Forbes Shire Council

Financial Assessment, Sustainability and Benchmarking Report

8 March 2013

Prepared by NSW Treasury Corporation for Forbes 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.

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

The report has been prepared for Forbes Shire Council, the DLG and the Independent Review Panel. TCorp shall not be liable to Forbes Shire Council or have any liability to any third party under the law of contract, tort and the principles of restitution or unjust enrichment or otherwise for any loss, expense or damage which may arise from or be incurred or suffered as a result of reliance on anything contained in this report.
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Section 1 Executive Summary

This report provides an independent assessment of Forbes 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’s financial performance has been satisfactory in some areas over the review period based on the following observations:

- Approximately 62.6% of the Council’s revenue base is derived from own sourced revenue (rates and annual charges, and user charges and fees). Council can rely upon these sources of revenue on an ongoing basis for financial flexibility
- Council’s Unrestricted Current Ratio has been above benchmark in each of the past four years indicating Council had sufficient liquidity
- Over the review period, Council had sufficient liquidity to meet its short term liabilities

Areas of concern are that:

- Council’s operating result has been declining since 2009. Council’s EBITDA in particular has declined by $2.1m over the review period to $6.5m. In 2011 and 2012, Council’s operating results have been negatively impacted by substantial increases in borrowings and depreciation expense and, costs associated with a bulky goods business centre that Council is developing as part of providing economic stimulus to the region
- Over the review period, Council did not spend the required amounts on renewals of building and infrastructure assets

The Council reported $11.9m of Infrastructure Backlog in 2012, which represents 4.2% of its infrastructure asset value of $290.1m. Other observations include:

- Council’s Infrastructure Backlog marginally decreased between 2009 and 2012
- A significant portion of the backlog (62.6%) was related to sewerage assets in 2012
- The required maintenance amounts are being spent on Council’s assets
- Over the review years, the spending on capital expenditure was sufficient to maintain the asset base although the Ratio was well below benchmark in 2012
The key observations from our review of Council’s 10 year forecasts for its General Fund are:

- The LTFP assumes that existing levels of services to the community are maintained
- The Operating Ratio is forecast to improve over time as revenue is forecast to increase at a greater rate than operating expenses each year. In 2013, operating expenses are forecast to decrease as they were unusually high in 2011 and 2012 due to flood related expenses and unplanned RMS funded road works
- Council’s level of fiscal flexibility is sound as Own Source Operating Revenue Ratio is maintained at levels above 60.0%
- It appears that Council will have sufficient liquidity throughout the next 10 years to service all short and long term liabilities, and currently scheduled capital expenditure
- The projections for capital expenditure show that Council is likely to face an infrastructure funding gap in the 10 year forecast period as current forecast expenditure is well below benchmark. Council needs to integrate its Asset Management Plan into its LTFP

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 financial position. Both past performance and the financial forecast support our findings that Council is moderately Sustainable.

Our key observations are:

- Council’s long term Sustainability is dependent on Council’s ability to control increases in expenses such as employee costs and materials and contracts expense in line with the LTFP forecasts
- The floods in recent years increase the challenge for Council of maintaining its asset base. Whilst Council receives funding to reimburse it for flood related costs. Events such as floods may result in Council having to delay or amend its scheduled capital works programs which can adversely impact asset quality. This is reflected in the low level of capital expenditure reported on 2012.
- Over the past four years, Council did not spend the required amounts on buildings and infrastructure renewals. If this trend continues, this could lead to a reduction of asset quality and ultimately service levels. Based on the current version of the LTFP, Council is forecast to incur an infrastructure funding gap. Through the recent development of Asset Management Plans, Council is working towards assessing the infrastructure gap in order to take the required measures to address it

In respect of our Benchmarking analysis we have compared 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 is mixed with a deteriorating and below average Operating Ratio result despite having an above benchmark and average Own Source Operating Revenue Ratio. In the medium term, Council’s Operating Ratio is forecast to improve and be above the peer group but below the benchmark
- Council was in a sound liquidity position with an Unrestricted Current Ratio above the group average. In medium term, Council’s liquidity position is forecast to remain sound and above the peer group
Council’s debt servicing capacity has generally been sound but below the peer group. This situation is forecast to remain unchanged in the medium term.

Over the review period, Council has outperformed the group average in terms of maintenance of assets and level of Infrastructure Backlog. Council’s performance in terms of capital expenditure was on average below its peers and Council’s level of renewals of assets was weak compared to the benchmark and the group’s average level. In the medium term, Council’s Capital Expenditure Ratio is forecast to improve marginally but to be below the benchmark and the peer group.

