Gwydir Shire Council

Financial Assessment and Sustainability Report

Date:	15/03/2017

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Disclaimer

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The report has been prepared based on information provided to TCorp by Gwydir Shire Council. 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 the preparation of this report. TCorp makes no representation as to the accuracy, reliability or completeness of the information contained in this report.

In addition, TCorp does not warrant or guarantee the outcomes or projections contained in this report. The projections and outcomes contained in this report do not necessarily take into consideration the commercial risks, various external factors or the possibility of poor performance by Gwydir Shire Council, all of which may negatively impact the financial capability and sustainability of the Council. This report focuses on Gwydir Shire Council's future sustainability, within prudent risk parameters and the limits of its financial projections.

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1. Executive Summary

In April 2013, TCorp provided Gwydir Shire Council (the Council) with a Financial Assessment and Benchmarking Report as part of the work undertaken for the Independent Local Government Review Panel.

In the report TCorp made the following observations:

- Council was posting consecutive operating deficits when capital grants and contributions were included or excluded. These deficits were forecast to continue over the 10 year forecast period
- Council had sufficient liquidity over the review period but was forecast to run out of funds if the existing service levels were continued within the General Fund
- Council had not spent sufficient funds on asset maintenance, renewals and purchases over the review period and this was forecast to continue and likely increase Council's Infrastructure Backlog
- Council had only completed its IP&R documentation for the first time and it recognised that the AMP and LTFP required some refinement

TCorp's report stated that Council had a Financial Sustainability Rating (FSR) of Very Weak with an Outlook of Neutral.

Following receipt of the report Council has undertaken a number of initiatives with the aim of improving its operating performance. These include:

- successfully applying for a one year SRV for FY2016 of 12.6% above the rate peg that boosted rates revenue to aid with financial sustainability
- successfully applying for a second, permanent SRV from FY2017 of 28.2% above the rate peg (including the retention of the previous 12.6% SRV), to permanently aid with financial sustainability
- undertaking a rigorous revaluation process for its road assets that has included introducing asset componentisation, while completing a reassessment of condition and effective lives and changing the depreciation methodology where appropriate
- reducing its employee count to 156 as at 30 June 2016 after it had grown to 172 by 30 June 2013
- engaging LG Solutions to assist with the completion of its future LTFP, into a format that is used by a significant number of other NSW councils

The key observations from our review of Council's consolidated historic performance are:

- Council achieved an operating surplus in FY2016 when one-off items are excluded, assisted by the SRV and a reduction in depreciation expense of 45.9%
- The road asset revaluation in 2015 was the catalyst for the depreciation expense decrease. This occurred in part because of a change of methodology to consumption-based depreciation. It also updated asset replacement costs and useful lives
- The waste operations and Naroo Aged Care facility (both operated within the General Fund) have been loss making over the period and these operations should be reviewed to achieve a minimum break-even operating position for both services
- Council's current cash position within the General Fund, when the waste operations are excluded, is of concern and it is important that Council remains focused on building its cash reserves within this Fund to build a buffer against any future adverse events

The key observations from our review of Council's updated 10-year forecasts for its consolidated fund are:

- Council is forecasting consistent operating surpluses over the 10 year period, assisted by the SRV and reduced depreciation expense
- However, as has been experienced already during FY2017, Council's operating result can be significantly impacted by adverse variations to its budget. For example, if the $1.8m negative variation in RMS charges in FY2017 occurs permanently or on a regular basis then the bottom line impact of approximately $0.3m p.a. would result in the General Fund posting operating deficits rather than marginal surpluses
- The General Fund cash position is forecast to remain an ongoing issue that Council will have to actively manage
- Council would benefit from expanding the underlying assumptions of its LTFP to improve the robustness of the forecast results

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

- The cash position with the General Fund is an area that requires improvement. The Council needs to continue its initiatives such as selling non-core property assets as a means of building a cash buffer to act as a cushion in the event it is exposed to a future adverse financial incident
- While the permanent SRV will assist with Council's aim to achieve consistent operating surpluses it cannot be relied upon as the solution to all of the challenges the Council faces
- Council needs to make sure that each individual Fund, and the business operations within these Funds, are able to achieve an average of a minimum break-even operating result
- Grants and contributions are forecast to continue as Council's largest revenue source over the next 10 years, Council therefore remains susceptible to any changes in the level of Federal or State grants received
- Council has significantly improved its road asset register and related information. This now provides a more accurate picture of Council's asset management requirements for its major asset class and a similar exercise for other assets is hoped to identify further efficiencies and cost savings
- While the change to consumption based depreciation has resulted in lower depreciation expenses, Council needs to ensure it allocates sufficient funds to meet its scheduled asset maintenance and renewal costs otherwise it is going to result in increased depreciation and maintenance costs in future years as its assets age
- Council needs to continue to improve the rigour of its LTFP. The transfer to the LG Solutions financial model should assist in this regard. It is noted that Council has now integrated its AMP information into the current LTFP

Based on our review of both the consolidated historic financial information and the 10-year financial forecast within Council's LTFP, we consider Council to have an updated Financial Sustainability Rating (FSR) of Weak with an Outlook of Neutral.

This is an improvement from the original 2013 FSR of Very Weak and an Outlook of Neutral.

The Outlook remains Neutral despite the LTFP forecasting a continuation of the improved operating result that was achieved in FY2016. The concern relating to the ongoing General Fund cash position and the negative budget variations experienced within FY2017 are the main contributing factors for the Outlook.

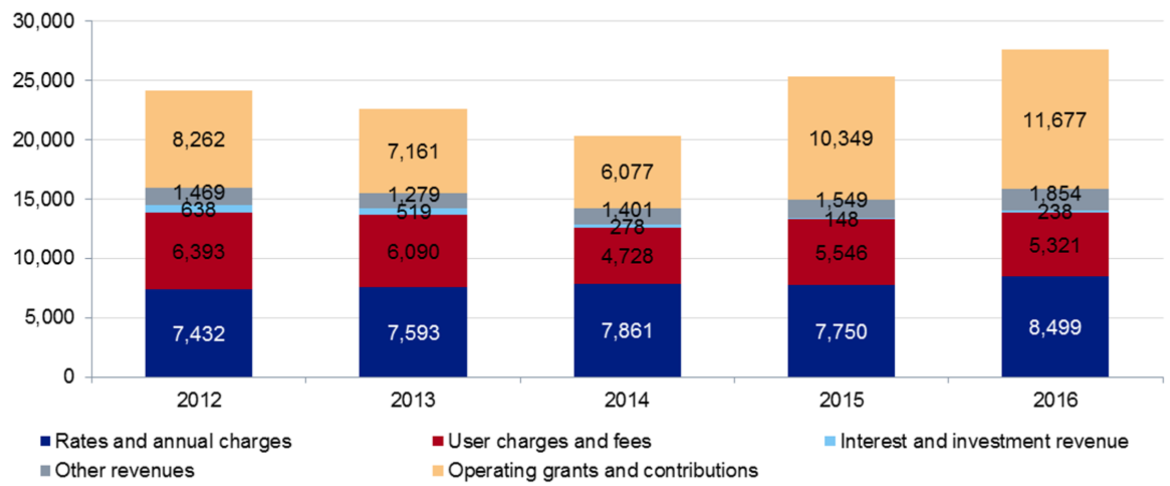
The negative budget variations are projected to reduce the forecast operating surplus by over 80% in FY2017 and this highlights how a negative variation in forecast grants and contributions can impact Council's forecast operating result. If this was to happen again in future years then Council may not be able to achieve the forecast operating surpluses.

