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Section 1 Executive Summary

This report provides an independent assessment of Wyong Shire Council's (the Council) financial capacity and its ability to undertake additional borrowings. The analysis is based on a review of the historical performance, current financial position, and long term financial forecasts. It also benchmarks the Council against its peers using key ratios.

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

Council has made two LIRS applications firstly for Warnervale Road Culverts funded by $3.2m of debt and secondly, for the Local Roads Pavement Renewal Program funded by $3.9m of debt.

TCorp's approach has been to:

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

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

- Although Council has reported operating deficits in the past three years, its EBITDA and Operating Ratio improved year on year and particularly in 2011
- Council has conducted a review of how it delivers its services, an organisational restructure and a review of its budgeting and depreciation methods which all led to improvements in the operating results in 2011
- Unrestricted Current and Cash Expense ratios are near or above benchmark in each of the three years. This indicates the Council has sufficient capacity to meet day to day expenses.

Council's reported infrastructure backlog of $193.2m in 2011 represents 12.3% of its infrastructure asset value of $1,574.2m. Other observations include:

- A majority of the backlog relates to public road assets and this is increasing year on year
- Council's Asset Maintenance Ratio, and Building and Infrastructure Renewal Ratio are both below benchmark
- The Capital Expenditure Ratio is above benchmark indicating the Council has invested a substantial amount on upgraded and/or new assets

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

- Council is forecasting surplus operating results and its Own Source Operating Revenue Ratio is forecast to continue to be well above benchmark
- Debt servicing levels are strong as indicated by forecast DSCRs and Interest Cover Ratios being substantially above benchmark

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- Cash and investments are forecast to be exhausted by 2016 which is not a sustainable position. A revision of the capital expenditure forecast to an affordable level should resolve this liquidity issue
- Capital expenditure levels incorporated into the forecast are well above benchmark

- [To insert summary comments about the benchmarking.]

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Section 2 Introduction

2.1: Purpose of Report

This report provides the Council with an independent assessment of their financial capacity and performance measured against a peer group of councils which will complement their internal due diligence, and the IP&R system of the Council and the DLG.

The report is to be provided to the LIRS Assessment Panel for its use in considering applications received under the LIRS.

The key areas focused on are:

- The financial capacity of the Council to undertake additional borrowings
- The financial performance of the Council in comparison to a range of similar councils and measured against prudent benchmarks

2.2: Scope and Methodology

TCorp's approach was to:

- Review the most recent three years of the Council's consolidated audited accounts using financial ratio analysis. In undertaking the ratio analysis TCorp has utilised ratio's substantially consistent with those used by Queensland Treasury Corporation (QTC) initially in its review of Queensland Local Government (2008), and subsequently updated in 2011
- Conduct a detailed review of the Council's 10 year financial forecasts including a review of the key assumptions that underpin the financial forecasts. The review of the financial forecasts focused on the particular Council fund that was undertaking the proposed debt commitment. For example where a project is being funded from the General fund we focussed our review on the General fund
- Identify significant changes to future financial forecasts from existing financial performance and highlight risks associated with such forecasts
- Conduct a benchmark review of a Council's performance against its peer group
- Prepare a report that provides an overview of the Council's existing and forecast financial position and its capacity to meet increased debt commitments
- Conduct a high level review of the Council's IP&R documents for factors which could impact the Council's financial capacity and performance

In undertaking its work, TCorp relied on:

- Council's audited financial statements (2008/09 to 2010/11)
- Council's financial forecast model
- Council's IP&R documents
- Discussions with Council officers
- Council's submissions to the DLG as part of their LIRS application
- Other publicly available information such as information published on the IPART website

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Benchmark Ratios

In conducting our review of the Councils' financial performance and forecasts we have measured performance against a set of benchmarks. These benchmarks are listed below. Benchmarks do not necessarily represent a pass or fail in respect of any particular area. One-off projects or events can impact a council's performance against a benchmark for a short period. Other factors such as the trends in results against the benchmarks are critical as well as the overall performance against all the benchmarks. As councils can have significant differences in their size and population densities, it is important to note that one benchmark does not fit all.

For example, the Cash Expense Ratio should be greater for smaller councils than larger councils as a protection against variation in performance and financial shocks.

Therefore these benchmarks are intended as a guide to performance.

The Glossary attached to this report explains how each ratio is calculated.

Ratio	Benchmark
Operating Ratio	> (4.0%)
Cash Expense Ratio	> 3.0 months
Unrestricted Current Ratio	> 1.50x
Own Source Operating Revenue Ratio	> 60.0%
Debt Service Cover Ratio (DSCR)	> 2.00x
Interest Cover Ratio	> 4.00x
Infrastructure Backlog Ratio	< 0.02x
Asset Maintenance Ratio	> 1.00x
Building and Infrastructure Asset Renewal Ratio	> 1.00x
Capital Expenditure Ratio	> 1.10x

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2.3: Overview of the Local Government Area

Wyong Shire Council LGA	
Locality & Size	
Locality	Sydney Surrounds
Area	740 km²
DLG Group	7
Demographics	
Population	149,746
% under 18	25%
% between 18 and 59	51%
% over 60	25%
Expected population 2025	176,000
Operations	
Number of employees (FTE)	1,070
Annual revenue	$207.8m
Infrastructure	
Roads	1,100 km
Bridges	24
Infrastructure backlog value	$193.2m
Total infrastructure value	$1574.2m

Wyong Shire Council Local Government Area (LGA) forms the northern portion of the Central Coast region, between Sydney and Newcastle. The LGA is bounded by the Pacific Ocean in the east, Olney, Wyong and Ourimbah State Forests in the west, Gosford City in the south and Lake Macquarie City in the North. The Shire includes the major service centre of Wyong-Tuggerah and numerous townships spread around Tuggerah Lake, Budgewoi Lake, Lake Munmorah and the southern shore of Lake Macquarie. The western half of the Shire is predominantly forest and rural areas.

