Blayney Shire Council

Financial Assessment and Sustainability Report

Date:	24 June 2015

New South Wales Treasury Corporation

Disclaimer

This report has been prepared by New South Wales Treasury Corporation (TCorp) in accordance with the appointment of TCorp by Blayney Shire Council (the Council) as detailed in TCorp's letter of 5 June 2015.

The report has been prepared based on information provided to TCorp. 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 Council's future Sustainability, within prudent risk parameters and the limits of its financial projections.

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Contents

1 Executive Summary

In April 2013, TCorp provided Blayney Shire Council (Council) with a Financial Assessment, Sustainability and Benchmarking Report as part of the work undertaken for the Independent Local Government Review Panel. Following the initial report, TCorp completed an updated Financial Assessment and Sustainability Report in November 2013 after being appointed by the Council.

In the November report, TCorp made the following observations:

- 2 scenarios were considered – 'Maintained Services' scenario and 'Reduced Services' scenario, which returned varying financial forecast results for the 10 year period.
  - 'Maintained Services' scenario included the approved Mining SRV and assumed a permanent 6 year SRV of 15% (including rate peg) between 2015 and 2020. This scenario forecast deficits for each year up to 2018 before operating results have a positive turnaround.
  - 'Reduced Services' scenario included the approved Mining SRV only. This scenario reported deficits throughout the 10 year financial forecast.
- Infrastructure Backlog increased from $9.6m in 2009 to $21.0m in 2013 following the Asset Revaluation process, improvement of Council's Asset Management Plan and analysis of infrastructure asset condition status. Although the 2013 Infrastructure Backlog Ratio of 0.13x was well above benchmark, it was an improvement from 2011's result of 0.15x.
- Asset Maintenance Ratio, Building and Infrastructure Asset Renewal Ratio and Capital Expenditure Ratio were all below benchmark over the entire review period. The Building and Infrastructure Asset Renewal Ratio showed a steep improvement in 2012 as a result of ongoing roads capital works and the rebuilding of Blayney Shire Community Centre. The ratio fell in 2013 once the Community Centre was completed, however still remained higher than historic levels due to works undertaken as a result of the mining SRV.

Following receipt of the report, Council has revised their Long Term Financial Plan (LTFP) and requested an updated Financial Assessment Report, FSR and Outlook, to be used in conjunction with finalising Council's Fit for the Future proposal which is to be submitted by 30 June 2015.

The LTFP was modelled with the following 3 SRVs:

- A 2008/09 single-year increase of 11.42% for a fixed period of 10 years towards the redevelopment of Blayney Shire Community Centre – approved until 2016 but was originally set to end 2018.
- A 2012/13 permanent SRV of 40.7% (inclusive of 3.6% rate peg) applicable only to the mining rate category – for funding roads, bridges, land acquisition, community infrastructure works and community contributions.
- A permanent general income increase of 4.69% for 2014/15 and 5.11% for 2015/16 recently determined by IPART, which incorporates the rate peg of 2.30% in 2014/15 and an assumed 3.0% in the following year. This SRV is to fund a program of infrastructure renewals – in particular roads, bridges, footpaths and buildings, while allowing Council to maintain its assets and services levels.

Our analysis focuses on the General Fund. Council's consolidated position also includes a Sewer Fund which operates as an independent entity, and is more able to adjust fees and charges to meet future operating and investing activities.

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

- Operating results (excluding capital grants and contributions) are forecast to return to a surplus position of $0.5m in 2015, and expected to reach $1.1m by 2024. This represents an improvement in comparison to the 'Maintained Services' scenario modelled in the previous LTFP, where a surplus was not going to be achieved until 2019.
- Council has historically had sound liquidity levels, this is expected to continue and improve over the 10 year forecast period.
- Council's reliance on external funding reduces as indicated by their increasing Own Source Operating Revenue Ratio.
- Council's Interest Cover Ratio and Debt Service Cover Ratio (DSCR) consistently perform above benchmark which suggests that they have the capacity to undertake additional borrowings for future capital expenditure if required.
- The Capital Expenditure Ratio is volatile for the entire forecast period but mostly performing above benchmark. Council has been trying to expand their asset base and at the same time reduce their Infrastructure Backlog. The annual expenditure is partially reliant on the amount of capital grants and contributions received each year.

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

- Council's forecast improvement in operating results will assist in being able to operate sustainably and eliminate its Infrastructure Backlog.
- Council has predicted minimal increases in grants and contributions throughout the forecast period. This enables their Own Source Operating Revenue Ratio to perform consistently above benchmark.
- Council has forecast to reduce its total borrowings while maintaining the existing standard of services to the community. This is considered to be achievable given their improving performance, and Council is also forecasting a build-up in cash reserves which could be used to meet unexpected expenditure.
- Council is expecting to eliminate its Infrastructure Backlog by 2023, whilst its Asset Maintenance Ratio, Building and Infrastructure Asset Renewal Ratio and Capital Expenditure Ratio comfortably meet benchmark levels.

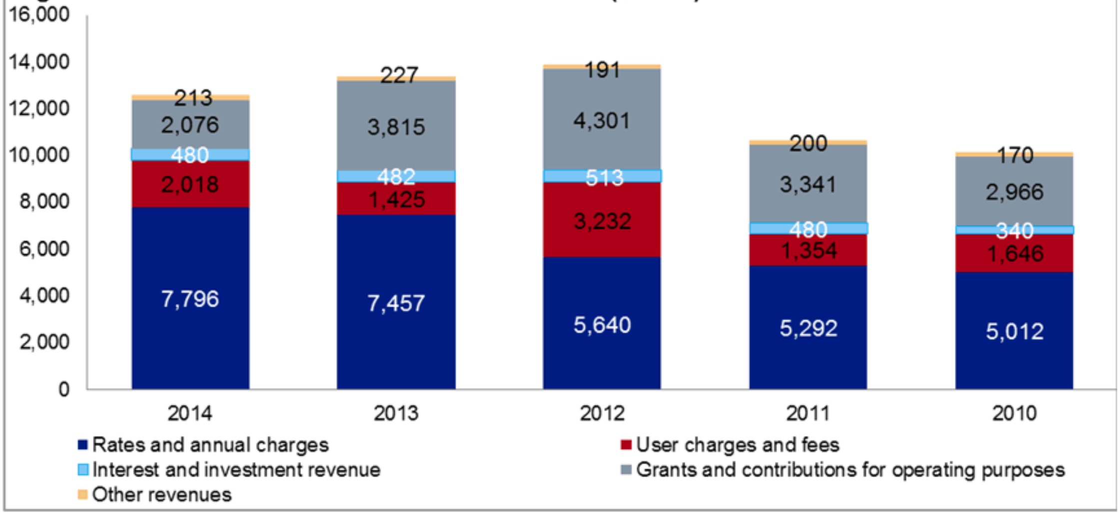
Based on our review of both the historic financial information and the 10 year financial forecast within Council's LTFP, we consider Council to be in a satisfactory and improving financial position. TCorp believes the Council's current financial Sustainability position is Moderate, with an Outlook of Positive. At this rating, Council is currently achieving a level of performance broadly consistent with the TCorp benchmarks. The LTFP indicates that, if achieved, Council's position is expected to improve over the next three years.

