Attachment A

May 2013 Resolution,

Report and Annexure-Treasury Corporation

Assessment of Financial Sustainability

Attachment A

9.3 Governance: Councillors – Local Government Remuneration Tribunal: Councillor Fees for the 2013/14 Financial Year

REPORT FROM: DIRECTOR OF CORPORATE AND COMMUNITY SERVICES
Actioning Officer: Anna Watt – Director of Corporate and Community Services

Moved: Cr Graham Seconded: Cr Scherf

4.05/13 RESOLUTION

That Council (as a Rural Category Council) implements, on and from 1 July 2013, the following maximum fees which have been determined by the Local Government Remuneration Tribunal for the 2013/14 financial year:

- Mayor: $10,480 plus $18,296 ($22,870 – 20%) = $28,776 per annum;
- Deputy Mayor: $10,480 plus $4,574 (20% of Mayoral Fee) = $15,054 per annum;
- Other Councillors: $10,480 each per annum.

When the above-mentioned motion was put to the vote, the outcome was five (5) votes to two (2) in favour of the motion.

CARRIED

9.4 Financial Management: Financial Sustainability of the New South Wales Local Government Sector

REPORT FROM: DIRECTOR OF CORPORATE AND COMMUNITY SERVICES
Actioning Officer: Anna Watt – Director of Corporate and Community Services and Eric Brown – Manager of Finance

Moved: Cr Graham Seconded: Cr Newman

5.05/13 RESOLUTION

1. That Council notes the information in this report as well as TCORP's report titled "Financial Sustainability of the New South Wales Local Government Sector – Findings, Recommendation and Analysis" attached as Annexure D to the Business Paper.
2. That Council requests the Director of Corporate and Community Services, when reviewing the Long Term Financial Plan later this calendar year, to aim for Council achieving an operating surplus within in the next three (3) years.
3. That Council requests the Director of Corporate and Community Services to report back to Council with options of how to best consult with the community regarding service level options into the future.

4. That Council requests that the Director of Corporate and Community Services to research and present a report to Council by November 2013; exploring options and identifying the benefits of implementing a Special Rate Variation for the 2014/15 Financial Year.

CARRIED

9.5 Governance: Adoption of Operational Plan 2013-2014

REPORT FROM: **DIRECTOR OF CORPORATE & COMMUNITY SERVICES**
Actioning Officers: **Eric Brown – Manager of Finance**

Moved: Cr Scherf Seconded: Cr Quinn

The General Manager distributed "Supplementary Commentary" dealing with questions and/or proposals contained within two community member (2) submissions received after the Business Paper had been finalised – relating to the Operational Plan 2013-2014) – for the consideration of Councillors.

6.05/13 RESOLUTION

1. That the expenditure amounts set out in the 2013/14 Operational Plan and Budget as exhibited, and attached to the Business Paper as part of Annexure E, be confirmed and voted for the carrying out of the various works and services of the Council for the 2013/14 financial year.
2. That the 2013/14 Operational Plan and Budget, as exhibited in accordance with the provisions of Section 405 of the Local Government Act 1993, and attached to the Business Paper as part of Annexure E, be adopted by Council.
3. That the Schedule of Fees and Charges that was adopted by Council on 18 April 2013 and exhibited as part of Council's Operational Plan and Budget, and attached to the Business Paper as part of Annexure E, be made, fixed and charged for 2013/14.
4. That, whereas the Estimates of Income and Expenditure of the Consolidated Fund for the year 2013/14 were adopted by Council on 18 April 2013, and whereas such estimates were advertised in the Glen Innes Examiner on 19 April 2013, and in accordance with the provisions of Section 535 of the Local Government Act 1993, Council makes, fixes and levies the rates for the year ending 30 June 2014 for the following rating categories:

   Farmland:
   A Farmland rate of 0.002466 cents in the dollar on the current land values of all rateable land in the Local Government Area being farmland, with a minimum rate of $331.00 per annum;

   Residential – Non-Urban:
   A Residential – Non-Urban rate of 0.005969 cents in the dollar on the current land values of all rateable land which is not within a Centre of Population in the Local Government Area, with a minimum rate of $425.00 per annum;

9.4 Financial Management: Financial Sustainability of the New South Wales Local Government Sector

REPORT FROM: DIRECTOR OF CORPORATE AND COMMUNITY SERVICES
Actioning Officer: Anna Watt – Director of Corporate and Community Services and Eric Brown – Manager of Finance

ANNEXURE D

PURPOSE
The purpose of this report is to present to Council the findings of the independent assessment by the Treasury Corporation of New South Wales (TCORP) of Council's financial position and the finding of the TCORP on the wider financial sustainability of the New South Wales Local Government Sector. (Please see Annexure D attached to the Business Paper).

BACKGROUND
In December 2011, the Division of Local Government (DLG) appointed TCORP and the NSW Treasury to assist in the analysis of the State Government's Local Infrastructure Renewal Scheme (LIRS) initiative. This initiative sought to address the state wide infrastructure backlog by providing Councils with an interest rate subsidy of four (4) percent on loans to fund infrastructure projects. TCORP's role in this process was to undertake a financial assessment for each Council seeking assistance under the LIRS scheme.

Council was successful in obtaining funding for two (2) projects being the maximum number of projects that Council could apply for in the first round. These two (2) projects were the $1.8 million dollar Central Business District Revitalisation Program and $1 million for the Accelerated Road Renewal Program.

After the establishment of the Independent Local Government Review Panel in March 2012, the DLG expanded the scope of TCORP's work to include a financial sustainability and benchmarking assessment of all 152 New South Wales (NSW) Councils.

In April 2013 TCORP released the Report titled; 'Financial Sustainability of the New South Wales Local Government Sector – Findings, Recommendations and Analysis'.

The findings and recommendations of the aforementioned report are summarised herein.

COMMENTARY
The completion of financial assessments of all NSW Councils is a positive step and should provide the State Government a much greater understanding of the issues facing Local Government. Further, it is hoped that a more informed State Government may be in a better position to assist in addressing these issues, in particular the growing infrastructure backlog and the asset maintenance gap.

This assessment has also provided Council with a good idea of where Council sits financially in respect of Local Government as a whole and what Council should aim for in the longer term to remain sustainable.
Council was identified in the TCORP assessment as being in a Moderate (and therefore sustainable) position in the long term. The outlook for Council was Neutral and indicated that Council was in a reasonable position both at present and in accordance with future predictions.

It should be noted that TCORP considers that a Council needs to be assessed at a Moderate level or higher to be 'acceptable' in terms of their sustainability. A Moderate rating is on average equivalent to marginally exceeding the 10 benchmarks identified below.

It is also particularly important to understand that the measurement conducted of Council's financial sustainability was conducted on a number of factors, but in large part the Long Term Financial Plan. As noted in the Operational budget for the 2013/14 financial year, Council is not currently meeting the expected deficit of $352,000. Primarily due to deterioration in the projected trading profit of Glen Innes Aggregates as well as a significant increase in Workers Compensation premiums.

For this reason, and assuming that this trend continues, it is necessary to consider Council's position with this in mind, not solely on the rating allocated by this review.

Further consideration needs also to be given to how this report relates to the subsequently released Future Directions report.

SUMMARY OF THE REPORT AND ITS FINDINGS
In reviewing the relevant work that had been done around Australia in recent years, TCORP determined that no concise definition of sustainability existed. Therefore TCORP developed its own definition, being:

> *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.*

The definition takes into account the effect ongoing change could have on a Council's operating position and service levels over the long term.

TCORP also compiled a list of 10 key benchmarks to use to measure performance on a common basis across all Councils. These key benchmarks are listed below (with Council comparatives identified from Council's TCORP report):

Infrastructure Status	Year ended 30 June		
	Benchmark	Council	
		2011	2010
Operating Ratio	> (4.0%)	(12.1%)	(5.4%)
Interest Cover Ratio	> 4.00x	8.42x	7.02x
Debt Service Cover Ratio	> 2.00x	5.13x	4.44x
Unrestricted Current Ratio	> 1.50x	2.40x	2.83x
Own Source Operating Revenue Ratio	> 60.0%	31.5%	32.2%
Cash Expense Ratio	> 3.0 months	6.8 months	7.0 months
Infrastructure Backlog Ratio	< 0.02x	0.17x	0.16x
Asset Maintenance Ratio	> 1.00x	0.62x	0.62x
Building and Infrastructure Renewals Ratio	> 1.00x	0.57x	0.97x
Capital Expenditure Ratio	> 1.10x	1.10x	0.51x

Definitions for these ratios are contained in the attached Annexure B.

TCORP also identified a Financial Sustainability Rating (FSR) system, as well as an outlook system, based on a particular Council's position in respect of the aforementioned key benchmarks. The FSR system ranges from Very Strong to Distressed. The spread of Councils within this rating system are as follows (Council was identified as Moderate):

Rating	Count	Percentage
Very Strong	0	0.0%
Strong	2	1.3%
Sound	32	21.1%
Moderate	79	52.0%
Weak	34	22.4%
Very Weak	5	3.3%
Distressed	0	0.0%
Total	**152**	**100.0%**

The spread of Councils within the Outlook distribution indicates that there are only five (5) Councils with a positive outlook while the majority of Councils are in a neutral outlook. Of concern are the 73 Councils within the negative outlook category, suggesting that the industry may be in a downward trend in respect of financial sustainability (Council was identified as Neutral):

Outlook	Count	Percentage
Positive	5	3.3%
Neutral	74	48.7%
Negative	73	48.0%
Total	**152**	**100.0%**

This FSR was determined by the outlook of Council projected in the Long Term Financial Plan. A Neutral outlook indicates that Council is projected to continue much as is and that there are no foreseeable events that will impact on Council's rating. The forecast was made over the next three years.

Matters that may cause a Negative Outlook would include:

- Forecasting of poor operating results;
- Increasing risks from large developments being undertaken;
- No apparent action being undertaken by Council to address financial pressures;
- Risk associated with poor (incomplete) Asset Management Plans.

It should be noted that the deterioration of Council's 2013/14 Operational Budget, combined with a deterioration of the Long Term Financial Plan, may affect Council's rating in this regard.

A summary of the main findings in respect of the NSW Local Government Industry as a whole are as follows:

- Operating deficits are unsustainable and at least a breakeven operating position is essential;
- There is a significant infrastructure backlog in NSW with an un-audited figure of $7.2 billion at June 2012;
- Pricing paths are needed for the medium term – IPART, DLG and Councils should work together to consider the development of a medium or long term, and achievable, pricing path so that Councils can achieve at least a breakeven operating position (to allow for special rates variations or implement increased rate peg limits);
- A breakeven position will not address the reported infrastructure backlog nor will it meet the unquantified asset maintenance gap;
- Sustainability of Local Government in NSW is deteriorating with nearly 50% of Councils expecting a deterioration in the short term;
- Extensive Community Consultation is required to address the expected continued deterioration of Councils' financial position while considering a combination of revenue increases, expenditure reductions and service level reviews;
- Asset management planning is improving but will require further (and ongoing) iterations for most Councils;
- There is a strong correlation between population density and the ability of a Council to generate its own revenue so that is can be self funding;
- Management of Council liquidity (cash reserves and invested funds) have been conservative across the majority of Councils with 93% of Councils meeting or exceeding the Unrestricted Current Ratio threshold;
- Water and Sewer Funds should be self sufficient and not incur financial deficits that undermine the overall financial position of the Council;

- Debt is underutilised and there are opportunities for it to be structured in a more cost effective manner.

COUNCIL SPECIFIC INTERPRETATION OF FINDINGS

How do these matters raised in the report relate to and affect Council:

- Operating deficits are unsustainable and at least a breakeven operating position is essential:

  It is important for Council to consider this in respect of the review of the Long Term Financial Plan scheduled for later this year. This particular matter was identified as one of the key findings of the TCORP report. An operating profit, therefore, should be aimed for in the medium term (the next five (5) years) as a matter of urgency. Community benefit factors must also be considered when identifying whether an operating surplus is achievable. However, this TCORP assessment, as well as the subsequently released Future Directions Report, places a very strong emphasis on the need to achieve an operating breakeven position. In fact, based on further findings in this report, Council needs to aim for an operating surplus which will enable Council to address the infrastructure backlog and the asset maintenance gap.

- There is a significant infrastructure backlog in NSW with an un-audited figure of $7.2 billion at June 2012:

  This is a significant infrastructure backlog, however, as the report identifies it should be noted that this is an un-audited figure. For this reason, the accuracy of this information may be questionable and the report does indicate that improved asset management principles will be required in NSW. It should be noted that Council is in the fortunate position of having been able to re-iterate and review the backlog and required asset maintenance figures on a number of occasions. From these reviews, Council has identified a backlog for the assets within the Glen Innes Severn Council area of $29.396 million. Further, Council has identified that there is a shortfall in the required annual maintenance of assets of $1.306 million. Council should consider this a good estimate of the backlog and the cost of maintaining such a large asset base and therefore, Council is in a similar position to a large number of other Councils within NSW.

  Based on the findings of the report, it is recommended that Council should re-consider its asset base to identify those assets that are not required and should not be maintained into the future. These assets should be disposed of to reduce the infrastructure backlog, raise additional funds and reduce the required annual maintenance of these assets.

- Pricing paths are needed for the medium term – IPART, DLG and Councils should work together to consider the development of a medium or long term, and achievable, pricing path so that Councils can achieve at least a breakeven operating position:

The TCORP assessment identified that Special Rate Variations (SRV) may be required in future to address the need for break-even positions or the Community should re-consider the service levels they require. This will require Community consultation and understanding. It appears that a significant focus on this area is developing and it would be prudent for Council to consider a Special Rate Variation as a future strategy to ensure financial sustainability.

- A breakeven position will not address the reported infrastructure backlog nor will it meet the unquantified asset maintenance gap:

  It must be understood that this report indicates that a breakeven position will not address the infrastructure backlog nor will it address the asset maintenance gap. It is a good start, but to address these items Council should realistically be aiming for an operating surplus to ensure that these surpluses can be re-invested in asset maintenance and renewal. For Council to address the infrastructure backlog as well as the asset maintenance gap, Council will need to allocate in the order of an additional $2 million dollars each and every year (given a $1.3 million asset maintenance gap and then allocating $700,000 additionally to asset renewal). A large portion of this will need to be sourced from additional revenue streams and realistically a portion of this must be sourced from increases in the Financial Assistance Grant.

  This goal may seem unachievable at present, which may be the case, without increases in external funding. However, for Council to be able to achieve this goal it is necessary for Council to take a multi-pronged approach including cost savings and revenue increases that are not related to grant funding. Therefore Council should do its utmost to address the matters it can address to ensure that Council will remain an independent and sustainable entity.

- Sustainability of Local Government in NSW is deteriorating with nearly 50% of Councils expecting a deterioration in the short term:

  The report indicated that a large proportion of the industry is on a Negative outlook and therefore there is significant concern regarding the sustainability of the industry as a whole. Perhaps the greatest concern to Council in this regard is that where there is such an overriding need for change it appears that strong action will be required at both the Local and State level to ensure viability of the sector. If change is not forthcoming from the local level, it appears that the State Government will need to take decisive action. Council was identified as being in a Moderate/Neutral position; thus suggesting that we are in a better position than a large proportion of other Councils. However, this view was qualified in the FDR.

- Extensive Community Consultation is required to address the expected continued deterioration of Council's financial position while considering a combination of revenue increases, expenditure reductions and service level reviews:

  The changes required at a Local level are significant and Council will need to consult with the community regarding the service levels required and balancing these service levels with increases in revenue/cuts in expenditure or SRV. At the present point in time, this consultation may be required to address Council's road infrastructure backlog in particular.

- Asset management planning is improving but will require further (and ongoing) iterations for most Councils:

  Council is in the fortunate position of having been able to prepare strong estimates of the infrastructure backlog in Council's Local Government Area. Council is confident that, although future refinements will be required, the information on hand is sufficient to be able to develop Long Term Financial planning estimates – based on the financial commitment required by Council to meet the backlog.

- There is a strong correlation between population density and the ability of a Council to generate its own revenue so that is can be self funding:

  Not surprisingly, this report indicates that population density and the rate revenue base are key factors in whether a Council was sustainable or not. Therefore the indication is that Councils with smaller populations or declining populations are more at risk.

  Council falls into a category of having a small rating base compared with a large asset base and for this reason; it will definitely affect the ability of Council to generate its own revenue to meet its asset renewal requirements. This can be seen in Council's infrastructure backlog, as well as the shortfall in the annual asset maintenance allocation (the asset maintenance gap). The report also indicates that a large proportion of rural councils were in a similar position (Graph 2, page 12).

- Management of Council liquidity (cash reserves and invested funds) have been conservative across the majority of Councils with 93% of Councils meeting or exceeding the Unrestricted Current Ratio (UCR) threshold:

  Council's liquidity is in a similar position with Council's UCR being over benchmark for the preceding three (3) years and being projected as remaining there for the length of the Long Term Financial Plan.

  This is an excellent position to be in; as overall Council's financial ratios were good with the primary reason for this being the setting of conservative budgets and good management (as noted in Council's individual TCORP assessment). The primary concerns are the asset management ratios which will require further strengthening; this requires a balance as the more Council spends the higher the asset management ratios, but the lower Councils' financial ratios will go.

- Water and Sewer Funds should be self sufficient and not incur financial deficits that undermine the overall financial position of the Council:

  Council is in the fortunate position of having had the foresight to have addressed this concern in the current financial year; raising the annual water access charge significantly to see the water fund projected to make profits from this financial year onwards.

  Further, the Sewer fund is in a healthy position, being expected to obtain a profit in the current financial year and to maintain a positive position for the life of the Long Term Financial Plan.

The above situation exposes Council to exactly the opposite risk; if the water and sewer functions were to be removed from Council, Council (the General Fund) would be in a much worse position.

- Debt is underutilised and there are opportunities for it to be structured in a more cost effective manner:

  Once again, Council is in a good position in this respect having had the foresight to use debt funding for larger projects. Both to ensure cross-generational funding as well as ensuring that capital works could be brought forward; resulting in reduced maintenance/renewal costs into the future.

  Council was identified (by TCORP) as being able to borrow an additional $4.8 million in loans over and above the additional borrowings identified in the Long Term Financial Plan. Council must first re-consider the Long Term Financial Plan before any further borrowings can be made. In particular it is important that Council consider the likelihood of further grant funding increases not materialising.

  As noted earlier, Council has also been fortunate to be allocated funding under the LIRS scheme, which is a very cost effective method of borrowing at a cost to Council of around 1.5% per annum in interest.

(a) Governance/Policy Implications

To remain financially sustainable into the future, Council needs to budget for at least a break even operating position, and needs to make decisions with regard to the current asset base. Assets that are not required need to be identified and should not be maintained into the future. This will reduce Council's infrastructure backlog and in turn reduce the required annual maintenance/renewal costs of Council's asset base. To achieve this position, some hard decisions will have to be made.

(b) Legal Implications

Nil.

(c) Social Implications

Council will need to consult with the community regarding service levels required into the future. Council will need to balance these service levels with increases in revenue, or reduce service levels, to remain sustainable into the future.

(d) Environmental Implications

Nil.

(e) Economic/ Asset Management Implications

Council was identified by TCORP as being in a Moderate position with a Neutral outlook. The associated FDR indicates that there will be future ramifications for Council if it cannot strengthen its financial position.

To strengthen Council's financial position, Council should aim to address the concerns raised in this report by making decisions in respect of cost savings,

revenue increases as well strengthening asset renewal. Money raised from these activities should be spent on renewing key assets only.

Further, assets that are not required or are not considered key to Council's operations must not be renewed and should be considered for disposal.

CONCLUSION

This report, as well as the associated Future Directions Report, have a significant impact on Council's Long Term Financial Plan as well as a significant influence on Council's Asset Management and Renewal Strategy. Council should aim to address the concerns raised in this report by making decisions in respect of cost savings, revenue increases as well as strengthening asset renewal. To identify the key item from the report, Council should aim at achieving an operating surplus and then should focus this surplus into asset renewal.

RECOMMENDATION

1. ***That Council notes the information in this report as well as TCORP's report titled "Financial Sustainability of the New South Wales Local Government Sector – Findings, Recommendation and Analysis" attached as Annexure D to the Business Paper.***
2. ***That Council requests the Director of Corporate and Community Services, when reviewing the Long Term Financial Plan later this calendar year, to aim for Council achieving an operating surplus within in the next three (3) years.***
3. ***That Council requests the Director of Corporate and Community Services to report back to Council with options of how to best consult with the community regarding service level options into the future.***
4. ***That Council requests that the Director of Corporate and Community Services to research and present a report to Council by November 2013; exploring options and identifying the benefits of implementing a Special Rate Variation for the 2014/15 Financial Year.***

Annexure D

Glen Innes Severn Council Meeting

23 May 2013

Financial Sustainability of the New South Wales Local Government Sector

APRIL 2013

FINDINGS, RECOMMENDATIONS AND ANALYSIS

D3

New South Wales
Treasury Corporation

Acknowledgement

Completing the financial assessment of the 152 Councils in New South Wales within a 12 month timeframe was a major task which involved and required the assistance of many people.

New South Wales Treasury Corporation (TCorp) would like to thank all those who assisted us in completing this major assignment within such a tight timeframe. In particular, we would like to thank:

- The staff of all the Councils who provided much assistance in helping us understand their businesses so we could make informed recommendations and findings
- Staff from the Division of Local Government (DLG) who provided valuable background information and assistance
- Queensland Treasury Corporation (QTC) staff for sharing a lot of their knowledge with us, particularly in respect of the similar process that they had undertaken and the ongoing work in respect of benchmarking Council performance
- The many staff and contractors from TCorp for their hard work and diligence in completing this assessment process

With such a large database of information created through this process, New South Wales now has the opportunity for a greater understanding of the issues facing Councils in this State and with the input from the Independent Sustainability Review Panel, the opportunity to assist in improving the outputs of this sector.

Stephen Knight

Chief Executive

New South Wales
Treasury Corporation

Contents

New South Wales
Treasury Corporation

1. Executive Summary

1.1 Background

In December 2011, DLG appointed TCorp to assist DLG and NSW Treasury in respect of the State Government's Local Infrastructure Renewal Scheme (LIRS) initiative. The LIRS initiative seeks to address Councils' 'Infrastructure Backlog' by providing Councils with an interest rate subsidy on borrowings from the private sector to fund qualifying projects.

TCorp's role was to undertake a financial assessment and benchmarking report for each Council seeking or requiring such an assessment under the LIRS.

In March 2012, the Minister for Local Government announced the establishment of an Independent Local Government Review Panel (Review Panel) chaired by Professor Graham Sansom. The Review Panel is to develop options to improve the strength and effectiveness of local government in NSW. Included under the Review Panel's Terms of Reference, the financial sustainability of each Local Government Area (LGA) is to be considered.

Following the announcement of the Review Panel, DLG expanded the scope of TCorp's reports to incorporate additional material to facilitate use by the Review Panel, particularly in respect of the area of financial sustainability. In addition, TCorp was requested to prepare reports for all 152 NSW Councils. TCorp's scope of work excluded the 14 County Councils in NSW.

This Report sets out TCorp's findings from its work assisting DLG and the Review Panel.

TCorp's key tasks in undertaking its work included:

- Creating a definition of sustainability
- Establishing a set of appropriate benchmark indicators
- Developing an assessment methodology including a rating scale and Outlook that could be used to compare Councils against a sustainability definition
- Reviewing both historical financial results and the long term (10 year) financial forecasts of each Council

In reviewing the relevant work that had been done around Australia in recent years, TCorp determined that no concise definition of sustainability existed. Therefore TCorp developed its own definition being:

> *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.*

The definition takes into account the effect ongoing change could have on a Council's operating position and service levels over the long term.

The definition brings together what TCorp considers are the key elements of financial strength, service and infrastructure requirements, and needs of the community. TCorp considers that this definition is concise enough to be remembered, whilst broad enough to cover the key aspects.

