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Treasury Corporation

Lismore City Council

Financial Assessment, Sustainability and Benchmarking Report

12 March 2013

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

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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 Lismore City Council, the DLG and the Independent Local Government Review Panel. TCorp shall not be liable to Lismore City 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 Lismore City Council's (the Council) financial capacity, and its future Sustainability. The analysis is based on a review of the historical performance, current financial position, and long term financial forecasts. It also benchmarks the Council against its peers using key ratios.

TCorp's approach has been to:

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

The Council has been satisfactorily managed in some areas over the review period based on the following observations:

- While Council has incurred operating deficits (excluding grants and contributions for capital purposes) in each of the past four years, Council's underlying operating results (measured using EBITDA) have improved from $15.0m in 2009 to $19.4m in 2012
- Council has had sufficient levels of liquidity throughout the review period
- Council have shown a willingness to focus on core activities, such as the closure of a child care centre, and the cancellation of a reopening of a lake pool for safety and financial reasons

Council reported $189.9m of Infrastructure Backlog in 2012 which represents 27.6% of its infrastructure asset value of $687.2m. Other observations include:

- 75.8% of the Backlog is related to road assets
- The Backlog has increased significantly each year over the review period

The key observations from our review of Council's 10 year forecasts are:

- The LTFP will not be completed in full until 2013 and we have based our analysis on a budgeting model which does not have a complete cash flow statement nor balance sheet
- Council is forecast to consistently record operating deficits below the benchmark
- The forecast capital expenditure is insufficient to meet the cost of forecast asset renewal requirements

We consider Council's financial position to be in a deteriorating position in respect of its longer term Sustainability. Our key observations are:

- Council's LTFP/ budgeting model forecasts consistent operating deficits below the benchmark
- Council is not spending sufficient amounts on asset renewal and this will reduce the quality of assets and impact the provision of services
- The road Infrastructure Backlog is high, and further under investment will impact on the quality of services offered to the community

- With an increasing and ageing population Council needs to address these issues and consider means of generating additional revenues or reducing operating expenses if it is to improve its prospects for Sustainability
- The completion of Council's Asset Management Plans and the LTFP in 2013 would assist TCorp to conduct a more complete analysis
- TCorp is unable to comment on Council's borrowing capacity at this stage without a complete LTFP

In respect of the Benchmarking analysis TCorp has compared the Council's key ratios with other councils in DLG group 4. The key observations are:

- Council's financial flexibility as indicated by the Operating Ratio is below the group average and the benchmark
- Council's Own Source Operating Revenue Ratio is above average and the benchmark
- Council's DSCR and Interest Cover Ratio are below the group averages and above the benchmarks. In the medium term Council's forecast ratios are expected to remain above the benchmarks
- Council has been in an acceptable liquidity position but this is forecast to decline
- Council's performance in terms of the four asset ratios has been generally lower than average compared to other councils in group 4:
    - The Infrastructure Backlog Ratio was weaker than the group average and benchmark.
    - The Capital Expenditure Ratio declined over the period to be below the group average and benchmark.
    - Council's Building and Infrastructure Asset Renewal Ratio and Asset Maintenance Ratio have been at the group averages but below the benchmarks

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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, Sustainability and performance measured against a peer group of councils. It will complement Council's internal due diligence, the IP&R system of the Council and the DLG, together with the work being undertaken by the Independent Local Government Review Panel.

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

The key areas focused on are:

- The financial capacity of the Council
- The long term Sustainability of the Council
- The financial performance of the Council in comparison to a range of similar councils and measured against prudent benchmarks

2.2: Scope and Methodology

TCorp's approach was to:

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

In undertaking its work, TCorp relied on:

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

Definition of Sustainability

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

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

Benchmark Ratios

In conducting our review of the Councils' financial performance, forecasts and Sustainability we have measured performance against a set of benchmarks. These benchmarks are listed below.

Benchmarks do not necessarily represent a pass or fail in respect of any particular area. One-off projects or events can impact a council's performance against a benchmark for a short period. Other factors such as the trends in results against the benchmarks are critical as well as the overall performance against all the benchmarks.

As councils can have significant differences in their size and population densities, it is important to note that one benchmark does not fit all. For example, the Cash Expense Ratio should be greater for smaller councils than larger councils as a protection against variation in performance and financial shocks. Therefore these benchmarks are intended as a guide to performance.

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

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

2.3: Overview of the Local Government Area

Lismore City Council LGA	
Locality & Size	
Locality	North coast
Area	1,267 km²
DLG Group	4
Demographics	
Population as at August 2011	42,766
% under 20	26.7%
% between 20 and 60	52.4%
% over 60	20.9%
Expected population 2026	47,700
Operations	
Number of employees (FTE)	397
Annual revenue	$88.4m
Infrastructure	
Roads	1,214 km
Kerbs and Gutters	299
Infrastructure backlog value	$190.0m
Total infrastructure value	$687.2m

Lismore City Council Local Government Area (LGA) is located on the north coast of NSW. It is a largely rural area with the town of Lismore as the major centre servicing the region. The town of Lismore is located on the Wilsons River. The town centre and parts of the town are situated on a floodplain. The LGA has a number of smaller villages at Nimbin, Dunoon, Clunes, Wyrallah and Bexhill. In addition, there are a number of hamlets throughout the LGA.

The proportion of young people in the LGA is much higher than other areas on the North Coast. One factor contributing to the higher number of young people is the presence of Southern Cross University.

The LGA's population grew by an average of 0.7% p.a. between 2006 and 2011. In line with national trends the LGA also has an ageing population with an increase in the number of residents over 65.

Council is a member of the Richmond Tweed Regional Library along with Byron, Ballina, and Tweed Shire Councils. Currently the library services a population of about 215,000 of which roughly 50.0% are members of the Library.

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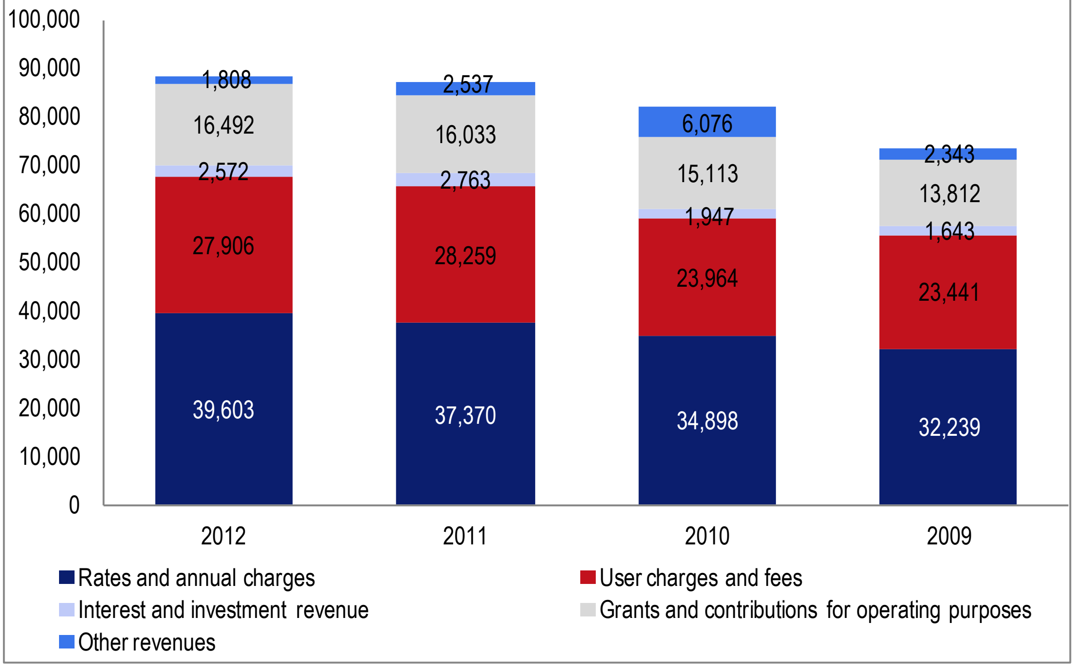
Section 3 Review of Financial Performance and Position

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 2011/12 ($'000s)



