Lismore City Council

Financial Assessment and Sustainability Report

FINAL

Date: 04.11.19

Disclaimer

This report has been prepared by New South Wales Treasury Corporation (TCorp) on the instructions of Lismore City Council (Council).

This report has been prepared based on information provided to TCorp by 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, usefulness, timeliness 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 Council, all of which may negatively impact the financial capability and sustainability of Council. This report focuses on Council's future sustainability, within prudent risk parameters and the limits of its financial projections.

This report is solely for the use of Council and is not intended to and should not be used or relied upon by anyone else. This report has been prepared for the purpose set out in the Engagement letter between TCorp and Council dated 3 October 2019 and subsequent correspondence between TCorp and Council. Disclosure, distribution or copying of this report for any other purpose than that detailed in the engagement terms with Council is prohibited. Recipients of this report should seek independent expert advice as this report was not prepared for them or for any other purpose than that detailed in the engagement terms with Council and cannot be relied upon other than for this.

TCorp shall not be liable to 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. TCorp expressly disclaims any duty to update any information contained in this report.

Contents

1. Executive Summary

This report provides an updated financial sustainability assessment for Lismore City Council (Council), following the initial assessment prepared by TCorp in March 2013. It is based on Council's annual audited financial statements from FY2014 to FY2018 and Council's March 2019 Long Term Financial Plan (LTFP). As FY2019 audited financial statements were not yet completed and therefore unavailable to TCorp, this report may not reflect the current financial position of or outlook for Council and does not take into account any changes in circumstances other than those contained in the information provided to us.

It should be noted that, in addition to providing this report, TCorp also acts as a lender to the Council.

TCorp is aware of a critical incident that occurred in August 2019 regarding a waste facility fire. Council has advised that it is working with its insurers to recover remediation and business interruption costs. The subsequent impact (if any) to Council's financial position or performance is not included in the LTFP provided to TCorp.

TCorp understands Council has also put an asset remediation strategy and zero-based budgeting in place for the FY2020 Budget to address its liquidity issues, however the decision to take these actions was subsequent to the preparation of the LTFP and its impact is not yet known.

In March 2013, TCorp provided Council with a Financial Assessment, Sustainability and Benchmarking Report as part of the work undertaken for the Independent Local Government Review Panel. In TCorp's initial assessment, Council's financial position with respect to long-term sustainability was deteriorating. This was principally due to the result of Council underinvesting in maintenance and asset renewals and its high roads infrastructure backlog

Based on the information provided to us, TCorp considers Council's operating results to have improved since the previous assessment. In 2013, Council's Operating Ratio was consistently negative over the historic and forecast review period. However, from FY2016 to FY2018, Council has been able to achieve operating surpluses although it is forecast to have operating deficits for FY2019 through to FY2022 before trending back to surplus from FY2023.

Based on the March 2019 LTFP provided, Council's liquidity position is distressed with external restrictions greater than the forecast cash and investment reserves for four of the next ten years. This indicates a potential issue for Council with meeting unexpected short-term funding requirements.

Council's infrastructure backlog remains very high at $160.2m and it has continued to underinvest in maintenance and renewal of existing assets since the 2013 assessment. Council forecasts it will spend 90% of required maintenance costs over the next ten years, which indicates that the infrastructure backlog is likely to continue to rise. TCorp understands Council is to apply for an SRV to help address this backlog. TCorp is not aware of the scope of this increase and is therefore unable to quantify the impact on any infrastructure backlog.

TCorp recommends that Council address its liquidity position as a priority and then focus on how best it can reduce its infrastructure backlog, while aiming to continue the operating surpluses achieved between FY2016 and FY2018.

2. Council Characteristics

Council area (km^2):	1,287.7km^2			
Population:	43,905			
aged less than 20	24.8%			
aged 20 to 60	49.8%			
aged over 60	25.4%			
Population change over five years:	-1.3%			
Outstanding rates and annual charges*:	9.02%			
Number of rating assessments:	Residential	Farmland	Business	Mining
FY2018	15,491	1,901	1,221	-
FY2017	15,365	1,904	1,217	-
FY2016	15,252	1,918	1,213	-

Statistics from 2015-16 and 2017-18 OLG comparative data sheet

** Source: 2018 Financial Statements*

There has been a decline in population over the past five years, however there is an increasing trend in the total number of rating assessments. Council's outstanding rates and annual charges have trended lower over the past five years from 11.45% to 9.02%, however this remains higher than the OLG Group average of 5.7% (*source: yourcouncil.nsw.gov.au*).

2.1 Management

Shelley Oldham has been Lismore City Council's General Manager since October 2018. She has experience in consultancy working with the public sector, as well as the Victorian State Government (Department of Treasury and Finance and the Chief Information Office).

She is supported by three new directors:

- Director of Corporate Services – Dr Graeme Towers
- Director of Infrastructure Services – Peter Jeuken
- Director of Partnership, Planning and Engagement – Dr Sharon Harwood

3. Review of Financial Performance and Position

This report is based on the annual audited accounts of the Council from FY2014 to FY2018. The General Fund represents approximately 73.8% of Council's total revenues in FY2018, while the Water and Sewer Funds represent 13.3% and 12.9% respectively.

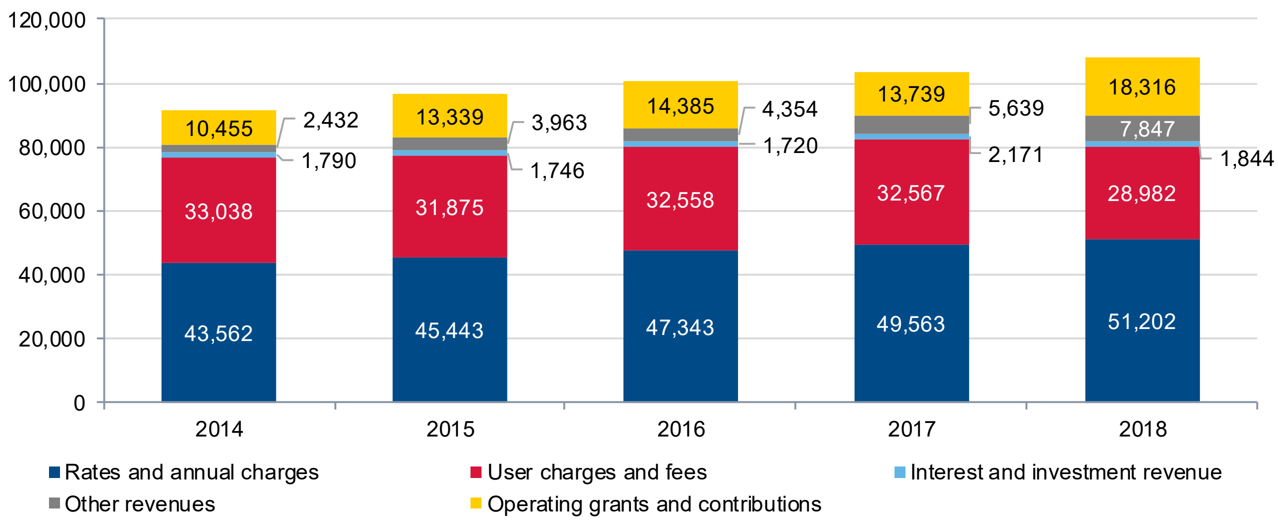
TCorp has made standard adjustments to focus our analysis on core operating council results. Grants and contributions for capital purposes, realised and unrealised gains on investments and other assets are excluded, as well as one-off items which Council has no control over (e.g. impairments).

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 are detailed in Appendix A.