In developing appropriate benchmark indicators to be used in the analysis, TCorp considered the work undertaken by QTC, the Independent Pricing and Regulatory Tribunal (IPART) and DLG. Based on the work previously undertaken, TCorp then compiled a list of 10 key benchmarks to use to measure performance on a common basis across all Councils.

TCorp also built on the work undertaken by QTC to create a Financial Sustainability Rating (FSR) and Outlook methodology, for the purpose of rating each individual Council. The FSR provides TCorp's assessment of each Council's current long term rating. The FSR methodology is used to individually assess Councils and categorise them into seven rating bands ranging from Very Strong to Distressed.

TCorp considers that a Council needs to be assessed at a Moderate or higher level to be acceptable in terms of their sustainability. A Moderate level FSR is on average equivalent to marginally exceeding the benchmarks utilised in TCorp's assessment process.

TCorp's assessment of the likely movement in a Council's FSR over the short term, being the next three years, is the Outlook. Councils were assigned an Outlook rating of Positive, Neutral or Negative. 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.

A Council with an FSR of Moderate and an Outlook of Negative, is assessed as being in a deteriorating position or at risk of being downgraded from Moderate to Weak. As TCorp considers a FSR of lower than Moderate to be at much greater risk of being unsustainable, Councils in this position need to be urgently considering options for addressing the areas of poor performance that are contributing to Council's assessed FSR and Outlook.

Likely causes of a Negative Outlook include:

- Forecast poor operating results
- Increasing risks from large developments being undertaken
- No apparent action being undertaken by Council to address financial pressures
- Risks associated with the current status, and potential implications for the Council's finances, of a Council's Asset Management Plan (AMP) which may not be completed to an acceptable standard

For Councils assigned a Negative Outlook, TCorp has provided some recommendations and areas of investigations to assist in improving the sustainability position. The recommendations include:

- The need to source additional revenue, such as under an SRV, to improve financial flexibility and to assist in reducing the Infrastructure Backlog
- For Councils with the borrowing capacity, consider using debt funding to reduce the Infrastructure Backlog and improve intergenerational equity
- Devising programs and strategies to contain rising costs and improve efficiencies
- Further improvement required in AMPs and integration into the Long Term Financial Plan (LTFP)
- Increasing spending on maintenance and infrastructure renewal, balancing this with the need for capital expenditure on new assets

In undertaking its assessment of the 152 Councils in NSW, TCorp has assessed:

- The financial capacity of each Council; which included an analysis of each Council's historical results from the 2009 to 2012 financial years (Review Period)
- The long term sustainability of each Council; which included an analysis of each Council's LTFP and the degree to which Council has completed its AMP and integrated the requirements of the AMP into its LTFP
- The financial performance of each Council in comparison to a range of similar Councils when measured against the established benchmarks

TCorp has consulted with all of the Councils that it has assessed and meetings have been held with many Councils from a cross section of the DLG Groups. TCorp has also been able to highlight to Councils anomalies that existed in their LTFP whether in respect of historical performance and how that linked to forecast assumptions, or where poor financial forecasts were a result of modelling errors. Some of the issues identified included where Councils needed to revisit some of their base assumptions or capacity to deliver existing service levels.

Further details of TCorp's methodology are provided in Section 3 of this Report.

1.2 TCorp's Key Findings

From its assessment of the 152 Councils and its analysis of the outcomes, TCorp considers that the key findings are:

1. **Operating deficits are unsustainable** - The majority of Councils are reporting operating deficits and a continuation of this trend is unsustainable. In 2012 only one third of Councils (50) reported an operating surplus. Over the 2009 to 2012 Review Period, the cumulative operating deficits for all Councils in NSW totalled $1.0b

2. **2012 operating deficits are understated** - The cumulative operating deficit of all Councils in 2012 of $288m understates the severity of the current position. In the 2012 financial year the Federal Government prepaid half of the 2013 Financial Assistance Grants which most Councils declared as revenue in 2012. Removing the impact of this prepayment results in the normalised deficit for the 2012 financial year being $469m, an increase of $181m

3. **Sustainability is deteriorating** - The sustainability position is expected to deteriorate over the short term for nearly 50% of all Councils, based on current LTFP. Should the current Outlooks eventuate, 70 of the 152 Councils in NSW (46%) would be rated as Weak or lower within three years

4. **Consultation with the community is required** - Addressing the expected continued deterioration of Councils' financial positions will require an extensive consultation process with the community to consider a combination of revenue increases, expenditure reductions and service level reviews

5. **Need to prevent further deterioration** - Achieving a breakeven operating position for Councils is one factor that will assist in preventing further deterioration in the financial position of the local government sector. The achievement of a breakeven operating position would provide sufficient funds to meet future requirements for maintenance of assets and services, but it would not provide sufficient funds to address the current (2012) reported Infrastructure Backlog of $7.2b, nor any as yet unquantified asset maintenance funding gap that may exist

6. **Improved focus created by the Integrated Planning and Reporting (IP&R) process** - The introduction of the IP&R process in 2009 has increased Councils' focus on longer term planning and strategy. TCorp recognises that Councils are at different stages of implementing the full suite of IP&R requirements. Continued work on refining AMPs, and methodologies for valuing Infrastructure Backlog will improve the quality of LTFPs and assets information over time. Councils who have not as yet completed their initial work under the IP&R process, need to do this urgently to provide a clearer picture of their financial status and future financial requirements

7. **Asset management planning is improving** - Asset planning is improving but will require further (and ongoing) iterations for most Councils. Whilst the majority of Councils have now completed their initial AMP, the analysis and discussions with Councils indicates that it can take a number of iterations before a high level of certainty can be attached to the outputs of the AMP

8. **An asset maintenance gap exists** – Councils' reported expenditure on the maintenance of their assets shows an annual shortfall in spending on asset maintenance. In 2012 alone, the reported maintenance gap was $389m across the local government sector in NSW, and has totalled $1.6b over the last four years

9. **Regional performance varies** - There is a higher proportion of Councils rated as Weak and Very Weak in the north coast region and the far western region of the State, compared to other regions. Much of this variation in performance can be attributed to population density, where lower levels of population and hence lower proportional numbers of rate payers are available to meet the costs of maintaining and renewing assets

1.3 Key Recommendations for Consideration

Based on the findings from its review into the financial assessment and sustainability of the local government sector in New South Wales, TCorp's recommendations are:

1. **At least breakeven operating positions are essential** - Councils need to achieve at least a breakeven operating position on an on-going basis. The future sustainability of Councils is dependent upon generating sufficient funds to meet the costs of maintaining and renewing assets to deliver services. Councils who have been operating with deficits and are forecasting to continue to do so, are not generating sufficient funds to continue providing services and renewing assets at their current levels. These Councils need to develop options to correct this position. Such options will necessarily involve extensive consultation with their

communities, and will need to consider options for revenue increases, reductions in expenditure, and reviews of existing service levels and standards. Surpluses generated by Councils can be used to address their Infrastructure Backlogs

2. **Pricing paths are needed for the medium term** - IPART, DLG and Councils should work together to consider the development of a medium or long term, and achievable pricing path so that Councils can achieve at least a breakeven operating position. A clear strategy across the local government sector is needed to promote future sustainability for Councils

3. **Rate increases must meet underlying costs** - Future increases in all rates and annual charges for Council services should be based on the underlying cost of delivering these services and the annual movement in the cost of these services. Where a decision by Council is made to increases rates and charges at a lower than required factor, the impacts of such actions must be clear in the context of each Council's sustainability

4. **Asset management planning must be prioritised** - Councils need to prioritise the completion and validation of their AMP and Infrastructure Backlog values so that a clear picture is available as to the total funding requirements for their assets. Without this certainty, Councils cannot accurately forecast their future funding requirements and put in place appropriate strategies

5. **Councillor and management capacity must be developed** - Councils and the DLG should continue to articulate the benefits of the IP&R process, by increasing the focus on linking long term strategies, asset management planning and long term financial forecasting to assist with decision making and promoting sustainability. Enhancing the knowledge and skills of Council management and elected officials, particularly in respect of the importance of financial and asset management, would greatly assist in this area

6. **Improved use of restricted funds** - A review of the system and guidelines for accessing restricted funds is needed. Under the current requirements, most Councils are required to hold substantial funds in reserve for specific purposes, often for lengthy periods of time. On average 50% to 60% of funds held by Councils are externally restricted. Being able to access more of these funds (eg through s 410 internal borrowing arrangements) could allow Councils to meet current asset renewal and maintenance requirements and be a more efficient use of funds

7. **Increased use of debt** - Debt is underutilised by some Councils and there are opportunities for more cost effective borrowing and debt management. Some Councils have low or zero debt, strong cash flows and outstanding Infrastructure Backlogs. For some of these Councils the use of debt can be an efficient means of addressing Backlog issues, enhancing intergenerational equity and improving asset quality and services. For many Councils with existing debt, overly conservative debt management practices are adopted which could be improved to deliver enhanced value and a lower cost of funds for Councils

1.4 Overall Results

Table 1 below provides the current FSR distribution of the 152 Councils in NSW as determined by TCorp's assessment process.

The results show that 113 (74.3%) of the 152 Councils are currently rated Moderate or better, and 39 (25.7%) are rated Weak or Very Weak. A Moderate rating indicates that a Council has an adequate capacity to meet its financial obligations in the short to medium term (being the next five years), and to manage risks to its business. A Council rated as Moderate is likely to have recorded some minor to moderate operating deficits and it may have also recently recorded a significant operating deficit. It is likely to be able to address any unforseen financial shocks with moderate revenue and/or expense adjustments. Achieving a Moderate level FSR is considered to be the base target level for Councils and those Councils with a FSR higher than Moderate are in a much stronger position to deliver services, manage their assets and risks and address their Infrastructure Backlogs. Councils rated as Moderate will generally not have sufficient funds to address their Infrastructure Backlogs.

No Councils were assigned an FSR of Very Strong or Distressed.

Table 1 - FSR Distribution

Rating	Count	Percentage
Very Strong	0	0.0%
Strong	2	1.3%
Sound	32	21.1%
Moderate	79	52.0%
Weak	34	22.4%
Very Weak	5	3.3%
Distressed	0	0.0%
Total	**152**	**100.0%**

The map in section 4.1 shows the geographic distribution of the assessed FSR for each Council.

TCorp also prepared an Outlook rating for each Council based on the perception of the likely future movement in the FSR rating of each Council. The Outlooks were assigned based on TCorp's view of the likely movement (if any) of a Council's FSR rating over the next three years.

The Outlooks determined are shown in Table 2 below:

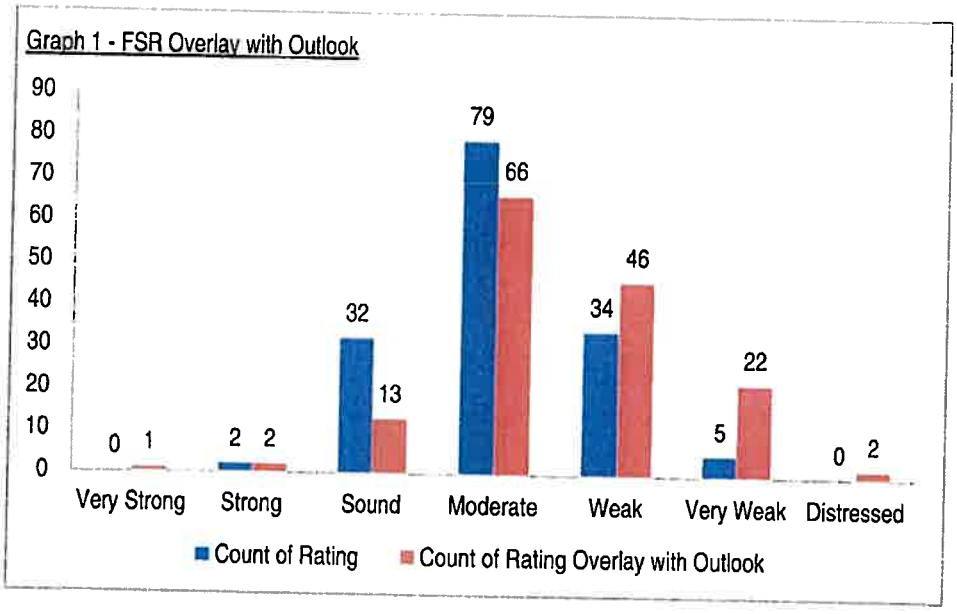
Table 2 - Outlook Distribution

Outlook	Count	Percentage
Positive	5	3.3%
Neutral	74	48.7%
Negative	73	48.0%

Following the determination of the Outlook, each Council has a FSR ranging from Very Strong to Distressed and an Outlook ranging from Positive to Negative.

Whilst an Outlook is not certain, if the Outlooks eventuate, only 82 Councils (53.9%) would be rated as Moderate or higher, with 70 Councils (46.1%) being rated Weak or lower, including two as Distressed.

The graph below shows the changes that would result if all the Outlooks occurred. This clearly illustrates the impact for the overall local government sector should no remedial action be taken by Councils and TCorp's perception of a general weakening trend over the short term eventuate.



The map in section 4.3 shows the geographic distribution of the assessed FSR for each Council if the Outlook occurs.

Analysis of the information to identify the causes of these forecast results reveals a number of factors that are driving TCorp's perception of the expected continued deterioration in the financial rating of many local Councils. These factors include:

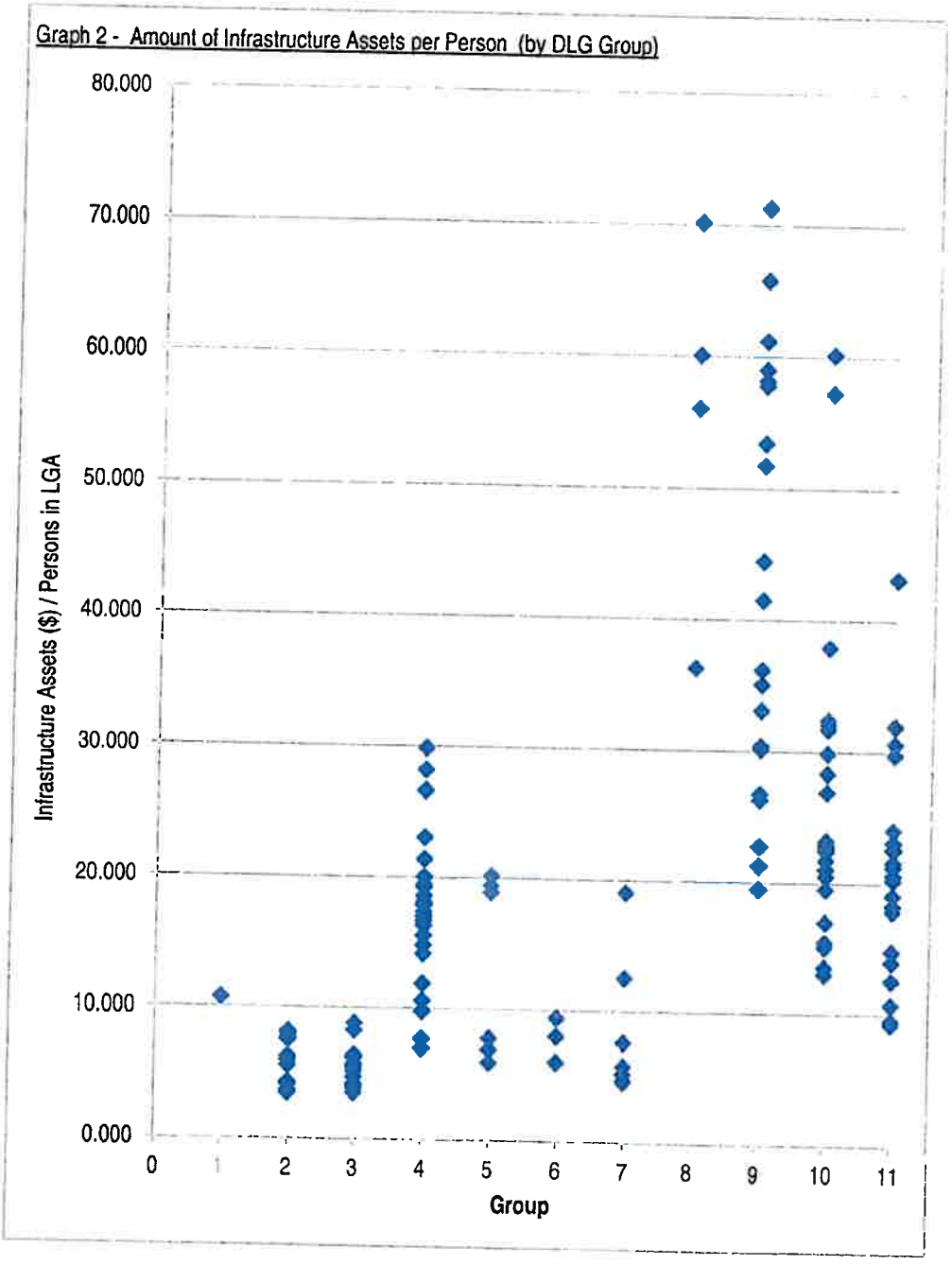
- The inability of many Councils to achieve a breakeven or surplus operating position
- The introduction of the IP&R process has increased the Councils' focus on the longer term, rather than just the next 12 month budget period and this has identified longer term trends and issues
- The AMP, introduced as part of the IP&R, has required Councils to consider the whole of life costs associated with their infrastructure assets and has highlighted the costs associated with renewing assets
- The AMP has also highlighted the underspending on the maintenance of assets, which can lead to a declining quality of assets, reflected in an increased Infrastructure Backlog
- Changes in demographics where some LGAs are experiencing declining populations, whilst others are experiencing strong population growth

1.5 Factors Affecting Sustainability

1.5.1 Population and Demographics

The graph below shows that Councils in regional and rural areas (DLG Groups 4, 8, 9, 10 and 11) have a much higher value of infrastructure assets per person to maintain. As these Groups also have lower population densities this increases the pressure on local ratepayers to fund infrastructure.

Graph 2 - Amount of Infrastructure Assets per Person (by DLG Group)



Population density compared to the amount of infrastructure managed by a Council is an important factor in determining the sustainability of a Council. Graph 2 shows on the horizontal axis the dollar value of infrastructure assets per person in the LGA. This excludes land and property, plant and equipment. The graph shows a distinct difference between Urban Councils in Groups 1 to 7 compared to the Rural Councils in Groups 8 to 11. Urban Councils generally have less of the cost of the infrastructure burden per resident. Each resident in a Rural Council has to support a greater amount of infrastructure asset. This is generally due to the lower population density in rural areas compared to the volume of assets, particularly length of roads.

It is important to note, that Councils in groups such as 8, 9 and 10 which had the higher dollar value of infrastructure assets per resident also had the highest proportion of Councils rated Weak and Very Weak. Group 11 Councils which are rural in nature had a much lower proportion of Councils in the Weak and Very Weak categories. This Group also had a lower rate of dollar value of infrastructure assets per resident compared to the other rural Council groups.

If a Council has a higher proportion of residents compared to its infrastructure value, it is generally less reliant on external sources of funds, more financially flexible and more likely to be self sustaining.

1.5.2 Features of a Sustainable Council

While a high population density and low reliance on external sources of funds are important factors to a sustainable Council, other factors which can assist their sustainability position include:

- Quality management and staff
  - An experienced management team which understands the business and are focused on sustainability
  - Appropriately qualified engineering staff who are able to understand relevant tasks required
  - Skilled grant officers and financial reporting staff which produce quality reporting data to assist in decision making and in the application for grants
  - Ability to attract and secure quality and skilled employees
  - Rural Councils are able to use State road contracts to provide some critical mass for the Council's roadwork team and equipment. It also helps in attracting and retaining expertise in the engineering area
- A responsible Council that understands its role
  - It is important for the Council to have a long term vision particularly when it manages assets with long useful lives
  - In respect of capital expenditure, Councils should concentrate on 'fit for purpose' standards for its assets and at levels agreed with the community
- Good reporting and budgeting
  - Conservative budgeting can be used as a tool to keep pressure on operating budgets. Surpluses generated can be allocated for capital expenditure
  - Producing good quality data and reports so that a Council is able to secure its appropriate entitlement of grants, such as flood grant funding

1.5.3 Regional Factors Impacting Sustainability

In conducting the review, TCorp has identified particular geographical regions which had relatively lower FSR and Outlooks when compared to other regions. This is not to say that all Councils in these areas were lower rated, with some regions having a large range of outcomes from Sound to Very Weak. In particular, two regions stood out as having lower FSR and Outlooks.

These two regions are firstly, the coastal and near coastal areas of the north coast of NSW, where 11 Councils are rated by TCorp as being in the lowest 24 FSR rated Councils in NSW. The second region covers the most western areas of NSW where eight Councils are in the lowest 24 FSR rated Councils in NSW.

We have considered these further and identified some factors affecting these regions.

In the north coast region, many of these Councils have some or all of the following characteristics:

- Highly prone to floods and storms (which have been prevalent in recent years)
- The coastal Councils suffer from holiday peak crowds that place great pressure on facilities
- Due to the popularity of many of these Council areas for retirement, ageing populations are a significant issue
- High demand for a large variety of services due to the age mix of the local (and tourist) populations

In the western region, most of these Councils have some or all of the following characteristics:

- Declining populations
- Large land areas and road networks
- Very low population densities
- Low rate bases, so Councils are heavily reliant on government operating and capital grants
- Susceptible to the full range of natural disasters of drought, floods and bushfires

Whilst many other Councils in NSW will also have some or all of these features, they are not in general affected by these factors to the same extent as these two regions.

1.5.4 Urban Councils

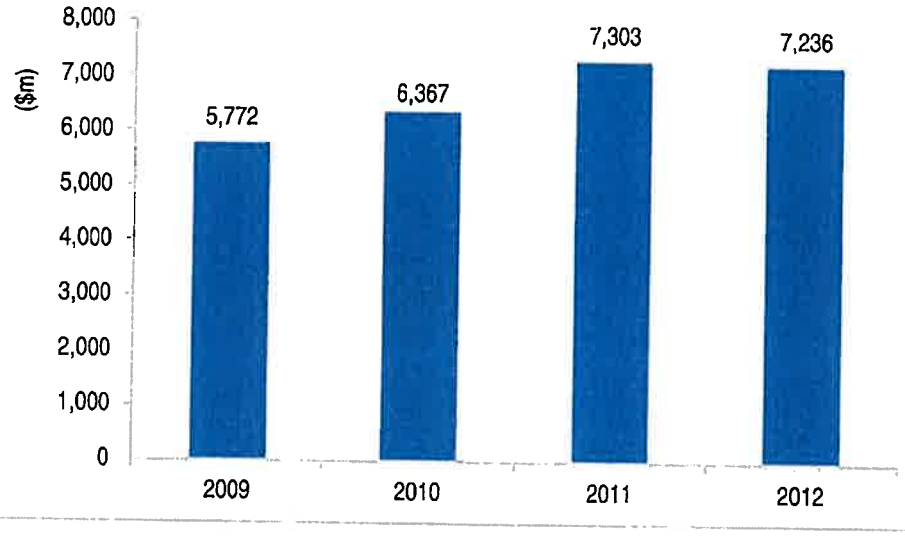
Given that population density is an important factor in sustainability, a lesser portion of Urban Councils have been assigned a Weak or Very Weak rating compared to Rural Councils. However, 19.8% of Urban Councils are still considered Weak or Very Weak. Most of these Councils were in regional areas outside of Sydney. Some of the factors which contributed to a low FSR score for Urban Councils are:

- Substantial increases in employee expenses, particularly workers compensation costs and superannuation
- High Infrastructure Backlogs and an inability to reduce this in the short term
- Underspending on asset maintenance and renewal

- Incomplete AMPs and Asset Revaluations which presents risks to their forecasts and reported numbers
- Substantial and unmitigated risks from undertaking major projects

1.6 Infrastructure Backlog

Graph 3 - Total Infrastructure Backlog for All 152 NSW Councils



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. For the purpose of this assessment TCorp has used the unaudited figures stated within Special Schedule 7 that accompanies the Councils' annual financial statements.