2 Review of Financial Performance and Position

TCorp has updated its review based on the 2014 annual audited accounts of the Council.

2.1 Revenue

Figure 1 - Revenue Sources for 2009/10 to 2013/14 ($'000s)



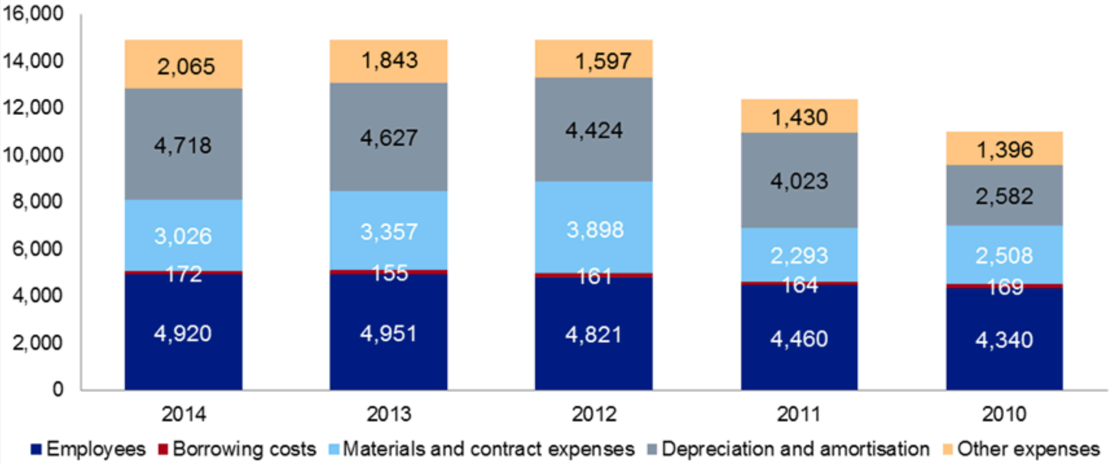
Key Observations

- Annual revenue has decreased since 2012, largely due to timing differences with the payment of Financial Assistance Grants (FAG).
- Rates and annual charges have increased over the 5 years, with 2013 experiencing a 32.2% increase from the previous year as Council implemented an approved 40.7% mining SRV. This equated to an additional $1.6m in revenue for 2013 and 2014, which will be retained permanently in the Council's revenue base. The Community Centre refurbishment SRV is still ongoing at the allocated $0.3m p.a., while ordinary rates, charges for waste and sewerage services have consistently gone up every year.
- User charges and fees have fluctuated every year and peaked at $3.2m in 2012 as Roads and Maritime Services (RMS) awarded the Council various contracts and this is still ongoing. In 2014, charges had increased by 41.6% from the previous year mainly because lease rentals and quarry revenues multiplied by 8.2x and 4.5x respectively. This increase includes a backdated pipeline lease income that was not budgeted for at the start of the year.
- Interest and investment revenue and other revenue components have remained constant over the review period.
- Operating grants and contributions have been volatile but were at their lowest of $2.1m in 2014. This was attributable to 2 main factors:
  - In 2014 only two quarters of the FAG was received as the other two quarters were prepaid in 2013. This adjustment reflects only a timing difference not a loss of income.

- Specific purpose grants for 2012 and 2013 were higher than usual – $1.0m in 2012 and $1.07m in 2013 as opposed to $0.4m in 2014, due to a larger amount received for the funding of other roads and bridges.

2.2 Expenses

Figure 2 - Expenses for 2009/10 to 2013/14 ($'000s)



Key Observations

- Annual expenses have risen by 35.5% since 2010 to $14.9m in 2014, but have remained relatively constant for the most recent 3 years.
- There were nominal increases in employee expenses since the start of the review period up to 2013 before expenses decreased slightly, despite the number of full-time employees increasing from 66 to 70 in 2014. 2012 recorded a higher than usual change of 8.1% as Council took over management and staff of the CentrePoint Sport & Leisure Centre (previously privately operated), which increased the headcount by 7.
- Materials and contract expenses increased by 70.0% in 2012 caused by an additional $1.6m spent on raw materials and consumables for increased maintenance of Council roads. Reduction in this expense during 2013 and 2014 occurred due to a greater level of capital works. This is consistent with growth in capital grant funding (transport component only) that increased from $0.5m to $1.5m in 2013, and $1.0m in 2014.
- Borrowing costs have remained static for the 5 year period.
- Other expenses show an upward trend however most changes are not material. The 12.0% increase in 2014 was mainly caused by higher than anticipated water charges (due to a dry summer).
- Depreciation and amortisation expenses increased by 55.8% in 2011, following the Asset Revaluation process in 2010 which saw the valuation of Council's assets increase by $100.5m.

Further valuation increases have occurred year-on-year in line with the smaller increments in asset valuation thereafter – $8.5m in 2011, $5.0m in 2012, $2.6m in 2013 and $0.5m in 2014.

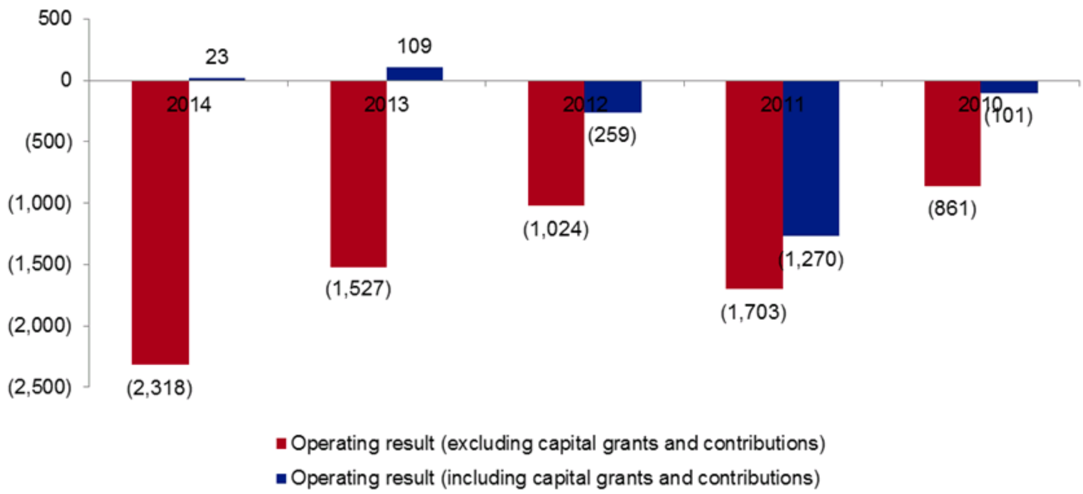
2.3 Operating Results

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 2009/10 to 2013/14 ($'000s)



Key Observations

- Council's 2014 operating results when capital grants and contributions are excluded has deteriorated for a second consecutive year. However this deterioration is due to the timing of the FAG that was $1.1m below the 2013 total.

