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Treasury Corporation

Upper Hunter Shire Council

Financial Assessment and Benchmarking Report

22 March 2013

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

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Disclaimer

This report has been prepared by New South Wales Treasury Corporation (TCorp) in accordance with the appointment of TCorp by the Division of Local Government (DLG) as detailed in TCorp's letters of 22 December 2011 and 28 May 2012. The report has been prepared 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 Upper Hunter Shire Council, the LIRS Assessment Panel and the DLG. TCorp shall not be liable to Upper Hunter 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 Upper Hunter 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 two applications, firstly for a Timber Bridge Replacement Program and secondly, an Urban Street Renewal Program and will borrow $1.7m and $1.5m respectively 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. Council's LIRS project is being funded from the General Fund so we focused our review on the General Fund

The Council's performance has been satisfactory over the review period based on the following observations:

- EBITDA has been improving year on year
- An overall improvement in the Cash Expense Ratio has been recorded
- Financial management has been strong, with Council utilising bank loans in recent years for projects such as airport runway rehabilitation, new bridge construction, medical centre upgrades, and other projects that will provide benefits to residents for the long term

Council's reported infrastructure backlog of $0.3m in 2011 represents less than 0.1% of its infrastructure asset value of $327.8m. Other observations include:

- Actual annual maintenance of infrastructure assets has been greater than required for each year of the review period
- The Asset Management Plan shows that most assets are at an acceptable standard and are being maintained to a level above the required level. Capital works programmes from the past three years show significant investments in roads, bridges and other significant assets

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

- The forecasts for rates and annual charges are based on the SRV for Council at 3.9% in 2012 and 4.5% in 2013. A flat rate of 1.0% until 2015, with zero increases or growth forecast thereafter. Based on recent increases to rates granted by IPART this is an extremely conservative assumption
- Employee costs are forecast to grow by 2.6% in 2012 and then forecast to be static thereafter. Given the fluctuating increases over the past three years may be optimistic

- In total, revenues are assumed to grow at a rate of less than 1.0% p.a. while expenses are projected to be static. TCorp consider that these assumptions should be revisited as we would expect revenues and expenses to grow in line with historical CPI increases of at least 2.5%. In addition, the historic performance of the last three years has shown that council have not been able to contain expenses to levels below CPI

In our view, the Council has the capacity to undertake the combined additional borrowings of $3.2m for the LIRS projects. This is based on the following analysis:

- The DSCR remains above benchmark of 2.00x in the 10 year forecast
- The Interest Cover Ratio is above the benchmark of 4.00x in the 10 year forecast
- Based on a minimum DSCR ratio of 2.00x, Council has the capacity to undertake additional borrowings in excess of its proposed LIRS borrowings, of a further $14.5m of debt in 2013

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 as indicated by the Operating Ratio is below the group average and benchmark
- Council's Own Source Operating Revenue Ratio is below average and the benchmark
- Council's DSCR and Interest Cover Ratio are well above the benchmarks. In the medium term Council's forecast ratios are expected to remain above the benchmarks
- Council was in a sound liquidity position but did not provide a medium term forecast
- Council's performances in terms of its Building and Infrastructure Asset Renewals Ratio, Asset Maintenance Ratio and Capital Expenditure Ratio were above the group averages and above or close to benchmarks.
- Council's Infrastructure Backlog was better than the group average and 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

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Benchmark Ratios

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

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

Therefore these benchmarks are intended as a guide to performance.

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

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

2.3: Overview of the Local Government Area

Upper Hunter Shire LGA	
Locality and Size	
Locality	Hunter
Area	8,103 km²
DLG Group No.	11
Demographics	
Population	13,754
% under 19	27.0%
% between 19 and 59	50.4%
% over 60	23.6%
Expected population in 2021	13,300
Operations	
Number of employees (FTE)	202
Annual revenue	$30.8m
Infrastructure	
Roads	1,838 km
Bridges	138
Infrastructure backlog value	$0.3m
Total infrastructure value	$327.8m

Upper Hunter Council Local Government Area (LGA) is located in the Hunter Region of New South Wales. It was formed in May 2004 from Scone Shire and parts of Murrurundi and Merriwa shires.

The business of Council is extensive and diverse and includes aged care, childcare, airports and saleyards. The Upper Hunter is the largest horse-rearing region in Australia.

There are 202 full-time equivalent staff employed by Upper Hunter Shire Council, making it one of the significant employers in the region.

The wine and tourism industry is part of the well known Hunter Valley.

Upper Hunter has experienced a declining population which is expected to continue to decline at a rate of 0.1%p.a.

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2.4: LIRS Application

Council has made two LIRS applications totalling $3.2m.

Project 1:

- Timber Bridge Replacement Program at a cost of $3.3m
- The project involves the replacement of 3 Bridges within the shire that are no longer trafficable or have weight restrictions
- The amount of the loan facility will be $1.7m
- The term of loan facility will be 10 years

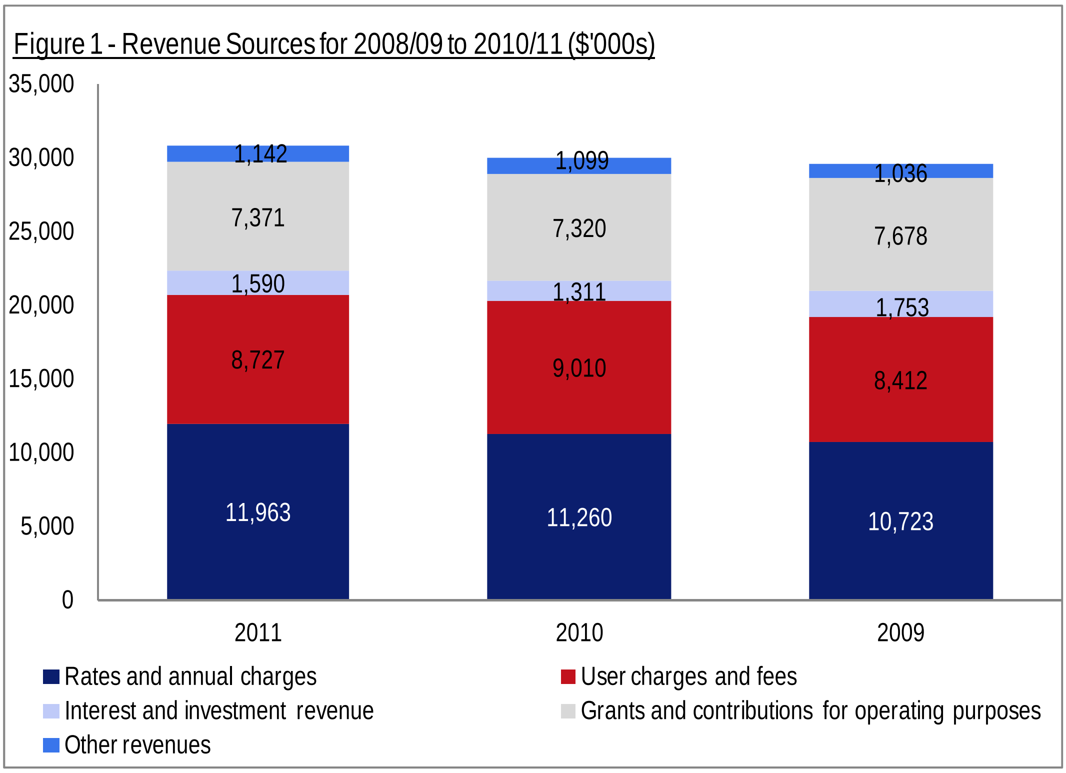
Project 2:

- Urban Street Renewal Program at a cost of $1.5m
- Project is to renew and upgrade 9 urban streets within the townships of Scone, Aberdeen and Murrurundi
- The amount of the loan facility will be $1.5m
- The term of loan facility will be 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



Key Observations

- Revenue from rates and annual charges has been increasing. Residential rate rises of 5.0% in 2011 and 10.2% in 2010 were a combination of rate peg increases and subdivision gains. In addition, Council has developed land in the area and the increased housing has increased rates received.
- User charges and fees can be volatile due to RMS works. A $0.4m decrease in fees received from the RMS in 2011 was the main driver of the decreased user charges and fees. Water fees remained static from year to year. Council also receive user fees from services such as the regional airport which has been operating at a surplus the past three years, and children's services which has been operating at a marginal deficit over the past three years.
- Interest and investment revenue increased in 2011 due to greater cash reserves coupled with higher interest rates.