The total Infrastructure Backlog for NSW Councils has increased from a reported $5.8b in 2009 to $7.2b in 2012, an increase of $1.5b (25.4%) over the Review Period. The main component of the Infrastructure Backlog is public roads (including footpaths and car parks) at $4.4b (61.2%) as at 2012. This reported increase is not necessarily a reflection of a sudden deterioration in asset quality across the State. Rather, it is at least partly a reflection of the improved reporting that has resulted from the introduction of the IP&R process and the work undertaken in respect of AMPs.

One of the major drivers of the Infrastructure Backlog is the underspending on the maintenance of assets. The total reported underspending on required asset maintenance over the Review Period was $1.6b, a number not inconsistent with the increase in the Infrastructure Backlog value over the same period ($1.5b).

1.7 Borrowing Capacity

In conducting its assessment and review process, TCorp considered the capacity of Councils to service their existing and forecast borrowings, and also each Council's capacity to service additional borrowings, based on each Council's current LTFP.

Over the Review Period from 2009 to 2012, Council borrowings have increased from $2.5b in 2009 to $3.0b in 2012, an increase of $516.0m (21.1%). The majority (more than 90%) of Councils have utilised debt as part of their overall funding strategy, although there are some notable exceptions of Councils having a no-debt policy.

Some of these 'no-debt policy' Councils are in the position of having no debt, significant capacity to take on debt (in terms of their financial capacity to repay debt over a period of time), as well as having significant levels of Infrastructure Backlog. These Councils should be considering using their financial capacity to borrow funds to upgrade infrastructure, thereby spreading the cost of infrastructure renewal over a number of years.

1.8 The Way Forward

The TCorp review and assessment process has generated a large amount of data, some of which requires additional analysis. The review has highlighted that an urgent need exists for improvements across the local government sector that could assist Councils in enhancing their financial wellbeing and prevent them from becoming unsustainable.

Action is required in the short to medium term to avoid any further deterioration in the overall financial performance of the sector and to address the current deficit positions and the Infrastructure Backlog. Without such action, long term sustainability for the sector will be under further pressure.

The introduction of the IP&R system has been the first stage in promoting improved financial management practices in the local government sector, particularly by increasing the focus on the longer term rather than just the next budget cycle. TCorp considers that there are many additional opportunities for improvements which could extend the gains already achieved, by building on the improved and more transparent information that is progressively being produced through the IP&R system.

TCorp's preparation of the FSR ratings and Outlooks for all 152 Councils highlighted a general weakening in the financial future of the sector, and TCorp considers that with the implementation of the recommendations contained in section 6 of this Report, significant improvements can be made to ensure the long term sustainability of the local government sector.

As TCorp has prepared this Report to assist the Review Panel in its deliberations, the Review Panel can build into its final report the proposed timetable for addressing the TCorp recommendations along with its own recommendations.

New South Wales Treasury Corporation

1.9 FSRs and Outlooks for 152 Councils

The table below shows the FSRs and Outlooks assigned by TCorp to the 152 Councils in NSW.

Table 3 - FSRs and Outlooks for 152 Councils

Council	FSR	Outlook
Albury City Council	Moderate	Neutral
Armidale-Dumaresq Council	Moderate	Neutral
Ashfield Municipal Council	Sound	Neutral
Auburn City Council	Sound	Negative
Ballina Shire Council	Moderate	Neutral
Balranald Shire Council	Weak	Negative
Bankstown City Council	Moderate	Negative
Bathurst Regional Council	Moderate	Negative
Bega Valley Shire Council	Sound	Neutral
Bellingen Shire Council	Moderate	Negative
Berrigan Shire Council	Moderate	Neutral
Blacktown City Council	Moderate	Neutral
Bland Shire Council	Weak	Neutral
Blayney Shire Council	Moderate	Negative
Blue Mountains City Council	Weak	Neutral
Bogan Shire Council	Moderate	Neutral
Bombala Council	Moderate	Neutral
Boorowa Council	Moderate	Negative
Botany Bay, City of	Weak	Neutral
Bourke Shire Council	Weak	Negative
Brewarrina Shire Council	Weak	Negative
Broken Hill City Council	Very Weak	Neutral
Burwood Council	Weak	Positive
Byron Shire Council	Weak	Negative
Cabonne Shire Council	Sound	Negative
Camden Council	Moderate	Neutral
Campbelltown City Council	Moderate	Negative
Canada Bay City Council	Moderate	Neutral
Canterbury City Council	Moderate	Negative
Carrathool Shire Council	Weak	Neutral
Central Darling Shire Council	Very Weak	Negative
Cessnock City Council	Moderate	Negative
Clarence Valley Council	Weak	Negative
Cobar Shire Council	Weak	Negative
Coffs Harbour City Council	Weak	Negative
Conargo Shire Council	Sound	Neutral
Coolamon Shire Council	Sound	Negative
Cooma-Monaro Shire Council	Weak	Neutral
Coonamble Shire Council	Sound	Negative
Cootamundra Shire Council	Moderate	Neutral
Corowa Shire Council	Moderate	Negative
Cowra Shire Council	Sound	Negative
Deniliquin Council	Moderate	Negative
Dubbo City Council	Moderate	Neutral
Dungog Shire Council	Weak	Negative
Eurobodalla Shire Council	Moderate	Neutral
Fairfield City Council	Sound	Neutral
Forbes Council	Moderate	Neutral
Gilgandra Shire Council	Weak	Neutral
Glen Innes Shire Council	Moderate	Neutral
Gloucester Shire Council	Very Weak	Neutral
Gosford City Council	Moderate	Neutral
Goulburn Mulwaree Council	Moderate	Negative
Great Lakes Council	Moderate	Neutral
Greater Hume Shire Council	Moderate	Negative
Greater Taree City Council	Very Weak	Negative
Griffith Council	Sound	Negative
Gundagai Shire Council	Moderate	Negative
Gunnedah Shire Council	Sound	Negative
Guyra Shire Council	Moderate	Negative
Gwydir Shire Council	Very Weak	Neutral
Harden Shire Council	Moderate	Negative
Hawkesbury Council	Moderate	Negative
Hay Shire Council	Moderate	Negative
Hills Shire Council	Sound	Positive
Holroyd City Council	Weak	Neutral
Hornsby Shire Council	Moderate	Neutral
Hunter's Hill Council	Moderate	Neutral
Hurstville City Council	Moderate	Neutral
Inverell Shire Council	Moderate	Neutral
Jerilderie Shire Council	Moderate	Negative
Junee Shire Council	Moderate	Neutral
Kempsey Shire Council	Weak	Negative
Kiama Municipal Council	Moderate	Neutral

Council	FSR	Outlook
Kogarah City Council	Moderate	Neutral
Ku-ring-gai Council	Sound	Neutral
Kyogle Council	Weak	Negative
Lachlan Shire Council	Moderate	Negative
Lake Macquarie City Council	Moderate	Neutral
Lane Cove Municipal Council	Sound	Negative
Leeton Shire Council	Moderate	Negative
Leichhardt Municipal Council	Sound	Neutral
Lismore City Council	Moderate	Negative
Lithgow City Council	Sound	Negative
Liverpool City Council	Sound	Negative
Liverpool Plains Shire Council	Weak	Negative
Lockhart Shire Council	Sound	Neutral
Maitland City Council	Moderate	Neutral
Manly Council	Sound	Neutral
Marrickville Council	Moderate	Neutral
Mid-Western Regional Council	Sound	Negative
Moree Plains Council	Moderate	Neutral
Mosman Council	Weak	Positive
Murray Shire Council	Moderate	Neutral
Murrumbidgee Shire Council	Moderate	Negative
Muswellbrook Shire Council	Moderate	Neutral
Nambucca Shire Council	Weak	Negative
Narrabri Shire Council	Moderate	Negative
Narrandera Shire Council	Sound	Negative
Narromine Shire Council	Moderate	Neutral
Newcastle City Council	Moderate	Negative
North Sydney Council	Moderate	Neutral
Oberon Council	Sound	Negative
Orange City Council	Sound	Negative
Palerang Council	Moderate	Negative
Parkes Shire Council	Moderate	Negative
Parramatta City Council	Moderate	Neutral
Penrith City Council	Weak	Neutral
Pittwater Council	Sound	Neutral
Port Macquarie-Hastings	Weak	Negative
Port Stephens Council	Moderate	Neutral
Queanbeyan City Council	Weak	Neutral
Randwick City Council	Sound	Neutral
Richmond Valley Council	Weak	Negative
Rockdale City Council	Moderate	Neutral
Ryde City Council	Sound	Negative
Shellharbour City Council	Moderate	Negative
Shoalhaven City Council	Sound	Negative
Singleton Shire Council	Moderate	Neutral
Snowy River Shire Council	Moderate	Negative
Strathfield Municipal Council	Moderate	Negative
Sutherland Shire Council	Moderate	Neutral
Sydney, Council of the City of	Strong	Positive
Tamworth Regional Council	Moderate	Neutral
Temora Shire Council	Sound	Neutral
Tenterfield Shire Council	Weak	Negative
Tumbarumba Shire Council	Strong	Negative
Tumut Shire Council	Moderate	Neutral
Tweed Shire Council	Moderate	Neutral
Upper Hunter Shire Council	Sound	Negative
Upper Lachlan Shire Council	Sound	Neutral
Uralla Shire Council	Weak	Neutral
Urana Shire Council	Weak	Neutral
Wagga Wagga City Council	Moderate	Negative
Wakool Shire Council	Weak	Negative
Walcha Shire Council	Weak	Negative
Walgett Shire Council	Moderate	Negative
Warren Shire Council	Moderate	Neutral
Warringah Council	Sound	Positive
Warrumbungle Shire Council	Weak	Negative
Waverley Council	Moderate	Neutral
Weddin Shire Council	Moderate	Negative
Wellington Council	Weak	Neutral
Wentworth Shire Council	Weak	Negative
Willoughby City Council	Moderate	Neutral
Wingecarribee Shire Council	Moderate	Neutral
Wollondilly Shire Council	Weak	Neutral
Wollongong City Council	Moderate	Neutral
Woollahra Municipal Council	Moderate	Neutral
Wyong Shire Council	Moderate	Neutral
Yass Valley Council	Moderate	Negative
Young Shire Council	Sound	Negative

2. Introduction

2.1 NSW Local Government Sector

The NSW local government sector comprises 152 independent Councils and their physical size and population density characteristics vary, ranging from densely populated urban Councils such as Waverley to remote rural Councils. The largest Council in area is Central Darling which covers 53,534 km², with the smallest being Hunters Hill at 5.7 km². Likewise, population size varies enormously, with Urana Shire Council having 1,180 residents, whilst Blacktown City Council has 312,479 residents.

Councils today provide a myriad of services (sometimes as an agent for other government agencies) that even many rate payers are not aware of, ranging from the traditional areas of local roads through to aged and child care, airports, cemeteries and many forms of recreational facilities.

Table 4 below shows the financial dimensions of the sector which illustrates the enormous scale of tasks undertaken by the local government sector in NSW.

Table 4 – Key Items for 152 Councils

($m)	2009	2010	2011	2012
Net assets	98,219.5	117,889.0	120,464.7	123,113.6
Total infrastructure assets	47,484.2	66,525.1	69,637.0	72,415.8
Borrowings	2,450.7	2,954.7	2,856.4	2,966.7
Infrastructure backlog	5,771.0	6,366.5	7,302.6	7,236.2
Cash and investments	5,637.7	6,040.0	6,261.9	6,791.9
Total revenue (exc. capital grants and contributions)	7,747.3	8,094.7	8,603.4	9,245.1
Operating results (exc. capital grants and contributions)	(148.1)	(203.0)	(386.6)	(287.8)

The introduction of the IP&R guidelines in 2009 has sought to improve the focus of Councils on longer term planning and strategy rather than focussing on shorter term plans and annual budget cycles, but it is clear that the sector faces many competing demands on its financial resources.

2.2 NSW Treasury Corporation Role

In December 2011, the DLG appointed TCorp to assist DLG and NSW Treasury in respect of the government's LIRS initiative. The LIRS initiative seeks to assist in addressing Councils' 'Infrastructure Backlog' by providing Councils with an interest rate subsidy on borrowings from the private sector for the funding of qualifying projects.

Infrastructure Backlog can be defined as the amount of investment that is required to be invested in a Council's infrastructure to bring those assets to a 'satisfactory' standard. Satisfactory is considered to

be a level at which an asset can perform at the standards usually expected for that asset in terms of its age and use.

TCorp's role was to undertake a financial assessment and benchmarking report for each Council seeking or requiring such an assessment under the LIRS. It was envisaged that there could be annual rounds of LIRS applications over potentially three years, with reports prepared accordingly. A second round of LIRS was announced in October 2012 with applications closed mid-January 2013.

In March 2012, the Minister for Local Government announced the establishment of an Independent Local Government Review Panel (Review Panel) to be chaired by Professor Graham Sansom. The Review Panel is to develop options to improve the strength and effectiveness of local government in NSW. Included under the Review Panel's Terms of Reference, the financial sustainability of each local government area is to be considered.

Since the announcement of the Review Panel, DLG has expanded the scope of TCorp's reports to incorporate additional material to facilitate use by the Review Panel, particularly in respect of the area of financial sustainability. In addition, TCorp has been requested to prepare reports for all 152 NSW Councils plus any of the 14 Water County Councils that apply under the LIRS scheme.

Following further discussions with DLG and the Chair of the Review Panel, TCorp was asked to provide additional assistance to DLG and the Review Panel by providing information similar to that contained in the report prepared by QTC in October 2008 'Financial Sustainability In Queensland Local Government'.

This Report sets out TCorp's findings from its related work to assist the Review Panel.

2.3 Other Sustainability Studies Undertaken in Australia

Over the last 10 years a number of reviews into the local government sector have been undertaken in various states. These have included reviews in South Australia (2005), NSW (2006), and Queensland (2008).

TCorp has drawn most from the Queensland work, particularly as QTC has continued to work closely with the Queensland local government sector. QTC has subsequently developed its earlier work in terms of the key benchmarks to a much more advanced stage in its efforts to focus attention on the key areas.

TCorp has also drawn from the benchmarks used by IPART, DLG, or TCorp's own work, particularly in respect of debt.

3. Methodology Adopted for Assessing Financial Sustainability

To undertake its review of the local government sector TCorp had to develop a robust and understandable methodology to conduct assessments of all the Councils. With Councils ranging from large urban Councils to small remote rural Councils, the methodology needed to be able to take into account the significant differences that exist between Councils.

In considering the issue of sustainability, TCorp considered the work previously undertaken in other jurisdictions around Australia and it became apparent that whilst there had been significant work undertaken, there were very few definitions of sustainability. Consequently, TCorp developed its own definition being:

> *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.*

The definition takes into account the effect a significant one-off change or financial shock could have on a Council's operating position and service levels over the long term.

The definition brings together what TCorp considers are the key elements of financial strength, service and infrastructure requirements, and needs of the community. TCorp considers that this definition is concise enough to be remembered, whilst broad enough to cover the key aspects.

TCorp then conducted an independent assessment of each Council in respect of their financial capacity, sustainability and performance measured against a peer group of Councils. These assessments were designed to complement each Council's internal due diligence, the IP&R system of the Council and the DLG, together with the work being undertaken by the Review Panel.

The key areas focused on for each Council are:

- The financial capacity
- The long term sustainability
- The financial performance in comparison to a range of similar Councils, and measured against prudent benchmarks

3.1 Overall Approach

TCorp has prepared a Report for each Council that provides an overview of its existing financial performance and position, a review of financial forecasts including its capacity to meet increased debt commitments, future sustainability, and benchmarking and comparisons with other Councils. TCorp's work includes:

- A review of Council's four most recent years of audited consolidated annual accounts
- A review of Council's 10 year consolidated and General Fund financial forecasts, and of a separate Water Fund and Sewerage Fund on an 'as needs' basis. The review includes assessment of key assumptions that underpin the financial forecasts

- Identifying significant changes to future financial forecasts from existing financial performance, and highlighting risks associated with such forecasts
- Discussions with Council management to understand overall strategy and management experience
- Benchmarking and comparisons with other Councils (against its comparable peers)
- Conducting an analysis of each Council's financial sustainability

3.2 Financial Indicators

In conducting the review of the Councils' financial performance, forecasts and sustainability, TCorp has 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. The Operating Ratio in particular has been set at a benchmark of negative 4.0%, but in TCorp's view, Councils over the long term need to achieve a breakeven position (at least 0% Operating Ratio). Small operating deficits in some years can be acceptable. Even at a breakeven position this will not generate sufficient funds for a Council to address any Infrastructure Backlog that it may have, nor any unquantified asset maintenance gap.

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 operating performance and financial shocks. In particular, the Own Source Operating Revenue Ratio benchmark may need to be different for Rural and Urban Councils. Many Rural Councils are unlikely to achieve the same level of Own Source Operating Revenue as an Urban Council due to their limited rate base. Further, it can be argued that Urban Councils should have a much higher Own Source Operating Revenue Ratio as these Councils not only have access to a larger rate base, but also the ability to raise income from other services such as car parking. So for many Urban Councils, this Ratio benchmark should be in excess of 80% rather than the current agreed level of 60%.

Despite the comments made above, in the interests of providing a consistent picture across all NSW Councils it was decided to measure the performance of all Councils against the same benchmarks. In future years there could be scope to develop these benchmarks further so that Councils can be measured and compared on the basis of benchmarks that are more tailored to their particular characteristics.

Appendix 2 attached to this Report explains how each ratio is calculated.

Table 5 - Benchmark Ratios

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

3.3 Financial Sustainability Ratings (FSR) and Outlooks

The FSR focuses on a Council's capacity to meet its financial commitments in the short, medium and long term. The Outlook focuses on the potential movement in a local government's FSR in the short term, and differentiates a local government's rating within a FSR category. In TCorp's view, the short term is the next three years, medium term is the next three to five years and long term is a five to ten year horizon.

In assigning a FSR and Outlook to each NSW Council, TCorp has utilised the same FSR and Outlook category descriptors as those currently used by QTC.

To assist in determining the FSR for each Council, TCorp developed a matrix of 10 key benchmark ratios to analyse each Council's performance. In developing the weightings for each benchmark ratio, TCorp has categorised the 10 benchmark ratios into four broad categories and then considered the relative importance of each category in terms of a Council's financial capacity and sustainability. The category of financial flexibility has been assigned a greater weighting because it measures two key measures for sustainability, the Council's revenue raising capacity, and its ability to sustain financial shocks, which are important factors for sustainability. As a Council's core servicing function and main asset is its infrastructure, its asset renewal and capital works program is an important factor in its long term sustainability. Debt servicing has been given the least weighting because most Councils are lowly geared compared to corporate entities. The categories, total weightings for each category, and the relevant ratios for each category are as follows:

- Financial flexibility (35%) – operating ratio, and own source operating revenue ratio
- Liquidity (20%) – cash expense ratio, and unrestricted current ratio
- Debt servicing (10%) – debt service cover ratio, and interest cover ratio
- Asset renewal and capital works (35%) – infrastructure backlog ratio, asset maintenance ratio, building and infrastructure asset ratio, and capital expenditure ratio

From these category weightings TCorp then allocated a weighting for each ratio within each of the categories based on the relative importance of each ratio within each category as shown below. These ratios and the benchmark levels were chosen after reviewing the ratios used by other states and what has been used in NSW by DLG and IPART to assess Councils. The series of ratios are intended to cover aspects of a Council's performance which impact its capacity and sustainability. The definition of each of these ratios is attached as Appendix 2.

It is important to note that when the FSR score is calculated, there is a range of results which exists within the FSR band. A Council may have received a higher FSR score than another Council but both Councils may fall within the same rating category. However, where a Council is close to the boundary of a FSR category, it is more likely that a change in their operations and environment will shift them to the next FSR category. In that instance, the outlook is more likely to be either Positive or Negative.

Table 6 – Benchmark Ratio Weightings

Ratio	Benchmark	Weighting (%)	Subtotals (%)
Financial Flexibility			
Operating ratio	> (4.0%)	17.5	35.0
Own source operating revenue ratio	> 60.0%	17.5	
Liquidity			
Cash expense ratio	> 3.0 months	10.0	20.0
Unrestricted current ratio	> 1.5x	10.0	
Debt Servicing			
Debt service cover ratio (DSCR)	> 2.0x	7.5	10.0
Interest cover ratio	> 4.0x	2.5	
Asset Renewal and Capital Works			
Infrastructure backlog ratio	< 0.02x	10.0	35.0
Asset maintenance ratio	> 1.0x	7.5	
Building and infrastructure asset renewal ratio	> 1.0x	7.5	
Capital expenditure ratio	> 1.1x	10.0	
Total		100.0	

3.4 Determination of the Outlook

Whilst the FSR primarily looks at historical performance, TCorp has also assessed each Council in terms of an Outlook that seeks to provide an indication of any potential future movement in the FSR in the short term (up to three years), based on currently known events, existing trends, and/or financial forecasts.

For NSW Councils there are three Outlook categories:

- Positive
- Neutral
- Negative

Please see Appendix 1 for the definitions of the Outlook categories.

The determination of an Outlook involves an assessment of the key issues that may impact the Council in the short term. For example, a Council which has been assessed as Moderate Negative has the potential to shift to a Weak category based on a foreseeable event or circumstance occurring. It does not necessarily mean a rating change is inevitable.

In particular, the following types of issues are considered:

- Specific risks and opportunities for each Council. Examples include:
  - if a Council has a major new (non-core) project underway or is about to commence a project such as a major civic centre or residential development where Council is assuming a substantial level of risk
  - if a Council has a significant investment in distressed or impaired financial assets where recovery of the capital amount is uncertain
  - if a Council has a pending SRV application (this can lead to upside opportunities)
- LTFP. As part of TCorp's assessment of each Council, TCorp analysed the trends in key performance ratios from both a historical perspective and for the 10 year forecast period, including reviewing the assumptions that underpin the forecasts. Reviewing these forecasts allows us to see the expected future trend in a Council's key performance indicators. The quality of these forecast performance indicators assists us in the assessment of the Outlook
- Other general matters such as, material population growth, changes in population age profile, and the ability to continue to deliver existing services in the short to medium term

3.5 Benchmarking Local Government Performance

In conducting the assessment, each Council's performance has been assessed against the 10 key benchmark ratios. Each Council has been provided with not only an assessment of their own performance and sustainability but also a comparison of the Council's performance when compared with its peers in the same DLG Group.

For each of the 10 benchmark ratios the historical performance of the Council is compared with the benchmark for that ratio, with the average for the DLG 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). Some of the graphs (regarding asset benchmarks) do not include the 2016 forecast position as those numbers are not forecast by the Councils as part of their LTFP.

For the purposes of this Report, TCorp has prepared a number of cumulative benchmark graphs and tables that are designed to provide an informative picture of the overall performance of NSW Councils both in terms of the range of performance, and performance in comparison to the benchmarks.