3.1 Revenue

Figure 1 - Revenue for FY2014 to FY2018 ($'000s)



Key Observations

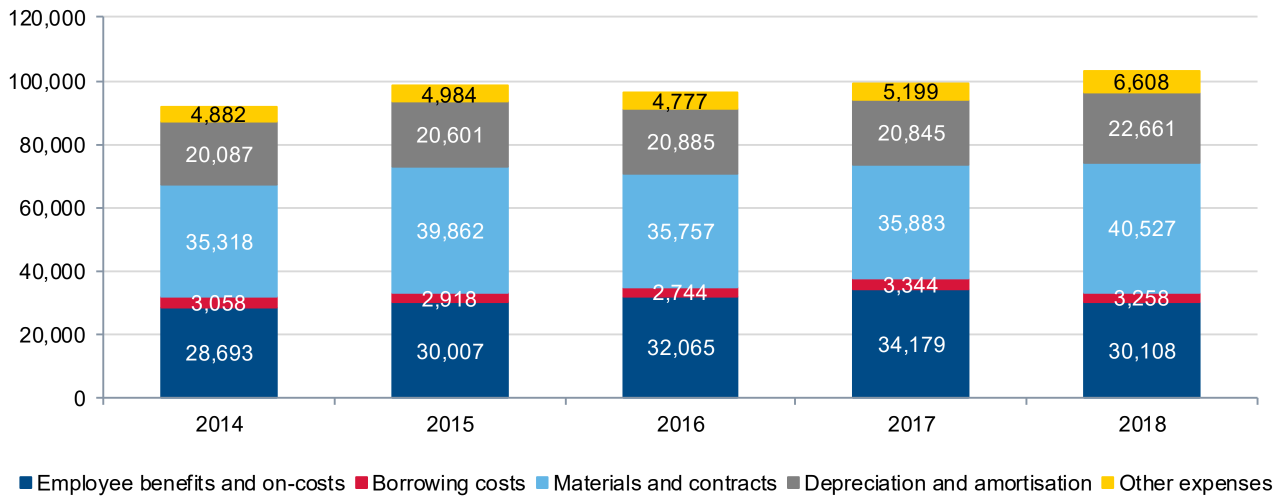
- Overall operating revenues increased 18.5% over the five-year period of FY2014 to FY2018 (the Review Period)
- Rates and annual charges have increased at levels above the rate peg in each year, primarily driven by domestic waste management services, water supply services and sewerage services – 4.3% ($1.9m), 4.2% ($1.9m), 4.7% ($2.2m) and 3.3% ($1.6m) in FY2015, FY2016, FY2017 and FY2018 respectively. IPART approved a special rate variation (SRV) of 3.6% (1.8% above the rate peg) for FY2017 to fund its Biodiversity Management Strategy, which is permitted to remain in the rate base permanently
- On 1 July 2017, Council entered into a new agreement with other councils to operate regional library services, which saw Lismore City Council relinquish 75% control of the Richmond Tweed Regional Library (RTRL). User charges and fees declined 11% ($3.6m) in FY2018 primarily due

to the loss of RTRL contributions by member councils ($4.8m) and a decline in quarry revenues ($1.3m), which was partially offset by increased building regulation fees ($0.3m) and RMS charges ($1.7m)

- Over the period, interest and investment revenue remained relatively static, except for FY2017 which saw a 26.2% ($0.4m) increase due to cash and investments increasing 69% ($65.9m) that year
- The main contributor to other revenues was recycling income over the period, with $1.8m of insurance claim recoveries in FY2018 from March 2017 flood recoveries
- Operating grants and contributions fluctuated over the period due to a combination of:
  - Timing of financial assistance grants in FY2015 – increased to $6.2m from $3.0m
  - Increased RMS contributions in FY2015 by 86.2% ($1.3m)
  - Natural Disaster Emergency Funding – $1.7m in FY2016, $6.5m in FY18
  - Roads to Recovery grants rose to $2.5m in FY2016 from $0.9m (up 185.6%)
- One-off revenue items were excluded including $2.3m of other revenue from the re-assessment of provisions for waste facility remediation in 2015 and $1.1m other revenue relating to the Lehman Brothers Class Action Recovery in 2016

3.2 Expenses

Figure 2 - Expenses for FY2014 to FY2018 ($'000s)



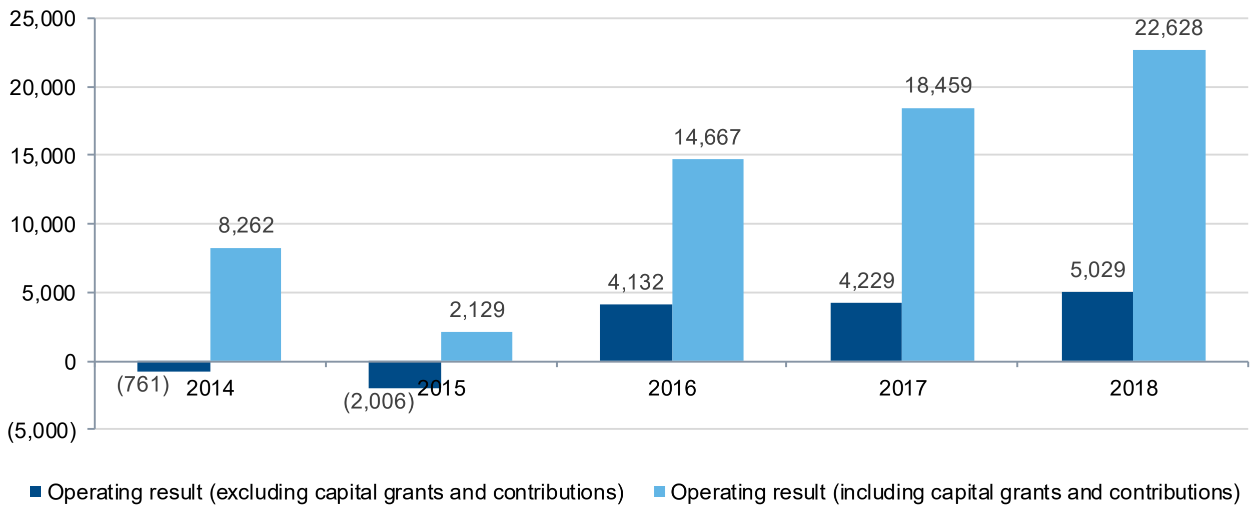
Key Observations

- Overall operating expenses increased 12.1% over the Review Period
- Employee benefits and on-costs increased 4.9% over the Review Period however the number of full-time-equivalent employees increased by 7.8% (from 400 to 431). FY2018 saw a fall in costs of 11.9% due to the change in control of the RTRL – Council's original budget included $5.3m in salary and wages attributable to this
- Borrowing costs increased in FY2017 by 21.9% ($0.6m) from an increase in total borrowings of 62.4% ($26.9m). Council has numerous loans within each fund with different maturities and interest rates, which cause fluctuations in borrowing costs as loans mature and new borrowings are taken up

- Materials and contracts costs spiked 12.9% ($4.5m) in FY2015 and 12.9% in FY2018 ($4.6m) due to increased expenditure relating to additional grants received – RMS works and works carried forward from FY2014 and road repairs, environmental works and flood recovery (FY2018)
- Depreciation expenses remained steady over the period while the asset base increased. This was due to the increase in long life and non-depreciable assets
- In FY2018, there was a 27.1% rise in costs following the reclassification of the RTRL – Council's contribution is now treated as an expense ($1.4m)
- $0.5m from legal costs related to investment recoveries from Lehman Brothers Australia (FY2016) and $3.3m from the transfer of assets and liabilities to other councils following the new agreement for the RTRL (FY2018), were classified as other expenses, and have been excluded for the purposes of our report, given their one-off nature

3.3 Operating Results

Figure 3 - Operating Results for FY2014 to FY2018 ($'000s)



Key Observations

- Over the Review Period, Council was able to generate increased operating revenues and contain costs to eventually reach operating surplus from FY2016
- Council was approved for a business specific five-year SRV in FY2014 (3.82%) and a permanent SRV in FY2017 (3.6% – 1.8% above the rate peg) allowing them to increase their rates revenue above the peg in those years and move towards operational surplus
- Capital grants and contributions grew significantly in the second half of the period which funded works including the Wilson Street Crossing, Regional Roads Repair Program and the Albert Park and Oakes Oval developments
- In FY2017 and FY2018, Council received grants to help fund flood repairs damage to roads