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 which 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 ratios 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:

- They provided clarifying comments on issues of its flood works and RMS contracts which have been incorporated into this report and reviewed by Council
- They provided additional information on the costs associated with a bulky goods business centre that Council is developing
- Council has agreed with the overall findings of the report

**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.

<table>
<thead>
<tr>
<th>Ratio</th>
<th>Benchmark</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating Ratio</td>
<td>&gt; (4.0%)</td>
</tr>
<tr>
<td>Cash Expense Ratio</td>
<td>&gt; 3.0 months</td>
</tr>
<tr>
<td>Unrestricted Current Ratio</td>
<td>&gt; 1.50x</td>
</tr>
<tr>
<td>Own Source Operating Revenue Ratio</td>
<td>&gt; 60.0%</td>
</tr>
<tr>
<td>Debt Service Cover Ratio (DSCR)</td>
<td>&gt; 2.00x</td>
</tr>
<tr>
<td>Interest Cover Ratio</td>
<td>&gt; 4.00x</td>
</tr>
<tr>
<td>Building and Infrastructure Backlog Ratio</td>
<td>&lt; 0.02x</td>
</tr>
<tr>
<td>Asset Maintenance Ratio</td>
<td>&gt; 1.00x</td>
</tr>
<tr>
<td>Building and Infrastructure Asset Renewal Ratio</td>
<td>&gt; 1.00x</td>
</tr>
<tr>
<td>Capital Expenditure Ratio</td>
<td>&gt; 1.10x</td>
</tr>
</tbody>
</table>
2.3: Overview of the Local Government Area

The Forbes Shire Council Local Government Area (LGA) is located in the central west of New South Wales, about 360 kilometres from Sydney.

The LGA is bounded by Parkes Shire in the north, Cabonne Council in the east, Cowra and Weddin Shires in the south, and Bland and Lachlan Shires in the west.

The LGA is predominantly rural, with several townships which include residential, industrial and commercial areas. Much of the rural area is used for farming including sheep and cattle grazing, dairy farming, orcharding and viticulture.

The population is mainly based in Forbes (approximately 95.0% of the total population). The median age is 41 years.
Section 3  Review of Financial Performance and Position

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

3.1: Revenue

Key Observations

- Rates and annual charges increased by 4.5% in 2010, 5.2% in 2011, and 1.4% in 2012 to $9.1m. Between 2009 and 2011, farmland and residential rates both increased by $0.2m and $0.3m to $2.8m and $2.0m respectively in 2011. They remained relatively static in 2012. In 2012, the increase in rates was in line with the rate peg. However, due to a change in accounting system, the treatment of Council rated land (and the associated expense) and pensioner rebate rates (and the associated grant income) were accounted for differently in 2012.

- User charges and fees decreased by 6.3% over the review period to $9.9m. This was mainly due to decreases in RMS charges ($1.3m decrease over the review period to $4.2m in 2012) and in water supply charges ($0.6m decrease over the review period to $0.7m in 2012). RMS charges fluctuate depending on the requirements of the RMS in the Forbes LGA and water supply charges decreased due to a wet period following a prolonged period of drought.

- Over the review period, operating grants and contributions decreased by 1.0% to $8.0m. They decreased by 8.8% ($0.7m) in 2010 due to the first instalment of the 2010 Financial Assistance Grant ($1.2m) being prepaid in 2009. Operating grants and contributions decreased by 15.0% ($1.1m) in 2011 to $6.3m mainly due to a delay in the receipt of Road to 9.088 8.959 8.513 8.148
9.877 9.079 8.567 10.546
2.073 2.006 1.623 1.962
1.962
8.048
6.300 7.416
8.130
Recovery grants which were received in 2012. In 2012, operating grants and contributions increased by 27.7% ($0.7m) to $8.0m following the Federal Government prepaying in 2012 half ($1.1m) of the 2013 Financial Assistance Grants.

- Other revenue increased by $0.6m over the review period to $0.9m. Council is the host council for Centroc (the regional organisation of central NSW Councils) and periodically receives Financial Assistance Funding on behalf of Centroc. In 2012, it amounted to $0.3m and was the main contributor to other revenue. However the monies are passed directly onto Centroc and are offset by the corresponding Centroc expense.

### 3.2: Expenses

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

**Key Observations**

- While the number of equivalent full time employees remained static over the review period, employee costs increased by 8.9% in 2010, 20.5% in 2011, and 5.0% in 2012 to $8.9m. This was due to increases in salaries and wages which rose by $2.6m between 2009 and 2012 to $6.6m as Council’s staff received increases in salaries granted under State awards. In addition, due to flood repair works and unplanned RMS funded projects on State roads, Council’s existing staff worked more overtime. This increased expenditure was offset by the funding received for flood works and the RMS contract income received for the RMS projects for which these expenses were incurred.

- Borrowing costs increased by $1.6m over the review period to $2.2m p.a. In 2011, Council entered into a finance lease for stage two of the sheep saleyards at the Central West Livestock Exchange. This project is a Private Public Agreement with Projects and Infrastructure. Due to these increases in borrowing costs, Council’s saleyards business incurred operating deficits of $0.3m in 2011 and $1.3m in 2012.
• Materials and contracts cost decreased by 4.5% over the review period to $10.9m. They declined by 23.7% ($2.7m) between 2009 and 2011 to $8.7m due to a decrease of $3.7m in contractor and consultancy costs which amounted to $4.0m in 2011. Materials and contracts costs increased by 25.2% ($2.2m) in 2012 due to additional works required by the RMS (RMS charges increased by $0.1m in 2012 to $4.2m while RMS contributions increased by $0.4m in 2012 to $1.2m) and grant funded flood damage works resulting from the 2012 flood events which increased the needs in terms of raw materials and consumables, and contractors.