These graphs and tables include comparisons of:

- Operating performance
- Own source operating revenue
- Liquidity - Unrestricted Current Ratio
- Infrastructure Backlog
- Capital expenditure

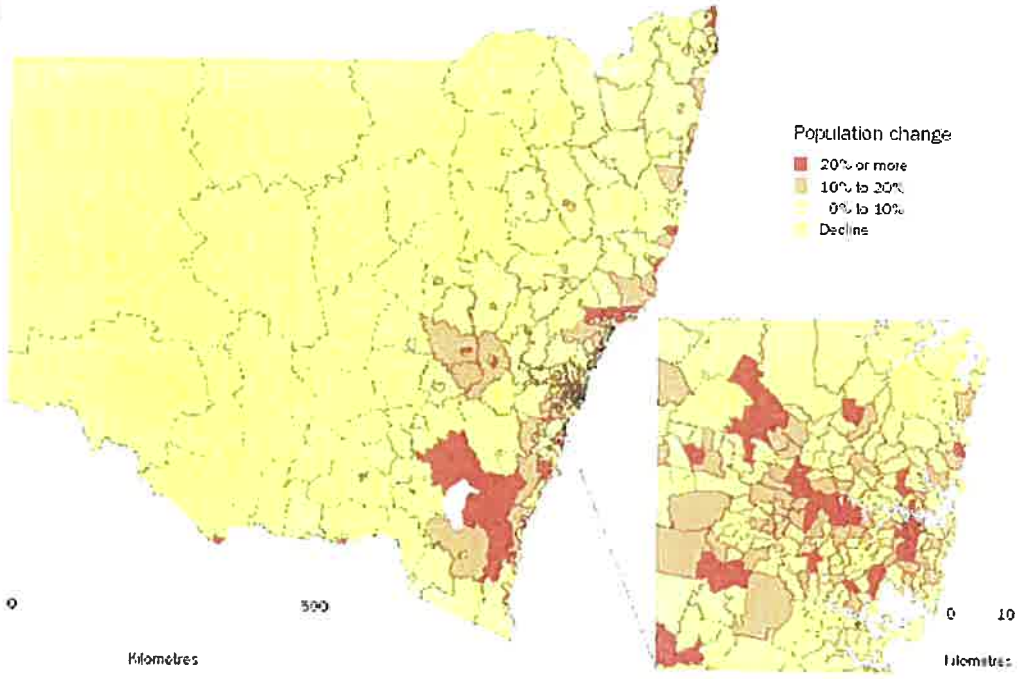
3.6 External Factors Affecting Local Governments

There is a range of land area size, population size, demographic, geography, climate and economic industry in the 152 Councils in NSW. The most densely populated metropolitan areas of Sydney are very different to the remote far west corner of the State with approximately 25 km² per person. Given the variety of the Councils' sizes and businesses, TCorp has identified a number of themes and risk factors which influences groups of Councils sharing similar characteristics.

3.6.1 Population Growth and Decline

Over the Review Period of July 2008 to June 2012, the population of NSW increased by approximately 314,000 (4.5%) with the majority of the growth from net overseas migration rather than from natural increases. This compares with the population growth of Australia over the same period of approximately 1,299,000 (6.1%). NSW therefore contributed to around 24% of the national population growth over the four years.

Graph 4 - Sourced from ABS (2011): Population Change in NSW from 2001 to 2011



Approximately 64% of the State's population reside in the Greater Sydney area. In the 10 years to 2011, the Greater Sydney area accounted for nearly three quarters of the State's population growth. Particular growth corridors include the North West of Sydney, inner Sydney city, inner South and inner South West. Areas of population decline include outer South West and outer West areas of Sydney.

Outside of the Greater Sydney area, the Hunter Valley region experienced the fastest population growth in the decade to 2011. This is followed by the region around Canberra, far north coast and mid-north coast.

In the inland parts of NSW, more than half of this predominantly rural area experienced population declines over the last decade. Population decline is largely due to the drought conditions over the last decade, with the greatest nominal population decline in the Griffith area. The greatest percentage decline in population is in the Bourke/Cobar area of Western NSW.

Both rapid population growth, and decline, present significant risks to a Council's financial sustainability.

LGAs with a growing population require new infrastructure assets and services, and Councils need to work closely with developers to fund the capital expenditure. Councils also need to ensure that the incremental increase in revenue from rates exceed any growth in expenses.

Councils located in LGAs with population decline are often faced with the challenge of funding for the maintenance and renewal of ageing assets while the economies of scale of service provisions decline. In the short term however, population decline does not necessarily lead directly to rates assessment base decrease and revenue decline. Most rural areas with population decline is as a result of the

migration of young people from the LGA, while the number of residential and farmland assessments remain static. LGAs experiencing population decline also often find it difficult to attract and maintain suitably qualified employees.

3.6.2 Demographic Changes

According to ABS' projections, the State's population is forecast to increase by an average of 1.1% p.a. from 2012 to 2022. The majority of the population growth is forecast to be mainly in the Greater Sydney area. The estimated average growth for the rest of NSW, excluding Sydney, is 0.8% p.a.

The proportion of persons aged 65 years and over is forecast to increase to 18.1% of the State's population, up from 14.7% in 2011. The forecast median age for NSW, excluding Sydney, is higher, at 44 years in 2022 compared to Greater Sydney's forecast median age of 37 in 2022. This compares with the forecast national median age of 39 years in 2022, an increase from 37 years in 2011.

Overall, the State's population, particularly outside of the urban areas, is shifting towards an older population. The implications and risks to Councils include greater demand of aged care related services and facilities, and an ageing workforce.

3.6.3 Natural Disasters

After an extended period of drought conditions, many parts of the State experienced flooding and storm events over the Review Period. These natural disaster events can cause wide spread destruction to Council owned infrastructure assets. The NSW Treasurer or his delegate may issue a Natural Disaster Declaration, and under this circumstance the Council may receive Australian and State Government financial assistance for emergency work and restoration of assets. Under these programs, the Roads and Maritime Services (RMS) (formerly known as Roads and Traffic Authority (RTA)) administers the funding related to roads and road bridges and the NSW Public Works administers funding related to other assets.

3.6.4 Cost Increases

It is important for businesses and organisations to understand the trends and forces affecting their revenues and costs. This information is vital in the budgeting, forecasting and strategic planning processes. One of the most widely used measures of cost increase is the Consumer Price Index (CPI), which measures quarterly changes in the price of a 'basket' of goods and services which account for a high proportion of expenditure by the population group, such as a metropolitan household.

Councils, who offer a varied range of services, have a number of factors affecting the cost of their operations. IPART has developed the Local Government Cost Index (LGCI), mainly for the purpose of

setting the maximum allowable increase in general income (the 'rate peg'). According to IPART, 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 index includes a variety of cost items including employee benefits and on-costs, building material costs, professional services costs and works compensation. In the survey undertaken by IPART in 2010, 41.2% of all costs consist of employee expenses although there are distinct variances in cost structure between Urban and Rural Councils. Rural Councils tend to have a lower component of cost from employees and a larger component from construction works. IPART has not developed separate indexes as differences in the rates of movement between Rural and Urban Councils are not significant.

Table 7 - Different Cost Indexes Over the Review Period

Index	2009	2010	2011	2012
LGCI (annual change to Sep)	3.4%	3.0%	3.4%	3.7%
CPI (annual change to Jun)	3.1%	2.4%	3.1%	2.4%
Wage Cost Index for NSW Public Sector (annual change to Jun)	3.0%	3.7%	4.5%	3.5%
Road and Bridge Construction Index for Australia (annual change to Jun)	3.2%	2.6%	5.4%	3.9%

4. Financial Sustainability Ratings and Outlooks

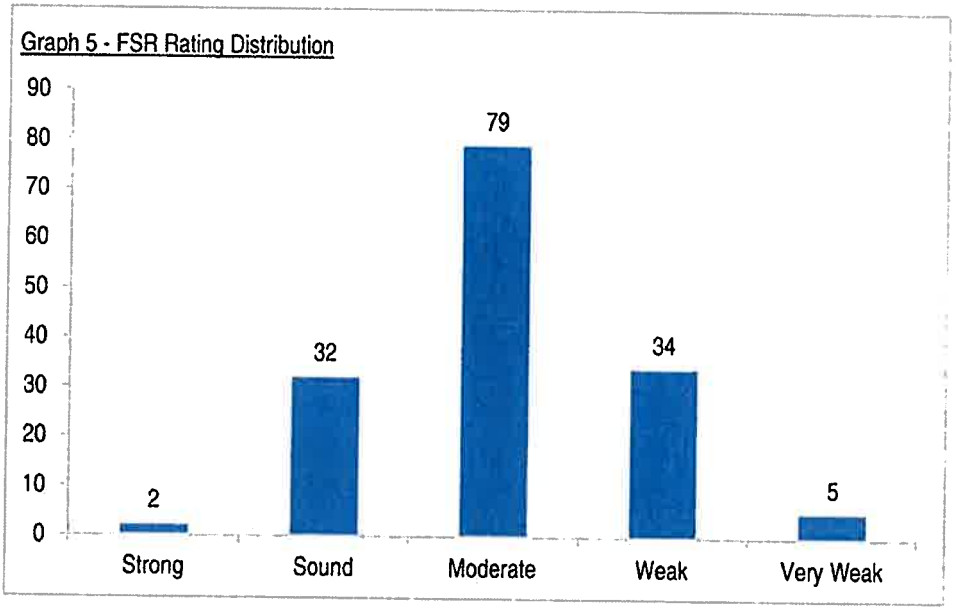
TCorp has prepared FSR and Outlooks for the 152 Councils in NSW.

In this section TCorp presents the FSR results for all Councils, as well as showing the FSR for Urban and Rural Councils. TCorp has used the current DLG Groupings as the basis for classifying Councils into Urban and Rural. DLG Groups 1 to 7 are classified as Urban and DLG Groups 8 to 11 are classified as Rural.

4.1 Financial Sustainability Ratings

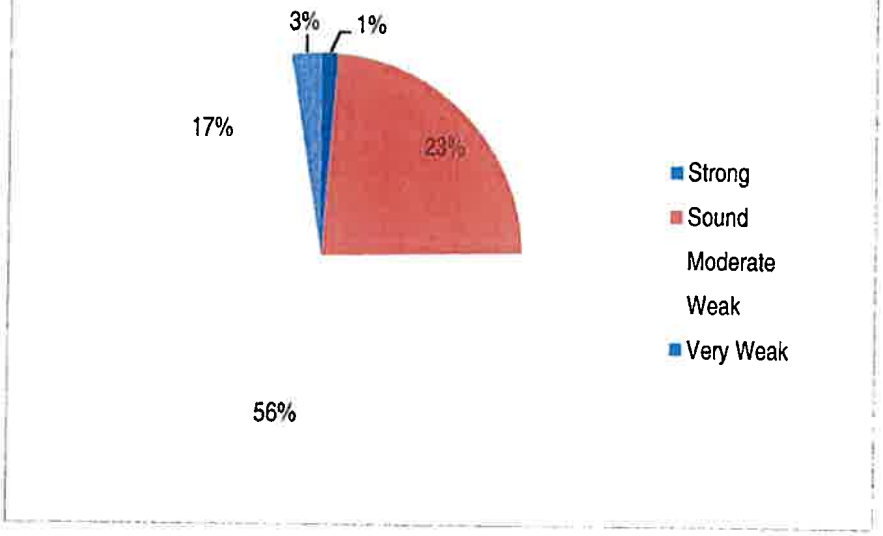
Graph 5 below shows that 113 or 74.3% of Councils have been given an FSR Rating of Moderate or above, while 39 or 25.7% were assigned a Rating of Weak or Very Weak. No Councils were assigned an FSR of Very Strong or Distressed.

Graph 5 - FSR Rating Distribution

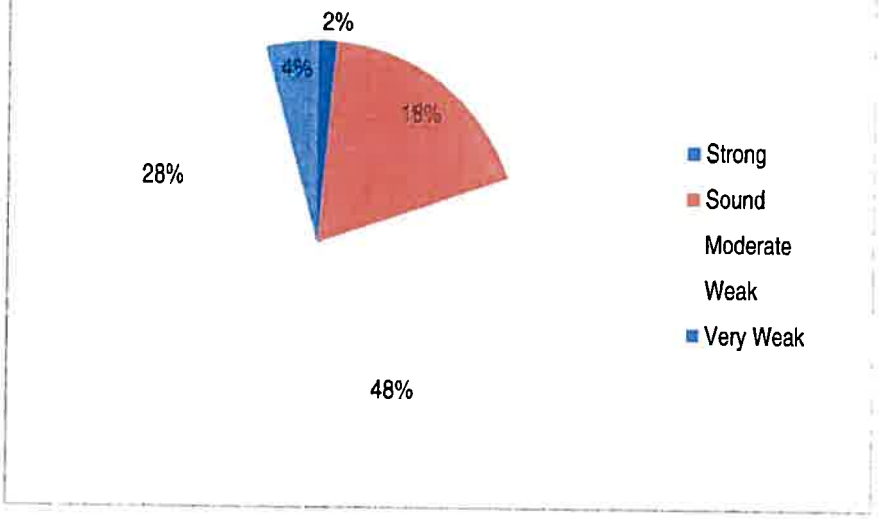


Looking at the break down of the FSR ratings, there are significant differences between Urban and Rural Council FSR ratings. For Urban Councils, 65 or 80.2% were rated Moderate or stronger. For Rural Councils, 48 or 67.6% of Councils were rated Moderate or stronger.

Graph 6 - Proportion of FSR for 81 Urban Councils



Graph 7 - Proportion of FSR for 71 Rural Councils

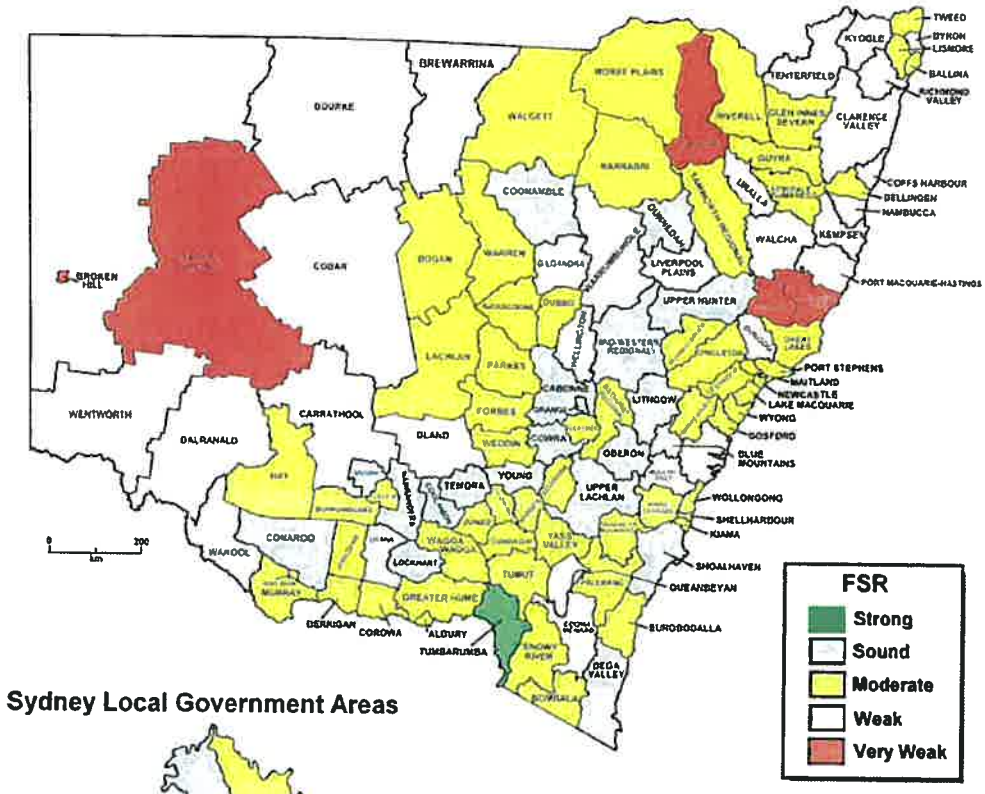


New South Wales
Treasury Corporation

The maps below show the FSR distributions across the LGAs in NSW.

Graph 8 - FSRs of NSW LGAs

NSW Local Government Areas



Sydney Local Government Areas

Sydney Urban Local Government Areas

4.2 Factors Affecting the FSR

4.2.1 Features of a Sustainable Council

TCorp's scope of work did not include the requirement to conduct an exhaustive comparative analysis of Councils to investigate what fundamentally drives the differences between a Council that is rated as Strong and a Council that is rated as Weak, especially if they have similar demographics or are within the same DLG group. That is, what are the better performing Councils doing that can be adopted by other Councils? However, TCorp has some observations that could be considered.

The simple answer to the question of what makes a good Council is:

Good management and a good Council working together with their community

While a high population density and low reliance on external sources of funds are important factors to a sustainable Council, other factors which can assist their sustainability position include:

- Quality management and staff
  - An experienced management team which understands the business and are focused on sustainability
  - Appropriately qualified engineering staff who are able to understand relevant tasks required
  - Skilled grant officers and financial reporting staff which produce quality reporting data to assist in decision making and in the application for grants
  - Ability to attract and secure quality and skilled employees
  - Rural Councils are able to use State road contracts to provide some critical mass for the Council's roadwork team and equipment. It also helps in attracting and retaining expertise in the engineering area
- A responsible Council that understands its role
  - It is important for the Council to have a long term vision particularly when it manages assets with long useful lives
  - In respect of capital expenditure, Councils should concentrate on 'fit for purpose' standards for its assets and at levels agreed with the community
- Good reporting and budgeting
  - Conservative budgeting can be used as a tool to keep pressure on operating budgets. Surpluses generated can be allocated for capital expenditure
  - Producing good quality data and reports so that a Council is able to secure its appropriate entitlement of grants, such as flood grant funding

4.2.2 Urban Councils

Given that population density is an important factor in sustainability, a lesser portion of Urban Councils have been assigned a Weak or Very Weak rating compared to Rural Councils. However, 19.8% of Urban Councils are still considered Weak or Very Weak. Most of these Councils were in regional areas outside of Sydney. Some of the factors which contributed to a low FSR score for Urban Councils are:

- Substantial increases in employee expenses particularly workers compensation and superannuation
- High Infrastructure Backlogs and an inability to reduce this in the short term
- Underspending on asset maintenance and renewal
- Incomplete AMPs and Asset Revaluations which presents risks to their forecasts and reported numbers
- Substantial and unmitigated risks from undertaking major projects

4.2.3 Regional Factors Impacting Sustainability

In conducting the review, TCorp has identified particular geographical regions which had relatively lower FSR and Outlooks when compared to other regions. This is not to say that all Councils in these areas were lower rated, with some regions having a large range of outcomes from Sound to Very Weak. In particular, two regions stood out as having lower FSR and Outlooks.

These two regions are firstly, the coastal and near coastal areas of the north coast of NSW, where 11 Councils are rated by TCorp as being in the lowest 24 FSR rated Councils in NSW. The second region covers the most western areas of NSW where eight Councils are in the lowest 24 FSR rated Councils in NSW.

We have considered these further and identified some factors affecting these regions.

In the north coast region, many of these Councils have some or all of the following characteristics:

- Highly prone to floods and storms (which have been prevalent in recent years)
- The coastal Councils suffer from holiday peak crowds that place great pressure on facilities
- Due to the popularity of many of these Council areas for retirement, ageing populations are a significant issue
- High demand for a large variety of services due to the age mix of the local (and tourist) populations

In the western region, most of these Councils have some or all of the following characteristics:

- Declining populations
- Large land areas and road networks
- Very low population densities
- Low rate bases so Councils are heavily reliant on government operating and capital grants
- Susceptible to the full range of natural disasters of drought, floods and bushfires

Whilst many other Councils in NSW will also have some or all of these features, they are not in general affected by these factors to the same extent as these two regions.

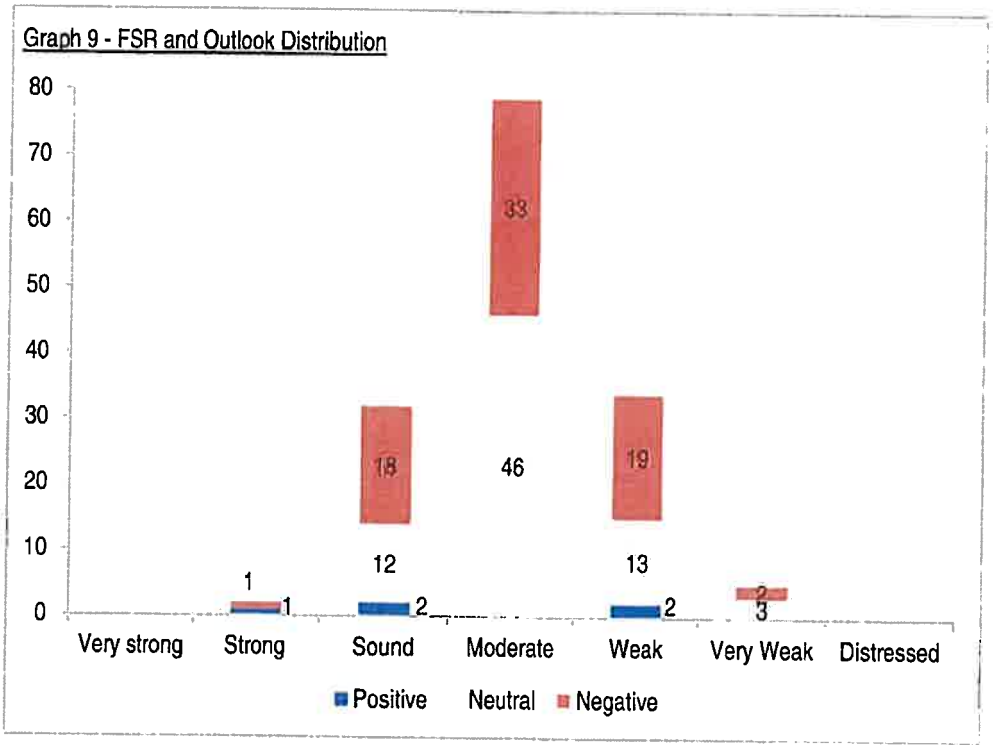
4.3 Outlooks

Table 8 and Graph 9 below shows the Outlooks assigned to all Councils.

Table 8 - Outlook Distribution

Outlook	Count	Percentage
Positive	5	3.3%
Neutral	74	48.7%
Negative	73	48.0%

Graph 9 - FSR and Outlook Distribution

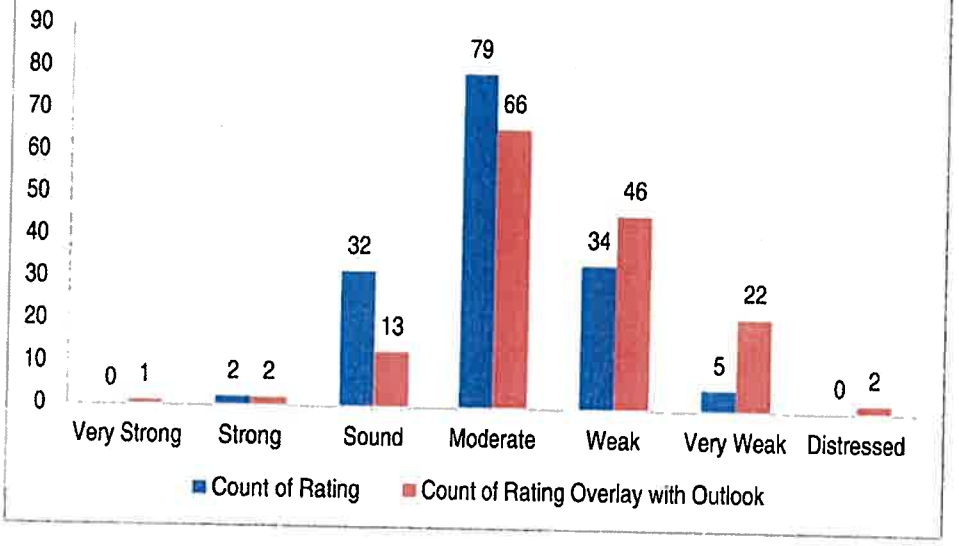


Outlooks are assigned based on the potential movement in a Council's FSR within the next three years. The Outlooks are Positive, Neutral or Negative. An Outlook does not necessarily mean that a FSR Rating will change, but it is deemed to be the most likely potential movement in an FSR based on current known risks and financial forecasts. A Negative Outlook means that there is a potential for deterioration in a Council's ability to meet its financial commitments in the short term and resulting in a change in rating. A Positive Outlook is less commonly assigned because there are fewer circumstances where there is a positive foreseeable event which, because of the risk of it not eventuating, has not already been incorporated into the FSR itself.

TCorp's assessment of the Outlooks shows that only five Councils have a Positive Outlook while 73 Councils or nearly 50% have a Negative Outlook.

