New South Wales
Treasury Corporation

Ku-ring-gai Council

Financial Assessment and Benchmarking Report

14 March 2013

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

Disclaimer

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

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

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

The report has been prepared for Ku-ring-gai Council, the LIRS Assessment Panel and the DLG. TCorp shall not be liable to Ku-ring-gai 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 Ku-ring-gai 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, one for an upgrade of the Gordon Library for a loan amount of $1.0m and also $1.0m for the upgrade of toilet amenities.

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 has had operating surpluses excluding capital grants and contributions in the last three years
- Approximately 67% of the Council's revenue base is derived from own sourced revenue (annual charges, and user charges and fees). They can rely upon these revenue streams on an ongoing basis for financial flexibility
- Operating expenses are generally well managed, although depreciation and amortisation have increased due to changing accounting policies and Asset Revaluations

Council's reported infrastructure backlog of $186.9m in 2011 represents 44.3% of its infrastructure asset value of $422.1m. Other observations include:

- The infrastructure backlog has increased by $43.0m since 2009 while the value of infrastructure assets have increased by $201.2m over the same period
- The Council has spent less than the required amount on maintenance over the last three years

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

- The General Fund shows operating surplus positions are forecast over the period when capital grants and contributions are excluded
- The financial forecasts include a capital expenditure program that is well above benchmark when compared to forecast depreciation expense

- Overall it appears that the Council will have sufficient liquidity to service all short term liabilities, and currently scheduled capital expenditure and related long term liabilities
- Council's level of fiscal flexibility is sound as Own Source Operating Revenue Ratio is trending higher and averages 73% during the forecast period
- Key assumptions within the financial forecasts appear to be reasonable

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

- The DSCR remains well above a benchmark of 2.0x in the 10 year forecast
- The Interest Cover Ratio is well above the benchmark of 4.0x in the 10 year forecast
- Council's liquidity is sufficient

In respect of our Benchmarking analysis we have compared the Council's key ratios with other councils in DLG group 3. Our key observations are:

- Council's financial flexibility as indicated by the Operating Ratio and Own Source Operating Revenue Ratio has been above the group average
- Council's DSCR and Interest Cover Ratio have been tracking the group average
- Council's liquidity ratios were below the group average because while they invest the majority of their funds in investments
- Council's Capital Expenditure Ratio is above the group average but they have a comparatively higher level of Infrastructure Backlog. Asset maintenance funding has been above the group average since 2011 but below the benchmark with the exception of 2011. Asset renewals have been marginally below benchmark since 2011 but have remained above the group average in each year

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

2.3: Overview of the Local Government Area

Ku-ring-gai Council LGA	
Locality and Size	
Locality	Sydney Outer
Area	85 km²
DLG Group No.	3
Demographics	
Population	109,297
% under 20	29%
% between 20 and 59	48%
% over 60	23%
Expected population in 2021	122,500
Operations	
Number of employees (FTE)	429
Annual revenue	$111m
Infrastructure	
Roads	417 km
Infrastructure backlog value	$186.9m
Total infrastructure value	$422.1m

Ku-ring-gai Council Local Government Area (LGA) is located approximately 16 kilometres north of Sydney CBD. The LGA contains nine suburbs and is divided into five wards. The area displays a wide variation in landscape and wildlife with significant areas of urban bushland identified as having high conservation status.

Of the residential area, 95 per cent is occupied by low-density housing. This residential area is bounded by Garigal National Park in the east, Lane Cove River Park in the west and Ku-ring-gai Chase National Park in the north.

Only five percent of land use in the Ku-ring-gai area is designated to business and other usage.

Within Council's infrastructure, property, plant and equipment (IPP&E) at 30 June 2011 there was:

- $222.3m of roads, bridges and footpaths
- $142.3m of stormwater drainage
- $34.4m of non specialised buildings
- $20.6m of depreciable land improvements
- $2.5m of other structures

2.4: LIRS Application

Council has made two LIRS applications.

Project: Asset renewal and upgrade of Council's public toilet amenities

Description: Council has completed an assessment of its building assets and created a program to bring the public toilet amenities to a satisfactory condition. 45 public toilet assets have been identified as requiring a major upgrade/renewal, of which 20 public toilet amenities are proposed to be included in this 5 year program.

The objective of the program is to upgrade poor and failed public toilet amenities, extend the remaining useful life, and address compliance and accessibility issues. This will directly benefit the community of Ku-ring-gai.

Amount of loan facility: $1.0m

Term of loan facility: 10 years

Project: Gordon library upgrade

Description: The Gordon library upgrade project proposes changes to the internal layout to ensure the library meets the changing needs of the community. The upgrade will provide more accessible and efficient use of space, address outdated systems and accommodate new technologies in managing library services.

Amount of loan facility: $1.0m

Estimated cost of the project: $1.65m

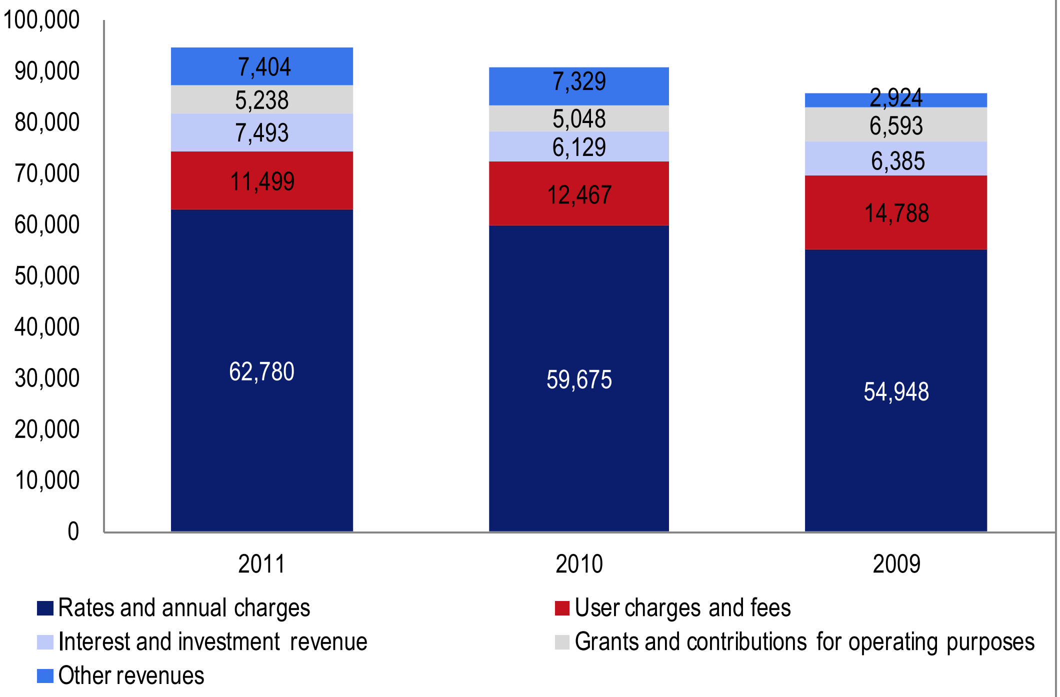
Term of loan facility: 10 years

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

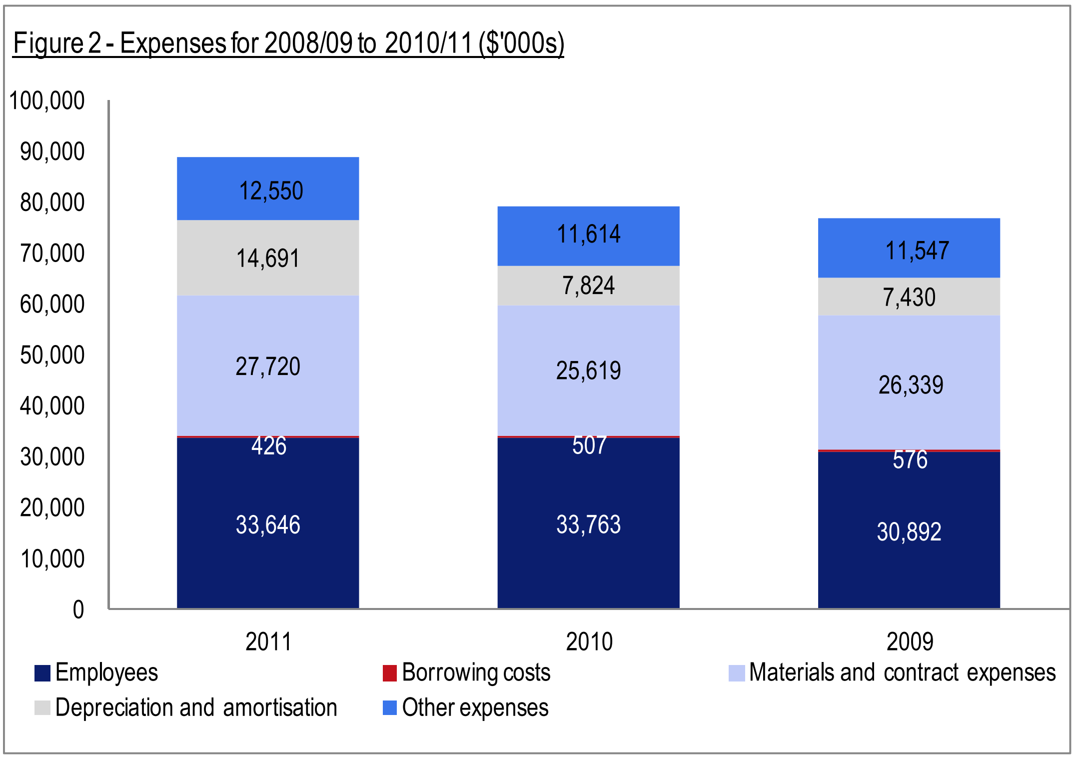
Figure 1 - Revenue Sources for 2008/09 to 2010/11 ($'000s)