3.4 Financial Management Indicators

Table 1: Performance Indicators

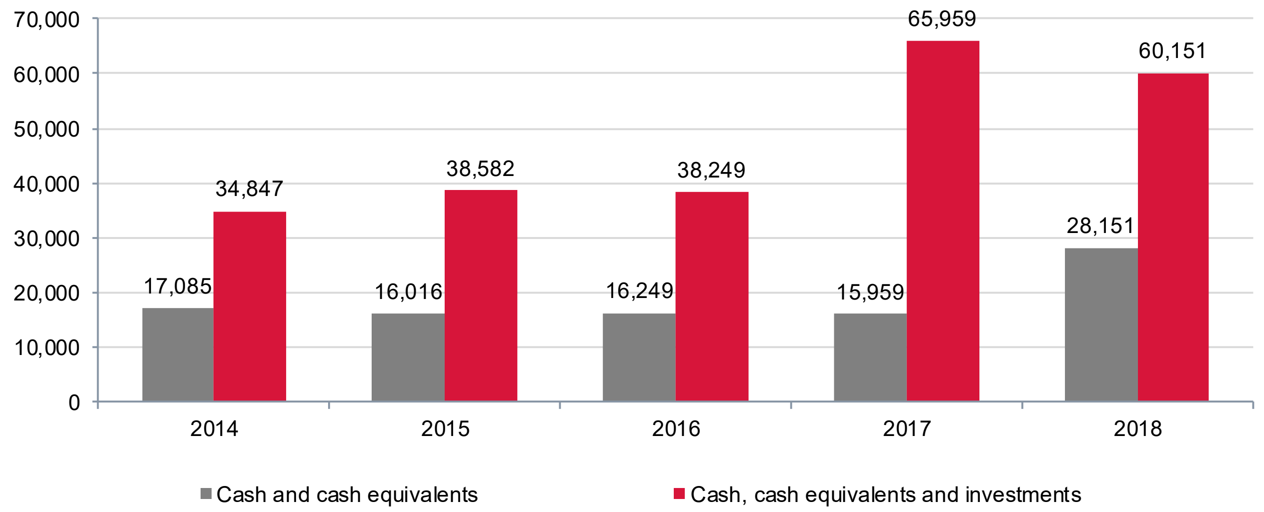
Performance Indicators	Year ended 30 June				
	2014	2015	2016	2017	2018
EBITDA ($'000s)	22,384	21,513	27,761	28,418	30,948
Operating Ratio	(0.8%)	(2.1%)	4.1%	4.1%	4.6%
Own Source Operating Revenue Ratio	80.6%	82.6%	77.5%	76.3%	71.4%
Interest Cover Ratio	7.32x	7.37x	10.12x	8.50x	9.50x
Debt Service Cover Ratio	2.51x	3.44x	4.48x	3.78x	3.95x
Cash Expense Ratio (CER)	4.9 months	5.1 months	5.5 months	9.9 months	8.4 months
Adjusted Cash Expense Ratio	1.1 months	1.9 months	1.3 months	1.6 months	0.8 months
Unrestricted Current Ratio	1.72x	1.51x	1.45x	1.50x	1.37x
Net assets ($'000s)	1,068,368	1,055,230	1,097,771	1,332,881	1,386,354

Key Observations

- The Operating Ratio improved in FY2016 primarily as a result of the $4.1m decrease in materials and contracts costs, combined with higher annual charges (increase of $1.3m). Council was able to maintain an operating surplus for the remainder of the period with EBITDA trending positively and costs relatively contained
- Council's Own Source Operating Revenue Ratio remained above the 60% benchmark for the historic five-year period with a downward trend from FY2015 due to increased capital grants
- Total borrowings increased significantly to $70.2m FY2017 due to a $31.1m new loan provided by TCorp to fund various infrastructure works including footpaths, art gallery, water and sewerage infrastructure. However, the DSCR and ICR remained above their respective benchmarks (2.0x and 4.0x respectively)
- CER improved year-on-year from FY2014 to FY2017 with higher cash balances from new (unspent) borrowings ($31.1m in FY17), combined with improved operating results. Please note that this ratio does not take into consideration external restrictions
- TCorp now analyses an adjusted CER that does not include externally restricted cash and investments. This ratio was at its lowest in FY2018 and supports our view that Council had a liquidity issue in August 2019 as a result of the fire at Council's waste facility
- The Unrestricted Current Ratio deteriorated slightly, however, remained around the 1.5x benchmark over the period. This was due to external restrictions rising from $29.8m (FY2014) to $56.2m (FY2018) mainly relating to sewerage services. This ratio is well below the OLG Group average of 3.0x for FY2018 (*source: yourcouncil.nsw.gov.au*)

3.5 Statement of Cashflows

Figure 4 - Cash and Investments for FY2014 to FY2018 ($'000s)



Key Observations

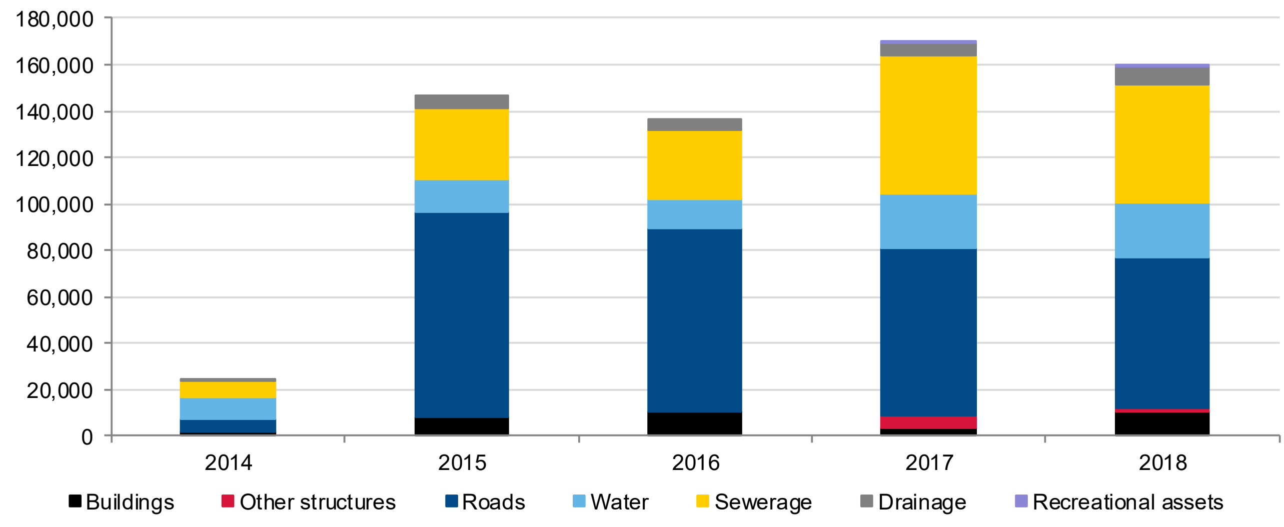
- Total cash and investments increased over the Review Period, with a higher allocation of cash placed into term deposits in the later years
- Of the $60.1m cash and investment balance held at 30 June 2018, $54.1m was current cash and term deposits. Of the $54.1m, $50.2m was externally restricted, $3.9m was internally restricted and Council had no unrestricted cash. Council's external restrictions consisted of $29.7m for sewerage services, $9.0m for water supplied, $8.1m specific purpose unexpended grants and $5.1m developer contributions. This high proportion of externally restricted cash was a factor in Council's liquidity issue faced in August 2019

3.6 Capital Expenditure

The following section predominantly relies on information obtained from Special Schedules 7 that accompany the Council's annual financial statements. These figures are unaudited and are therefore Council's estimated figures. Auditing of these numbers will provide greater certainty as to the accuracy of the numbers.

