New South Wales
Treasury Corporation

Gunnedah Shire Council

Financial Assessment, Sustainability and Benchmarking Report

8 March 2013

Prepared by NSW Treasury Corporation for Gunnedah Shire Council, the Division of Local Government and the Independent Local Government Review Panel.

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 to assist the DLG and the Independent Local Government Review Panel in its consideration of the Sustainability of each local government area in NSW.

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.

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The report has been prepared for Gunnedah Shire Council, the DLG and the Independent Local Government Review Panel. TCorp shall not be liable to Gunnedah 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.

New South Wales
Treasury Corporation

Index

Section 1 Executive Summary

This report provides an independent assessment of Gunnedah Shire Council's (the Council) financial capacity, and its future Sustainability. 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.

TCorp's approach has been to:

- Review the most recent four years of Council's consolidated financial results
- Conduct a detailed review of the Council's 10 year financial forecasts, with a particular focus on a council's General Fund. Where a council operates a Water or other Fund the financial capacity of these other Funds may be reviewed where considered necessary.

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

- Since 2010, Council has been reporting operating surpluses excluding capital grants and contributions. Council's underlying results (measured using EBITDA) increased by $4.4m between 2009 and 2012 to $10.7m
- Over the review period, Council had sufficient liquidity to meet its short term liabilities

Over the review period, Council had a moderate level of borrowings ($1.8m in 2012, being 0.6% of the Net Assets) and had flexibility in regard to carrying more long term debt.

Over the past four years, Council has reported in Special Schedule 7 only the items which were publicly reported as being in need of immediate maintenance to bring up to a satisfactory condition ($1.6m in 2009, $0.5m in 2010 and $0.3m in 2012). Following the development of their AMP, the value of the Backlog has been estimated at $25.7m. Over the review period, Council spent the required amounts on maintenance on assets that were publicly reported as in need of immediate maintenance. In the AMP, the required maintenance levels have also been reviewed and their estimates are higher compared to the historical levels.

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

- TCorp has based its analysis on a scenario where the operating income remains in line with the rate peg ('current income' scenario). This scenario assumes that existing service levels to the community are maintained and that the necessary expenditure is being spent to maintain the infrastructure in satisfactory condition. This scenario was developed by Council in order to highlight the limits of the current revenue base to cover the infrastructure expenditure presented as necessary in the AMP
- In conducting our analysis TCorp has also considered the 'sustainable services' scenario that has been developed by Council and approved by its community. Council intends lodging with IPART an application for an SRV that will assist in addressing its major areas of concern in terms of asset condition
- Operating performance is forecast to remain at satisfactory levels, the Operating Ratio being above TCorp's benchmark each year between 2013 and 2022. However, operating deficits (excluding capital grants and contributions) are forecast each year

New South Wales
Treasury Corporation

- Overall, Council's level of fiscal flexibility will remain sound. Operating grants and contributions are forecast to represent approximately one third of Council's operating revenue.
- Due to high levels of capital expenditure forecast between 2014 and 2016 in particular, Council's cash reserves will decrease substantially which will impact Council's ability to service its short term liabilities. However, this would not be the case under Council's adopted 'Sustainability' model which requires the approval of an SRV by IPART.
- In its base case scenario, Council does not forecast to add further borrowings in the period between 2013 and 2022, and will have sufficient capacity to service its exciting debt commitments. Under Council's 'Sustainability' model it proposes to take out new debt funding of $11.0m over the next 10 years
- The level of capital expenditure is forecast to meet the asset renewal benchmark indicating that assets should be kept in satisfactory condition

Based on its credit metrics of DSCR and Interest Cover Ratio, Council could have the capacity to undertake additional borrowings. However, the forecasts show consistent operating deficits when capital grants and contributions are excluded and liquidity pressures between 2013 and 2022. In TCorp's view, it would be prudent for Council to wait for the outcome of its SRV application with IPART prior to considering any further borrowings.

TCorp believes Council to be currently moderately Sustainable but facing increasing pressures particularly due to the condition of its assets. Council reported operating surpluses when capital grants and contributions are excluded in three of the past four years. The AMP has highlighted that Council needs to undertake extensive maintenance and renewal works in order to prevent its asset base from deteriorating to critical levels. It appears that based on the current projected income levels, Council cannot comply with these infrastructure funding requirements without weakening its cash position. However, the 'Sustainability' model constructed and adopted by Council shows that Council would be able to fund all of the required infrastructure expenditure and maintain both sound operating results and cash position.

In respect of the long term Sustainability of the Council our key observations are:

- Over the past four years and prior to the development of AMP, Council appears to have spent the required amounts on renewal of building and infrastructure assets in 2010 and 2012, and the required amounts on capital expenditure each year with the exception of 2011. However, the recent development of AMP have highlighted that the assets needed extensive works in order to be maintained in satisfactory condition which require high levels of expenditure in the short to medium term.
- In recent months, Council has been proactive in seeking solutions to ensure its long term Sustainability. Council decided, in consultation with its community, to apply for a multi-year SRV starting in 2014. The 'sustainable services' scenario of the LTFP adopted by Council shows that with the SRV Council could generate operating surpluses when capital grants and contributions are excluded and maintain strong cash reserves while spending the required amounts on capital expenditure to maintain its assets in satisfactory condition. In addition, Council could take a more balanced funding position through the increased use of loan funding to facilitate greater inter-generational equity.

In respect of our Benchmarking analysis we have compared the Council's key ratios with other councils in DLG Group 11. Our key observations are:

- Council's financial flexibility as indicated by the Operating Ratio and Own Source Operating Revenue Ratio has generally been higher than the group average over the review period. In the medium term, Council's Operating Ratio is forecast to decline but to remain sound, outperforming both the benchmark and the peer group
- Council's liquidity position has remained sound over the review period. Council's Unrestricted Current Ratio has been above the group average since 2010. In the medium term, Council's liquidity position is forecast to substantially deteriorate (both of Council's liquidity ratios being below the benchmark and group average) due to Council investing substantial amounts on capital expenditure
- Council's debt servicing position has been sound aver the review period and has generally outperformed the group average
- Since 2011, Council's level of Infrastructure Backlog has been below the group average. Council's performance in terms of maintenance of assets and renewal of assets has generally been higher than the group's average levels over the review period. Council's Capital Expenditure Ratio was consistently below the peer group and is forecast to improve in the medium term, outperforming the benchmark and the group average

Section 2 Introduction

2.1: Purpose of Report

This report provides the Council with an independent assessment of their financial capacity, Sustainability and performance measured against a peer group of councils. It will complement their internal due diligence, and the IP&R system of the Council and the DLG, together with the work being undertaken by the Independent Local Government Review Panel.

The report is to be provided to the DLG and the Independent Local Government Review Panel.

The key areas focused on are:

- The financial capacity of the Council
- The long term Sustainability of the Council
- 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 four 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 Council's General Fund
- Identify significant changes to future financial forecasts from existing financial performance and highlight risks associated with such forecasts, including those that could impact Council's Sustainability
- 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 and achieve long term Sustainability
- Conduct a high level review of the Council's IP&R documents for factors which could impact the Council's financial capacity, performance and Sustainability

In undertaking its work, TCorp relied on:

- Council's audited financial statements (2008/09 to 2011/12)
- Council's financial forecast model
- Council's IP&R documents
- Discussions with Council officers
- Other publicly available information such as information published on the IPART website

In completing the report, TCorp worked closely with Council management to analyse and understand the information gathered. The Council was given a draft copy of the report for their review and comment. Based on our discussions with Council:

- Council agrees with the findings of the report
- Council lays stress on the fact that the study has been undertaken using an informing model from Council's LTFP which was constructed to show the inadequacy of Council's historical income levels when fully addressing the Sustainability of its assets into the future. This model has not been adopted by Council and its community. The community of Gunnedah chose to adopt the 'Sustainability' model which is reliant on a pending SRV application in future years

Definition of Sustainability

In conducting our reviews, TCorp has relied upon the following definition of sustainability to provide guidance:

"A local government will be financially sustainable over the long term when it is able to generate sufficient funds to provide the levels of service and infrastructure agreed with its community."

Benchmark Ratios

In conducting our review of the Councils' financial performance, forecasts and Sustainability 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
Building and 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

Gunnedah Shire Council LGA	
Locality & Size	
Locality	Northern
Area	4,994.0km^2
DLG Group	11
Demographics	
Population as at 2011	12,066
% under 18	28.0%
% between 18 and 59	47.8%
% over 60	24.2%
Expected increase in population between 2013 and 2022	0.5% p.a.
Operations	
Number of employees (FTE)	163
Annual revenue	$34.7m
Infrastructure	
Roads	1,348.3 km
Bridges	54
Infrastructure backlog value	$0.3m
Total infrastructure value	$257.9m

Gunnedah Shire Council Local Government Area (LGA) is located in the North West Slopes region of New South Wales. The LGA is adjacent to the Liverpool Plains in the Namoi River valley and is traversed by the Oxley Highway and the Kamilaroi Highway.

The Shire includes the towns of Gunnedah, Curlewis, Breeza, Carroll, Mullaley, Emerald Hill, Tambar Springs and Kelvin. Over 75.0% of the Shire population live in Gunnedah or Curlewis.

Since 2008, the population has consistently increased at an approximate rate of 1.0% p.a. The median age is 40 years old. Council approved a significant number of new dwelling applications. In addition, the pending opening of two major mines within two or three years is forecast to create several hundred new direct employment opportunities. Council has modelled all of its plans around a 0.5% increase in each year for the next 10 years.