2. Review of Financial Performance and Position

TCorp has updated its review based on the FY2016 consolidated annual audited accounts of the Council.

2.1 Revenue

Figure 1 - Revenue for FY2012 to FY2016 ($'000s)

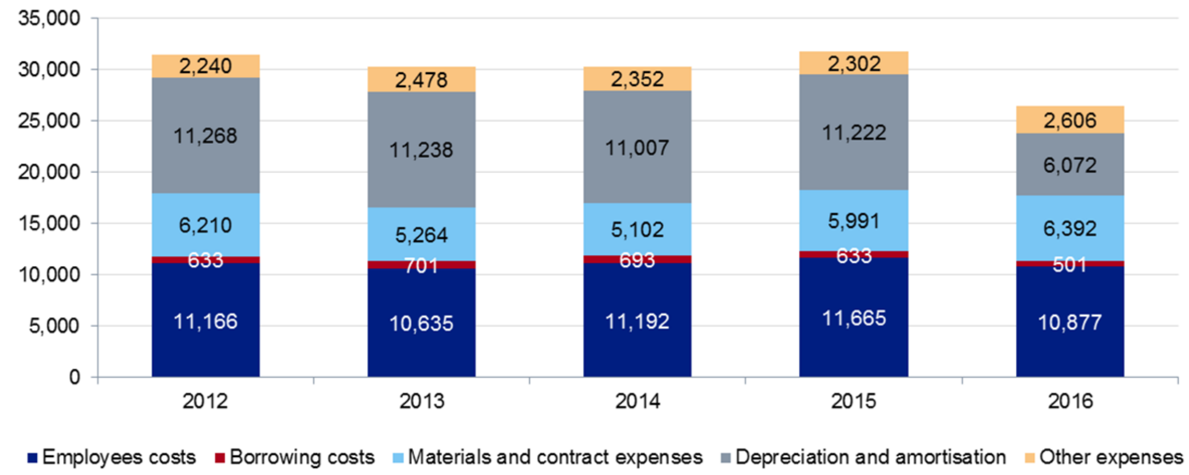


Key Observations

- Rates and annual charges were relatively stable until FY2016 when Council was approved a one-year SRV of 12.6% above the rate peg for the year. This assisted in increasing rates and annual charges by 9.7% in this year
- User charges and fees have oscillated over the review period due to fluctuations in RMS charges received for works completed on State controlled roads. Since FY2015 Council has outsourced its medical centre operations resulting in a loss of revenue of approximately $0.8m p.a. which is offset by a reduction in related expenses
- Interest and investment revenue has reduced due to reducing interest rates and also a reducing balance of cash and investments that has reduced from $12.1m to $8.5m over the period
- Other revenues include the Naroo Aged Care facility from FY2015 of $0.6m-$0.7m
- Operating grants and contributions were impacted by the timing of the FAGs until FY2015, when Council began receiving the full four quarterly payments within the allocated year. Operating grants and contributions has been the largest source of revenue in the past two years

2.2 Expenses

Figure 2 - Expenses for FY2012 to FY2016 ($'000s)



Key Observations

- Employee costs have been impacted by capitalised costs year to year but employee numbers peaked in FY2013 at 172 and have reduced to 156 in FY2016
- Borrowing costs increased in line with an increase in total borrowings but reduced from FY2014 as Council began paying down its borrowings
- Materials and contract expenses have fluctuated linked in part to the amount of RMS road works completed
- Depreciation expense remained relatively stable until FY2016 when the 2015 asset revaluation and change in depreciation methodology has seen a 45.9% decrease in depreciation. This decrease reduced Council's depreciation to 1.3% of the fair value of its depreciable I,P,P&E, a reduction from 2.3% in FY2015. This is compared to the FY2016 average of all NSW councils of 1.7%.

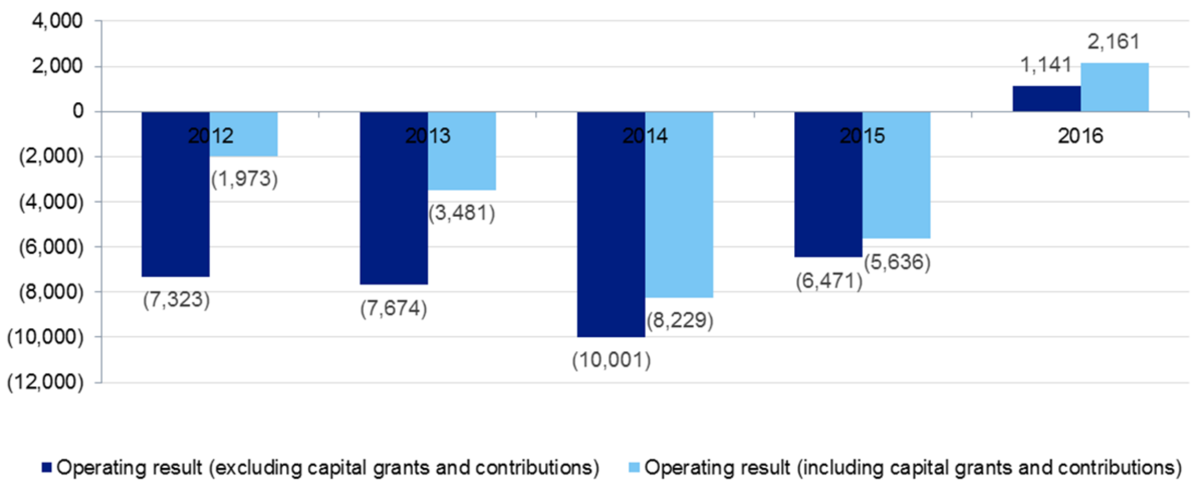
2.3 Operating Results

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 FY2012 to FY2016 ($'000s)



Key Observations

- The FY2016 operating result stands out as being a significant improvement on the previous years. The combination of the SRV and substantial reduction in depreciation expense has resulted in the achievement of an operating surplus including and excluding capital grants and contributions
- Over the five year period the Naroo Aged Care facility has contributed a net loss of $0.8m to the General Fund. Council needs to aim for all non-core operations to achieve a minimum break-even operating result. If the losses continue it will impact Council's long term goal of being financially sustainable. Within FY2017 a negative variation for revenue related to Naroo of $0.8m has been recognised against the original FY2017 budget will likely impact the operating result again
- Council's waste operations (operated within the General Fund for the purposes of this report) has also contributed a net loss of $0.4m over the five year period, with the losses all being in the past three years. Again, it is important that Council reviews the operations of this service to ensure that the long-term operating position is a minimum break-even. If the revenue is not enough to meet expenses then the rates charged for the service should be increased. In FY2017 the original budget of a $28k surplus has also been negatively impacted by variations and is currently expected to post a net loss of $238k