• Due to the Asset Revaluations process, annual depreciation expense increased by 18.3% in 2010, 39.3% in 2011 and 8.5% in 2012 to $8.4m.

• Other expenses increased by 39.1% ($1.1m) over the review period to $3.7m. This was due to increases in electricity and heating expenses, Centroc expenses (representing the transfer of funds received on behalf of Centroc and recorded in other income), caravan park costs (which are offset by caravan park income), and youth services expenses. Council officers have indicated that the caravan park business is self-funding.
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.

Key Observations

- Council reported operating surpluses excluding capital grants and contributions in 2009 and 2010. In recent years, Council’s operating results were negatively impacted by increases in borrowing, and depreciation expenses and, employee and material and contracts expenses incurred by the current economic development stimulus project. These costs related to the economic development will be capitalised in future years. As a consequence, Council reported large operating deficits excluding capital grants and contributions which amounted to $2.1m in 2011 and $4.1m in 2012. Council expenses include a non-cash depreciation expense ($8.4m in 2012), which has increased over the past four years following the Asset Revaluations process. Whilst the non cash nature of depreciation can favourably impact on ratios such as EBITDA that focus on cash, depreciation is an important expense at it represents the allocation of the value of an asset over its useful life.

- In 2012, Council incurred a $3.2m operating deficit including capital grants and contributions. The deficit was due to an increase of $4.7m in operating expenses that year.
### 3.4: Financial Management Indicators

<table>
<thead>
<tr>
<th>Performance Indicators</th>
<th>Year ended 30 June</th>
</tr>
</thead>
<tbody>
<tr>
<td>EBITDA ($'000s)</td>
<td>2012</td>
</tr>
<tr>
<td>Operating Ratio</td>
<td>(13.5%)</td>
</tr>
<tr>
<td>Interest Cover Ratio</td>
<td>2.91x</td>
</tr>
<tr>
<td>Debt Service Cover Ratio</td>
<td>2.46x</td>
</tr>
<tr>
<td>Unrestricted Current Ratio</td>
<td>11.83x</td>
</tr>
<tr>
<td>Own Source Operating Revenue Ratio</td>
<td>61.5%</td>
</tr>
<tr>
<td>Cash Expense Ratio</td>
<td>8.6 months</td>
</tr>
<tr>
<td>Net assets ($'000s)</td>
<td>319,187</td>
</tr>
</tbody>
</table>

**Key Observations**

- Council’s operating result has been declining since 2009. The Operating Ratio substantially decreased over the review period and was below the benchmark in 2011 and 2012. Council’s underlying results (measured using EBITDA) decreased by $2.1m over the review period to $6.5m.
- 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 Cash Expense Ratio was consistently below the benchmark between 2009 and 2011. However, Council had sufficient liquidity as it maintained most of its cash in long term deposits with more favourable interest rates. In 2012, the Cash Expense Ratio was above the benchmark as Council maintained a greater part of its cash in short term deposits.
- The DSCR was consistently above the benchmark of 2.00x over the past four years. The Interest Cover Ratio was above the benchmark of 4.00x, with the exception of 2012 after the Council entered into a finance lease arrangement.
- Council had borrowings of $20.6m in 2012, being 6.5% of the Net Assets. These borrowings include a finance lease amounting to $14.6m for the construction of the sheep yards at the Central West Livestock Exchange which started in 2011. As the finance lease was in its early stages in 2012, Council only paid interest charges. Council will start to repay the principal in 2013.
- The Own Source Operating Revenue Ratio was above the benchmark of 60.0% over the review period, indicating Council had financial flexibility.
- Net Assets increased by $88.4m between 2009 and 2012 mainly 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.

- When the Asset Revaluations are excluded, the underlying trend in all four years has been an 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 $5.7m 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

- Council’s cash and investments increased by $6.0m over the review period to $36.9m in 2012.
- In 2012, Council had $36.9m in cash and investments (including $16.8m in cash) of which $14.7m was externally restricted, $12.8m was internally restricted and $9.4m was unrestricted.
- Over the review period, Council did not have any CDOs or any other forms of investment securities.