The LGA is a growing business area and has established rural, construction and retail industries. The proportions of land usage are 37% forestry, 29% bushland, 15% extensive agriculture and 8% residential.

The LGA is popular for retirees and families with young children. This is characterised by a higher proportion of population between the age of 0 to 14 and over 55, compared to the State average. The population is generally ageing and those aged between 20 to 29 continue to migrate out of the region for work, lifestyle reasons and studies.

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2.4: LIRS Application

Council has made two LIRS application.

Project 1: Warnervale Road Culverts

Description: The project involves reconstructing approximately 900m of Warnervale Road and installing box culverts across the floodplains and associated flood levees.

Amount of loan facility: $3.2m

Term of loan facility: 10 years

Project 2: Local Roads Pavement Renewal Program

Description: A $5.2m program to renew road segments where the pavement layer has reached the end of its useful life.

Amount of loan facility: $3.9m

Term of loan facility: 10 years

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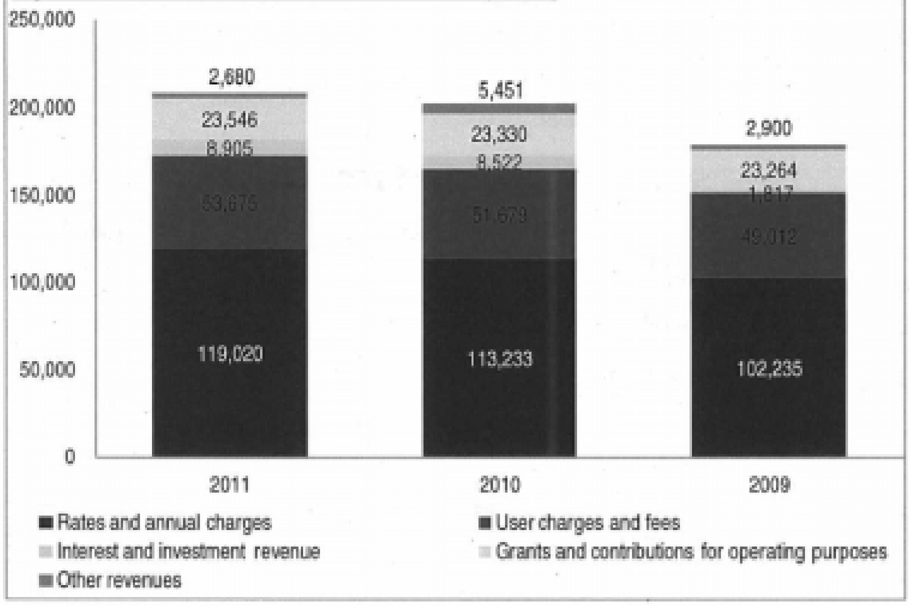
Section 3 Review of Financial Performance and Position

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

3.1: Revenue

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



Key Observations

- Own source operating revenue (rates and annual charges, and user fees and charges) made up 68.7% of the Council's revenue sourced in 2011.
- Rates and annual charges increased by 10.8% in 2010 and 5.1% in 2011. The increase in 2010 was mainly due to the introduction of an IPART approved drainage service charge. This charge generated an additional $5.3m of revenue in 2010. The 2011 increase in revenue was mainly due to a 9.6% ($1.8m) increase in the domestic waste management annual charge and 18.0% ($1.2m) increase in the water supply annual charge.
- User fees and charges revenue increased by 5.4% in 2010 mainly due to an 11.3% ($2.1m) increase in water supply charges. Council also operated four holiday parks which generated $0.5m surplus in 2011 and a $2.9m deficit in 2010. The six childcare centres reported a total $0.9m deficit in 2011.
- The dip in interest and investment revenue in 2010 is mainly attributed to a $4.0m fair value adjustment in managed fund investments. The Council did not hold CDOs or FRNs.
- Revenue from operating grants and contributions has been steady for the last three years at around $23m each year.