3.6.1 Infrastructure Backlog

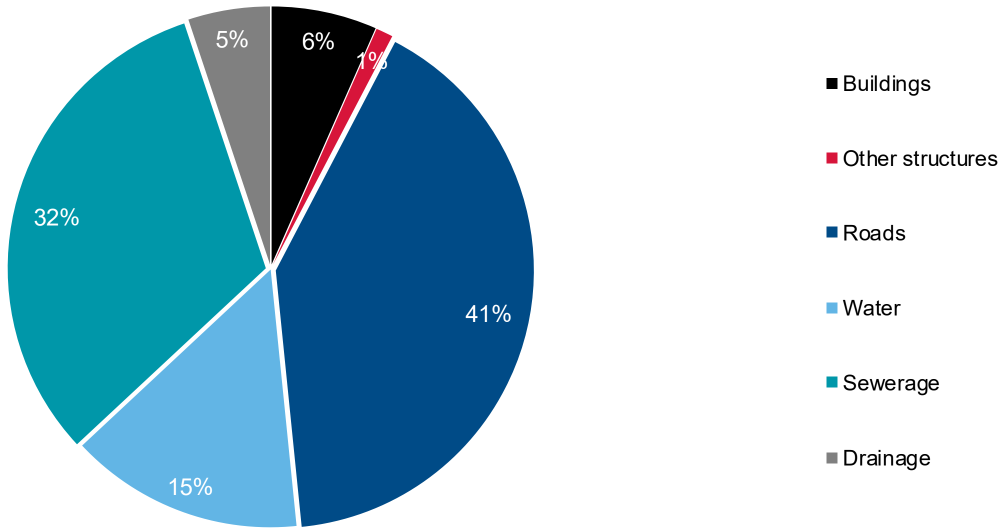
Figure 5 - Infrastructure Backlog for FY2014 to FY2018 ($'000s)



Key Observations

- Council's infrastructure backlog increased significantly from FY2014 ($23.8m) to FY2018 ($160.2m). This was due to two asset revaluations:
  - Council conducting a complete re-assessment of its sealed road network in FY2015 and adopting an improved methodology for determining the overall condition of the network and backlog values
  - A revaluation of water and sewer infrastructure in FY2017 in line with Council's five-year revaluation requirement. This resulted in a significant valuation adjustment
- In FY2017 and FY2018, Council received grants to help fund flood repairs damage to roads which helped reduce the roads infrastructure backlog marginally
- Council has not been investing sufficiently on maintenance and renewal of assets. The roads and sewerage backlogs are high which may impact the quality of services provided to the local Lismore community
- TCorp understands Council is planning to apply for an SRV in order to help address its infrastructure backlog and economic development requirements. TCorp is not aware of the scope of this SRV increase and is therefore unable to quantify the impact on any infrastructure backlog

Figure 6 - Infrastructure Backlog Composition for FY2018



Key Observations

- Council reported $160.2m of infrastructure backlog in FY2018, representing 18.1% of its infrastructure assets of $887.2m
- The $887.2m total asset value comprises 12.3% buildings and other structures (including recreational assets), 28.5% road assets, 5.8% stormwater drainage, 19.9% water and 33.4% sewerage

3.6.2 Infrastructure Status

Infrastructure Status	Year ended 30 June				
	2014	2015	2016	2017	2018
Bring to satisfactory standard ($'000s)	23,809	147,098	136,728	169,886	160,246
Required annual maintenance ($'000s)	46,681	14,174	10,975	11,120	11,332
Actual annual maintenance ($'000s)	35,077	13,868	10,869	10,342	10,498
Total value infrastructure assets ($'000s)	643,021	622,185	634,536	851,689	887,221
Total assets ($'000s)	1,136,825	1,123,851	1,160,464	1,425,397	1,473,640
Infrastructure Backlog Ratio	0.04x	0.24x	0.22x	0.20x	0.18x
Asset Maintenance Ratio	0.75x	0.98x	0.99x	0.93x	0.93x
Building and Infrastructure Asset Renewal Ratio	0.87x	0.94x	0.98x	1.45x	0.74x
Capital Expenditure Ratio	1.23x	0.84x	1.49x	1.90x	1.70x

Key Observations

- Council's infrastructure ratios (Building and Infrastructure Asset Renewal, Asset Maintenance and Infrastructure Backlog ratios) have not met industry benchmark levels over the Review Period (except in FY2017 where assets were being renewed at levels high enough to account for depreciation mainly due to grant funding received). This indicates that Council has not been investing enough funds in asset renewals or maintenance to meet their agreed service levels

- The Capital Expenditure Ratio indicates that Council has prioritised new assets ahead of asset renewals in the later years of the Review Period. This was due to major projects undertaken since FY2016 including the Art Gallery refurbishment and upgrade of the South Lismore Sewerage Treatment Plant
- Following the methodology change in FY2015, infrastructure backlog has remained consistently high, rising to $169.9m in FY2017 and reducing to $160.2m (-5.7%) in FY2018 as a result of grant funding received for flood repair works for roads ($8.3m)

3.6.3 Capital Expenditure Program

The following figures are sourced from the Council's annual financial statements at Note 9. New capital works are major non-recurrent projects which may comprise upgrades to existing assets.

Capital Program ($'000s)	Year ended 30 June				
	2014	2015	2016	2017	2018
New assets	305	459	16,978	16,318	35,104
Renewal of existing assets	30,114	19,300	16,587	26,699	13,710
Total	**30,419**	**19,759**	**33,565**	**43,017**	**48,814**

Key Observations

- Capital expenditure reduced 35% in FY15 due to major grant funding and non-cash dedications of assets not being received for major projects in that year compared to other years
- Council has seen a change in the structure of its capital expenditure spend from focusing on renewal of existing assets to investing in new assets more recently. This is due to the Art Gallery Refurbishment ($6.0m) which was majority funded through grants and the upgrade of the South Lismore Sewerage Treatment Plant ($25.4m). Both projects incorporated a proportion of new assets
- Given Council's $160.2m backlog, the renewal or replacement of assets needs to be addressed as a priority for Council to maintain their provision of services to the community at adequate levels
- Over the Review Period, Council's significant projects include:
  - Roads – $64.5m
  - Upgrade of Sewerage Treatment Plant – $25.4m (this is due to complete in FY2020)
  - Upgrade of Water Treatment Plant – $15.7m
  - Waste Disposal works – $10.4m
  - Refurbishment of Art Gallery – $6.0m
  - Parks and gardens – $5.5m

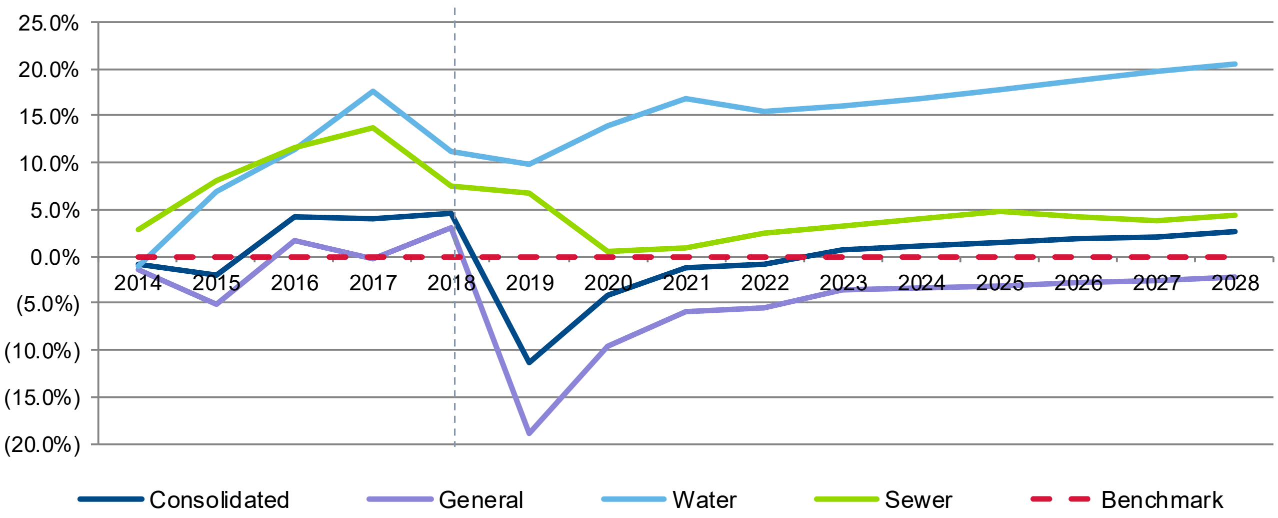
4. Review of Financial Forecasts

TCorp has been provided with a Long Term Financial Plan (LTFP) dated March 2019 that shows the forecast financial statements and assumptions from FY2020 to FY2029 but does not include Council's FY2020 budget or FY2019 actual numbers. The FY2019 figures are based on the adopted Quarterly Budget Review Statement for the period ending March 2019. It should be highlighted that TCorp's review is based on this LTFP which does not include subsequent strategic and operational decisions highlighted previously.