Key Observations

- Total operating revenues have increased by $8.8m over the period, representing an average increase of 5.1% p.a.
- Rates and annual charges increased by 8.6% in 2010 and 5.2% in 2011. Four SRVs, for various infrastructure and recreational facilities upgrades, were in place over the review period. The 2006 approved SRV was used to fund environmental projects. This was due to expire in June 2012 but an extension has been approved by IPART. The 2007 approved SRV is used to fund road infrastructure upgrade work and is due to expire in June 2013. The 2010 approved SRV was used to fund North Turramurra Recreational Area and was for a single year only. The 2011 approved SRV is used to fund new recreational activities and is due to expire in June 2015.
- In both years the domestic waste management services annual charges increased by over $1.0m p.a.
- User fees and charges have reduced in 2011 due to a $1.4m reduction in infrastructure restoration charges. The 2010 decrease is due to rental income from other council properties being re-classified as other revenues.

3.2: Expenses



Key Observations

- Total expenses have increased by $12.2m over the period, representing an average annual increase of 8.0% p.a.
- Employee costs increased by 9.3% in 2010 and then were static in 2011. The 2010 increase was driven by salary increments of $1.5m, increased superannuation costs, workers compensation insurance and employee leave entitlements. The 2011 result was static as the salary increments and increased superannuation costs were offset by reduced workers compensation insurance and increased capitalised costs. Council also reduced its total equivalent full time employees by 35 to 429.
- The 2011 increase in material and contract costs was from a $0.9m lease expense and $0.5m increase in planning and development legal expenses while contractor and consultancy costs also grew by $1.0m.
- Depreciation increased by 97.7% over the review period. This followed the 2010 Asset Revaluations of roads, bridges and footpaths, stormwater drainage, and depreciable land improvements.
- The 8.1% increase in other expenses in 2011 was driven by a $0.8m increase in street lighting costs.

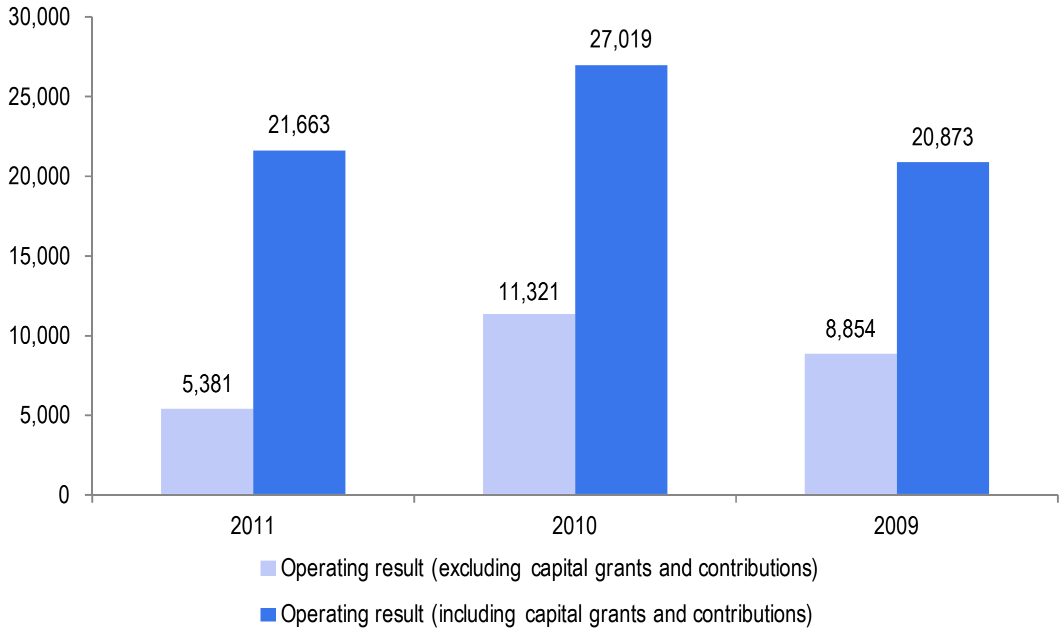
3.3: Operating Results

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

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

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

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



Key Observations

- The operating result has been in surplus each year when capital grants are excluded. The weaker 2011 result was impacted by increased depreciation.
- The non-cash depreciation expense, ($14.7m in 2011), has increased by $7.3m 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

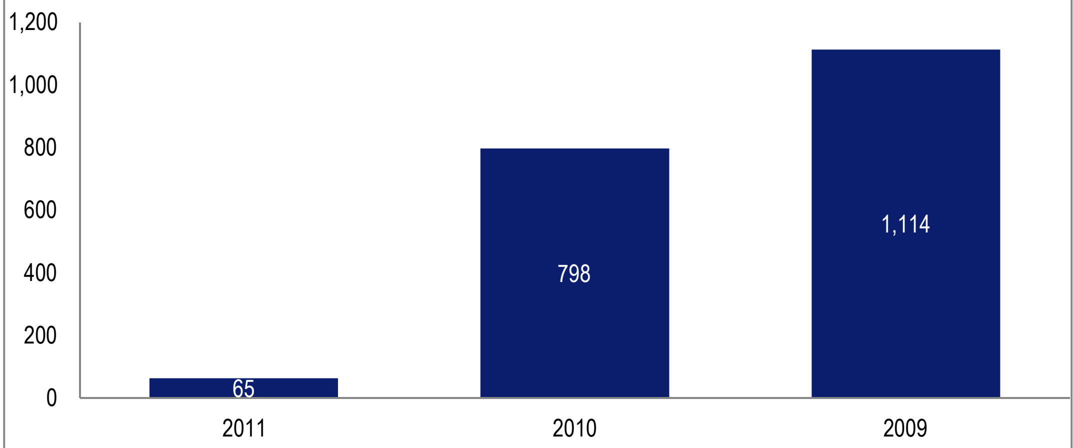
Performance Indicators	Year ended 30 June		
	2011	**2010**	**2009**
EBITDA ($'000s)	20,498	19,652	16,860
Operating Ratio	5.7%	12.5%	10.3%
Interest Cover Ratio	48.12x	38.76x	29.27x
Debt Service Cover Ratio	9.91x	8.47x	6.86x
Unrestricted Current Ratio	2.03x	2.11x	2.14x
Cash Expense Ratio	0.0 months	0.1 months	0.2 months
Own Source Operating Revenue Ratio	67.1%	67.8%	71.4%
Net assets ($'000s)	951,492	780,388	597,575

Key Observations

- EBITDA, a measure of Council's underlying trading performance was strongest in 2011.
- In all three years the Interest Cover Ratio and DSCR were substantially above the benchmark indicating that Council had sufficient capacity to manage their debt commitments. The results also indicate further borrowings could be accommodated.
- Council has total borrowings of $7.6m in 2011 compared to $8.7m in 2009. The 2011 figure represents 0.8% of Net Assets.
- The Operating Ratio has been positive in all three years.
- The Unrestricted Current Ratio and Own Source Operating Revenue Ratio has been above their respective benchmarks in all three years but have been on a marginally downward trend. Council has a sufficient level of fiscal flexibility, in the event of being in faced with unforseen events.
- The Cash Expense Ratio is below the benchmark in each year as the majority of Council funds are held in current investments (refer to Section 3.5).
- Net Assets have increased in each year due to the Asset Revaluations process. In 2010 there was a $147.0m increase in infrastructure assets and operational land while in 2011 there was a $149.3m increase in community land. 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 the ongoing operations of a Council.
- When excluding the Asset Revaluations, Council has increased the IPP&E asset base by $39.5m over the review period, with asset purchases being higher than the combined value of disposed assets and depreciation.

