New South Wales Treasury Corporation

Narrabri Shire Council

Financial Assessment and Benchmarking Report

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

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

Council has made one application for Narrabri Aquatic Centre at a cost of $6.5m.

TCorp's approach has been to:

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

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

- Rates and annual charges have been rising in recent years in accordance with rate pegging and farmland rate increments
- With the exception of flood-affected 2011, management have controlled employee expenses to a satisfactory level in recent years
- Financial management and liquidity ratios are acceptable and reflect Council's ability to satisfy its financial obligations in the short term.

Council's reported infrastructure backlog of $29.9m in 2011 represents 15.5% of its infrastructure asset value of $192.7m. Other observations include:

- Consistent with many other rural councils, the backlog is largely road related
- The Infrastructure Backlog Ratio has remained static over the review period as the 2011 increase in the backlog has been largely off-set by the increase in the total value of infrastructure assets

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

- 2012 performance is impacted by flood restoration works and capital works on the airport, swimming pool and various roads
- Overall it appears that the Council will have sufficient liquidity throughout the next 10 year period to service all short term liabilities and currently scheduled capital expenditure and related long term liabilities
- Council's level of fiscal flexibility is low as own source revenue is maintained at levels below 50.0% for the forecast period
- Council's key assumptions within the financial forecasts are considered to be reasonable

In our view, the Council has the capacity to undertake the combined additional borrowings of $5.0m for the LIRS project. This is based on the following analysis:

- The DSCR remains above the benchmark of 2.00x in nine of the 10 years forecast
- The Interest Cover Ratio is above the benchmark of 4.00x for the entire forecast period

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 was below the benchmark in two of the last four years. Council's Interest Cover Ratio is above the benchmark but below group average. In the medium term these forecast ratios are expected to marginally decline and remain in line with the benchmarks
- Council was in a sound liquidity position which is expected to improve in the medium term
- Council's performances in terms of its Building and Infrastructure Asset Renewals Ratio, Asset Maintenance Ratio and Capital Expenditure Ratio have declined to be below the group averages and benchmarks
- Council's Infrastructure Backlog is higher 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

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

Narrabri Shire Council	
Locality and Size	
Locality	Northern
Area	13,028 km²
DLG Group No.	11
Demographics	
Population	12,925
% under 19	28.6%
% between 19 and 59	49.4%
% over 60	22.0%
Expected population in 2021	12,000
Operations	
Number of employees (FTE)	119
Annual revenue	$37.1m
Infrastructure	
Backlog - Roads	62.9%
Backlog - Sewerage	16.7%
Infrastructure backlog value	$29.9m
Total infrastructure value	$203.9m

Narrabri Shire Council Local Government Area (LGA) is situated on the Namoi River and lies 521 km northwest of Sydney. It sits on the junction of two important trade routes, the Kamilaroi Highway and the Newell Highway.

Agriculture, forestry & fishing is the largest industry in terms of business numbers in Narrabri Shire, with cotton being the largest. Other agricultural industries in the area include wheat, beef and lamb. Nearby attractions are Mount Kaputar National Park and the Australia Telescope Compact Array at the Paul Wild Observatory.

Although Narrabri is the administrative centre of the Shire, the local government area also consists of the towns of Wee Waa and Boggabri. A new $42.0m regional hospital, $5.0m research facility extension and mining approvals have resulted in approximately 1,000 temporary residents working in the area.

2.4: LIRS Application

Council has made one LIRS application.

Project: Narrabri Aquatic Centre

Description: This project is to establish new facilities at the current pool and to refurbish the existing pool at a cost of $6.5m. It comprises two stages, stage one being the establishment of an indoor aquatic centre comprising of a new indoor aquatic centre with new 25 metre pool, new amenities and plant room; new outdoor water play park and shade structure; external pavements and new car parking. Stage two will be the refurbishment of the existing outdoor 50m pool. The project is assisted by Voluntary Planning Agreement for $1.5m from Whitehaven Coal Pty Ltd.

Amount of loan facility: $5.0m

Term of loan facility: 10 years

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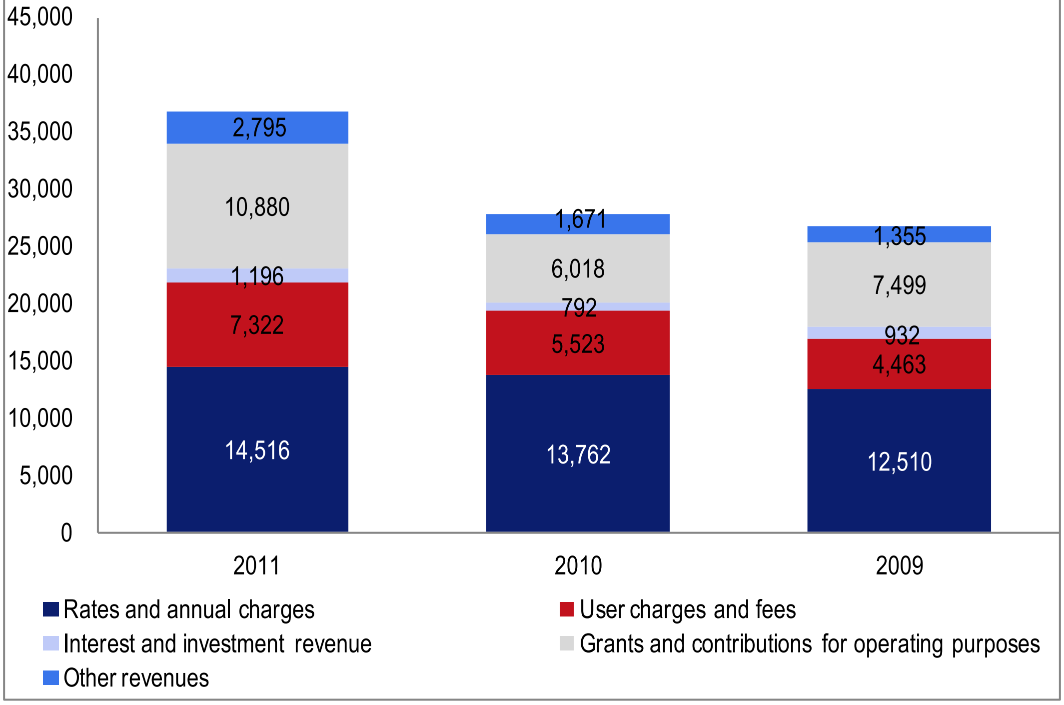
Section 3 Review of Financial Performance and Position