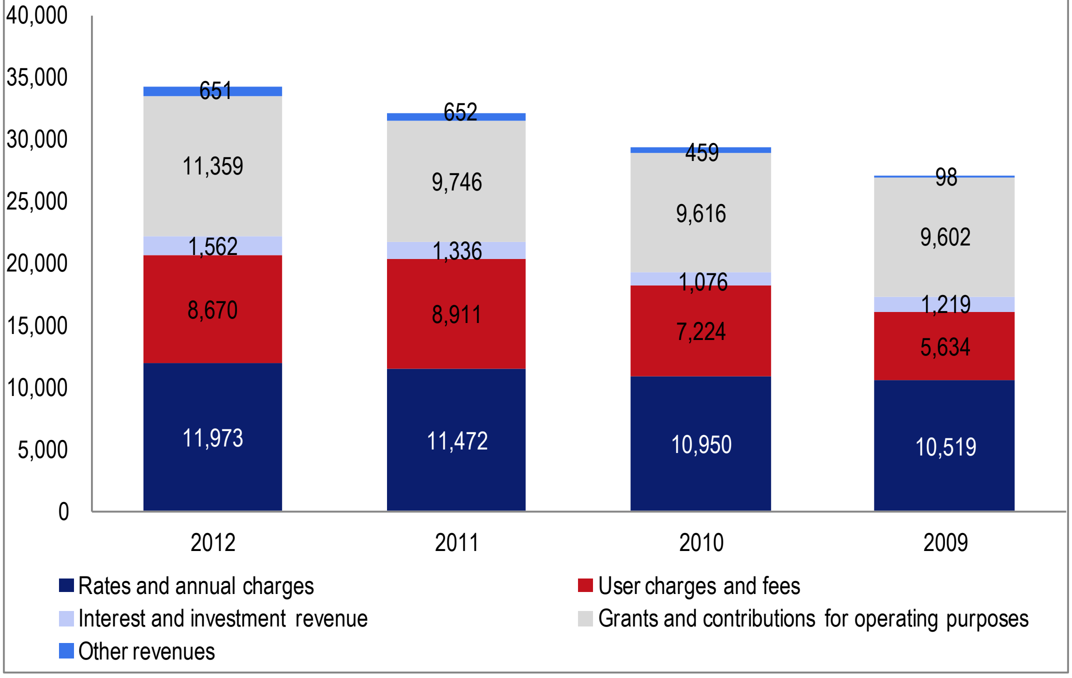
The LGA's main industries include agriculture, coal mining and coal seam gas exploration. Gunnedah Saleyards are one of the top four in New South Wales, yarding over 120,000 prime beef cattle p.a. The mining activity includes six open cut mines.

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 2011/12 ($'000s)



Key Observations

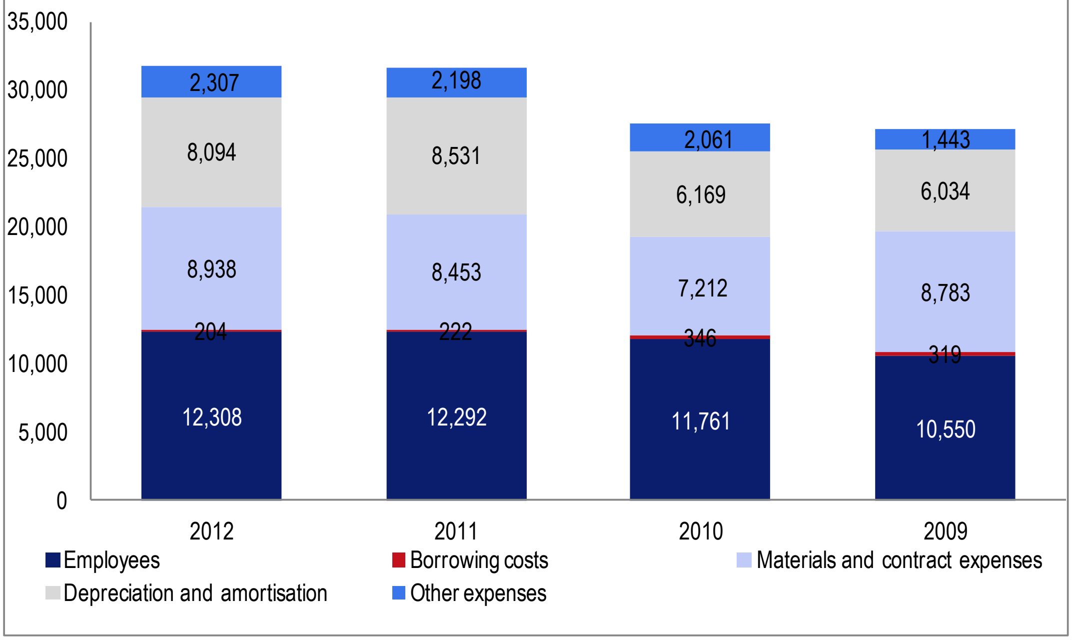
- Rates and annual charges increased by 4.1% in 2010, 4.8% in 2011, and 4.4% in 2012 to $12.0m. Mining rates, domestic waste management charges and sewerage charges increased by a total of $1.3m over the review period. The increase in mining rates was due to a rating mix strategy decision: Council increased these rates in order to give relief to the farming, business and residential sectors. The increases in waste and sewer charges were aimed at boosting the operating results and building cash levels that would cover the prevailing expenditure requirements for these funds. Over the review period, Council generated operating surpluses in the Water Fund which increased from $0.9m in 2009 to $1.0m in 2012. Since 2010, Council has generated operating surpluses in the Sewer Fund that increased from $0.2m in 2010 to $0.8m in 2012.
- User charges and fees increased by 53.9% ($3.0m) over the review period to $8.7m. They increased substantially between 2009 and 2011 particularly (28.2% increase in 2010, 23.4% in 2011) due to important increases in RMS charges and private works. RMS charges increased by $0.5m in 2010 and $1.2m in 2011 to $3.4m. Private works increased by $0.6m

each year in 2010 and 2011 to $1.3m. In 2012, user charges and fees decreased by $0.2m, mainly due to a decrease of $0.4m in private works to $1.0m.

- Operating grants and contributions remained relatively static between 2009 and 2011. In 2012, they increased by 16.6% ($1.6m) to $11.4m. This was mainly due to the Federal Government's decision to prepay in 2012 half ($2.0m) of the 2013 Financial Assistance Grants (FAG). In addition, community care and transport grants for other roads and bridges funding both increased by $0.4m amounting to $3.5m and $0.9m respectively in 2012 while other grants such as Roads to Recovery decreased by $0.3m to $0.5m.
- Other revenues increased by $0.6m over the review period to $0.7m. In 2010, they increased by $0.4m to $0.5m mainly due to the sales revenue from various kiosks across Council (located in swimming pools, theatre and other touristic locations) that were previously reported in user charges and fees; they amounted to $0.3m in 2010. Other revenues increased by $0.2m in 2011 and remained static in 2012.

3.2: Expenses

Figure 2 - Expenses for 2008/09 to 2011/12 ($'000s)



Key Observations

- Over the review period, number of equivalent full time employees including vacancies increased from 167 to 171 employees. Employee costs increased by 11.5% in 2010 and 4.5% in 2011 to $12.3m reflecting the increase in staff numbers as well as increases in awards and competency. In 2012, employee costs remained relatively static.
- Materials and contracts costs increased by 1.8% over the review period to $8.9m. They decreased by 17.9% ($1.6m) in 2010 and increased by 17.2% ($1.2m) in 2011 to $8.5m due to a significant move towards increased works and contracts being undertaken by staff as

opposed to contracting works. Materials and contracts costs increased by 5.7% ($0.5m) in 2012 to $8.9m due to additional works carried out under the State roads contract and due to increased costs of materials.

- Due to the Asset Revaluations process, annual depreciation expense increased by 34.1% ($2.1m) over the review period to $8.1m, peaking at $8.5m in 2011 as most of the revaluations were undertaken during the previous financial year.
- Other expenses increased by $0.9m over the review period to $2.3m. In 2012, electricity and heating, and insurance were the main contributors, amounting to $0.6m and $0.5m respectively.

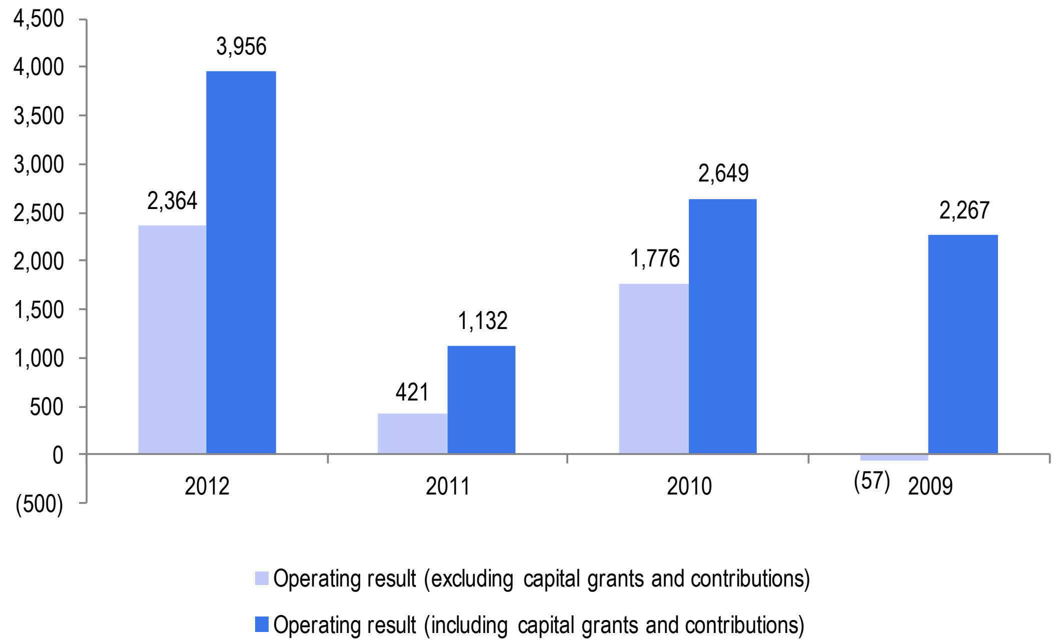
3.3: Operating Results

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 2011/12 ($'000s)



Key Observations

- Council has consistently reported operating surpluses (excluding capital grants and contributions) since 2010. In 2010, Council's operating revenue was boosted by increases in user fees and charges. In 2011, the operating surplus decreased by $1.4m to $0.4m due to a substantial increase in depreciation. In 2012, Council's operating surplus increased by $1.9m to $2.4m, favourably impacted by the increase in operating grants and contributions.
- Council expenses include a non-cash depreciation expense, ($8.1m in 2012), which has substantially increased since 2009. Whilst the non cash nature of depreciation can favourably impact on ratios such as EBITDA that focus on cash, depreciation is an important expense at it represents the allocation of the value of an asset over its useful life.
- Council's operating results including capital grants and contributions were consistently high over the review period, peaking at $4.0m in 2012. Over the review period, Council was in receipt of several developer contributions for water, sewerage and stormwater purposes in particular.