To demonstrate the potential impact on each Council's FSR, the figures on the previous page, firstly in Graph 9, the Outlooks in each of the FSR categories. For example, it shows that of the current 32 Councils with a Sound FSR Rating, two have a Positive Outlook, 12 a Neutral Outlook and 18 a Negative Outlook. Consequently, if all of the Outlooks eventuated then Councils' FSR Ratings would be amended to the FSR Ratings shown in Graph 10 below.

Graph 10 - FSR Overlay with Outlook



If these Outlooks eventuate, many Councils will be in a weakened position. Under this potential scenario, 82 Councils (53.9%) would be rated as Moderate or stronger, with 70 Councils (46.1%) rated as Weak, Very Weak or Distressed.

The rationale for a larger number of Negative Outlooks can be found if consideration is given to the major changes that Councils have been going through in the past five years. In particular, with the introduction of the IP&R, and the requirement for Councils to undertake a revaluation and reassessment of their assets, including preparation of a comprehensive AMP, and 10 year financial forecast, the likelihood of future financial unsustainability of Councils has become much clearer.

It should be noted that for many Councils, there is still much work to be done in upgrading their IP&R documentation and their 10 year LTFP. As this occurs, it may be that some of the Negative Outlooks would be removed as the perception of risk currently attached to Councils that, for instance, currently have not prepared or fully integrated their AMP into their LTFP, will be removed and a Neutral Outlook determined. Only further and ongoing analysis in the future will determine if these Outlooks should change.

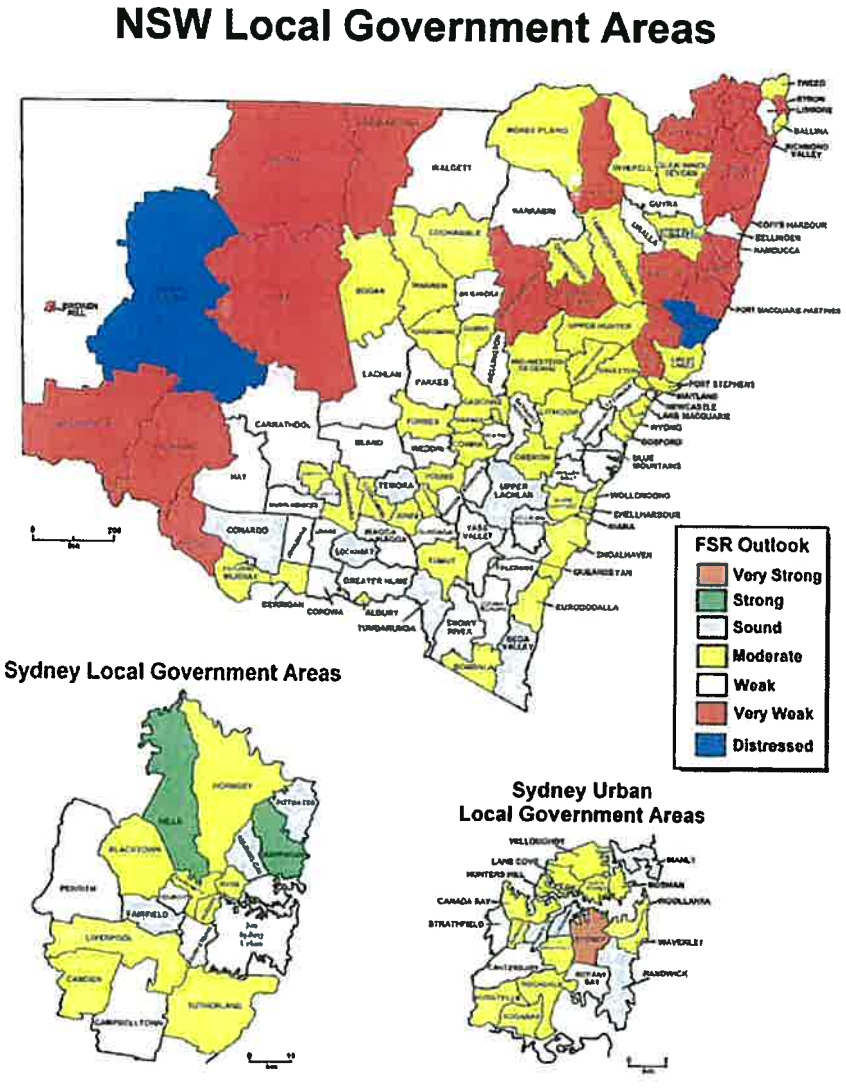
An overall review of this data provides the following key observations:

- Overall, there is a greater percentage of Urban Councils (24.7%) than Rural Councils (19.7%) which TCorp consider to be Sound or better

- There is a much higher percentage of Rural Councils (32.4%) which TCorp considers to be Weak or Very Weak compared to Urban Councils (19.8%)
- Based solely on their FSR, no Councils were rated as either Very Strong or Distressed
- One Urban Council has a Strong FSR with a Positive Outlook and TCorp would expect that Council to achieve a Very Strong rating within the next few years. Two Rural Councils are rated Very Weak with a Negative Outlook both these Councils are expected to have a Distressed rating within the next few years

The map below shows the regional distribution of this FSR overlay analysis. When compared with the previous map in section 4.1, more Councils are in the Weak or worse FSR category.

Graph 11 – FSR Overlay Maps



4.3.1 Factors in Determining the Outlook

Some of the factors which contributed to a Council receiving a Positive Outlook include:

- Successful SRV applications which will likely improve Council's operating results to the next FSR category
- A detailed program of maintenance and renewal works to reduce the Infrastructure Backlog
- Additional own sourced revenue in the short term which would improve Council's financial flexibility
- Proactive in seeking cost savings and efficiency programs are in place

Some of the factors which contributed to a Council receiving Negative Outlook are:

- Declining operating results which are likely to continue in the short to medium term
- Incomplete AMPs and Asset Revaluations which present a downside risk to Council's operating results including an underestimate of the Infrastructure Backlog, required annual maintenance and significant increase in future depreciation expense
- Incomplete or LTFPs with unreasonable assumptions and Council's forecast results appear to be too optimistic
- Historical trend of underspending on maintenance and infrastructure renewal which can lead to an increase in the Infrastructure Backlog
- Council is embarking on a major project with high level of risk
- Shifts in population including a declining population and ageing population which may not lead to immediate or short term decline in operating results but could impact the Council's long term sustainability

For Councils assigned a Negative Outlook, TCorp has provided some recommendations and areas of investigations to assist in improving the sustainability position. The recommendations include:

- The need to source additional revenue, such as under an SRV, to improve financial flexibility and to assist in reducing the Infrastructure Backlog
- For Councils with the borrowing capacity, consider using debt funding to reduce the Infrastructure Backlog and improve intergenerational equity
- Devising programs and strategies to contain rising costs and improve efficiencies
- Further improvement required in AMPs and integration into the LTFP
- Update the LTFP to reflect reasonable assumptions based on the current understanding of future trends
- Increasing spending on maintenance and infrastructure renewal, balancing this with the need for capital expenditure on new assets
- Careful risk management and contingencies need to be in place when embarking on a major project

4.4 Key Financial Indicators

Table 9 below shows the results for all Councils for the five most important FSR financial indicators from TCorp's perspective.

Table 9 - Results of Key Financial Indicators

Indicator	Quantitative Measure	Definition	Benchmark	Average Historical Results	2012 Result
Operating Ratio	Measures a Council's ability to contain operating expenditure within operating revenue	(Operating revenue excluding capital grants and contributions less operating expenses) / Operating revenue excluding capital grants and contributions	> (4.0%)	(4.0%)	(4.4%)
Own Source Operating Revenue 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	Rates, utilities and charges / total operating revenue (inclusive of capital grants and contributions)	> 60%	57.6%	56.7%
Unrestricted Current Ratio	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	Current assets less all external restrictions / current liabilities less specific purpose liabilities	> 1.5x	3.60x	3.80x
Capital Expenditure Ratio	Indicates the extent to which a Council is forecasting expansion of its asset base with capital expenditure spent on both new assets, and replacement and renewal of existing assets	Annual capital expenditure / annual depreciation	> 1.1x	1.49x	1.20x
Infrastructure Backlog Ratio	This ratio shows what proportion the backlog is against total value of a Council's infrastructure	Estimated cost to bring assets to a satisfactory condition / total infrastructure assets	< 0.2x	0.14x	0.13x

The overall performance of Councils (when measured using averages) against these benchmarks appears reasonably satisfactory, with the exception of the Infrastructure Backlog.

When the results are broken down and shown by FSR Group, a much greater variation in performance is apparent.

Table 10 - Councils which meet or exceed benchmark in 2012 (by FSR)

Rating	Strong		Sound		Moderate		Weak		Very Weak		Total	
Total Rated Councils	2		32		79		34		5		152	
Ratios												
Operating Ratio	2	100%	28	88%	45	57%	4	12%	-	-	79	52%
Own Source Operating Revenue Ratio	1	50%	17	53%	40	51%	12	35%	-	-	70	46%
Unrestricted Current Ratio	2	100%	31	97%	79	100%	28	82%	2	40%	142	93%
Capital Expenditure Ratio	2	100%	27	84%	48	61%	8	24%	2	40%	87	57%
Infrastructure Backlog Ratio	-	-	8	25%	3	4%	1	3%	-	-	12	8%

The key observations from this data are:

- As can be expected, performance against benchmarks trend lower as the FSR rating of Councils weaken
- Only 12 Councils (8%) meet the Infrastructure Backlog Ratio benchmark
- 54% of Councils (82) do not meet the Own Source Operating Revenue ratio, which indicates high reliance on external funding sources such as operating grants and contributions
- The strongest performance, with 142 Councils (93%) meeting the benchmark, is in respect of the Unrestricted Current ratio, indicating Councils have been able to maintain acceptable liquidity positions
- Only 87 Councils (57%) invested sufficient funds in capital expenditure in 2012

4.5 Feedback to Councils

Whilst it was not a core component of the role that TCorp was engaged to undertake, in preparing individual reports for each Council TCorp generally provided some constructive feedback to Councils.

By way of example, for some Councils TCorp noted the need for a greater focus on the basis of the assumptions that underpin their LTFP. Also, a lack of linkage to strategic plans and historical performance was evident in some of the reviews of the assumptions.

In some of the reviews TCorp was able to highlight to Councils that the forecast LTFP resulted in extremely adverse outcomes (such as insolvency), giving Councils the opportunity to look at addressing these. Some poor forecasts are simply modelling problems which can be addressed relatively easily, while others will require more significant changes in assumptions and in some cases, reviews of service levels.

In other cases TCorp was able to highlight anomalies in historical performance which showed that a Council needed to increase its focus either on particular areas of expense or to consider whether a Council should discuss with their community the desire and need for a SRV.

It was not within TCorp's mandate to do anything other than provide information to Council for their consideration or to suggest opportunities for further investigation.

5. Analysis of Data

5.1 Issues in the Analysis of Data

In reviewing the data collected during the assessments of all 152 Councils, a number of issues need to be considered to put in context the recent developments in respect of Council's financial and management reporting. These developments should be noted when reviewing the findings from the assessment process undertaken by TCorp.

5.1.1 IP&R

It is important to remember the developments in recent years by the DLG and Councils as they have worked towards supporting a strategic approach to planning and reporting of Councils. Initiatives such as the introduction of the IP&R system in 2009 has seen Councils develop plans in respect of:

- Community Strategy
- Long Term Financial Planning
- Asset Management
- Workforce Management

As the IP&R has been progressively introduced, Councils are at different stages of their development of the IP&R documentation. For many Councils it will take some time for a high level of accuracy to be achieved particularly in respect of Asset Management Planning, and the financial impacts that flow from quality plans to maintain assets.

5.1.2 Asset Revaluations

The Asset Revaluation process has required Councils to report assets at fair value and review the values on a continuous basis. This involves a review of the depreciation rates, useful lives and residual values of their assets, and reflecting these amendments in their financial accounts. For many Councils, this has resulted in significant changes not only to asset values shown in their balance sheets but also impacted their annual depreciation expenses, capital expenditure programs, and annual maintenance requirements.

For example, the total annual depreciation for all 152 Councils has increased by $638.0m (41.3%) from 2009 to 2012, whilst the value of infrastructure has increased by $24.9b (52.5%) over the same period.

5.1.3 LTFP Assumptions

Each Council prepared their own financial models and LTFP using their own forecast assumptions. As a result of not having consistent assumptions there is a large variation between quality of data and forecasting techniques.

In order to evaluate the reasonableness of a Council's forecast model, TCorp has compared the model assumptions with TCorp's benchmarks and historical trends for annual increases in the various revenue and expenditure items. Any material differences from these benchmarks should have been explained through the LTFP. Some of the issues identified during this process include:

1. **Incomplete forecasts** - Given that many Councils are still in the developing stage of the IP&R process, some Councils have not produced a full LTFP which includes an income statement, cash flow statement and balance sheet. Each of these financial statements display different information which is important in the understanding of the Council's overall future financial position.

2. **Unrealistic assumptions** - Some assumptions are inconsistent with historical performance, overly optimistic, overly conservative, or have no adequate explanation provided as to the basis of the assumption. Councils may input unrealistic, 'wish list' assumptions with the aim of producing a particular outcome but then lack supporting evidence which casts doubt on the achievability of the forecast results.

3. **The need to review LTFP results** - Some financial forecasts, particularly in the long term, produce results which show the Council as insolvent or with severe liquidity issues. Further discussions with these Councils often reveal that this is due to poor financial modelling techniques and unrealistic assumptions. A thorough internal review of the model outcomes would have resolved these errors or highlighted to Council areas of concerns so strategies to overcome them could have been developed.

4. **Real versus nominal** - Some Councils use real, instead of nominal numbers, and a combination of both real and nominal numbers was seen in one forecast. The limitation of a forecast using real numbers is that different revenue and expenditure items may increase at different inflation rates, with many items increasing at a faster rate than CPI. A forecast using real numbers is not an accurate reflection of the overall future financial position.

5. **Understanding of the base case and scenarios** - Councils should develop a "base case" LTFP demonstrating the most likely financial outcomes, using current assumptions. This provides a good foundation to analyse any weaknesses and improvements. A Council should consider the risks around the assumptions used and develop some "scenario cases" to demonstrate other possible outcomes. This will highlight areas of high risks and strategies that can be considered should the scenarios eventuate. Councils can also test the financial impact of any strategies they are considering such as an SRV application or new major project.

6. **Frequency of updates** - Whilst revenue and expense drivers are constantly evolving, Councils should update their LTFP on a timely basis to reflect shifts demonstrated from the production of historical accounts or likely to result from the introduction of major initiatives.

7. **Lack of linkage between strategic plans, AMP and LTFP** - Councils need to develop an understanding of the financial impact of their strategies and AMP, and understand their full funding requirements. As many Councils are still in the developing stage of the IP&R process, the integrations are not strong. For example, future capital expenditure requirements are not reflected in the LTFP and the financial impact cannot be analysed.

8. **Lack of 10 year capital expenditure forecasts** - Councils own and operate mostly long term assets. Councils LTFP should consider the renewal and replacement costs of these assets and the funding requirements, but often Councils forecasts of capital expenditure do not stretch beyond a short to medium term horizon (less than five years). Further development in AMPs and integration to the LTFP should improve this area.

9. **Depreciation expenses forecast are often understated** - Many LTFPs have not included sufficient depreciation expense forecasts which reflect the latest information on assets' useful lives, depreciation rates and fair values, plus increased depreciation costs from future capital expenditures. Some Councils have used a static depreciation cost number across the 10 forecast years which is unrealistic.

10. **Revenue and expenses assumptions are not aligned** - Conservative assumptions in revenue items or expense items are not aligned with the consequential expense or revenue items. For example, an additional revenue source needs to be matched by the incremental expense increase and, a reduction in operating grants needs to be aligned with changes in services and costs.

11. **Employee numbers and costs** - Many Councils have recently experienced high increases in employment costs, particularly workers compensation costs and employee entitlement costs. There is little evidence to suggest that these Councils' recent experiences with employee numbers and cost increase drivers are included in the LTFP. For example, LTFPs with reduced employee expenses should reflect cost reduction strategies and/or reduced services.

12. **Internal transactions** - Different Councils have treated internal transactions between funds in a different manner and often inconsistently with the audited financial statements. This makes comparisons between historical and forecasts, and between Councils difficult.

13. **Cash reserves build up** - In the medium to long term section of some LTFPs, cash reserves are built up and are not spent on capital expenditure, or not invested in higher yielding term deposits. This either underestimates Council's future capital expenditure program or underestimates the Council's investment revenue.

5.1.4 Council Reporting by Fund

Councils in NSW generally segregate their functional structure that may include, a General Fund, Water Fund and Sewerage Fund. The funds from each of these Funds are restricted to be used in that particular Fund unless the Council has approved internal borrowings between the Funds. For Councils

that do not directly provide water or sewerage services, as they are for example, provided by Sydney Water or a regional County Council, only a General Fund may be operated.

The different funds are used as IPART regulates the ordinary rates that apply to the General Fund but not to the Water or Sewer Funds, so these amounts need to be separately reported.

In conducting its analysis, TCorp has focused on the consolidated results of Councils for their historical data and predominantly on the General Fund for the forecast data. On a few occasions, TCorp has used consolidated results for both historical and forecast numbers as the Water and Sewerage Funds were not a material part of the Council operations, or full data was not available.

5.1.5 Presentation of Financial Data

Conscious of the issues raised, in preparing the FSR and Outlook rating, TCorp considered the performance of Councils against the key areas of:

- Financial flexibility
- Liquidity
- Debt servicing capacity
- Capital works and asset renewals

For the aggregate forecast information, TCorp have only included the 2016 figures as a snapshot to give a general idea of the likely medium term trend. Not all the forecast years have been aggregated because of the variations between the Councils in assumptions, model format and quality of data.

In undertaking its review and assessment of each Council TCorp attempted to remove one-off adjustments that were reported in some Councils accounts, so that TCorp could focus the analysis on core operating performance. Examples of adjustments made include:

- Exclusion of all capital grants and contributions
- Exclusion of gains/losses on disposal of assets (where not part of normal business)
- Exclusion of revaluation increments or decrements

5.2 Financial Flexibility

TCorp's two key indicators of financial flexibility are:

- Operating performance
- Own source operating revenue

In the local government sector, operating performance is just as important as it is with any private sector business and other levels of government, when considering the long term capacity to meet the on-going funding requirements of a business.

5.2.1 Operating Performance

We have measured operating performance using the following ratio

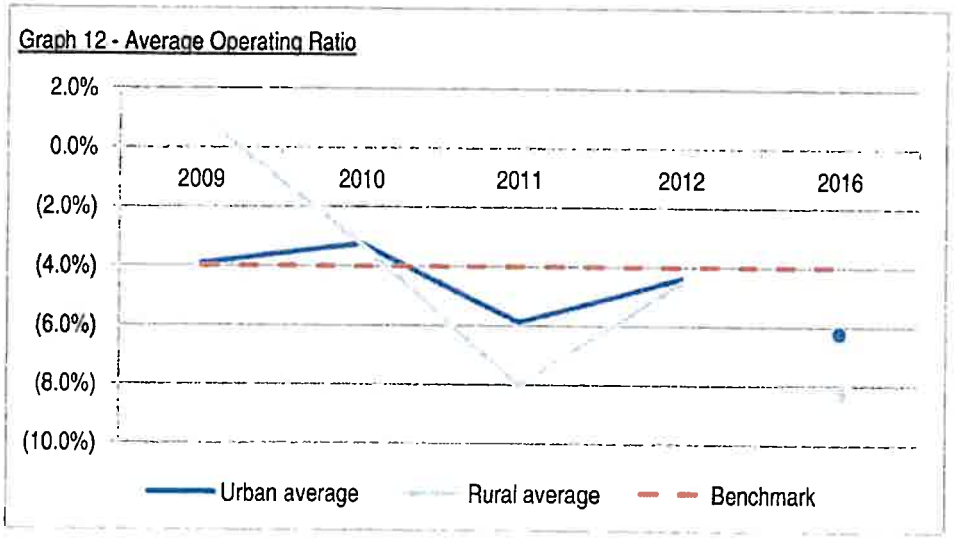
$$Ratio = \frac{Operating\ revenue\ excluding\ capital\ grants\ and\ contributions - operating\ expenses}{Operating\ revenue\ excluding\ capital\ grants\ and\ contributions}$$

This ratio measures a Council's achievement of containing operating expenditure within operating revenue. It is important to distinguish that this ratio is focussing on operating performance and hence capital grants and contributions are excluded.

The Benchmark we have used is greater than negative 4%.

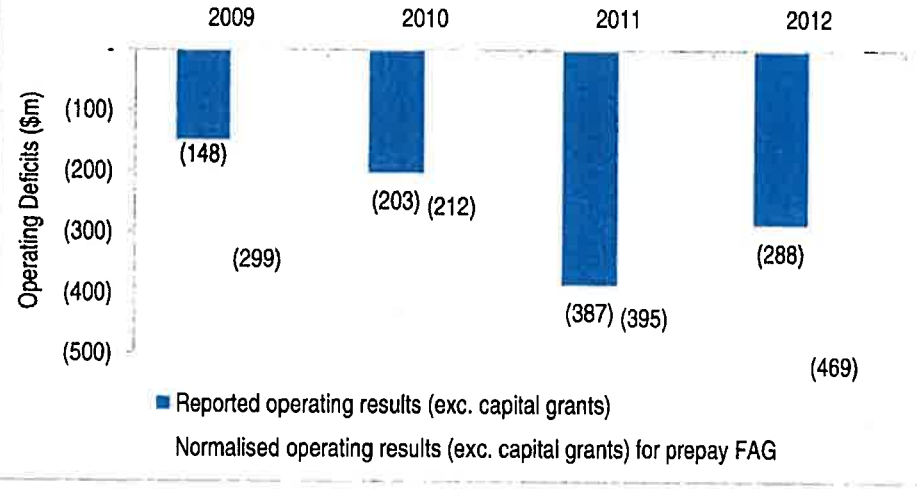
Whilst TCorp has used in its initial benchmark assessment, a benchmark of greater than negative 4% for the short term, TCorp views that Councils, for this benchmark, should be achieving at least a breakeven operating position, on average, over the long term. Councils should seek to move to a break even position as soon as possible to prevent further deterioration of their financial position.

Graph 12 - Average Operating Ratio



Based on TCorp's analysis, over the Review Period, the local government sector in NSW has reported a net operating deficit (which excludes capital grants and contributions) of $1.0b. The results deteriorated over the period from 2009 to 2011, and improved marginally in 2012. The results over the period were favourably impacted at least partly by the Federal Government decision to prepay some of the Financial Assistance Grant (FAG) to Councils in a previous financial year. If the effects of these prepayments were excluded, the operating deficits for the Review Period would be in line with Graph 13 below. The results in the 2012 year are particularly skewed because half of the 2013 entitlements were prepaid in 2012 whereas a quarter of the FAG was prepaid in the years from 2009 to 2011.

Graph 13 - Total Operating Deficits of 152 Councils Adjusted for FAG Prepayments

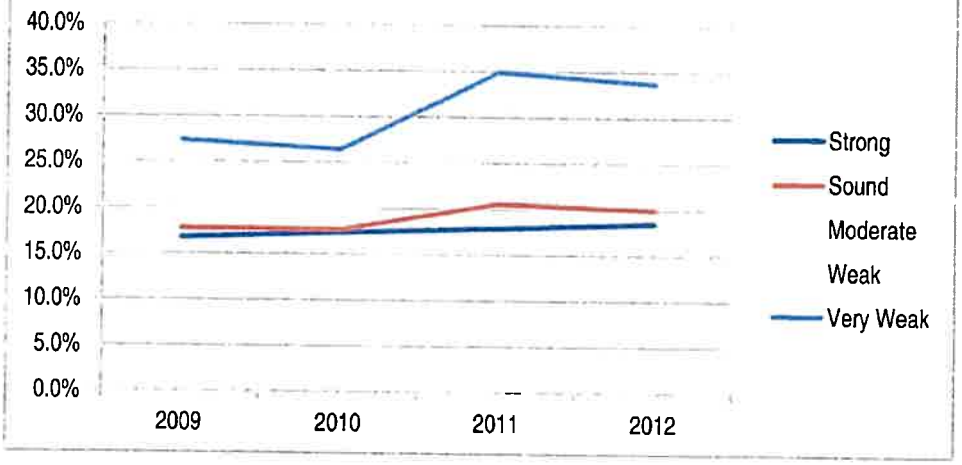


The adjusted numbers demonstrate the scale of the problem facing the local government sector. Assuming no prepayment of FAG occurs in the 2013 financial year, Councils will receive around $537.5m less from FAG compared to the 2012 year (excluding the adjustments to be made for CPI and population updates). This is likely to have a major adverse impact on Councils' reported results for the 2013 financial year, where potentially an operating deficit of up to $1.0b could be reported.