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

3.1: Revenue

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



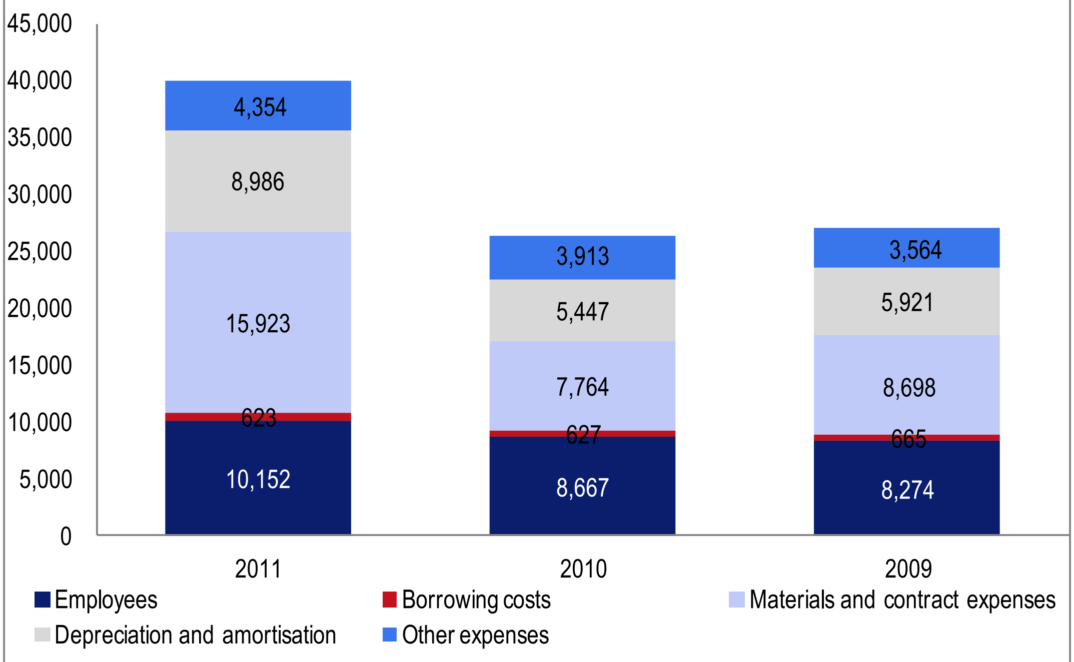
Key Observations

- Rates and annual charges have been rising in recent years in accordance with rate pegging and farmland rate increments. In total, rates increased by 5.5% in 2011. Farmland rates account for 36.5% of total rates and annual charges, and these increased by 8.0% in 2011. This growth was helped by a catch up provision, which allows for the recoupment of under levied amounts in the previous three years. Residential rate increases were in line with the 3.6% rate peg.
- User charges and fees increased by 32.6% in 2011, mainly due to RMS works on the Kamilaroi Highway. These works attributed to 55.6% ($1.0m) of the year on year increase of $1.8m. Contributions to works increased from $0.1m to $0.6m, and were another driver of the annual percentage change.
- Favourable financial markets and rising interest rates contributed to the $0.4m (50.1%) increase in interest and investment revenue in 2011.
- A flood restoration grant of $4.5m in 2011 was the reason for the increase in grants and contributions for operating purposes.

- Increases in other revenues were aided by community centres and halls, which saw a 60.7% increase of $0.5m. The net cost of operation has been increasing and resulted in a loss of ($1.2m) in 2011.

3.2: Expenses

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



Key Observations

- Employee expenses increased by 17.1% in 2011, from $8.7m to $10.2m. Wages increased by 9.1% as overtime hours for flood works were required, while $0.6m of the increase related to higher superannuation expenses.
- In 2010, total expenses declined by 2.6%, and employee costs were kept in line with standard wage increments.
- Flood restoration related expenses and maintenance on RMS roads were the main drivers of the 105.1% increase in materials and contract expenses. Unsealed rural roads that were washed out in the floods of 2011 required re-gravelling and this was the main contributor to the increased expenses, which were offset by government grants.
- The Asset Revaluations process resulted in increases to the value of Council's infrastructure assets. This process also resulted in the 2011 depreciation charge increasing by 64.9% to $9.0m. Depreciation fell in 2010 as Council reassessed sewerage and water supply networks and reset the useful lives of their assets.
- Other expenses contain items such as insurance and electricity. The general trend has been growth in operating and admin expenses since 2009. Council also operates an airport at a net cost of $0.3m and cultural centres at a net cost of $1.2m. While these operate at a loss, they are considered by Council to be essential services to the community.

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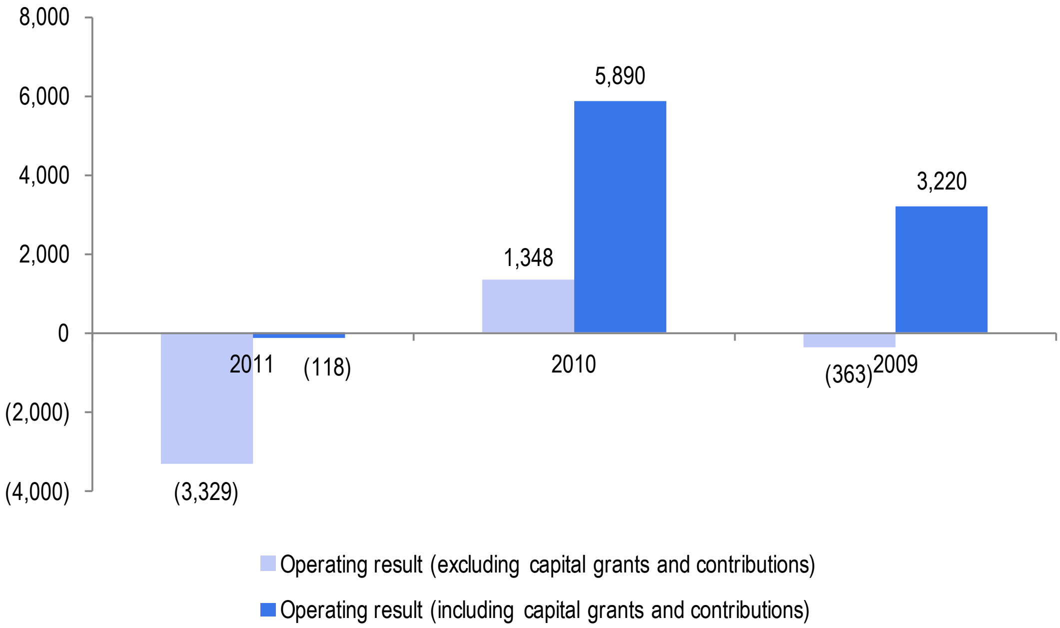
3.3: Operating Results

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

- Operations were significantly affected by floods in 2011. Restoration works required increased focus on clean-up and maintenance, which shifted works from capital projects and required increased staffing and materials for operations.
- Operating Results in 2010 were positive, as catch up on farmland rates, increased water supplied and a significant increase in RMS funding all contributed to increased revenue of $2.3m (8.9%). These results coincided with a general decline in expenses to a total of $0.7m (2.6%).

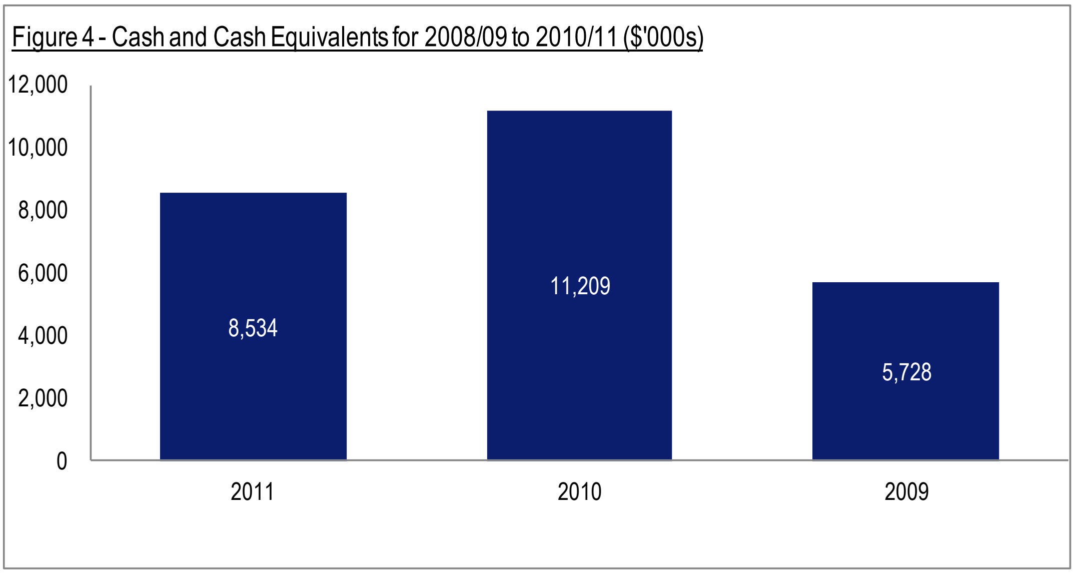
3.4: Financial Management Indicators

Performance Indicators	Year ended 30 June		
	2011	2010	2009
EBITDA ($'000s)	6,709	8,165	5,637
Operating Ratio	(7.8%)	7.3%	(3.6%)
Interest Cover Ratio	10.77x	13.02x	8.48x
Debt Service Cover Ratio	1.94x	1.74x	2.80x
Unrestricted Current Ratio	3.24x	1.93x	3.10x
Own Sourced Revenue	54.1%	58.3%	57.0%
Cash Expense Ratio	3.4 months	6.6 months	3.3 months
Net Assets ($'000s)	228,005	209,886	201,704

Key Observations

- EBITDA has increased from $5.6m in 2009 to $6.7m in 2011, driven by increases in rates, other revenues and operating grants. Depreciation growth has had a negative effect on the Operating Ratio, which declined in 2011.
- Unrestricted Current Ratio is above benchmark and reflects Council's ability to satisfy obligations in the short term.
- Cash Expense Ratio decreased in 2011 as cash expenses increased and cash and cash equivalents decreased following the repayment of debt.
- Own Sourced Operating Revenue Ratio has been below benchmark in all three years. Council has less than one person per square kilometre, and a general characteristic of small rural councils such as this is a greater reliance on grants and contributions
- The Asset Revaluations over the last three years have resulted in a high level of volatility in Net Assets over this period. 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.
- The underlying trend in all three years has been a growing Net Asset base, which increased by $18.1m (8.6%) in 2011 mainly due to Asset Revaluations. Overall, the Infrastructure, Property, Plant and Equipment (IPP&E) asset base has declined with asset purchases being less than the combined value of disposed assets and annual depreciation. Over the last three years this amounted to a $0.8m net decrease in the value of IPP&E.