TCorp is aware of a critical incident affecting Lismore City Council that occurred in August 2019 relating to a waste facility fire. Council has confirmed that it is working with its insurers to recover remediation and business interruption costs and that short-term financing was not required. Council has also adopted an asset remediation strategy and zero-based budgeting in the 2019/20 Budget to address its cash position. Due to the timing of this report, these matters are not reflected in the LTFP that TCorp has assessed.

4.1 Operating Results

Figure 7 - Operating Ratio



Key Observations:

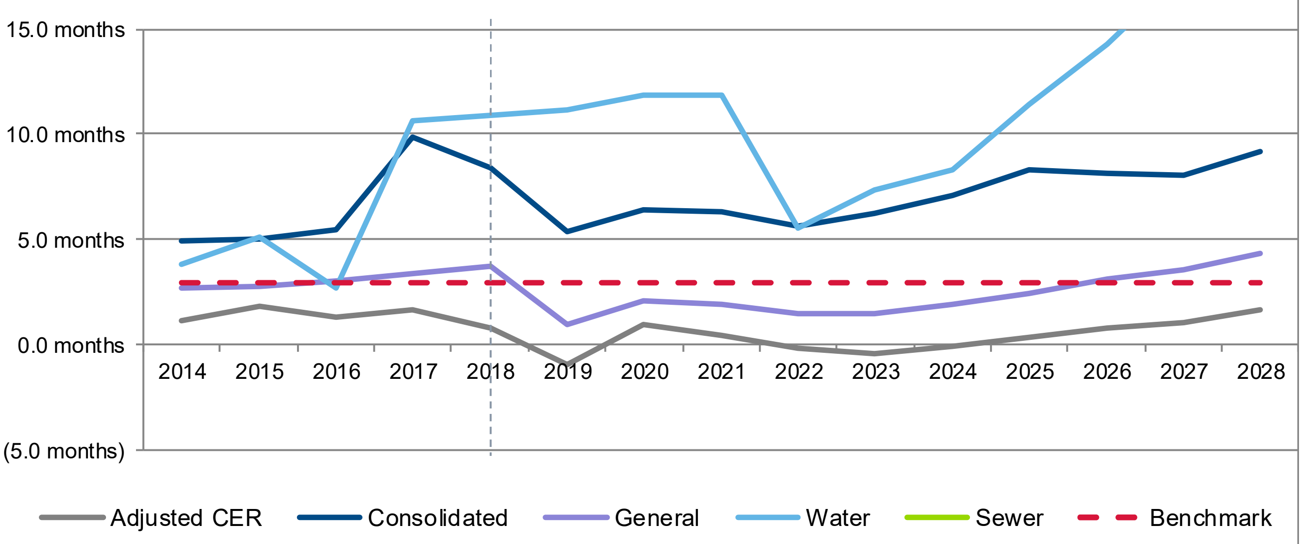
- On a consolidated basis, Council has forecast operating deficits until FY2023, from a surplus of \$5.0m (excluding capital grants) in FY2018, due to the General Fund performance and spike in materials and contracts costs. Operating performance moves back towards surplus over the forecast period as these costs normalise, borrowing costs reduce (as loans amortise), and rates and annual charges and user charges and fees increase each year
- In FY2019, Council has budgeted operating expenses to increase by 15.1% and operating revenues to decrease by 1.4%, resulting in a deficit of \$12.2m. This was primarily due to:
  - 36.4% (\$14.8m) increase in materials and contracts costs – caused by one-off items for remediation works for waste disposal and quarries, and flood repair works to roads of ~\$10m. This was offset by grants received for the flood repair works of \$8.3m
  - 21.5% (\$3.9m) reduction in operating grants and contributions – this was due to a further reduction in roads flood funding during the year and timing of financial assistance grants

- Council has advised that waste disposal and quarry fees were included in User Charges and Fees for the forecast period to supplement the loss of income from the new RTRL agreement. However, these are no longer expected to eventuate due to operations being scaled back or delayed in various areas. An estimated $4.0m per annum has been removed from the General Fund's User Charges and Fee revenue for the forecast period to account for this
- Depreciation expense is forecast to rise over the ten-year period in line with Council's increasing asset base. Council's asset system is being monitored and improved on an annual basis with depreciation now a better reflection of asset consumption
- Materials and contracts expenses are expected to normalise from FY2020 for the remainder of the period, while borrowing costs are forecast to reduce in line with the lower interest rate environment

4.2 Financial Management Indicators

4.2.1 Liquidity Ratios

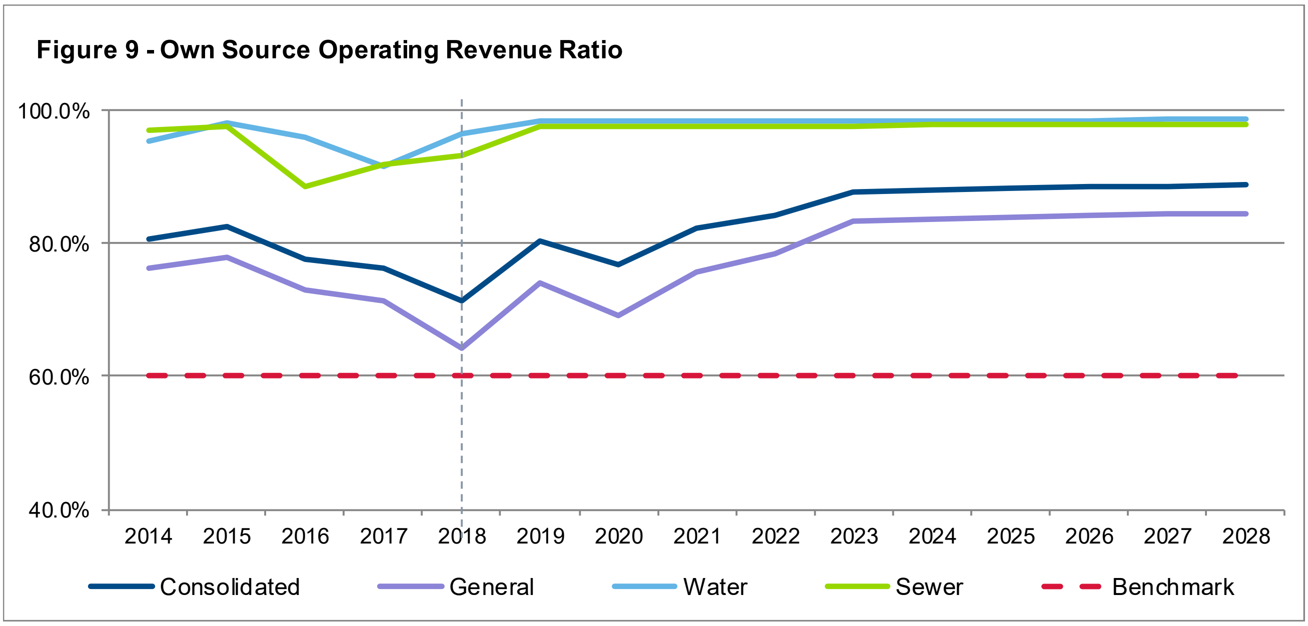
Figure 8 - Cash Expense Ratio



Key Observations

- Council's consolidated Cash Expense Ratio (CER) is forecast to remain above benchmark however this is significantly skewed by the Water and Sewer Fund CERs which are well above benchmark
- The General Fund CER is forecast to be below the 3.0-month benchmark for seven out of ten-years. Council appears to have a liquidity issue within the General Fund with external restrictions greater than its cash and investment reserves for four of the next ten years
- Council's LTFP shows a slight shortfall for asset renewals over the next ten-years with ~90% of required maintenance expected, which will likely result in the infrastructure backlog increasing further. Given the quantum of Council's infrastructure backlog, the annual required maintenance appears low however we have confirmed with Council that it will take time to fully address this situation given Council's financial position