3.4: Financial Management Indicators

Performance Indicators	Year ended 30 June			
	2012	**2011**	**2010**	**2009**
EBITDA ($'000s)	10,662	9,174	8,291	6,296
Operating Ratio	6.9%	1.3%	6.1%	(0.2%)
Interest Cover Ratio	52.26x	41.32x	23.96x	19.74x
Debt Service Cover Ratio	16.84x	13.96x	10.53x	8.24x
Unrestricted Current Ratio	5.12x	5.57x	4.02x	3.63x
Own Source Operating Revenue Ratio	57.7%	62.1%	60.2%	54.9%
Cash Expense Ratio	1.1 months	0.7 months	7.8 months	5.9 months
Net assets ($'000s)	312,444	293,844	272,220	178,601

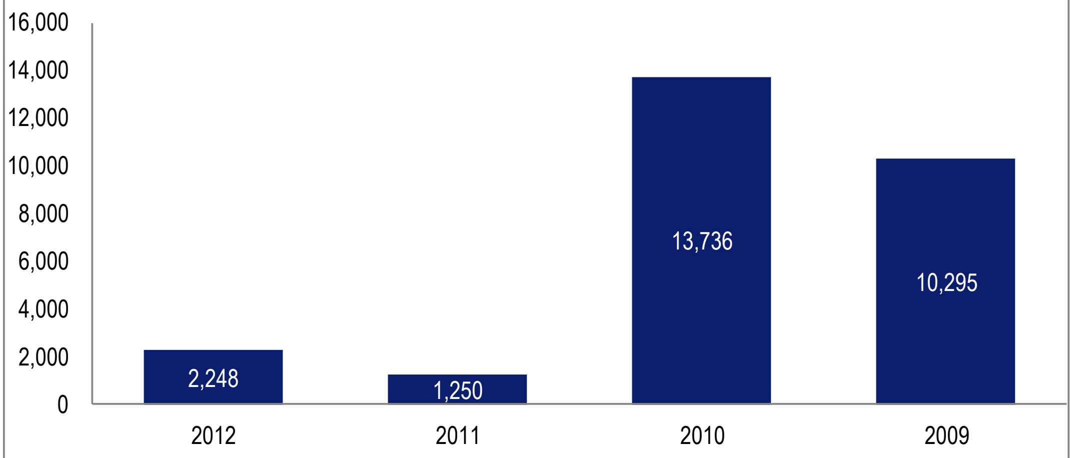
Key Observations

- Council's operating performance has been sound over the review period. The Operating Ratio was consistently above the benchmark while Council's EBITDA increased by $4.4m between 2009 and 2012 to $10.7m.
- Council's Interest Cover Ratio and DSCR indicate that they had some flexibility in regard to carrying more debt. The DSCR has been above the benchmark of 2.00x over the past four years.
- Council had total borrowings of $1.8m outstanding in 2012, being 0.6% of Net Assets.
- The Unrestricted Current Ratio has been above the benchmark of 1.50x over the past four years indicating Council had sufficient liquidity to meet its short term liabilities.
- The Own Source Operating Revenue Ratio was above the benchmark of 60.0% in two of the past four years (2010 and 2011). In 2009 and 2012, the ratio was below the benchmark due to high levels of capital and operating grants received these years. Council officers have indicated that Council auspices on behalf of both the state and federal governments a large scale community care (aged services) department that services the region including Tamworth, Narrabri, Moree and other locations outside of Gunnedah. These services are entirely grant funded and without such they would not be undertaken by Council as they do not fall under the responsibility of local government. Council currently auspices such to provide employment opportunities into the community. These operating grants totalled $2.8m in 2009, $3.0m in 2010, $3.1m in 2011 and $3.5m in 2012. When these grants are excluded, the Own Source Operating Ratio is above the benchmark of 60.0% in each of the past four years, indicating Council has financial flexibility.
- Between 2009 and 2010, the Cash Expense Ratio was above the benchmark of three months. Since 2011, the ratio has been below the benchmark of three months as Council invested its cash in term deposits with more favourable interest rates. In 2012, Council had term deposits amounting to $24.3m classified as investments which indicate Council had sufficient liquidity.
- Net Assets increased by $133.8m between 2009 and 2012 due to the Asset Revaluations that increased the value of roads, bridges, footpaths, and drainage assets, and reduced the value of community land assets.

- The Asset Revaluations over the last four 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.
- When the Asset Revaluations are excluded, the underlying trend in all four years has been a marginally expanding infrastructure, property, plant, and equipment (IPP&E) asset base with asset purchases being larger than the combined value of disposed assets and annual depreciation. Over the four years, this amounted to a $3.3m increase in IPP&E assets.

3.5: Statement of Cashflows

Figure 4 - Cash and Cash Equivalents for 2008/09 to 2011/12 ($'000s)



Key Observations

- While cash and cash equivalents decreased by $8.0m over the review period to $2.2m, total cash and investments increased by $9.6m to $32.3m. Since 2011, Council's cash and cash equivalents have substantially decreased due to Council investing its cash in term deposits with more favourable interest rates.
- In 2012, Council had cash and investments amounting to $32.3m (including $2.2m in cash), of which $18.9m was externally restricted, $9.9m was internally restricted, and $3.5m was unrestricted.
- In 2012, the investment portfolio was comprised of term deposits amounting to $24.3m, equity linked notes worth $4.8m and floating rates notes amounting to $0.9m.
- Prior to the Global Financial Crisis, Council invested in managed funds and CDO's. The value of managed funds decreased from $3.5m in 2009 to $2.2m in 2011 while CDO's were worth $0.5m in 2009. Council disposed of these securities in 2012 and 2010 respectively. Council officers have indicated that Council received the full face value as well as interest return on both products.

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

Over the past four years, Council reported in Special Schedules 7 the items which were publicly reported to Council as being in need of immediate maintenance to bring up to a satisfactory condition ($1.6m in 2009, $0.5m in 2010 and $0.3m in 2012). Through the recent development of Council's AMP for all classes of assets, the backlog has been reviewed and its value was estimated at $25.7m. This data being now publicly available, it will be listed in Special Schedule 7 in future years directly in-line with the AMP data.

3.6(b): Infrastructure Status

Infrastructure Status	Year ended 30 June			
	2012	2011	2010	2009
Bring to satisfactory standard ($'000s)	25,700	N/A	N/A	N/A
Required annual maintenance ($'000s)	5,966	5,097	5,034	6,431
Actual annual maintenance ($'000s)	6,045	6,277	5,330	6,192
Total value of infrastructure assets ($'000s)	257,901	249,062	234,837	142,926
Total assets ($'000s)	321,967	303,276	284,425	189,909
Building and Infrastructure Backlog Ratio	0.10x	0.10x	0.11x	0.18x
Asset Maintenance Ratio	1.01x	1.23x	1.06x	0.96x
Building and Infrastructure Renewals Ratio	1.16x	0.85x	1.43x	0.58x
Capital Expenditure Ratio	1.11x	0.67x	1.45x	1.41x

- The value of the actual backlog has not been reported over the past four years. For the purposes of comparative analysis, TCorp has used the value of the actual backlog of $25.7m as recently estimated through the AMP. Based on that estimate, the Building and Infrastructure Backlog Ratio was consistently above the benchmark of 0.02x over the review period. The ratio decreased over time due to the increase in the value of infrastructure assets following the Asset Revaluations.
- The Asset Maintenance Ratio has consistently been above the benchmark of 1.00x since 2010, indicating spending on maintenance on assets that were publicly reported as requiring maintenance has been sufficient. The required maintenance levels indicated in the AMP are higher in 2013, and have been estimated at $8.6m for roads, $0.7m for buildings, $1.7m for sewer assets and $2.6m for water assets. The reported Asset Maintenance Ratio is skewed upwards because it does not include all required maintenance and only publicly reported items.

- The Building and Infrastructure Renewals Ratio was above the benchmark in 2010 and 2012, indicating spending on asset renewal was sufficient those years. In 2012, the Building and Infrastructure Renewal Ratio was above the Capital Expenditure Ratio due to Council undertaking more asset renewals ($7.2m) than addition of new assets ($2.3m).
- The Capital Expenditure Ratio was above the benchmark of 1.10x each year with the exception of 2011, indicating that spending on renewal and addition of assets was sufficient those years.

In order to undertake the necessary maintenance, replacement and upgrade of assets as highlighted by the AMP, Council made a formal notification to IPART of its intention to apply for a SRV in the general rate component of 16.0% in 2014, and a further 6.0% each year in 2015 and 2016 (making the actual increase in total ordinary rates including the rate peg of approximately 19.0% in 2014 and, 9.0% in 2015 and 2016).

Council officers indicated that Council adopted this proposal in consultation with its community to work towards keeping all of its assets in satisfactory conditions as well as maintaining the service levels to current standards. In order to do so, Council chose to apply for an SRV which was agreed by the community and was the preferred option.

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			
	2012	**2011**	**2010**	**2009**
New capital works	2,257	1,109	3,619	1,724
Replacement/refurbishment of existing assets	7,189	5,546	5,685	4,941
Total	**9,446**	**6,655**	**9,304**	**6,665**

Over the review period, Council undertook several capital projects including:

- Initial stages of improvements of the Namoi River Parklands (with a focus on Donnelly Fields, upgrades of parklands access, environmental enhancement and water quality improvements)
- Improvement to Council's urban and rural road networks including reconstruction works in George Street, completion of the sealed pavement on Preston and isolated renewals on the Bluevale Road, Quia Road and Wandobah Road
- Extension of the cycleway network along Wondobah Road
- Renewal of sewer main by insitu relining and water main replacements
- Completion of stormwater pipelines
- Improvement of village amenities (improvement to the hall, park and other facilities in Breeza and Tambar Springs)
- Improvement of local parks and amenities (including installation of fitness gym equipment in the Stock Road median and replacement of outdated play equipment)

3.7: Specific Risks to Council

- Infrastructure funding requirements. Many of Council's assets such as roads, stormwater infrastructure and other assets are deteriorating and require high levels of maintenance, upgrade and renewal that Council cannot totally cover with its current income structure. Council is in the process of lodging an application for a three-year SRV starting in 2014. The approval for the SRV in full is important in order for Council to be able to maintain its assets in satisfactory condition.
- Maturity of Council's asset management data. As indicated in the Asset Management Strategy, infrastructure assets such as roads, drains, bridges, water, sewerage and public buildings present particular challenges as their condition and longevity can be difficult to determine. Through the development of Asset Management Plans, Council has a more accurate picture of the current condition of its assets. The accuracy of the asset management data is essential in order for Council to be able to plan for large peaks and troughs in expenditure for renewing and replacing its assets.
- Changes in the mining and gas industries. The mining and gas industries contribute millions of dollars annually to LGA's economy and provide an important source of employment to the population. Any changes in the major mining and gas extraction industries in the Gunnedah basin as well as any changes in the agreements that Council negotiates with these companies can be considered as a challenge. Council officers have indicated that major mining companies such as BHP and Shenhua are currently in the process of obtaining mining licences in the Gunnedah LGA which will have a major impact on the demand for Council services and resources. The ability to negotiate planning agreements and other commercial agreements with these companies that are sufficient to fund any increased impost is paramount to the future financial Sustainability of Council. Any shortfall in these agreements in comparison to the increased cost burden would put significant pressure on Council's finances and its long term financial Sustainability at risk.