2.4 Financial Management Indicators

Performance Indicators	Year ended 30 June				
	2014	2013	2012	2011	2010
EBITDA ($'000s)	2,572	3,255	3,561	2,484	1,890
Operating Ratio	(18.4%)	(11.4%)	(7.4%)	(16.0%)	(8.5%)
Interest Cover Ratio	14.95x	21.00x	22.12x	15.15x	11.18x
Debt Service Cover Ratio	8.84x	13.13x	14.48x	10.18x	6.47x
Unrestricted Current Ratio	4.13x	7.80x	4.77x	4.32x	4.12x
Own Sourced Operating Revenue Ratio	65.8%	59.0%	60.6%	59.9%	61.1%
Cash Expense Ratio	15.8 months	4.9 months	8.3 months	11.2 months	9.1 months
Net assets ($'000s)	194,088	193,254	190,635	185,923	178,718

Key Observations

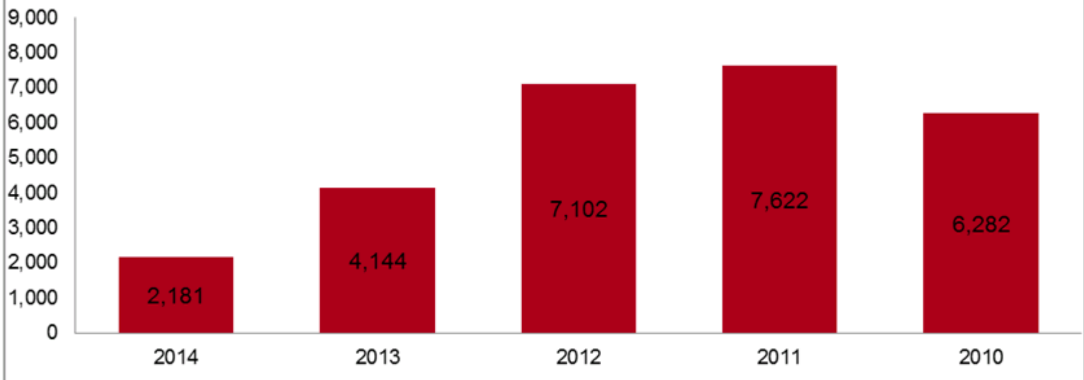
- Changes made since previous assessment:
  - Unrestricted Current Ratio for 2013 was revised in Council's 2014 Annual Report, increasing from 6.94x to 7.80x.
  - Cash Expense Ratio for 2013 dropped from 12.0 months to 4.9 months as current term deposits have been classified as Investments (rather than part of cash and cash equivalents) within the 2014 annual audited accounts.
- EBITDA decreased from 2013 to 2014 predominantly due to the reduced FAG received that year, where Council only recorded half of their entitled 2014 FAG as half the 2014 payment was reported in 2013's figures. Overall, EBITDA has increased by 36.1% since the start of the review period to 2014, this figure has moved in accordance with Council's operating results (excluding grants and contributions) for the last 3 years as depreciation and interest expense had minimal variance.
- The Interest Cover Ratio and Debt Service Cover Ratio both well exceed the respective benchmarks which reflect Council's low level of borrowings. In 2014, Council has utilised further debt arrangements with the Local Infrastructure Renewal Scheme to replace and repair ageing timber bridges across the LGA, evident through the $0.9m increase in loans in 2014. This leaves Council's total borrowings at a conservative 1.4% of net assets.
- Council's Unrestricted Current Ratio has been consistently performing around the 4.0x mark, except 2013 with 7.80x due to the introduction of the mining SRV. Council's payables were at their lowest that year, which indicates that Council is in a strong position to meet short term obligations as they fall due.
- The Own Source Operating Revenue Ratio has been maintained at benchmark levels up to 2014, where it improved slightly to 65.8% mainly because rates, utilities and charges increased by $0.9m from 2013. External funding also reduced which contributed to Council's enhanced financial flexibility.
- The Cash Expense Ratio has been well above benchmark for the entire review period, noting that 2013 would have reported 13.2 months if current term deposits were incorporated as part of

cash equivalents. In 2014 and going forward, TCorp has amended the calculation of this ratio to include current term deposits.

- Net assets for the review period reflect post-asset revaluation figures, gradually increasing through the years. There was a $0.8m increase in 2014, which consists of $0.3m from the net operating result for the year (inclusive net gains from disposal of assets) plus $0.5m from the revaluation of sewerage network assets. Excluding asset revaluations, Council's IPP&E asset base reduced by $0.04m in 2014. This was an improvement from 2013's $2.0m reduction in the IPP&E asset base as Council moved to address their Infrastructure Backlog.

2.5 Statement of Cashflows

Figure 4 - Cash and Cash Equivalents for 2009/10 to 2013/14 ($'000s)



Key Observations

- Cash and cash equivalents have decreased significantly from the 2012 levels. This is caused by the re-categorisation of term deposits as they have been split into short term and long term assets in the 2014 annual report. Council's holdings of Cash, cash equivalents and current investments have increased from $11.4m in 2013 to $13.2m in 2014, an overall 109.8% higher than 2010.
- Of the $13.2m – this is broken down into $1.2m in cash, $1.0m in short term deposits, and $11.0m in long term deposits. Of this, $6.9m was externally restricted and $6.3m was internally restricted.
- As at 2014, Council no longer holds any funds in Collateral Debt Obligations (CDOs).

2.6 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.

2.6.1 Infrastructure Backlog

Figure 5 - Infrastructure Backlog for 2009/10 to 2013/14($'000s)

