Centre on The Concourse, as well as Chatswood Library and a variety of support facilities, and retail stores. The Capital Expenditure is forecast to decrease to near benchmark levels in future years.

Section 6 Conclusion and Recommendations

Based on our review of both the historic financial information and the 10 year financial forecast within our recommendation on the following key points:

- Council Own Sourced Operating Revenue Ratio has been consistently above benchmark each year
- Council has shown a strong understanding of debt management and have been willing to seek external financial expertise to match debt instruments to their needs
- Council has shown a forward thinking approach to capital expenditure by combining new assets with revenue generating opportunities as evidenced by their work on the works depot and art studio
- Current Council management has a strong focus on the performance of Council's key Concourse asset

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

- Council has acknowledged that their asset base is unsustainable under the current funding model. Council should seek either further revenue sources or cost efficiencies to reduce or eliminate the forecast asset renewal funding gap

Appendix A Historical Financial Information Tables

Table 1- Income Statement

Income Statement ($'000's)	Year ended 30 June			% annual change	
	2011	2010	2009	2011	2010
Revenue					
Rates and annual charges	47,379	45,849	43,345	3.3%	5.8%
User charges and fees	15,781	14,910	13,521	5.8%	10.3%
Interest and investment revenue	3,335	4,996	8,091	(33.2%)	(38.3%)
Grants and contributions for operating purposes	7,455	6,049	5,578	23.2%	8.4%
Other revenues	10,915	11,790	8,220	(7.4%)	43.4%
Total revenue	**84,865**	**83,594**	**78,755**	**1.5%**	**6.1%**
Expenses					
Employees	36,305	34,268	32,222	5.9%	6.3%
Borrowing costs	3,472	1,938	2,289	79.2%	(15.3%)
Materials and contract expenses	26,811	24,771	24,317	8.2%	1.9%
Depreciation and amortisation	10,558	8,983	8,743	17.5%	2.7%
Other expenses	10,694	9,846	9,572	8.6%	2.9%
Total expenses	**87,840**	**79,806**	**77,143**	**10.1%**	**3.5%**
Operating result (excluding capital grants and contributions)	**(2,975)**	**3,788**	**1,612**	**(178.5%)**	**135.0%**
Operating result (including capital grants and contributions)	**4,083**	**9,672**	**5,770**	**(57.8%)**	**67.6%**

Table 2 - Items excluded from Income Statement

Excluded items ($'000)			
	2011	2010	2009
Grants and contributions for capital purposes	7,058	5,884	4,158
Interest revenue/ (losses)	558	545	200
Net gain from the disposal of assets	16,412	139	2,615

Table 3 - Balance Sheet

Balance Sheet ($'000's)	Year Ended 30 June			% annual change	
	2011	2010	2009	2011	2010
Current assets					
Cash and equivalents	11,163	7,042	7,661	58.5%	(8.1%)
Investments	13,000	32,866	74,844	(60.4%)	(56.1%)
Receivables	29,056	6,188	4,391	369.6%	40.9%
Inventories	20	25	29	(20.0%)	(13.8%)
Other	397	160	1,165	148.1%	(86.3%)
Assets held for sale	1,525	8,589	8,589	(82.2%)	0.0%
Total current assets	55,161	54,870	96,679	0.5%	(43.2%)
Non-current assets					
Investments	11,309	19,751	33,706	(42.7%)	(41.4%)
Receivables	42	42	42	0.0%	0.0%
Infrastructure, property, plant & equipment	2,671,566	2,542,474	2,330,882	5.1%	9.1%
Investments held using equity method	52	43	68	20.9%	(36.8%)
Investment property	8,150	8,700	0	(6.3%)	N/A
Total non-current assets	2,691,119	2,571,010	2,364,698	4.7%	8.7%
Total assets	**2,746,280**	**2,625,880**	**2,461,377**	**4.6%**	**6.7%**
Current liabilities					
Payables	14,294	19,466	15,742	(26.6%)	23.7%
Borrowings	1,307	1,015	749	28.8%	35.5%
Provisions	9,864	9,211	8,572	7.1%	7.5%
Total current liabilities	25,465	29,692	25,063	(14.2%)	18.5%
Non-current liabilities					
Borrowings	1,365	1,468	2,230	(7.0%)	(34.2%)
Payables	61,382	37,120	34,090	65.4%	8.9%
Provisions	434	456	394	(4.8%)	15.7%
Total non-current liabilities	63,181	39,044	36,714	61.8%	6.3%
Total liabilities	**88,646**	**68,736**	**61,777**	**29.0%**	**11.3%**
Net assets	**2,657,634**	**2,557,144**	**2,399,600**	**3.9%**	**6.6%**

Table 4-Cashflow

Cash Flow Statement ($'000's)	Year ended 30 June		
	2011	**2010**	**2009**
Cash flows from operating activities	10,685	22,307	17,609
Cash flows from investing activities	(30,375)	(25,470)	(15,365)
Proceeds from borrowings and advances	25,000	3,300	0
Repayment of borrowings and advances	(1,189)	(756)	(726)
Cash flows from financing activities	23,811	2,544	(726)
Net increase/(decrease) in cash and equivalents	**4,121**	**(619)**	**1,518**
Cash and equivalents	11,163	7,042	7,661

Appendix B Glossary

Asset Revaluations

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

Collateralised Debt Obligation (CDO)

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

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

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

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

Division of Local Government (DLG)

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

Depreciation of Infrastructure Assets

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

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

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

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

New South Wales
Treasury Corporation

Building and Infrastructure Backlog Ratio

Benchmark = Less than 0.02x

Ratio = estimated cost to bring assets to a satisfactory condition (from Special Schedule 7) / total infrastructure, building, other structures and depreciable land improvement assets (from note 9a)

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

Interest Cover Ratio

Benchmark = Greater than 4.0x

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

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

Operating Ratio

Benchmark = Better than negative 4%

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

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

Own Source Operating Revenue Ratio

Benchmark = Greater than 60%

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

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

Unrestricted Current Ratio

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

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

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