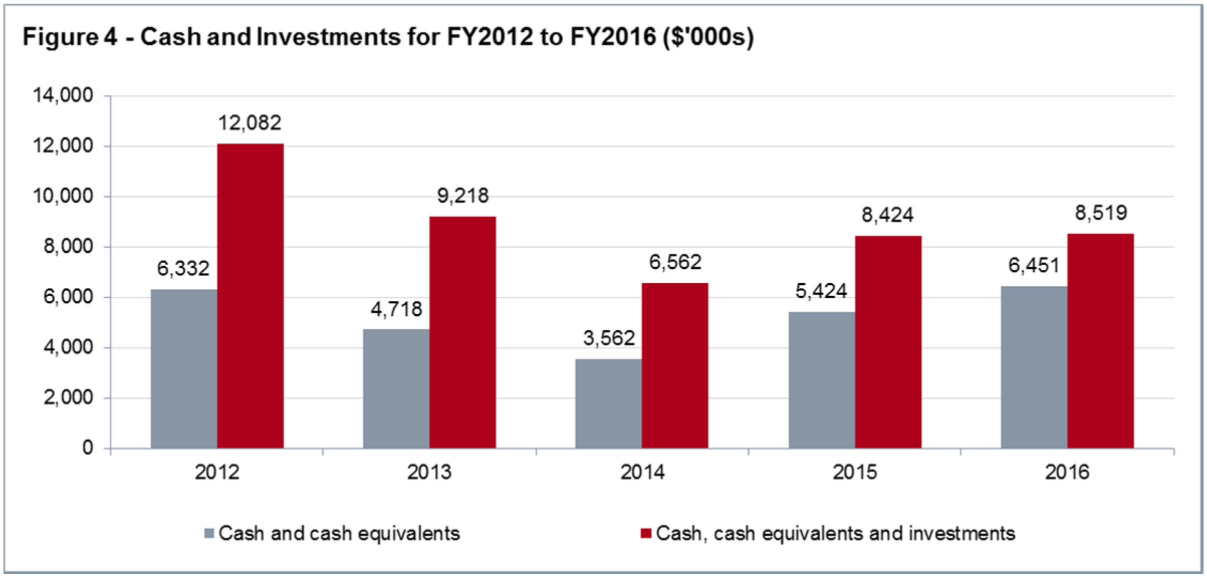
2.4 Financial Management Indicators

Performance Indicators	Year ended 30 June				
	2012	2013	2014	2015	2016
EBITDA ($'000s)	4,578	4,265	2,609	5,384	7,714
Operating Ratio	(30.3%)	(33.9%)	(42.8%)	(25.5%)	4.1%
Own Sourced Operating Revenue Ratio	53.9%	57.7%	65.9%	57.3%	55.6%
Interest Cover Ratio	7.23x	6.08x	3.76x	8.51x	15.40x
Debt Service Cover Ratio	3.44x	3.10x	1.34x	3.91x	5.04x
Cash Expense Cover Ratio	3.9 months	6.0 months	4.2 months	5.1 months	5.1 months
Unrestricted Current Ratio	2.50x	1.79x	0.58x	2.22x	2.11x
Net assets ($'000s)	192,335	214,335	207,438	414,630	412,701

Key Observations

- The DSCR and ICR were below TCorp's respective benchmarks in FY2014 due to Council receiving only 50% of its FAGs. This highlights how variations in grants and contributions can impact Council. Notwithstanding this Council has a manageable level of borrowings however there remains limited capacity to service any additional borrowings
- The Cash Expense Cover Ratio is satisfactory on a consolidated basis however when analysing the General Fund in isolation, the ratio has been below the 3.0x benchmark for the past three years. This continues to be an area that requires Council focus is discussed further in Section 3.2.1
- Net Assets doubled in value in FY2015 following a gain on revaluation of Council's road, bridge and 'other' infrastructure assets as Council transitioned to reporting its assets at fair value. This revaluation added $213.6m to the net asset total

2.5 Cash Position



Key Observations

- Council's cash and investments has reduced over the review period but has improved in the last two years with the reduced FAGs in FY2014 taking the total to its lowest point as Council utilised reserves to cover the temporary shortfall
- TCorp notes that the cash holdings within the General Fund are lower than what TCorp would consider prudent
- Council's purchases of I,P,P&E (capital expenditure) has fluctuated year to year but has averaged $8.6m p.a. compared to cash flows from operations which have averaged $7.7m p.a. This has partly been offset by a $2.5m net increase in borrowings over the period
- Of the $8.5m cash and investments at 30 June 2016, $6.2m was externally restricted, $1.3m was internally restricted and $1.0m was unrestricted. $6.3m was held in term deposits (historically all with NAB) with $2.2m held as cash at bank.
- In February 2017 Council lodged $1.0m in the TCorpIM Cash Fund

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.

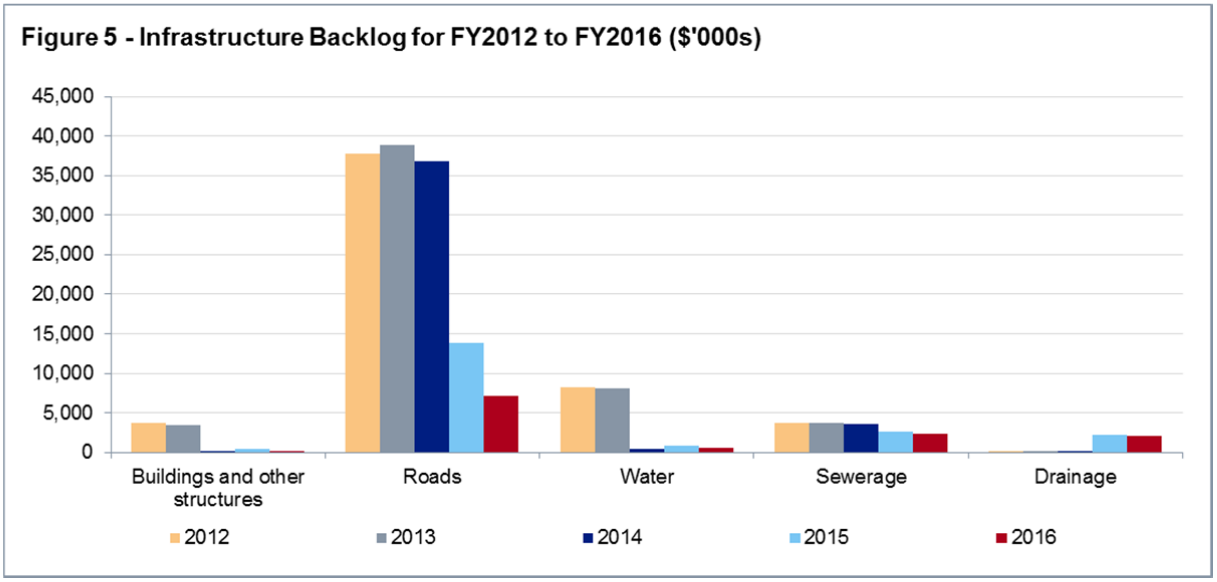
2.6.1 Infrastructure Status

Infrastructure Status	Year ended 30 June				
	2012	2013	2014	2015	2016
Bring to satisfactory standard ($'000s)	53,626	54,139	41,068	19,943	12,257
Required annual maintenance ($'000s)	9,886	9,765	8,880	7,084	2,947
Actual annual maintenance ($'000s)	6,692	9,252	9,252	6,600	2,947
Total value infrastructure assets ($'000s)	164,071	188,096	188,136	398,149	401,696
Total assets ($'000s)	210,881	232,909	228,844	435,738	432,997
Infrastructure Backlog Ratio	0.33x	0.29x	0.22x	0.05x	0.03x
Asset Maintenance Ratio	0.68x	0.95x	1.04x	0.93x	1.00x
Building and Infrastructure Asset Renewal Ratio	0.35x	0.42x	0.74x	0.21x	1.02x
Capital Expenditure Ratio	0.58x	0.93x	0.76x	0.26x	0.86x