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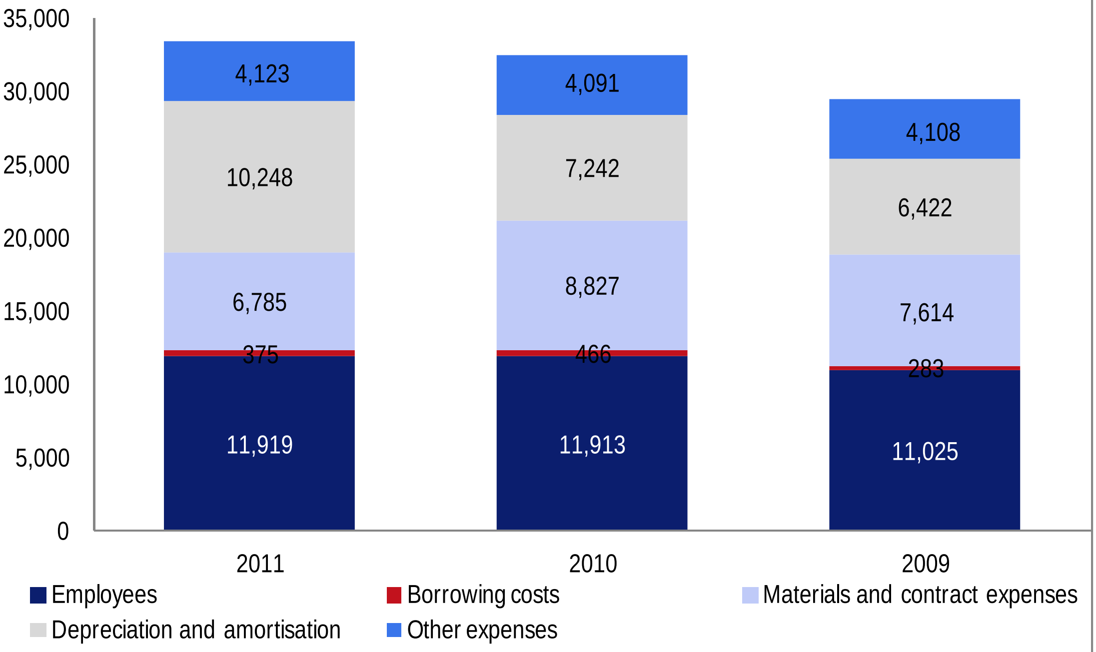
3.2: Expenses

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



Key Observations

- Employee expenses remained static in 2011 following an 8.1% increase in 2010. Employee expenses have been affected by floods in recent years as greater staff hours were required and unscheduled restoration works took priority over new capital projects, which led to fewer wages being capitalised in 2011 than expected. Employee expenses increased by $0.9m in 2010, driven by a $0.4m increase in employee leave entitlements and $0.5m increase in workers compensation insurance.
- Materials and contract expenses have been fluctuating and in 2011 a high level of infrastructure asset work, including an airport upgrade and new industrial estate works, contributed to a 23.1% decrease as these expenses were capitalised. A 15.9% increase in 2010 occurred following an increase in maintenance works carried out during the year, contractor expenses for RMS and flood related works.
- The Asset Revaluations process resulted in the value of Council's infrastructure assets increasing by $71.8m in 2010, which led to the depreciation charge increasing by 59.6% to $10.2m between 2009 and 2011.

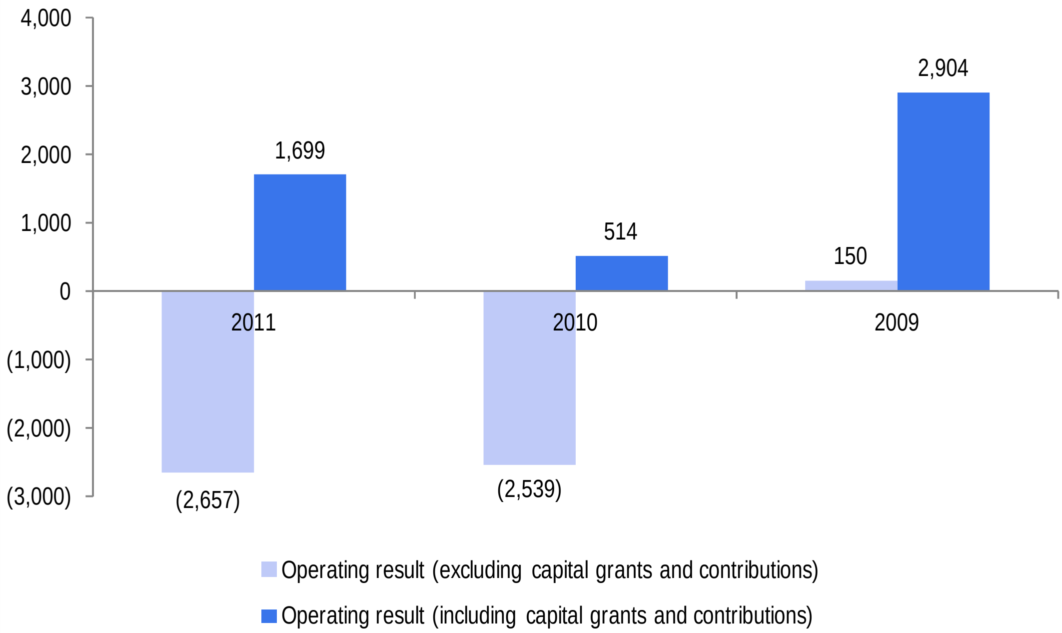
3.3: Operating Results

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

- Council posted declining net operating results excluding capital grants and contributions for the past two years. 2011 and 2010 results were adversely affected by the increased depreciation charges and flood repair works.
- Council expenses include a large non-cash depreciation expense ($10.3m in 2011), which has increased substantially over the past three years following the Asset Revaluations. 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

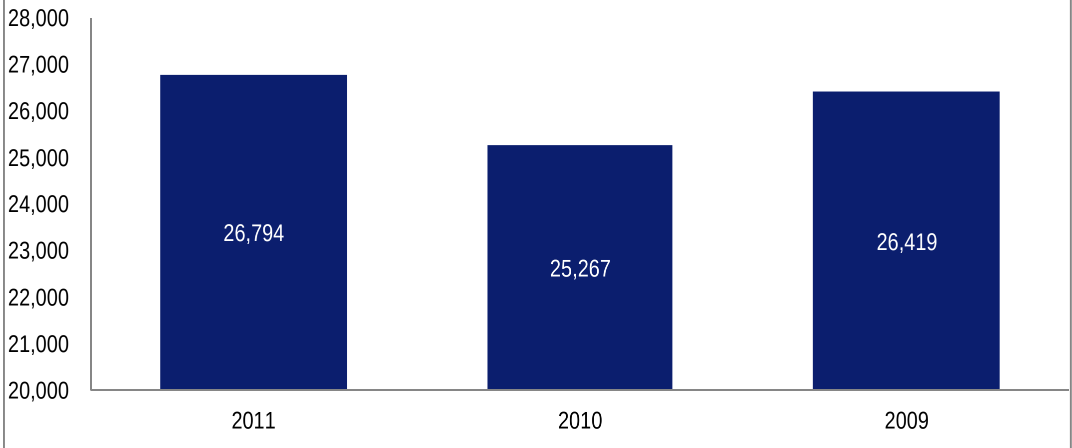
Performance Indicators	Year ended 30 June		
	2011	2010	2009
EBITDA ($'000s)	7,966	5,169	6,855
Operating Ratio	(8.6%)	(8.5%)	0.5%
Interest Cover Ratio	21.24x	11.09x	24.22x
Debt Service Cover Ratio	15.32x	8.35x	17.53x
Unrestricted Current Ratio	4.44x	4.34x	5.44x
Own Sourced Revenue	58.9%	61.3%	59.1%
Cash expense ratio	14.1 months	12.2 months	13.9 months
Net assets ($'000s)	511,859	490,319	351,849