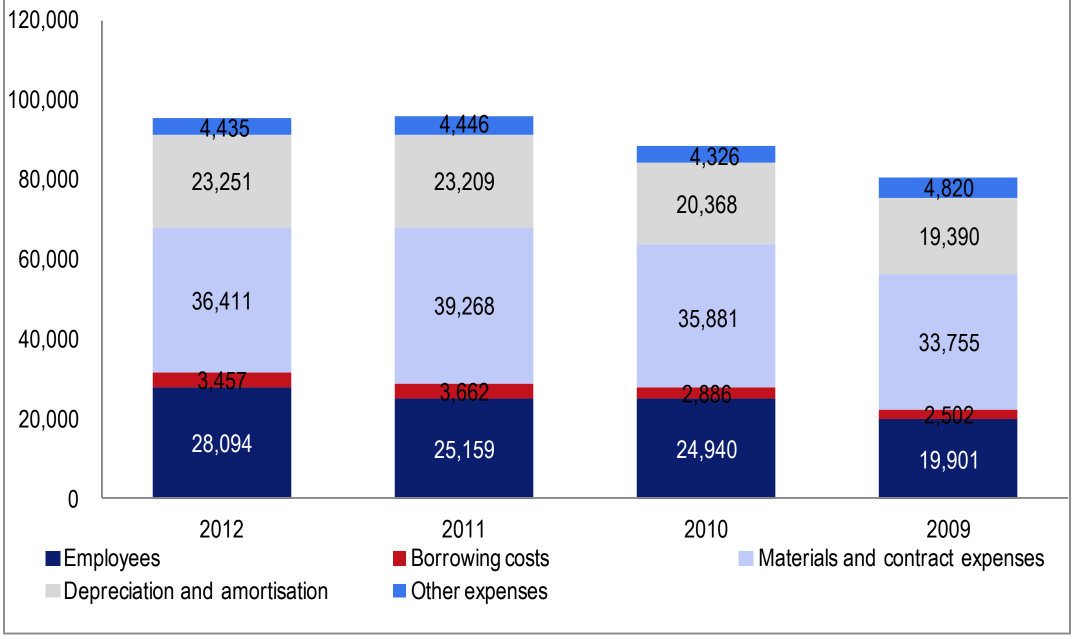
Key Observations

- Rates and annual charges have been increasing above the IPART approved rate peg over the review period due to increases in non rate pegged income including annual charges relating to water services and waste management.
- The Minister for Local Government approved a SRV from 2011 to 2013 worth $0.1m p.a. The SRV is used for business promotion purposes and is collected from business-rated properties.
- User fees and charges in 2012 are sourced from RMS fees ($2.2m), quarry revenues ($7.5m), revenue from swimming pools ($0.2m), and cemeteries ($1.1m). From 2011 onwards, Council has also been in receipt of over $4.0m p.a. in member Councils' contributions to the Richmond Tweed Regional Library.
- Council made a small surplus of $0.2m from quarry operations in 2012, while making losses of over $2.0m p.a. the last two years from the Goonellabah Sports and Aquatic Centre.
- Within operating grants and contributions, Council have been in receipt of natural disaster emergency funding of between $1.7m and $5.1m p.a. in response to the flood events in recent years.
- Grants and contributions for operating purposes increased in 2012 and 2011 due to the prepayment of Financial Assistance Grants ($2.0m in 2012).

- Other revenues include rental revenue from Council properties and revenue from private works carried out by Council.

3.2: Expenses

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



Key Observations

- Employee expenses have risen by 41.2% over the review period to $28.1m in 2012. Full time equivalent staff numbers have risen from 383 in 2010 to 397 in 2012. In 2012 Council converted a number of casual vacancies into full time positions, which resulted in a corresponding decrease in materials and contracts costs as these were previously paid to casual labour hire contractors.
- After year on year increases, materials and contracts expenses decreased in 2012 by 7.3% to $36.4m due to less flood restoration works and the transfer of casual labour cost to employee expenses.
- The annual depreciation expense increased by 19.9% to $23.3m over the review period following the Asset Revaluations process which increased the value of Council's infrastructure assets.
- Other expenses include electricity and heating, and street lighting.
- The member councils made contributions of $5.3m to the running of the Richmond Tweed regional Library in 2011. As the "Executive Council" of the Library, all financial reporting is consolidated into Council's financial statements. Council's contribution was $1.3m in 2011.

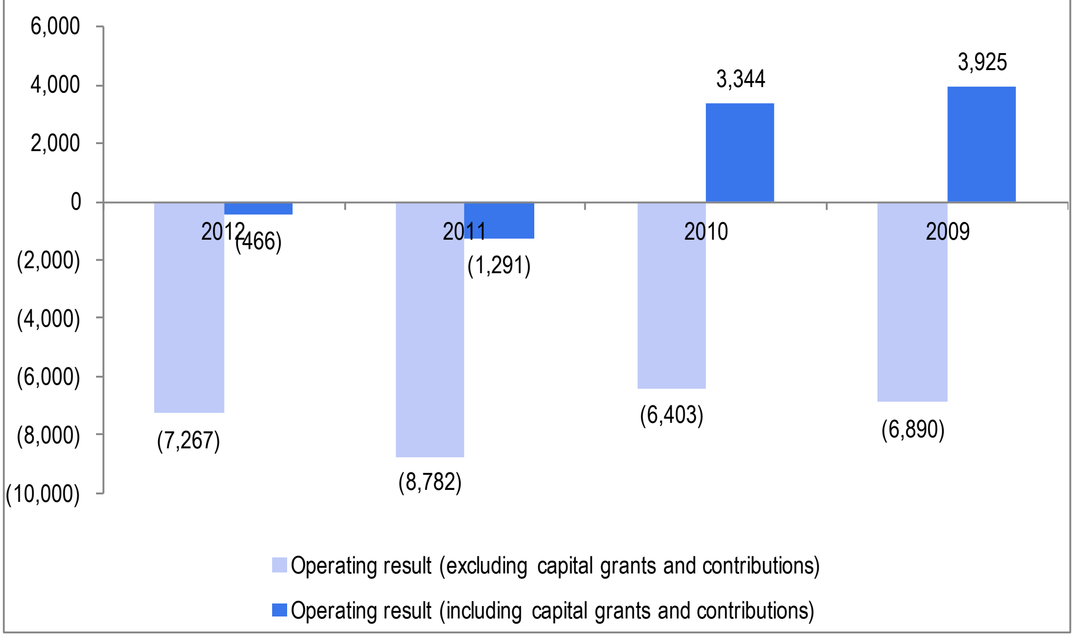
3.3: Operating Results

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

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

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

Figure 3 - Operating Results for 2008/09 to 2011/12 ($'000s)



Key Observations

- Council has consistently posted net operating deficits excluding capital grants and contributions.
- Council expenses include a non-cash depreciation expense, ($23.3m in 2012), which has increased substantially 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, depreciation is an important expense as it represents the allocation of the value of an asset over its useful life.

3.4: Financial Management Indicators

Performance Indicators	Year ended 30 June			
	2012	2011	2010	2009
EBITDA ($'000s)	19,441	18,089	16,851	15,002
Operating Ratio	(8.2%)	(10.1%)	(7.8%)	(9.4%)
Interest Cover Ratio	5.62x	4.94x	5.84x	6.00x
Debt Service Cover Ratio	3.40x	3.08x	3.44x	3.40x
Unrestricted Current Ratio	2.25x	2.13x	1.80x	1.39x
Own Source Operating Revenue Ratio	70.9%	69.5%	64.2%	66.1%
Cash Expense Ratio	5.7 months	5.5 months	7.0 months	4.0 months
Net Assets ($'000s)	1,068,592	1,046,681	991,098	651,742

Key Observations

- Council's EBITDA has increased over the review period.
- Council's Interest Cover Ratio and DSCR indicate that Council had flexibility in regard to carrying more debt. Council had $47.6m in outstanding borrowings in June 2012, being 4.5% of Net Assets.
- The Unrestricted Current Ratio has been near or above the benchmark in most of the review years indicating liquidity is sufficient.
- The Cash Expense Ratio has been well above the benchmark each year.
- The Own Source Operating Revenue Ratio has been above the benchmark in all four years, reflecting Council's relatively diverse sources of revenue.
- Net Assets have increased by $416.9m between 2009 and 2012 due to the consecutive Asset Revaluations which increased the value of Council's infrastructure assets and community land.
- The Asset Revaluations over the last three years have resulted in some volatility in Net Assets. 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 Council.
- 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 last four years this amounted to a $12.5m net increase in IPP&E.