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

Council reported an Infrastructure Backlog of $11.9m in 2012, with 62.7% related to sewer assets. The total value of the backlog marginally decreased ($0.3m) over the review period. The backlog related to buildings decreased from $4.0m in 2009 to $0.1m in 2012 following several upgrades undertaken in recent years. In the meantime, the value of the backlog related to sewerage increased from $0.8m 2009 to $7.5m in 2012. Council officers indicated that a number of assessments are currently being undertaken in order to finalise the renewal program of the ageing sewer assets in accordance with the AMP. The backlog related to sewer assets will probably see a further incremental increase before the program is able to be implemented. In contrast, Council believe that the backlog related to roads will likely to be valued downwards in subsequent updates of the AMP. The AMP for roads has been completed but they are still subject to updates as further road condition assessments are being undertaken. Overall, the level of the backlog is forecast to remain consistent with the existing levels.
Council has recently improved its backlog valuation techniques. In addition, a number of assessments are being undertaken to organise the renewal programs. As a consequence, it is anticipated that the backlog will decrease in coming years.

3.6(b): Infrastructure Status

<table>
<thead>
<tr>
<th>Infrastructure Status</th>
<th>Year ended 30 June</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2012</td>
</tr>
<tr>
<td>Bring to satisfactory standard ($'000s)</td>
<td>11,946</td>
</tr>
<tr>
<td>Required annual maintenance ($'000s)</td>
<td>3,501</td>
</tr>
<tr>
<td>Actual annual maintenance ($'000s)</td>
<td>4,600</td>
</tr>
<tr>
<td>Total value of infrastructure assets ($'000s)</td>
<td>290,103</td>
</tr>
<tr>
<td>Total assets ($'000s)</td>
<td>344,497</td>
</tr>
<tr>
<td>Building and Infrastructure Backlog Ratio</td>
<td>0.04x</td>
</tr>
<tr>
<td>Asset Maintenance Ratio</td>
<td>1.31x</td>
</tr>
<tr>
<td>Building and Infrastructure Renewals Ratio</td>
<td>0.26x</td>
</tr>
<tr>
<td>Capital Expenditure Ratio</td>
<td>0.56x</td>
</tr>
</tbody>
</table>

- The Building and Infrastructure Backlog Ratio was consistently above the benchmark of 0.02x over the review period. The ratio marginally declined over time due to increases in the value of the Infrastructure Assets following the Asset Revaluations.
- The Asset Maintenance Ratio was consistently above the benchmark of 1.00x, indicating spending on asset maintenance was sufficient.
- The Building and Infrastructure Renewals Ratio was consistently well below the benchmark of 1.00x, indicating spending on building and infrastructure renewals has not been sufficient. Over the review period, Council prioritised flood repair works and RMS works over renewal of assets.
- The Capital Expenditure Ratio was above the benchmark in 2010 and 2011, indicating spending on asset additions was sufficient in those years. In 2011, the ratio was favourably impacted by the commencement of stage two of the saleyards project ($14.2m expenditure). In 2012, the ratio decreased to a level well below the benchmark of 1.10x as a consequence of a decrease in purchases of IPP&E compared to 2011 and increased depreciation. Overall, the spending on capital expenditure was sufficient to maintain the asset base.
### 3.6(c): Capital Program

<table>
<thead>
<tr>
<th>Capital Program ($'000s)</th>
<th>Year ended 30 June</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2012</td>
</tr>
<tr>
<td>New capital works</td>
<td>3,352</td>
</tr>
<tr>
<td>Replacement/refurbishment of existing assets</td>
<td>1,661</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>5,013</td>
</tr>
</tbody>
</table>

In recent years, Council completed several capital projects including:

- Stage two and three of the Central West Livestock Exchange
- Forbes Medical Centre
- Jemalong Regional Education Centre
- Water Park and Skatepark
- Residential subdivision of York Street
- Stage one of the Central West Industrial Park
- CBD improvements
- Repairs of historic Bates Bridge
- Acquisition of the Forbes Riverside Apex Tourist Park (caravan park)
- Jemalong Retirement Village sewerage works
- Daroobalgie Water Main
- Construction of a third bore
3.7: Specific Risks to Council

- **Ageing infrastructure.** Council's infrastructure is ageing and needs significant renewal, maintenance and repair which requires capital and staffing costs. Council is reviewing its strategic assets through the Asset Management Plans (AMP) and the LTFP. In local villages in particular, roads require more maintenance including the upgrading of the dirt roads.

- **Supporting economic growth in the community.** Council needs to support new and existing businesses. Public and private sectors need to work together to develop and improve local businesses. In the Community Strategic Plan, attracting new industry and manufacture enterprise to Forbes has been identified as a key challenge raised by the local community at ‘Forbes Futures Forum’ that was held in November 2011. Industry in particular needs to be improved to increase economic development. In recent years, the focus has been on agricultural development but the CSP suggests that Council should help to adjust its focus to promote industry. Council has economic development incentives in place to foster expansion of existing businesses and to attract new business. Currently Council is developing a new bulky goods business centre which has secured one major national retailer as anchor tenant and negotiations continue with two further national enterprises.