3.5: Statement of Cashflows

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



Key Observations

- Council keeps minimal funds classified as cash and cash equivalents. A significant proportion of Council's funds are held in term deposit accounts classified under investments.
- Total cash and cash equivalents, and investments have increased from $76.2m in 2009 to $107.4m in 2011. Of the $107.4m, $76.3m is externally restricted, $27.3m is internally restricted and $3.8m is unrestricted.
- Within the investments portfolio of $107.4m, $25.0m is invested in current term deposit accounts, $27.5m in non-current term deposit accounts, $32.2m in negotiable certificates of deposits and floating rate notes, $3.0m in CDOs and $6.0m in other long term financial assets. Based on advice from their financial advisers, Council expects to receive the full carrying value of the one CDO security at maturity in December 2014. The other long term financial assets relate to constant proportion debt obligations and Council have advised that they expect to be repaid the full carrying value of $6m for this security as it is capital guaranteed by RBS Australia.
- The levels of cash and investments along with the Unrestricted Current Ratio highlights an adequate liquidity position with Council able to meet all short term liabilities when they fall due.

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)

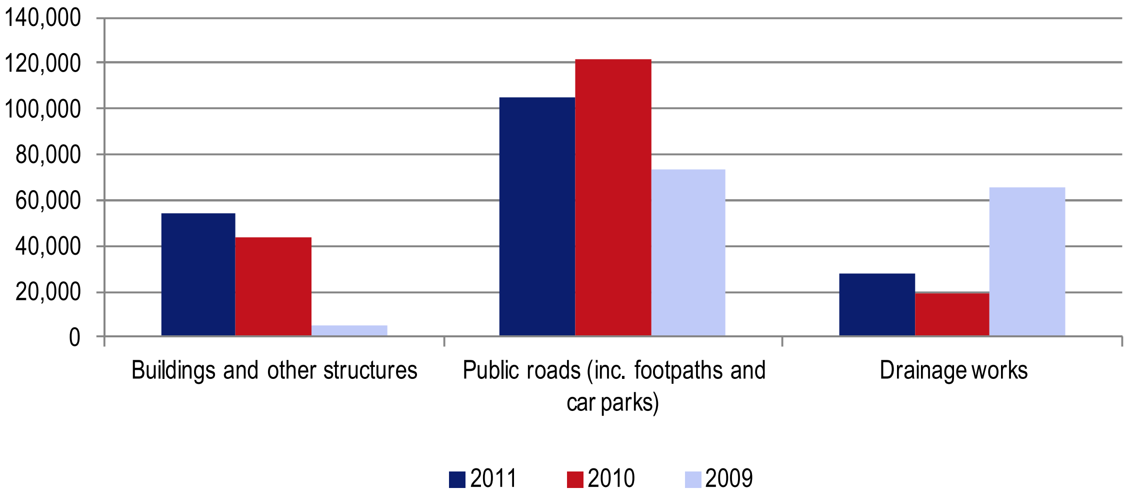
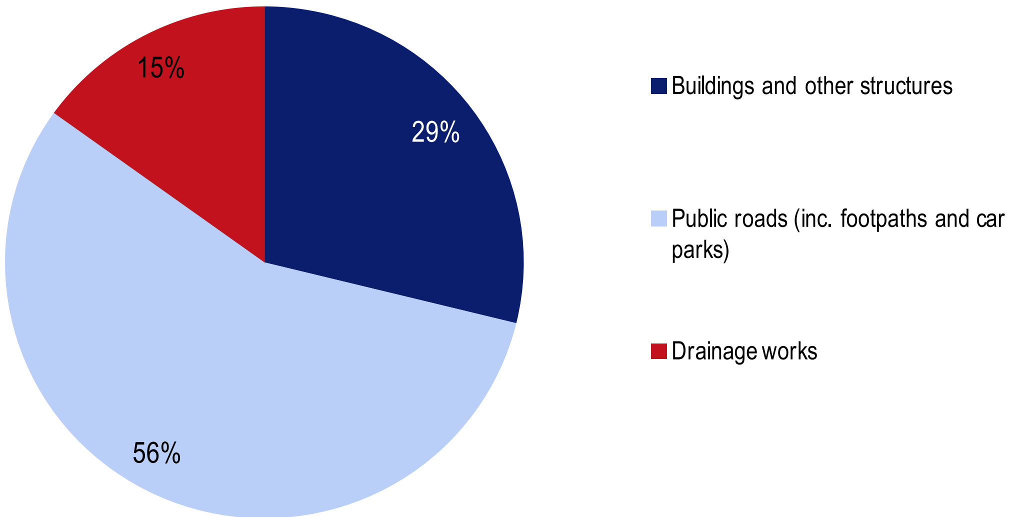


Figure 6 - Infrastructure Backlog Composition for 2010/11



The Infrastructure Backlog is valued at $186.9m in 2011, an increase from $144.0m in 2009. Of the backlog, $104.9m relates to public roads and $53.9m relates to buildings and other structures.

3.6(b): Infrastructure Status

Infrastructure Status	Year ended 30 June		
	2011	2010	2009
Bring to satisfactory standard ($'000s)	186,945	185,046	143,978
Required annual maintenance ($'000s)	4,307	8,253	14,787
Actual annual maintenance ($'000s)	4,661	5,843	9,133
Total value of infrastructure assets ($'000s)	422,072	413,877	220,914
Total assets ($'000s)	979,256	809,606	624,745
Building and Infrastructure Backlog Ratio	0.44x	0.45x	0.65x
Asset Maintenance Ratio	1.08x	0.71x	0.62x
Building and Infrastructure Renewals Ratio	0.98x	1.60x	1.67x
Capital Expenditure Ratio	2.24x	2.65x	2.12x

The Building and Infrastructure Backlog Ratio has reduced since 2009 mainly due to the increased value of infrastructure assets. The 2011 ratio is still a long way from the benchmark of 0.02x.

The Asset Maintenance Ratio was below the benchmark in 2009 and 2010 but has been on an upward trend and was above the benchmark in 2011. The required annual maintenance has reduced due to Council completing their Asset Management Plan. This has improved Council's focus on capital renewals and upgrades which in turn reduce the maintenance required, as the assets are of a higher standard. Council also secured an infrastructure levy that provides an additional $2.1m p.a. towards the road renewals and upgrades.

The Building and Infrastructure Renewals Ratio has been on a downward trend and has dropped marginally below the benchmark in 2011. The lower ratio in 2011 is mainly due to the increased depreciation expense.

The Capital Expenditure Ratio has been substantially above the benchmark in all three years. Council has increased their asset additions in each year against the increase in depreciation.

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	7,049	10,769	7,000
Replacement/refurbishment of existing assets	6,470	10,473	9,000
Total	**13,519**	**21,242**	**16,000**

Council have begun/are due to begin the following major projects:

- Relocation of Council's administrative services at a cost of $23.6m
- New indoor aquatic and leisure centre at West Pymble at a cost of $12.6m
- Open space acquisition for new parks and playgrounds at a cost of $11.5m
- North Turramurra recreation area, including three new sports fields at a cost of $5.6m
- Upgrade of Koola Park sports facility at East Killara at a cost of $3.2m
- New park at Killara at a cost of $1.1m
- Expanding Cameron Park at Turramurra at a cost of $1.0m
- Upgrade of St Ives village green at $0.7m
- Relocation of the Council depot in Gordon to a new facility at Pymble creating approximately $3m to fund community projects

3.7: Specific Risks to Council

- Ageing workforce. Council is aware that there are existing skills shortages and tight labour supply in areas such as urban planning, engineering, policy, surveying, environmental health and child care and these are likely to continue to worsen. With experienced staff moving towards retirement (approximately 25% of the workforce in 2014 would be eligible to apply), Council face recruitment and retention challenges in a competitive labour market. Council has incorporated strategies in their Workforce Plan to attract new suitable employees and retain their existing staff.
- Changing community service standards. Council undertakes community consultation to manage community expectations on service and asset standards.
- Asset Backlog. Council has a sizeable asset backlog and is undertaking community consultation to ensure that Council is focusing on the appropriate asset standards for renewal and maintenance. Additionally, Council is reviewing the useful lives of assets to ensure that these are accurately reflected in their LTFP.