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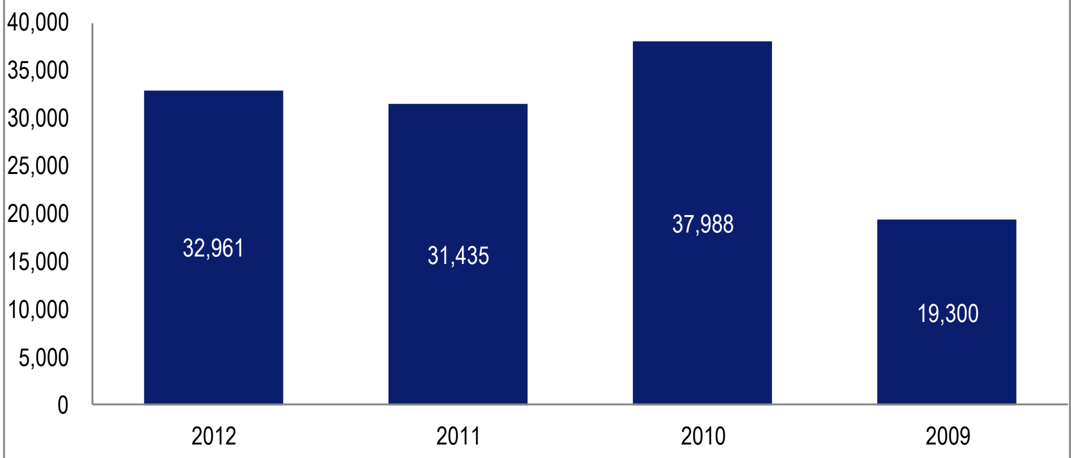
3.5: Statement of Cashflows

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



Key Observations

- Cash and cash equivalents have increased over the review period, and total cash and investments have increased by $13.3m over the same period to $42.1m in 2012.
- The Unrestricted Current Ratio indicates Council had sufficient liquidity.
- Council had $42.1m in total cash and investments in 2012 of which $33.0m was held in cash, $5.4m in long term deposits, $1.6m in managed funds, $1.0m in equity linked notes, $0.3m in CDOs and $1.0m in bonds.
- Within the $42.1m in total cash and investments, $29.7m was externally restricted and $12.4m was internally restricted. Council had zero unrestricted funds.
- Council's $1.0m in managed funds is held within a Blackrock Care and Maintenance Fund which is not rated.
- Of Council's $0.3m in CDOs, $0.1m is unrated, and $0.2m is rated CCC+.
- Council holds $1.0m in retail bonds issued by Heritage Bank which are rated BBB+.

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 2011/12($'000s)

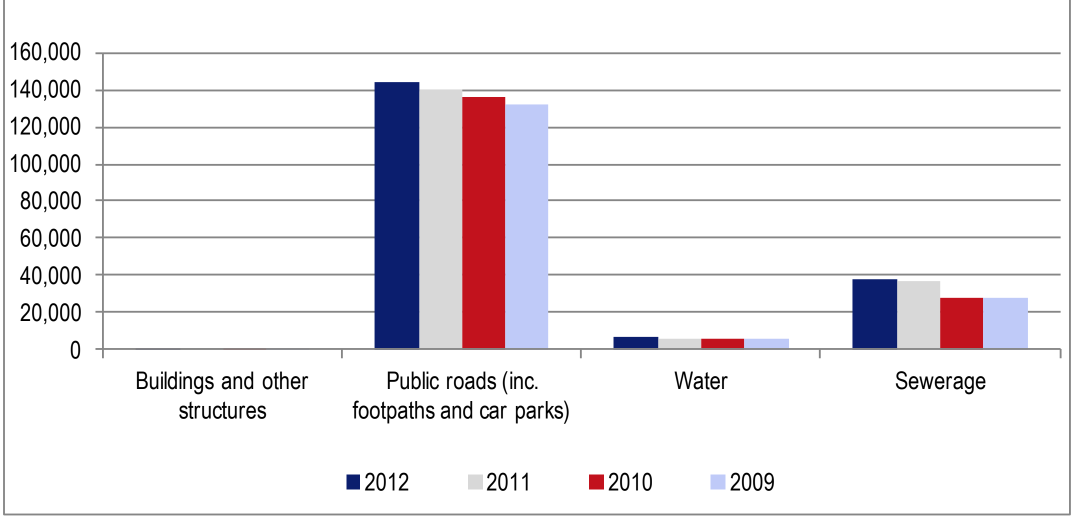
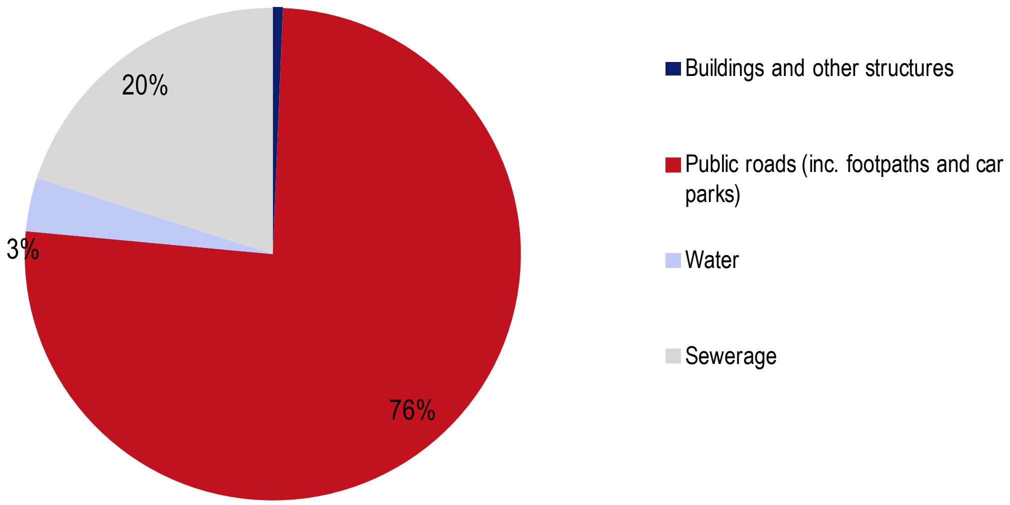


Figure 6 - Infrastructure Backlog Composition for 2011/12



Similarly to neighbouring LGAs the Backlog is mainly related to the road network. Council is currently in the progress of producing updated AMPs for water assets which should be finalised by early 2013.

The latest Road AMP completed in 2010 stated that Council has improved since surveys taken in 1999 and 2006 in its level of service for roads through increased funding, both from increased internal allocations and successful grant applications.

The community has an expectation that the level of service provided for road assets will continue to be improved into the future. Council recognises that existing funding is sufficient to maintain the existing level of service but is concerned that in order to meet the higher expectations of the community further funding is needed. As such, there is a “gap” between the level of service that Council is currently able to provide and community expectations.

The last community survey conducted in 2007 indicates that the two core services that respondents were least satisfied with were “developing and maintaining rural roads” and “developing and maintaining urban roads”.

3.6(b): Infrastructure Status

Infrastructure Status	Year ended 30 June			
	2012	2011	2010	2009
Bring to satisfactory standard ($’000s)	189,946	184,414	171,591	166,594
Required annual maintenance ($’000s)	19,471	18,907	18,356	17,820
Actual annual maintenance ($’000s)	16,426	15,969	15,581	15,204
Total value of infrastructure assets ($’000s)	687,211	687,655	664,760	420,102
Total assets ($’000s)	1,137,092	1,112,505	1,061,079	705,886
Building and Infrastructure Backlog Ratio	0.28x	0.27x	0.26x	0.40x
Asset Maintenance Ratio	0.84x	0.84x	0.85x	0.85x
Building and Infrastructure Renewals Ratio	0.53x	0.64x	0.66x	0.65x
Capital Expenditure Ratio	1.01x	0.73x	1.53x	1.40x

The Building and Infrastructure Renewals Ratio and Asset Maintenance Ratio both indicate that Council has not been spending the required amounts on asset renewal and maintenance. A continuation of this level of spending will likely see an increase in the Infrastructure Backlog. While the Capital Expenditure Ratio would indicate that Council prioritised new assets ahead of asset renewal, the availability of grant funding influences Council’s investment decisions.

3.6(c): Capital Program

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

Capital Program ($'000s)	Year ended 30 June			
	2012	**2011**	**2010**	**2009**
New capital works	11,120	400	0	10,000
Replacement/refurbishment of existing assets	16,193	23,873	23,096	10,000
Total	**27,313**	**24,273**	**23,096**	**20,000**

Major capital projects completed over the review period include:

- Southern Truck Main Project. This $13.7m sewerage project involves the construction of a 9.4km pipeline
- Council commenced work on a sewerage link for the North Woodburn network to join the Richmond Valley Wastewater Scheme
- Architects have been appointed for the $6.0m upgrade of City Hall for which Council received $5.0m in Federal Government funds.
- Reconstruction of Bridge Street
- Timber bridge replacements in Nimbin
- Construction of a skate park in Nimbin

3.7: Specific Risks to Council

- Expanding Infrastructure Backlog. The Council currently has a large road Backlog valuation that is expected to increase as the required asset maintenance and renewal amounts are not forecast to be spent.
- Council has classified a number of privately owned land parcels as local open space, or bushland. As a result, Council will be required to purchase these land parcels when required.
- Insurance claims. As a result of the collapse of Council's insurance underwriter, this has left Council exposed to claims for the period between 1993 and 1997. At this stage Council is unaware of any claims outstanding for this period.
- Ageing population. The LGA has an ageing population. Funding the increasing needs of an ageing population will require a changed focus from Council in future years. Council have run various schemes to promote awareness of this issue, such as holding a Healthy Ageing Day and a "Move2Change" program, which helps promote healthy lifestyles.