- **Saleyards finance lease.** In 2011, Council entered a finance lease of $14.6m to fund the second stage of the saleyards at the Central West Livestock Exchange. This lease substantially increased Council's borrowing costs which rose from $0.7m in 2010 to $2.2m in 2012. Council's saleyards business incurred operating deficits of $0.3m in 2011 and $1.3m in 2012. This was mainly due to the increases in the borrowing costs. In addition, a decrease of $0.6m in user charges in 2011 to $2.3m as well as increases in materials and contacts, and depreciation costs since 2011 have negatively impacted the operating results from the saleyards business. It is likely that these operating deficits will continue as borrowing costs are forecast to remain high in upcoming years. Council should continue to review user charges annually with a view to balancing budget requirements with maintaining competitiveness. Increased focus on marketing and growing the throughput may assist in mitigating the pressure on charges.
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.

4.1:  Operating Results

![Operating Ratio for General Fund](image)

The Operating Ratio deteriorated in 2011 and 2012 due to substantial increases in borrowing costs and depreciation and, employee and materials and contracts costs associated with the development of the bulky goods business centre.

The projections show that operating deficits excluding capital grants and contributions are forecast each year between 2013 and 2021. The deficits are forecast to decrease over time with the Operating Ratio forecast to be above the benchmark from 2017 onwards, as operating revenue is forecast to increase at greater rates than operating expenses.

In 2013, the Ratio is forecast to be favourably impacted by a decline of $3.6m in operating expenses due to a decrease of $1.8m in employee costs and a decrease of $1.9m in other expenses. In 2012, employee costs were high due to unplanned works funded by the RMS that incurred high levels of overtime on Saturdays and rostered days off. In addition, the forecasts indicate a decrease of $1.9m in other expenses in 2013. Other expenses were high in 2012, due an increase of $0.7m in electricity and heating expenses in particular. The forecast decreases in expenses will need to be carefully managed by Council to ensure that they are achieved.
4.2: Financial Management Indicators

Liquidity Ratios

The Cash Expense Ratio was below the benchmark of three months in 2011 and 2012 as Council maintained most of its cash in long term deposits.

From 2013 onwards, the Cash Expense Ratio is forecast to be above the benchmark, indicating Council has sufficient liquidity. The ratio is forecast to be higher than the historical levels. We assume that as the current LTFP is updated and optimised, the ratio will be around its historical levels. Based on Council’s historical investment policy, it is likely that cash reserves will be invested in long term deposits with more favourable interest rates.
Fiscal Flexibility Ratios

The Unrestricted Current Ratio is consistently above the benchmark of 1.50x, indicating Council has sufficient liquidity to meet its short term liabilities.

The Own Source Operating Ratio is above the benchmark each year of the forecast at levels around 69.0%. These projections are higher compared to the historical levels.
We consider the ratio to be overstated for the entire forecast as the projection for capital grants and contributions are forecast to be lower than historical levels which skews the ratio upwards. It is expected that as the certainty of the receipt of capital grants is confirmed and forecasts are adjusted, that own source revenue will continue to be around historical levels.

The DSCR is above the benchmark each year of the forecast, indicating Council has the capacity to service its existing loans including the finance lease that started in 2011. As indicated in the current version of the LTFP, Council does not forecast to add any further borrowings during the 2013 to 2022 period.
Similarly to the DSCR, the Interest Cover Ratio shows that Council has sufficient capacity to service scheduled debt commitments.

4.3: Capital Expenditure

The Capital Expenditure Ratio is below the benchmark of 1.10x each year of the forecast.

The total value of capital expenditure ($50.8m) forecast for the 10 upcoming years is lower than the accumulated depreciation ($79.1m), indicating that Council’s assets base is theoretically forecast to deteriorate at a greater level than Council is forecasting to replace or expand its asset base. As a consequence, Council will experience a deteriorating quality of assets. Once the AMP is fully integrated with the LTFP, Council is likely to face an infrastructure funding gap.

The LTFP shows a static capital expenditure of $5.1m each year from 2014 to 2022. Council officers indicated that, as the LTFP is a base case scenario, it is assumed that a conservative status quo is maintained in terms of capital expenditure. Council has recently completed its AMP and is currently working towards assessing the funding gaps and updating the LTFP.

Capital projects forecast for the 2013 to 2016 period include improvements of the pipe infrastructure, upgrades of pedestrian access, completion of the backwash and waste treatment facility.
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%