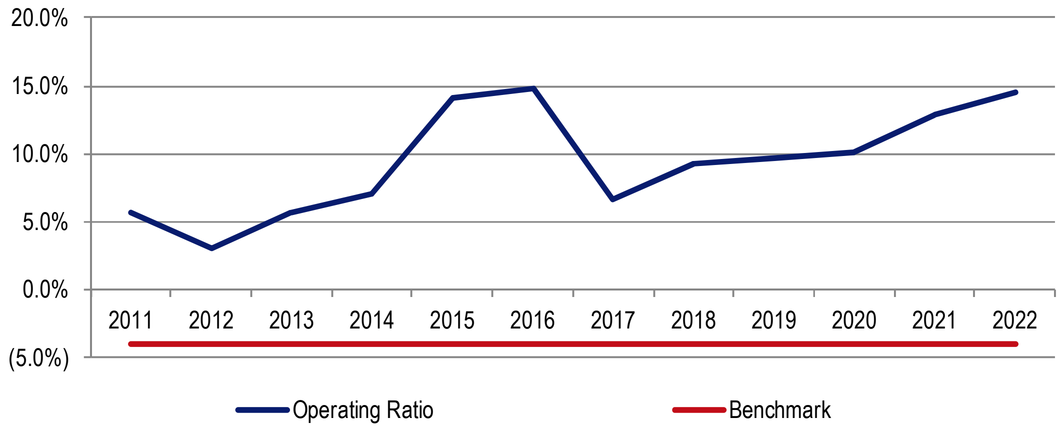
Section 4 Review of Financial Forecasts

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

The LIRS loan relates to the General Fund, therefore we have focused our financial analysis solely upon this Fund.

4.1: Operating Results

Figure 7 - Operating Ratio

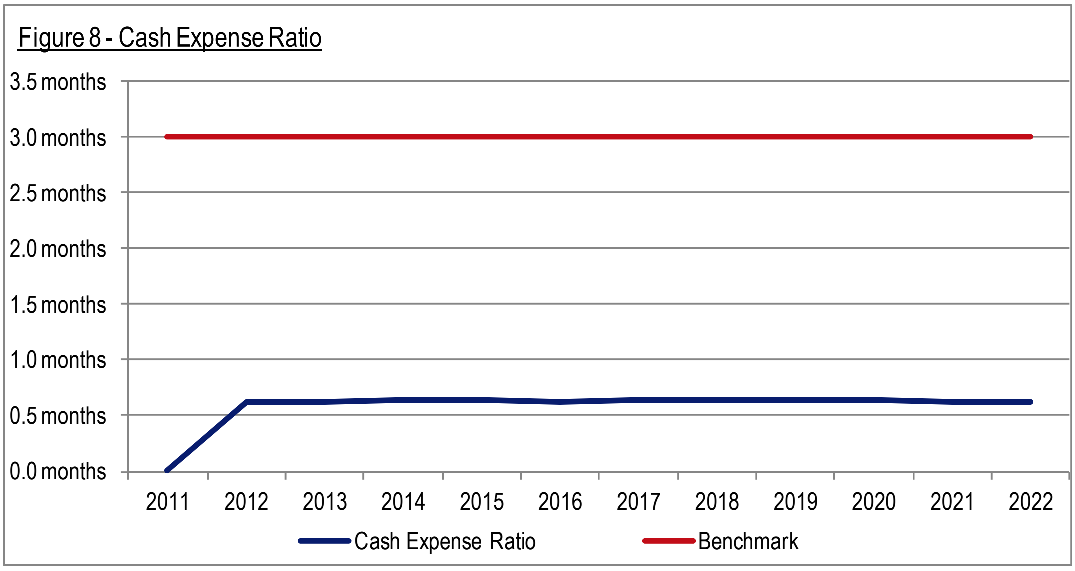


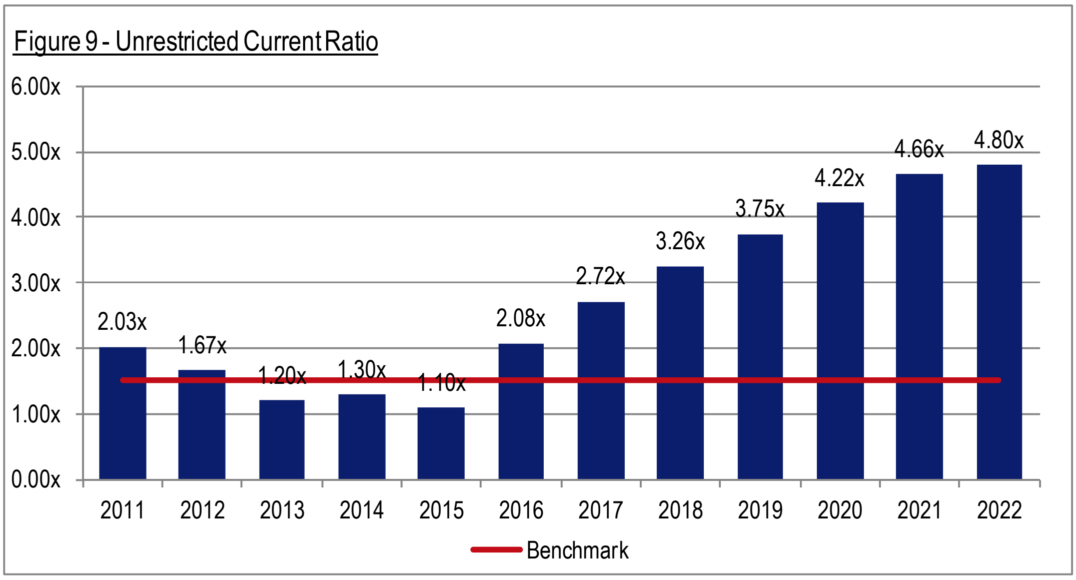
The overall trend in operating results is improving over the forecast period due to revenue growth (averaging 4.3% p.a.) outstripping expenses growth (averaging 3.3% p.a.). Revenue growth is driven by rates and annual charges, in particular the infrastructure levy, as well as user fees and charges and other revenues.

The strong results in 2015 and 2016 are primarily due to forecast gains on the sale of assets of $12.3m and $13.7m respectively from the services relocation project.

4.2: Financial Management Indicators

Liquidity Ratios



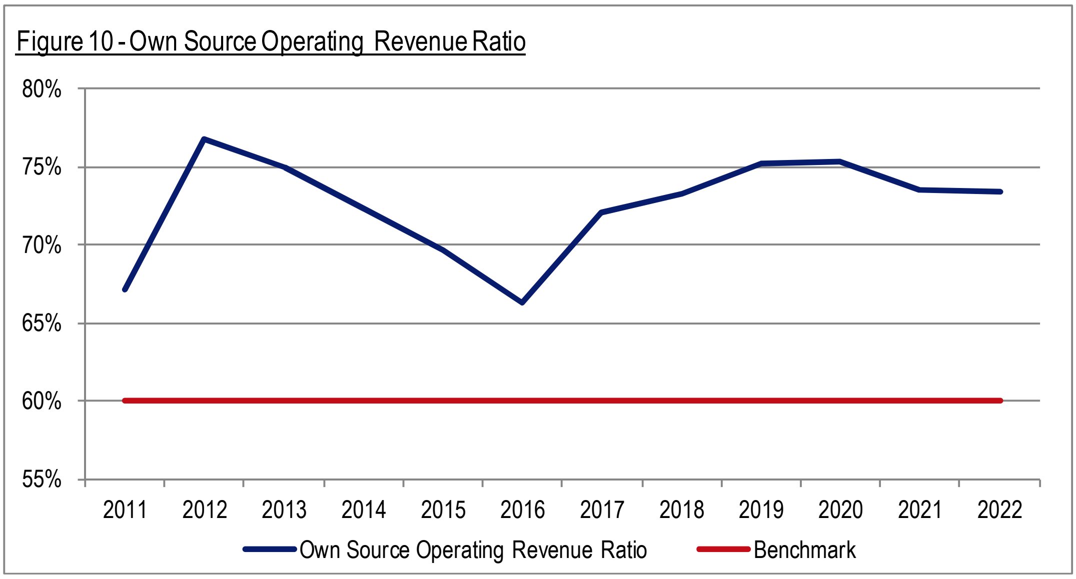


The Council is forecasting low cash balances over the forecast period as Council invests excess cash. Investment balances are increasing over the forecast period.

The Unrestricted Current Ratio falls below the benchmark of 1.50x from 2013 to 2015 due to a combination of lower unrestricted current assets and higher unrestricted current liabilities in these years. This is driven by capital expenditure being funded by a combination of internal reserves and short term borrowings that will be repaid upon the sale of assets.