Key Observations

- Councils EBITDA has generally trended higher over the review period.
- Interest Cover Ratio and Debt Service Cover Ratio have been high due to Council's relatively low levels of borrowings. The drop in these ratios in 2010 was the result of a lower EBITDA performance, which was affected by higher materials and contract expenses resulting from flood restoration works.
- The Unrestricted Current Ratio has been above the benchmark of 1.50x over the past three years, indicating Council has sufficient liquidity.
- Own Sourced Operating Revenue Ratio has been near benchmark level. Small rural councils typically rely on grants to maintain operations.
- Net Assets have increased by $205.3m between 2009 and 2011 due to the consecutive Asset Revaluations in 2010 and in 2011 which increased the value of roads, bridges, and drainage infrastructure.
- The underlying trend in all three years has been a growing Net Asset base. Infrastructure, Property, Plant and Equipment (IPP&E) asset base has grown with asset purchases being greater than the combined value of disposed assets and annual depreciation. Over the last three years this amounted to a $13.5m net increase in the value of IPP&E.
- Council has total borrowings of $8.0m in 2011, being 1.6% 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 marginally increased over the review period. Of the $26.8m, short term deposits account for $24.5m, with the remaining $2.3m is made up of cash deposits. Of this, external restrictions account for $18.3m, $8.3m is internally restricted and $0.2m is unrestricted. Council have no exposure to CDOs or linked notes.

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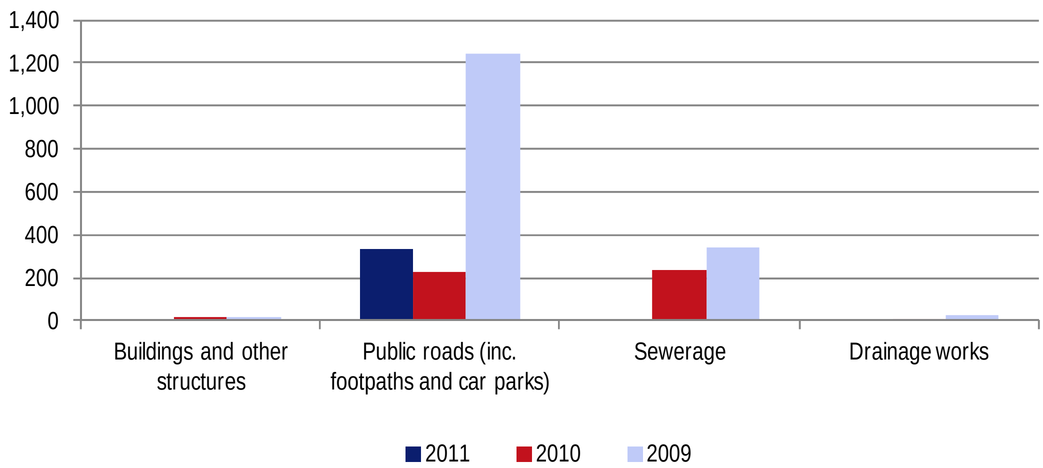
3.6: Capital Expenditure

The following section predominantly relies on information obtained from Special Schedules 7 and 8 that accompany the annual financial statements. These figures are unaudited and are therefore Council's estimated figures.

3.6(a): Infrastructure Backlog

Figure 5 - Infrastructure Backlog for 2008/09 to 2010/11 ($'000s)



Council identify infrastructure assets as of less than satisfactory standard and include these in their backlog. Reported Infrastructure Backlog is minimal at 0.00x and is 100.0% related to roads as of 2011. Council reported $1.6m in Infrastructure Backlog in 2009 and have reduced this backlog to $0.3m in 2011.

3.6(b): Infrastructure Status

Infrastructure Status	Year ended 30 June		
	2011	2010	2009
Bring to satisfactory standard ($'000s)	330	497	1,625
Required annual maintenance ($'000s)	6,224	5,952	4,861
Actual annual maintenance ($'000s)	7,431	7,823	6,350
Total value infrastructure assets ($'000s)	327,771	315,256	243,500
Total assets ($'000s)	529,282	505,270	365,738
Infrastructure Backlog Ratio	0.00x	0.00x	0.01x
Asset Maintenance Ratio	1.19x	1.31x	1.31x
Building and infrastructure asset renewal ratio	0.89x	1.02x	1.11x
Capital Expenditure Ratio	0.90x	1.27x	1.75x

The Asset Maintenance Ratio is exceeding the benchmark, indicating that Council is maintaining their assets to an extent that no further backlog is developing.

While Council's capital expenditure has been adequate over three years, both the Building and Infrastructure Asset Renewal Ratio and the Capital Expenditure Ratio declined in 2010 and 2011, mainly due to the Asset Revaluations process.

Whilst Council's asset maintenance and renewal performance has been strong, if the asset renewal ratios do not meet the benchmarks in the future, the Council's Infrastructure Backlog will likely begin to grow.

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	1,369	4,334	N/A
Replacement/refurbishment of existing assets	11,555	7,400	N/A
Total	12,924	11,734	N/A

The 2011 capital programme was affected by flooding in the region, and more funds were required for replacement/ refurbishment of flood damaged assets. New capital works included completion of a new playground and grandstand in Council parks.

The major capital works completed during 2010 included drainage improvements, and resealing and reconstruction of a number of roads.

No numerical breakdown of the capital programme was provided in 2009, however works included the resealing and reconstruction of a number of roads. In addition major sewerage works were completed in a number of mains, pump and treatment plants in 2009.

Council's capital expenditure priority is roads and bridges and the greatest proportion of budget expenditure is assigned to these assets. Council has started its bridge building program to replace bridges that are approaching the end of their economic life. Council commenced or completed four bridges in 2011 with seven bridges being constructed over the next three years.

Over $1.0m was spent on an upgrade to the Scone Regional Airport runway in 2011 financed by grants, private contributions and Council funding.

3.7: Specific Risks to Council

- Population increasing linked to mining expansion in the LGA. Increasing mining activity in the region and emergence of coal seam gas exploration within the shire may add residents to the region in the next five years. Council are responsible for providing extra services and negotiating with other Government departments and developers to make sure this increased population has sufficient services and housing. Council is working to understand the financial impacts of the anticipated growth and costs associated with coal mining. This aims to develop strategies to address the impacts and take advantage of the opportunities.
- Low fiscal flexibility. Council relies upon successfully attracting grant funding from both the State and Federal Government to complement their limited own source operating revenues. As Council is reliant on this funding they have a higher risk than Councils if the State or Federal Government amends their funding practices or policies in future years. Council believes that they will be able to continue to receive these levels of grants.
- Environmental and natural disasters. Council's LGA has been declared a natural disaster area a number of times in recent years due to floods. Council has a large number of bridges (138) which are vulnerable to damage and risk being washed away during extreme floods. In addition, 70% of Council roads are unsealed and are also prone to damage. There is increasing tension between the local mining industry and other industries in the area because of the perceived environmental impacts of coal mining, including dust, water usage, water contamination and the destruction of agricultural land, as well as the impact of coal trucks on local and regional roads.

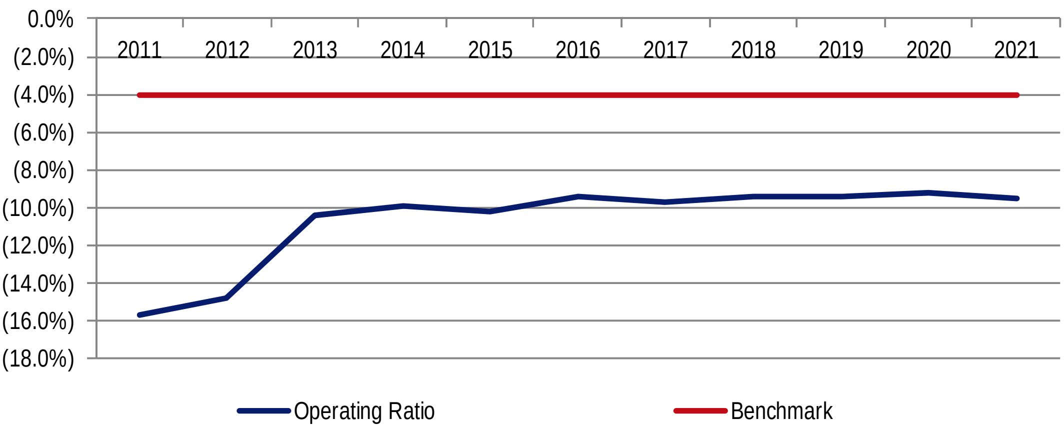
Section 4 Review of Financial Forecasts

The financial forecast model shows the projected financial statements and assumptions for the next 10 years up to 2021. The model includes the $1.7m and $1.5m loans without any LIRS subsidy.