Key Observations and Risks

- The LTFP is a ‘base case’ scenario where a conservative status quo is maintained in terms of its capital expenditure. However, the effect of this assumption will be a deteriorating asset base and whilst the current scenario assumes that service levels remain unchanged, it is unlikely that this can be achieved using the current assumptions.
- The LTFP was completed prior to 30 June 2012 and built on projected figures for 2012. It has not been updated with the actual 2012 figures. As a consequence, the forecasts show substantial variations in 2013, in rates and annual charges in particular.
- TCorp based its analysis on the actual figures for 2011 and 2012 for the General Fund as well as projections for the 2013-2022 period.
- Rates and annual charges are forecast to increase by 11.6% ($0.8m) in 2013. When calculating the forecast projections, Council did not split rates received on Council’s rated land as well as pensioner rebate rates as it did in 2012 (as mentioned in section 3.1.), instead they were incorporated in rates and charges. ). Rates and annual charges are forecast to increase by 3.0% p.a. from 2014 onwards.
- User charges and fees are forecast to increase by 4.1% in 2013 and 3.0% p.a. from 2014 onwards. Operating grants and contributions are forecast to decrease by 11.9% ($0.9m) in 2013 to $6.8m to adjust for the prepayment in 2012 of half ($1.1m) of the 2013 Financial Assistance Grants. Operating grants and contributions are forecast to increase by 2.0% p.a. from 2014 onwards.
- Capital grants and contributions are forecast to amount to $0.1m each year of the forecast which is lower than historical receipts.
- Employee costs are forecast to decrease by 23.5% ($1.8m) in 2013 as they were exceptionally high in 2011 and 2012 due to flood repair works and unplanned RMS works. Employee costs are forecast to increase by 2.6% p.a. from 2014 onwards. Council does not budget for either expense or income related to RMS works as these are unknown at the time of preparing the forecast.
- Materials and contracts costs are forecast to decrease by 1.6% ($0.1m) in 2013 and to increase at an average rate of 3.7% p.a. from 2014 onwards. As the LTFP is a 'conservative status quo' scenario, materials and contracts expenses are forecast to remain at levels equivalent to the higher than usual levels recorded in 2011 and 2012 due to the flood works.
- Depreciation expense is forecast to be static ($7.9m each year) and will be updated when the AMP is incorporated to the LTFP.
- Other expenses are forecast to decrease by 51.9% ($1.9m) in 2013 although they have increased substantially since 2009. Council’s forecast for electricity expenses are included within appropriate areas of the operational budget such as materials and contracts for instance. Other expenses are forecast to increase by 2.0% p.a. from 2014 onwards.
- TCorp notes that many of the assumptions behind the LTFP are significantly different to the historical performance of Council and TCorp’s stated benchmark assumptions. Council has recognised that further work is required in respect of its financial forecast and as the LTFP is updated, some items will need to be adjusted such as rates and annual charges in 2013, capital grants and contributions and depreciation. Council also needs to integrate its AMP with the LTFP.
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. Some comments and observations are:

- Based on benchmarks of DSCR>2.00x and Interest Cover Ratio>4.00x, up to $4.2m could be borrowed in 2013
- The DSCR and the Interest Cover Ratio are above their respective benchmarks each year when the borrowings are incorporated into the model
- This scenario has been calculated by basing borrowing capacity on a 10 year amortising loan with an interest rate of 7.50% p.a.
- As noted in our comments in section 4.4, we consider that some of the assumptions in Council’s current LTFP need reviewing. In TCorp’s view it would be prudent for Council to complete its review of its LTFP including integrating its AMP with its LTFP prior to proceeding with any further borrowings.
TCorp believes Council to be moderately Sustainable. Council has a record of reporting some operating surpluses as well as operating deficits in 2011 and 2012 due to substantial increases in operating expenses. Council is likely able to manage some unforeseen financial shocks but Council needs to reduce its expenses in accordance with its forecast for 2013.

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

- Council’s long-term Sustainability is dependent on Council’s ability to control and reduce the increases in expenses such as employee costs and materials and contracts. If these expenses continue to increase, they are likely to impact negatively on Council’s Sustainability. Some of the increased expenses such as flood-related works and RMS works are offset by increases in the associated grants and income. Council’s also need to manage the increase in borrowing costs and, other costs related to the current economic development project.
- Based on the current version of the LTFP, Council aims to substantially decrease employee costs in 2013 which were high in recent years due to flood repair works and unplanned RMS funded projects on State roads.
- The floods in recent years have increased the challenge for Council of maintaining a Sustainable LGA. Widespread destruction of assets such as roads has required shifted capital work priorities and delays in the capital program.
- Over the past four years, the value of Infrastructure Backlog remained static while spending on renewal work was insufficient. Based on the current version of the LTFP, spending on asset renewals will be insufficient in the 10 year forecast which could lead to a reduction in the quality of its assets and ultimately impact service standards. In particular, through the recent development of AMPs, Council will work towards assessing the infrastructure gap in order to take the required measures to address it. Council needs to complete its AMPs and integrate it with its LTFP.
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 LTFP). Figures 22 to 24 do not include the 2016 forecast position as those numbers are not available.

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

Financial Flexibility

Council’s Operating Ratio has substantially deteriorated over the past four years. Since 2011, the ratio has been below both the benchmark and the group average. In the medium term, Council’s Operating Ratio is forecast to improve and be above the group average but below the benchmark.
Over the review period, Council’s Own Source Operating Revenue has outperformed benchmark and the group average. In the medium term, Council’s ratio is forecast to improve and remain above the benchmark and the peer group.
Council’s liquidity position has been sound over the review period and has improved in recent years. Council’s Unrestricted Current Ratio was consistently above the benchmark and the group average. Since 2011, Council’s Unrestricted Current Ratio has been the highest within the group. Council’s Cash Expense Ratio was below the benchmark and the group average between 2009 and 2011. In 2012, the ratio substantially improved and outperformed both the benchmark and the peer group, as Council maintained a greater part of its cash in short term deposits.