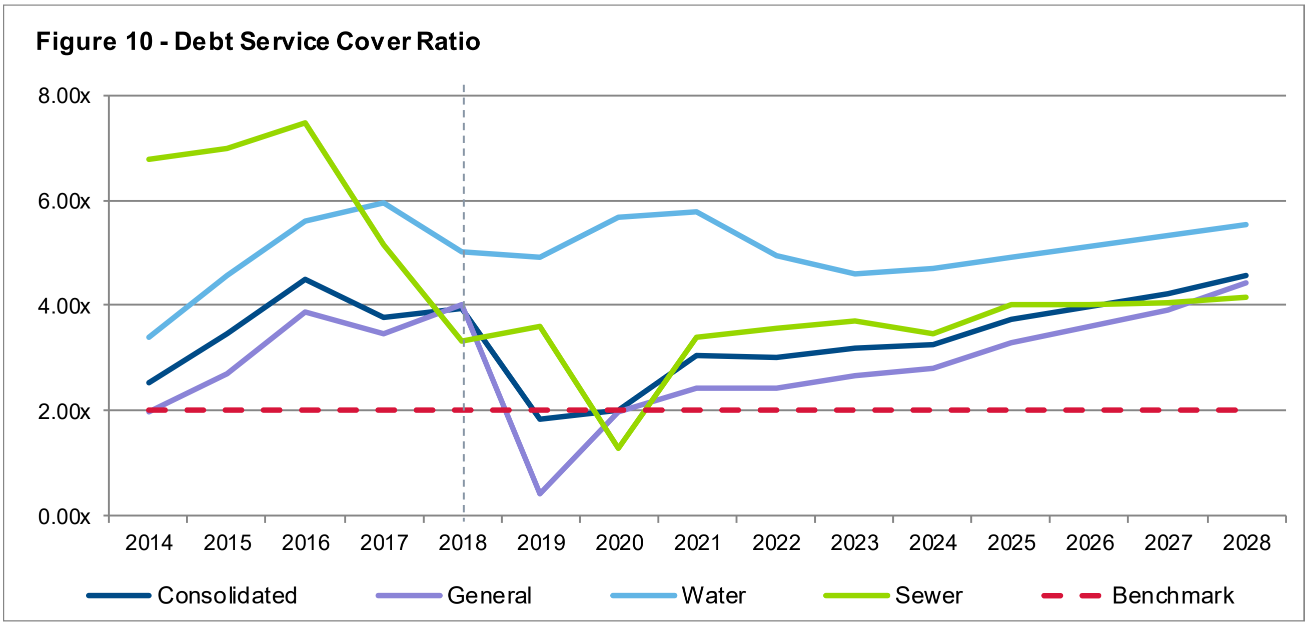
4.2.2 Fiscal Flexibility Ratios



Key Observations

- Council's Own Source Operating Revenue Ratio remains above 60% industry benchmark for the Review Period, both historic and forecast. This indicates that Council is less reliant on grants and external funding sources
- FY2019 capital grants were originally budgeted at $15.8m primarily to fund three projects however only one project application was granted (~$1.3m) – we have reduced capital grants and contributions for FY2019 by $11.3m for the purposes of this report

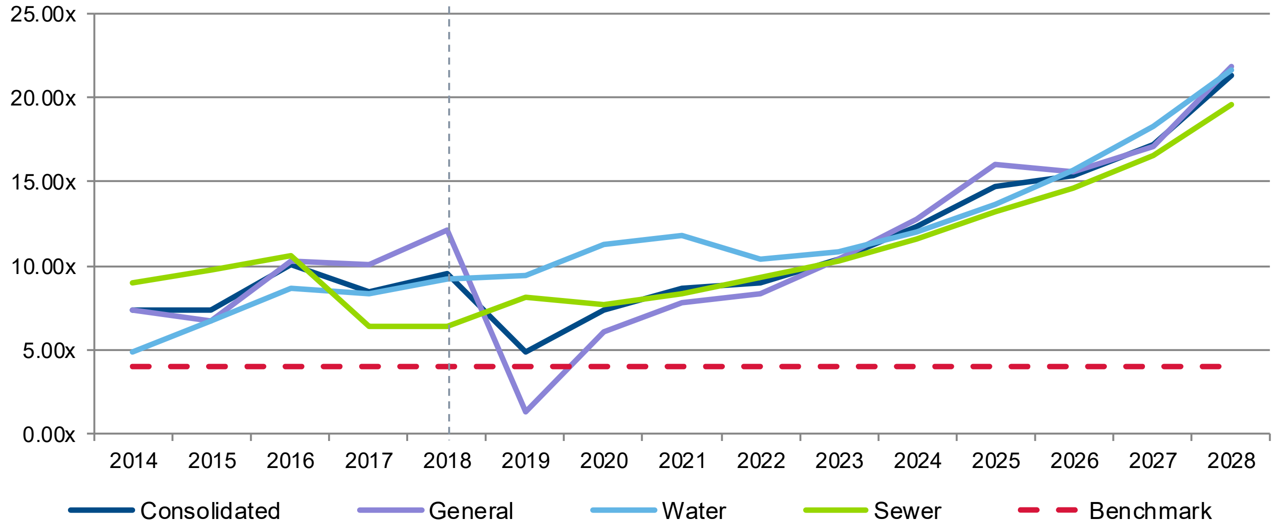
4.2.3 Debt Ratios



Key Observations

- The consolidated Debt Service Cover Ratio (DSCR) trends above benchmark, except for FY2019 (1.83x) and FY2020 (2.02x). It indicates that Council has the capacity to service its existing and forecast borrowings over the Review Period
- In FY2019, the DSCR is impacted by the significantly lower EBITDA in the General Fund as a result of the issue of increased materials and contracts costs previously observed. The materials and contracts increase are due to one-off remediation works and normalise from FY2020
- In FY2020, a Crown Facility loan ($3.3m) within the Sewer Fund is due to be repaid
- Council has forecast $28.6m new borrowings over the next ten-years to fund capital works. Council has advised that some of these capital works have since been removed including Lismore Park (~$2.0m borrowings). As a result, if forecast borrowings decrease, it will marginally but favourably impact the DSCR while potentially negatively impacting Council's CER and liquidity position

Figure 11 - Interest Cover Ratio

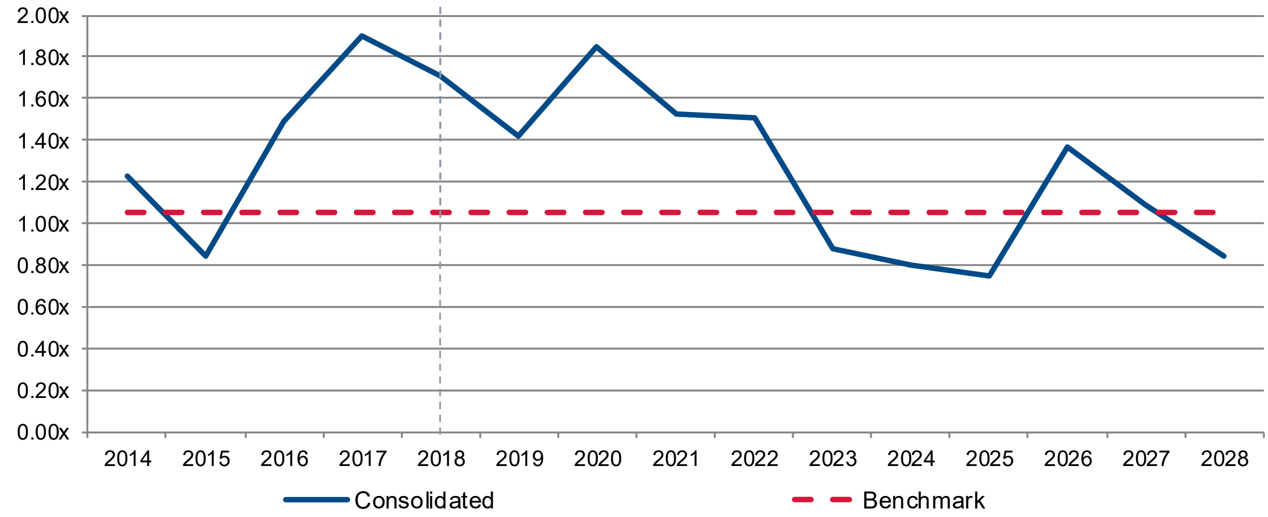


Key Observations

- Council's Interest Cover Ratio (ICR) remains well above the 4.0x benchmark and trends positively as interest costs are forecast to reduce. This ratio indicates that Council can service its scheduled and forecast debt repayments, with capacity to service further debt interest costs from FY2020
- However, unless Council improves its liquidity position, TCorp does not recommend further borrowings in addition to the existing loans in the LTFP