The LIRS loan relates to the General Fund, therefore we have focused our financial analysis solely upon this Fund. Council's consolidated position includes a Water and Sewer Fund however these are operated as independent entities, which unlike the General Fund are more able to adjust the appropriate fees and charges to meet all future operating and investing expenses.

4.1: Operating Results

Figure 7- Operating Ratio for General Fund



The General Fund shows deficit positions are expected in all 10 years when capital grants and contributions are excluded. Static growth is projected thereafter.

The ratio highlights that over the longer term Council could face financial sustainability issues, although the figure is due to improve throughout the model from the worst ratio deficit in 2012 of 15.7% to 6.5% in 2021.

The ratio is static over the life of the forecast due to Council projecting little or no growth in revenue and expenses.

4.2: Financial Management Indicators

The financial indicators are linked to the utilisation of debt in early years and the use of cash for capital works projects. The indicators remain static over time as the amortising debt reduces, operating deficits improve and cash is allocated to Capital expenditure.

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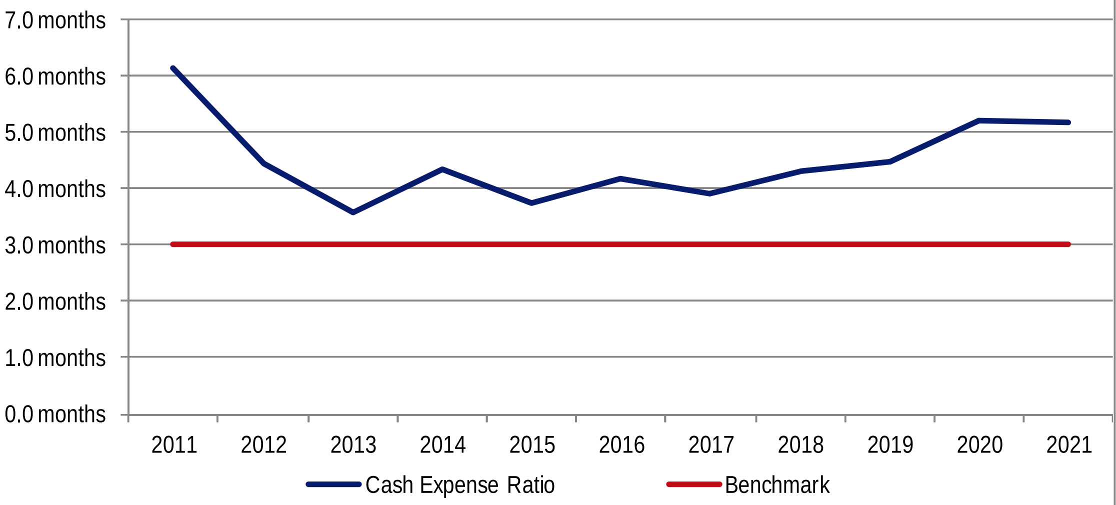
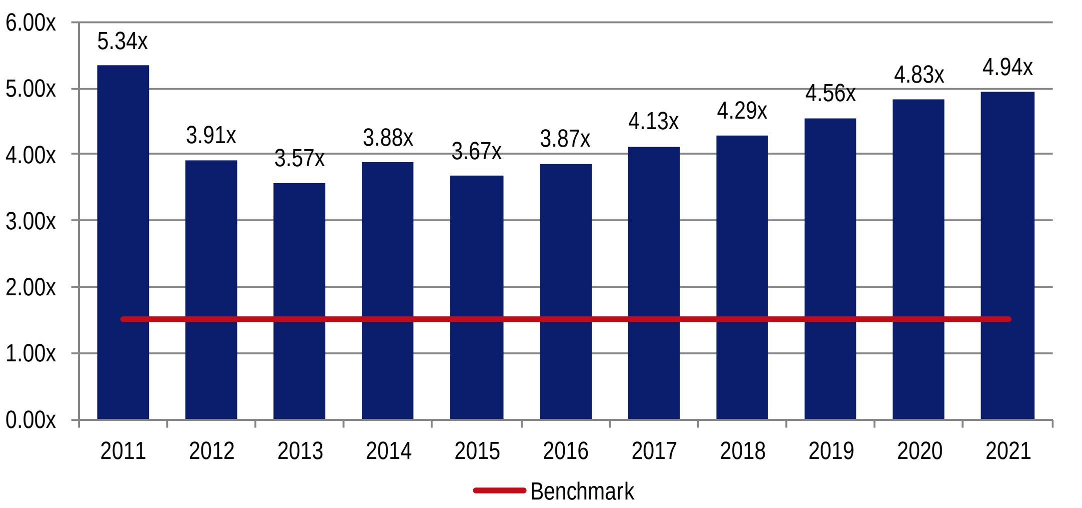
Liquidity Ratios

Figure 8 - Cash Expense Ratio for General Fund



Council forecast a strong cash position over the life of the forecast with the Cash Expense Ratio exceeding benchmark in all forecast years.

Figure 9 - Unrestricted Current Ratio for General Fund



The Unrestricted Current Ratio for General Fund is above the benchmark of 1.50x for the life of the forecast. Based on the above ratios, Council will have sufficient capacity to manage the LIRS debt service commitments for the life of the loan.

Overall it appears that the Council will have sufficient liquidity throughout the forecast period to service all short term liabilities, currently scheduled capital expenditure and related long term liabilities.

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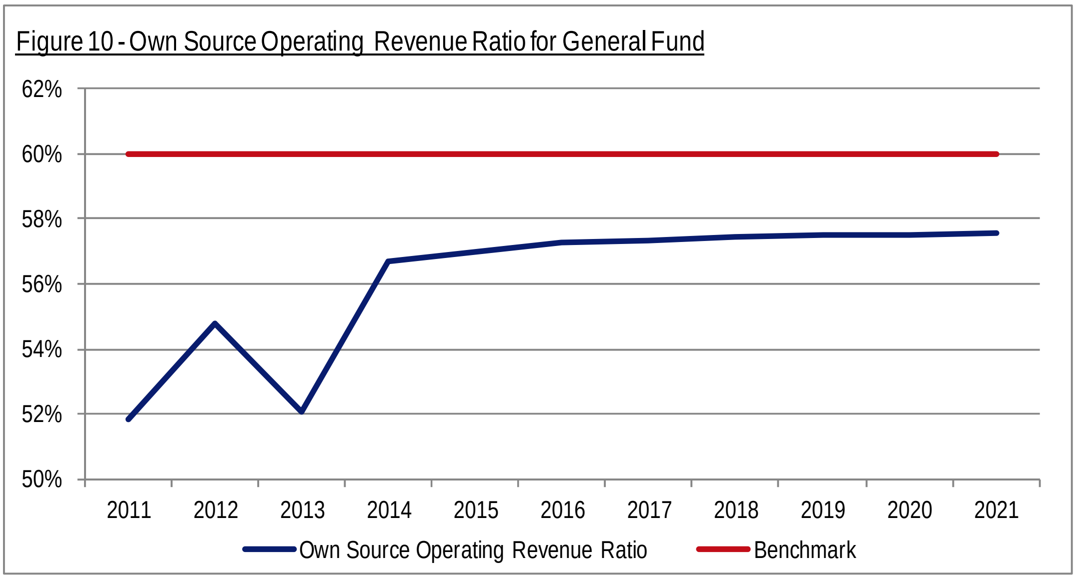
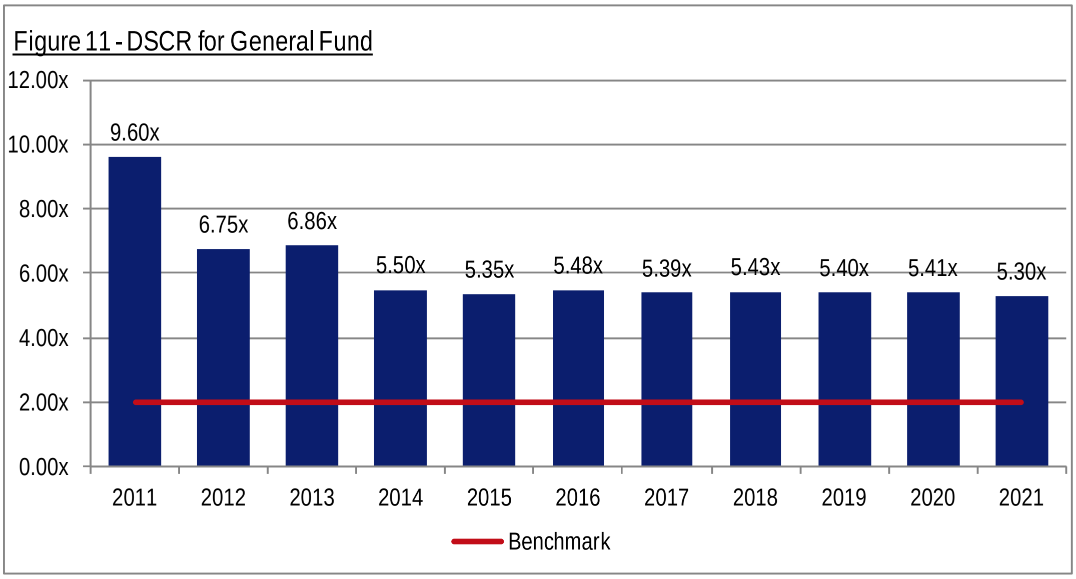
Fiscal Flexibility Ratios