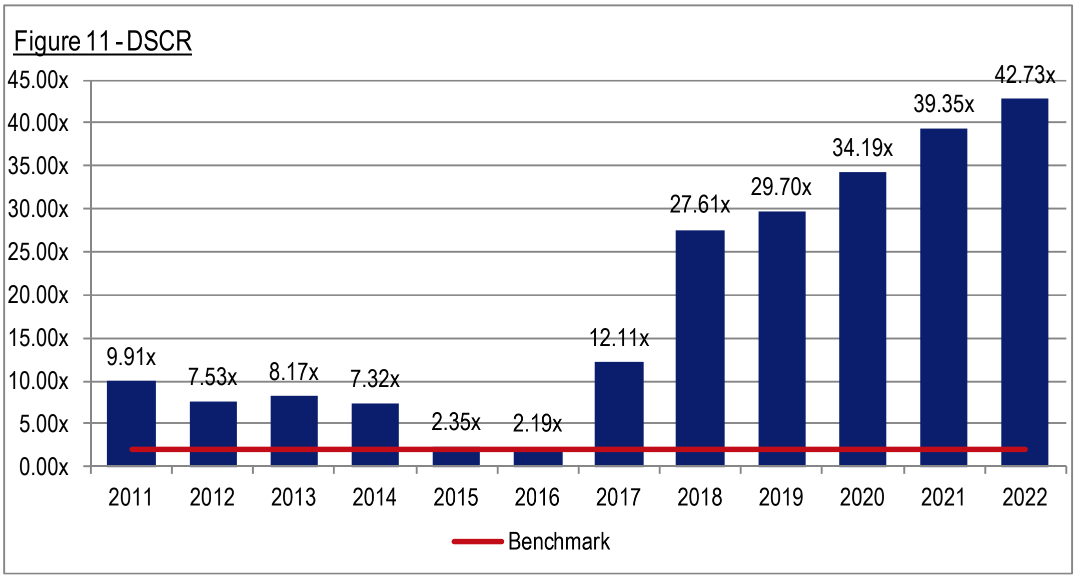
This indicates that Council is forecasting sufficient liquidity levels over the period.

Fiscal Flexibility Ratios



Council's forecast Own Source Operating Revenue Ratio is slightly overstated because Council does not separate user fees and charges forecast from the category of other revenue. Other revenue includes parking fines, rental income and recycling income which are within the Council's control although they are not included in the strict definition of this Ratio.

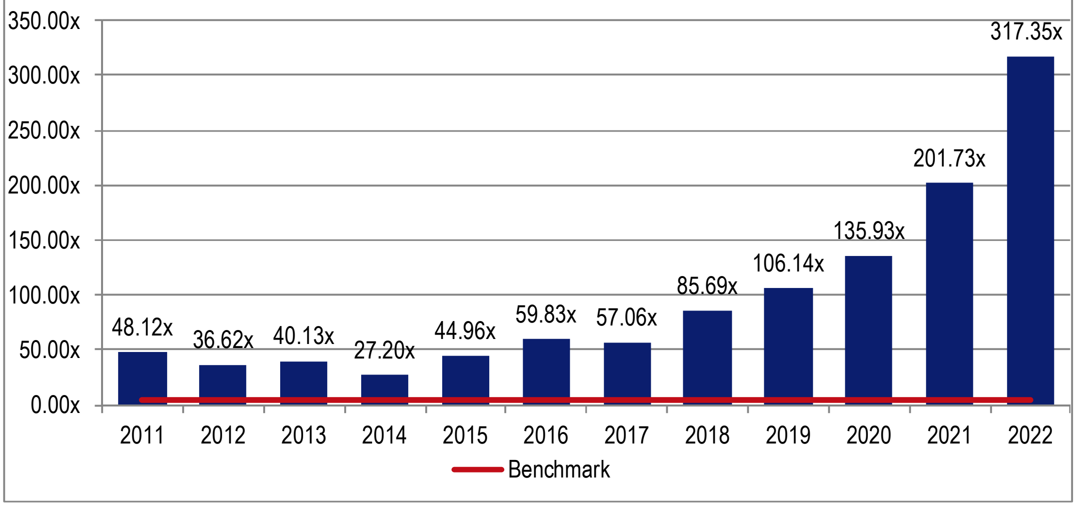
The dip in 2016 is due to the gain on the sale of assets of $13.7m which negatively skews the Ratio.



Council's forecast includes loan drawdowns of $31.4m in 2013, including the loans for the LIRS projects, and $1.6m in 2014. These drawdowns are for the services relocation project, West Pymble aquatic centre project, the public toilet amenities upgrade and the Gordon library upgrade.

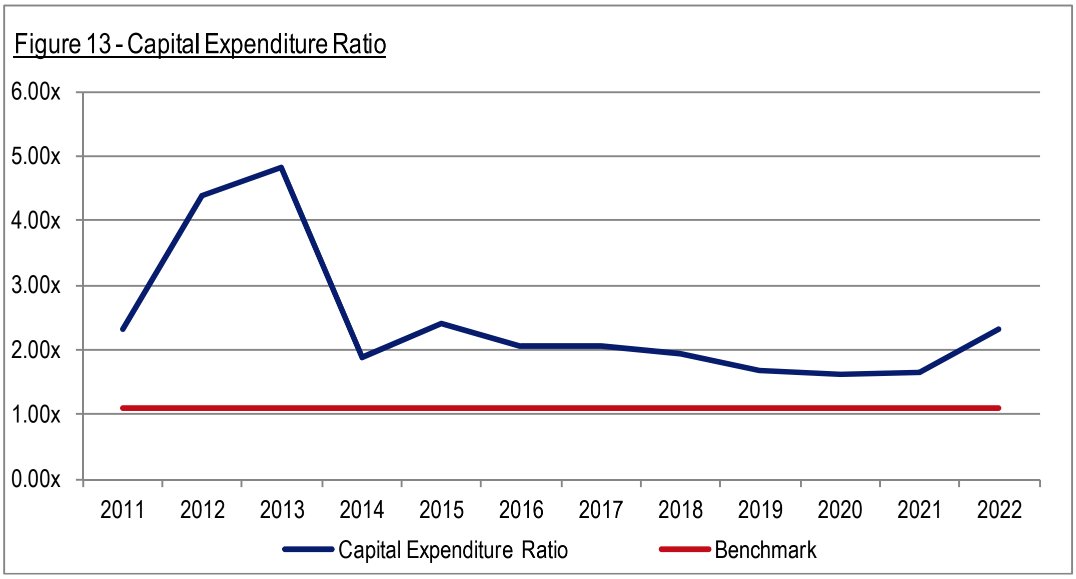
The DSCR remains above benchmark over the forecast period. The dips in 2015 and 2016 are due to planned debt repayments of $14.3m and $16.6m respectively which are to be funded by asset sales from the services relocation project. These repayments are above the minimum required repayments and will only occur in line with asset sales. If the gains from the sale of assets and the extraordinary debt repayments are excluded in these years the DSCR are 8.94x in 2015 and 9.21x in 2016.

Figure 12 - Interest Cover Ratio



The Interest Cover Ratio remains well above benchmark in all years of the forecast period.

With both the DSCR and Interest Cover Ratios being well above benchmark and increasing, apart from the extraordinary debt repayments skewing the DSCR in 2015 and 2016, this supports that the Council would be able to service more debt over the forecast period.



4.3: Capital Expenditure

The Council's forecast Capital Expenditure Ratio remains above benchmark over the forecast period. The high levels in 2012 and 2013 are due to spending on parks and recreation, and Council buildings. Parks and recreation projects include the West Pymble Pool upgrade, land acquisition for new parks, North Turramurra Recreation Area and new facilities at Koola Park, Killara. Council Building projects include depot relocation, relocation of Council administration services, new State Emergency Services/Rural Fire Services building and the LIRS projects.

This level of capital expenditure is likely to reduce the infrastructure backlog over the forecast period.

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>

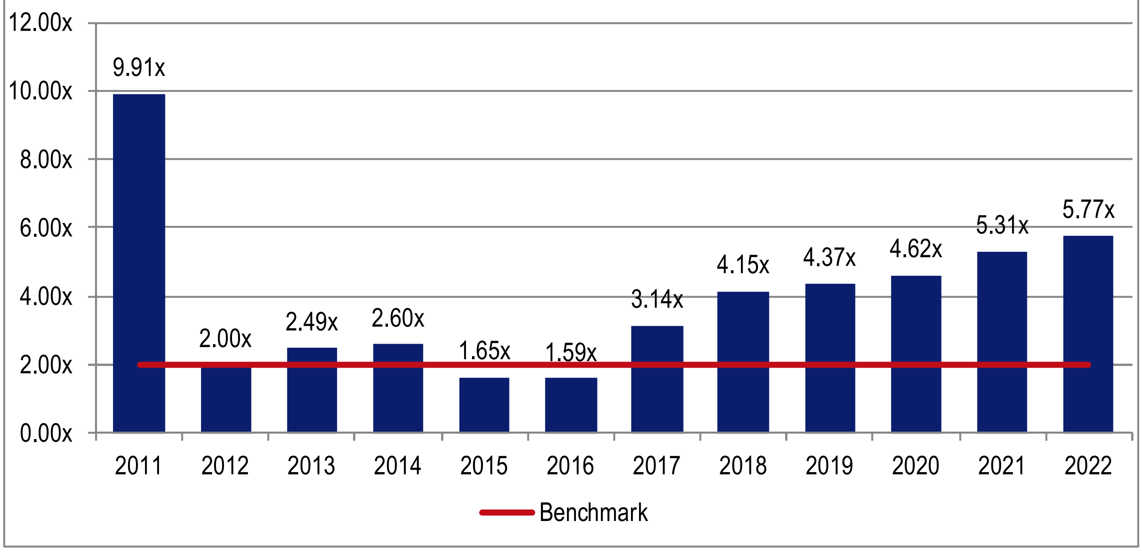
- Council has forecast rates and annual charges to increase by an average of 3.8% p.a. over the forecast period primarily driven by the infrastructure levy which increases by an average of 4.1% p.a. from 2013. The infrastructure levy and environmental levy are forecast to remain in the rate base beyond their scheduled expiration dates (this would be subject to the approval of IPART). Council has also forecast assessment growth of 0.7% p.a.
- Council has forecast user fees and charges to increase by an average of 3.9% p.a. over the forecast period primarily driven by the expected revenues from the services relocation project.
- Council has forecast interest revenue at the expected BBSW over the forecast period. Interest revenue changes in line with cash and investment balances.
- Operating grants and contributions increase by an average of 2.3% p.a.
- Capital grants and contributions are volatile over the forecast period but increase by an average of 2.6% p.a.
- Employee costs increase by an average of 3.5% p.a. over the forecast period.
- Materials and contracts expenses increase by an average of 3.1% p.a. over the forecast period.
- Depreciation and amortisation expenses increase by an average of 3.6% p.a.
- Other expenses increase by 19.2% in 2013 due to the start of operating expenses from the services relocation project. Increases in other expenses average 2.6% p.a. from 2014.
- With the exception of our comments in respect of the extension of the various levies, the assumptions used by Council appear to be reasonable.