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Section 4 Review of Financial Forecasts

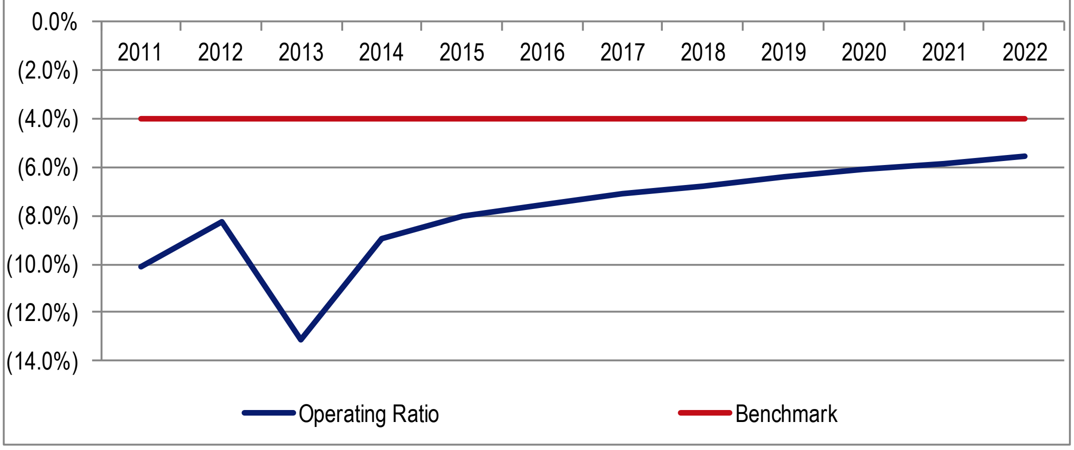
The financial forecast model shows some of the projected financial statements and assumptions for the next 10 years.

Council operates a Water Fund, Sewer Fund and a General Fund, and we have conducted our analysis on a consolidated basis. The model TCorp have analysed is a budgeting model rather than a LTFP and does not include a balance sheet.

Council will develop a new Community Strategic Plan (CSP) in 2013 which will outline the objectives and priorities of the community and Council over the coming years. As part of this process, Council is developing a LTFP which will assess the future impact of Council's proposed works outlined in the CSP and the funding options including potential borrowings.

4.1: Operating Results

Figure 7- Operating Ratio



The Operating Ratio remains below the benchmark for the lifetime of the forecast, but is forecast to gradually improve. Decreased borrowing expenses positively affect the results.

The ratio is skewed downwards in 2013 due to a reduction in user fees and charges of $2.7m and a reduction in operating grants and contributions of $9.5m. Other revenues are also forecast to increase by $4.4m

There are also significant discrepancies in expenses between the actual 2012 results and the 2013 budget. Materials and contract expenses are forecast to decrease by $4.8m, and employee expenses are forecast to decrease by $1.1m

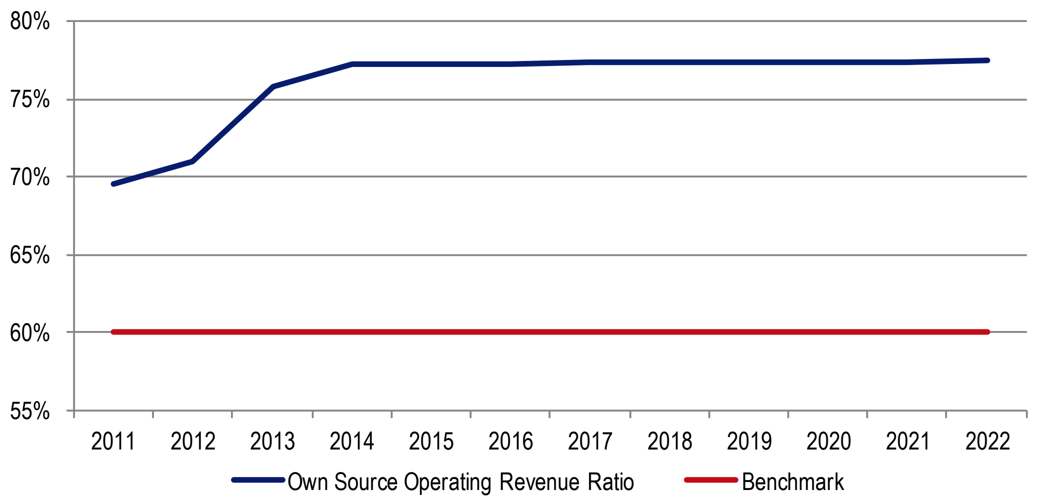
4.2: Financial Management Indicators

Liquidity Ratios

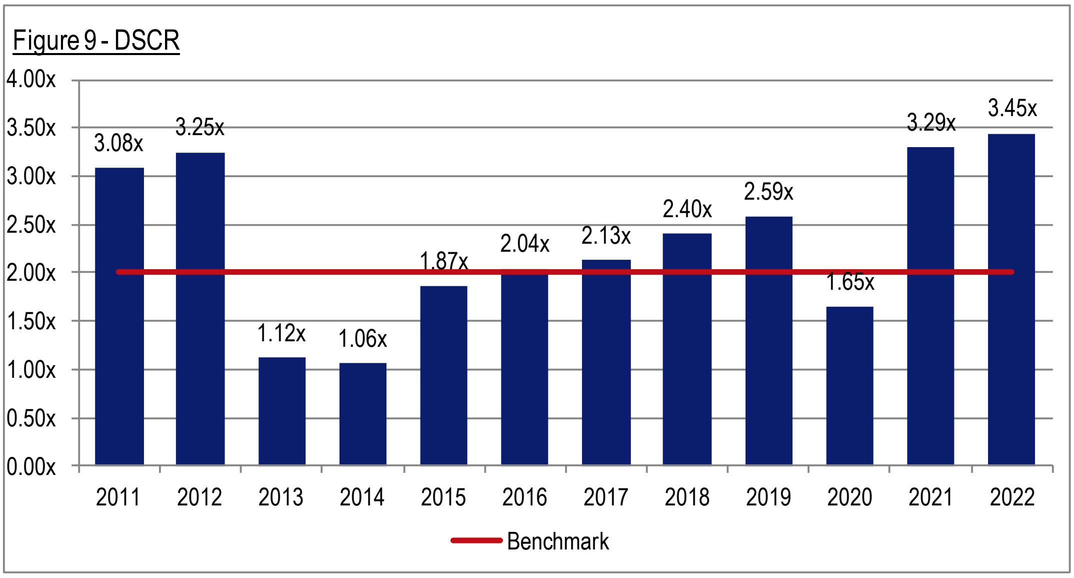
TCorp does not have the information to comment on the liquidity of Council going forward.

Fiscal Flexibility Ratios

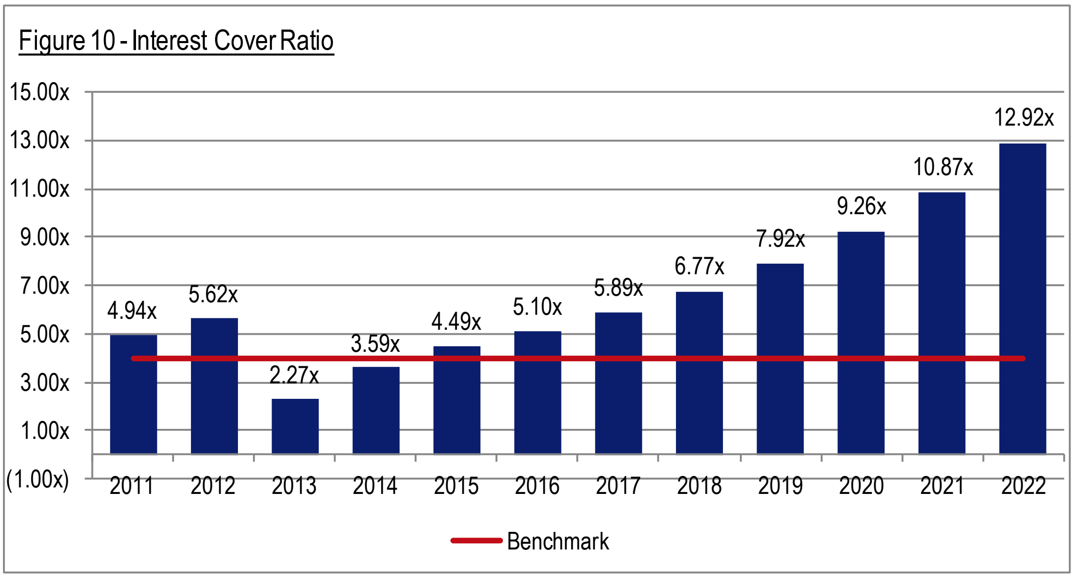
Figure 8 - Own Source Operating Revenue Ratio



Consistent with historical results, the Own Source Operating Ratio is above the benchmark each year of the forecast. This indicates that Council will have fiscal flexibility and is not heavily reliant on external sources of funds. The ratio is skewed upwards due to forecast grants and contributions being less than received in the past.