3.5: Statement of Cashflows



Key Observations

- Council's cash reserves have increased by 14.2% on a compound annual growth basis over the past three years.
- Council current investments included $11.0m held in long term deposits at 30 June 2011.
- Council's overall cash, cash equivalent, and investments position has decreased over the past three years, and this correlates directly with increased new capital projects.
- Within Council's, cash, cash equivalents, and investments of $22.8m, $15.2m was externally restricted, $7.6m internally restricted, and Council held no unrestricted reserves.
- Exposure to CDOs and FRNs totalled $3.3m in 2011, with a current written down value $1.5. These securities are due to mature in the coming years; two in 2013, three in 2014 and one in 2015.

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)

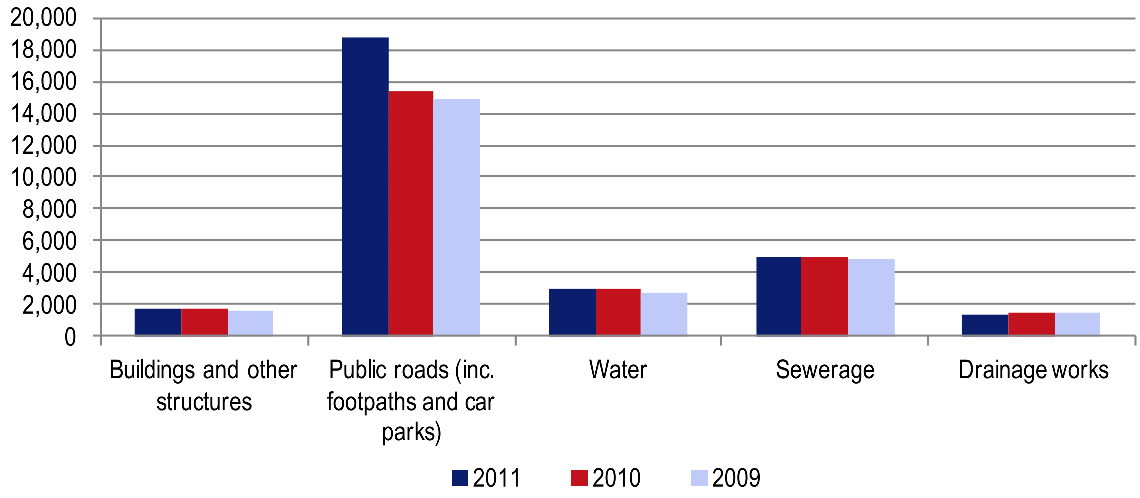
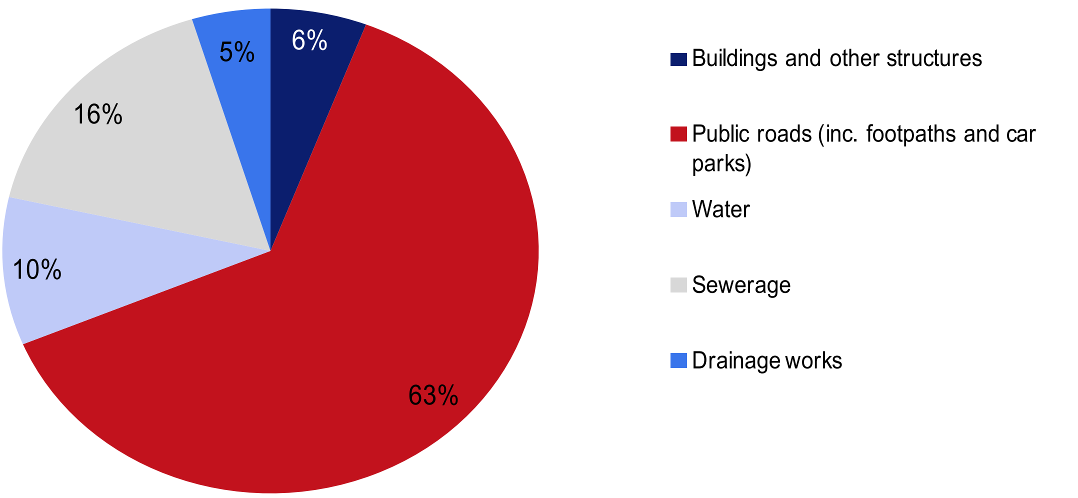


Figure 6 - Infrastructure Backlog Composition for 2010/11



The Council reported a $29.9m backlog in 2011. Consistent with many other rural councils, the backlog is largely road related and being a rural council there are more kilometres of roads to maintain compared to urban councils.

Sewerage backlog comprises 16.0% of the overall backlog, with 80.0% of this split equally between Narrabri and Wee Waa.

The Water backlog is mainly related to pipelines.

3.6(b): Infrastructure Status

Infrastructure Status	Year ended 30 June		
	2011	2010	2009
Bring to satisfactory standard ($'000s)	29,861	26,480	25,597
Required annual maintenance ($'000s)	7,874	6,475	6,000
Actual annual maintenance ($'000s)	6,955	6,076	6,149
Total value infrastructure assets ($'000s)	192,749	187,580	175,100
Total assets ($'000s)	242,537	224,869	214,953
Infrastructure Backlog Ratio	0.15x	0.14x	0.15x
Asset Maintenance Ratio	0.88x	0.94x	1.02x
Building and Infrastructure Asset Renewal Ratio	0.40x	0.97x	0.81x
Capital Expenditure Ratio	0.47x	1.06x	1.59x

The Infrastructure Backlog Ratio has remained static over the period as the 2011 increase in the backlog has been largely off-set by the increase in the total value of infrastructure assets.

Council's Asset Maintenance Ratio has been declining since 2009 and is now below benchmark, indicating that Council are not investing sufficient funds to ensure existing assets are being maintained to standard. Council has increased the actual annual maintenance over the past three years by 13.8%, however the required annual maintenance has increased by 31.2% over the same period.

The Building and Infrastructure Asset Renewals Ratio has been below the benchmark in all recent years.

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	8,129	9,656	3,200
Replacement/refurbishment of existing assets	23,126	15,717	8,389
Total	**31,255**	**25,373**	**11,589**

Council's capital programme has been greatly affected by flooding in recent financial years and resources were diverted from scheduled capital works to flood restoration works.

Some of the main capital projects in recent years were;

- Refurbishment of the airport road ($0.1m)
- Completion of the Oakey Creek bridge ($6.0m)
- Coghill bridge ($1.6m)
- Millie Road reseal and rehabilitation ($0.8m)

3.7: Specific Risks to Council

- Declining population. Council, like a number of rural LGA's, are expecting a decline in population as migration towards the coast occurs, especially amongst young adults. This trend has been exacerbated by the recent drought in the region, and will reduce the demand for (and ultimately availability of) services along with reducing employment and business opportunities. Council is aware of this trend and consider this their largest challenge. Council is hopeful that the opening of new mines in the LGA will provide employment opportunities while the return of agricultural business (following the drought ending) will also provide economic stimulus.
- Ageing population. Linked to the trend of declining population, there is a potential problem in the future, because the migration of young adults places Council under strain to manage the service requirements for the aged, attract suitable employees and continue to provide affordable services.
- Mining expansion. Narrabri is situated in the Gunnedah Basin which is estimated to contain around 12% of coal reserves available in NSW. While mining expansion can provide an economic stimulus to the LGA, it will also place additional pressure on infrastructure and Council's ability to attract staff. Council will seek to ensure that they receive appropriate funding from the mining company to compensate for the increased service provision requirements and possible loss of staff.
- Environmental and natural disasters. Council has had to defer their capital expenditure program due to floods in both December 2009 and November 2010. Both of these events have a compounding effect. The capital expenditure that has been delayed is included in the subsequent year's budget and other projects are delayed, impacting the Infrastructure Backlog.