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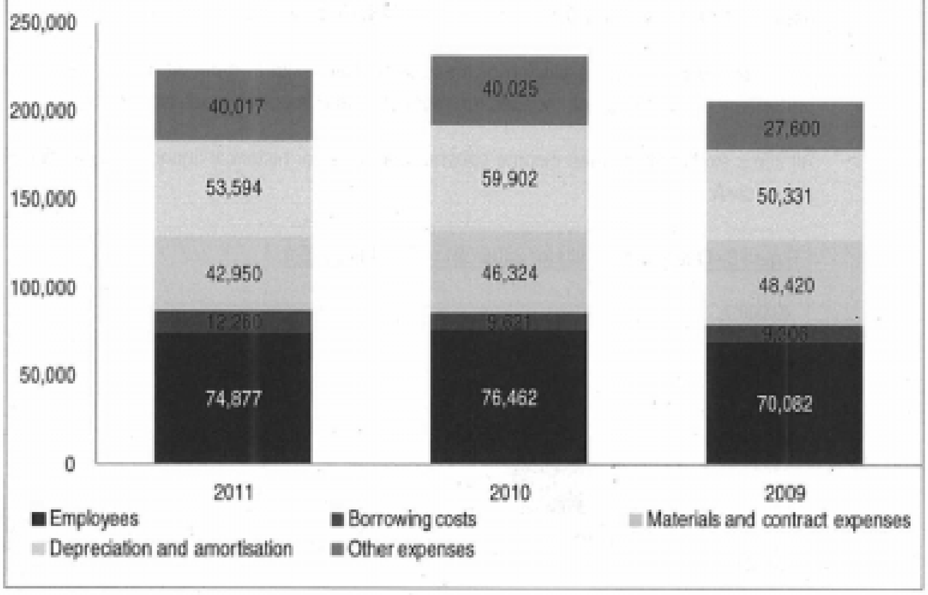
3.2: Expenses

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



Key Observations

- Employee costs have fluctuated over the last three years. The increase from 2009 to 2010 was due to a 6.2% ($3.3m) increase in salary and wages, and 39.4% ($2.2m) increase in superannuation costs. The decrease in employee costs in 2011 can be attributed to an organisational restructure where the number of full time equivalent staff reduced from 1,149 in 2010 to 1,070 in 2011.
- Borrowing costs increased in 2011 due to an increase in long term loans of $26.5m. The loans were used for water and sewer capital works, in particular for the Mardi to Mangrove Dam link and to refinance debt in the Water Fund.
- Materials and contract expenses decreased over the period by 4.3% in 2010 and 7.3% in 2011. The decline in 2010 is mainly due to a reduction in contract and consultancy costs by 8.8% ($4.2m). The decrease from 2010 to 2011 is mainly due to a reduction in legal expenses. Council conducted a number of legal investigations in 2010 using external lawyers and costs reduced in 2011 after the appointment of a legal counsel.
- Depreciation expense has fluctuated over the three years due to Asset Revaluations and a review of its roads assets' useful life which found that depreciation expense was overstated.
- Other expenses increased by $12.4m from 2009 to 2010 mainly due to tip asset rehabilitation adjustments of $11.0m in each of the years 2010 and 2011.

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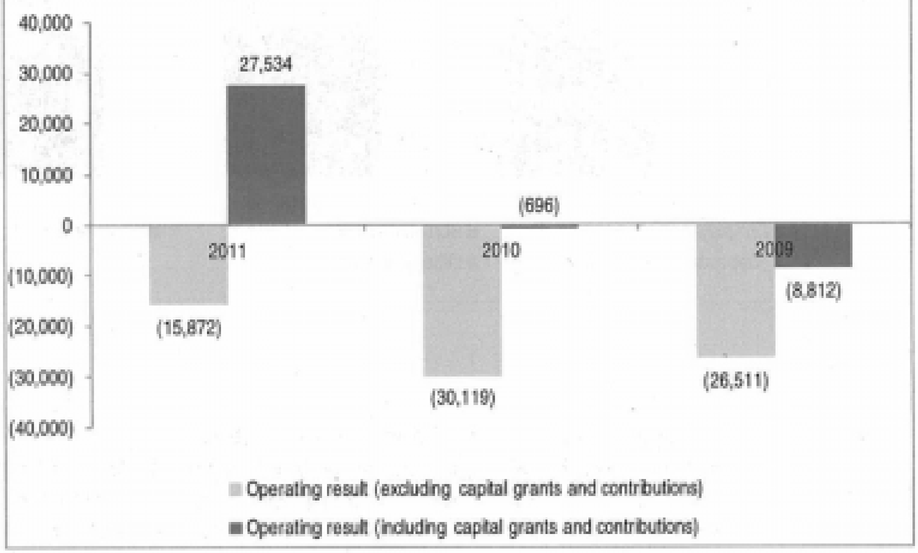
3.3: Operating Results

TCorp has made some standard adjustments to focus the analysis on core operating council results. Grants and contributions for capital purposes, realised and unrealised gains on investments and other assets are excluded, as well as one-off items which Council have no control over (e.g. impairments).

TCorp believes that the exclusion of these items will assist in normalising the measurement of key performance indicators, and the measurement of Council's performance against its peers.

All items excluded from the income statement and further historical financial information is detailed in Appendix A.

Figure 3 - Operating Results for 2008/09 to 2010/11 ($'000s)



Key Observations

- Council has reported operating deficits excluding capital grants and contributions in the last three years. Revenue has been increasing at a steady pace but expenses have fluctuated mainly due to the tip asset rehabilitation costs and depreciation expense.
- A review of the Council's service delivery, an organisational restructure and a review of its budgeting and depreciation methods led to improvements in the operating results in 2011.