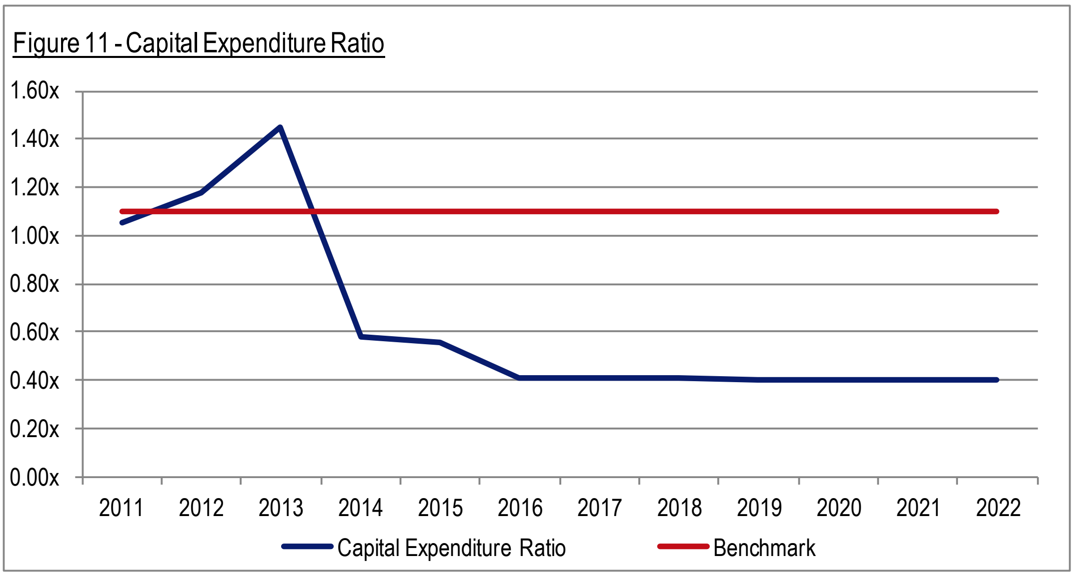


The DSCR shows that Council has the capacity to service all forecast borrowings. The DSCR in 2013 is negatively affected by a high operating deficit, and by high principal repayments in 2014 and 2020. ($5.9m p.a.)



The Interest Cover Ratio, similar to the DSCR, shows the Council has sufficient capacity to service scheduled debt commitments. According to this ratio, there is capacity to service further debt interest costs from 2015 onwards before the Council's ratio decreases to the 4.00x benchmark.

4.3: Capital Expenditure



The forecast capital expenditure is well below benchmark levels required to meet the expected cost of asset renewals. The total deficit for capital expenditure versus depreciation across the 10 year period amounts to $74.3m in nominal terms. As part of Council's next round of CSP in 2013, Council will need to review service levels with community consultation. Once this has been completed, Council will have to consider amending service levels, sourcing additional funds or find further efficiencies to fund capital expenditure.

4.4: Financial Model Assumption Review

Councils have used their own assumptions in developing their forecasts.

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

TCorp's benchmarks:

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

<u>Key Observations and Risks</u>

- The model provided to TCorp and analysed, is a budgeting tool rather than a LTFP. Council aims to produce a LTFP in 2013. For a more complete analysis TCorp would need to examine the LTFP in 2013.
- The model does not include a forecast balance sheet or cash flow statement
- The budgeting model assumes that rates and annual charges will increase by an average of 3.0% p.a.
- User fees and charges are assumed to increase by an average of 3.0% p.a.
- Other revenue is assumed to increase by 2.7% to 3.0%p.a.
- Operating grants and contributions is forecast to dip in 2013 and is forecast to increase by 2.3% to 3.0% p.a.
- Employee costs are forecast to increase by an average of 3.2% p.a.
- Materials and contracts costs are forecast to increase by an average of 2.5% p.a.

4.5: Borrowing Capacity

TCorp is not in a position to comment on the borrowings capacity of Council based on the budgeting model we have based our analysis on. In particular, a lack of reliable forecast liquidity indicators limit TCorp's ability to assess Council's borrowing capacity.

4.6 Sustainability

Based on the information that has been provided to TCorp, Council's financial position is currently deteriorating. Whilst some areas of Council's performance is satisfactory, until a full LTFP is prepared with an integrated AMP and CSP, it is difficult to fully evaluate the future Sustainability position. However, Council has a record of reporting operating deficits and this is forecast to continue and also has a large Infrastructure Backlog.

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

- Council has not been spending sufficient amounts on asset renewal and the long term budgeting model forecasts a relatively low level of capital expenditure. In the longer term this will reduce the quality of assets and diminish Council's capacity to provide services
- In 2012, Council made a number of decisions which should assist in making Council more Sustainable in the future. Council reviewed its range of services and decided to focus on core activities:
    - Council sold a childcare centre. The provision of long-day care was once the domain of Council but the rise of commercial providers and the not-for-profit sector led Council to sell its childcare centre
    - Council decided not to reopen the free Lismore Lake Pool. Serious safety issues were flagged and without an injection of $1.0m, Council must close the Pool
    - In recognition of serious risks in flood times, Council made the decision to request all long-term tenants of Lismore Tourist Caravan Park to leave and return the park to a tourist facility with a maximum of 50 nights stay per year

Section 5 Benchmarking and Comparisons with Other Councils

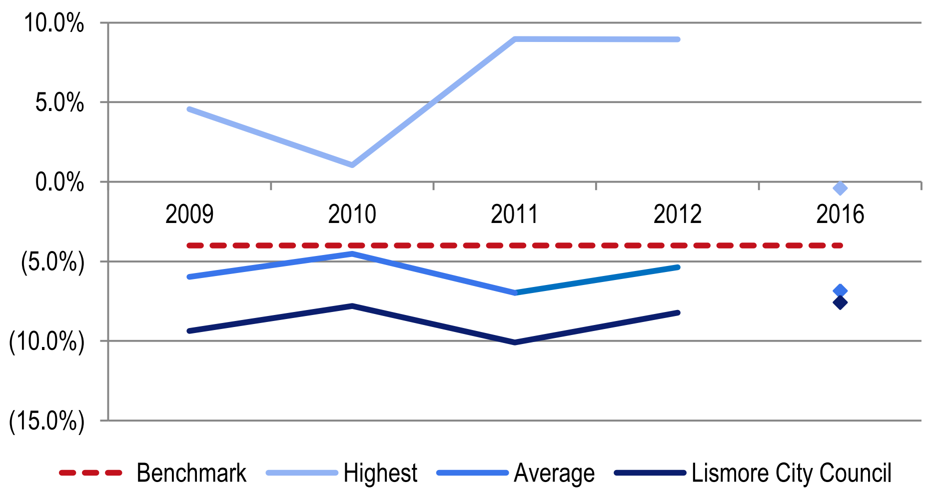
Each council's performance has been assessed against ten key benchmark ratios. This section of the report compares the Council's performance with its peers in the same DLG Group. The Council is in DLG Group 4. There are 31 councils in this group and at the time of preparing this report, we have data for all of these councils.

In Figure 12 to Figure 21, 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 19 to 21 do not include the 2016 forecast position as those numbers are not available.