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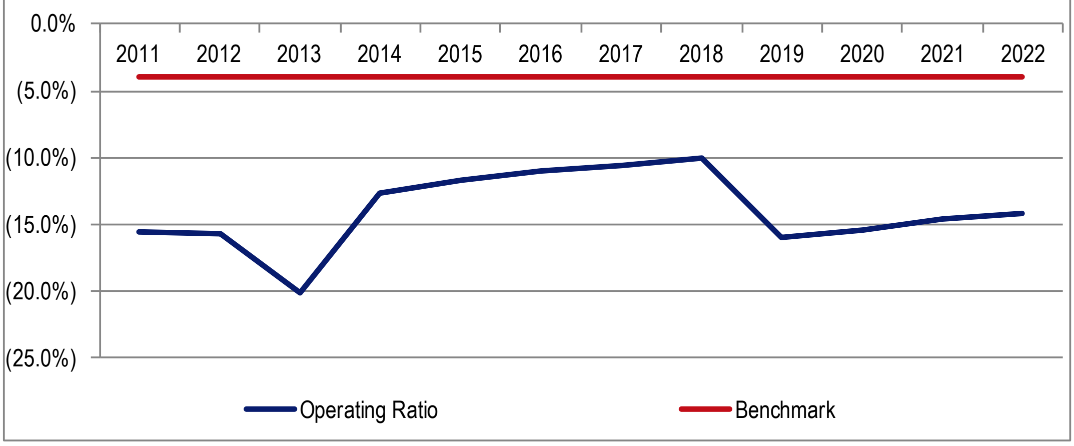
Section 4 Review of Financial Forecasts

The financial forecast model shows the projected financial statements and assumptions for the next 10 years. The model includes the $5.0m loan 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 both a Water and Sewer Fund however these are operated as independent entities, which unlike the General Fund are more able to set 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 Operating Ratio is forecast to be negative for all 10 years of the forecast, consistent with historical results. Overall, Council's expenses are forecast to increase by a larger amount than own sourced revenues despite an improvement in the medium term.

Council's forecasts are impacted by contributions from mines, which are due to be paid to Council from recent capital works at the airport. This is evidenced by the uplift in operating ratio in 2014 to 2018.

Based on these forecasts, over the 10 year period the consistent operating deficits will impact Council's long term financial sustainability.

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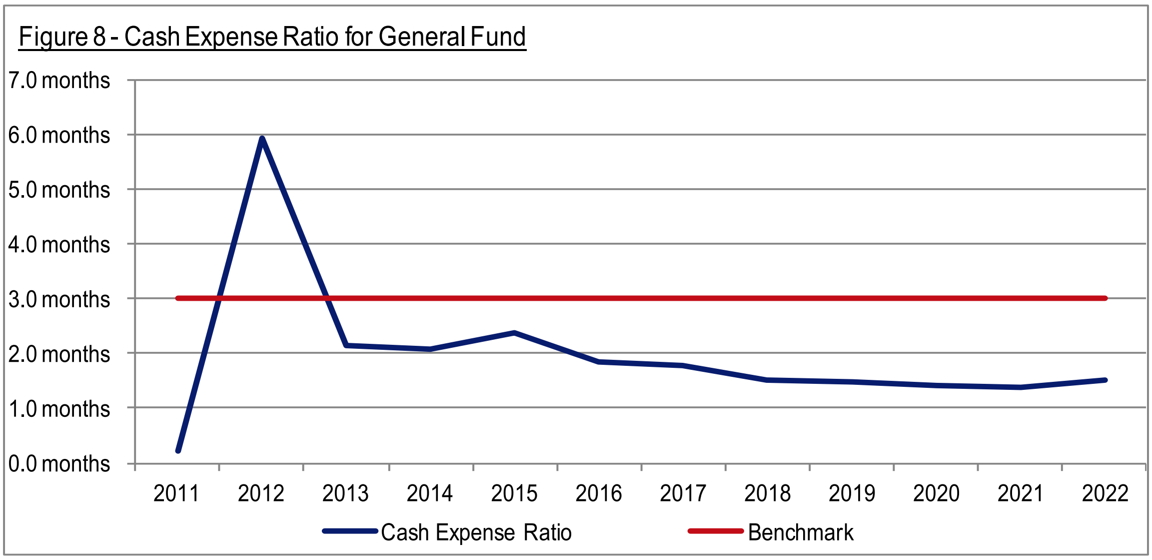
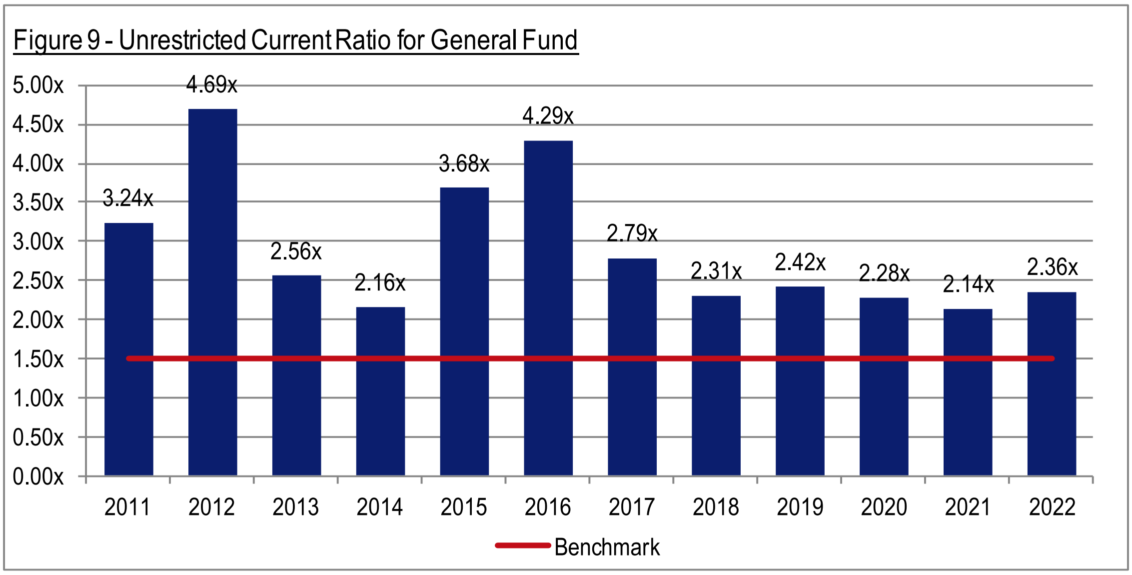
4.2: Financial Management Indicators