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3.4: Financial Management Indicators

Performance Indicators	Year ended 30 June		
	2011	2010	2009
EBITDA ($'000s)	49,982	39,404	33,126
Operating Ratio	(7.6%)	(14.9%)	(14.8%)
Interest Cover Ratio	4.08x	4.10x	3.56x
Debt Service Cover Ratio	2.18x	1.88x	1.90x
Unrestricted Current Ratio	1.83x	1.45x	1.62x
Own Source Operating Revenue Ratio	68.7%	71.2%	76.8%
Cash Expense Ratio	3.9 months	3.6 months	1.5 months
Net assets ($'000s)	1,901,367	1,794,920	1,651,028

Key Observations

- Although Council reported operating deficits in the past three years, its EBITDA and Operating Ratio improved significantly in 2011.
- Council's Debt Service Cover Ratio is marginally below benchmark in two of the three years but above benchmark in 2011. The Interest Cover Ratio also improved over the reviewperiod. The improvement in the Ratios is mainly attributed to better EBITDA while debt servicing capacity had increased over this period.
- The Unrestricted Current and Cash Expense ratio's are near or above benchmark. This indicates the Council had sufficient capacity to meet day to day expenses but without flexibility to meet unforseen events.
- The declining Own Source Operating Revenue Ratio is skewed by higher receipts of capital grants and contributions particularly in 2011. In particular, Council received specific purpose grants of $12.8m in 2010 and $27.7m in 2011 for its water supply services.
- The Asset Revaluations over the last three years have resulted in a high level of volatility in Net Assets over this period. Consequently, in the short term the value of Net Assets is not necessarily an informative indicator of performance. In the medium to long term however, this is a key indicator of a Council's capacity to add value to its operations. Over time, Net Assets should increase at least in line with inflation plus an allowance for increased population and/or improved or increased services. Declining Net Assets is a key indicator of the Council's assets not being able to sustain the ongoing operations of a Council.
- When the Asset Revaluations are excluded, the underlying trend in all three 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 three years this amounted to an $116.1m increase in IPP&E assets.

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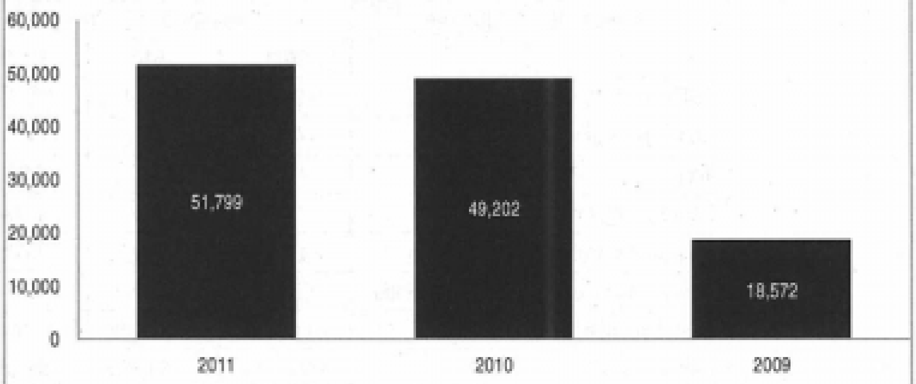
3.5: Statement of Cashflows

Figure 4 - Cash and Cash Equivalents for 2008/09 to 2010/11 ($'000s)



Key Observations

- Cash and cash equivalents have increased over the period primarily due to an increase in cashflow from operating activities.
- Investment levels have declined over the period as Council reduced its investments in managed funds. This reduced in value from $53.1m in 2009 to $13.1m in 2011. These investments were also revalued downwards by $4.0m in 2009.
- Within Council's total cash and investments of $138.2m in 2011, $83.7m is externally restricted, $39.7m is internally restricted and $14.8m is unrestricted.
- Within Council's investments were $13.1m in managed funds, $4.1m in bank bonds and the remainder of the investments are in deposits at call or term deposits.
- The cash reserves, along with the Unrestricted Current Ratio and Cash Expense Ratio in 2011, support the Council's ability to meet its current day to day obligations.

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3.6: Capital Expenditure

The following section predominantly relies on information obtained from Special Schedules 7 and 8 that accompany the annual financial statements. These figures are unaudited and are therefore Council's estimated figures.

3.6(a): Infrastructure Backlog

Figure 5 - Infrastructure Backlog for 2008/09 to 2010/11 ($'000s)