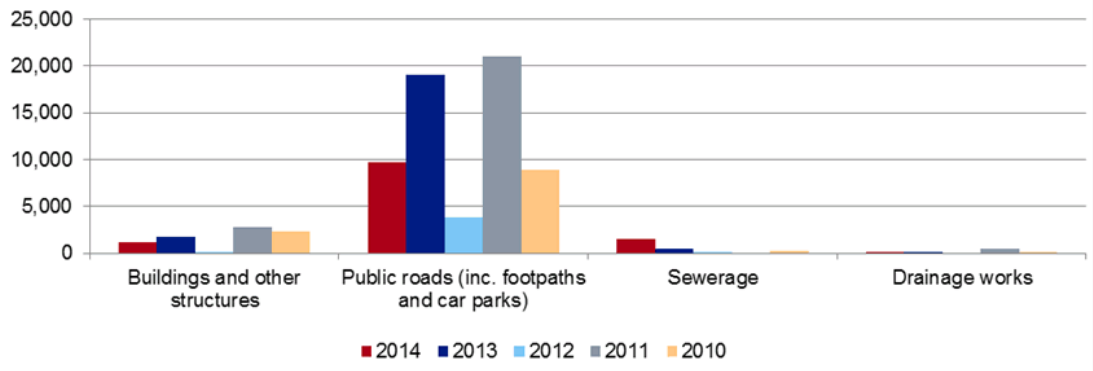
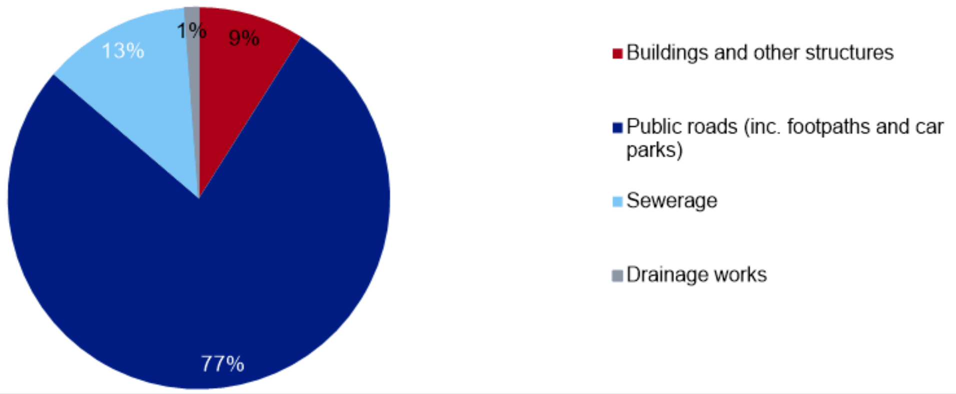


Figure 6 - Infrastructure Backlog Composition for 2013/14



The Infrastructure Backlog for 2014 of $12.6m is marginally higher than the 2010 reported numbers. However, the backlog decreased considerably from 2013 following the completion of major capital projects.

Reported backlog numbers have varied as Asset Management Plans have been reviewed. In 2011 reported backlog increased to $24.3m, primarily due to pavement structure for public roads requiring an estimated $12.0m uplift (as opposed to $2.0m in 2010). Council confirmed that the 2012 figures were reported in error, and the 2013 total of $21.4m was a more accurate representation of the backlog total across those years.

2.6.2 Infrastructure Status

Infrastructure status	Year ended 30 June				
	2014	2013	2012	2011	2010
Bring to satisfactory standard ($'000s)	12,588	21,417	3,947	24,260	11,555
Required annual maintenance ($'000s)	2,556	4,984	2,176	2,754	2,243
Actual annual maintenance ($'000s)	2,219	3,320	1,736	1,740	1,583
Total value infrastructure assets ($'000s)	165,544	165,045	163,790	159,573	155,987
Total assets ($'000s)	199,717	197,565	195,275	190,260	183,206
Infrastructure Backlog Ratio	0.08x	0.13x	0.02x	0.15x	0.07x
Asset Maintenance Ratio	0.87x	0.67x	0.80x	0.63x	0.71x
Building and Infrastructure Asset Renewal Ratio	1.07x	0.69x	0.97x	0.16x	0.45x
Capital Expenditure Ratio	0.99x	0.57x	0.77x	0.29x	0.82x

Council has actively worked on improving their Infrastructure Backlog over recent years through the approved SRVs. This has immediately had a positive impact as reflected in 2014's ratio of 0.08x compared to 0.13x in 2013.

Council's Asset Maintenance Ratio also failed to reach benchmark level, but it has moved in line with the Infrastructure Backlog Ratio and improved in 2014.

The Building and Infrastructure Asset Renewal Ratio achieved a level 1.07x in 2014 due to works being undertaken as a result of the ongoing mining SRV that was implemented in 2012.

The Capital Expenditure Ratio has been relatively volatile but the latest 2014 figure demonstrated that Council has invested at a similar level to its annual depreciation expense. Although the ratio still remains below benchmark, the improvement of all four asset-focused ratios in 2014 indicate that Council is now able to improve its asset management performance with the benefit of the additional funds provided by the SRVs.

2.6.3 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				
	2014	2013	2012	2011	2010
New capital works	927	0	300	35	218
Replacement/refurbishment of existing assets	3,699	3,483	2,562	2,370	202
Total	4,626	3,483	2,862	2,405	420

Main Capital Projects 2013/2014

Burnt Yards Road Reconstruction	$0.5m
Errowanbang Road Reconstruction	$0.3m
Hobbys Yards Road Construction	$0.3m
Garland Road Bridge Reconstruction	$0.5m
Naylor Street Bridge Rehabilitation	$0.4m
Newbridge Road Bridge	$0.8m

Above is a list of Council's main capital works in 2014. In 2014, Council's total capital program expanded by 32.8% following the 43.1% increase in capital grants and contributions. Capital works over the review period have been focussing on the renewal of existing assets.

TCorp

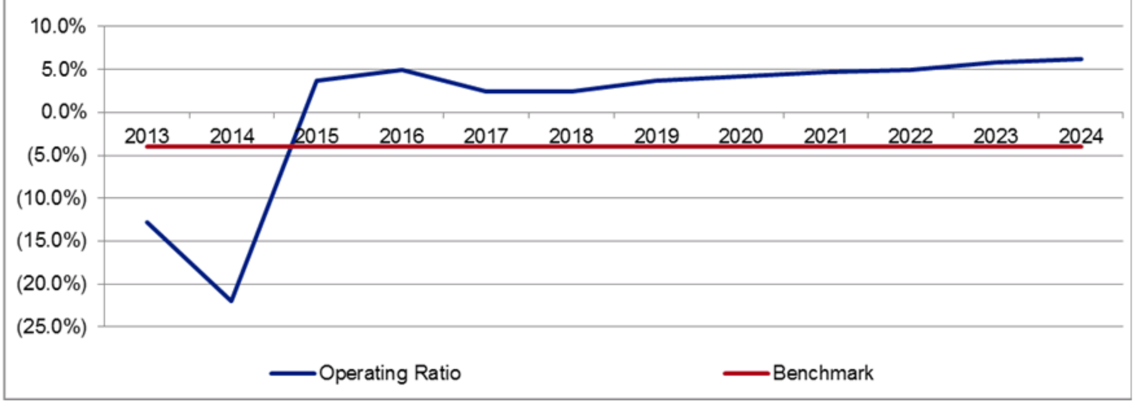
3 Review of Financial Forecasts

The revised 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 a Sewer Fund, this are operated as an independent entity, which unlike the General Fund is more able to adjust the appropriate fees and charges to meet all future operating and investing expenses.

The LTFP has been based on maintaining the existing standard of services to the community. Council believes the asset management plan to be feasible and has stated that even if revenue was to decrease, it has strong capacity to borrow or, alternatively use reserves.