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

Liquidity Ratios



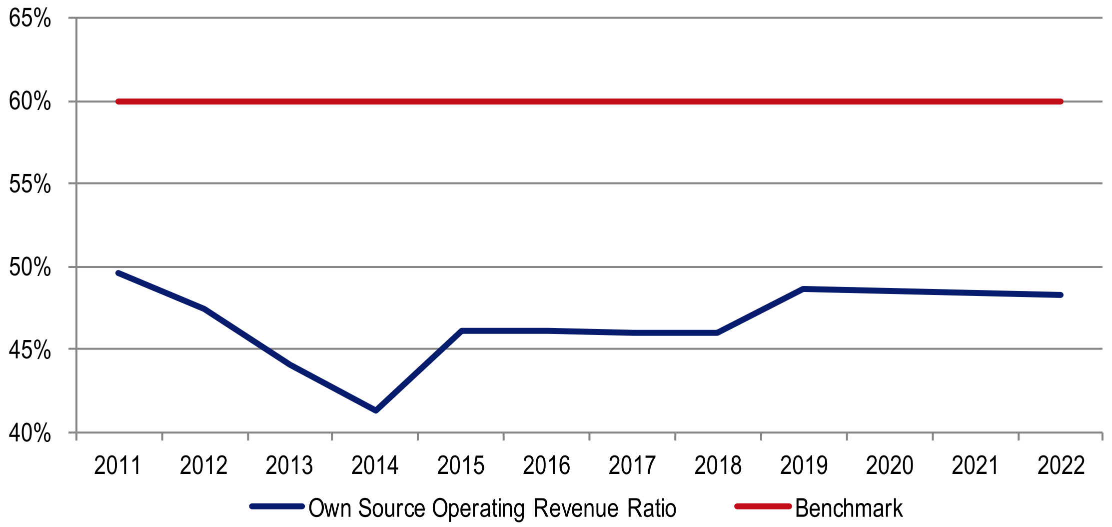
Council's Cash Expense Ratio is consistently below benchmark from 2013. When Council's investments are included in this ratio ($1.0m in long term deposits in 2011) Council would be meeting the benchmark. Council should consider increasing their flexibility in regards to liquidity, as they would not be well positioned if cash reserves were to be called upon in unforeseen circumstances.



Council's Unrestricted Current Ratio is above the benchmark of 1.50x over the forecast period.

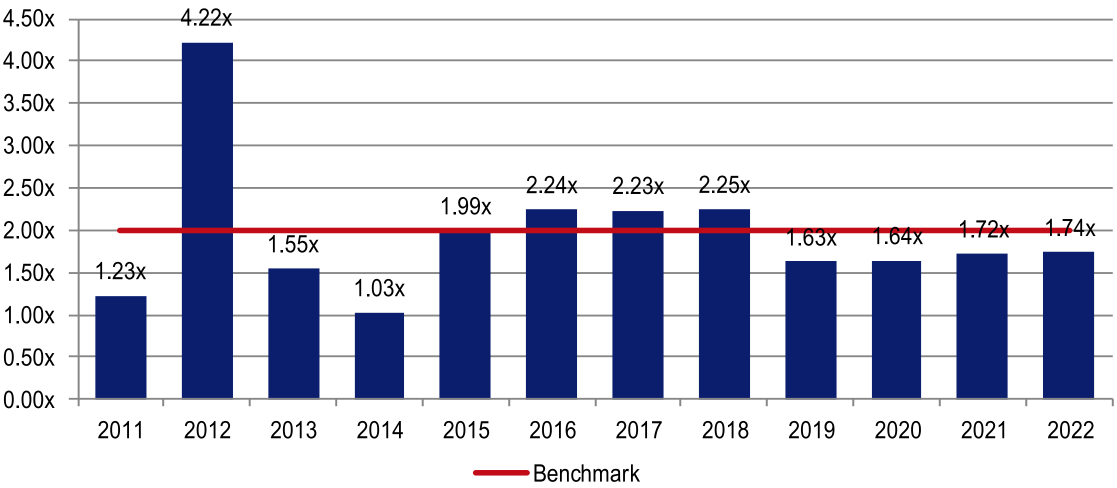
Fiscal Flexibility Ratios

Figure 10 - Own Source Operating Revenue Ratio for General Fund



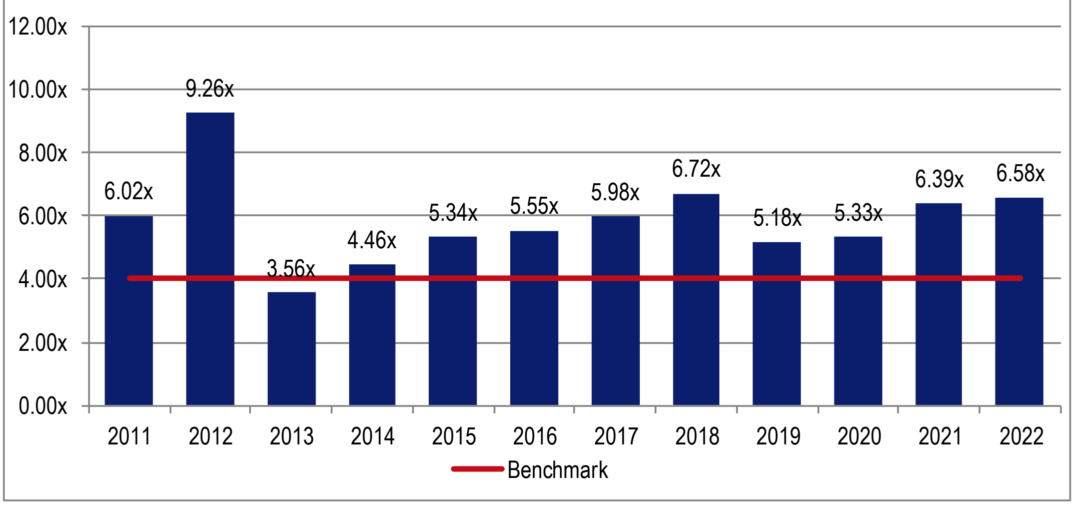
Own sourced operating revenue is forecast to be below benchmark for all forecast years. Council rely on operating grants and mining contributions to works to maintain sustainability.

Figure 11 - DSCR for General Fund



Council project a DSCR which fluctuates above and below benchmark for the forecast period. In addition to the $5.0m LIRS loan, Council will continue to repay debt for loans used to upgrade airport facilities and have indicated that they will refinance $2.5m of debt in 2014. The effect of the repayment of debt ion 2014 is reflected in the 1.03x DSCR.

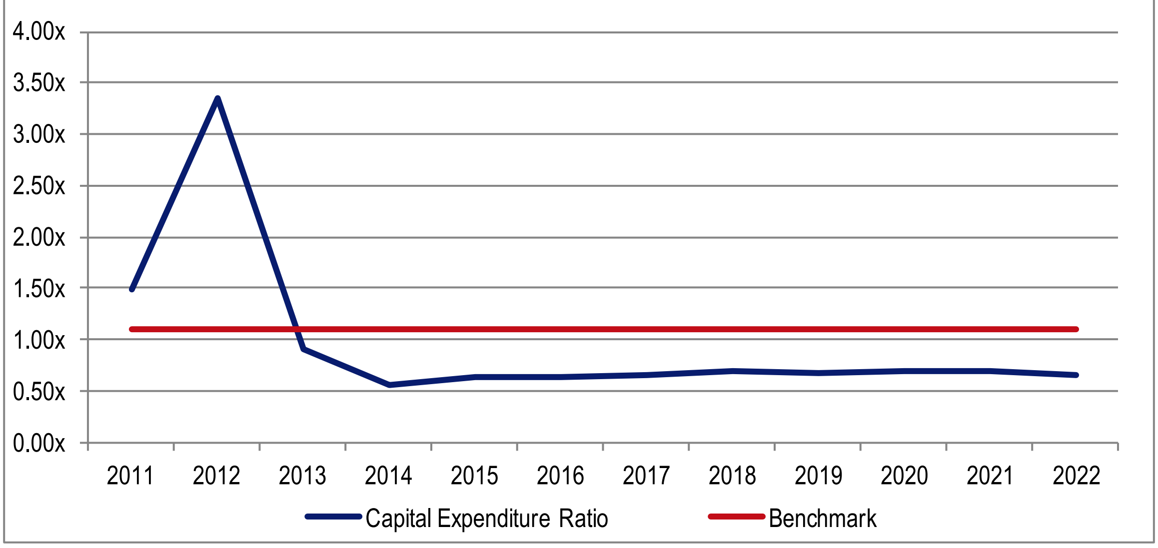
Figure 12 - Interest Cover Ratio for General Fund



The Interest Cover Ratio shows the Council has sufficient capacity to service scheduled debt commitments, including the LIRS loan.

4.3: Capital Expenditure

Figure 13 - Capital Expenditure Ratio for General Fund



The Capital Expenditure Ratio deteriorates over the initial years of the forecast period and is below the benchmark for most of the period due to falling capital expenditure and increasing depreciation costs. This suggests that the Infrastructure Backlog may continue to increase. This issue may be compounded if service level demands increase over the forecast period, which may happen given the forecast increases in mining activity and associated population over the period.