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. Our comments and observations are:

- Based on a benchmark of DSCR>2x except for 2015 and 2016 which include extraordinary debt repayments funded by asset sales, $44.4m could be borrowed in addition to the $2.0m borrowings proposed under LIRS in 2013.
- As the DSCR improves from 2017 after the extraordinary debt repayments made in 2015 and 2016, there could be further capacity to take on increased borrowings from that point; however, we would recommend a subsequent review of the Council's financial position nearer the time to confirm if this remains the case.
- This scenario has been calculated by modelling a 10 year amortising loan at an interest rate of 7.5% p.a.

Figure 14 - DSCR for General Fund including additional borrowings



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 3. There are 17 councils in this group and at the time of preparing this report, we have data for all of these councils.

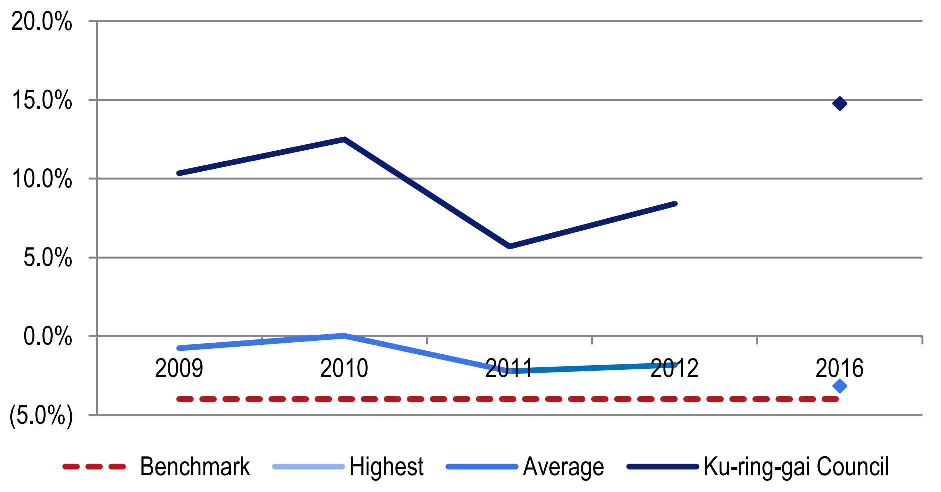
In Figure 15 to Figure 24, the graphs compare the historical performance of Council with the benchmark for that ratio, with the average for the Group, with the highest performance (or lowest performance in the case of the Infrastructure Backlog Ratio where a low ratio is an indicator of strong performance), 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.

This section has been completed at a later date to the rest of the report and therefore is inclusive of the 2012 data. The rest of the report has not been amended to include analysis of the 2012 figures.

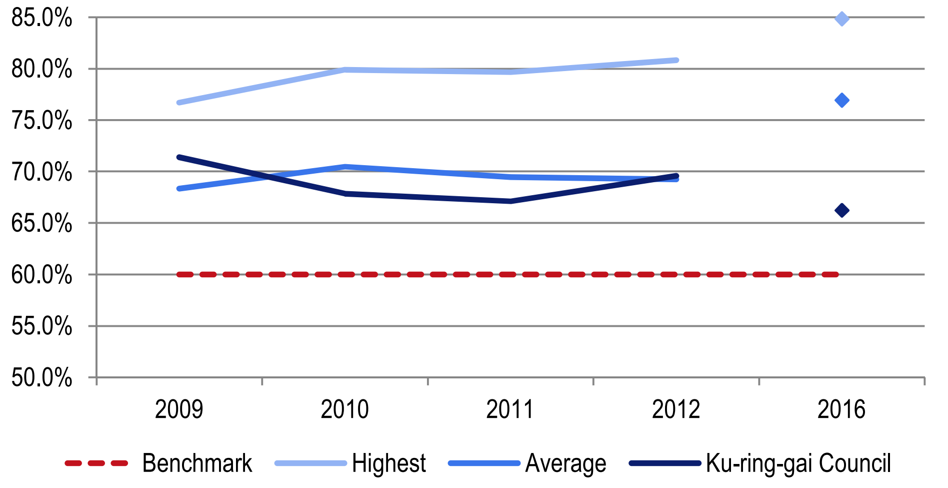
Financial Flexibility

Figure 15 - Operating Ratio Comparison



Council's Operating Ratio is the highest performer in the group, above both the group average and benchmark and is forecast to remain in that position in the medium term.

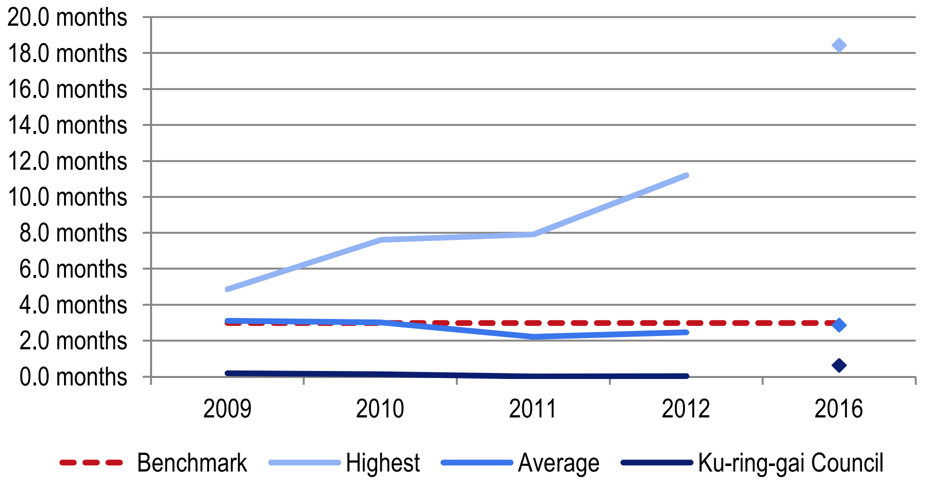
Figure 16 - Own Source Operating Revenue Ratio Comparison



Council's Own Source Operating Revenue Ratio has remained above the benchmark in each year and above the group average in two of the four years. It is forecast to decrease marginally but remain above the benchmark. The forecast group average increases generally due to the reduction in forecast grants and contributions by most of the councils in the group which skews the projected average upwards in 2016.

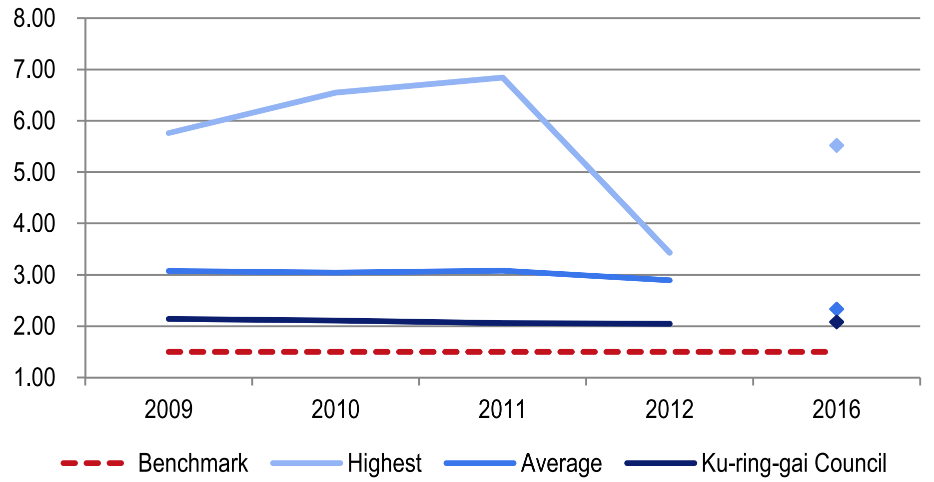
Liquidity

Figure 17 - Cash Expense Ratio Comparison



Council's Cash Expense Ratio has been below the group average and benchmark in each year and is forecast to remain below both indicators in the medium term. Council invests the majority of its funds within investments that are not captured within this ratio.