The Own Sourced Operating Revenue Ratio is forecast to be below benchmark each year of the forecast, with a low of 51.9% in 2011. Small rural councils typically rely on grants to maintain operations and given the fact that Council has 1.7 people per km^2, projected Own Sourced Operating Revenue Ratio is realistic.



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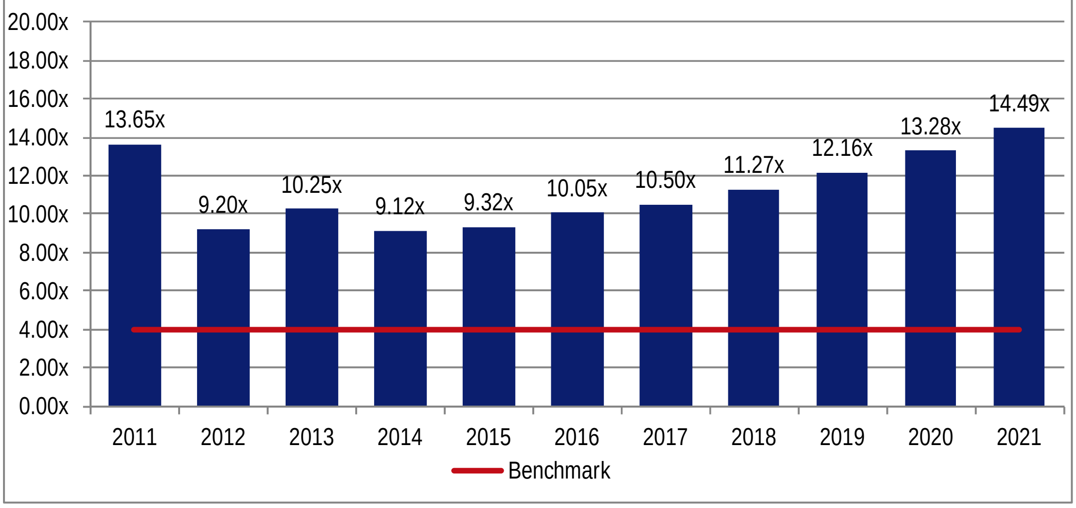
The DSCR is above benchmark of 2.00x for the life of the forecast. Based on the above ratios, Council will have sufficient capacity to manage the LIRS debt service commitments for the life of the loan.

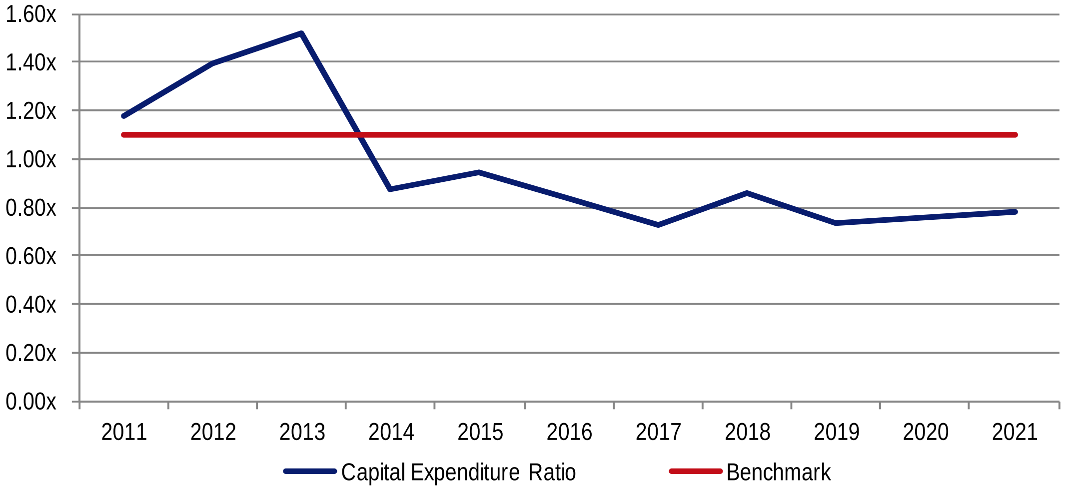
Figure 12 - Interest Cover Ratio for General Fund



The Interest Cover Ratio, similarly to the DSCR, shows the Council has sufficient capacity to service scheduled debt commitments, including the LIRS loans. Based on current total debt of $8.0m and a high of $10.1m in 2014, there is capacity to service further debt interest costs before the Council's ratio decreases to the 4.00x benchmark.

4.3: Capital Expenditure

Figure 13 - Capital Expenditure Ratio for General Fund



Capital expenditure ratios fall below benchmark from 2014. The forecast below benchmark levels of capital expenditure over the majority of the forecast period will increase pressure on existing assets. The total deficit figure for capital expenditure versus depreciation across the period amounts to $3.4m in nominal terms (0.6% of 2011 total assets).

4.4: Financial Model Assumption Review

Councils have used their own assumptions in developing their forecasts.

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

TCorp's benchmarks:

- Rates and annual charges: TCorp notes that 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%
- Interest and investment revenue: annual return of 5%
- All other revenue items: the estimated annual CPI increase of 2.5%
- Employee costs: 3.5% (estimated CPI+1%)
- All other expenses: the estimated annual CPI increase of 2.5%

<u>Key Observations and Risks</u>

Overall the LTFP forecasts are conservative based on the following observations:

- The forecasts for rates and annual charges are based on the SRV for Council at 3.9% in 2012 and 4.5% in 2013. A flat rate of 1.0% until 2015, with zero rate or growth forecast thereafter. Based on recent increases to rates granted by IPART this is an extremely conservative assumption
- The annual increases for user charges and fees are less than 1%
- Employee costs are forecast to grow by 2.6% in 2012 and then forecast to be static thereafter. Given the fluctuating increases over the past three years this may be optimistic
- In total, revenues are assumed to grow at a rate of less than 1.0% p.a. while expenses are projected to remain static. TCorp finds this assumption optimistic and would expect expenses to grow in line with historical CPI increases of at least 2.5%. In addition, the historic performance of the last three years has shown that council have not been able to contain expenses to levels below CPI
- LTFP service levels are consistent with ongoing service levels and no reduction of service levels are forecast