Key Observations

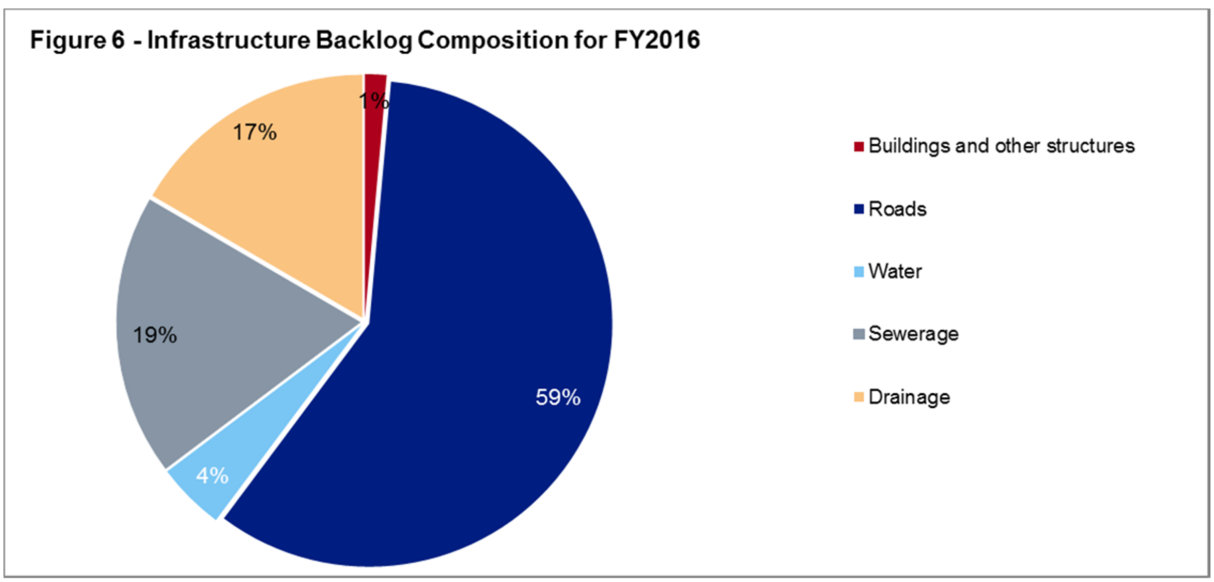
- The road infrastructure revaluation and review in FY2015 has impacted all the asset related ratios and figures
- The FY2016 required and actual maintenance more than halved as heavy patching has been reclassified as renewal (capital) works
- The reduced annual depreciation expense has meant that the Building and Infrastructure Asset Renewal Ratio was above 1.00x for the first time in FY2016

2.6.2 Infrastructure Backlog



Key Observations

- Council's reported Infrastructure Backlog has reduced significantly since FY2013. The main reason for the reduction has been the revaluation of Council's assets to fair value that more than halved the backlog in FY2015. The improved accuracy of the upgrade costs required to improve assets back to a satisfactory standard has also assisted with the reduction in the total



Key Observations

- The Infrastructure Backlog reduced to $12.3m in FY2016 which is a figure that Council can realistically reduce over the medium to long term - Council forecasts it will be able to eliminate the backlog by FY2026
- Road assets make up approximately 65% of Council's I,P,P&E therefore the outstanding Backlog percentage for FY2016 appears relatively proportionate for its main asset class. On the other end

of the spectrum, stormwater drainage only represents 0.75% of Council's I,P,P&E but represents 17% of the total backlog

2.6.3 Capital Expenditure Program

The following figures are sourced from the Council's Annual Financial Statements from Note 9(a). New capital works are major non-recurrent projects which may comprise upgrades to existing assets.

Capital Program ($'000s)	**Year ended 30 June**				
	2012	**2013**	**2014**	**2015**	**2016**
New capital works	224	5,122	2,309	4,371	2,157
Replacement/refurbishment of existing assets	8,416	7,405	6,865	2,023	6,543
Total	**8,640**	**12,527**	**9,174**	**6,394**	**8,700**

Council's scheduled consolidated capital expenditure program amounts to $59.4m over the next 10 years, $58.3m of which is within the General Fund, $0.9m within the Water Fund and $0.2m within the Sewer Fund.

Approximately two thirds, 66.8%, of the capital expenditure relates to road renewals and upgrades.

Council's 10-year forecast capital expenditure program, is to be funded by:

- $54.7m from internally generated revenues/reserves
- $4.7m from capital grants and contributions
- $0.0m from new loan borrowings

With Council improving its asset management data during the 2015 road assets revaluation, the forecast average capital expenditure of $5.9m p.a. over the next 10 years, is below the historical average amount of $9.1m p.a. spent over the past five years.

The forecast decrease in annual capital expenditure is due to advances in technology that has resulted in efficiencies being made in road rehabilitation, reconstruction and maintenance. This was evidenced when Council reviewed the derivation of its unit rates from analysing recent work orders from 2011 onwards as part of the 2015 revaluation process.

The 2015 road revaluations have significantly improved the asset management data for this asset class and Council has now linked its asset register with its Geographic Information System (GIS). Council has utilised depreciation profiles published by Auckland Council for pavement, seal and concrete structures that have contributed to the reduced depreciation expense. These profiles show how different components have different consumption rates and are therefore depreciated at different rates during the various stages of their useful lives.

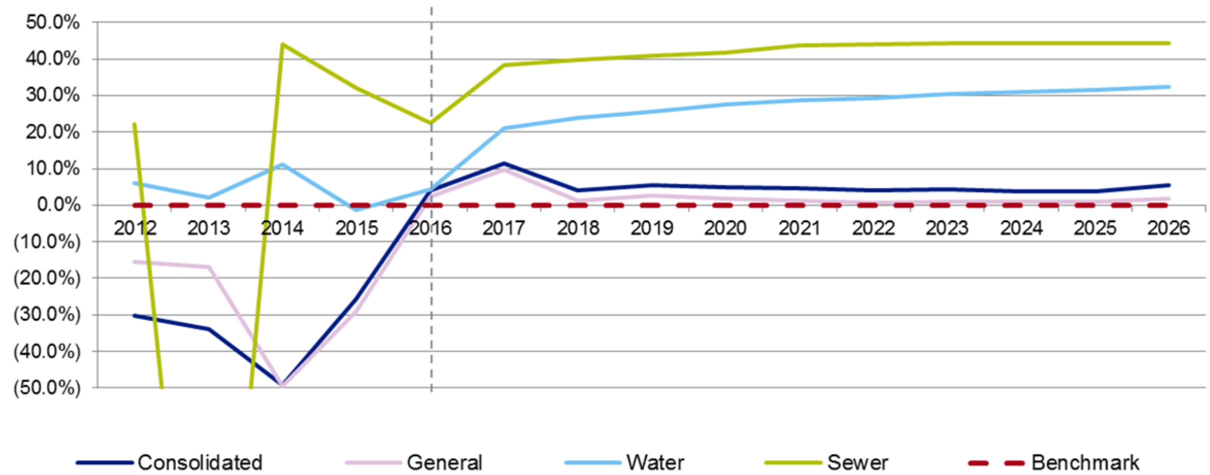
Council has not updated the notes to the FY2016 financial statements to reflect the change in depreciation methodology for these assets and should do so when completing the FY2017 financial statements.

3. Review of Financial Forecasts

TCorp has been provided with a revised financial forecast model that shows the projected financial statements and assumptions for the next 10 years. Council operates a General Fund (including the waste operations and the Naroo Aged Care Facility), Sewer Fund and Water Fund. In FY2016, the General Fund represented 93.7% of operating revenue, Sewer Fund 1.0% and Water Fund 5.3%.