New South Wales
Treasury Corporation

Section 4 Review of Financial Forecasts

The financial forecast model shows the projected financial statements and assumptions for the next 10 years. We have focused our financial analysis upon the General Fund as although Council's consolidated position includes both a Water and Sewer Fund these are operated as independent entities, which unlike the General Fund are more able to adjust the appropriate fees and charges to meet all future operating and investing expenses.

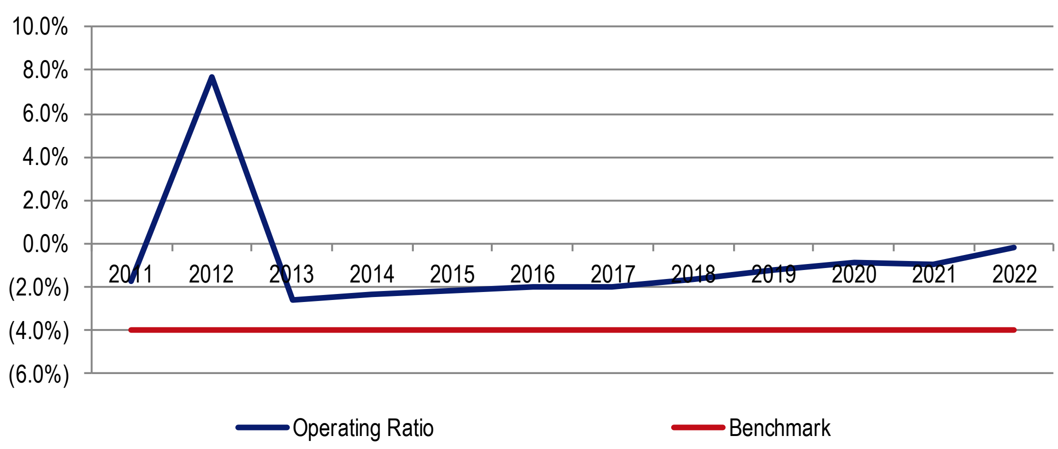
In its preliminary work to develop its LTFP, Council has established four scenarios which model incrementally its forecast financial performance between 2013 and 2022. These scenarios are structured in layers (current income, sustainable services, service and asset expansion, new assets and services) where each layer incorporates the previous one. Council has adopted the second scenario ('sustainable services') which includes SRV's in 2014, 2015 and 2016. Council is currently reconstructing all of its IP&R documents including the LTFP that will be adopted by Council on the 30th of January. These plans will form the base of the application to IPART.

When reviewing Council's forecast financial position, TCorp based its analysis on the 'current income' scenario of the LTFP where the rate growth is limited to the rate peg as these SRV's have not been granted yet. This scenario highlights the pressures that Council will face when maintaining its current service levels as well as its assets in adequate conditions without increasing its income.

TCorp notes that this 'current income' scenario is not Council's preferred scenario and they are proactively seeking an improved outcome via applying for three SRV's in 2014, 2015 and 2016.

4.1: Operating Results

Figure 7- Operating Ratio for General Fund



The Operating Ratio is above the benchmark each year of the forecast, indicating that Council's operating performance will remain at satisfactory levels. However, operating deficits are reported each year when capital grants and contributions are excluded (these deficits amount approximately to $0.6m between 2013 and 2018 decreased to $0.1m in 2022).

In 2012, the ratio was skewed upwards due to high levels of operating grants and contributions received following the prepayment of 2013 FAG.

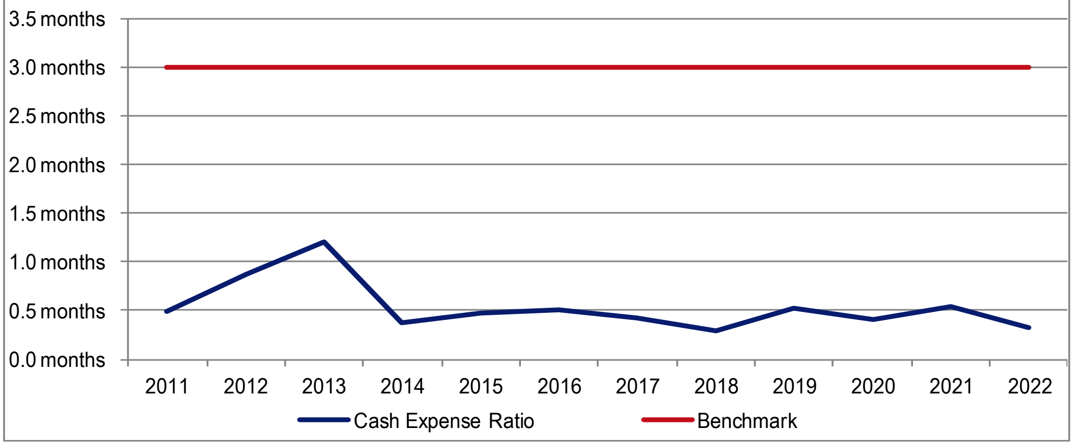
The ratio drops in 2013 due to a decline in total revenue following forecast decreases in user charges and fees and, operating grants and contributions.

From 2014 onwards, the ratio slightly improves as operating revenue is forecast to increase at greater rates than operating expenses.

4.2: Financial Management Indicators

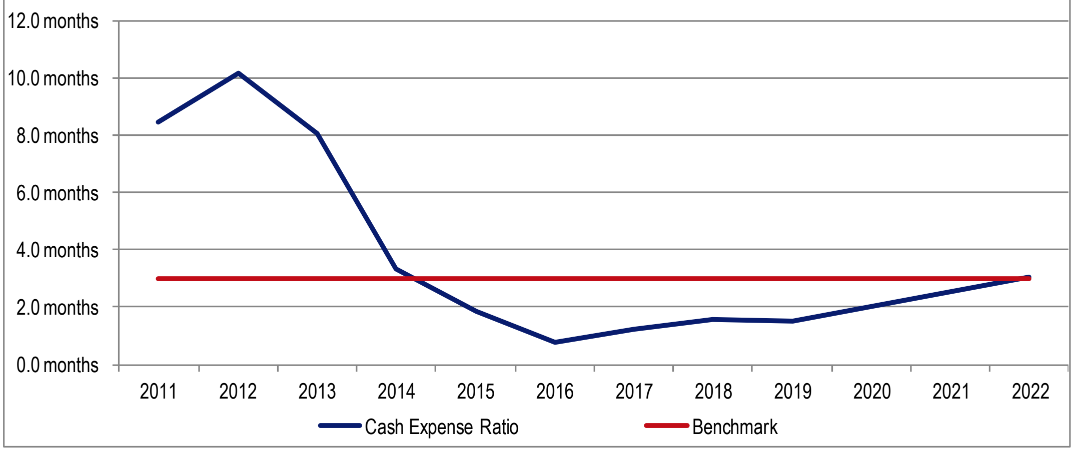
Liquidity Ratios

Figure 8 - Cash Expense Ratio for General Fund



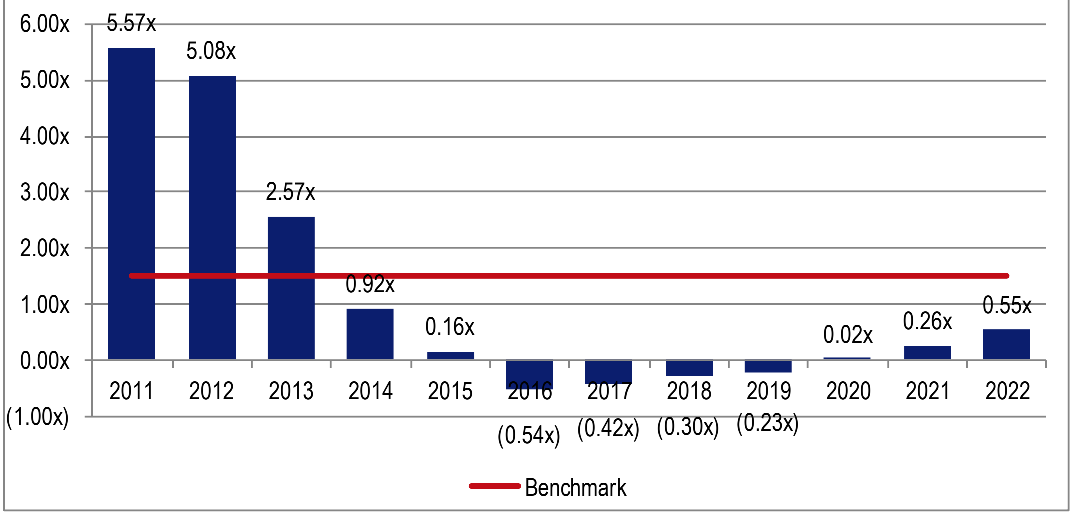
The Cash Expense Ratio is approximately nil for the 10 upcoming years due to Council maintaining the majority of its cash reserves in cash investments.

Figure 8a - Cash Expense Ratio for General Fund (including current and non-current investments)



When investments are included, the Cash Expense Ratio remains below the benchmark of three months between 2015 and 2021, indicating Council will have limited liquidity.

Figure 9 - Unrestricted Current Ratio for General Fund

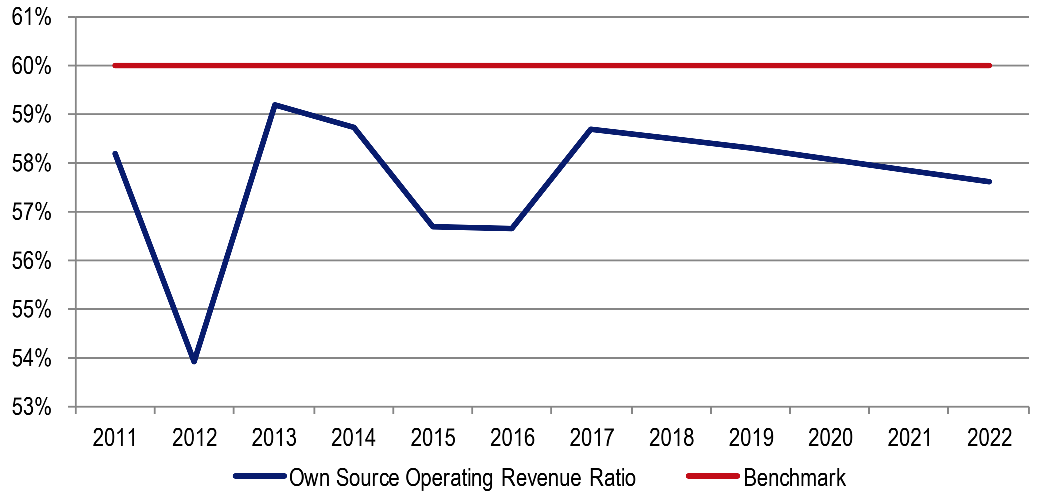


The Unrestricted Current Ratio is forecast to drop below the benchmark in 2014 and to remain below the benchmark for the remainder of the forecast, indicating Council will not have sufficient liquidity to meet its short term liabilities. In particular, the ratio is forecast to be negative between 2016 and 2019.