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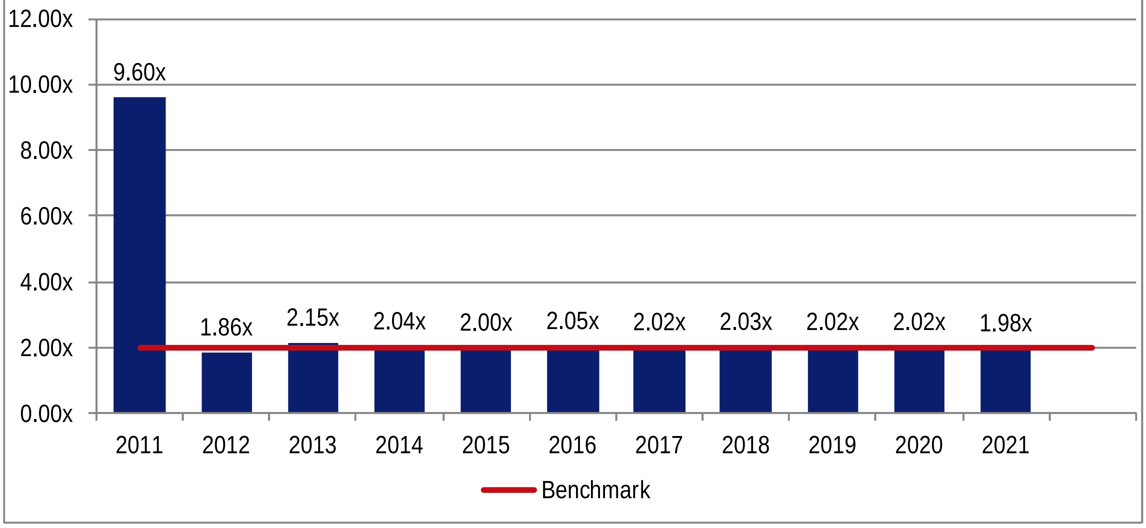
4.5: Borrowing Capacity

When analysing the financial capacity of the Council we believe Council will be able to incorporate additional loan funding in addition to the LIRS loan facilities. Some comments and observations are:

Figure 14 - DSCR for General Fund



- Based on a benchmark of DSCR>2.00x, $14.5m could be borrowed in addition to the $3.2m borrowings proposed under LIRS
- This scenario has been calculated by basing borrowing capacity on a 10 year amortising loan at a rate of 6.44% p.a

Section 5 Benchmarking and Comparisons with Other Councils

Each council's performance has been assessed against ten key benchmark ratios. The benchmarking assessment has been conducted on a consolidated basis for councils operating more than one fund. This section of the report compares the Council's performance with its peers in the same DLG Group. The Council is in DLG Group 11. There are 21 councils in this group and at the time of preparing this report, we have data for all of these councils.

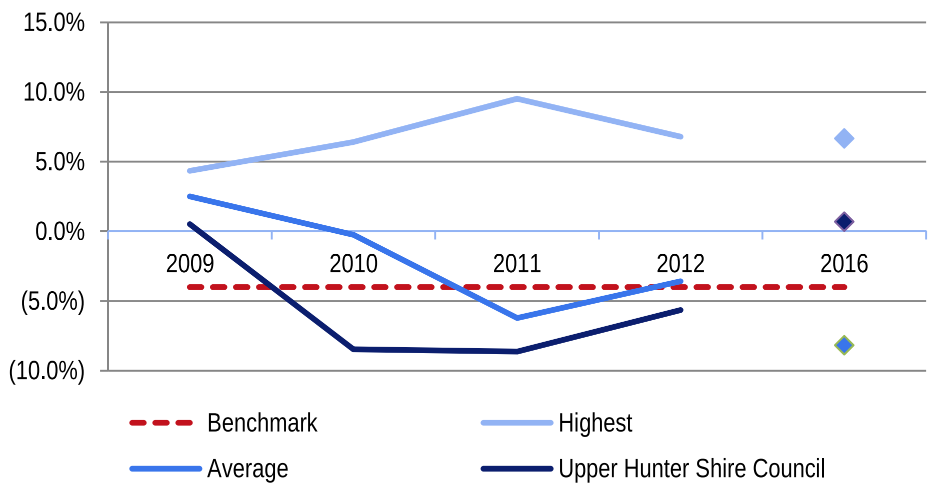
In Figure 15 to Figure 24, the graphs compare the historical performance of Council with the benchmark for that ratio, with the average for the Group, with the highest performance (or lowest performance in the case of the Infrastructure Backlog Ratio where a low ratio is an indicator of strong performance), and with the forecast position of the Council as at 2016 (as per Council's LTFP). Figures 22 to 24 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.

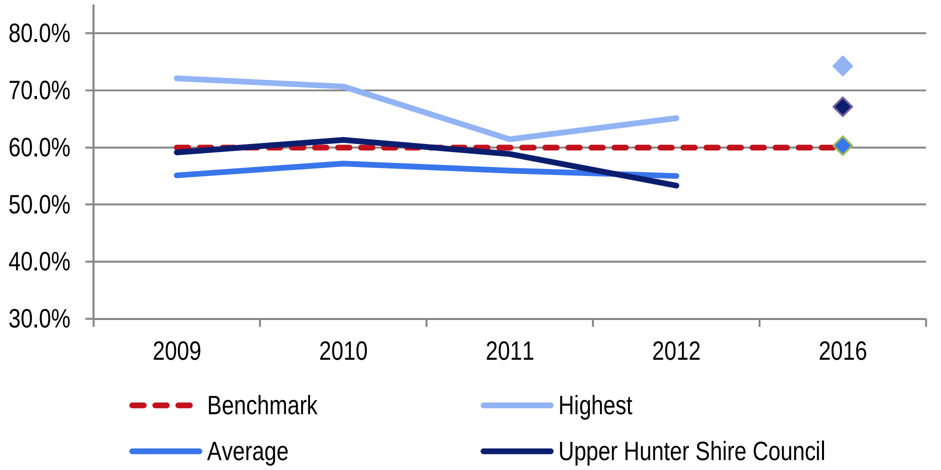
Financial Flexibility

Figure 15 - Operating Ratio Comparison



Council's Operating Ratio was below the group average and benchmark in three of the last four years. The results are forecast to improve in the medium term to be above the group average and benchmark.

Figure 16 - Own Source Operating Revenue Ratio Comparison



Council's Own Source Operating Revenue Ratio declined to be below the group average and benchmark. The ratio is forecast to improve in the medium term to be above the group average and the benchmark.

Liquidity

Figure 17 - Cash Expense Ratio Comparison

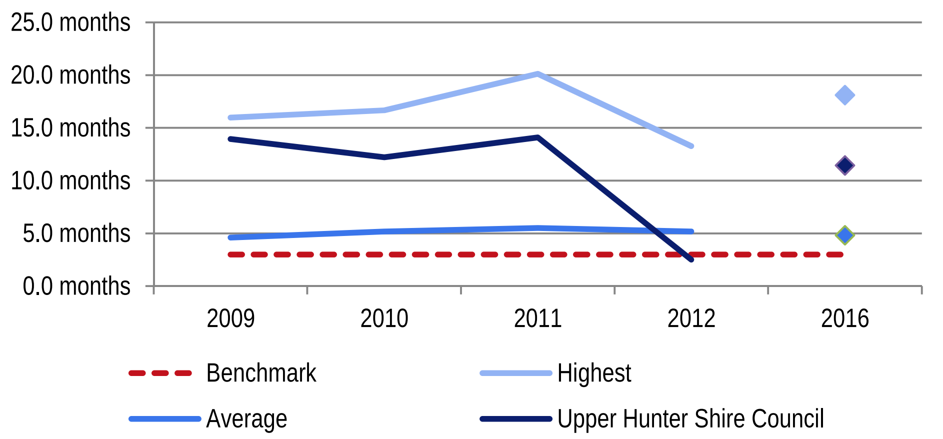
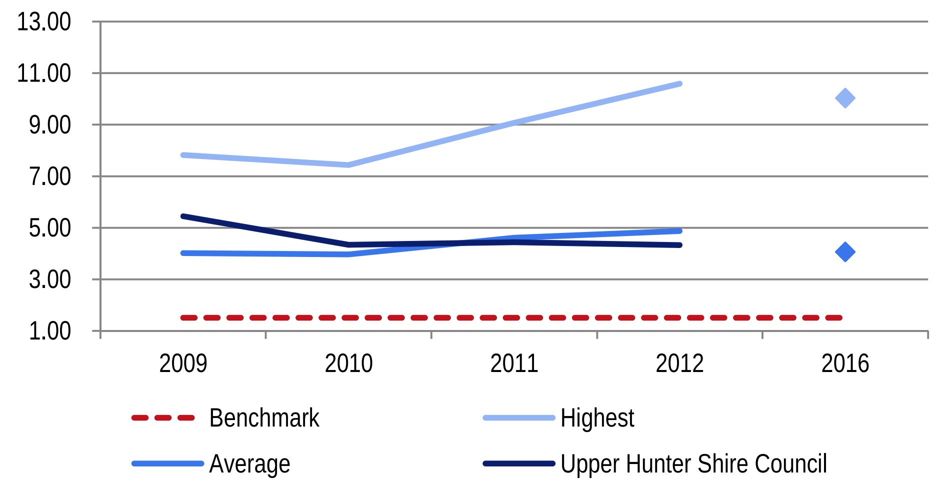


Figure 18 - Unrestricted Current Ratio Comparison



On average over the past four years, the Council's liquidity position has been sound as indicated by an above benchmark Unrestricted Current Ratio. Council did not provide a forecast Unrestricted Current Ratio.