TCorp notes that as Councils received the prepayment in 2012, Councils' cash reserves and investments for 2012 increased by $530.0m to $6.8b.

5.2.1.1 Impact of Depreciation

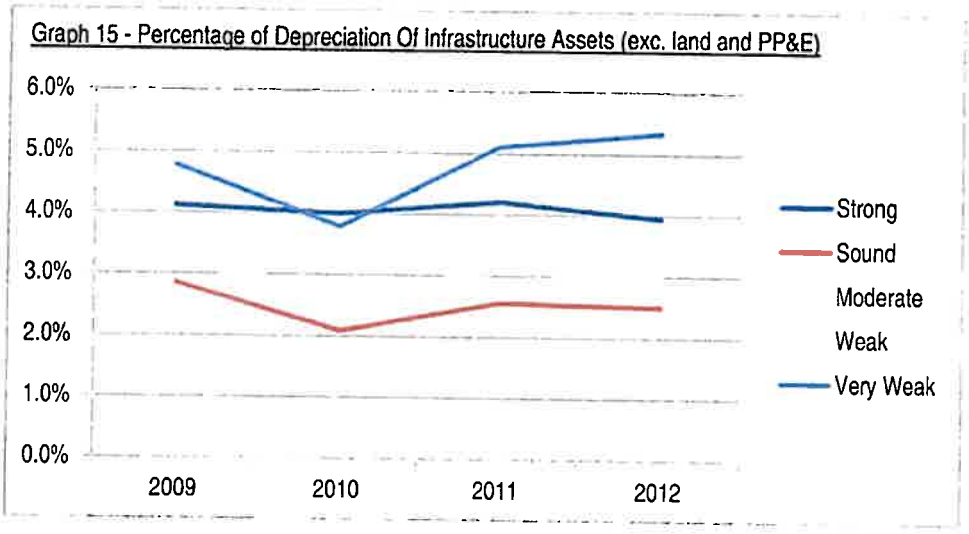
Graph 14 - Percentage of Depreciation Of Expenses



The Asset Revaluations process that commenced in 2009 has seen major changes in the value of Council assets and annual depreciation charges. These impacts are also flowing through to future capital expenditure requirements and programs as Councils act on their improved understanding of asset values, maintenance and renewal costs.

The treatment of depreciation expense remains a contentious issue amongst some Councils. While TCorp acknowledges the non-cash nature of depreciation, it is an important expense as it represents the allocation of the value of an asset over its useful life. Without the recognition of the depreciating nature of assets and the need to expense the estimated annual use of that asset, Council accounts would not accurately reflect the true position of the asset base of the Council.

Over the Review Period, annual depreciation and amortisation charges increased from $1.5b in 2009 to $2.2b in 2012, an increase of $638.0m (41.3%).



Whilst the majority of Councils have substantially completed their first round of Asset Revaluations, the ongoing development and implementation of asset management planning will continue to have an impact for several more years. As Councils either complete or fine tune their asset plans with asset lives, depreciation rates and residual values of assets will be reviewed and then incorporated into the LTFP of the Council.

TCorp's analysis shows that Councils with a higher FSR generally have a lower average rate of depreciation, and depreciation represents a lower percentage of total expenses. These two observations are consistent across most of the rating groups so that the stronger the FSR rating, the lower the depreciation rate and the lower the proportion of depreciation as a percentage of total expenses.

The lowest total annual depreciation levels are around 2.5% (as a percentage of infrastructure values) with the highest being 5.3%. For the Councils rated as Strong, depreciation represents around 18.5% of expenses whilst for weaker Councils it can be as high as 33.8% of total expenses.

This observation could be a combination of inaccurate or incomplete AMPs, and assessments of remaining useful lives and depreciation rates where further investigation is required by Council to consider this issue.

5.2.2 Own Source Operating Revenue

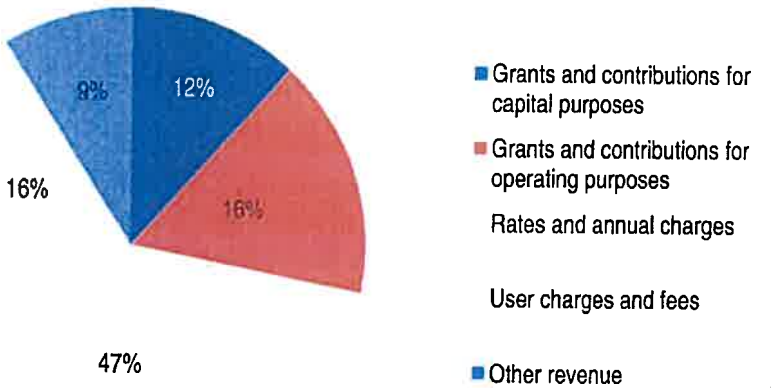
This ratio measures fiscal flexibility. It is the degree of reliance on external funding sources such as operating grants and contributions. A Council's financial flexibility improves the higher the level of its own source revenue.

$$Ratio = \frac{\textit{rates, utilities and charges}}{\textit{total operating revenue (inclusive of capital grants and contributions)}}$$

The benchmark is greater than 60%.

The following pie chart shows the major categories of revenues for Councils.

Graph 16 - Sources of Revenue in 2012



Over the Review Period, rates and annual charges have remained static as a percentage of total revenues. At 47%, rates and annual charges is the most important category of Council revenue.

IPART sets the maximum allowable increases in rates each year based on a review of the Local Government Cost Index that they have developed.

NSW is the only State in Australia that uses an independent body to set rates for Councils.

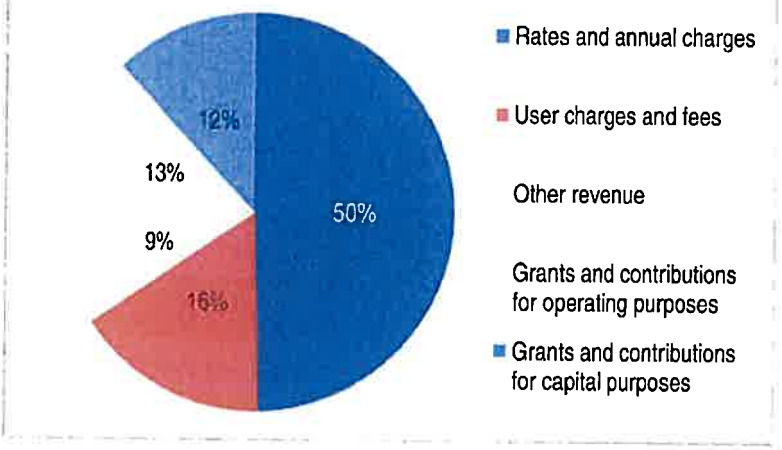
In addition to the annual rate setting process, IPART also considers applications for additional rate increases in excess of the general rate peg increases, under the process known as SRV.

Over the Review Period, the revenue mix for Councils has been relatively stable as shown in Table 11.

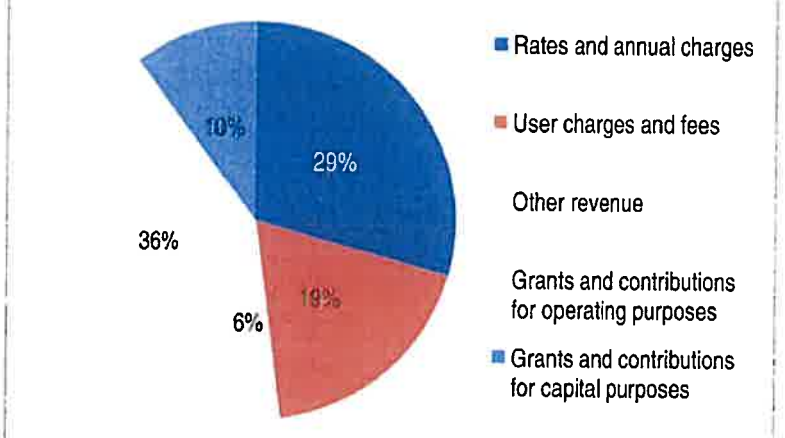
Table 11 - Sources of Revenue for 152 Councils

	2009 ($'000)	2009 (%)	2012 ($'000)	2012 (%)
Grants and contributions for capital purposes	1,182,627	13.2%	1,230,196	11.7%
Grants and contributions for operating purposes	1,377,901	15.4%	1,717,587	16.4%
Rates and annual charges	4,169,757	46.7%	4,865,958	46.5%
User charges and fees	1,455,219	16.3%	1,720,475	16.4%
Other revenue	744,401	8.3%	941,125	9.0%
Total revenue (inc. capital grants)	**8,929,905**	**100.0%**	**10,475,341**	**100.0%**

Graph 17 - Sources of Revenue at 2012 for 81 Urban Councils



Graph 18 - Sources of Revenue at 2012 for 71 Rural Councils

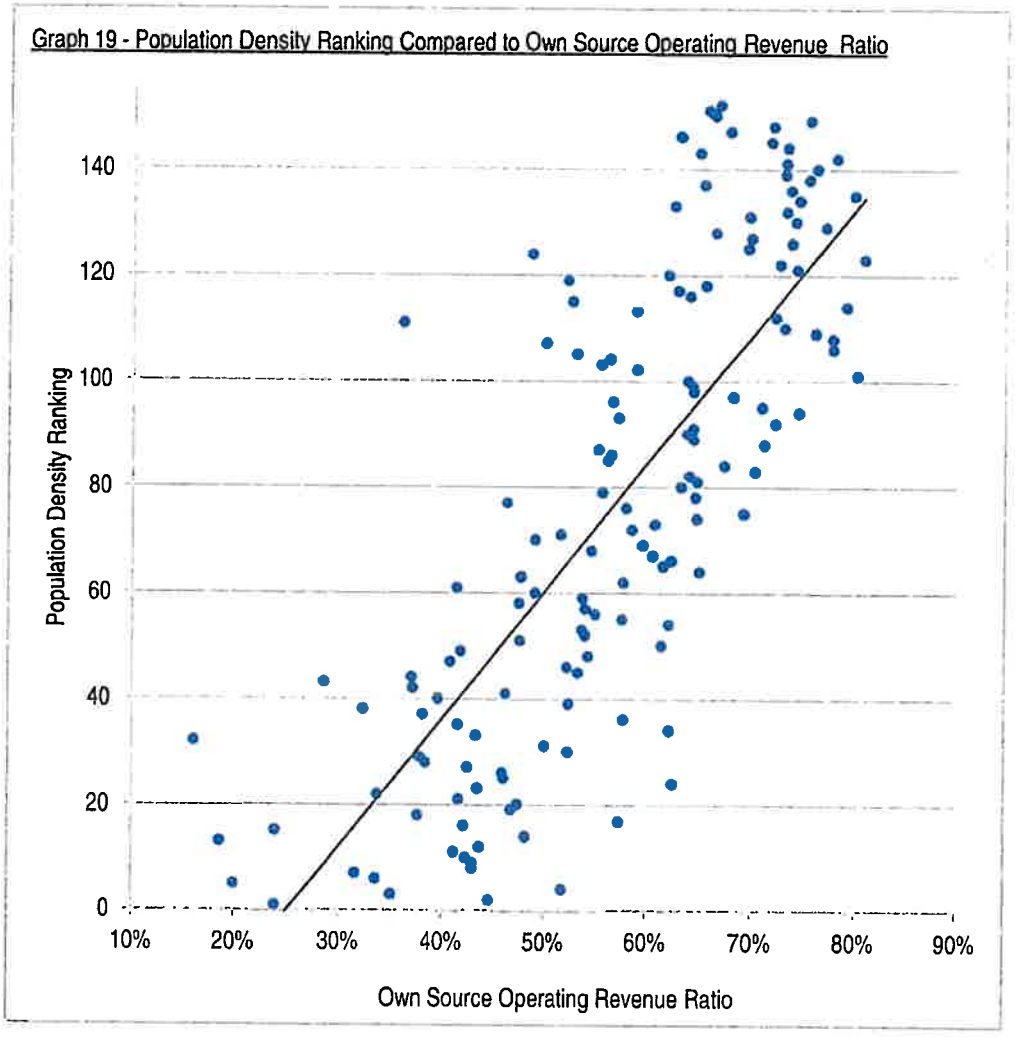


The pie charts on the previous page highlight differences between the sources of revenue for Urban versus Rural Councils. Whereas 50% of Urban Councils revenue is derived from rates and charges, for Rural Councils the proportion is 29%.

Operating grants and contributions make up 13% of the total revenue for Urban Councils, whilst 36% of total revenue for Rural Councils is obtained from this source. This clearly demonstrates the reliance of rural Councils on these operating grants and contributions as a major source of revenue.

The analysis also supports the view that population density has a strong relationship with the generation of own source operating revenue and sustainability. The graph below shows that that there is a statistically significant correlation between population density and the Own Source Operating Revenue Ratio. In general, the higher the population density of the LGA, the less reliant the Council is on external funding.

Graph 19 - Population Density Ranking Compared to Own Source Operating Revenue Ratio



5.3 Liquidity

5.3.1 Unrestricted Current Ratio

TCorp's key indicator for liquidity is:

- Unrestricted Current Ratio

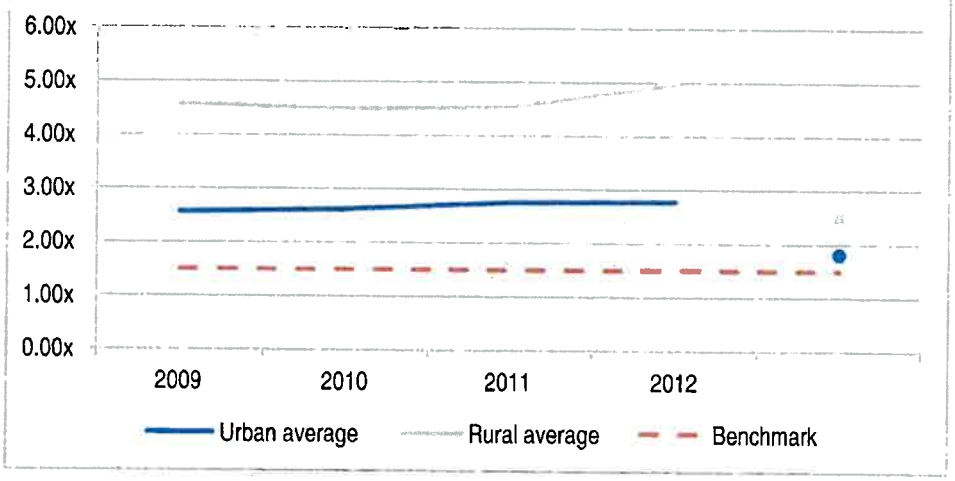
Restrictions placed on various funding sources (e.g. Section 94 developer contributions, RMS contributions) complicate the traditional current ratio used to assess liquidity of businesses as cash allocated to specific projects is restricted and cannot be used to meet a Council's other operating and borrowing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

External restrictions include externally restricted funds held in Water and Sewerage Funds.

$$Ratio = \frac{Current\ assets\ less\ all\ external\ restrictions}{current\ liabilities\ less\ specific\ purpose\ liabilities}$$

The benchmark is greater than 1.5x.

Graph 20 - Average Unrestricted Current Ratio



The above graph indicates that rural Councils maintain a more conservative position in respect of their Unrestricted Current ratio, although both groups are well above benchmark.

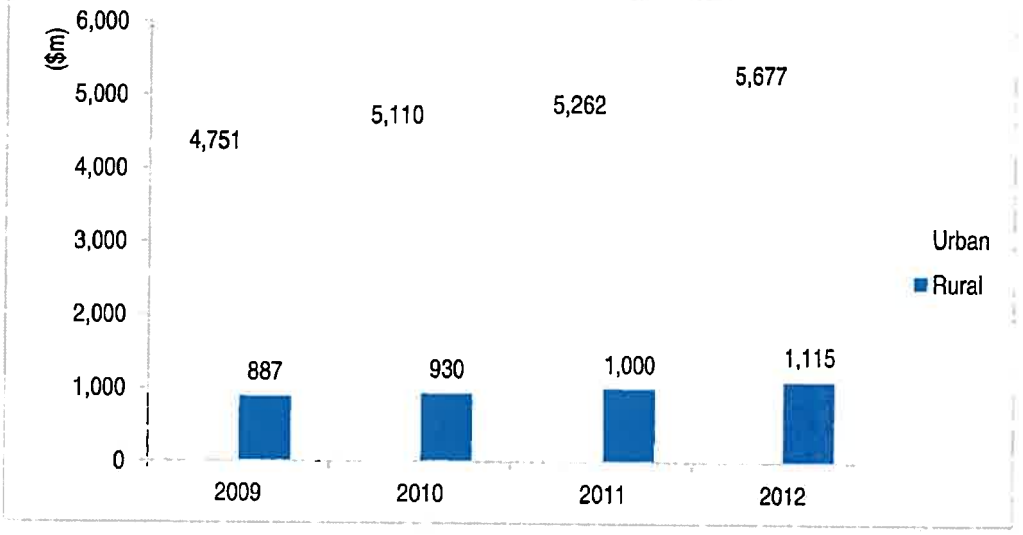
5.3.1.1 Investments

To support their liquidity positions, Councils have three major categories of cash reserves:

- Cash and cash equivalents – for working capital purposes and usually defined as maturity of less than three months
- Short term investments (includes term deposits of three to 12 months)
- Longer term investments

The graph below shows the movement in Councils' cash reserves over the Review Period. In 2012, invested funds by all Councils increased by $530.0m from 2011, largely driven by the Federal Government decision to prepay half of the 2013 Financial Assistance Grants.

Graph 21 - Total Cash and Investments for 81 Urban and 71 Rural Councils



As noted above, Councils have restrictions imposed on some of their cash reserves as these restricted funds can only be used for specific purposes. The level of restriction placed on reserves can vary significantly across Councils but it can be as much as 80% of reserves. Overall, the externally restricted funds average between 50% and 60% of all funds held.

Urban Councils have 5.5% of Net Assets in cash and investments, while Rural Councils have 5.7% of the Net Assets in cash and investments.

5.3.2 Debt Servicing Capacity

TCorp's key indicator is:

- Debt service cover ratio

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

$$Ratio = \frac{Operating\ results\ before\ interest\ and\ depreciation\ (EBITDA)}{Principal\ repayments\ (from\ the\ statement\ of\ cash\ flows) + borrowing\ interest\ costs\ (from\ the\ income\ statement)}$$

The benchmark is greater than 2.0x.

This indicator is most relevant to consider in relation to individual Councils rather than considering it on an overall or average basis. In completing its analysis, TCorp has considered the potential for each Council to undertake additional borrowings based on their current LTFP, and a high level analysis of their credit, liquidity and operating performance measures.

The impact of restricted funds on available or free cash to service loan repayments must also be considered, and for many of the Councils assessed, further detailed work is required to take into account these restricted funds before determining the final capacity of each Council.

It is however relevant to note that there a number of Councils that have no debt, significant capacity to repay additional debt, yet have Infrastructure Backlogs.

5.4 Capital Works and Asset Renewals

5.4.1 Capital Expenditure Ratio

TCorp's key indicator is:

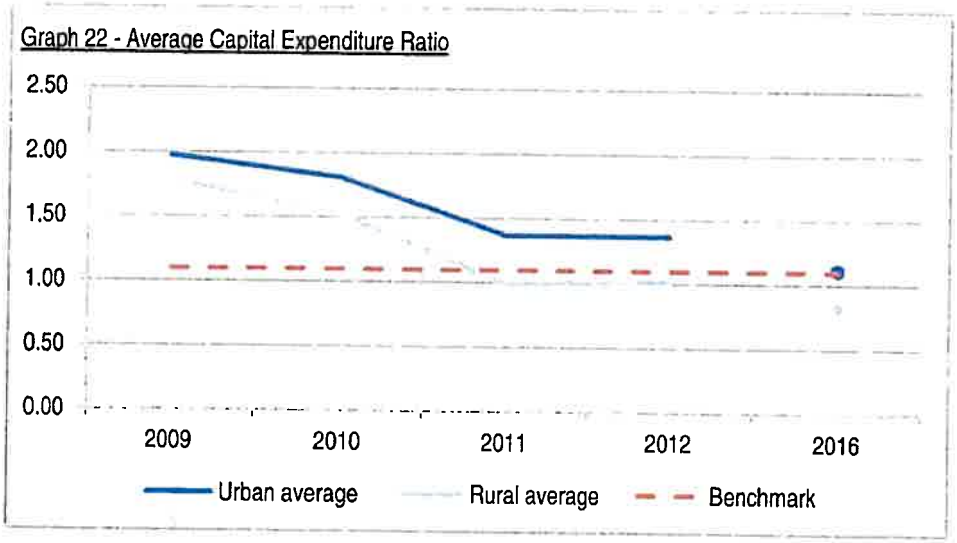
- Capital Expenditure ratio

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.

$$Ratio = \frac{Annual\ capital\ expenditure}{Annual\ depreciation}$$

The benchmark is greater than 1.1x.

Graph 22 - Average Capital Expenditure Ratio



This graph shows a declining performance in respect of investment in new and replacement assets over the Review Period, albeit the average expenditure across the sector is above benchmark.

A number of factors cloud this analysis. Firstly, high growth Councils in fringe metropolitan growth areas (such as Camden) have extremely high capital expenditure programs to meet the demand for housing and new infrastructure to support rapidly increasing population. Councils in mature areas have lower expenditure rates.

The Councils in DLG Groups 8, 9 and 10, representing predominantly the areas west of the Great Dividing Range have the lowest average capital expenditures over the Review Period. These Councils generally have a large asset base and relatively large depreciation costs, compared to the size of the population and the rates assessment base.

The other primary observation is that the review of all the current LTFPs indicates a continued decline in capital expenditure over the next five years to an average level of just below the benchmark. This is likely to be due to incomplete capital expenditure forecasts, and conservative capital grants and contributions forecast data, where some Councils only include the grants in their forecasts once they receive formal approval of the grants.

5.4.2 Infrastructure Backlog

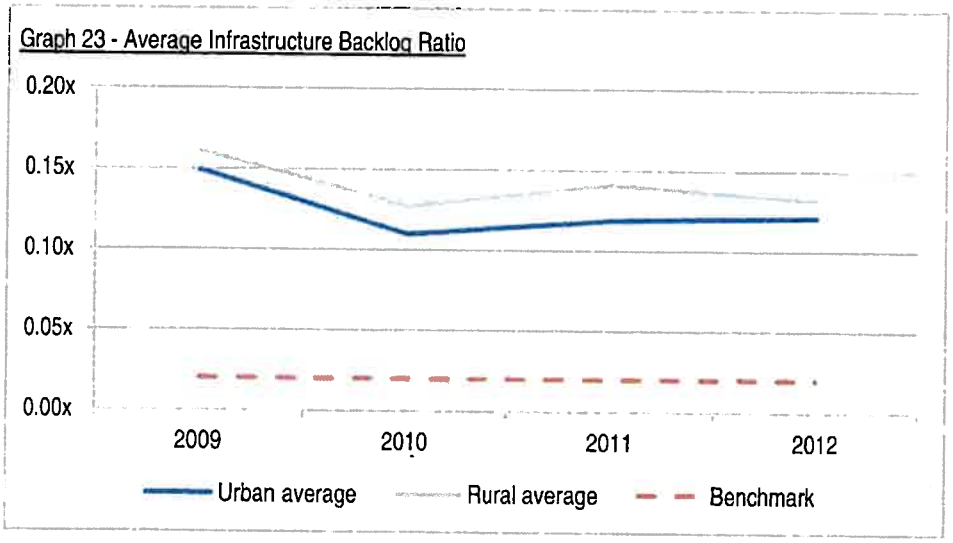
This ratio shows what proportion the backlog is against the total value of a Council's infrastructure. The total value of infrastructure, buildings, other structures and depreciable land improvement assets for all NSW Councils was $72.4b in 2012.

$$Ratio = \frac{\textit{estimated cost to bring assets to a satisfactory condition}}{\textit{total value of infrastructure, building, other structures and depreciable land improvement assets}}$$

TCorp has adopted a benchmark of 0.2x based on work undertaken by organisations such as Review Today and Access Economics.