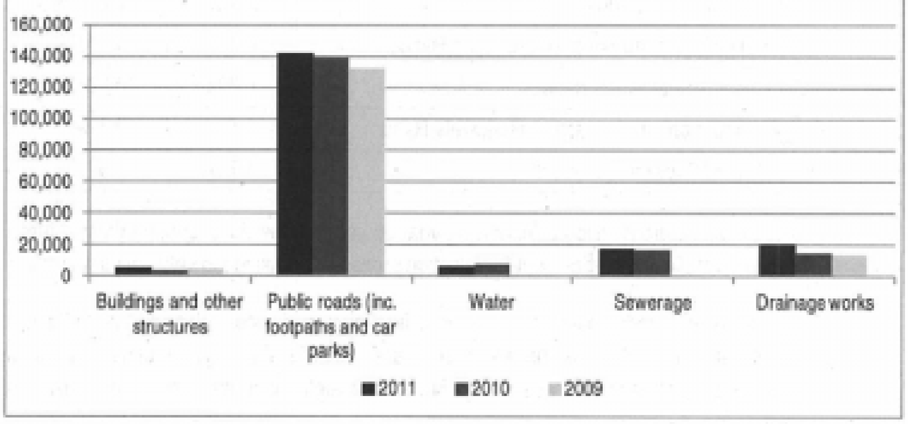
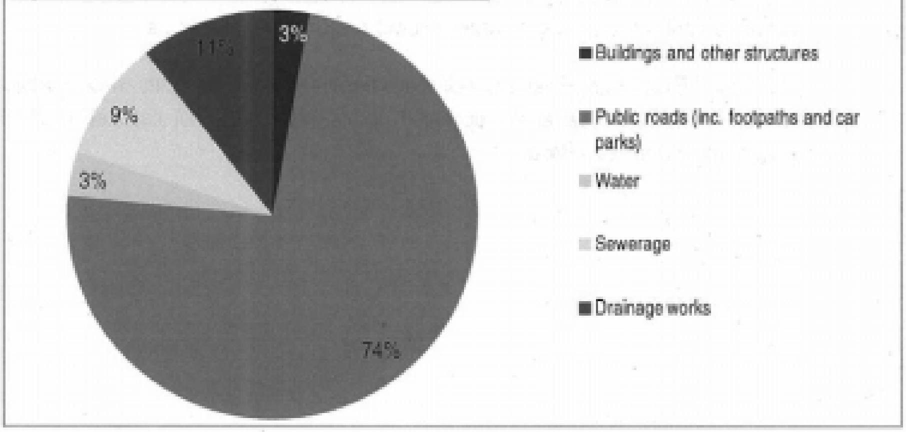


Figure 6 - Infrastructure Backlog Composition for 2010/11



Council reported an Infrastructure Backlog of $193.2m in 2011 which is an increase from the $150.7m in 2009. 73.6% ($142.2m) of the Backlog in 2011 is related to public roads assets. $94.8m of this relates to sealed road surfaces. In 2011, Council spent $20.7m on a roads and drainage capital works

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program but the Infrastructure Backlog for these categories continue to rise. The LIRS applications seek to address some of the backlog in the roads category.

3.6(b): Infrastructure Status

Infrastructure Status	Year ended 30 June		
	2011	2010	2009
Bring to satisfactory standard ($'000s)	193,168	184,095	150,700
Required annual maintenance ($'000s)	37,534	35,309	24,397
Actual annual maintenance ($'000s)	30,175	17,783	26,160
Total value of infrastructure assets ($'000s)	1,574,248	1,543,084	1,401,772
Total assets ($'000s)	2,217,940	2,089,799	1,853,830
Building and Infrastructure Backlog Ratio	0.12x	0.12x	0.11x
Asset Maintenance Ratio	0.80x	0.50x	1.07x
Building and Infrastructure Renewals Ratio	0.52x	0.61x	0.82x
Capital Expenditure Ratio	1.74x	2.04x	1.31x

The Infrastructure Backlog is increasing year on year but the Building and Infrastructure Backlog Ratio has been static due to the Asset Revaluation process increasing the value of infrastructure assets.

Council is also underspending on asset maintenance as indicated by the Asset Maintenance Ratio of lower than 1.00x in two of the last three years. In 2011, the largest category of shortfall was in the maintenance of sewerage assets. $1.5m more maintenance was spent on public road assets than required for the year.

The Building and Infrastructure Asset Renewal Ratio is not meeting the benchmark and indicates that Council did not spend enough on asset renewal in each of the three years.

The Capital Expenditure Ratio was well above benchmark in all the years which indicates the Council has spent more on new and/or upgraded assets which were not captured in the Building and Infrastructure Renewals Ratio.

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3.6(c): Capital Program

The following figures are sourced from the Council's Annual Financial Statements at Special Schedule No. 8 and are not audited. New capital works are major non-recurrent projects.

Capital Program ($'000s)	Year ended 30 June		
	2011	2010	2009
New capital works	69,064	85,000	35,000
Replacement/refurbishment of existing assets	25,906	23,000	25,000
Total	**94,970**	**108,000**	**60,000**

Recent major capital works completed by the Council includes:

- A $20.7m road and drainage capital works program across the LGA
- Mardi Area High Voltage Power Upgrade
- Approximately $120m Mardi to Mangrove Dam Link project jointly with Gosford City Council

3.7: Specific Risks to Council

- Remediation of tip sites. Council has the responsibility of remediating former tip sites on community land. This involves significant planning and expenditure. Council has included in its LTFP the expected cost of site remediation but more long term monitoring is required to determine the costs. The current cost estimate is $50m.
- Rising community expectations. The community expects the existing level of services to continue at a reasonable quality. There is also a greater demand for community, recreational and cultural services. Through its community consultation process, asset management planning and long term financial planning, the Council needs to prioritise its service provisions with its limited resources.
- Creation of the Central Coast Water Corporation (CCWC) and Joint Services Business (JSB) with Gosford City Council. In late 2006, the State Government passed legislation to enable the amalgamation of Wyong and Gosford Councils' water and sewerage functions and establish a Central Coast Water Corporation. A corporate entity started in July 2011 and, all water and sewerage staff and functions will be transferred to the CCWC by 1 July 2014. A JSB is also planned to be established by 1 July 2017 to provide joint corporate services for the CCW and both councils. These changes may have a disruptive impact on Council's service delivery and be costly to implement in the short term. In the long term successful restructures are expected to generate cost savings for the Council.