4.3 Capital Expenditure

Figure 12 - Capital Expenditure Ratio



Key Observations

- Council's consolidated expenditure program amounts to $337.8m over the next ten years, of which 66.5% is within the General Fund, 16.2% within the Water Fund and 17.3% within the Sewer Fund
- Scheduled capital works include:
  - Roads and footpaths – $79.6m
  - Sewerage network – $45.1m
  - Water supply network – $34.8m
- Council's ten-year forecast capital expenditure program of $337.8m is to be funded by:
  - $264.9m from internally generated revenues / reserves
  - $28.6m from new loan borrowings
  - $44.3m from capital grants and contributions
- Council has advised that some capital works originally forecast in its LTFP are no longer expected to occur including Lismore Park (~$10.0m) and footpaths ($1.3m)

4.4 Financial Model Assumptions Review

Council has used its own assumptions in developing the forecasts.

	Year ended 30 June				
	2019	**2020**	**2021**	**2022**	**2023**
Rates income	2.7%	2.7%	2.1%	2.1%	2.1%
Annual charges	2.7%	2.7%	2.1%	2.1%	2.1%
User charges	2.7%	2.7%	2.1%	2.1%	2.1%
Statutory and regulatory user charges	2.7%	2.7%	2.1%	2.1%	2.1%
Other revenues	2.7%	2.7%	2.1%	2.1%	2.1%
Grants and contributions – financial assistance grants	0.0%	0.0%	0.0%	0.0%	0.0%
Grants and contributions – other recurring	2.7%	2.7%	2.1%	2.1%	2.1%
Employee benefits and on costs	2.5%	2.5%	2.5%	2.5%	2.5%
Materials and contracts	2.7%	2.7%	2.1%	2.1%	2.1%
Depreciation and amortisation	2.1%	2.1%	2.1%	2.1%	2.1%
Other expenses	2.7%	2.7%	2.1%	2.1%	2.1%
Interest rate on borrowings	4.0%	4.0%	4.0%	4.0%	4.0%
Interest rate on investments	2.5%	2.5%	2.5%	2.5%	2.5%
Inflation	2.1%	2.1%	2.1%	2.1%	2.1%
Population growth	0.25%	0.25%	0.25%	0.25%	0.25%

Key Observations

- Council endeavours to operate at existing service levels however we recommend Council addresses its infrastructure backlog as a priority in order to be able to do so
- Council's assumptions appear reasonable and in line with state awards, CPI and IPART rate pegging
- The original LTFP assumed interest on investments at 3.5% p.a. however, after discussion with Council, this was amended to 2.5% p.a. given the current interest rate environment

5. Conclusion and Recommendations

Based on our review of both Council's historic financial information and the ten-year financial forecasts provided in Council's LTFP, we consider Council to have a moderate FSR with a neutral outlook. This is an improvement from Council's position in the previous review TCorp conducted in 2013 in which Council was considered to have a deteriorating financial position and moderate FSR with a negative outlook.

TCorp's financial sustainability rating and outlook is based on the LTFP dated March 2019 and does not reflect strategies which have been subsequently implemented to address some of Council's identified issues, including:

- The waste facility fire critical incident in August 2019 and potential financial ramifications;
- Council's recently implemented asset remediation strategy to address its cash position; and
- The zero-based budgeting adopted by Council in the 2019/20 Budget to address its cash position

Based on the information provided to TCorp, our analysis has determined the following key points:

- Operating performance was above benchmark from FY2016 to FY2018 as Council increased its revenue base while being able to contain costs to an extent. It is forecast to go into deficit for the next four years, however, trends back into surplus from FY2023
- Council is able to generate enough own source revenue so as to not heavily rely on external sources of funding
- Council has sufficient capacity to service its existing and forecast debt repayments

TCorp recommends that the following points be considered as a priority:

- Council has not been investing enough in renewals and replacement of existing assets to reduce its significant $160.2m infrastructure backlog – mainly roads, sewerage and water. This may impact the ability for Council to provide adequate service levels to the community going forward
- In FY2018, Council had no unrestricted cash reserves and is forecast to rely on externally restricted cash to meet unrelated expenses in four of the ten forecast years. This indicates a potential liquidity issue for Council and a potential inability to meet unexpected short-term funding requirements. As highlighted above in section 4.2.3, Council should not undertake further borrowings in addition to the existing loans in the LTFP until its liquidity position improves. We note that Council has implemented an asset remediation strategy and zero-based budgeting in the 2019/20 Budget to address its cash position however TCorp cannot comment on this as the LTFP assessed was prepared prior to the implementation of these strategies

Appendix A: Historical Financial Information Tables

Income Statement ($'000s)	Year ended 30 June														
	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
	Actual	Actual	Actual	Actual	Actual	Budget	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast
Revenue															
Rates and annual charges	43,562	45,443	47,343	49,563	51,202	52,738	54,371	55,946	57,434	58,962	60,531	62,142	63,796	65,492	67,233
User charges and fees	33,038	31,875	32,558	32,567	28,982	27,226	28,348	29,894	30,805	31,736	32,698	33,685	34,692	35,732	36,793
Interest and investment revenue	1,790	1,746	1,720	2,171	1,844	1,758	1,102	1,049	954	1,057	1,218	1,453	1,451	1,465	1,692
Other revenues	2,432	3,963	4,354	5,639	7,847	10,520	3,151	3,180	3,218	3,296	3,378	3,458	3,544	3,628	3,655
Operating grants and contributions	10,455	13,339	14,385	13,739	18,316	14,383	10,418	10,430	10,515	10,602	10,692	10,783	10,862	10,943	11,026
Total operating revenue	**91,277**	**96,366**	**100,360**	**103,679**	**108,191**	**106,625**	**97,390**	**100,498**	**102,927**	**105,654**	**108,516**	**111,521**	**114,345**	**117,260**	**120,398**
Expenses															
Employee costs	28,693	30,007	32,065	34,179	30,108	29,642	29,884	30,579	31,363	32,146	32,968	33,790	34,653	35,518	36,481
Borrowing costs	3,058	2,918	2,744	3,344	3,258	3,024	3,324	3,302	3,348	3,051	2,654	2,272	2,249	2,065	1,718
Materials and contract expenses	35,318	39,862	35,757	35,883	40,527	55,292	37,760	35,788	36,065	35,999	37,084	38,017	39,007	39,953	40,966
Depreciation and amortisation	20,087	20,601	20,885	20,845	22,661	23,879	25,250	26,355	27,446	28,118	28,806	29,512	30,235	30,977	31,737
Other expenses	4,882	4,984	4,777	5,199	6,608	6,946	5,268	5,657	5,541	5,669	5,835	6,318	6,102	6,227	6,388
Total operating expenses	**92,038**	**98,372**	**96,228**	**99,450**	**103,162**	**118,783**	**101,486**	**101,682**	**103,763**	**104,982**	**107,347**	**109,909**	**112,247**	**114,740**	**117,289**
Operating result (excluding capital grants and contributions)	**(761)**	**(2,006)**	**4,132**	**4,229**	**5,029**	**(12,157)**	**(4,096)**	**(1,183)**	**(836)**	**671**	**1,169**	**1,612**	**2,097**	**2,520**	**3,110**