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

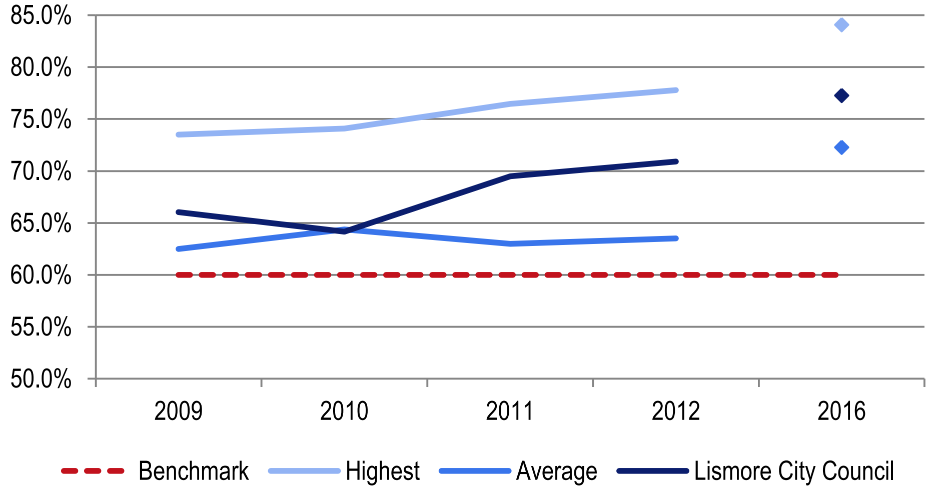
Financial Flexibility

Figure 12 - Operating Ratio Comparison



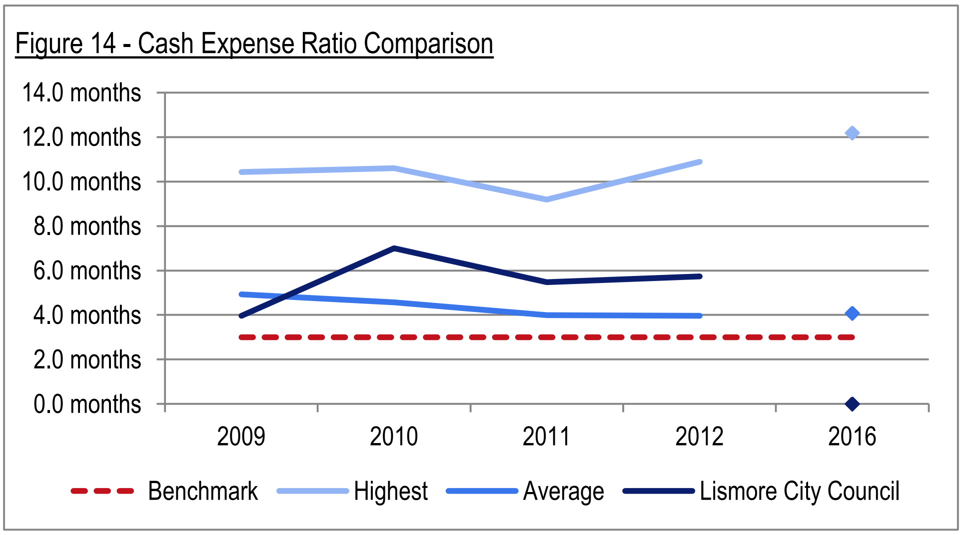
Council's Operating Ratio was below the group average and benchmark over the last four years. Consistent with other councils in the group, it experienced a decline in operating results in 2011 due to increased depreciation expense and an increase in 2012 due to the prepaid Financial Assistance Grant. The ratio is forecast to marginally improve in the medium term though it will remain below the benchmark and group average.

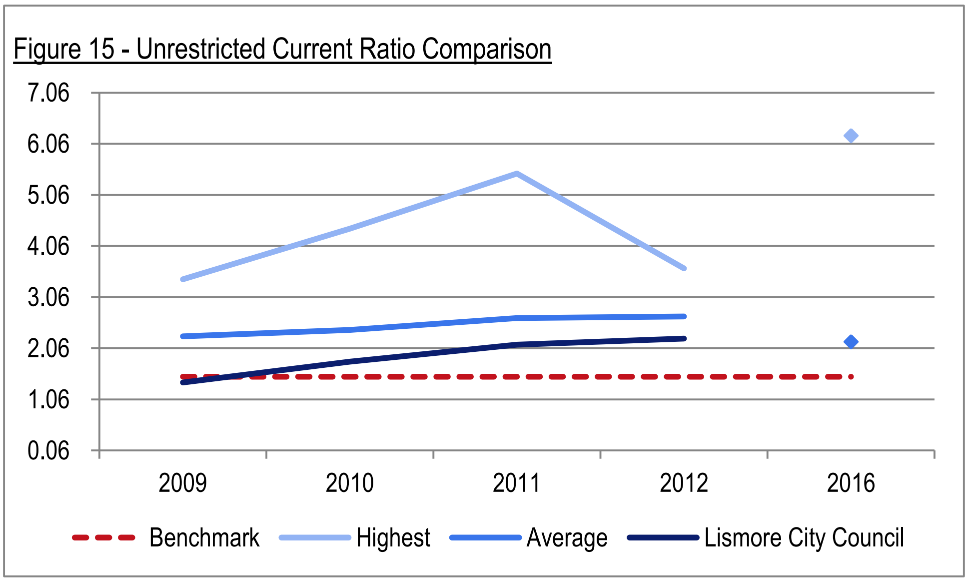
Figure 13 - Own Source Operating Revenue Ratio Comparison



Council's Own Source Operating Revenue Ratio was above the benchmark and at or above the group average over the last four years. The ratio is forecast to improve in the medium term and remain above the benchmark and group average.

Liquidity





On average over the last four years, the Council's liquidity position has been acceptable. Council has not provided a forecast Unrestricted Current Ratio but the Cash Expense Ratio declines significantly in the medium term.

Debt Servicing

Figure 16 - Debt Service Cover Ratio Comparison

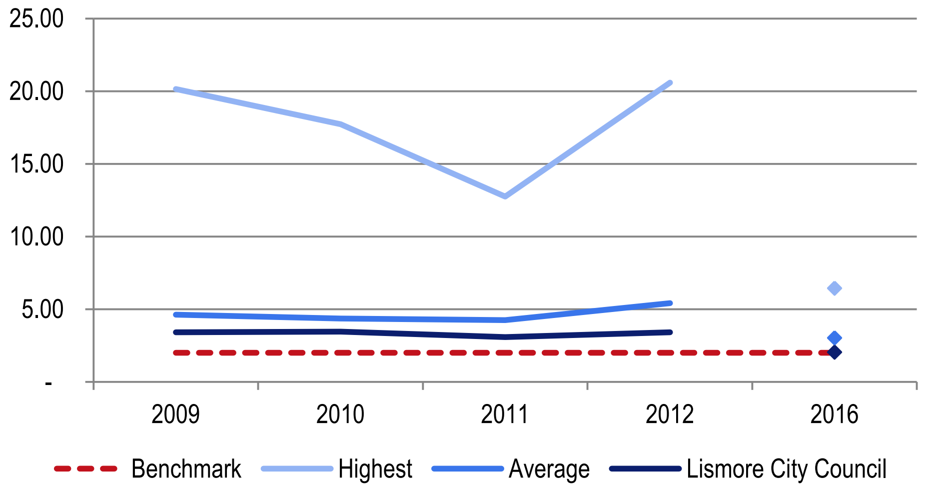
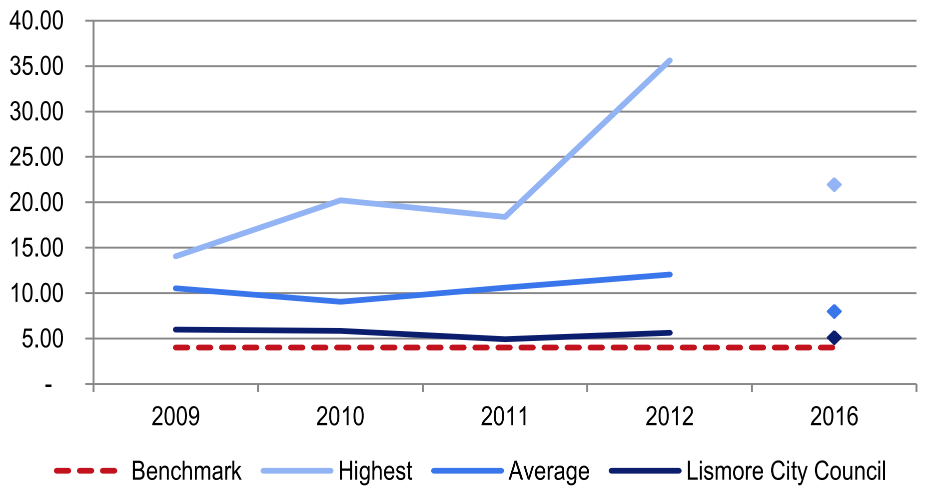


Figure 17 - Interest Cover Ratio Comparison



Over the review period, Council was above the benchmarks but below group averages. These ratios are forecast to marginally decline in the medium term but remain above the benchmarks.