Debt Servicing

Figure 19 - Debt Service Cover Ratio Comparison

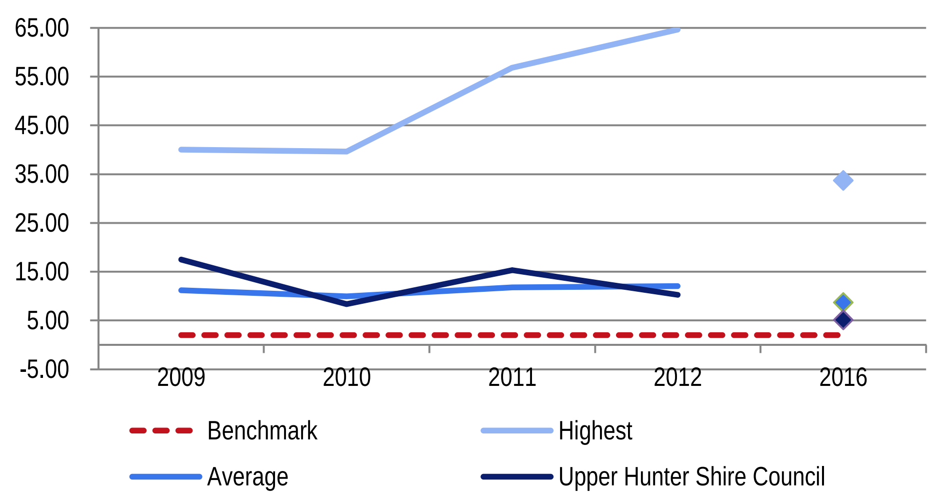
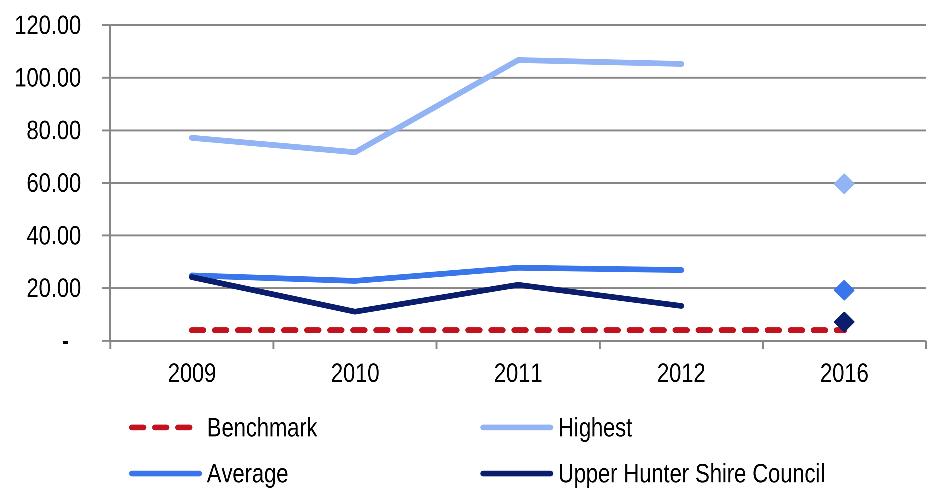


Figure 20 - Interest Cover Ratio Comparison



Over the review period, Council had above benchmark DSCR and Interest Cover Ratio that were around or below the group averages. These ratios are forecast to remain above the benchmarks but below group averages in the medium term.