Figure 18 - Unrestricted Current Ratio Comparison



Council's Unrestricted Current Ratio has been below the group average but has remained above the benchmark in each year. It is forecast to remain in a similar position in the medium term.

Debt Servicing

Figure 19 - Debt Service Cover Ratio Comparison

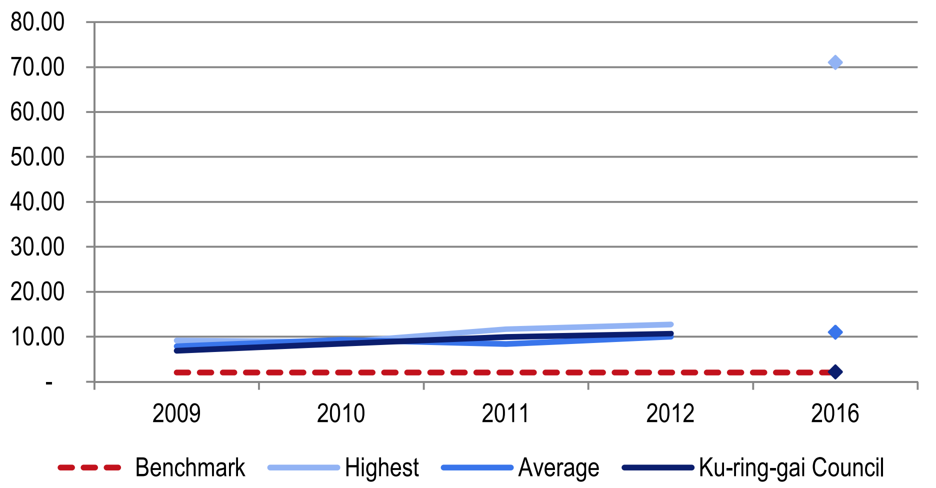
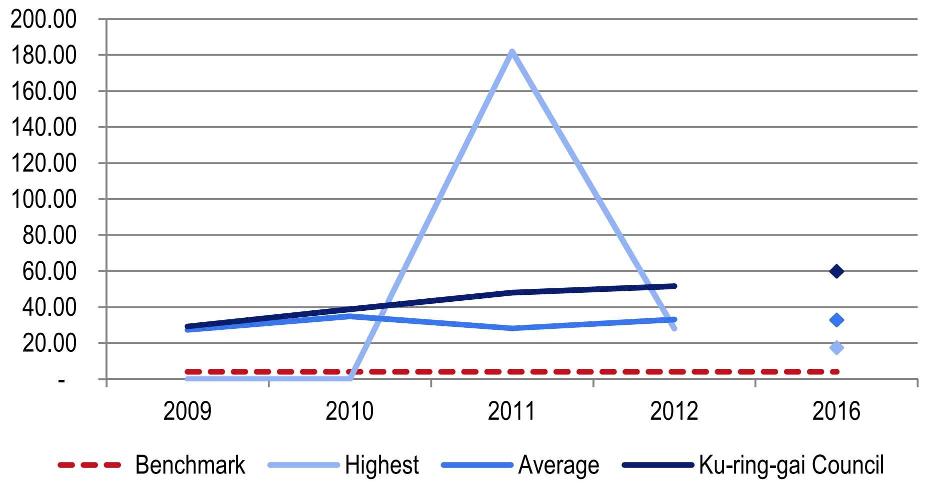


Figure 20 - Interest Cover Ratio Comparison



Council's DSCR and Interest Cover Ratio have been above the benchmark in each year. The Interest Cover Ratio has also been above the group average in each year and is forecast to be above the group average. The DSCR has been above the group average since 2011 but in 2016 is forecast to decrease to be marginally above the benchmark as Council has scheduled large debt repayments in both 2015 and 2016.

Asset Renewal and Capital Works

Figure 21 - Capital Expenditure Ratio Comparison

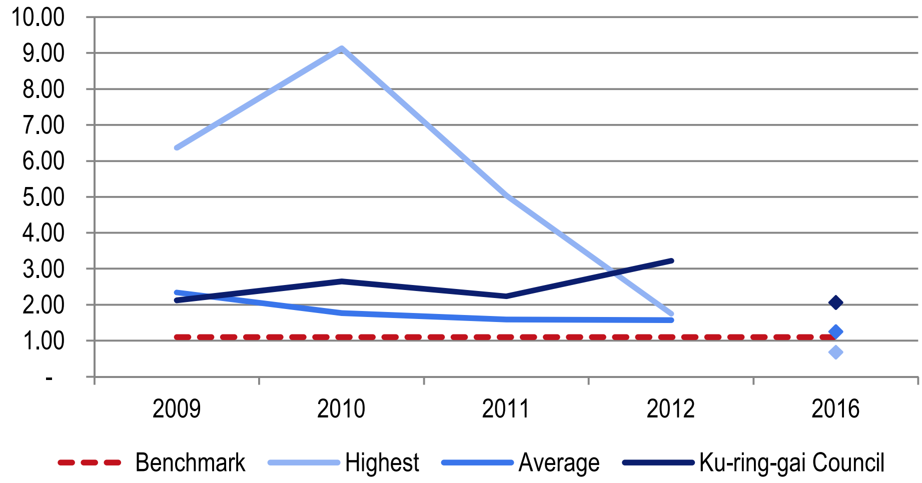
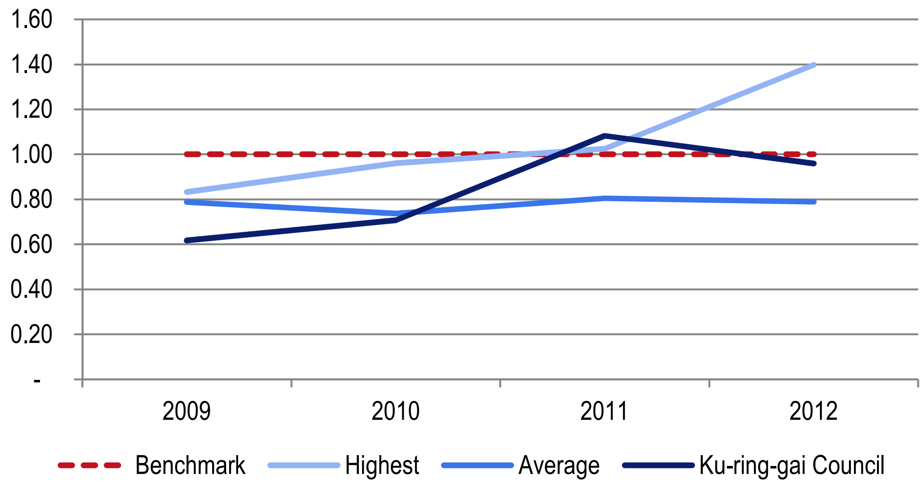


Figure 22 - Asset Maintenance Ratio Comparison



Council's Capital Expenditure Ratio has been above the benchmark in each year and above the group average from 2010. Over the medium term it is forecast to decrease but remain above both indicators.

Council's Asset Maintenance Ratio has been above the group average since 2011 but below the benchmark with the exception of 2011.