3.1 Operating Results

Figure 7- Operating Ratio for General Fund



Operating results (excluding capital grants and contributions) are forecast to produce an operating surplus in 2015 and to remain above benchmark for the rest of the 10 year period. This is an improvement from the previous forecast where Council was expecting to be in deficit up to 2019 before break-even is achieved. The ratio improves from the lowest point in 2014 at -21.9% ($2.5m deficit) to the highest in 2024 at 6.3% ($1.1m surplus).

The 2014 result was attributed to the timing differences associated with the prepayment of FAG in 2013 and earlier years, and a reduction of specific purpose grants for funding of roads and bridges. The improvement in 2015's result is forecast due to a $2.3m increase in rates and annual charges and a full year of the FAG being received.

The higher rates are driven by the current SRVs in place, but the major contributing factor is the supplementary land valuation for the Cadia Valley Operations (increase in value from $41.7m to $71.5m) which is forecast to produce an additional $1.7m for the mining rate category. 2017 expects a lower result with the early completion of the Community Centre – the SRV was originally set to end in 2018 but given the project finished under budget, Council intends to finalise the SRV in 2016.

User charges and fees are forecast to decrease by $0.2m in 2015 and $0.3m in 2016. Through collaboration with RMS, Council has been able to address the majority of the local State road network issues and expects a reduction in income for the next 2 years ($0.2m is forecast in 2016 as opposed to $0.5m received in 2014).

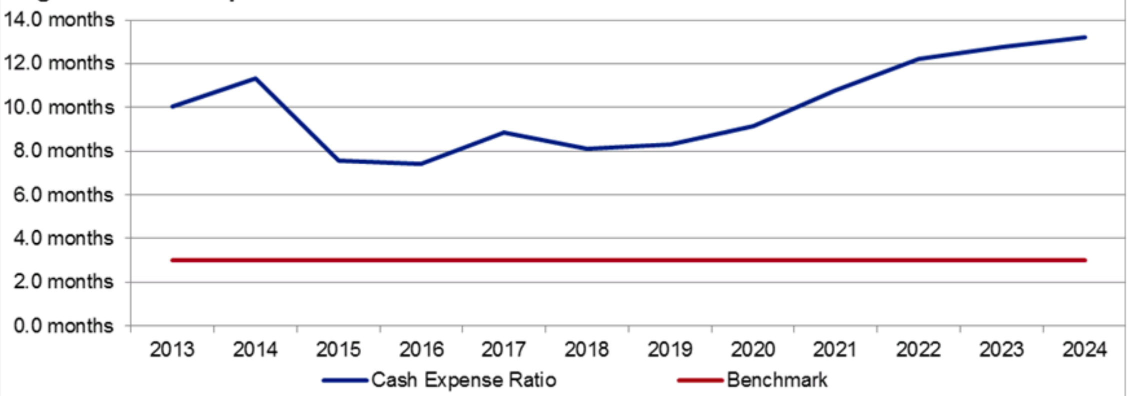
Council has assumed a 47.0% reduction in other revenue due to the exclusion of insurance rebates in their forecast as it is not considered a definite source of income – Council receives a rebate if they meet compliance requirements of the self-audit and Continuous Improvement Pathway verification, provided StateCover and Statewide Mutual have excess funds for the rebate scheme. However it is noted that Council has received insurance rebates for most years from 2010 to 2015 (except 2013), and in 2014 this component comprised 41.3% of Council's total other revenue.

In 2016 other expenses are forecast to increase by 14.6% because of various item increments – the largest being NSW Rural Fire Service contributions of $0.1m.

3.2 Financial Management Indicators

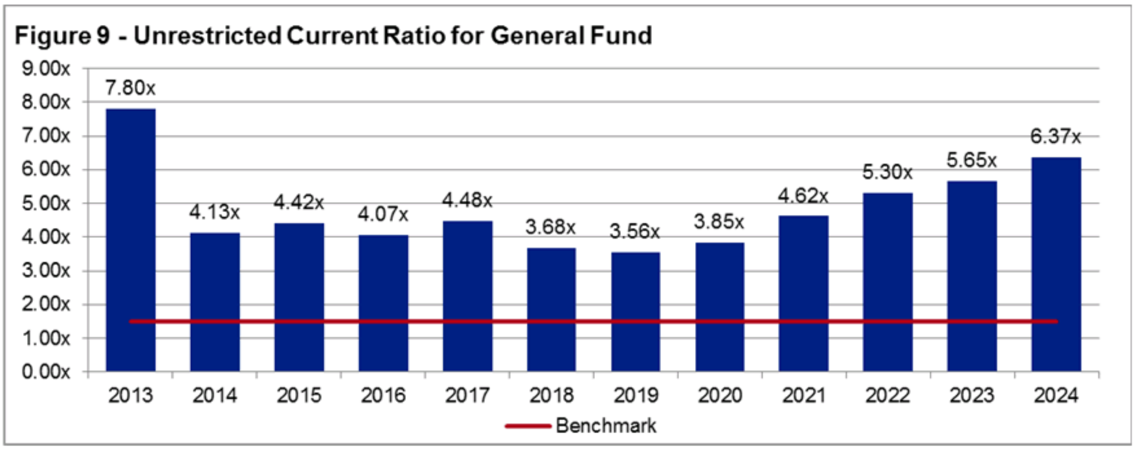
Liquidity Ratios

Figure 8 - Cash Expense Ratio for General Fund



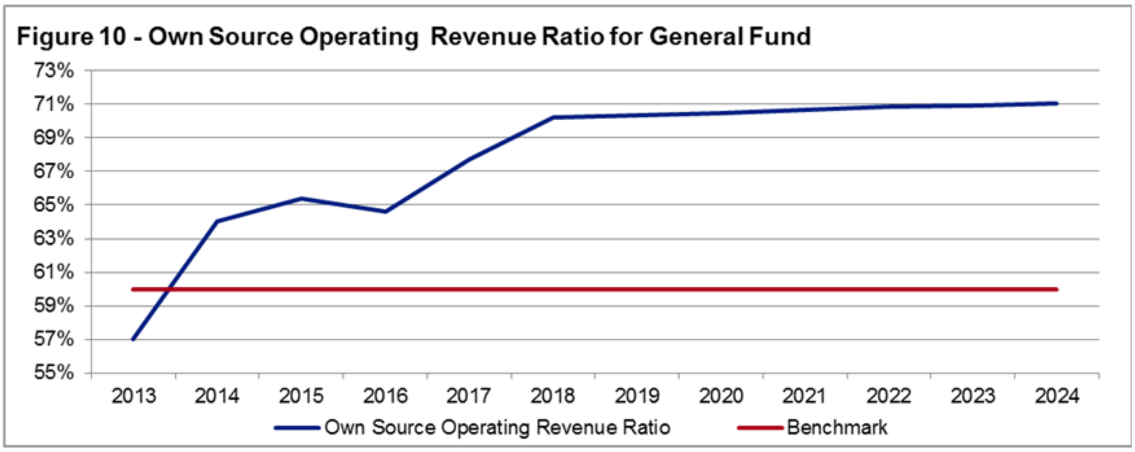
This ratio has been adjusted to include term deposits classified under current investments to provide a more accurate cash position for Council. Council predicts a Cash Expense Ratio well above the benchmark for the entire forecast period, however the trend fluctuates according to cash flow movements. The 32.8% decrease in 2015 was caused by a net decrease in cash flow, and the reclassification of $7.5m in investments into current ($5.2m) and non-current ($2.3m).