Asset Renewal and Capital Works

Figure 18 - Capital Expenditure Ratio Comparison

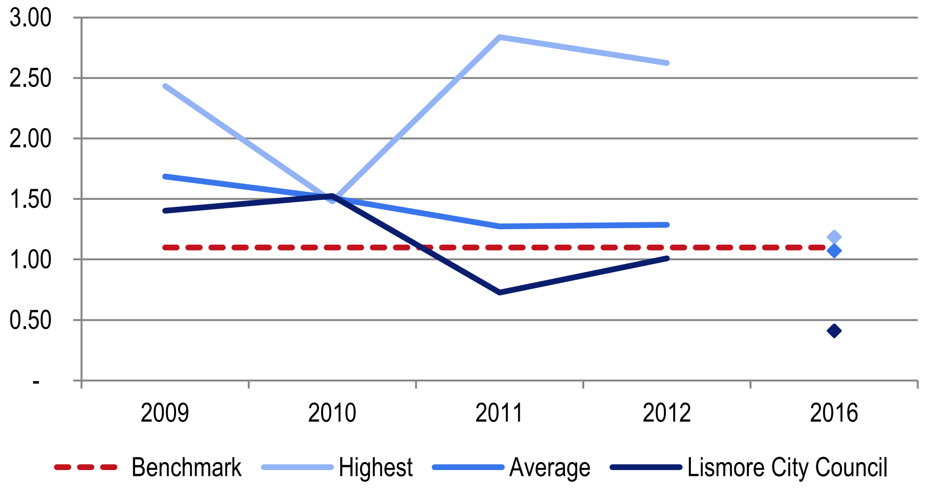


Figure 19 - Asset Maintenance Ratio Comparison

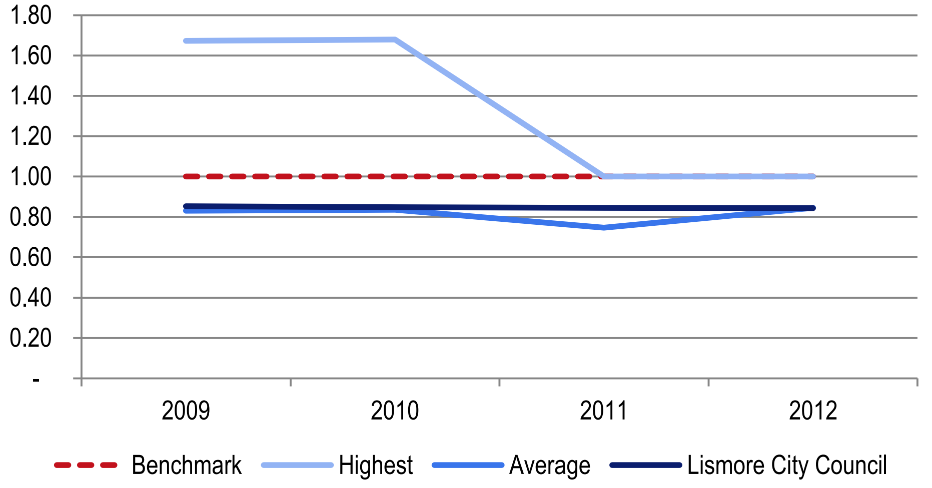


Figure 20 - Infrastructure Backlog Ratio Comparison

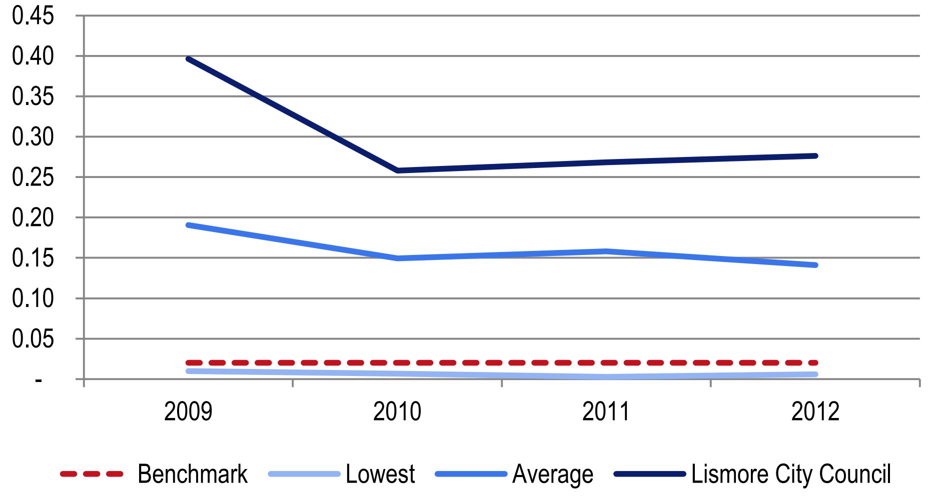
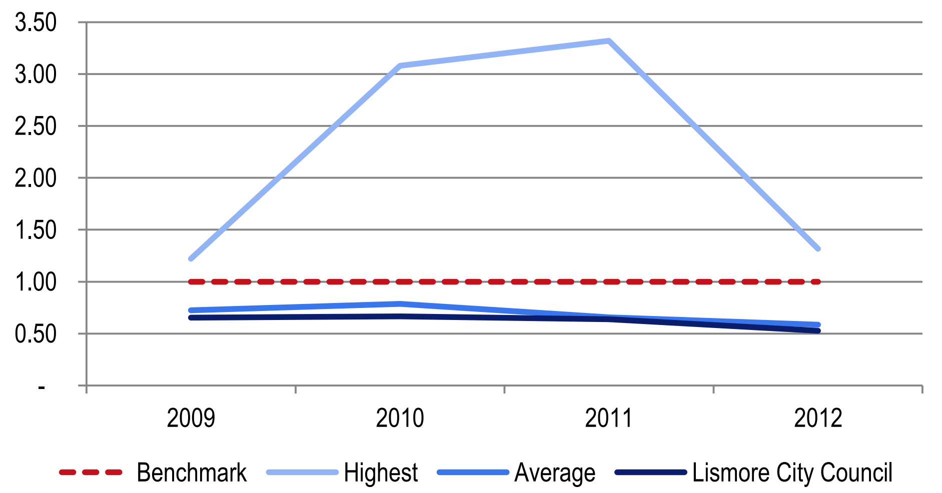


Figure 21 - Building and Infrastructure Asset Renewal Ratio



Overall, Council had a higher Infrastructure Backlog Ratio than other councils in the group that was also higher than the benchmark.

Council's Capital Expenditure Ratio declined over the review period to be below the group average and benchmark.

Council's Building and Infrastructure Asset Renewal Ratio and Asset Maintenance Ratio were around group averages and below the benchmarks.

Section 6 Conclusion and Recommendations

Based on our review of both the historic financial information and the 10 year financial forecast within Council's LTFP we consider Council's financial position to be deteriorating in respect of its longer term Sustainability.

We base our recommendation on the following key points:

- Council is not spending sufficient amounts on maintenance and asset renewal and in the long term this will reduce the quality of assets and potentially impact the provision of services
- The road Infrastructure Backlog is high, and further under investment will impact on the quality of services offered to the community
- The completion of Council's Asset Management Plans and the LTFP in 2013 would assist TCorp to conduct a more complete analysis

New South Wales Treasury Corporation

Appendix A Historical Financial Information Tables

Table 1- Income Statement

Income Statement ($'000s)	Year ended 30 June				% annual change		
	2012	2011	2010	2009	2012	2011	2010
Revenue							
Rates and annual charges	39,603	37,370	34,898	32,239	6.0%	7.1%	8.2%
User charges and fees	27,906	28,259	23,964	23,441	(1.2%)	17.9%	2.2%
Interest and investment revenue	2,572	2,763	1,947	1,643	(6.9%)	41.9%	18.5%
Grants and contributions for operating purposes	16,492	16,033	15,113	13,812	2.9%	6.1%	9.4%
Other revenues	1,808	2,537	6,076	2,343	(28.7%)	(58.2%)	159.3%
Total revenue	**88,381**	**86,962**	**81,998**	**73,478**	**1.6%**	**6.1%**	**11.6%**
Expenses							
Employees	28,094	25,159	24,940	19,901	11.7%	0.9%	25.3%
Borrowing costs	3,457	3,662	2,886	2,502	(5.6%)	26.9%	15.3%
Materials and contract expenses	36,411	39,268	35,881	33,755	(7.3%)	9.4%	6.3%
Depreciation and amortisation	23,251	23,209	20,368	19,390	0.2%	13.9%	5.0%
Other expenses	4,435	4,446	4,326	4,820	(0.2%)	2.8%	(10.2%)
Total expenses	**95,648**	**95,744**	**88,401**	**80,368**	**(0.1%)**	**8.3%**	**10.0%**
Operating result (excluding capital grants and contributions)	**(7,267)**	**(8,782)**	**(6,403)**	**(6,890)**	**17.3%**	**(37.2%)**	**7.1%**
Operating result (including capital grants and contributions)	**(466)**	**(1,291)**	**3,344**	**3,925**	**63.9%**	**(138.6%)**	**(14.8%)**

Table 2 - Items excluded from Income Statement

Excluded items ($'000s)				
	2012	2011	2010	2009
Grants and contributions for capital purposes	6,801	7,491	9,747	10,815
Interest revenue/ (losses)	35	933	633	(2,359)
Interest free loan received	0	0	2,510	0
Richmond Tweed library equity	0	0	5,196	0
Net gain/(loss) from the disposal of assets	(3,261)	(6,523)	1,024	(14)