The spike in 2012 is as a result of significant flood restoration works in the LGA.

The total deficit figure for capital expenditure versus depreciation across the 10 year period amounts to $5.0m in nominal terms.

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>

- Forecasts in 2012 are affected by flood restoration works and capital works on the airport, swimming pool and various roads.
- Rates and annual charges are forecast to increase by 2.5% p.a. to 3.0% p.a. over the forecast, while user charges and fees are forecast to increase by 3.0% p.a. for the forecast period.
- Operating grants and contributions show large increases in 2013 and 2015 as contributions from mines for various projects impact revenues. Following the completion of the projects in 2014, operating grants decline by 22.2% then grow by 2.5% p.a. until 2019.
- Materials and Contract expenses fall by 32.5% in 2015 following the completion of projects. Growth of 3.0% p.a. is forecast thereafter.
- Employee Costs are forecast to grow by 3.0% p.a., which is in line with recent historical performance. Council is developing strategies to achieve efficiencies in respect of employee costs.
- Other expenses are forecast to grow by 3.5% p.a. over the forecast period.
- LTFP service levels are consistent with ongoing service levels and no reduction of service levels is forecast.

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4.5: Borrowing Capacity

When analysing the financial capacity of the Council we believe Council will not be able to incorporate additional loan funding in addition to the LIRS loan facilities. Council has minimal debt servicing abilities, as indicated by its relatively low forecast DSCR and Interest Cover Ratios, and EBITDA its forecast to fluctuate.

While Council do not forecast a liquidity issue, they may face funding difficulties for future capital projects. Council will need to consider future capital projects as they may be reliant on continuing contributions and operating grants.

Council may consider adjusting its capital expenditure program to an affordable level, source additional operating cash flow or reduce operating cash expense. This could allow additional borrowing to be considered.

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.

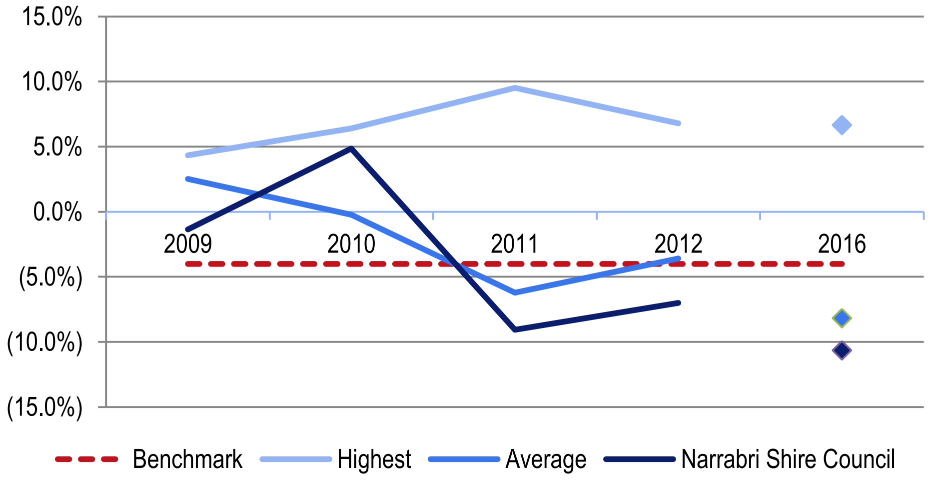
In Figure 14 to Figure 23, the graphs compare the historical performance of Council with the benchmark for that ratio, with the average for the Group, with the highest performance (or lowest performance in the case of the Infrastructure Backlog Ratio where a low ratio is an indicator of strong performance),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

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

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

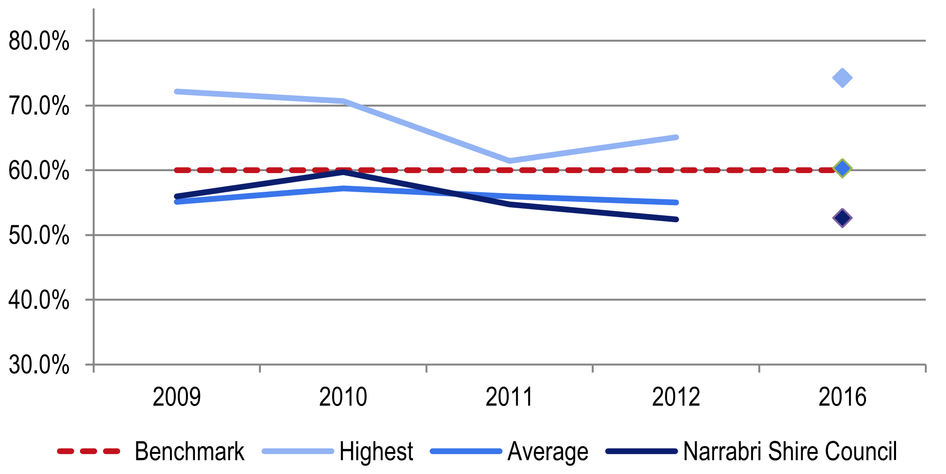
Financial Flexibility

Figure 14 - Operating Ratio Comparison



Council's Operating Ratio declined to be below the group average and benchmark in the last two years. The results are forecast to decline further in the medium term and remain below the group average and benchmark.

Figure 15- Own Source Operating Revenue Ratio Comparison



Council's Own Source Operating Revenue Ratio was below the group average and benchmark. The ratio is forecast to marginally decline in the medium term and remains below the group average and the benchmark.

Liquidity

Figure 16 - Cash Expense Ratio Comparison

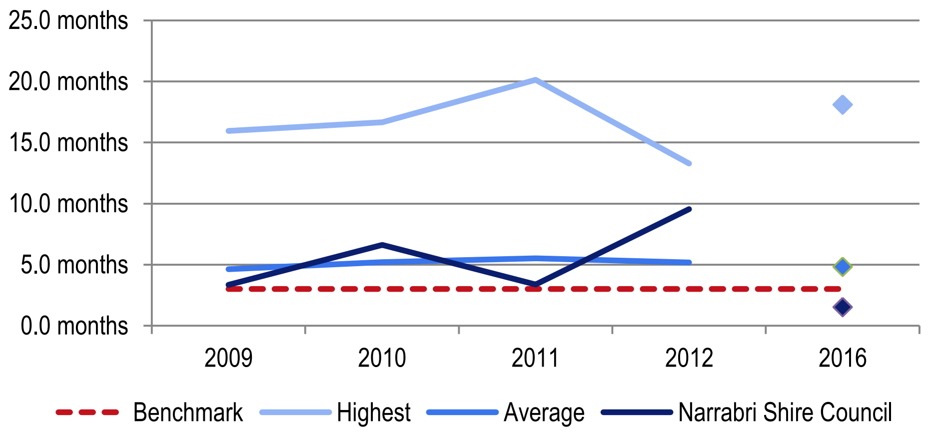
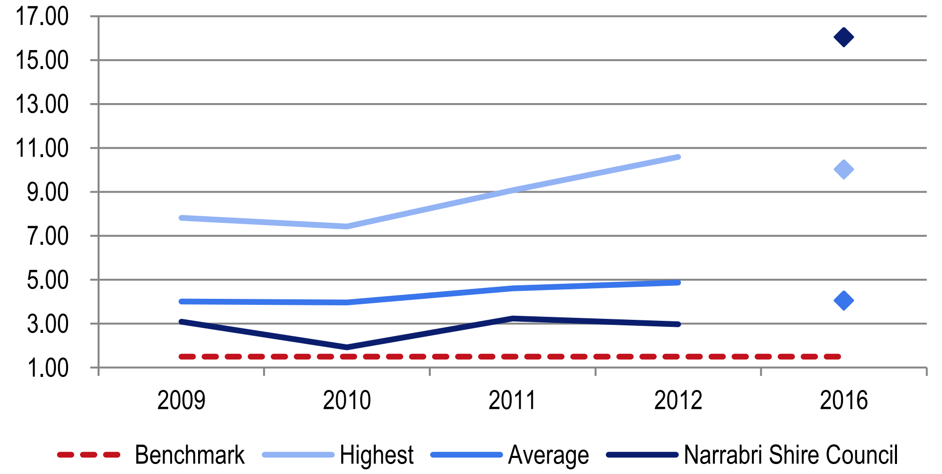


Figure 17 - Unrestricted Current Ratio Comparison



On average over the past four years, the Council's liquidity position has been sound as indicated by an above benchmark Unrestricted Current Ratio and this is forecast to improve in the medium term.