Figure 23- Infrastructure Backlog Ratio Comparison

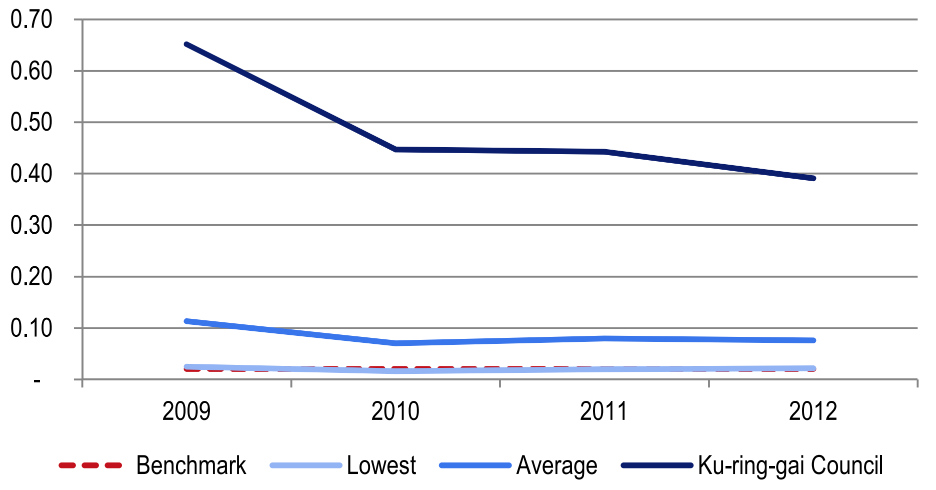
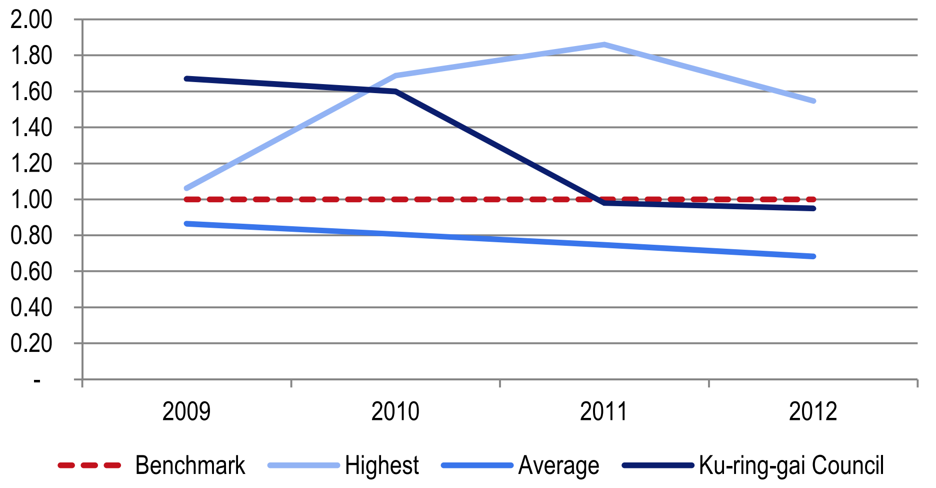


Figure 24 - Building and Infrastructure Asset Renewal Ratio



Council's Infrastructure Backlog Ratio has been above the benchmark and group average in each year but has been on a marginal downward trend since 2010 although this is predominantly due to the increase in the value of infrastructure assets in each year as opposed to consecutive decreases in the Backlog total.

Council's Building and Infrastructure Asset Renewal Ratio has decreased below the benchmark since 2011 while remaining above the group average in each year.

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 sound financial position. Both past performance and the financial forecasts support our findings that Council has sufficient financial capacity to service the additional borrowings proposed under its LIRS applications.

We base our recommendation on the following key points:

- Council has sufficient capacity to manage the additional $2.0m debt supported by a DSCR and Interest Cover Ratio above the benchmarks in all 10 years of its financial forecast
- Based on the forecast model it has the capacity to service additional debt of $44.4m
- Council has sufficient liquidity to manage their short term liabilities during the 10 year forecast period
- Council has maintained control of expenses in the past three years except for the comments on the depreciation expenses
- Council has maintained operating surpluses excluding capital grants and contributions in the past three years
- Council has a relatively low level of borrowings at $7.6m, only 0.8% of net assets in 2011

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

- Council's current forecast model assumes that the infrastructure levy and environmental levy continue through the forecast period. However, these levies are currently scheduled to expire in 2015 and 2020 respectively. Council will need to apply for an extension of these levies to reach its forecast operating results

New South Wales
Treasury Corporation

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	62,780	59,675	54,948	5.2%	8.6%
User charges and fees	11,499	12,467	14,788	(7.8%)	(15.7%)
Interest and investment revenue	7,493	6,129	6,385	22.3%	(4.0%)
Grants and contributions for operating purposes	5,238	5,048	6,593	3.8%	(23.4%)
Other revenues	7,404	7,329	2,924	1.0%	150.6%
Total revenue	**94,414**	**90,648**	**85,638**	**4.2%**	**5.9%**
Employees	33,646	33,763	30,892	(0.3%)	9.3%
Borrowing costs	426	507	576	(16.0%)	(12.0%)
Materials and contract expenses	27,720	25,619	26,339	8.2%	(2.7%)
Depreciation and amortisation	14,691	7,824	7,430	87.8%	5.3%
Other expenses	12,550	11,614	11,547	8.1%	0.6%
Total expenses	**89,033**	**79,327**	**76,784**	**12.2%**	**3.3%**
Operating result	**5,381**	**11,321**	**8,854**	**(52.5%)**	**27.9%**

Table 2 - Items excluded from Income Statement

Excluded items ($'000s)			
	2011	2010	2009
Grants and contributions for capital purposes	16,282	15,698	12,019
Decrease in the fair value of investments	183	2,961	3,595
Gain on disposal of assets	347	11,839	26

New South Wales
Treasury Corporation

Table 3 - Balance Sheet

Balance Sheet ($'000s)	Year Ended 30 June			% annual change	
	2011	**2010**	**2009**	**2011**	**2010**
Current assets					
Cash and equivalents	65	798	1,114	(91.9%)	(28.4%)
Investments	50,319	39,200	35,753	28.4%	9.6%
Receivables	6,729	5,706	5,439	17.9%	4.9%
Inventories	264	221	240	19.5%	(7.9%)
Other	1,202	585	976	105.5%	(40.1%)
Non-current assets classified as held for sale	0	0	5,827	N/A	(100.0%)
Total current assets	58,579	46,510	49,349	25.9%	(5.8%)
Non-current assets					
Investments	56,972	67,166	39,314	(15.2%)	70.8%
Receivables	222	215	194	3.3%	10.8%
Infrastructure, property, plant & equipment	863,209	695,715	535,888	24.1%	29.8%
Intangible assets	274	0	0	N/A	N/A
Total non-current assets	920,677	763,096	575,396	20.7%	32.6%
Total assets	**979,256**	**809,606**	**624,745**	**21.0%**	**29.6%**
Current liabilities					
Payables	10,417	13,175	10,179	(20.9%)	29.4%
Borrowings	1,857	1,651	1,813	12.5%	(8.9%)
Provisions	9,474	8,888	8,091	6.6%	9.9%
Total current liabilities	21,748	23,714	20,083	(8.3%)	18.1%
Non-current liabilities					
Borrowings	5,748	5,244	6,895	9.6%	(23.9%)
Provisions	268	260	192	3.1%	35.4%
Total non-current liabilities	6,016	5,504	7,087	9.3%	(22.3%)
Total liabilities	**27,764**	**29,218**	**27,170**	**(5.0%)**	**7.5%**
Net assets	**951,492**	**780,388**	**597,575**	**21.9%**	**30.6%**

Table 4-Cashflow

Cashflow Statement ($'000s)	Year ended 30 June		
	2011	**2010**	**2009**
Cashflows from operating activities	32,595	38,842	23,928
Cashflows from investing activities	(34,038)	(37,345)	(21,751)
Proceeds from borrowings and advances	2,352	0	1,000
Repayment of borrowings and advances	(1,642)	(1,813)	(1,880)
Cashflows from financing activities	710	(1,813)	(880)
Net increase/(decrease) in cash and equivalents	**(733)**	**(316)**	**1,297**
Cash and equivalents	65	798	1,114

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

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

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

cases this has led to significantly higher depreciation charges, and will contribute to higher reported operating deficits.

EBITDA

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

Grants and Contributions for Capital Purposes

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

Grants and Contributions for Operating Purposes

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

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

Independent Commission Against Corruption (ICAC)

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

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

Independent Pricing and Regulatory Tribunal (IPART)

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

Infrastructure Backlog

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

Integrated Planning and Reporting (IP&R) Framework

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

Local Government Cost Index (LGCI)

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

Net Assets

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

Roads and Maritime Services (RMS)

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

Section 64 Contribution

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

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

Section 94 Contribution

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

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

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

Special Rate Variation (SRV)

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

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

The applications are reviewed and approved by IPART.

Ratio Explanations

Asset Maintenance Ratio

Benchmark = Greater than 1.0x

Ratio = actual asset maintenance / required asset maintenance

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

Building and Infrastructure Renewals Ratio

Benchmark = Greater than 1.0x

Ratio = Asset renewals / depreciation of building and infrastructure assets

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

Cash Expense Cover Ratio

Benchmark = Greater than 3.0 months

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

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

Capital Expenditure Ratio

Benchmark = Greater than 1.1x

Ratio = annual capital expenditure / annual depreciation

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

Debt Service Cover Ratio (DSCR)

Benchmark = Greater than 2.0x

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

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

Infrastructure Backlog Ratio

Benchmark = Less than 0.02x

Ratio = estimated cost to bring assets to a satisfactory condition (from Special Schedule 7) / total infrastructure, 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.