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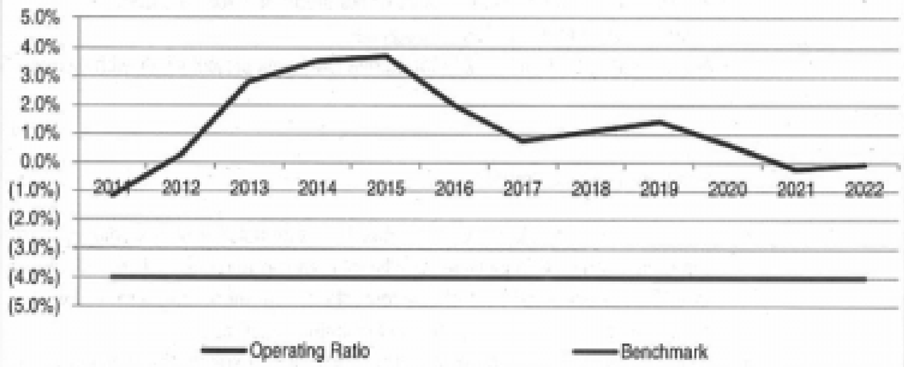
Section 4 Review of Financial Forecasts

The financial forecast model shows the projected financial statements and assumptions for the next 10 years. The model includes the $7.1m loans without any LIRS subsidy.

The LIRS loans both relate to the General Fund, therefore we have focused our financial analysis solely upon this Fund. Council's consolidated position includes both a Water and Sewer Fund however these are operated as independent entities, which unlike the General Fund are more able to adjust the appropriate fees and charges to meet all future operating and investing expenses. These forecasts do not include the potential benefits and cost of the CCWC and JSB restructures as the detailed costings are still being developed.

4.1: Operating Results

Figure 7 - Operating Ratio for General Fund



Council's Operating Ratio fluctuates over the period but is generally forecast to be in surplus positions over the next 10 years. The Ratio trends downwards over the life of the forecast because assumed expense increases exceed revenue growth.

The Ratio is estimated to increase sharply in 2012 due to budgeted $4.8m increase in domestic and non-domestic waste charges to recoup the estimated increase in tip remediation costs. User fees and charges are also budgeted to increase by $8.8m of which $5.8m relates to increased internal revenue from Council's other funds and $2.9m in higher per tonne tipping fees. The increase in revenue is partly offset by higher employee costs from increased defined benefits provisions and workers compensation costs. Materials and contracts expense is forecast to increase by 29.0% due to $2m increase in waste management costs, $2m in estuary management planning for which grant funding was provided for and $2m increase in community and recreational expenses.

The increase from 2012 to 2013 is mainly attributed to a forecast increase of rates and annual charges revenue of $5.4m which represents a 6.1% year on year increase. This is mainly due to an increase in domestic and non-domestic waste charges. Depreciation expense is also forecast to decrease by 9.7% ($2.6m) from 2012 to 2013 as a large portion of assets will be fully depreciated by this year.

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The dips in 2016 and 2017 relate to higher forecast materials and contracts costs from tip remediation expense.

4.2: Financial Management Indicators

Liquidity Ratios

Figure 8 - Cash Expense Ratio for General Fund

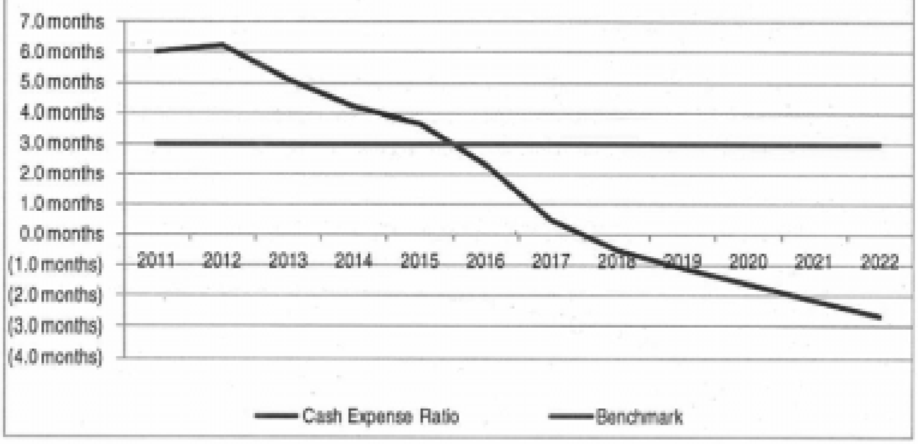
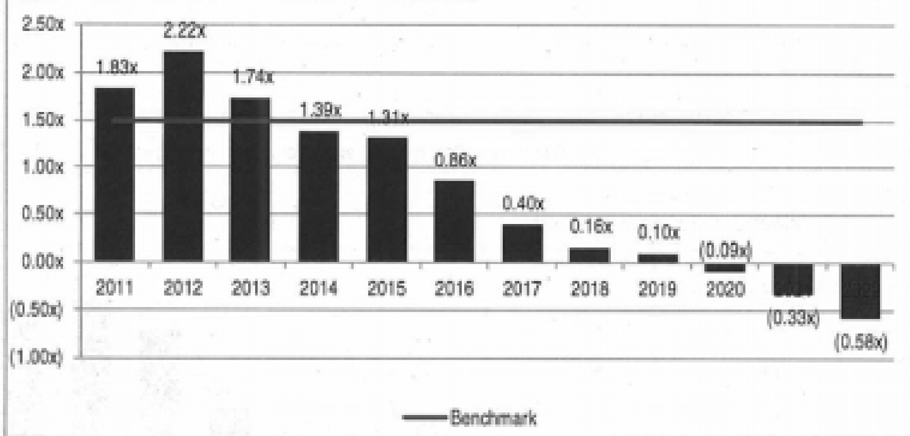