Between 2014 and 2016, the ratio is negatively impacted by substantial decreases in current cash and investments due to high levels of capital expenditure.

Fiscal Flexibility Ratios

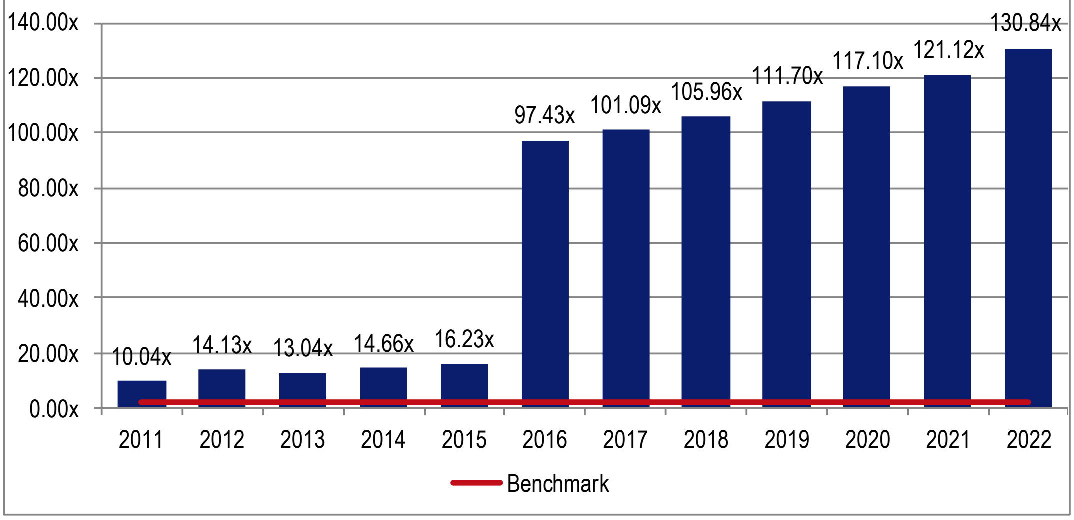
Figure 10 - Own Source Operating Revenue Ratio for General Fund



The Own Source Operating Revenue Ratio remains below the benchmark each year of the forecast period, indicating Council will be dependent on operating grants and contributions that will represent approximately 38.0% of Council's total revenue (excluding capital grants and contributions). As mentioned in section 3.4., Council auspices on behalf of both the state and federal governments aged care services which are grant funded. These grants impact negatively the Own Source Operating Ratio.

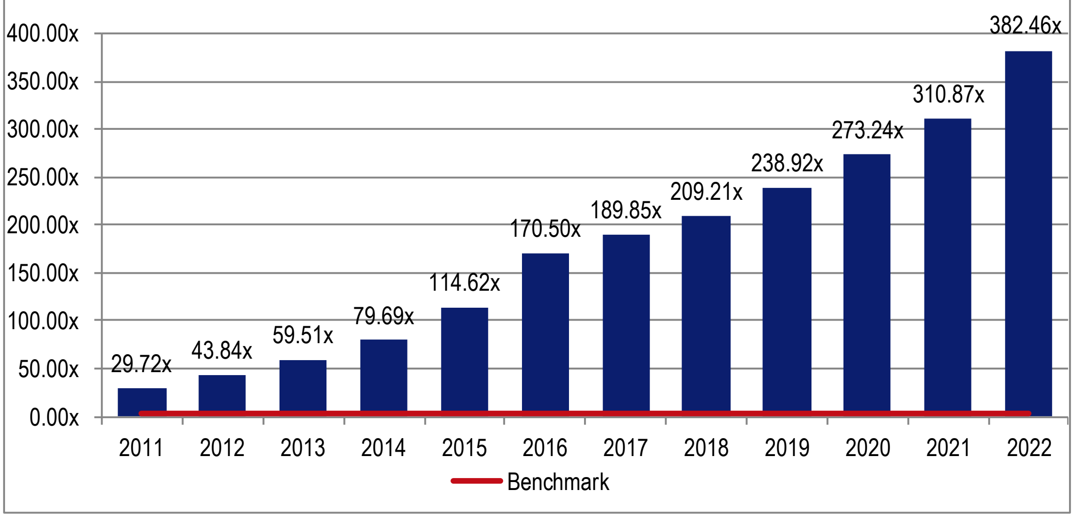
The ratio was skewed downwards in 2012 due to high levels of operating grants and contributions received that year. Between 2013 and 2022, the ratio is at its lowest position in 2015 and 2016 due to high levels of capital grants and contributions forecast to be received ($1.2m each year).

Figure 11 - DSCR for General Fund



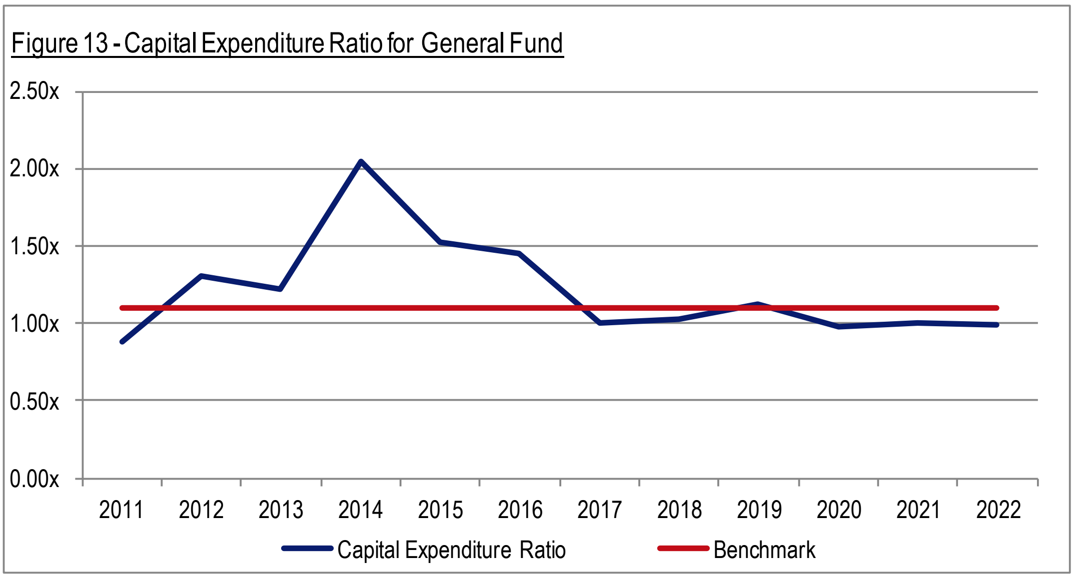
The DSCR is above the benchmark each year indicating that Council has the capacity to service its existing loans. Council does not forecast to add any further borrowings between 2013 and 2022. Council's 'Sustainability' model proposes taking $11.0min new loans over the 10 year period.

Figure 12 - Interest Cover Ratio for General Fund



Similar to the DSCR, the Interest Cover Ratio shows that Council has sufficient capacity to service scheduled debt commitments. Based on these metrics, there is capacity to service further debt interest costs before the ratio decreases to the 4.00x benchmark. Council debt capacity to take on further borrowings is limited by its current forecast liquidity position. This situation would be corrected if Council's SRV applications are approved.

4.3: Capital Expenditure



The Capital Expenditure Ratio is above or near the benchmark each year of the forecast. The ratio is high between 2014 and 2016 due to high levels expenditure on renewal, upgrade and addition of assets those years.

As indicated in the Delivery Plan, the capital expenditure is mainly road related including reconstructions, pavement renewals and gravel and bitumen re-sheeting.

Between 2013 and 2017, major capital projects included in the Delivery Plan are:

- Renewal of the swimming pool complex ($0.5m in 2014, $1.6m in 2015, $6.6m in 2016)
- General re-sheeting program on unsealed rural roads ($0.6m in 2013, $0.7m each year between 2014 and 2016, $1.1m in 2017)
- Replacement of Simpsons Bridge ($1.4m in 2016)
- Pavement renewal on sealed rural roads ($1.0m in 2017)
- Plant replacement program (more than $1.7m p.a. between 2013 and 2017)

Overall, the total value of capital expenditure ($91.0m) forecast for the 10 upcoming years is higher than the accumulated depreciation ($85.5m), indicating that Council's asset base is expected to increase. Council officers have mentioned that this is mainly related to Council addressing its renewal backlog across this period.

The 'current income' scenario highlights that if Council does not raise its income but maintains its current service levels and spends the required amounts on upgrade, renewal and addition of assets, then this will pressure Council's operating and cash positions. Council's strategy is to raise its income through a multi-year SRV starting in 2014 to match the required asset expenditure. The 'sustainable services' scenario adopted by Council shows that with SRV's Council could generate operating surpluses when capital grants and contributions are excluded and maintain strong cash reserves while spending the required amounts on capital expenditure to maintain its assets in satisfactory condition.

4.4: Financial Model Assumption Review

Councils have used their own assumptions in developing their forecasts.