3.1 Operating Results

Figure 7 - Operating Ratio

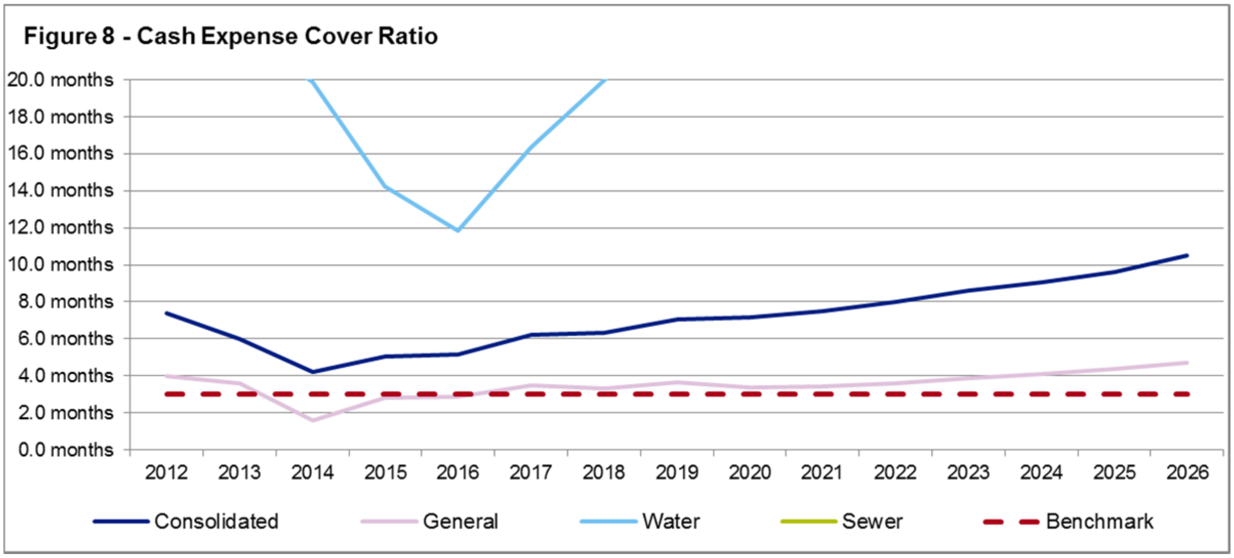


Key Observations

- Historically the higher levels of depreciation have contributed to the significant historical operating deficits, especially within the General Fund until FY2016 and the Sewer Fund specifically in FY2013
- The permanent 28.2% SRV above the rate peg for FY2017 (including the previous 12.6% SRV that was originally temporary), is forecast to contribute to maintaining the General Fund (and therefore the consolidated entity) in a surplus in each of the forecast years
- The FY2017 budget has been revised downward from the original budget due to a number of negative variations. This results in the current FY2017 budgeted consolidated operating performance reducing from a \$3.4m surplus to a \$0.6m surplus. The main negative variations for FY2017 relate to:
  - A \$1.8m reduction in forecast RMS revenues
  - A \$0.8m reduction in forecast Naroo Aged Care facility revenue due to a decrease in residents at the facility during the year
  - A \$0.2m reduction in forecast FAGs
  - A \$0.2m increase in waste fund employee costs and materials and contracts
- If this negative \$2.8m variation was to occur in future years then it would likely turn the forecast General Fund and consolidated surpluses to deficits. This represents a significant risk for Council

3.2 Financial Management Indicators

3.2.1 Liquidity Ratios

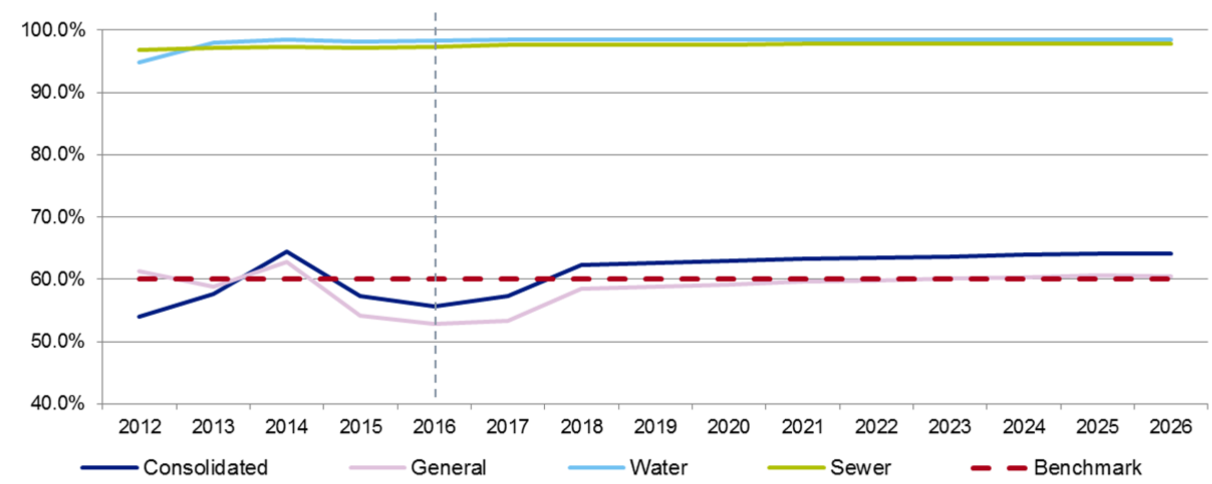


Key Observations

- On a consolidated basis the ratio has remained above the benchmark and is forecast to improve over the next 10 years
- According to the December 2016 Quarterly Budget Report, Council is currently operating in overdraft within the General Fund. Council has stated that this is because it has to fund works relating to the Roads to Recovery Program up front, before being reimbursed by the grant funding
- The General Fund ratio is the area for concern, and while it is forecast to improve over the forecast period it does include the cash and investments held within the waste operations business, a business that Council operates as a separate fund within its accounts. When the waste operations are separated the General Fund ratio would remain below the 3.0 month benchmark for the forecast period
- Council does have a strategy of selling non-core property assets as a means to improving the General Fund cash position however has not included this within the LTFP at this stage

3.2.2 Fiscal Flexibility Ratios

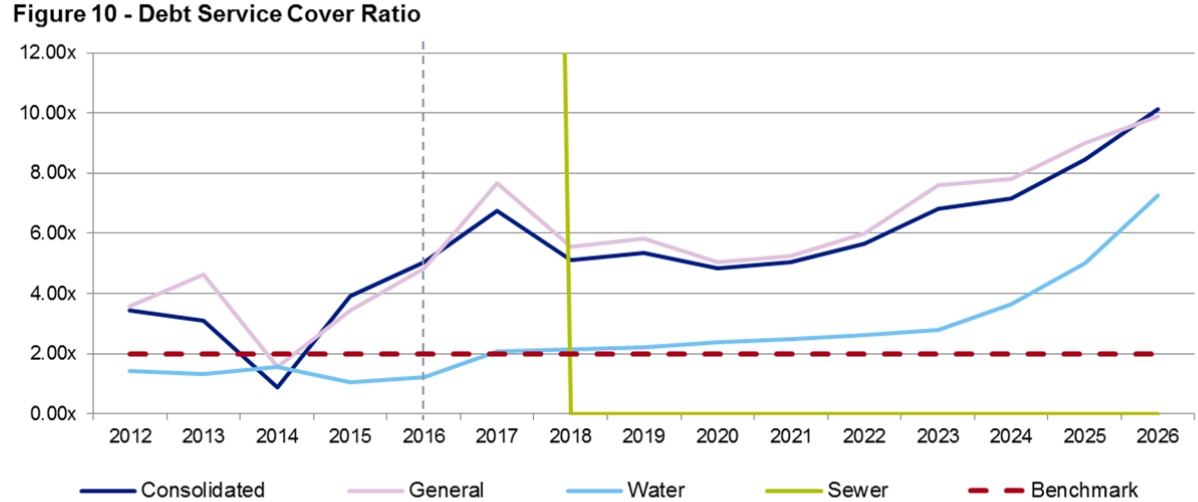
Figure 9 - Own Source Operating Revenue Ratio