Debt Servicing

Figure 18 - Debt Service Cover Ratio Comparison

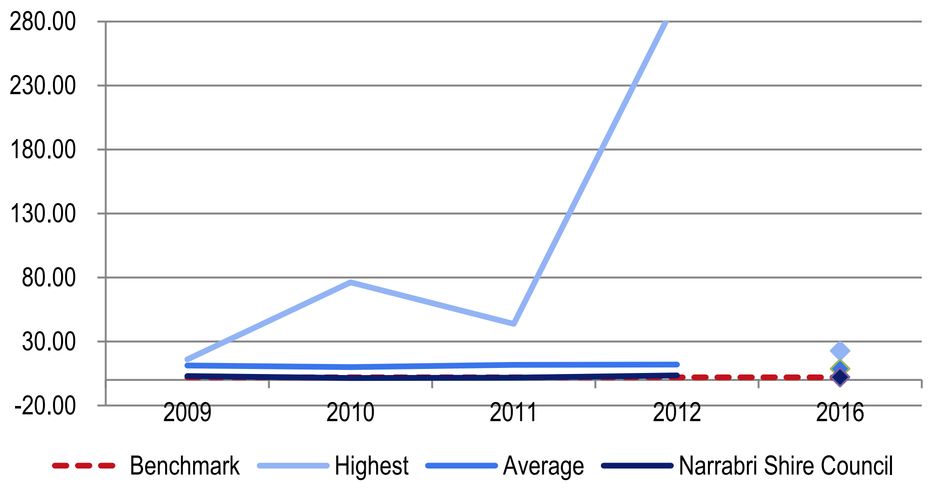
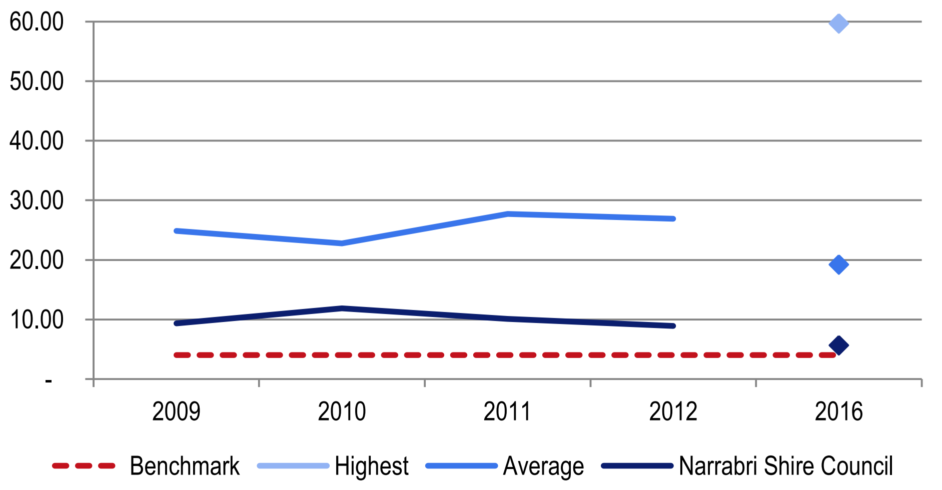


Figure 19 - Interest Cover Ratio Comparison



Over the review period, Council's DSCR was below the benchmark in two of the last four years and it was below the group average. Council's Interest Cover Ratio was above the benchmark but below the group average. These ratios are forecast to marginally decline to be in line with the benchmarks in the medium term.