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

TCorp's benchmarks:

- Rates and annual charges: TCorp notes that the LGCI increased by 3.4% in the year to September 2011, and in December 2011, IPART announced that the rate peg to apply in the 2012/13 financial year will be 3.6%. Beyond 2013 TCorp has assessed a general benchmark for rates and annual charges to increase by mid-range LGCI annual increases of 3.0%
- Interest and investment revenue: annual return of 5.0%
- All other revenue items: the estimated annual CPI increase of 2.5%
- Employee costs: 3.5% (estimated CPI+1.0%)
- All other expenses: the estimated annual CPI increase of 2.5%

<u>Key Observations and Risks</u>

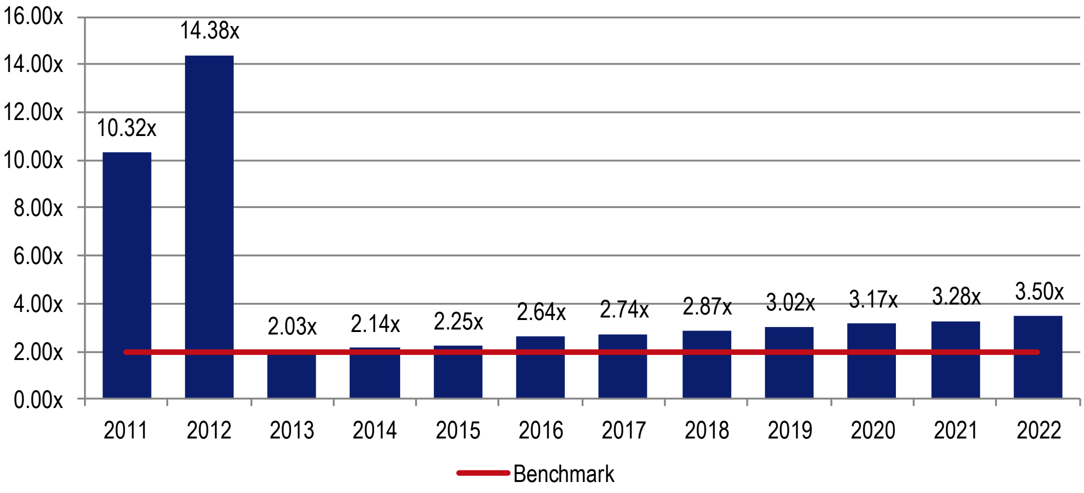
- The 'current income' scenario assumes that existing service levels are maintained. Council officers have indicated that this scenario was used to demonstrate the gap between income levels and amounts needed in expenditure to maintain the current service levels and to keep the infrastructure in satisfactory condition.
- The model was built on estimates of the 2012 figures. TCorp based its analysis on the actual figures for the General Fund in 2011 and 2012 (as indicated in Note 21 of the financial statements) as well as the projections for the 2013-2022 period.
- Based on the actual 2012 figures, rates and annual charges are forecast to increase by 5.2% in 2013 (3.2% based on the estimated 2012 figures). Rates and annual charges are forecast to increase by 3.6% p.a. from 2014 onwards.
- Based on the actual 2012 figures, user fees and charges are forecast to decrease by 24.1% ($1.6m) in 2013 due to Council not taking on the same level of private works and RMS contract works. In the short to medium term, Council wishes to prioritise capital works for its own assets as indicated in section 4.3. User fees and charges are forecast to increase at an average rate of 5.0% p.a. for the remainder of the forecast.
- Operating grants and contributions are forecast to decrease by 15.5% ($1.7m) in 2013 as an adjustment to the prepayment in 2012 of the $2.0m of the 2013 FAG. Operating grants and contributions are forecast to increase at an average rate of 5.4% p.a. from 2014 onwards.
- Capital grants and contributions are forecast to be lower than the historical levels for the entire forecast ($0.3m approximately each year with the exception of 2015 and 2016). They include developer contributions and capital agreements. In 2015 and 2016, Council forecasts to receive a $1.0m grant for flood mitigation works each year.
- Employee costs are forecast to remain static in 2013 and to increase at an average rate of 3.2% p.a. from 2014 onwards.
- Materials and contracts costs are forecast to decrease by 32.4% ($2.6m) in 2013 due to a decrease in private works and RMS contract works. Materials and contracts costs are

forecast to increase by 11.7% ($0.6m) in 2014 due to Council forecasting to perform more private works and to undertake additional road related works. Materials and contracts costs are forecast to increase at an average rate of 5.3% p.a. from 2015 onwards.

4.5: Borrowing Capacity

When analysing the financial capacity of the Council we believe Council could be able to incorporate additional loan funding in addition to its existing debt facilities. In recent years, Council has not taken on new debt funding as it is waiting on finalising the development of the Asset Management Plans (AMP) and the LTFP. Council officers have indicated that now that Council has developed these documents, it is scheduled to utilise further debt funding; the low level of debt going into this era has allowed Council to reduce the impact of required SRV amounts.

Figure 14 - DSCR for General Fund with an additional $19.0m in borrowings



Some comments and observations are:

- Based on a benchmark of DSCR>2.00x, up to $19.0m could be borrowed in 2013 in addition to the existing borrowings already incorporated into the LTFP. The 'Sustainability' model developed by Council proposes additional borrowings of $11.0m in the 10 year period.
- This scenario has been calculated by basing borrowing capacity on a 10 year amortising loan with an interest rate of 7.5%.
- However, as noted in our comments in section 4.1, the forecasts show that deficit positions are expected each year when capital grants and contributions are excluded as well as liquidity pressures. In TCorp's view, it would be prudent for Council to wait until it receives notification from IPART in respect of its SRV applications so that it knows if it will be able to implement its preferred 'sustainable services' scenario prior to proceeding with any further borrowings.

4.6 Sustainability

TCorp believes Council to be currently moderately Sustainable. Whilst Council has reported operating surpluses in three of the past four years it has some issues associated with its future liquidity and ability to manage unforseen financial shocks. The recent development of the AMP have highlighted the importance and the challenge for Council to undertake extensive maintenance works, upgrades and renewals of assets in order to maintain its assets in satisfactory condition. Council has built the requirements of its AMP into its LTFP in the model create for 'Sustainability' however it is still subject to approval of a proposed SRV application to IPART.

In considering the longer term financial Sustainability of the Council we make the following comments:

- Council has been proactive in seeking solutions to maintain its assets in satisfactory condition. Council has highlighted the limits of its actual revenue base when it comes to keeping all assets to adequate levels and maintaining the current service levels. Through community consultations, Council has adopted to apply for an SRV instead of cutting operations and capital works that would impact negatively Council's operations and infrastructure base. Council's long term Sustainability would be aided by the grant of an SRV which would avoid Council having to resort to other measures such as cutting the expenditure on asset maintenance and renewal which will significantly reduce the assets condition

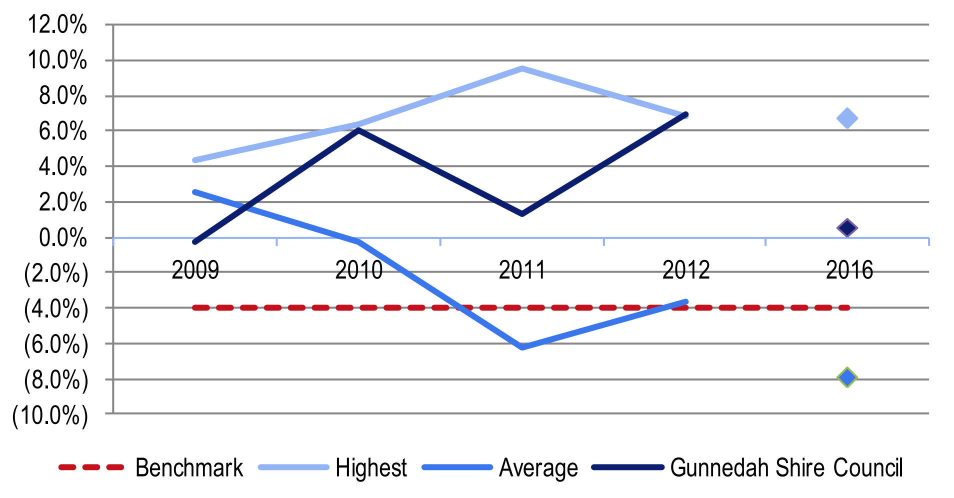
Section 5 Benchmarking and Comparisons with Other Councils

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

In Figure 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 'current income' scenario of the LTFP which is not Council's preferred scenario.). 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.

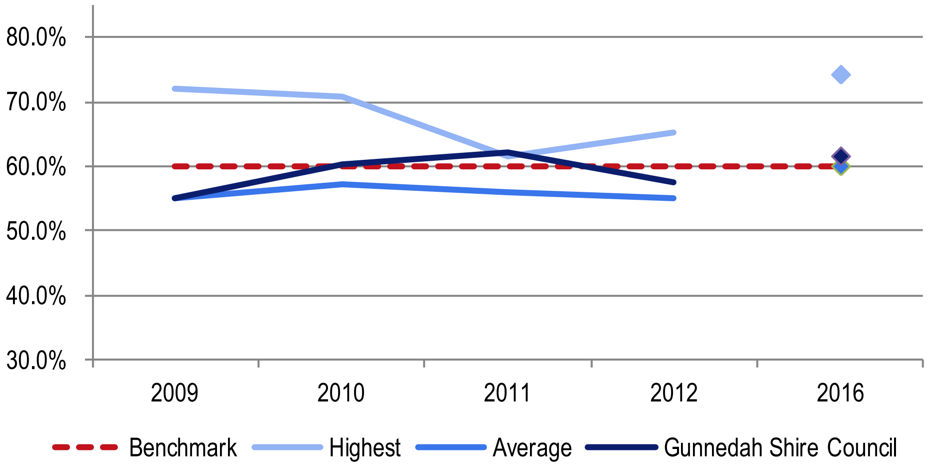
Financial Flexibility

Figure 15 - Operating Ratio Comparison



Council's Operating Ratio has consistently been above the benchmark over the past four years, and it has outperformed the group average since 2010. In the medium term, Council's Operating Ratio is forecast to decline but to remain sound, outperforming both the benchmark and the peer group average.

Figure 16 - Own Source Operating Revenue Ratio Comparison



On average, councils from this DLG group have been reliant on external funding sources such as grants and contributions over the past four years. Council's Own Source Operating Ratio has been above the benchmark in two of the past four years and has consistently outperformed the group average.