Excluded Items ($'000s)	Year ended 30 June														
	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
	Actual	Actual	Actual	Actual	Actual	Budget	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast
Capital grants and contributions	9,023	4,135	10,535	14,230	17,599	8,303	4,151	8,991	6,887	2,557	2,597	2,639	2,682	2,725	2,770
Net gain/(loss) from the disposal of assets	(2,323)	(3,166)	(1,003)	(2,479)	(3,488)	(1,175)	(1,166)	(1,158)	(1,149)	(1,141)	(1,133)	(1,124)	(1,116)	(1,116)	(1,116)
Net share of interest in joint venture	104	(42)	(62)	-	62	(35)	-	-	-	-	-	-	-	-	-
Legal costs on investment recoveries	-	-	(456)	-	-	-	-	-	-	-	-	-	-	-	-
Fair value adjustments on investments	345	12	-	-	-	-	-	-	-	-	-	-	-	-	-
Re-assessment of provisions for waste facility remediation	-	2,302	-	-	-	-	-	-	-	-	-	-	-	-	-
Class action recovery - Lehman Brothers investments	-	-	1,110	-	-	-	-	-	-	-	-	-	-	-	-
FAGs received in advance	-	-	-	3,048	149	20	(3,217)	-	-	-	-	-	-	-	-
Discount adjustments on remediation provisions	(376)	(97)	(70)	(39)	(48)	-	-	-	-	-	-	-	-	-	-
Unwinding interest on $6m interest free loan	(266)	(263)	(260)	(257)	(254)	(251)	(247)	(243)	(166)	-	-	-	-	-	-
Net RTRL assets transferred	-	-	-	-	(3,312)	-	-	-	-	-	-	-	-	-	-
Operating result (including capital grants and contributions)	**8,262**	**2,129**	**14,667**	**18,459**	**22,628**	**(3,854)**	**55**	**7,807**	**6,051**	**3,228**	**3,766**	**4,251**	**4,779**	**5,245**	**5,880**

	2014	2015	2016	2017	2018
Full-time equivalent employees at year end	57	58	59	68	61

Statement of Financial Position ($'000s)	Year ended 30 June														
	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
	Actual	Actual	Actual	Actual	Actual	Budget	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast
Cash & current TDs	28,359	31,582	33,249	61,959	54,151	41,440	39,208	38,166	34,398	38,497	44,922	54,333	54,267	54,835	63,880
Other investments	6,488	7,000	5,000	4,000	6,000	6,046	4,869	3,781	3,781	3,781	3,781	3,781	3,781	3,781	3,781
I,P,P & E	1,077,065	1,059,593	1,098,585	1,333,974	1,387,717	1,414,605	1,433,668	1,443,834	1,456,734	1,450,136	1,443,620	1,434,940	1,447,017	1,446,743	1,440,817
Current assets	50,698	53,849	53,366	84,529	75,307	63,969	56,429	55,375	51,762	56,035	62,966	72,895	73,380	74,460	84,016
Non-current assets	1,086,127	1,070,002	1,107,098	1,340,868	1,398,333	1,425,476	1,443,462	1,452,671	1,465,662	1,459,158	1,452,738	1,444,157	1,456,336	1,456,167	1,450,348
Total assets	**1,136,825**	**1,123,851**	**1,160,464**	**1,425,397**	**1,473,640**	**1,489,444**	**1,499,890**	**1,508,046**	**1,517,424**	**1,515,193**	**1,515,704**	**1,517,052**	**1,529,716**	**1,530,627**	**1,534,364**
Current borrowings	3,219	3,322	3,573	4,583	4,829	4,801	1,512	1,249	6,997	7,377	6,699	2,516	6,366	6,270	5,142
Non-current borrowings	44,527	43,347	39,645	65,589	62,509	64,342	66,220	65,976	59,897	52,520	45,821	43,306	41,313	35,043	29,901
Current liabilities	19,954	23,845	21,386	24,739	22,440	30,523	24,183	21,291	27,071	25,363	25,183	21,107	27,133	25,261	24,586
Non-current liabilities	48,503	44,776	41,307	67,777	64,846	66,660	68,538	68,294	62,215	54,838	48,140	45,624	43,631	37,361	32,219
Total liabilities	**68,457**	**68,621**	**62,693**	**92,516**	**87,286**	**97,183**	**92,721**	**89,585**	**89,287**	**80,201**	**73,323**	**66,731**	**70,764**	**62,622**	**56,806**
Net assets	**1,068,368**	**1,055,230**	**1,097,771**	**1,332,881**	**1,386,354**	**1,392,261**	**1,407,170**	**1,418,461**	**1,428,137**	**1,434,992**	**1,442,381**	**1,450,321**	**1,458,952**	**1,468,005**	**1,477,558**

Cash Flow Statement ($'000s)	Year ended 30 June														
	2014	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**	**2026**	**2027**	**2028**
	Actual	**Actual**	**Actual**	**Actual**	**Actual**	**Budget**	**Forecast**	**Forecast**	**Forecast**	**Forecast**	**Forecast**	**Forecast**	**Forecast**	**Forecast**	**Forecast**
Cash flows from operating activities	26,576	24,672	30,118	38,895	38,350	20,025	44,544	38,512	38,010	35,857	36,918	38,246	39,369	40,686	41,968
Sale/(purchase) of investment securities	372	(4,792)	566	(28,000)	18,000	3,000	5,500	5,000	0	0	0	0	0	0	0
Cash flows from investing activities	(28,920)	(24,664)	(26,434)	(66,139)	(23,324)	(30,998)	(41,041)	(35,135)	(41,447)	(24,761)	(23,116)	(22,136)	(41,292)	(33,753)	(26,652)
Free cash flow	**(2,344)**	**8**	**3,684**	**(27,244)**	**15,026**	**(10,972)**	**3,503**	**3,377**	**(3,437)**	**11,096**	**13,802**	**16,110**	**(1,923)**	**6,933**	**15,315**
Proceeds from borrowings and finance leases	4,050	2,250	0	31,121	1,749	6,335	7,380	5,523	6,310	0	0	0	8,310	0	0
Repayment of borrowings and finance lease liabilities	(5,853)	(3,327)	(3,451)	(4,167)	(4,583)	(5,028)	(8,792)	(6,030)	(6,640)	(6,997)	(7,377)	(6,699)	(6,453)	(6,366)	(6,270)
Cash flows from financing activities	(1,803)	(1,077)	(3,451)	26,954	(2,834)	1,307	(1,412)	(507)	(330)	(6,997)	(7,377)	(6,699)	1,857	(6,366)	(6,270)
Net increase/(decrease) in cash & equivalents	**(4,147)**	**(1,069)**	**233**	**(290)**	**12,192**	**(9,666)**	**2,091**	**2,870**	**(3,767)**	**4,099**	**6,425**	**9,412**	**(66)**	**568**	**9,045**

Appendix B: Glossary

Office of Local Government (OLG)

OLG is an Office in the Planning, Industry and Environment cluster and is responsible for local government across NSW. OLG's organisational purpose is to 'strengthen local government' and its organisational outcome is 'fit for the future councils leading strong 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.

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.

Capital Grants and Contributions

Councils receive various capital grants and contributions that are nearly always 100% specific in nature. Since 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.

Independent Pricing and Regulatory Tribunal (IPART)

IPART has four main functions relating to the 128 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.

Net Assets

Net Assets is measured as total assets less total liabilities. 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.

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.

Special Rate Variation (SRV)

An 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.

Appendix C: 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 (CER)

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 (ICR)

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 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.

NSW Treasury Corporation (TCorp)
Level 7, Deutsche Bank Place
126 Phillip Street, Sydney NSW 2000, Australia
T: +61 2 9325 9325 F: +61 2 9325 9333
W: tcorp.nsw.gov.au ABN: 99 095 235 825