Asset Renewal and Capital Works

Figure 20 - Capital Expenditure Ratio Comparison

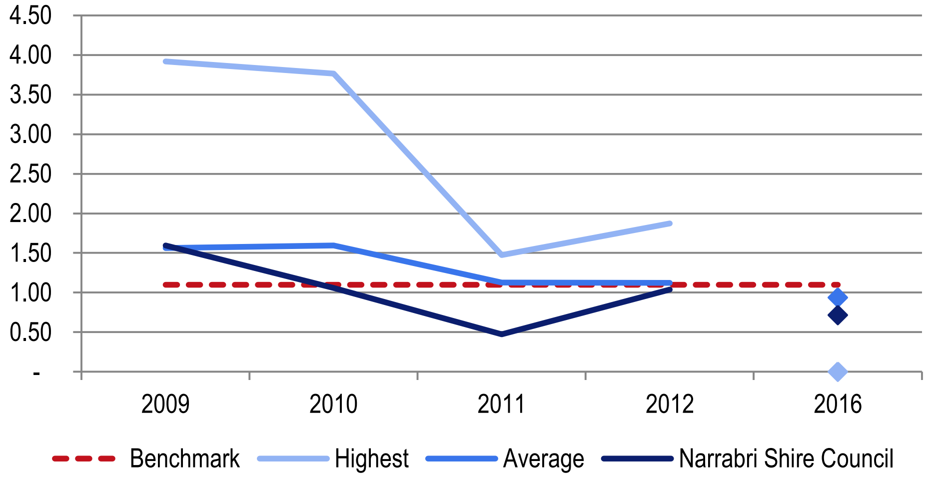


Figure 21 - Asset Maintenance Ratio Comparison

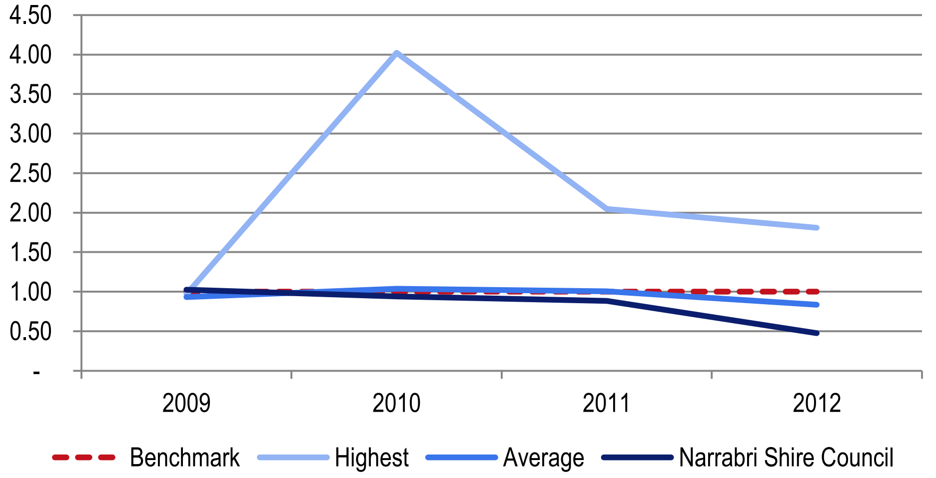


Figure 22 - Infrastructure Backlog Ratio Comparison

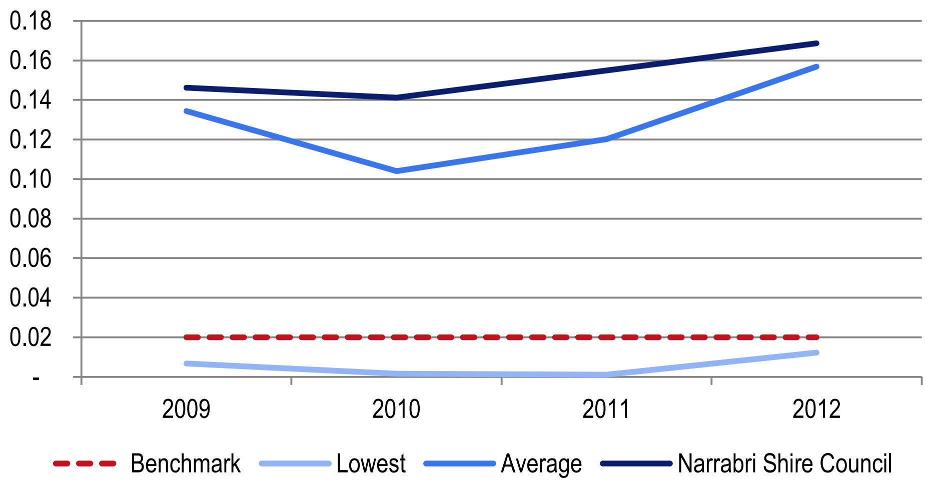
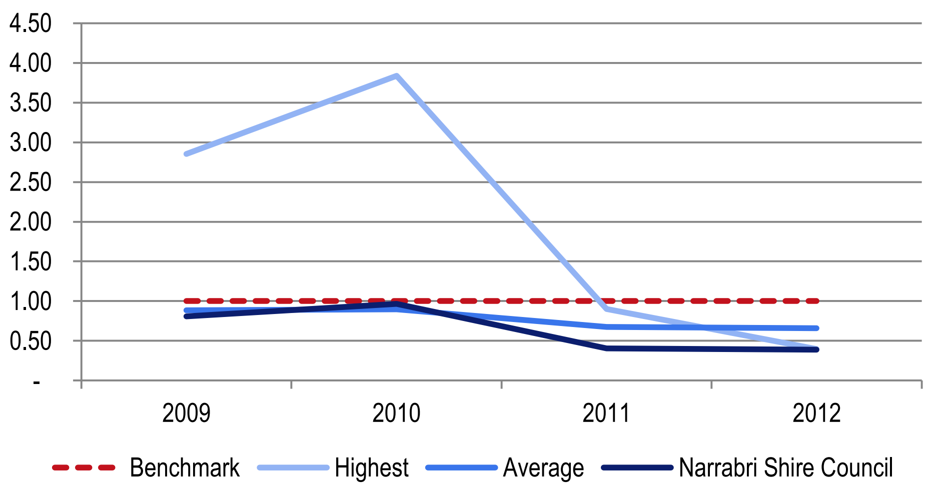


Figure 23 - Building and Infrastructure Asset Renewal Ratio



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

Council's Capital Expenditure Ratio, Asset Maintenance Ratio and Building and Infrastructure Asset Renewal Ratio declined over the period to be below the group averages and benchmarks.

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, albeit with long term sustainability issues.

We base our recommendation on the following key points:

- EBITDA has been increasing, driven by increases in rates, other revenues and operating grants
- Financial management and liquidity ratios are above benchmark and reflects Council's ability to satisfy obligations in the short term
- The project is being part funded by contributions from the mines. Given the projected increase in mining activity in the region and the expected increase in temporary and permanent residents, the aquatic centre upgrade is an important project for Council's service provision

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

- The Operating Ratio is forecast to be in deficit for all 10 years of the forecast, consistent with historical results. This level of operating deficit could impact the Council's long term financial sustainability
- Council's LTFP does not include sufficient capital expenditure to maintain its assets in a satisfactory condition. Council need to develop options for increasing revenues, reducing expenses and increasing funds available for maintenance/renewal of its asset base

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	14,516	13,762	12,510	5.5%	10.0%
User charges and fees	7,322	5,523	4,463	32.6%	23.8%
Interest and investment revenue	1,196	792	932	51.0%	(15.0%)
Grants and contributions for operating purposes	10,880	6,018	7,499	80.8%	(19.7%)
Other revenues	2,795	1,671	1,355	67.3%	23.3%
Total revenue	**36,709**	**27,766**	**26,759**	**32.2%**	**3.8%**
Expenses					
Employees	10,152	8,667	8,274	17.1%	4.7%
Borrowing costs	623	627	665	(0.6%)	(5.7%)
Materials and contract expenses	15,923	7,764	8,698	105.1%	(10.7%)
Depreciation and amortisation	8,986	5,447	5,921	65.0%	(8.0%)
Other expenses	4,354	3,913	3,564	11.3%	9.8%
Total expenses	**40,038**	**26,418**	**27,122**	**51.6%**	**(2.6%)**
Operating result (excluding capital grants and contributions)	**(3,329)**	**1,348**	**(363)**	(347.0%)	471.3%
Operating result (including capital grants and contributions)	**(118)**	**5,890**	**3,220**	(102.0%)	82.9%

Table 2 - Items excluded from Income Statement

Excluded items					
Grants and contributions for capital purposes	3,211	4,542	3,583	(29.3%)	26.8%
Fair Valuation movements in Investments	429	743	(586)	(42.3%)	N/A
Interest applicable on Interest Free Loan	(146)	899	0	(116.2%)	N/A
Net gain from the disposal of assets	(237)	(155)	0	(52.9%)	N/A

Table 3 - Balance Sheet

Balance Sheet ($'000s)	Year Ended 30 June			% annual change	
	2011	2010	2009	2011	2010
Current assets					
Cash and cash equivalents	8,534	11,209	5,728	(23.9%)	95.7%
Investments	12,750	1,916	4,175	565.4%	(54.1%)
Receivables	2,376	2,187	1,152	8.6%	89.8%
Inventories	1,750	1,910	1,231	(8.4%)	55.2%
Other	223	231	197	(3.5%)	17.3%
Total current assets	25,633	17,453	12,483	46.9%	39.8%
Non-current assets					
Investments	1,516	5,298	5,347	(71.4%)	(0.9%)
Receivables	598	571	573	4.7%	(0.3%)
Infrastructure, property, plant & equipment	214,680	201,430	196,429	6.6%	2.5%
Investment accounted for using the equity method	110	117	121	(6.0%)	(3.3%)
Total non-current assets	216,904	207,416	202,470	4.6%	2.4%
Total assets	**242,537**	**224,869**	**214,953**	7.9%	4.6%
Current liabilities					
Payables	2,132	1,769	1,811	20.5%	(2.3%)
Borrowings	911	2,758	473	(67.0%)	483.1%
Provisions	1,913	2,033	2,035	(5.9%)	(0.1%)
Total current liabilities	4,956	6,560	4,319	(24.5%)	51.9%
Non-current liabilities					
Borrowings	9,435	8,314	8,830	13.5%	(5.8%)
Provisions	141	109	100	29.4%	9.0%
Total non-current liabilities	9,576	8,423	8,930	13.7%	(5.7%)
Total liabilities	**14,532**	**14,983**	**13,249**	(3.0%)	13.1%
Net assets	**228,005**	**209,886**	**201,704**	8.6%	4.1%

Table 4-Cashflow

Cash Flow Statement ($'000s)	Year ended 30 June		
	2011	2010	2009
Cash flows from operating activities	10,836	9,613	8,536
Cash flows from investing activities	(12,639)	(6,657)	(8,806)
Proceeds from borrowings and advances	1,970	6,595	680
Repayment of borrowings and advances	(2,842)	(4,073)	(1,349)
Cash flows from financing activities	(872)	2,522	(669)
Net increase/(decrease) in cash and equivalents	**(2,675)**	**5,478**	**(939)**
Cash and equivalents	8,534	11,209	5,728

Appendix B Glossary

Asset Revaluations

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

Collateralised Debt Obligation (CDO)

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

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

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

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

Division of Local Government (DLG)

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

Depreciation of Infrastructure Assets

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

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

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

EBITDA

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

Grants and Contributions for Capital Purposes

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

Grants and Contributions for Operating Purposes

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

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

Independent Commission Against Corruption (ICAC)

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

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

Independent Pricing and Regulatory Tribunal (IPART)

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

Infrastructure Backlog

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

Integrated Planning and Reporting (IP&R) Framework

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

Local Government Cost Index (LGCI)

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

Net Assets

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

Roads and Maritime Services (RMS)

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

Section 64 Contribution

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

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

Section 94 Contribution

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

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

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

Special Rate Variation (SRV)

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

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

The applications are reviewed and approved by IPART.

Ratio Explanations

Asset Maintenance Ratio

Benchmark = Greater than 1.0x

Ratio = actual asset maintenance / required asset maintenance

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

Building and Infrastructure Renewals Ratio

Benchmark = Greater than 1.0x

Ratio = Asset renewals / depreciation of building and infrastructure assets

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

Cash Expense Cover Ratio

Benchmark = Greater than 3.0 months

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

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.