The ratio is expected to gradually increase until the end of the 10 year forecast with Council's improved annual cash flow position at $5.9m, as opposed to the lowest point in 2016 at $0.6m. Note Council's forecast outstanding borrowings diminishes every year with no new debt arrangements (from $2.2m in 2014 to $0.03m in 2025).

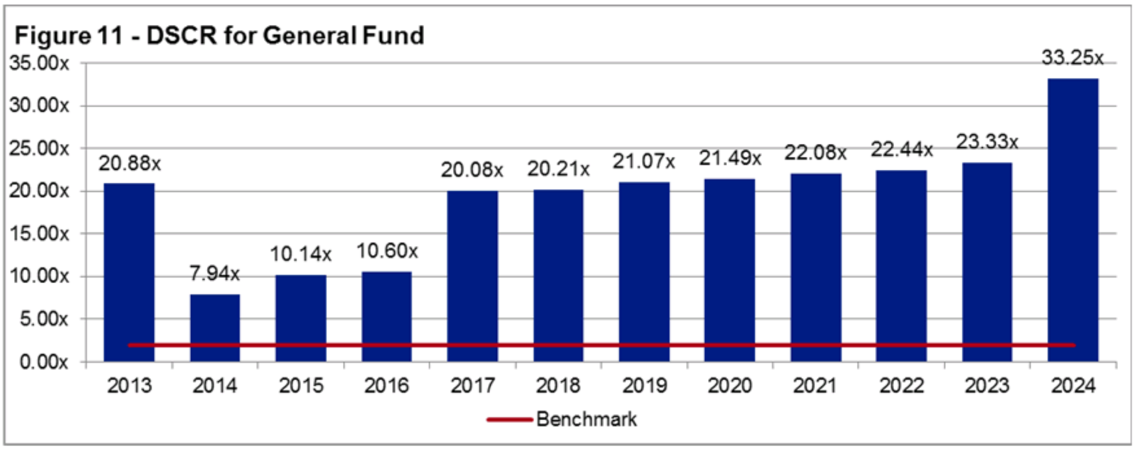


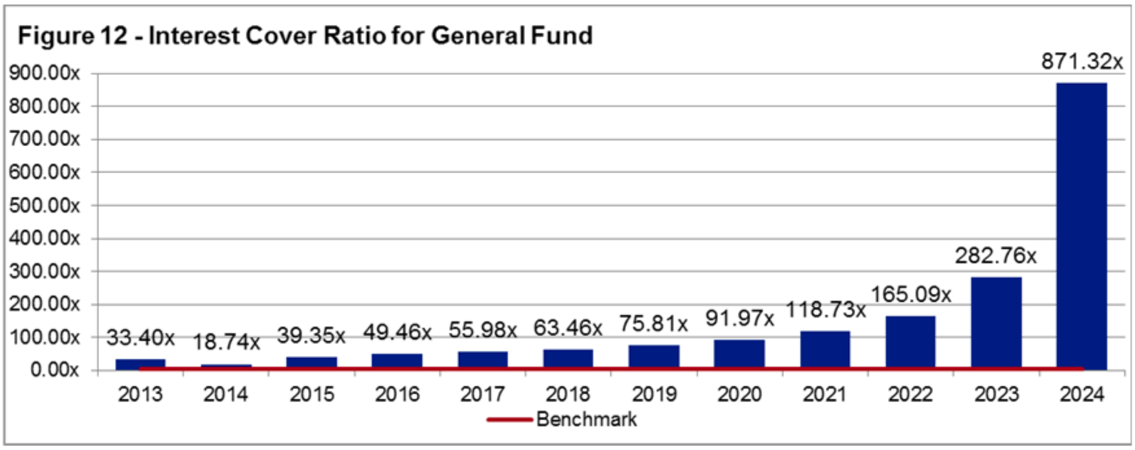
Council's Unrestricted Current Ratio consistently performs above benchmark for both historical and forecast periods. The ratio improves as cash holdings increase through the years, coupled with borrowings that are projected to reduce until they are eventually cleared in 2025. With that, Council has strong liquidity levels over the 10 year period.

Fiscal Flexibility Ratios



The Own Source Operating Revenue Ratio is forecast to remain at a stable level until 2016, before increasing to 70% in 2017 and 73% in 2018 before again stabilising. This occurs as in 2017 the Roads to Recovery capital grants are forecast to reduce by half (the Federal Government had agreed to provide twice the allocated amount for 2016), while user charges and fees are projected to show a positive turnaround in 2017, and likewise for rates and annual charges from 2018. All of these factors result in it appearing that Council will be more self-sufficient going forward.



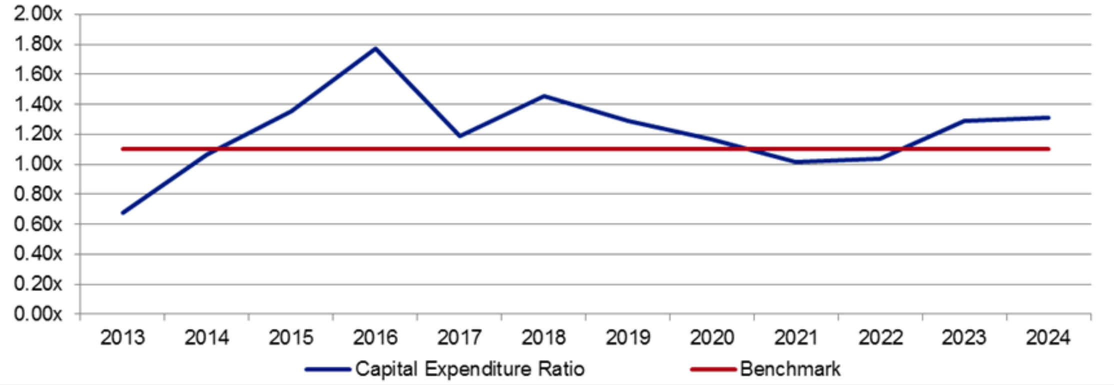


Council's DSCR and Interest Cover Ratio are well above benchmark for the entire historical and forecast periods, which indicates that Council has ample capacity to service its existing debt and could comfortably manage further borrowings.

2014 ratios were at the lowest point as Council drew down on their LIRS loan (Blayney Bridges Recovery Program) approved for $1.0m, as indicated on their cash flows for financing activities. From then, Council's forecast borrowings reduce through the 10 year period as it does not expect to require any additional debt funding, leaving the DSCR and Interest Cover Ratio increasing yearly to reach the highest point in 2024.