Liquidity

Figure 17 - Cash Expense Ratio Comparison

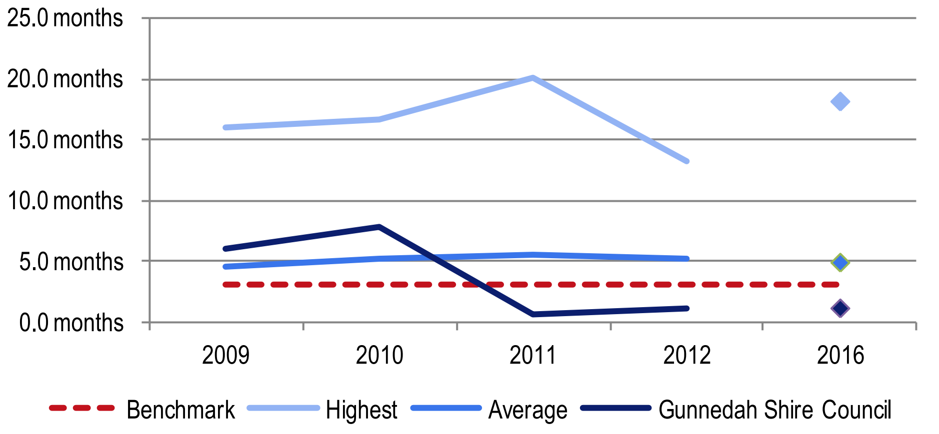
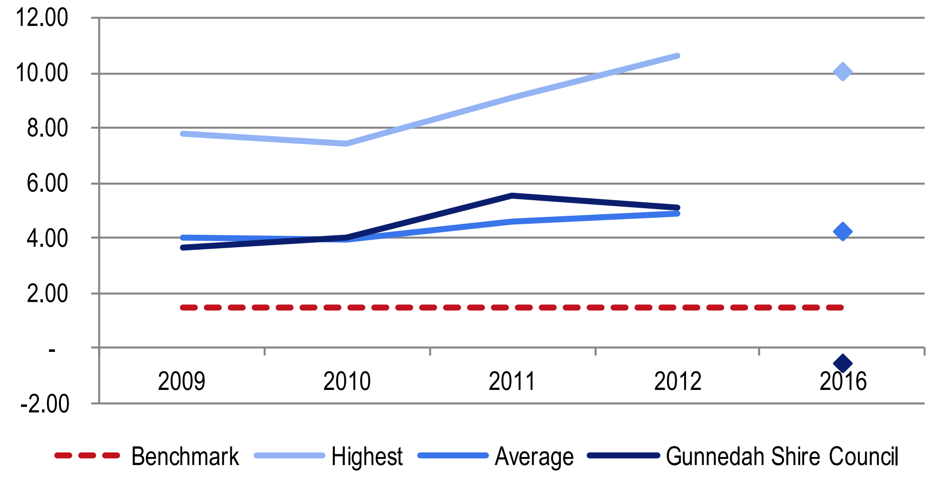


Figure 18 - Unrestricted Current Ratio Comparison

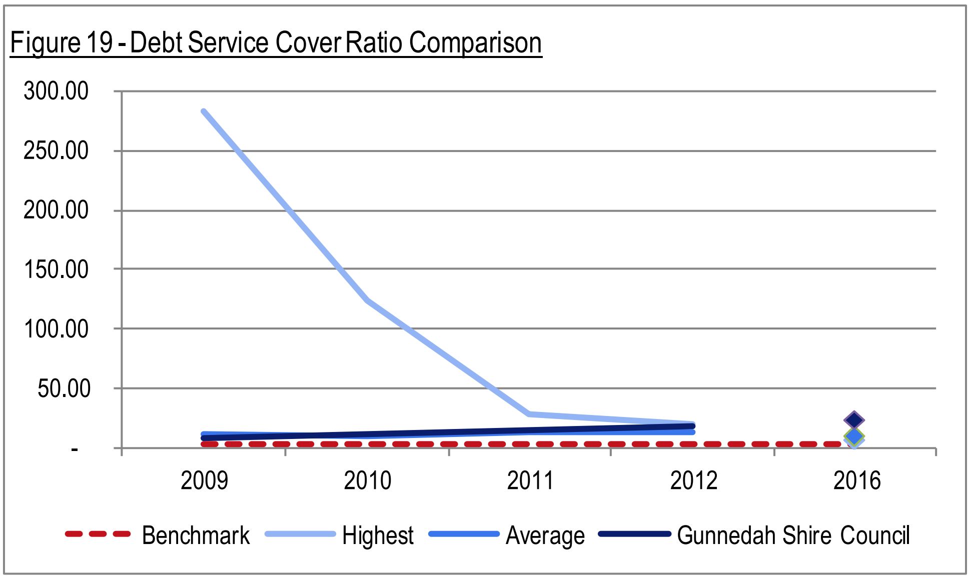


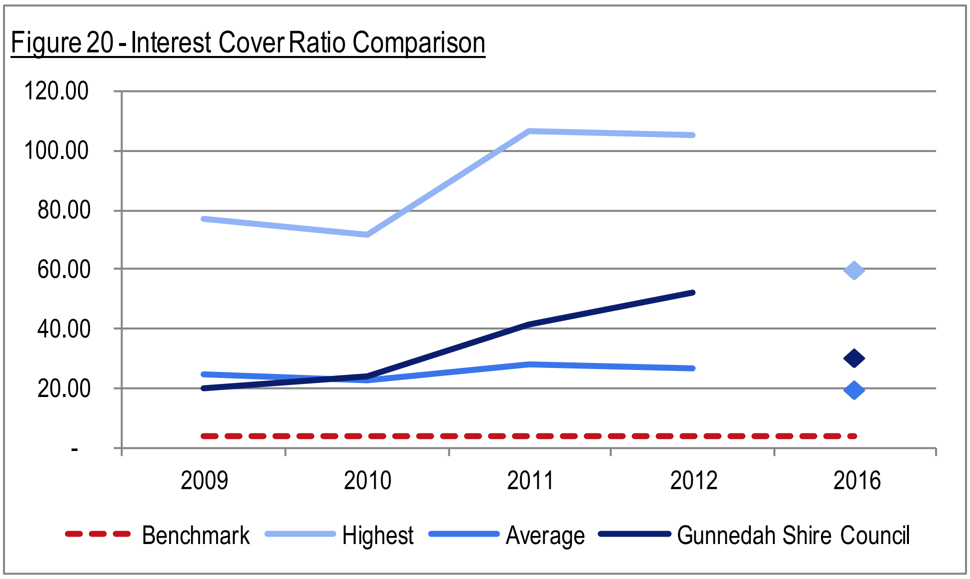
Council's liquidity position has remained sound over the review period. Council's Unrestricted Current Ratio was consistently above the benchmark and has been above the group average since 2010. Since 2011, Council's Cash Expense Ratio has been below both the benchmark and the group average as Council has been investing its cash in term deposits with more favourable interest rates:

In the medium term, Council's liquidity position is forecast to substantially deteriorate (both liquidity ratios being below the benchmark and the group average) due to Council investing substantial amounts in capital expenditure.

New South Wales Treasury Corporation

Debt Servicing





Council's debt servicing capacity has been sound over the review period. Council's DSCR and Interest Cover Ratio were consistently above their respective benchmarks and since 2010, both of Council's ratios have been above the group average.

In the medium term, Council's debt servicing capacity is forecast to remain sound, both of Council's ratios outperforming the benchmark and the peer group average. These results do not take into account the $11.0m borrowings proposed to be taken out between 2013 and 2022 in Council's 'Sustainability' model which is Council's preferred model.