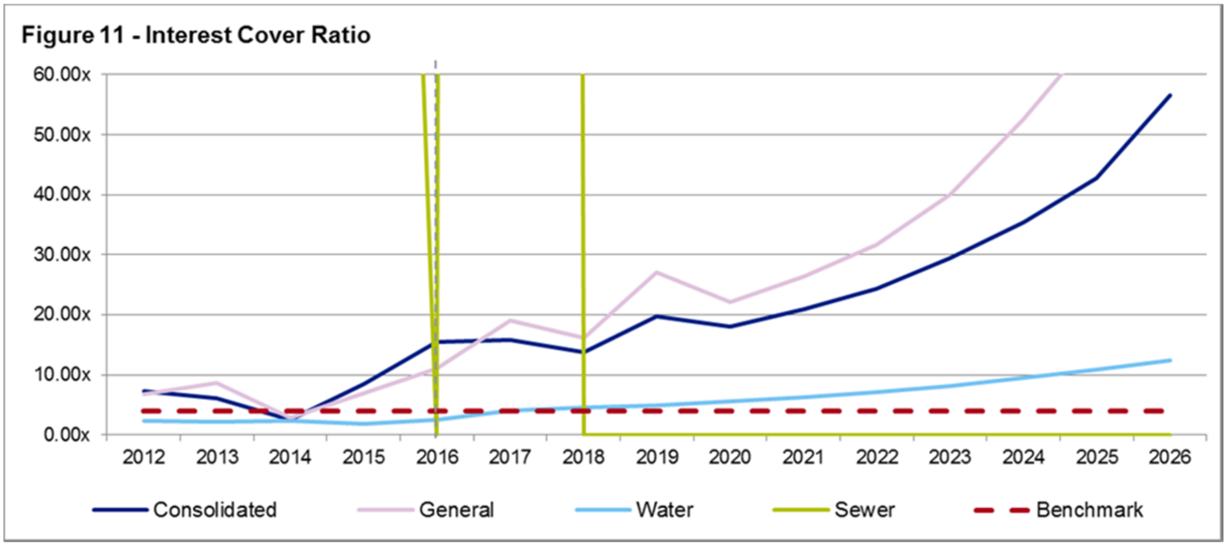


Key Observations

- Similar to most rural councils, a significant proportion of Council's revenue comes from grants and contributions. This has resulted in the ratio being below the benchmark in four of the five previous years, with the reduced FAGs in FY2014 inflating the result in this year
- The ratio is forecast to increase over the forecast period due to the low level of capital grants and contributions forecast ($0.5m p.a. against the $2.6m p.a. historical average), as well as the increasing rates revenue boosted from the SRV. Council is forecast to remain reliant on grants and contributions for over 35% of its revenue in each of the next 10 years

Figure 10 - Debt Service Cover Ratio

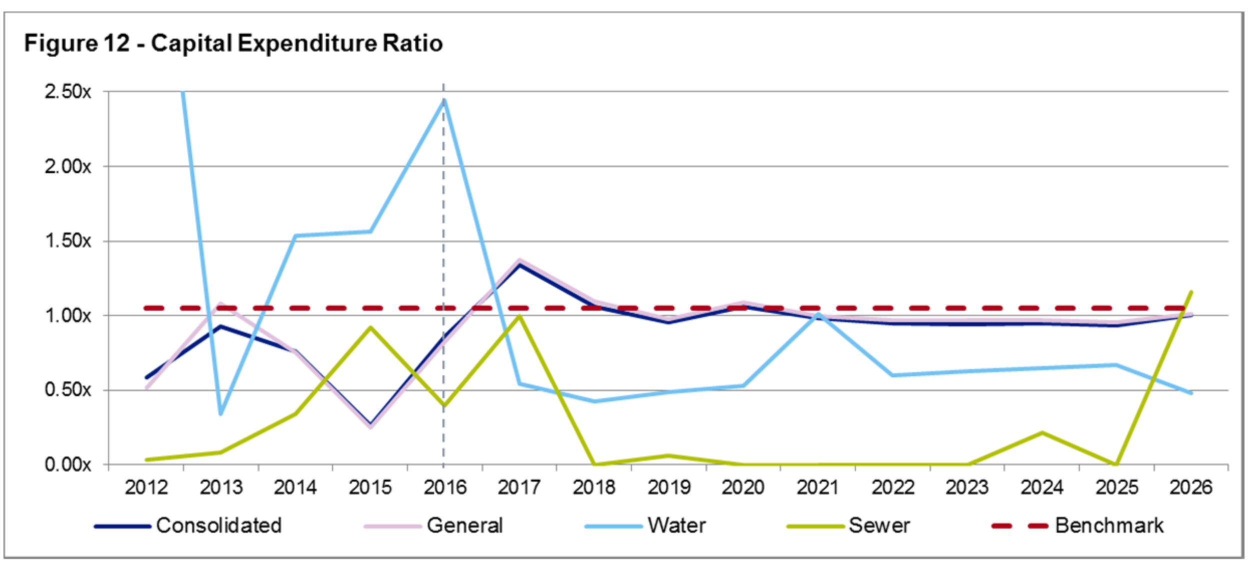




Key Observations

- Council had $11.3m of outstanding borrowings at FY2016 and is not planning to utilise additional borrowings over the next 10 years. The ratios are therefore forecast to improve in both the General and Water Funds as the borrowings are paid down
- The Sewer Fund will become debt free in FY2018 as the small outstanding borrowings are repaid

3.3 Capital Expenditure



Key Observations

- On a consolidated basis the forecast ratio is marginally below the 1.05x benchmark, assisted by the reduced depreciation expense that historically had resulted in the ratio remaining further below the benchmark
- Sewer and Water Fund capital expenditure is cyclical in nature due to the relative long useful lives of the relevant assets. Minimal capital expenditure is expected across the next 10 years within the Sewer Fund with the assets forecast to depreciate by $0.6m while similarly the Water Fund assets are forecast to depreciate by $2.6m

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, 3.7% in 2012, 2.8% in 2013, 2.5% in 2014 and 1.8% in 2015. In December 2016 IPART announced that the rate peg to apply in FY2018 will be 1.5%. Beyond FY2017 TCorp has assessed a general benchmark for rates and annual charges to increase by mid-range LGCI annual increases of 1.5% to 2.5%
  - 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 2.5% to 3.5%
- All other revenue items: the estimated annual CPI increase of 1.5% to 2.5%
- Employee costs: 2.5% to 3.5% (estimated CPI+1.0%)
- Borrowing costs: new loans to be assessed with an interest rate of 3.5% to 6.0%, depending on the term of the loan and when the loan is forecast to be drawn down
- All other expenses: the estimated annual CPI increase of 1.5% to 2.5%

Table 2 - Key Assumptions	Year ended 30 June					
	Historical Average	2017 Budget	2018 Forecast	2019 Forecast	2020 Forecast	2021 Forecast
Population growth	(1.7%)	0.0%	0.0%	0.0%	0.0%	0.0%
Service level growth	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Rates and annual charges	3.5%	19.2%	2.0%	2.1%	2.2%	2.2%
Employee costs	(0.5%)	(6.4%)	9.3%	4.6%	6.5%	5.5%
Depreciation	(46.3%)	8.6%	(6.9%)	(4.1%)	(2.3%)	(1.3%)
Interest rate (investments)	3.9%	4.3%	5.3%	5.7%	6.4%	7.2%
Interest rate (borrowings)	5.6%	6.4%	5.9%	4.6%	5.5%	5.4%