Figure 9 - Unrestricted Current Ratio for General Fund



The Cash Expense Ratio has been calculated using both cash and investments because the Council models these items together. In 2011, 92.5% of Council's investments are in term deposits.

Both the Cash Expense Ratio and Unrestricted Ratio indicate that Council will face serious liquidity issues and by 2016 its cash and investments are exhausted. This declining position is forecast to continue to deteriorate. This is mainly attributed to a level of forecast capital expenditure well above benchmarks (see figure 13 for details). In discussions with Council management, it is clear that they are aware of this issue. Council will need to review its capital expenditure forecast, its asset management requirements and balance these factors with its liquidity position to maintain an

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acceptable financial position. Following our discussions, management have run a number of scenarios, each of which forecast a lower (but still acceptable) level of capital expenditure.

As expected, by reducing the forecast capital expenditure results in these scenarios indicating that positive cash results and no liquidity issues would be achieved. Consequently, we do not believe that Council has any particular financial issue in this area, provided of course they recognise the need to revisit and reschedule their forecast capital expenditure program.

Fiscal Flexibility Ratios

Council's Own Source Operating Revenue Ratio is forecast to be above benchmark. It increases from 2011 to 2012 because forecast capital grants are not included in the model. It also increased from 2013 to 2014 due to a drop in forecast operating grants which skew the ratio upwards.

Figure 10 - Own Source Operating Revenue Ratio for General Fund

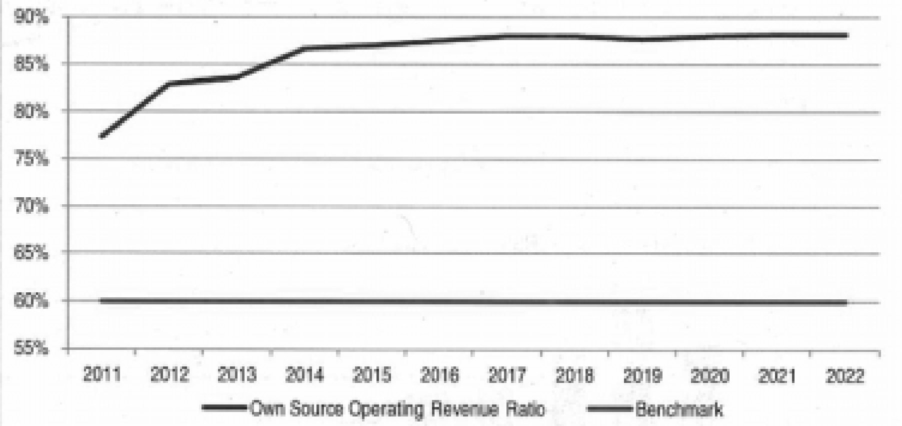
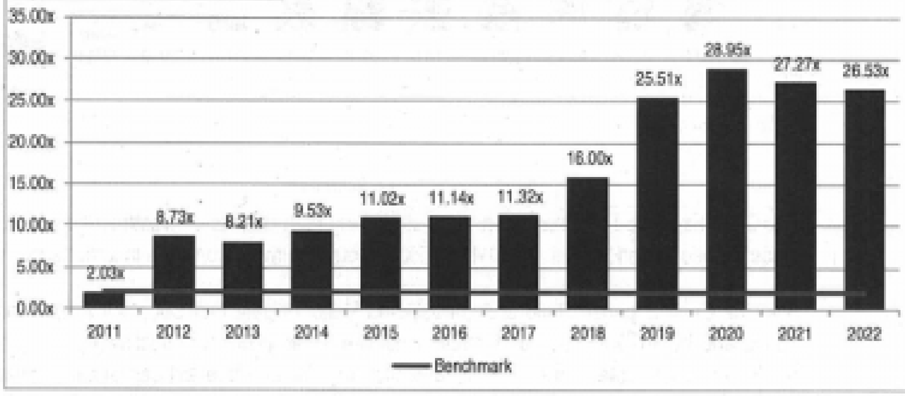