Table 3 - Balance Sheet

Balance Sheet ($'000s)	Year Ended 30 June				% annual change		
	2012	2011	2010	2009	2012	2011	2010
Current assets							
Cash and cash equivalents	32,961	31,435	37,988	19,300	4.9%	(17.3%)	96.8%
Investments	3,504	614	961	950	470.7%	(36.1%)	1.2%
Receivables	11,794	14,180	13,957	8,178	(16.8%)	1.6%	70.7%
Inventories	6,945	6,940	6,690	8,493	0.1%	3.7%	(21.2%)
Other	37	7	44	22	428.6%	(84.1%)	100.0%
Total current assets	55,241	53,176	59,640	36,943	3.9%	(10.8%)	61.4%
Non-current assets							
Investments	5,704	7,826	5,796	8,643	(27.1%)	35.0%	(32.9%)
Receivables	2,625	1,877	2,131	3,959	39.9%	(11.9%)	(46.2%)
Inventories	115	0	0	0	N/A	N/A	N/A
Infrastructure, property, plant & equipment	1,072,578	1,048,701	992,620	655,325	2.3%	5.6%	51.5%
Intangible assets	829	925	892	1,016	(10.4%)	3.7%	(12.2%)
Total non-current assets	1,081,851	1,059,329	1,001,439	668,943	2.1%	5.8%	49.7%
Total assets	**1,137,092**	**1,112,505**	**1,061,079**	**705,886**	**2.2%**	**4.8%**	**50.3%**
Current liabilities							
Payables	9,226	9,622	12,798	7,213	(4.1%)	(24.8%)	77.4%
Borrowings	2,544	2,259	2,209	2,024	12.6%	2.3%	9.1%
Provisions	7,340	6,369	6,401	4,791	15.2%	(0.5%)	33.6%
Total current liabilities	19,110	18,250	21,408	14,028	4.7%	(14.8%)	52.6%
Non-current liabilities							
Payables	1,779	1,809	1,054	1,171	(1.7%)	71.6%	(10.0%)
Borrowings	45,011	42,227	44,486	36,324	6.6%	(5.1%)	22.5%
Provisions	2,600	3,538	3,033	2,621	(26.5%)	16.7%	15.7%
Total non-current liabilities	49,390	47,574	48,573	40,116	3.8%	(2.1%)	21.1%
Total liabilities	**68,500**	**65,824**	**69,981**	**54,144**	**4.1%**	**(5.9%)**	**29.2%**
Net assets	**1,068,592**	**1,046,681**	**991,098**	**651,742**	**2.1%**	**5.6%**	**52.1%**

Table 4-Cashflow

Cashflow Statement ($'000s)	Year ended 30 June			
	2012	**2011**	**2010**	**2009**
Cashflows from operating activities	21,241	19,025	23,486	17,350
Cashflows from investing activities	(22,784)	(23,369)	(15,655)	(11,491)
Proceeds from borrowings and advances	5,327	0	12,865	8,094
Repayment of borrowings and advances	(2,258)	(2,209)	(2,008)	(1,908)
Cashflows from financing activities	3,069	(2,209)	10,857	6,186
Net increase/(decrease) in cash and equivalents	**1,526**	**(6,553)**	**18,688**	**12,045**
Cash and equivalents	32,961	31,435	37,988	19,300

New South Wales
Treasury Corporation

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 with representatives from the Department of Premier and Cabinet and NSW Treasury.

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

Division of Local Government (DLG)

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

Depreciation of Infrastructure Assets

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

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

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

EBITDA

EBITDA is an acronym for "earnings before interest, taxes, depreciation, and amortisation". It is often used to measure the cash earnings that can be used to pay interest and repay principal.

Grants and Contributions for Capital Purposes

Councils receive various capital grants and contributions that are nearly always 100% specific in nature. Due to the fact that they are specifically allocated in respect of capital expenditure they are excluded from the operational result for a council in TCorp's analysis of a council's financial position.

Grants and Contributions for Operating Purposes

General purpose grants are distributed through the NSW Local Government Grants Commission. When distributing the general component each council receives a minimum amount, which would be the amount if 30% of all funds were allocated on a per capita basis. When distributing the other 70%, the Grants Commission attempts to assess the extent of relative disadvantage between councils. The approach taken considers cost disadvantage in the provision of services on the one hand and an assessment of revenue raising capacity on the other.

Councils also receive specific operating grants for one-off specific projects that are distributed to be spent directly on the project that the funding was allocated to.

Independent Commission Against Corruption (ICAC)

ICAC was established by the NSW Government in 1989 in response to growing community concern about the integrity of public administration in NSW.

The jurisdiction of the ICAC extends to all NSW public sector agencies (except the NSW Police Force) and employees, including government departments, local councils, members of Parliament, ministers, the judiciary and the governor. The ICAC's jurisdiction also extends to those performing public official functions.

Independent Pricing and Regulatory Tribunal (IPART)

IPART has four main functions relating to the 152 local councils in NSW. Each year, IPART determines the rate peg, or the allowable annual increase in general income for councils. They also review and determine council applications for increases in general income above the rate peg, known as "Special Rate Variations". They approve increases in council minimum rates. They also review council development contributions plans that propose contribution levels that exceed caps set by the Government.

Infrastructure Backlog

Infrastructure backlog is defined as the estimated cost to bring infrastructure, building, other structures and depreciable land improvements to a satisfactory standard, measured at a particular point in time. It is unaudited and stated within Special Schedule 7 that accompanies the council's audited annual financial statements.

Integrated Planning and Reporting (IP&R) Framework

As part of the NSW Government's commitment to a strong and sustainable local government system, the *Local Government Amendment (Planning and Reporting) Act 2009* was assented on 1 October 2009. From this legislative reform the IP&R framework was devised to replace the former Management Plan and Social Plan with an integrated framework. It also includes a new requirement to prepare a long-term Community Strategic Plan and Resourcing Strategy. The other essential elements of the new framework are a Long-Term Financial Plan (LTFP), Operational Plan and Delivery Program and an Asset Management Plan.

Local Government Cost Index (LGCI)

The LGCI is a measure of movements in the unit costs incurred by NSW councils for ordinary council activities funded from general rate revenue. The LGCI is designed to measure how much the price of a fixed "basket" of inputs acquired by councils in a given period compares with the price of the same set of inputs in the base period. The LGCI is measured by IPART.

Net Assets

Net Assets is measured as total assets less total liabilities. The Asset Revaluations over the past years have resulted in a high level of volatility in many councils' Net Assets figure. Consequently, in the short term the value of Net Assets is not necessarily an informative indicator of performance. In the medium to long term however, this is a key indicator of a council's capacity to add value to its operations. Over time, Net Assets should increase at least in line with inflation plus an allowance for increased population and/or improved or increased services. Declining Net Assets is a key indicator of the council's assets not being able to sustain ongoing operations.

Roads and Maritime Services (RMS)

The NSW State Government agency with responsibility for roads and maritime services, formerly the Roads and Traffic Authority (RTA).

Section 64 Contribution

Development Servicing Plans (DSPs) are made under the provisions of Section 64 of the Local Government Act 1993 and Sections 305 to 307 of the Water Management Act 2000.

DSPs outline the developer charges applicable to developments for Water, Sewer and Stormwater within each Local Government Area.

Section 94 Contribution

Section 94 of the Environmental Planning and Assessment Act 1979 allows councils to collect contributions from the development of land in order to help meet the additional demand for community and open space facilities generated by that development.

It is a monetary contribution levied on developers at the development application stage to help pay for additional community facilities and/or infrastructure such as provision of libraries; community facilities; open space; roads; drainage; and the provision of car parking in commercial areas.

The contribution is determined based on a formula which should be contained in each council's Section 94 Contribution Plan, which also identifies the basis for levying the contributions and the works to be undertaken with the funds raised.

Special Rate Variation (SRV)

A SRV allows councils to increase general income above the rate peg, under the provisions of the Local Government Act 1993. There are two types of special rate variations that a council may apply for:

- a single year variation (section 508(2)) or
- a multi-year variation for between two to seven years (section 508A).

The applications are reviewed and approved by IPART.

Sustainability

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

Ratio Explanations

Asset Maintenance Ratio

Benchmark = Greater than 1.0x

Ratio = actual asset maintenance / required asset maintenance

This ratio compares actual versus required annual asset maintenance, as detailed in Special Schedule 7. A ratio of above 1.0x indicates that the council is investing enough funds within the year to stop the infrastructure backlog from growing.

Building and Infrastructure Renewals Ratio

Benchmark = Greater than 1.0x

Ratio = Asset renewals / depreciation of building and infrastructure assets

This ratio compares the proportion spent on infrastructure asset renewals and the asset's deterioration measured by its accounting depreciation. Asset renewal represents the replacement or refurbishment of existing assets to an equivalent capacity or performance as opposed to the acquisition of new assets or the refurbishment of old assets that increase capacity or performance.

Cash Expense Cover Ratio

Benchmark = Greater than 3.0 months

Ratio = current year's cash and cash equivalents / (total expenses – depreciation – interest costs)*12

This liquidity ratio indicates the number of months a council can continue paying for its immediate expenses without additional cash inflow.

Capital Expenditure Ratio

Benchmark = Greater than 1.1x

Ratio = annual capital expenditure / annual depreciation

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

Debt Service Cover Ratio (DSCR)

Benchmark = Greater than 2.0x

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

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

Building and Infrastructure Backlog Ratio

Benchmark = Less than 0.02x

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

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

Interest Cover Ratio

Benchmark = Greater than 4.0x

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

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

Operating Ratio

Benchmark = Better than negative 4%

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

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

Own Source Operating Revenue Ratio

Benchmark = Greater than 60%

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

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

Unrestricted Current Ratio

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

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

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