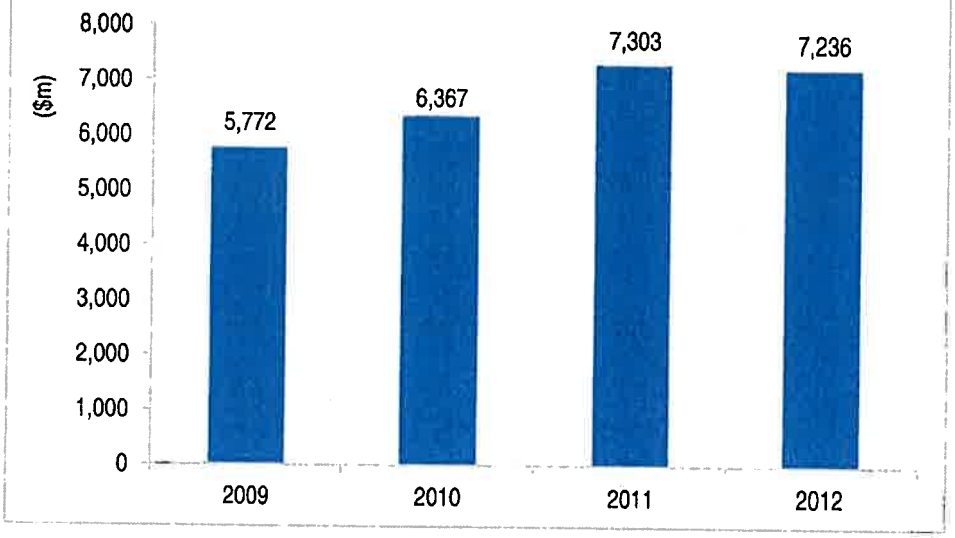
The average ratios shown in the graph below has been calculated as the average Infrastructure Backlog Ratio of each individual 152 Councils.

Graph 23 - Average Infrastructure Backlog Ratio



The total Infrastructure Backlog for NSW Councils has increased from a reported $5.8b in 2009 to $7.2b in 2012, an increase of $1.5b (25.4%) over the period. The main component of the Infrastructure Backlog is public roads (including footpaths and car parks) at $4.4b (61.2%) as at 2012. Buildings and other structures are the next largest category at $1.0b (14.2%), with water, sewerage and drainage assets making up the balance.

Graph 24 - Total Infrastructure Backlog for All 152 NSW Councils



This reported increase is not necessarily a reflection of a sudden deterioration in asset quality across the State. Rather, it is at least partly a reflection of the improved reporting that has resulted from the introduction of the IP&R process and the work undertaken in respect of AMPs. For Councils who have undertaken their AMP, many are working on refining their methodologies and undertaking further analysis including conducting additional condition reporting on their assets.

The refinement of this work has in some cases led to a reduced value of Infrastructure Backlog being reported. There remain some Councils who have either not completed or not fully completed their AMP in respect of all assets.

We understand that DLG is currently undertaking an infrastructure audit which should provide greater clarity and certainty around the total Backlog value.

One of the major drivers of the Infrastructure Backlog is the underspending on the maintenance of assets. The graph on the next page shows the gap between the reported required level of maintenance and actual maintenance spent on an annual basis from 2009 to 2012 by all NSW Councils. The total reported underspend over the period was $1.6b, a number not inconsistent with the increase in the Infrastructure Backlog value over the same period ($1.5b).

From the analysis we have some reservations about the accuracy of some of these reported maintenance numbers. They are not audited, and in addition the required levels of maintenance are subject to change as Councils work on refining their AMPs and more correct levels of maintenance and cost.

Graph 25 - Total Asset Maintenance Gap for All 152 NSW Councils

5.5 Borrowing Capacity

In conducting its assessment and review process, TCorp considered the capacity of Councils to service their existing and forecast borrowings, and also each Council's capacity to service additional borrowings, based on each Council's current LTFP.

Within each individual Council's report, TCorp included its initial views on the capacity of the Council to take on further debt. For each Council, further analysis would be required to take into account any restrictions that Council has on its free cash flows which might be available to meet any additional debt repayments.

Over the Review Period from 2009 to 2012, Council borrowings have increased from $2.5b in 2009 to $3.0b in 2012, an increase of $516.0m (21.1%). Over the Review Period, the majority (more than 90%) of Councils have utilised debt as part of their overall funding strategy, although there are some notable exceptions of Councils having a no debt policy.

Some of these 'no-debt policy' Councils are in the position of having no debt, significant capacity to take on debt (in terms of their financial capacity to repay debt over a period of time), as well as having significant levels of Infrastructure Backlog. These Councils should be considering using their financial capacity to borrow funds to upgrade infrastructure, thereby spreading the cost of infrastructure renewal over a number of years.

We also note that in reviewing the LTFP of Councils, a decreasing number of Councils are forecasting to hold debt in 2016 when compared to 2012 (106 down from 114).

6. Findings and Recommendations

6.1 Main Findings

From its assessment of the 152 Councils and its analysis of the outcomes, TCorp's main findings are:

1. **Operating deficits are unsustainable** - The majority of Councils are reporting operating deficits. In 2012 only one third of Councils (50) reported an operating surplus. Over the 2009 to 2012 Review Period, based on the analysis, the cumulative operating deficits for all Councils in NSW totalled $1.0b. The Asset Revaluations process, introduced over the 2009 to 2012 period, (a necessary change to reflect Accounting Standards), has adversely impacted reported operating results due to increased depreciation charges. Whilst operating deficits may be acceptable from time to time, continuing deficits will not allow Councils to maintain or expand their assets and services, or address their Infrastructure Backlogs

2. **2012 operating deficits are understated** - The cumulative operating deficit of all Councils in 2012 of $288m understates the severity of the current position. In the 2012 financial year the Federal Government prepaid half of the 2013 Financial Assistance Grants which most Councils declared as revenue in 2012. Removing the impact of this prepayment results in the normalised deficit for the 2012 financial year being $469m, an increase of $181m

3. **Sustainability is deteriorating** - The sustainability position is expected to deteriorate over the short term for nearly 50% of all Councils, based on current LTFP. Should the current Outlooks eventuate, 70 of the 152 Councils in NSW (46%) would be rated as Weak or lower within three years

4. **Consultation with the community is required** - Addressing the expected continued deterioration of Councils financial positions will require an extensive consultation process with the community to consider a combination of revenue increases, expenditure reductions and service level reviews

5. **Need to prevent further deterioration** - Achieving a breakeven operating position for Councils is one factor that will assist in preventing further deterioration in the financial position of the local government sector. The achievement of a breakeven operating position would provide sufficient funds to meet future requirements for maintenance of assets and services, but it would not provide sufficient funds to address the current (2012) reported Infrastructure Backlog of $7.2b, nor any as yet unquantified asset maintenance funding gap that may exist

6. **Improved focus created by the IP&R process** - The introduction of the IP&R process in 2009 has increased Councils' focus on longer term planning and strategy. TCorp recognises that Councils are at different stages of implementing the full suite of IP&R requirements. Continued work on refining AMPs, and methodologies for valuing Infrastructure Backlog will improve the quality of LTFPs and assets information over time. Council's who have not as yet completed their initial work under the IP&R process, need to do this urgently to provide a clearer picture of their financial status and future financial requirements

7. **Asset management planning is improving** - Asset planning is improving but will require further (and ongoing) iterations for most Councils. Whilst the majority of Councils have now completed their initial AMP, the analysis and discussions with Councils indicates that it can take a number of iterations before a high level of certainty can be attached to the outputs of the AMP

8. **An asset maintenance gap exists** - Councils reported expenditure on the maintenance of their assets shows an annual shortfall in spending on asset maintenance. In 2012 alone the reported maintenance gap was $387m across the local government sector in NSW, and has totalled $1.57b over the last four years

9. **Regional performance varies** - There is a higher proportion of Councils rated as Weak and Very Weak in the north coast region and the far western region of the State, compared to other regions. The reasons for the weakness varies between the regions, highlighting that both areas with growing and declining population can have a weak sustainability position

10. **Population density is a key factor**- There is a strong positive correlation between the population density of a LGA and the ability of a Council to generate its own revenue so that it can be self funding. Lower population density means that Councils have a greater reliance on receiving external operating grants and contributions

11. **Depreciation rates and expenses, and methodologies vary across Councils** - TCorp's analysis shows that depreciation rates as a proportion of infrastructure asset values are higher for Councils that TCorp has rated as weaker in terms of their FSR. This indicates that further work may need to be undertaken in respect of the analysis of depreciation, particularly for lower rated Councils to ensure that they are depreciating assets at the correct rate to reflect the applicable asset lives. Abnormalities such as accounting gains and losses when Councils replace their assets can also arise if incorrect depreciation rates are used

12. **Liquidity levels in Councils are generally considered to be acceptable and in some cases overly conservative** - 93% of Councils (142) met or exceeded the Unrestricted Current Ratio in 2012, indicating strong liquidity positions exist. 78 Councils reported an Unrestricted Current Ratio of more than 3.0x versus a benchmark of 1.5x, indicating overly conservative practices are adopted that could be reviewed to improve performance. 19 Councils recorded a Cash Expense Ratio of above 10 months coverage of cash expenses in 2012. Some Councils could increase their use of term deposits to enhance investment returns

13. **Management of cash reserves and invested funds** - Councils have been increasing their cash reserves and invested funds with $6.8b held as at 30 June 2012. In 2012, invested funds by Councils increased by $530.0m from 2011 largely driven by the Federal government decision to prepay half of the 2013 FAG. It is important to note Councils are required to hold a substantial percentage of their funds for restricted purposes (eg Section 94 contributions). The level of restricted funds varies across Councils but can be up to 80% for some Councils (and averages 50% to 60%). Councils' investments in the credit troubled Collateralised Debt

Obligation market has reduced significantly with total exposures reducing from nearly $600m in 2008 to less than $100m as at 30 June 2012

14. **Whilst the reported Infrastructure Backlog across all Councils as at 30 June 2012 has decreased marginally to $7.2b, these numbers are not audited and require further refinement** - TCorp's analysis indicates that there is not a consistent methodology adopted across all Councils in calculating the Infrastructure Backlog value. Additionally, some Councils are still working on their initial AMP and determination of their Infrastructure Backlog value. The level of AMP development varies across Councils from high level desktop estimates to detailed condition reports

15. **Long term financial planning is improving but further work needs to be done** - Under the IP&R process, Councils are moving from a short term budgeting focus to a longer term financial forecasting focus. Further improvements are still needed, particularly in linking AMPs and strategic plans to the financial plans. This will provide an understanding of the future funding requirements and enable the development of strategies

16. **The transparency of the rate setting process is improving as IPART continues its work in this area** - The SRV methodology used by IPART allows Councils to seek rate increases over and above the rate peg increases granted each year. With the community consultation process, this provides an opportunity for the constituents to determine their level of satisfactory service and their capacity to pay for this

17. **There are a small number of Councils increasing their charges at rates lower than CPI** - Councils need to consider the impact on their financial position of decisions to not increase charges at levels consistent with the cost increases of delivering services. Councils need to balance their consideration of their long term financial position with the community's desires for low rates and charges

18. **Water and Sewer Funds should be self sufficient and not incur financial deficits that undermine the overall financial position of the Council** - Where Councils provide water and sewer services, these need to be provided on the basis that they generate sufficient funds to meet ongoing operating and capital costs. The analysis indicates that there are a small number of Councils where these funds are operating at deficits

19. **Major projects expertise and resources available to Councils need to be considered before committing to projects** - The analysis shows that some Councils are not resourced to deal with the complexities of major projects, such as large civic or entertainment facilities. Careful consideration of all requirements including ongoing operational costs should be included in the preparation of overall business plans and individual project plans to ensure that projects are effectively delivered and do not become an unexpected financial burden for Councils

20. **Access to skilled staff can be an issue particularly for more remote Councils -** Providing assistance to Councils in respect of specialist skills such as engineering and finance needs to be considered. Some form of shared resource may be appropriate where a resource can cover two or more Councils

21. **Debt is underutilised and there are opportunities for it to be structured in a more cost effective manner** - Some Councils have low or zero debt, strong cash flows and outstanding Infrastructure Backlogs. For some of these Councils the use of debt can be an efficient means of addressing Backlog issues, enhancing intergenerational equity and improving asset quality and services. For many Councils with existing debt, overly conservative debt management practices are adopted which could be improved to deliver enhanced value and a lower cost of funds for Councils

22. **There are opportunities for improving the consistency of reporting Council data** - One of the difficulties with undertaking the assessment process has been that in some cases, comparative data is prepared on inconsistent bases across Councils. Many of these issues can be simply resolved by providing clearer guidelines for Councils so that a consistent methodology is adopted

23. **Cost shifting occurs between different levels of government** - TCorp has sighted examples of instances where Councils have been adversely impacted by other levels of government transferring responsibility for certain assets without appropriate funds being provided. Examples of cost shifting include where a State and/or regional road is re-classified as a local road and the responsibility for these assets are transferred to the local Council without adequate compensation to maintain the assets. Other examples include revenue generating activities, such as the operation of caravan parks, that Councils have used to cross subsidise maintenance or other services, being taken from them without adequate compensation or recognition of the adverse impact on the Council

24. **Shared services are not necessarily the solution to all problems** - There have been, and continue to be, a number of examples where shared services have been a major failure. Establishing the correct governance structure is critical to the success of shared services. TCorp sees some value in the use of shared resources particularly for smaller regional and rural Councils where a highly skilled resource such as an engineer could be 'shared' by more than one Council. Positive examples of resource sharing include joint procurements and coordinated road maintenance scheduling between adjoining Councils

25. **The provision of capital grants to build non-commercial projects can adversely impact Councils** - Some Councils have been adversely impacted by using one-off capital grant funding to construct major and often non-core assets such as entertainment or recreational facilities that burden the community for future years as the facilities cannot be operated on a commercial or break even basis. In such circumstances, other services may have to be cut to pay for the operating costs of the new assets. Such a strategy is acceptable so long as the community is aware and accepting of this trade-off

6.2 Recommendations

Based on the findings from its review into the financial assessment and sustainability of the local government sector in New South Wales, TCorp's recommendations are:

1. **At least breakeven operating positions are essential** - Councils need to achieve at least a breakeven operating position on an on-going basis. The future sustainability of Councils is dependent upon generating sufficient funds to meet the costs of maintaining and renewing assets to deliver services. Councils who have been operating with deficits and are forecasting to continue to do so, are not generating sufficient funds to continue providing services and renewing assets at their current levels. These Councils need to develop options to correct this position. Such options will necessarily involve extensive consultation with their communities, and will need to consider options for revenue increases, reductions in expenditure, and reviews of existing service levels and standards. Surpluses generated can be used to address Infrastructure Backlogs

2. **Pricing paths are needed for the medium term** - IPART, DLG and Councils should work together to consider the development of a medium or long term, and achievable, pricing path so that Councils can achieve at least a breakeven operating position. A clear strategy across the local government sector is needed to promote future sustainability for Councils

3. **Rate increases must meet underlying costs** - Future increases in all rates and annual charges for Council services should be based on the underlying cost of delivering these services and the annual movement in the cost of these services. Where a decision by Council is made to increase rates and charges at a lower than required factor, the impacts of such actions must be clear in the context of each Council's sustainability

4. **Asset management planning must be prioritised** - Councils need to prioritise the completion and validation of their AMP and Infrastructure Backlog values so that a clear picture is available as to the total funding requirements in respect of their assets. Without this certainty, Councils cannot accurately forecast their future funding requirements and put in place appropriate strategies

5. **Councillor and management capacity must be developed** - Councils and the DLG should continue to articulate the benefits of the IP&R process, by increasing the focus on linking long term strategies, asset management planning and long term financial forecasting to assist with decision making and promoting sustainability. Enhancing the knowledge and skills of Council management and elected officials, particularly in respect of the importance of financial and asset management, would greatly assist in this area

6. **Improved use of restricted funds** - A review of the system and guidelines for accessing restricted funds is needed. Under the current requirements, most Councils are required to hold substantial funds in reserve for specific purposes, often for lengthy periods of time. On average 50% to 60% of funds held by Councils are externally restricted. Being able to access more of these funds (eg through s 410 internal borrowing arrangements) could allow Councils to meet current asset renewal and maintenance requirements and be a more efficient use of funds

7. **Increased use of debt** - Debt is underutilised by some Councils and there are opportunities for more cost effective borrowing and debt management. Some Councils have low or zero debt, strong cash flows and outstanding Infrastructure Backlogs. For some of these Councils the use of debt can be an efficient means of addressing Infrastructure Backlog issues, enhancing intergenerational equity and improving asset quality and services. For many Councils with existing debt, overly conservative debt management practices are adopted which could be improved to deliver enhanced value and a lower cost of funds for Councils

8. **DLG should consider developing and implementing training programs for Council staff and Councillors in financial management and planning** - In particular, training in the development of effective LTFPs would promote a greater understanding of the impact of decisions made by Councils on their finances. The assessment indicates that some Councils need assistance in understanding how to approach the development of an effective LTFP. For example, the use of a base case and various scenarios with supporting data that aligns with Councils' strategic plans

9. **Consideration be given to providing Councils with a standard set of economic and financial assumptions to be used in preparing their LTFP** - Standardising the assumptions such as CPI forecasts, and increases in residential rates would assist in comparative data analysis and consistency of forecasts

10. **Councils should look to identify their skills gaps and seek to address these needs, particularly in the areas of engineering, and financial management and reporting** - For smaller Councils the use of a skilled resource shared across two or three Councils could assist in providing access to the necessary skills

11. **A review of the current IP&R guidelines should be conducted** - With the IP&R system having been in place since 2009, TCorp considers that it is opportune for DLG and Councils to conduct a review to see if improvements in the guidelines and methodologies are needed. Potential areas for review include reporting definitions, calculation methodologies covering areas such as the Infrastructure Backlog, (including the meaning of 'satisfactory' standard) and the calculation of data included in the various Special Schedules required to be presented as part of each Council's annual reporting

12. **A review be undertaken to ensure that the current Special Schedules (particularly schedules 7 and 8) attached to each Council's annual accounts are providing relevant information** - Councils are currently required to provide a range of additional asset and maintenance information. The TCorp review process has shown that inconsistent approaches to preparing the information in these Schedules are adopted by Councils. It is considered appropriate that information in these Schedules should be relevant and consistently prepared across Councils to allow for comparative analysis and facilitate informed decisions in respect of any issues raised

13. **Consideration be given to have the Special Schedules attached to each Councils annual accounts audited to verify the accuracy of the information** - TCorp's review process has shown an inconsistency in the approach of Councils to calculating the data included in these Schedules, particularly Schedules 7 and 8. Without a high level of confidence in the data presented, it is more difficult to make informed decisions. Including these Schedules in the annual audit process would promote a higher level of accuracy

14. **A review should be conducted to ensure that a consistent approach to auditing of annual accounts is being undertaken** - The TCorp assessment process has shown examples such as where the treatment of items of expenditure on assets may be expensed by some Councils but capitalised by others. Whilst not widespread, there would be value in having a consistent approach from Councils including an over-riding audit review, perhaps by the Audit Office of NSW to ensure that a consistent approach to audits and accounting treatment is occurring

15. **Further development and analysis of the benchmarking data and methodologies is required** - The work undertaken to-date by TCorp has generated a significant amount of data. Some of the benchmarks TCorp has adopted have not been used or seen by Councils prior to the work. TCorp consider that further development of the benchmarking work would prove beneficial to the sector and ultimately could be used for an analysis across the Australian local government sector. For example, the methodology needs to be refined to take into account the differences that exist between Rural and Urban Councils

16. **Councils should arrange for a regular independent review of their financial position to be undertaken** - A review process on at least a three yearly basis could be used to inform Councils and promote improved forecasting, reporting, consistency of methodologies and decision making

17. **Treasury management policies need to be reviewed to improve Council management of liquidity** - The variable performance across the Council sector indicates that some Councils are not managing their cash reserves to the most efficient level with cash reserves left in bank accounts earning low interest, rather than utilising term deposits or other approved investment facilities with higher yields. This is illustrated where our analysis has shown Councils holding relatively high levels of cash and not taking advantage of investments in approved instruments such as term deposits. Further, Councils with high Unrestricted Current Ratios could improve their financial performance with improved use of their funds. In 2012, 78 Councils had Unrestricted Current Ratios of over 3.0x which is a level twice the benchmark

18. **A full analysis of the depreciation and AMP methods being used be conducted to ensure that Councils are depreciating assets in an accurate and consistent manner -** TCorp's analysis has revealed a significant range of average depreciation rates used by Councils across the sector. Average depreciation rates for infrastructure assets vary from 2.5% to more than 5.0%. Such a range appears too large and further analysis needs to be conducted to validate the depreciation and AMP information. With depreciation expense being a significant portion of Council's annual expenses, this is an important exercise to ensure Councils can adequately fund the replacement and renewal of their depreciating assets on an ongoing basis

19. **The potential use of alternative funding and provisioning arrangements for expenses such as Workers Compensation be investigated -** Opportunities exist for considering alternate models for such expenses. There are examples where Councils have adopted such alternate models and achieved significant financial savings. This analysis could be extended to the overall costs associated with workers compensation costs in the local government sector

20. **Consideration be given for Councils to be offered assistance by some State government agencies in respect of major and complex asset procurements -** The State government has available through its existing resources, in-house skills that could be used to provide assistance to local government

New South Wales
Treasury Corporation

Disclaimer

This Report has been prepared by TCorp in accordance with the appointment of TCorp by the DLG. 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 by DLG, each Local Council and from publicly available sources such as the Australian Bureau of Statistics. 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 Councils all of which may negatively impact the financial capability and sustainability of the Councils. 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.

To the extent permitted by law, neither TCorp nor any of its employees, contractors, servants or agents accept any responsibility or liability (including, without limitation, liability in negligence) for any expense, damage, claim, cause of action, loss or costs incurred by any person, directly or indirectly, relying or acting, or refraining to act, on the basis of the contents of this Report.

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Appendix 1 Ratings and Definitions

Table A1 - Financial Sustainability Ratings

Rating	Definition
Very Strong	• A local government with a very strong capacity to meet its financial commitments in the short, medium and long term. • It has a record of reporting operating surpluses. • It is highly likely to be able to manage unforseen financial shocks and any adverse changes in its business without revenue and/or expense adjustments. • Its capacity to manage core business risks is very strong.
Strong	• A local government with a strong capacity to meet its financial commitments in the short, medium and long term. • It generally has a record of operating surpluses and may occasionally report minor operating deficits. It is able to address its operating deficits, manage major unforseen financial shocks and any adverse changes in its business with minor revenue and/or expense adjustments. • The expense adjustments are likely to result in only minor changes to the range of and/or quality of services offered. • Its capacity to manage core business risks is strong.
Sound	• A local government with an adequate capacity to meet its financial commitments in the short, medium and long term. • While it is likely that it may have a record of minor to moderate operating deficits, the local government is expected to regularly report operating surpluses. It is likely able to address its operating deficits, manage major unforseen financial shocks and any adverse changes in its business with minor or moderate revenue and/or expense adjustments. • The expense adjustments are likely to result in some changes to the range of and/or quality of services offered. • Its capacity to manage core business risks is sound.
Moderate	• A local government with an adequate capacity to meet its financial commitments in the short to medium term and an acceptable capacity in the long term. • While it has some record of reporting minor to moderate operating deficits the local government may also have recently reported a significant operating deficit. • It is likely able to address its operating deficits, manage unforseen financial shocks and any adverse changes in its business, with moderate revenue and/or expense adjustments. The expense adjustments are likely to result in a number of changes to the range of and/or quality of services offered. • Its capacity to manage core business risks is moderate.