3.3 Capital Expenditure

Figure 13 - Capital Expenditure Ratio for General Fund



Excluding the Sewer Fund, Council managed to achieve a satisfactory Capital Expenditure Ratio of 1.07x in 2014 and this ratio is forecast to fluctuate with most years returning a positive result exceeding benchmark. An upward trend is expected until the ratio reaches a peak in 2016, due to Council receiving twice the usual capital grants for the Roads to Recovery Programme that year, plus the Community Centre and permanent general SRV allowing for further capital expenditure. After those two SRVs conclude, Council forecasts a reduction in IPP&E purchases by 32.0% in 2017.

Given that Council's assets would require renewals at different times, it is expected that the asset renewals and purchases are variable from year to year. Council is considered to be managing this well as the average ratio over the 10 year forecast is above benchmark at 1.29x.

Blayney Shire's population is expected to increase by over 8% by 2031. However, for the purpose of the LTFP, Council has assumed a constant population base as any increase in costs will be offset against increase in revenue.

3.4 Financial Model Assumption Review

Council has used its 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 Local Government Cost Index (LGCI) increased by 3.4% in the year to September 2011, 2.8% in 2012, and 3.6% in 2013 and 3.4% in 2014. In December 2013 IPART announced that the rate peg to apply in the 2014/15 financial year will be 2.3%. Beyond 2015 TCorp has assessed a general benchmark for rates and annual charges to increase by mid-range LGCI annual increases of 3.0%.
- IPART developed the LGCI to use for setting the maximum allowable increase in general income for local government in NSW (rate peg). The LGCI is the measure of movement in the unit costs incurred by NSW council activities funded from the general rate base.
- 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%

Key Observations and Risks

- Rates and annual charges are forecast to increase in 2015 and 2016 due to the current SRVs in place, with a significant 33.9% improvement in 2015 following the revaluation of land for the Cadia Valley Operations. A slight decline is expected in 2017 due to the Community Centre and general SRV finalising, after which the average annual increase applied is 2.9%, consistent with the approximate rate peg.
- User charges and fees are expected to decrease for 2 consecutive years before it reverts to a yearly increment of 3.4% in 2017. The reduction is induced by less income from RMS and decreasing income from the CentrePoint Leisure Centre.
- A 9.0% increase in interest and investment revenue was forecast in 2015 with the reclassification of some investments to longer term investments that can be expected to derive a higher rate of return. Forecast returns are based on the forecast 90 Day Bank Bill Swap Rate plus a small margin of 0.5% to reflect strategic investments in longer term investment products.
- Other revenues are expected to decline by 47.0% with the exclusion of insurance rebates in Council's forecast as it is not considered a definite source of income. A reasonable increase of 2.6% p.a. is forecast thereafter.
- Employee benefits and on-costs are forecast to increase by an average of 3.5% p.a. from 2015 which is considered reasonable.
- Borrowing costs are forecast to reduce in line with Council's plan to reduce their borrowings over the 10 year period. Based on Council's forecast, this does not adversely impact their Infrastructure Backlog as they expect to eliminate the Infrastructure Backlog Ratio to zero by 2023.

- Materials and contract expenses are expected to drop by 20.0% in 2016, which happens in line with increased capitalised asset renewals, evident through Council's improved Building and Infrastructure Renewals Ratio. After which this expense is forecast to increase annually by an average of 2.5% as per CPI.
- Depreciation and amortisation expenses have been modelled to increase by 1.0% for most years, an average of 0.8% p.a. throughout the forecast period.
- Other expenses are forecast to increase by 14.6% in 2016 mainly due to extra contributions to NSW Rural Fire Service. Excluding 2016's result, Council was able to maintain expenses at an average increment of 2.7% p.a.

In summary, the recently approved SRV and regularisation of the FAG payment result in a stronger operational performance for 2015 when Council is expected to return to a surplus position. The following years see Council maintain an operating surplus of between 2.4% and 5.8% p.a. At the same time Council has forecast sufficient funds will be allocated to capital expenditure. The SRV funds have been allocated to renew Council's asset base and provide new assets when required.

3.5 Sustainability

Based on the information received and the revised LTFP, TCorp believes the Council's financial Sustainability is Moderate, with an Outlook of Positive.

In considering the longer term financial Sustainability of the Council we make the following additional comments in respect of their General Fund:

- Council is forecasting an improvement in their operating performance that will enable small operating surpluses each year from 2015. This is a key measure in ensuring Council is sustainable in the long term.
- Council's reliance on grants and contributions have reduced over the forecast period, which proves that Council has sufficient financial flexibility.
- Council's liquidity levels are expected to continue and improve over the 10 year forecast period.
- Council has the capacity to undertake additional borrowings for future capital expenditure if required.
- Council projects their cash and cash equivalents to build-up, at the same time for their borrowings to be nearly paid in full by the end of the 10 year period.
- Council has participated in the CENTROC Joint Organisation of Council's pilot that has focused on regional collaboration and cost savings.

4 Conclusion and Recommendations

Based on our review of both the historic financial information and the 10 year financial forecast within Council's LTFP, we consider Council to be in a satisfactory and improving financial position. TCorp believes the Council's current financial Sustainability position is Moderate, with an Outlook of Positive. At this rating, Council is currently achieving a level of performance broadly consistent with the TCorp benchmarks. The LTFP indicates that, if achieved, Council's position is expected to improve over the next three years.

We base our recommendation on the following key points:

- Council has demonstrated a willingness to seek approvals for SRVs to assist in addressing its need for additional revenue to meet infrastructure costs.
- Council's financial position has been improving, particularly when the timing differences associated with the FAG payments are taken into account.
- Council is forecasting operating surpluses, sound levels of liquidity and own source revenue is at sound levels to support the operations.

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

- If the forecast increase in population occurs, Council will need to adjust its planning in future to take any impacts of that into account.