New South Wales
Treasury Corporation

Asset Renewal and Capital Works

Figure 21 - Capital Expenditure Ratio Comparison

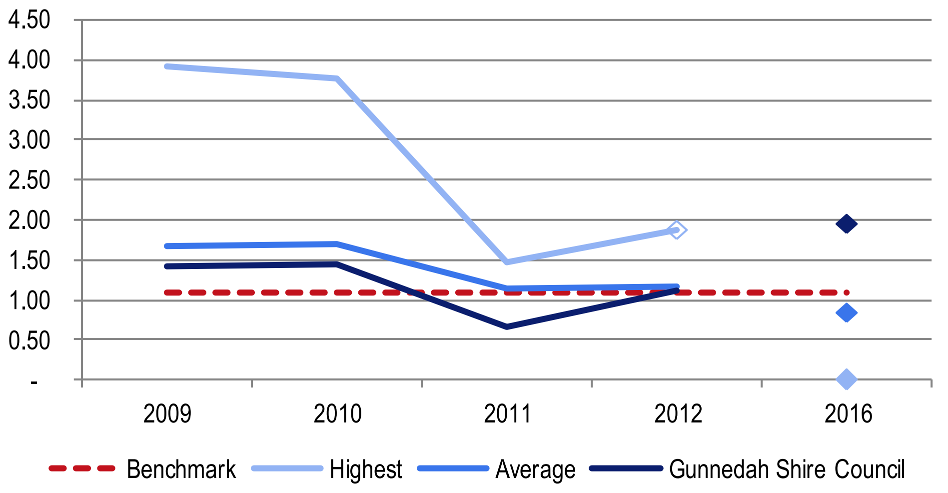


Figure 22 - Asset Maintenance Ratio Comparison

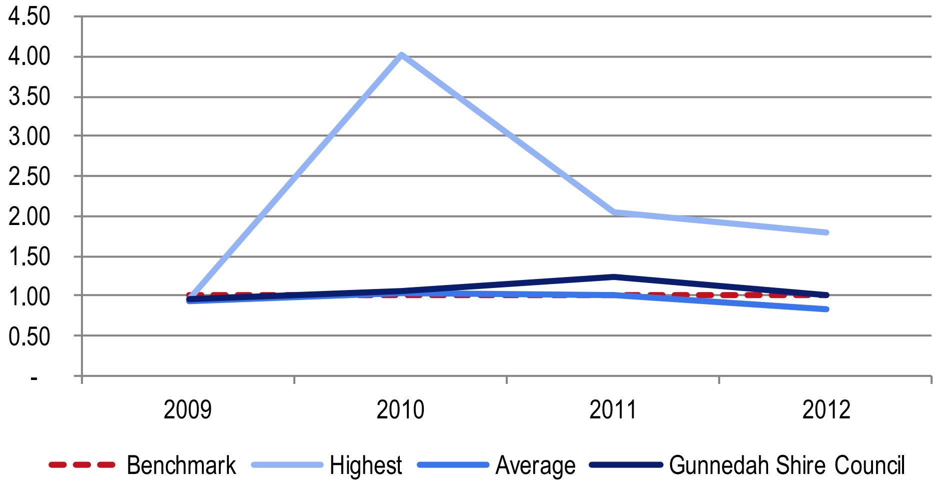


Figure 23 - Infrastructure Backlog Ratio Comparison

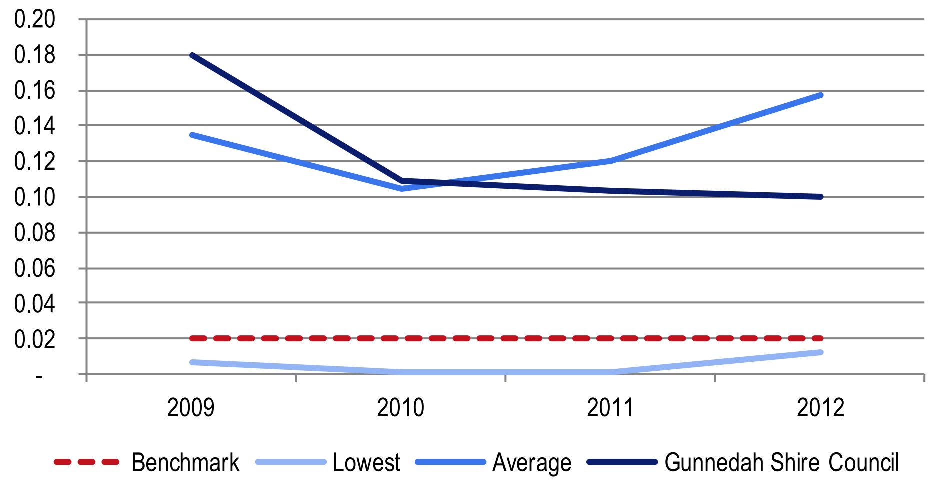
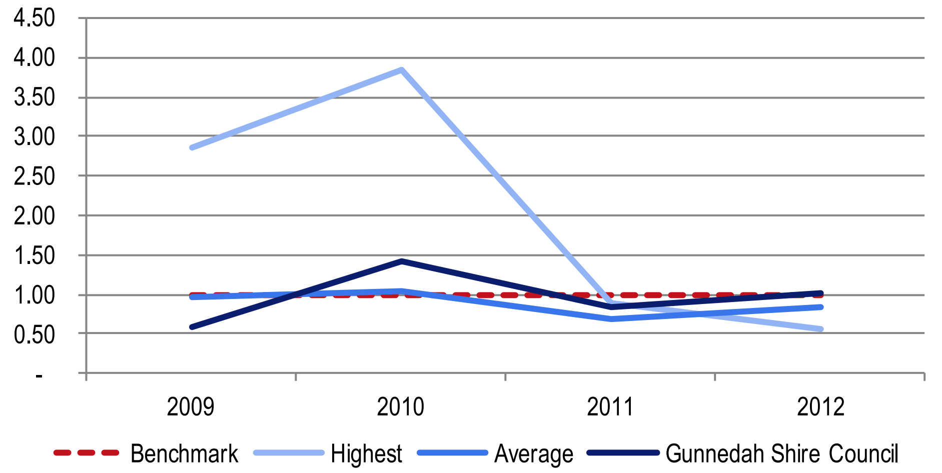


Figure 24 - Building and Infrastructure Asset Renewal Ratio



Since 2011, Council's level of Infrastructure Backlog has been below the group average but above the benchmark. Since 2010, Council's spending on maintenance of assets has been above both the benchmark and the group average.

Council's Capital Expenditure Ratio was above the benchmark in three of the past four years but it was consistently below the group average. In the medium term, Council's Capital Expenditure Ratio is forecast to improve and outperform the benchmark and the peer group.

Council's Building and Infrastructure Renewal Ratio was above the benchmark in two of the past four and it has outperformed the group average since 2010.

Section 6 Conclusion and Recommendations

Based on our review of both the historic financial information and the 10 year financial forecast within Council's LTFP ('current income' scenario) we consider Council to be moderately Sustainable. Although Council's four-past-year financial results can be considered as satisfactory (Council reported operating surpluses in three of the past four years, Council had sufficient cash and further capacity to borrow), Council's infrastructure assets condition is becoming challenging as highlighted by the recently completed AMP. In recent months, Council undertook extensive works in order to develop its AMP and to conduct community consultations in order to take the necessary measures to be able to maintain its service levels and keep its assets in safe and satisfactory condition. Based on the LTFP, cash is forecast to fall to negative levels which highlights that this high level of capital expenditure is not Sustainable in the long term.

We base our recommendation on the following key points:

- Since 2010, Council has recorded operating surpluses excluding capital grants
- Council's Unrestricted Current Ratio has been above benchmark in each of the past four years indicating Council had sufficient liquidity
- Council had a moderate level of borrowings and further capacity to borrow

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

- Historically, Council's measurement of its Infrastructure Backlog and required asset maintenance was based on what was publicly reported. Council's approach potentially underestimated its required annual maintenance in Backlog. Through the development of the AMP, Council obtained a realistic picture of its infrastructure assets condition. In particular, Council obtained better estimates of its Infrastructure Backlog, as well as the costs of maintenance, upgrade, renewal and addition of assets that are necessary to maintain the asset base to satisfactory levels. In particular, the AMP has highlighted the need to undertake extensive maintenance and renewals in order to prevent Council's asset base from deteriorating in future years. Based on the historic levels of revenue, if Council maintains its current service levels and spends the required amounts on maintenance, renewal and action of assets, then Council will face liquidity pressures. The forecast level of capital expenditure is forecast to deplete Council's cash reserves to an unsustainable level.
- Following community consultations, Council will apply for a three-year SRV starting in 2014 in order to fulfil the forecast infrastructure funding requirements. If this SRV is not granted then Council will need to review its service levels and forecast capital expenditure or/and find costs savings.

New South Wales Treasury Corporation

Appendix A Historical Financial Information Tables

Table 1- Income Statement

Income Statement ($'000s)	Year ended 30 June				% annual change		
	2012	2011	2010	2009	2012	2011	2010
Revenue							
Rates and annual charges	11,973	11,472	10,950	10,519	4.4%	4.8%	4.1%
User charges and fees	8,670	8,911	7,224	5,634	(2.7%)	23.4%	28.2%
Interest and investment revenue	1,562	1,336	1,076	1,219	16.9%	24.2%	(11.7%)
Grants and contributions for operating purposes	11,359	9,746	9,616	9,602	16.6%	1.4%	0.1%
Other revenues	651	652	459	98	(0.2%)	42.0%	368.4%
Total revenue	**34,215**	**32,117**	**29,325**	**27,072**	**6.5%**	**9.5%**	**8.3%**
Expenses							
Employees	12,308	12,292	11,761	10,550	0.1%	4.5%	11.5%
Borrowing costs	204	222	346	319	(8.1%)	(35.8%)	8.5%
Materials and contract expenses	8,938	8,453	7,212	8,783	5.7%	17.2%	(17.9%)
Depreciation and amortisation	8,094	8,531	6,169	6,034	(5.1%)	38.3%	2.2%
Other expenses	2,307	2,198	2,061	1,443	5.0%	6.6%	42.8%
Total expenses	**31,851**	**31,696**	**27,549**	**27,129**	**0.5%**	**15.1%**	**1.5%**
Operating result (excluding capital grants and contributions)	**2,364**	**421**	**1,776**	**(57)**	461.5%	(76.3%)	3215.8%
Operating result (including capital grants and contributions)	**3,956**	**1,132**	**2,649**	**2,267**	249.5%	(57.3%)	16.9%

Table 2 - Items excluded from Income Statement

Excluded items ($'000s)				
	2012	2011	2010	2009
Grants and contributions for capital purposes	1,592	711	873	2,324
Net gains from the disposal of assets	440	0	128	188
Impairment	159	183	15	18
Net losses from the disposal of assets	0	494	0	0
Fair valuation movements in Investments (at FV or Held for Trading)	472	464	1,431	(945)

Table 3 - Balance Sheet

Balance Sheet ($'000s)	Year Ended 30 June				% annual change		
	2012	2011	2010	2009	2012	2011	2010
Current assets							
Cash and equivalents	2,248	1,250	13,736	10,295	79.8%	(90.9%)	33.4%
Investments	24,331	18,034	2,790	4,484	34.9%	546.4%	(37.8%)
Receivables	3,852	5,401	5,184	4,077	(28.7%)	4.2%	27.2%
Inventories	406	430	502	549	(5.6%)	(14.3%)	(8.6%)
Other	47	231	30	94	(79.7%)	670.0%	(68.1%)
Total current assets	30,884	25,346	22,242	19,499	21.8%	14.0%	14.1%
Non-current assets							
Investments	5,707	7,130	7,746	7,898	(20.0%)	(8.0%)	(1.9%)
Receivables	65	73	41	43	(11.0%)	78.0%	(4.7%)
Infrastructure, property, plant & equipment	285,311	270,727	254,396	162,469	5.4%	6.4%	56.6%
Total non-current assets	291,083	277,930	262,183	170,410	4.7%	6.0%	53.9%
Total assets	**321,967**	**303,276**	**284,425**	**189,909**	**6.2%**	**6.6%**	**49.8%**
Current liabilities							
Payables	2,598	2,050	3,181	2,150	26.7%	(35.6%)	48.0%
Borrowings	399	429	532	441	(7.0%)	(19.4%)	20.6%
Provisions	3,482	3,600	3,417	3,360	(3.3%)	5.4%	1.7%
Total current liabilities	6,479	6,079	7,130	5,951	6.6%	(14.7%)	19.8%
Non-current liabilities							
Borrowings	1,382	1,781	2,209	2,615	(22.4%)	(19.4%)	(15.5%)
Provisions	1,662	1,572	2,866	2,742	5.7%	(45.2%)	4.5%
Total non-current liabilities	3,044	3,353	5,075	5,357	(9.2%)	(33.9%)	(5.3%)
Total liabilities	**9,523**	**9,432**	**12,205**	**11,308**	**1.0%**	**(22.7%)**	**7.9%**
Net assets	**312,444**	**293,844**	**272,220**	**178,601**	**6.3%**	**7.9%**	**52.4%**

Table 4-Cashflow

Cashflow Statement ($'000s)	Year ended 30 June			
	2012	**2011**	**2010**	**2009**
Cashflows from operating activities	14,327	7,070	9,034	10,612
Cashflows from investing activities	(12,900)	(19,025)	(5,278)	(9,320)
Proceeds from borrowings and advances	0	0	30	0
Repayment of borrowings and advances	(429)	(435)	(441)	(445)
Cashflows from financing activities	(429)	(435)	(411)	(445)
Net increase/(decrease) in cash and equivalents	**998**	**(12,390)**	**3,345**	**847**
Cash and equivalents	2,248	1,250	13,736	10,295

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 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.

Sustainability

A local government will be financially sustainable over the long term when it is able to generate sufficient funds to provide the levels of service and infrastructure agreed with its community

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

Building and Infrastructure Backlog Ratio

Benchmark = Less than 0.02x

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

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

Interest Cover Ratio

Benchmark = Greater than 4.0x

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

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

Operating Ratio

Benchmark = Better than negative 4%

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

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

Own Source Operating Revenue Ratio

Benchmark = Greater than 60%

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

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

Unrestricted Current Ratio

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

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

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