In the medium term, Council’s liquidity position is forecast to decline compared to its recently recorded levels. However, it is forecast to remain above the benchmark and the group average.
Over the review period, Council's debt servicing capacity has remained relatively sound. The DSCR was consistently above benchmark over the past four years. The Interest Cover Ratio was consistently above its benchmark, with the exception of 2012 after the Council entered into a finance lease arrangement. Both of Council's ratios were consistently below the group average over the review period.

In the medium term, Council's debt servicing capacity is forecast to remain sound but below the peer group.
Asset Renewal and Capital Works

Figure 21 - Capital Expenditure Ratio Comparison

Figure 22 - Asset Maintenance Ratio Comparison
Over the review period, Council’s Infrastructure Backlog has consistently been above the benchmark but below the group’s average level of Backlog. Council’s spending on maintenance of assets has consistently outperformed the benchmark and the peer group.

Council’s Capital Expenditure Ratio was above the benchmark in 2010 and 2011 and outperformed the group average in 2011. In 2012, the ratio dipped below the benchmark and the peer group. In the medium term, Council’s Capital Expenditure Ratio is forecast to marginally improve but to remain below the benchmark and the group average.

Council’s Building and Infrastructure Asset Renewal Ratio has consistently been weak when compared to the benchmark and the peer group.
Section 6  Conclusion and Recommendations

Based on our review of both the historic financial information and the 10 year financial forecast within Council’s LTTP we consider Council to be in a satisfactory financial position. Both past performance and the financial forecast support our findings that Council is moderately Sustainable assuming that Council’s operating expenses can be controlled as set out in Council’s LTTP.

We base our recommendation on the following key points:

- Council’s Own Sourced Revenue Ratio remained above the benchmark each year over the review period Council had financial flexibility
- Council’s Unrestricted Current Ratio has been above the benchmark over the past four years indicating Council had sufficient liquidity to manage its short term liabilities

However we would also recommend the following points being considered:

- Council’s operating result has been declining since 2009. In recent years, it has been negatively impacted by substantial increases in operating expenses due to events such as the Asset Revaluations, the development of a bulky goods business centre and the costs associated with the expansion of the saleyards.
- Since 2011, Council reported increasing operating deficits excluding capital grants and contributions.
- Over the review period, spending on renewals of building and infrastructure assets has been well below the required levels. If this trend continues, service levels and quality are likely to be impacted
- TCorp notes that many of the assumptions behind the LTTP are significantly different to the historical performance of Council and TCorp’s stated benchmark assumptions. Council has recognised that further work is required in respect of its financial forecast and as the LTTP is updated, some items will need to be adjusted such as rates and annual charges in 2013, capital grants and contributions and depreciation. Council also needs to integrate its AMP with the LTTP
## Appendix A  Historical Financial Information Tables

### Table 1- Income Statement

<table>
<thead>
<tr>
<th>Income Statement ($'000s)</th>
<th>Year ended 30 June</th>
<th>% annual change</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Revenue</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rates and annual charges</td>
<td>9,088</td>
<td>8,959</td>
</tr>
<tr>
<td>User charges and fees</td>
<td>9,877</td>
<td>9,079</td>
</tr>
<tr>
<td>Interest and investment revenue</td>
<td>2,073</td>
<td>2,006</td>
</tr>
<tr>
<td>Grants and contributions for operating purposes</td>
<td>8,048</td>
<td>6,300</td>
</tr>
<tr>
<td>Other revenues</td>
<td>931</td>
<td>954</td>
</tr>
<tr>
<td><strong>Total revenue</strong></td>
<td>30,017</td>
<td>27,298</td>
</tr>
</tbody>
</table>

**Expenses**

<table>
<thead>
<tr>
<th>Expenses</th>
<th>2012</th>
<th>2011</th>
<th>2010</th>
<th>2009</th>
<th>% annual change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employees</td>
<td>8,851</td>
<td>8,430</td>
<td>6,995</td>
<td>6,426</td>
<td>5.0%</td>
</tr>
<tr>
<td>Borrowing costs</td>
<td>2,245</td>
<td>1,531</td>
<td>696</td>
<td>669</td>
<td>46.6%</td>
</tr>
<tr>
<td>Materials and contract expenses</td>
<td>10,879</td>
<td>8,691</td>
<td>9,355</td>
<td>11,391</td>
<td>25.2%</td>
</tr>
<tr>
<td>Depreciation and amortisation</td>
<td>8,351</td>
<td>7,694</td>
<td>5,523</td>
<td>4,667</td>
<td>8.5%</td>
</tr>
<tr>
<td>Other expenses</td>
<td>3,744</td>
<td>3,032</td>
<td>2,377</td>
<td>2,691</td>
<td>23.5%</td>
</tr>
<tr>
<td><strong>Total expenses</strong></td>
<td>34,070</td>
<td>29,378</td>
<td>24,946</td>
<td>25,844</td>
<td>16.0%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Operating result (excluding capital grants and contributions)</th>
<th>2012</th>
<th>2011</th>
<th>2010</th>
<th>2009</th>
<th>% annual change</th>
</tr>
</thead>
<tbody>
<tr>
<td>(4,053)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>(94.9%)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Operating result (including capital grants and contributions)</th>
<th>2012</th>
<th>2011</th>
<th>2010</th>
<th>2009</th>
<th>% annual change</th>
</tr>
</thead>
<tbody>
<tr>
<td>(3,220)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>(896.9%)</td>
</tr>
</tbody>
</table>