Appendix A Historical Financial Information Tables

Table 1-Income Statement

Income statement	Year ended 30 June					% annual change			
	2014	2013	2012	2011	2010	2014	2013	2012	2011
Revenue									
Rates and annual charges	7,796	7,457	5,640	5,292	5,012	4.5%	32.2%	6.6%	5.6%
User charges and fees	2,018	1,425	3,232	1,354	1,646	41.6%	(55.9%)	138.7%	(17.7%)
Interest and investment revenue	480	482	513	480	340	(0.4%)	(6.0%)	6.9%	41.2%
Grants and contributions for operating purposes	213	227	191	200	170	(6.2%)	18.8%	(4.5%)	17.6%
Other revenues	2,076	3,815	4,301	3,341	2,966	(45.6%)	(11.3%)	28.7%	12.6%
Total revenue	**12,583**	**13,406**	**13,877**	**10,667**	**10,134**	**(6.1%)**	**(3.4%)**	**30.1%**	**5.3%**
Expenses									
Employees	4,920	4,951	4,821	4,460	4,340	(0.6%)	2.7%	8.1%	2.8%
Borrowing costs	172	155	161	164	169	11.0%	(3.7%)	(1.8%)	(3.0%)
Materials and contract expenses	3,026	3,357	3,898	2,293	2,508	(9.9%)	(13.9%)	70.0%	(8.6%)
Depreciation and amortisation	4,718	4,627	4,424	4,023	2,582	2.0%	4.6%	10.0%	55.8%
Other expenses	2,065	1,843	1,597	1,430	1,396	12.0%	15.4%	11.7%	2.4%
Total expenses	**14,901**	**14,933**	**14,901**	**12,370**	**10,995**	**(0.2%)**	**0.2%**	**20.5%**	**12.5%**
Operating result (excluding capital grants and contributions)	**(2,318)**	**(1,527)**	**(1,024)**	**(1,703)**	**(861)**	(51.8%)	(49.1%)	39.9%	(97.8%)
Operating result (including capital grants and contributions)	**23**	**109**	**(259)**	**(1,270)**	**(101)**	(78.9%)	142.1%	79.6%	(1157.4 %)

Table 2 - Items excluded from Income Statement

Excluded items	2014	2013	2012	2011	2010
Grants and contributions for capital purposes	2,341	1,636	765	433	760
Net gain/(loss) from the disposal of assets	283	(24)	(277)	4	169

Table 3 – Employee Numbers

	2014	2013	2012	2011	2010
Full Time Equivalent Employees at year end	70	66	70	63	65

Table 4 – Balance Sheet

Balance sheet ($'000s)	Year ended 30 June					% annual change			
	2014	2013	2012	2011	2010	2014	2013	2012	2011
Current assets									
Cash and cash equivalents	2,181	4,144	7,102	7,622	6,282	(47.4%)	(41.7%)	(6.8%)	21.3%
Investments - current term deposits	11,000	7,000	0	0	0	57.1%	N/A	N/A	N/A
Investments - other	0	233	0	380	0	N/A	N/A	(100.0%)	N/A
Receivables	772	642	2,974	1,107	1,130	20.2%	(78.4%)	168.7%	(2.0%)
Inventories	768	900	854	1,000	891	(14.7%)	5.4%	(14.6%)	12.2%
Other	18	149	160	166	137	(87.9%)	(6.9%)	(3.6%)	21.2%
Total current assets	14,739	13,068	11,090	10,275	8,440	12.8%	17.8%	7.9%	21.7%
Non-current assets									
Investments	0	0	233	233	613	N/A	(100.0%)	0.0%	(62.0%)
Receivables	32	61	178	219	224	(47.5%)	(65.7%)	(18.7%)	(2.2%)
Infrastructure, property, plant & equipment	184,665	184,173	183,774	179,533	173,929	0.3%	0.2%	2.4%	3.2%
Intangibles	281	263	0	0	0	6.8%	N/A	N/A	N/A
Total non-current assets	184,978	184,497	184,185	179,985	174,766	0.3%	0.2%	2.3%	3.0%
Total assets	**199,717**	**197,565**	**195,275**	**190,260**	**183,206**	**1.1%**	**1.2%**	**2.6%**	**3.9%**

Balance sheet ($'000s)	Year ended 30 June					% annual change			
	2014	2013	2012	2011	2010	2014	2013	2012	2011
Current liabilities									
Payables	963	641	1,106	787	817	50.2%	(42.0%)	40.5%	(3.7%)
Borrowings	183	98	92	85	80	86.7%	6.5%	8.2%	6.3%
Provisions	1,812	1,233	1,174	1,135	1,210	47.0%	5.0%	3.4%	(6.2%)
Total current liabilities	2,958	1,972	2,372	2,007	2,107	50.0%	(16.9%)	18.2%	(4.7%)
Non-current liabilities									
Payables	113	123	0	0	0	(8.1%)	N/A	N/A	N/A
Borrowings	2,506	1,710	1,809	1,901	1,986	46.5%	(5.5%)	(4.8%)	(4.3%)
Provisions	52	506	459	429	395	(89.7%)	10.2%	7.0%	8.6%
Total non-current liabilities	2,671	2,339	2,268	2,330	2,381	14.2%	3.1%	(2.7%)	(2.1%)
Total liabilities	**5,629**	**4,311**	**4,640**	**4,337**	**4,488**	**30.6%**	**(7.1%)**	**7.0%**	**(3.4%)**
Net assets	**194,088**	**193,254**	**190,635**	**185,923**	**178,718**	**0.4%**	**1.4%**	**2.5%**	**4.0%**

Table 5 - Cashflow

Cash Flow Statement ($'000s)	Year ended 30 June				
	2014	2013	2012	2011	2010
Cash flows from operating activities	5,263	6,775	2,809	2,429	2,486
Cash flows from investing activities	(8,107)	(9,640)	(3,244)	(1,009)	377
Proceeds from borrowings and advances	1,000	0	0	0	0
Repayment of borrowings and advances	(119)	(93)	(85)	(80)	(123)
Cash flows from financing activities	881	(93)	(85)	(80)	(123)
Net increase/(decrease) in cash and equivalents	**(1,963)**	**(2,958)**	**(520)**	**1,340**	**2,740**

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 (now OLG) with representatives from the Department of Premier and Cabinet and NSW Treasury.

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

Office of Local Government (OLG)

OLG (previously DLG) is an Office in the Planning and Environment cluster and is responsible for local government across NSW. OLG’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 OLG has a policy, legislative, investigative and program focus in matters ranging from local government finance, infrastructure, governance, performance, collaboration and community engagement. OLG 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.

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.

[1] IPART “Revenue Framework for Local Government” December 2009 p.83
[2] DLG “Recognition of certain assets at fair value” March 2009

Financial Sustainability Rating (FSR)

The FSR is an assessment of a council's capacity to meet its financial commitments in the short, medium and long term. The FSR for each Council has been determined based on the review and consideration of a Council's historical performance against a set of benchmark indicators. The rating methodology consists of seven FSR categories. The FSR is calculated using weighted benchmarks according to the relative importance of each benchmark in terms of a Council's financial capacity and sustainability.

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).

Outlook

The Outlook assigned to Council is TCorp's assessment of the potential movement of Council's FSR within the next three years. The outlook methodology consists of three categories. A positive Outlook indicates that a Council's FSR is likely to improve in the short term, whilst a Neutral Outlook indicates that the FSR is likely to remain unchanged. A Negative Outlook indicates that a Council's FSR is more likely to deteriorate and is a sign of a general weakening in performance and sustainability.

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 + current term deposits / (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.

Level 22, Governor Phillip Tower, 1 Farrer Place
SYDNEY NSW 2000, AUSTRALIA

T: +61 2 9325 9325 F: +61 2 9325 9333
W: tcorp.nsw.gov.au ABN: 99 095 235 825

New South Wales Treasury Corporation

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