Key Observations and Risks

- Council forecasts the population will not decrease and is in fact hopeful that it can stimulate the population to increase over the medium to long term however it has assumed the population will remain at current levels
- Council has assumed that service levels will remain at current levels
- After the FY2017 boost from the permanent SRV, rates and annual charges are forecast to increase at approximately 2% p.a.
- Employee costs have reduced over the review period as Council has reduced employee numbers. After a further forecast decrease in FY2017 Employee costs are forecast to increase at levels higher than forecast CPI. Council has stated that these fluctuations relate to the amount of employee costs that are capitalised year to year depending on the level of renewal works scheduled however it is not possible to verify this from the information provided to TCorp
- Depreciation expense is forecast to increase in FY2017 before decreasing year-on-year from FY2018. This will only be possible if Council spends sufficient funds on its asset maintenance and renewals each year to ensure its assets do not deteriorate in standard, which would result in increasing, not decreasing, depreciation over time when using the consumption based methodology for some asset classes
- Council's forecast interest and investment revenue, as a percentage of the end of year cash and investments total, increases rapidly over the next five years. This does not appear realistic given the current economic outlook and TCorp's forecast interest rates
- Overall, Council currently has a basic suite of assumptions and would benefit from expanding these and from utilising future economic assumptions that TCorp could provide. It is expected that the transfer to the LG Solutions LTFP model will also result in an expansion of the assumptions

3.5 Sustainability

Based on the information received and the revised LTFP, TCorp calculates the Council's Financial Sustainability Rating as Weak.

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

- Council's improvement in its FSR has been assisted by the approval of the permanent SRV that will boost its own sourced operating revenue
- The revaluation of council's road assets and the associated change in depreciation methodology to consumption based depreciation for a number of asset classes has significantly reduced the depreciation expense. This revaluation has resulted in a much improved asset register and Council's asset engineer is confident that the reduced figure is an accurate representation of the current rate of consumption for the majority of Council's road assets. The asset engineer has stated that Council has the capacity to maintain its road assets at their current high standard so that depreciation expense will not increase over time as the consumption based depreciation methodology suggests it should do. Any failure to maintain the high standards could seriously undermine Council's financial results
- Council's current General Fund cash position, when excluding its waste operations reserves, remains relatively low and is an area that requires continued focus and attention. The General Fund cash position is forecast to remain relatively tight over the next 10 years with the additional

rates revenue from the SRV being allocated to assist with the asset maintenance and renewal expenditure that is expected to help eradicate the Infrastructure Backlog
- Given Council's challenge of managing a large geographical area when compared to its population it will always have a high dependency on grants and contributions from other levels of Government, when compared to regional or metropolitan councils. This can result in any reduction in these grants and contributions leaving Council with a budget shortfall and needing to reduce expenses to limit the negative impact to the operating result as is currently the case in FY2017
- Council operates a waste management business and the Naroo Aged Care facility and both businesses have recorded operating deficits in recent years. It is critical that Council endeavours for these businesses to contribute to the long term sustainability of Council and not be detrimental to this goal
- Council has controlled its Employee costs well over the past five years however has forecast this expense item to increase at levels well above CPI from FY2018. Council has stated that this is linked to the level of capitalised employee costs. This is an area that Council should monitor to ensure it can identify efficiencies to limit the forecast increases

4. Conclusion and Recommendations

Based on our review of both the consolidated historic financial information and the 10-year financial forecast within Council's LTFP, we consider Council to have a Financial Sustainability Rating (FSR) of Weak with an Outlook of Neutral. This is an improvement from TCorp's previous 2013 review when Council was given a FSR of Very Weak and an Outlook of Neutral.

We base our analysis on the following key points:

- The 2015 road revaluation has resulted in a large decrease in depreciation in FY2016 and depreciation is forecast to reduce further as the next revaluation of buildings is also expected to identify efficiencies and savings. The reduction in depreciation expense is a key reason for the Council achieving the operating surplus in FY2016 and during the forecast 10 year period
- Council's operating performance has been boosted in FY2016 by the one year SRV and is forecast to continue to benefit from the permanent SRV that was approved for FY2017 onwards. This has contributed to the improved operating result compared to previous years

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

- Council's General Fund cash position is of concern, especially when excluding the waste operations and the cash position remains susceptible to an adverse financial event. This situation requires Council's continued focus and until this improves it would be an inhibitor to achieving an improved FSR above Weak
- Council is reliant on grants and contributions as well as RMS State road works to boost its revenue and operating performance. A negative variation in expected grants or RMS works can have a significant impact on the forecast operating result. This is now projected to be the situation in FY2017, resulting in Council having to seek additional expense savings to compensate for the negative revenue variations
- With the consumption based depreciation methodology, as an assets useful life decreases, the corresponding depreciation expense increases. It Council is not able to maintain these assets at a high standard then additional maintenance and renewals expenditure will need to be spent in

the future. Council's asset manager is confident that it has the capacity to maintain these assets at a high enough standard to avoid the additional costs however if Council doesn't follow the proposed maintenance program there could be a cost blowout over the long term

- Council needs to expand its LTFP assumptions to ensure that its modelling is in line with current market expectations. This should be aided by transferring the model to LG Solutions along with utilising some of TCorp's economic assumptions in the future
- Other councils that have been operating loss making aged care facilities have investigated the possibility of selling the facility to a private operator and in some cases have gone ahead with the sale to aid their sustainability
- Any deterioration in the forecast results and the General Fund cash position could result in the Outlook changing to Negative in the future prior to the FSR deteriorating back to Very Weak

Appendix A Consolidated Historical and Forecast Financial Information Tables

Income Statement ($'000s)	Year ended 30 June														
	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
	Actual	Actual	Actual	Actual	Actual	Budget	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast
Revenue															
Rates and annual charges	7,432	7,593	7,861	7,750	8,499	10,131	10,333	10,550	10,783	11,020	11,240	11,476	11,717	11,952	12,191
User charges and fees	6,393	6,090	4,728	5,546	5,321	5,297	5,459	5,624	5,785	5,963	6,152	6,342	6,527	6,733	6,901
Interest and investment revenue	638	519	278	148	238	425	581	710	859	1,062	1,184	1,290	1,378	1,495	1,533
Other revenues	1,469	1,279	1,401	1,549	1,854	1,590	1,624	1,702	1,747	1,798	1,853	1,908	1,962	2,022	2,073
Operating grants and contributions	8,262	7,161	6,077	10,349	11,677	12,340	10,504	10,692	10,876	11,081	11,306	11,528	11,738	11,970	12,270
Total operating revenue	**24,194**	**22,642**	**20,345**	**25,342**	**27,589**	**29,783**	**28,501**	**29,277**	**30,050**	**30,924**	**31,734**	**32,545**	**33,322**	**34,172**	**34,967**
Expenses															
Employee costs	11,166	10,635	11,192	11,665	10,877	10,180	11,129	11,636	12,395	13,075	13,806	14,430	15,321	16,101	16,518
Borrowing costs	633	701	693	633	501	678	577	402	425	356	298	248	199	165	134
Materials and contract expenses	6,210	5,264	5,102	5,991	6,392	6,313	6,813	6,983	7,217	7,517	7,722	7,749	7,788	7,784	7,806
Depreciation and amortisation	11,268	11,238	11,007	11,222	6,072	6,594	6,138	5,887	5,748	5,672	5,631	5,608	5,595	5,588	5,584
Other expenses	2,240	2,478	2,352	2,302	2,606	2,588	2,656	2,728	2,804	2,882	2,966	3,052	3,142	3,233	3,040
Total operating expenses	**31,517**	**30,316**	**30,346**	**31,813**	**26,448**	**26,353**	**27,312**	**27,636**	**28,589**	**29,503**	**30,422**	**31,086**	**32,045**	**32,871**	**33,082**
Operating result (excluding capital grants and contributions)	**(7,323)**	**(7,674)**	**(10,001)**	**(6,471)**	**1,141**	**3,430**	**1,189**	**1,642**	**1,461**	**1,421**	**1,312**	**1,459**	**1,277**	**1,301**	**1,885**