Figure 11 - DSCR for General Fund



After a $10.7m loan repayment in 2011, Council's DSCR is forecast to be substantially above the benchmark level. This improves over time as existing debts are repaid and no further drawdowns are included in the forecast except for the LIRS loan drawdowns of $7.1m in 2013. The General Fund had

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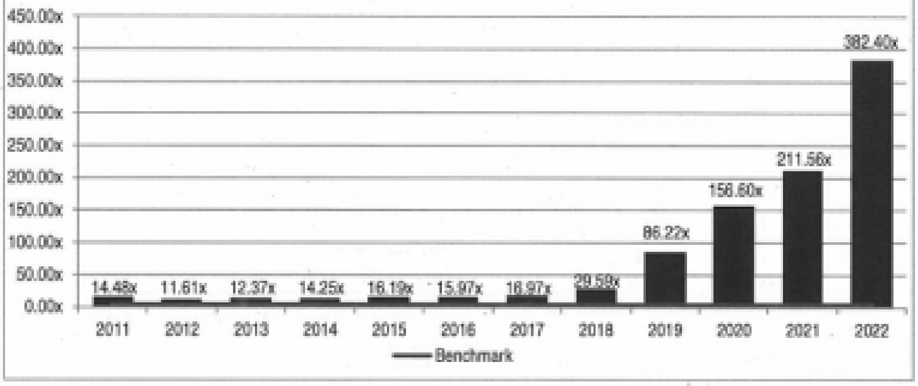
a low level of debt of $3.4m on 30 June 2011 which represents 0.5% of General Fund's net assets. Debt outstanding is forecast to peak in 2013 at $8.8m after the LIRS loans are drawn down.

Figure 12 - Interest Cover Ratio for General Fund



Similar to the DSCR, the Interest Cover Ratio is well above benchmark levels for the entire forecast period reflecting Council's ability to service its debt costs.

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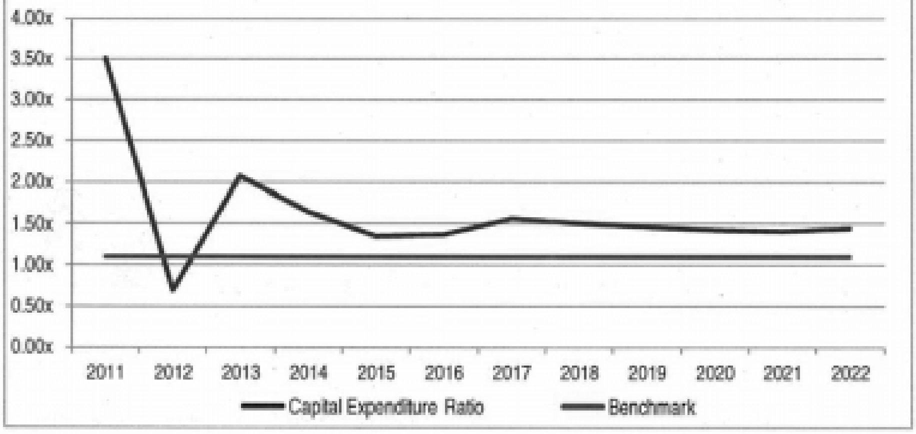
4.3: Capital Expenditure

Figure 13 - Capital Expenditure Ratio for General Fund



Council's forecast capital expenditure is on average well above benchmark levels with more than sufficient capacity to cater for a growing population and to meet increasing service demands from the community.

As previously mentioned, this high level of capital expenditure assumption is negatively affecting Council's liquidity. A more affordable capital expenditure schedule should be achievable based on the current forecast depreciation figures and operating cash flow. Reducing capital expenditure to a benchmark Ratio of 1.1x should significantly improve Council's cash position so it does not operate in cash deficits.

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4.4: Financial Model Assumption Review

Councils have used their own assumptions in developing their forecasts.

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

TCorp's benchmarks:

- Rates and annual charges: TCorp notes that rates increased by 3.4% in the year to September 2011, and in December 2011, IPART announced that the rate peg to apply in the 2012/13 financial year will be 3.6%. Beyond 2013 TCorp has assessed a general benchmark for rates and annual charges to increase by mid-range LGCI annual increases of 3.0%
- Interest and investment revenue: annual return of 5%
- All other revenue items: the estimated annual CPI increase of 2.5%
- Employee costs: 3.5% (estimated CPI+1%)
- All other expenses: the estimated annual CPI increase of 2.5%

Key Observations and Risks

- The LTFP assumes that current services and service levels are maintained. It excludes the impact of the CCWC and JBS restructures.
- Capital expenditure assumptions are very high compared to depreciation and this is having an adverse impact on its liquidity. Capital expenditure should be reviewed and revised to a more affordable level so Council is not forecast to be in cash deficits. Management is aware of this issue.
- Annual rates and charges revenue are forecast to increase by an average of 3.2% p.a. which is consistent with our benchmark.
- User fees and charges revenue are forecast to increase by around 4.1% p.a. which is slightly optimistic but not unreasonable as the LGA population is growing and Council can control the fees charged.
- Employee costs are forecast to increase by an average of 4.0% p.a. which appears a little above benchmark but reasonable.
- Overall, the assumptions in the model are considered reasonable and any variations from our benchmark expectations have been explained.