### Table 2 - Items excluded from Income Statement

<table>
<thead>
<tr>
<th>Excluded items ($'000s)</th>
<th>2012</th>
<th>2011</th>
<th>2010</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Grants and contributions for capital purposes</td>
<td>833</td>
<td>1,757</td>
<td>544</td>
<td>133</td>
</tr>
<tr>
<td>Net gain from the disposal of assets</td>
<td>158</td>
<td>40</td>
<td>167</td>
<td>469</td>
</tr>
</tbody>
</table>
Table 3 - Balance Sheet

<table>
<thead>
<tr>
<th>Balance Sheet ($'000s)</th>
<th>Year Ended 30 June</th>
<th>% annual change</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Current assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash and equivalents</td>
<td>16,815</td>
<td>3,878</td>
</tr>
<tr>
<td>Investments</td>
<td>20,120</td>
<td>30,160</td>
</tr>
<tr>
<td>Receivables</td>
<td>1,744</td>
<td>2,953</td>
</tr>
<tr>
<td>Inventories</td>
<td>2,342</td>
<td>2,335</td>
</tr>
<tr>
<td>Other</td>
<td>380</td>
<td>313</td>
</tr>
<tr>
<td>Total current assets</td>
<td>41,401</td>
<td>39,639</td>
</tr>
<tr>
<td><strong>Non-current assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investments</td>
<td>0</td>
<td>1,000</td>
</tr>
<tr>
<td>Receivables</td>
<td>538</td>
<td>22</td>
</tr>
<tr>
<td>Infrastructure, property, plant &amp; equipment</td>
<td>302,558</td>
<td>292,207</td>
</tr>
<tr>
<td>Total non-current assets</td>
<td>303,096</td>
<td>293,229</td>
</tr>
<tr>
<td><strong>Total assets</strong></td>
<td>344,497</td>
<td>332,868</td>
</tr>
<tr>
<td><strong>Current liabilities</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Payables</td>
<td>1,474</td>
<td>1,488</td>
</tr>
<tr>
<td>Borrowings</td>
<td>441</td>
<td>411</td>
</tr>
<tr>
<td>Provisions</td>
<td>2,483</td>
<td>2,336</td>
</tr>
<tr>
<td>Total current liabilities</td>
<td>4,398</td>
<td>4,235</td>
</tr>
<tr>
<td><strong>Non-current liabilities</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Borrowings</td>
<td>20,160</td>
<td>19,562</td>
</tr>
<tr>
<td>Provisions</td>
<td>752</td>
<td>816</td>
</tr>
<tr>
<td>Total non-current liabilities</td>
<td>20,912</td>
<td>20,378</td>
</tr>
<tr>
<td><strong>Total liabilities</strong></td>
<td>25,310</td>
<td>24,613</td>
</tr>
<tr>
<td><strong>Net assets</strong></td>
<td>319,187</td>
<td>308,255</td>
</tr>
</tbody>
</table>
Table 4-Cashflow

<table>
<thead>
<tr>
<th>Cashflow Statement ($'000s)</th>
<th>Year ended 30 June</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2012</td>
</tr>
<tr>
<td>Cashflows from operating activities</td>
<td></td>
</tr>
<tr>
<td>7,135</td>
<td></td>
</tr>
<tr>
<td>Cashflows from investing activities</td>
<td></td>
</tr>
<tr>
<td>5,174</td>
<td>(19,019)</td>
</tr>
<tr>
<td>Proceeds from borrowings and advances</td>
<td>1,039</td>
</tr>
<tr>
<td>Repayment of borrowings and advances</td>
<td>(411)</td>
</tr>
<tr>
<td>Cashflows from financing activities</td>
<td></td>
</tr>
<tr>
<td>628</td>
<td>13,151</td>
</tr>
<tr>
<td>Net increase/(decrease) in cash and equivalents</td>
<td>12,937</td>
</tr>
<tr>
<td>Cash and equivalents</td>
<td>16,815</td>
</tr>
</tbody>
</table>
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 2009², DLG required all NSW councils to revalue their infrastructure assets to recognise the fair value of these assets by the end of the 2009/10 financial year.

Collateralised Debt Obligation (CDO)

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

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

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

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

Division of Local Government (DLG)

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

Depreciation of Infrastructure Assets

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

¹IPART “Revenue Framework for Local Government” December 2009 p.83
²DLG “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.

Councillors 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.