Excluded Items ($'000s)	Year ended 30 June														
	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
	Actual	Actual	Actual	Actual	Actual	Budget	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast
Capital grants and contributions	5,350	4,193	1,772	835	1,020	682	426	433	440	447	448	450	451	452	463
Net gain/(loss) from the disposal of assets	25	38	(284)	(613)	(3,350)										
Insurance claim recoveries	0	0	910	0	0										
Impairment (loss)	0	(1,686)	0	0	(130)										
Fair valuation of financial liabilities on recognition	192	0	321	147	0										
Fair value adjustments on IPP&E	0	0	0	0	(5,430)										
Amortisation of discounts for remediation liabilities	(175)	(188)	(188)	(188)	(219)										
Unwinding discount on reduced interest loan	0	(23)	(49)	(87)	(82)										
Operating result (including capital grants and contributions)	**(1,973)**	**(3,481)**	**(8,229)**	**(5,636)**	**2,161**	**4,112**	**1,615**	**2,075**	**1,901**	**1,868**	**1,760**	**1,909**	**1,728**	**1,753**	**2,348**

	2012	2013	2014	2015	2016
Full-time equivalent employees at year end	169	172	165	162	156

Balance Sheet ($'000s)	Year ended 30 June														
	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
	Actual	Actual	Actual	Actual	Actual	Budget	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast
Current assets															
Cash and cash equivalents	6,332	4,718	3,562	5,424	6,451	9,884	10,867	12,507	13,360	14,713	16,279	18,144	19,843	21,756	23,956
Investments	5,750	4,500	3,000	3,000	2,068										
Receivables	3,813	2,248	2,529	2,173	1,051	2,098	2,098	2,098	2,098	2,098	2,098	2,098	2,098	2,098	2,098
Inventories	235	338	444	452	230	479	479	479	479	479	479	479	479	479	479
Other	5	16	16	33	15	16	16	16	16	16	16	16	16	16	16
Total current assets	**16,135**	**11,820**	**9,551**	**11,082**	**9,815**	**12,477**	**13,460**	**15,100**	**15,953**	**17,306**	**18,872**	**20,737**	**22,436**	**24,349**	**26,549**
Non-current assets															
Receivables	311	282	500	583	518	458	458	458	458	458	458	458	458	458	458
Infrastructure, property, plant & equipment	194,435	220,807	218,793	424,073	422,664	426,055	426,437	426,162	426,510	426,401	426,094	425,787	425,503	425,150	425,159
Total non-current assets	194,746	221,089	219,293	424,656	423,182	426,513	426,895	426,620	426,968	426,859	426,552	426,245	425,961	425,608	425,617
Total assets	**210,881**	**232,909**	**228,844**	**435,738**	**432,997**	**438,990**	**440,355**	**441,720**	**442,921**	**444,165**	**445,424**	**446,982**	**448,397**	**449,957**	**452,166**

Balance Sheet ($'000s)	Year ended 30 June														
	2012	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**	**2026**
	Actual	**Actual**	**Actual**	**Actual**	**Actual**	**Budget**	**Forecast**	**Forecast**	**Forecast**	**Forecast**	**Forecast**	**Forecast**	**Forecast**	**Forecast**	**Forecast**
Current liabilities															
Payables	1,854	1,894	2,250	2,022	2,158	1,951	1,971	1,971	1,971	1,971	1,971	1,971	1,971	1,971	1,971
Borrowings	730	677	890	1,009	948	912	967	1,077	1,155	1,116	981	827	789	670	616
Provisions	2,945	2,909	3,061	2,951	2,833	1,901	1,901	1,901	1,901	1,901	1,901	1,901	1,901	1,901	1,901
Total current liabilities	**5,529**	**5,480**	**6,201**	**5,982**	**5,939**	**4,764**	**4,839**	**4,949**	**5,027**	**4,988**	**4,853**	**4,699**	**4,661**	**4,542**	**4,488**
Non-current liabilities															
Borrowings	9,759	9,677	11,593	11,332	10,363	9,754	8,787	7,710	6,555	5,439	4,458	3,630	2,841	2,171	1,555
Provisions	3,258	3,417	3,612	3,794	3,994	2,951	2,951	2,951	2,951	2,951	2,951	2,951	2,951	2,951	2,951
Total non-current liabilities	13,017	13,094	15,205	15,126	14,357	12,705	11,738	10,661	9,506	8,390	7,409	6,581	5,792	5,122	4,506
Total liabilities	**18,546**	**18,574**	**21,406**	**21,108**	**20,296**	**17,469**	**16,577**	**15,610**	**14,533**	**13,378**	**12,262**	**11,281**	**10,453**	**9,664**	**8,994**
Net assets	**192,335**	**214,335**	**207,438**	**414,630**	**412,701**	**421,521**	**423,778**	**426,110**	**428,388**	**430,787**	**433,162**	**435,701**	**437,944**	**440,293**	**443,172**

Cash Flow Statement ($'000s)	Year ended 30 June														
	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
	Actual	Actual	Actual	Actual	Actual	Budget	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast
Cash flows from operating activities	10,538	9,189	3,598	5,403	9,577	10,706	7,753	7,961	7,649	7,540	7,391	7,516	7,323	7,341	7,933
Cash flows from investing activities	(12,286)	(10,668)	(7,155)	(3,546)	(7,520)	(8,429)	(5,802)	(5,245)	(5,640)	(5,071)	(4,845)	(4,824)	(4,835)	(4,758)	(5,117)
Free cash flow	**(1,748)**	**(1,479)**	**(3,557)**	**1,857**	**2,057**	**2,277**	**1,950**	**2,716**	**2,009**	**2,469**	**2,546**	**2,692**	**2,489**	**2,583**	**2,816**
Proceeds from borrowings and advances	2,000	542	3,649	750	0	0	0	0	0	0	0	0	0	0	0
Repayment of borrowings and advances	(696)	(677)	(1,248)	(745)	(1,030)	(912)	(967)	(1,077)	(1,155)	(1,116)	(981)	(827)	(789)	(670)	(616)
Cash flows from financing activities	1,304	(135)	2,401	5	(1,030)	(912)	(967)	(1,077)	(1,155)	(1,116)	(981)	(827)	(789)	(670)	(616)
Net increase/(decrease) in cash and equivalents	**(444)**	**(1,614)**	**(1,156)**	**1,862**	**1,027**	**1,365**	**983**	**1,639**	**854**	**1,353**	**1,566**	**1,865**	**1,699**	**1,913**	**2,200**

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.

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

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

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.

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.

Operating Grants and Contributions

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.

Capital Grants and Contributions

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 Asset Renewal 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 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 1.05x

Ratio = annual capital expenditure / annual depreciation

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

Debt Service Cover Ratio (DSCR)

Benchmark = Greater than 2.0x

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

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

Infrastructure Backlog Ratio

Benchmark = Less than 0.02x

Ratio = estimated cost to bring assets to a satisfactory condition (from Special Schedule 7) / total infrastructure 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 = Greater than 0%

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.