Asset Renewal and Capital Works

Figure 21 - Capital Expenditure Ratio Comparison

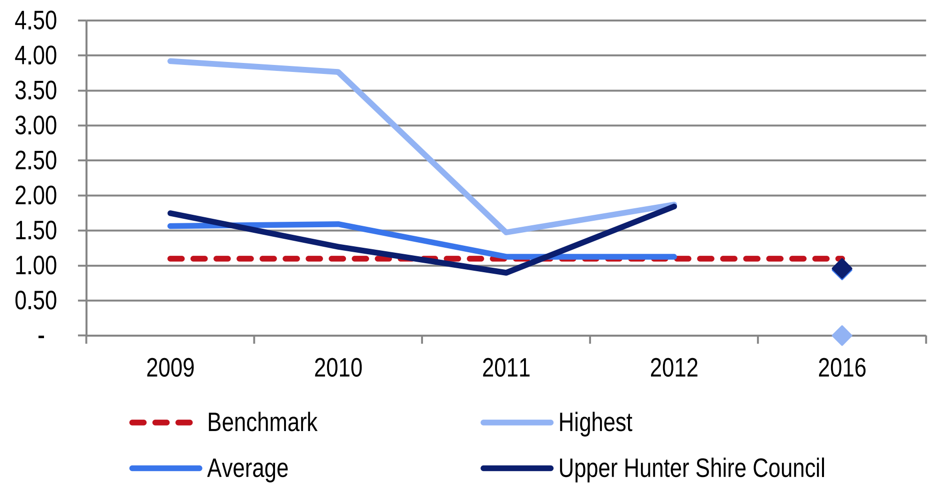


Figure 22 - Asset Maintenance Ratio Comparison

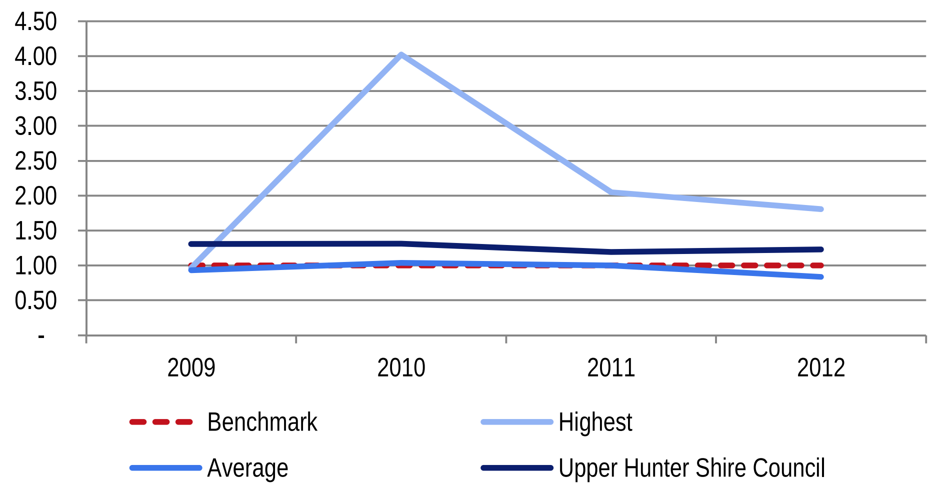


Figure 23 - Infrastructure Backlog Ratio Comparison

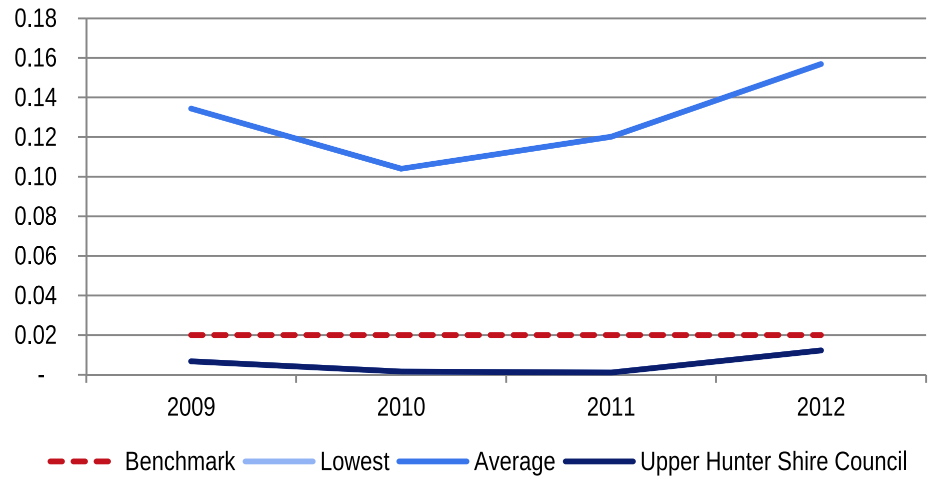
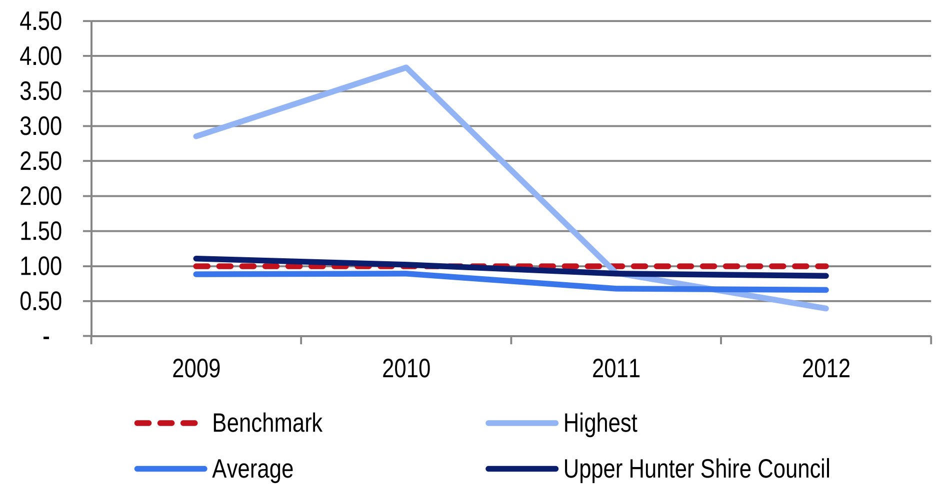


Figure 24 - Building and Infrastructure Asset Renewal Ratio



Council's Infrastructure Backlog Ratio was below the group average and benchmark over the review period.

Council's Capital Expenditure Ratio, Asset Maintenance Ratio and Building and Infrastructure Asset Renewal Ratio were above the group averages and above or close to the benchmarks over the review period.

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.

We base our recommendation on the following key points:

- In our view, the Council has the capacity to undertake the combined additional borrowings of $3.1m for the LIRS project.
- Council's operating result (measured using EBITDA) has improved over the review period
- At 2011 short term deposits accounted for $24.5m, with the remaining $2.3m made up of cash deposits and no exposure to CDO's, indicating good liquidity and cash management
- Based on a benchmark of DSCR>2.00x, $14.5m could be borrowed in 2013 in addition to the $3.2m borrowings proposed under LIRS

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

- Council posted declining net operating results excluding capital grants and contributions for the past two years. Although results were affected by natural disasters, the trend has been downward in recent years
- The Infrastructure backlog value may need to be reassessed. Council has advised that the asset management plan is being revised and more thorough estimates will be released with the 2012 accounts. Subject to the outcome of any revisions to the asset management plan, Council's LTFP may need to be reviewed
- The assumptions contained in Council's LTFP in respect of rate and employee cost increases, should be revisited to ensure they accurately reflect likely outcomes

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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	11,963	11,260	10,723	6.2%	5.0%
User charges and fees	8,727	9,010	8,412	(3.1%)	7.1%
Interest and investment revenue	1,590	1,311	1,753	21.3%	(25.2%)
Grants and contributions for operating purposes	7,371	7,320	7,678	0.7%	(4.7%)
Other revenues	1,142	1,099	1,036	3.9%	6.1%
Total revenue	30,793	30,000	29,602	2.6%	1.3%
Expenses					
Employees	11,919	11,913	11,025	0.1%	8.1%
Borrowing costs	375	466	283	(19.5%)	64.7%
Materials and contract expenses	6,785	8,827	7,614	(23.1%)	15.9%
Depreciation and amortisation	10,248	7,242	6,422	41.5%	12.8%
Other expenses	4,123	4,091	4,108	0.8%	(0.4%)
Total expenses	33,450	32,539	29,452	2.8%	10.5%
Operating result (excluding capital grants and contributions)	(2,657)	(2,539)	150	(4.6%)	(1792.7%)
Operating result (including capital grants and contributions)	(2,657)	(2,539)	150	(4.6%)	(1792.7%)

Table 2 - Items excluded from Income Statement

Excluded items					
Grants and contributions for capital purposes	4,356	3,053	2,754	42.7%	10.9%
Minority interests	8	2	17	300.0%	(88.2%)
Net loss from the disposal of assets	693	74	110	836.5%	(32.7%)

Table 3 - Balance Sheet

Balance Sheet ($'000s)	Year Ended 30 June			% annual change	
	2011	2010	2009	2011	2010
Current assets					
Cash and cash equivalents	26,794	25,267	26,419	6.0%	(4.4%)
Receivables	5,643	4,303	3,513	31.1%	22.5%
Inventories	2,105	1,930	1,987	9.1%	(2.9%)
Other	236	234	332	0.9%	(29.5%)
Total current assets	34,778	31,734	32,251	9.6%	(1.6%)
Non-current assets					
Investments	47	241	239	(80.5%)	0.8%
Infrastructure, property, plant & equipment	494,457	473,295	333,248	4.5%	42.0%
Total non-current assets	494,504	473,536	333,487	4.4%	42.0%
Total assets	529,282	505,270	365,738	4.8%	38.2%
Current liabilities					
Payables	2,627	2,705	3,134	(2.9%)	(13.7%)
Borrowings	208	145	138	43.4%	5.1%
Provisions	4,054	4,242	3,195	(4.4%)	32.8%
Total current liabilities	6,889	7,092	6,467	(2.9%)	9.7%
Non-current liabilities					
Borrowings	7,840	5,198	5,008	50.8%	3.8%
Provisions	2,694	2,661	2,414	1.2%	10.2%
Total non-current liabilities	10,534	7,859	7,422	34.0%	5.9%
Total liabilities	17,423	14,951	13,889	16.5%	7.6%
Net assets	511,859	490,319	351,849	4.4%	39.4%

Table 4-Cashflow

Cash Flow Statement ($'000s)	Year ended 30 June		
	2011	2010	2009
Cash flows from operating activities	9,453	8,231	10,286
Cash flows from investing activities	(10,631)	(9,580)	(11,681)
Proceeds from borrowings and advances	2,850	350	3,820
Repayment of borrowings and advances	(145)	(153)	(108)
Cash flows from financing activities	2,705	197	3,712
Net increase/(decrease) in cash and equivalents	1,527	(1,152)	2,317
Cash and equivalents	26,794	25,267	26,419

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Appendix B Glossary

Asset Revaluations

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

Collateralised Debt Obligation (CDO)

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

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

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

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

Division of Local Government (DLG)

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

Depreciation of Infrastructure Assets

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

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

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

EBITDA

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

Grants and Contributions for Capital Purposes

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

Grants and Contributions for Operating Purposes

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

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

Independent Commission Against Corruption (ICAC)

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

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

Independent Pricing and Regulatory Tribunal (IPART)

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

Infrastructure Backlog

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

Integrated Planning and Reporting (IP&R) Framework

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

Local Government Cost Index (LGCI)

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

Net Assets

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

Roads and Maritime Services (RMS)

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

Section 64 Contribution

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

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

Section 94 Contribution

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

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

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

Special Rate Variation (SRV)

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

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

The applications are reviewed and approved by IPART.

Ratio Explanations

Asset Maintenance Ratio

Benchmark = Greater than 1.0x

Ratio = actual asset maintenance / required asset maintenance

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

Building and Infrastructure Renewals Ratio

Benchmark = Greater than 1.0x

Ratio = Asset renewals / depreciation of building and infrastructure assets

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

Cash Expense Cover Ratio

Benchmark = Greater than 3.0 months

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

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

Capital Expenditure Ratio

Benchmark = Greater than 1.1x

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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, 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)

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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.