Weak	• A local government with an acceptable capacity to meet its financial commitments in the short to medium term and a limited capacity in the long term. • It has a record of reporting moderate to significant operating deficits with a recent operating deficit being significant. It is unlikely to be able to address its operating deficits, manage unforseen financial shocks and any adverse changes in its business, without the need for significant revenue and/or expense adjustments. • The expense adjustments would result in significant changes to the range of and/or quality of services offered. • It may experience difficulty in managing core business risks.
Very Weak	• A local government with a limited capacity to meet its financial commitments in the short to medium term and a very limited capacity long term. • It has a record of reporting significant operating deficits. It is highly unlikely to be able to address its operating deficits, manage unforseen financial shocks and any adverse changes in its business without the need for structural reform and major revenue and/or expense adjustments. • The expense adjustments are likely to result in significant changes to the range of and/or quality of services offered and it may need the assistance from higher levels of government. • It has difficulty in managing its core business risks.
Distressed	• A local government with a very limited capacity to meet its short term financial commitments and no capacity to meet its medium to long term financial commitments. • It has a record of reporting significant operating deficits. • To be able to address its operating deficits, meet its medium and long term obligations, manage unforseen financial shocks and any adverse changes in its business, major revenue and expense adjustments and structural reform will be required. • The local government is unlikely to have the capacity to manage core business risks and may need assistance from higher levels of government.

Table A2 - Outlook

Outlook	Definition
Positive	As a result of a foreseeable event or circumstance occurring, there is the potential for enhancement in the local government's capacity to meet its financial commitments (short and/or long term) and resulting change in its rating. However, it does not necessarily indicate that a rating change may be forthcoming.
Neutral	There are no known foreseeable events that would have a direct impact on the financial sustainability of the local government. It may be possible for a rating upgrade or downgrade to occur from a neutral outlook, if warranted by an event or circumstance.
Negative	As a result of a foreseeable event or circumstance occurring, there is the potential for deterioration in the local government's capacity to meet its financial commitments (short and/or long term) and resulting change in its rating. However, it does not necessarily indicate that a rating change may be forthcoming.

Appendix 2 Benchmark 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

$$Ratio = \frac{Asset\ Renewals}{Depreciation\ of\ building\ and\ infrastructure\ assets}$$

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

$$Ratio = \frac{Current\ year's\ cash\ and\ cash\ equivalents}{(Total\ expenses - depreciation - interest\ costs)*12}$$

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

$$Ratio = \frac{Annual\ capital\ expenditure}{Annual\ depreciation}$$

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

$$Ratio = \frac{Operating\ results\ before\ interest\ and\ depreciation\ (EBITDA)}{Principal\ repayments\ (from\ the\ statement\ of\ cash\ flows)\ +\ borrowing\ interest\ costs\ (from\ the\ income\ statement)}$$

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

Infrastructure Backlog Ratio

Benchmark = Less than 0.02x

$$Ratio = \frac{Estimated\ cost\ to\ bring\ assets\ to\ a\ satisfactory\ condition\ (from\ Special\ Schedule\ 7)}{Total\ infrastructure,\ building,\ other\ structures\ and\ depreciable\ land\ improvement\ assets\ (from\ Note\ 9a)}$$

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

Interest Cover Ratio

Benchmark = Greater than 4.0x

$$Ratio = \frac{Operating\ results\ before\ interest\ and\ depreciation\ (EBITDA)}{Borrowing\ interest\ costs\ (from\ the\ income\ statement)}$$

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%

$$Ratio = \frac{Operating\ revenue\ excluding\ capital\ grants\ and\ contributions - operating\ expenses}{Operating\ revenue\ excluding\ capital\ grants\ and\ contributions}$$

This ratio measures a Council's achievement of containing operating expenditure within operating revenue. It is important to distinguish that this ratio is focussing on operating performance and hence capital grants and contributions are excluded.

Own Source Operating Revenue Ratio

Benchmark = Greater than 60%

$$Ratio = \frac{Rates,\ utilities\ and\ charges}{Total\ operating\ revenue\ (inclusive\ of\ capital\ grants\ and\ contributions)}$$

This ratio measures 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

$$Ratio = \frac{Current\ assets\ less\ all\ external\ restrictions}{Current\ liabilities\ less\ specific\ purpose\ liabilities}$$

Restrictions placed on various funding sources (e.g. Section 94 developer contributions, RMS contributions) complicate the traditional current ratio used to assess liquidity of businesses as cash allocated to specific projects is 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 short term obligations as they fall due.

Appendix 3 Additional and Supporting Information

Table A3 Council Group Numbers

Group 1		
City of Sydney		
Group 2		
Ashfield Municipal Council	Lane Cove Municipal Council	Pittwater Council
Botany Bay, The Council of the City of	Leichhardt Municipal Council	Strathfield Municipal Council
Burwood Council	Manly Council	Waverley Council
Hunter's Hill Council	Mosman Council	Woollahra Municipal Council
Kogarah City Council	North Sydney Council	
Group 3		
Auburn City Council	Holroyd City Council	Rockdale City Council
Bankstown City Council	Hurstville City Council	Ryde City Council
Blacktown City Council	Ku-ring-gai Council	Sutherland Shire Council
Canada Bay City Council	Marrickville Council	Warringah Council
Canterbury City Council	Parramatta City Council	Willoughby City Council
Fairfield City Council	Randwick City Council	
Group 4		
Albury City Council	Eurobodalla Shire Council	Port Macquarie-Hastings Council
Armidale-Dumaresq Council	Goulburn Mulwaree Council	Port Stephens Council
Ballina Shire Council	Great Lakes Council	Queanbeyan City Council
Bathurst Regional Council	Greater Taree City Council	Richmond Valley Council
Bega Valley Shire Council	Griffith Council	Shellharbour City Council
Broken Hill City Council	Kempsey Shire Council	Singleton Shire Council
Byron Shire Council	Kiama Municipal Council	Tamworth Regional Council
Cessnock City Council	Lismore City Council	Wagga Wagga City Council
Clarence Valley Council	Lithgow City Council	Wingecarribee Shire Council
Deniliquin Council	Mid-Western Regional Council	
Dubbo City Council	Orange City Council	
Group 5		
Coffs Harbour City Council	Newcastle City Council	Wollongong City Council
Lake Macquarie City Council	Shoalhaven City Council	
Maitland City Council	Tweed Shire Council	
Group 6		
Camden Council	Hawkesbury Council	Wollondilly Shire Council
Group 7		
Blue Mountains City Council	Hills Shire Council	Penrith City Council
Campbelltown City Council	Hornsby Shire Council	Wyong Shire Council
Gosford City Council	Liverpool City Council	
Group 8		
Brewarrina Shire Council	Jerilderie Shire Council	
Conargo Shire Council	Urana Shire Council	

Group 9		
Balranald Shire Council	Coolamon Shire Council	Lockhart Shire Council
Bogan Shire Council	Coonamble Shire Council	Murrumbidgee Shire Council
Bombala Council	Gilgandra Shire Council	Tumbarumba Shire Council
Boorowa Council	Gundagai Shire Council	Wakool Shire Council
Bourke Shire Council	Guyra Shire Council	Walcha Shire Council
Carrathool Shire Council	Harden Shire Council	Warren Shire Council
Central Darling Shire Council	Hay Shire Council	Weddin Shire Council
Group 10		
Berrigan Shire Council	Junee Shire Council	Temora Shire Council
Bland Shire Council	Kyogle Council	Tenterfield Shire Council
Blayney Shire Council	Lachlan Shire Council	Upper Lachlan Shire Council
Cobar Shire Council	Liverpool Plains Shire Council	Uralla Shire Council
Cootamundra Shire Council	Murray Shire Council	Walgett Shire Council
Dungog Shire Council	Narrandera Shire Council	Wellington Council
Glen Innes Shire Council	Narromine Shire Council	Wentworth Shire Council
Gloucester Shire Council	Oberon Council	
Gwydir Shire Council	Snowy River Shire Council	
Group 11		
Bellingen Shire Council	Gunnedah Shire Council	Palerang Council
Cabonne Shire Council	Inverell Shire Council	Parkes Shire Council
Cooma-Monaro Shire Council	Leeton Shire Council	Tumut Shire Council
Corowa Shire Council	Moree Plains Council	Upper Hunter Shire Council
Cowra Shire Council	Muswellbrook Shire Council	Warrumbungle Shire Council
Forbes Council	Nambucca Shire Council	Yass Valley Council
Greater Hume Shire Council	Narrabri Shire Council	Young Shire Council

New South Wales Treasury Corporation

Table A4 - Cumulative Key Indicators in 2012 by Group

$'000	1	2	3	4	5	6	7	8	9	10	11	Total
Operating performance												
Total revenue	479,898	715,505	1,930,047	2,128,342	1,128,251	159,792	1,236,343	38,569	286,646	486,370	655,382	9,245,145
Total expenses	424,549	741,689	1,962,716	2,245,156	1,175,944	172,364	1,281,070	39,009	301,167	513,093	676,150	9,532,907
Cumulative operating performance	**55,349**	**(26,184)**	**(32,669)**	**(116,814)**	**(47,693)**	**(12,572)**	**(44,727)**	**(440)**	**(14,521)**	**(26,723)**	**(20,768)**	**(287,762)**
Cumulative operating ratio	11.5%	(3.7%)	(1.7%)	(5.5%)	(4.2%)	(7.9%)	(3.6%)	(1.1%)	(5.1%)	(5.5%)	(3.2%)	(3.1%)
Balance sheet items												
Borrowings (current)	-	12,638	83,754	78,412	46,667	2,665	45,085	268	3,737	16,079	15,062	304,367
Borrowings (non-current)	-	53,714	165,022	1,061,862	604,472	24,261	470,197	3,132	20,273	65,048	194,390	2,662,371
Total borrowings	-	66,352	248,776	1,140,274	651,139	26,926	515,282	3,400	24,010	81,127	209,452	2,966,738
Net assets	**7,169,663**	**7,599,313**	**30,292,501**	**25,744,951**	**13,099,562**	**1,960,883**	**17,860,860**	**434,349**	**3,931,108**	**6,611,789**	**8,408,604**	**123,113,583**
Borrowings/ net assets	0.0%	0.9%	0.8%	4.4%	5.0%	1.4%	2.9%	0.8%	0.6%	1.2%	2.5%	2.4%
Cash and cash equivalents	160,900	135,853	272,984	480,098	230,235	11,611	317,149	22,005	140,791	167,694	208,646	2,147,966
Investments (current)	105,556	235,064	807,965	860,958	359,862	98,950	329,477	4,056	44,365	125,014	321,703	3,292,970
Investments (non - current)	258,747	65,301	277,463	262,567	352,262	11,429	42,199	-	718	16,302	63,954	1,350,942
Total cash and investments	**525,203**	**436,218**	**1,358,412**	**1,603,623**	**942,359**	**121,990**	**688,825**	**26,061**	**185,874**	**309,010**	**594,303**	**6,791,878**
Cash and investment/ backlog	6.07x	0.99x	1.30x	0.64x	1.59x	0.90x	0.93x	0.84x	0.67x	0.52x	0.74x	0.94x

New South Wales Treasury Corporation

$'000	1	2	3	4	5	6	7	8	9	10	11	Total
Assets and capital expenditure												
Infrastructure, property, plant and equipment	6,532,376	7,056,999	28,760,903	25,332,088	12,874,791	1,840,951	17,847,549	412,039	3,781,008	6,397,437	8,036,677	118,872,818
Depreciation and amortisation	79,143	112,972	357,123	591,295	302,237	41,635	287,680	11,449	82,469	136,587	179,774	2,182,364
Depreciation/IPP&E	**1.2%**	**1.6%**	**1.2%**	**2.3%**	**2.3%**	**2.3%**	**1.6%**	**2.8%**	**2.2%**	**2.1%**	**2.2%**	**1.8%**
Depreciation/expense	18.6%	15.2%	18.2%	26.3%	25.7%	24.2%	22.5%	29.3%	27.4%	26.6%	26.6%	22.9%
Asset additions	105,517	131,412	597,497	774,902	412,199	112,407	396,394	12,512	79,384	147,749	230,022	2,999,995
WDV disposed assets	6,919	17,407	24,113	64,160	29,179	3,693	17,379	1,603	8,755	15,002	16,177	204,387
Capex	98,598	114,005	573,384	710,742	383,020	108,714	379,015	10,909	70,629	132,747	213,845	2,795,608
Cumulative capex ratio	1.25x	1.01x	1.61x	1.20x	1.27x	2.61x	1.32x	0.95x	0.86x	0.97x	1.19x	1.28x
Actual annual maintenance	33,145	66,019	197,155	295,623	120,063	26,142	141,365	8,337	64,020	93,585	108,818	1,154,272
Required annual maintenance	35,684	86,019	250,739	467,985	158,207	32,683	164,383	7,618	65,677	126,512	148,198	1,543,705
Cumulative maintenance shortfall	**(2,539)**	**(20,000)**	**(53,584)**	**(172,362)**	**(38,144)**	**(6,541)**	**(23,018)**	**719**	**(1,657)**	**(32,927)**	**(39,380)**	**(389,433)**
Cumulative maintenance ratio	**0.93x**	**0.77x**	**0.79x**	**0.63x**	**0.76x**	**0.80x**	**0.86x**	**1.09x**	**0.97x**	**0.74x**	**0.73x**	**0.75x**

New South Wales Treasury Corporation

$'000	1	2	3	4	5	6	7	8	9	10	11	Total
Backlog												
Bring to satisfactory standard	86,544	441,483	1,048,138	2,491,804	591,714	135,179	738,865	30,990	277,962	591,608	801,865	7,236,152
Infrastructure Backlog - Buildings and other structures	80,517	85,152	254,916	125,887	182,558	20,753	150,687	2,831	16,779	56,995	48,407	1,025,482
Building and other structures (% of total backlog)	93.0%	19.3%	24.3%	5.1%	30.9%	15.4%	20.4%	9.1%	6.0%	9.6%	6.0%	14.2%
Infrastructure Backlog - Public roads (inc. footpaths and car parks)	5,454	158,470	637,823	1,686,129	351,481	100,398	441,329	25,902	180,832	399,274	438,833	4,425,925
Public roads (% of total backlog)	6.3%	35.9%	60.9%	67.7%	59.4%	74.3%	59.7%	83.6%	65.1%	67.5%	54.7%	61.2%

Table A5 - Cumulative Operating Results By Group

Groups	2009	2010	2011	2012
Total revenue				
1	415,309	432,860	467,116	479,898
2	613,028	650,897	678,495	715,505
3	1,657,240	1,718,713	1,815,651	1,930,047
4	1,736,580	1,848,649	1,959,882	2,128,342
5	947,406	995,666	1,063,742	1,128,251
6	135,450	137,357	147,171	159,792
7	1,036,388	1,093,626	1,149,821	1,236,343
8	28,068	28,576	33,129	38,569
9	224,010	223,574	251,447	286,646
10	412,992	409,420	438,059	486,370
11	540,807	555,342	598,924	655,382
Total revenue (exc. capital grants and contributions)	7,747,278	8,094,680	8,603,437	9,245,145
Total expenses				
1	363,905	378,743	390,798	424,549
2	636,361	663,819	708,604	741,689
3	1,663,602	1,726,081	1,855,271	1,962,716
4	1,841,518	1,935,448	2,106,386	2,245,156
5	986,875	1,045,666	1,135,955	1,175,944
6	140,536	140,815	162,639	172,364
7	1,072,669	1,156,483	1,204,251	1,281,070
8	25,956	27,540	36,378	39,009
9	222,045	237,553	270,201	301,167
10	415,969	429,034	485,343	513,093
11	525,918	556,483	634,172	676,150
Total expenses	7,895,354	8,297,665	8,989,998	9,532,907

New South Wales Treasury Corporation

Total operating results				
1	51,404	54,117	76,318	55,349
2	(23,333)	(12,922)	(30,109)	(26,184)
3	(6,362)	(7,368)	(39,620)	(32,669)
4	(104,938)	(86,799)	(146,504)	(116,814)
5	(39,469)	(50,000)	(72,213)	(47,693)
6	(5,086)	(3,458)	(15,468)	(12,572)
7	(36,281)	(62,857)	(54,430)	(44,727)
8	2,112	1,036	(3,249)	(440)
9	1,965	(13,979)	(18,754)	(14,521)
10	(2,977)	(19,614)	(47,284)	(26,723)
11	14,889	(1,141)	(35,248)	(20,768)
Total operating results (exc. capital grants and contributions)	(148,076)	(202,985)	(386,561)	(287,762)

Table A6 - Cumulative Average Ratios

Ratio	Historical (Count of Councils in Sample)	Historical (Average Ratio*)	Forecast (Count of Councils in Sample)	Forecast (2015/16) Average Ratio
Operating Ratio	152	(4.0%)	145	(7.5%)
Cash Expense Ratio	152	5.1 months	139	4.9 months
Unrestricted Current Ratio	152	3.60x	105	3.08x
Own Source Operating Revenue Ratio	152	57.6%	144	64.5%
Debt Service Cover Ratio**	114	13.26x	107	4.89x
Capital Expenditure Ratio	152	1.49x	140	1.07x
Infrastructure Backlog Ratio	151	0.14x		
Asset Maintenance Ratio	152	0.87x		
Building and Infrastructure Asset Renewal Ratio	152	0.84x		

Notes:

* The averages are calculated as the average ratio for each Council over the Review Period and then it is averaged over the number of Councils in the sample.

** Councils with less than $1.0m total borrowings as at 30 June 2012 have been excluded.

Table A7 - Number of Councils Who Met or Exceed Benchmark in 2012 (by Group)

Group	1	2	3	4	5	6	7	8	9	10	11
Operating Ratio	1	6	13	14	4	1	4	2	10	14	10
Cash Expense Ratio	1	5	3	14	3	-	4	4	18	18	13
Unrestricted Current Ratio	1	12	17	29	6	3	7	3	20	23	21
Own Source Operating Revenue Ratio	1	14	16	19	5	1	6	-	-	2	6
Debt Service Cover Ratio	1	13	15	29	6	3	8	4	21	25	21
Interest Cover Ratio	1	13	16	29	5	3	7	4	20	25	20
Capital Expenditure Ratio	1	5	13	23	5	2	5	1	8	9	15
Infrastructure Backlog Ratio	-	3	-	2	1	-	1	1	1	1	2
Asset Maintenance Ratio	-	3	3	6	1	-	2	4	7	5	7
Building and Infrastructure Asset Renewal Ratio	-	1	2	4	1	-	1	1	5	2	3
Total Councils	1	14	17	31	7	3	8	4	21	25	21

Table A8 - Percentage of Councils Who Met or Exceed Benchmark in 2012 (by Group)

Group	1	2	3	4	5	6	7	8	9	10	11
Operating Ratio	100%	43%	76%	45%	57%	33%	50%	50%	48%	56%	48%
Cash Expense Ratio	100%	36%	18%	45%	43%	-	50%	100%	86%	72%	62%
Unrestricted Current Ratio	100%	86%	100%	94%	86%	100%	88%	75%	95%	92%	100%
Own Source Operating Revenue Ratio	100%	100%	94%	61%	71%	33%	75%	-	-	8%	29%
Debt Service Cover Ratio	100%	93%	88%	94%	86%	100%	100%	100%	100%	100%	100%
Interest Cover Ratio	100%	93%	94%	94%	71%	100%	88%	100%	95%	100%	95%
Capital Expenditure Ratio	100%	36%	76%	74%	71%	67%	63%	25%	38%	36%	71%
Infrastructure Backlog Ratio	-	21%	-	6%	14%	-	13%	25%	5%	4%	10%
Asset Maintenance Ratio	-	21%	18%	19%	14%	-	25%	100%	33%	20%	33%
Building and Infrastructure Asset Renewal Ratio	-	7%	12%	13%	14%	-	13%	25%	24%	8%	14%

Table A9 - Number of Councils Who Met or Exceed Benchmark in 2012 (by FSR)

FSR	Strong	Sound	Moderate	Weak	Very Weak
Operating Ratio	2	28	45	4	-
Cash Expense Ratio	2	19	42	20	-
Unrestricted Current Ratio	2	31	79	28	2
Own Source Operating Revenue Ratio	1	17	40	12	-
Debt Service Cover Ratio	2	32	77	30	5
Interest Cover Ratio	2	32	74	30	5
Capital Expenditure Ratio	2	27	48	8	2
Infrastructure Backlog Ratio	-	8	3	1	-
Asset Maintenance Ratio	1	11	15	11	-
Building and Infrastructure Asset Renewal Ratio	1	10	9	-	-
Total councils	2	32	79	34	5

Table A10 - Percentage of Councils Who Met or Exceed Benchmark in 2012 (by FSR)

FSR	Strong	Sound	Moderate	Weak	Very Weak
Operating Ratio	100%	88%	57%	12%	0%
Cash Expense Ratio	100%	59%	53%	59%	0%
Unrestricted Current Ratio	100%	97%	100%	82%	40%
Own Source Operating Revenue Ratio	50%	53%	51%	35%	0%
Debt Service Cover Ratio	100%	100%	97%	88%	100%
Interest Cover Ratio	100%	100%	94%	88%	100%
Capital Expenditure Ratio	100%	84%	61%	24%	40%
Infrastructure Backlog Ratio	0%	25%	4%	3%	0%
Asset Maintenance Ratio	50%	34%	19%	32%	0%
Building and Infrastructure Asset Renewal Ratio	50%	31%	11%	0%	0%
Total councils	2	32	79	34	5

Table A11 - FSR Distribution Amongst Urban and Rural Councils

Group	Strong	Sound	Moderate	Weak	Very Weak	Total
Urban						
1	1	-	-	-	-	1
2	-	5	6	3	-	14
3	-	6	10	1	-	17
4	-	5	18	6	2	31
5	-	1	5	1	-	7
6	-	-	2	1	-	3
7	-	2	4	2	-	8
Total urban councils	1	19	45	14	2	81
Percentage of urban councils	1.2%	23.5%	55.6%	17.3%	2.5%	53.3%
Rural						
8	-	1	1	2	-	4
9	1	3	10	6	1	21
10	-	4	10	9	2	25
11	-	5	13	3	-	21
Total rural councils	1	13	34	20	3	71
Percentage of rural councils	1.4%	18.3%	47.9%	28.2%	4.2%	46.7%
Total councils	2	32	79	34	5	152
Percentage of total councils	1.3%	21.1%	52.0%	22.4%	3.3%	

Table A12 - FSR and Outlook Distributions

	Positive	Neutral	Negative	Total
Very strong	-	-	-	-
Strong	1		1	2
Sound	2	12	18	32
Moderate		46	33	79
Weak	2	13	19	34
Very weak		3	2	5
Distressed	-	-	-	-
Total	5	74	73	152

New South Wales
Treasury Corporation

Appendix 4 Glossary

Term	Explanations
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.
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.

[1] IPART "Revenue Framework for Local Government" December 2009 p.83
[2] DLG "Recognition of certain assets at fair value" March 2009

Term	Explanations
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 (AMP).
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.

Term	Explanations
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 SRVs 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	TCorp has defined sustainability as: 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. This definition takes into account the effect a significant one-off change or financial shock could have on a Council's operating position and service levels over the long term.