
THE NEWCASTLE REPORT: issues for sustainability

A report on the financial sustainability of Newcastle City Council

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Terms of Reference

- The purpose of this report is to:
 - Assess the state of existing Council infrastructure.
 - Estimate the cost of fixing existing infrastructure and renewing it in future.
 - Estimate the cost of expanding infrastructure and services under restrained, responsive and current spending strategies.
 - Explore whether modest, ambitious or current revenue policies could fund such spending strategies with a sustainable debt level and a healthy operating surplus.
 - Identify non-revenue raising measures (e.g. productivity improvements) that might assist in this task.

Disclaimer

- This report is based on the findings of three technical reports commissioned by Review Today Pty Ltd.
- These technical reports are in turn based on data and information furnished by Newcastle City Council (NCC) and other sources (e.g. ABS, DIPNR).
- All parties to the Review Today consortium have taken due care and diligence in arriving at their findings and conclusions, which are based on an analysis of NCC data using proprietary methodologies owned and applied by each party.
- The NCC has vouched that its data is accurate and reliable. It has not been the remit of Review Today or its partners to audit the veracity of that data.

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Summary

- NCC has a \$134 million infrastructure backlog and has another \$630 million of infrastructure renewal in the next twenty years. It also needs to expand its infrastructure stock to accommodate the growth of its population let alone its economy.
- In addition it faces demands on its operating services which cover a wide range of functions from essential services (e.g. garbage collection, roads, storm water, parks, building approvals) to social amenities (e.g. libraries, museums, swimming pools, cycleways, community forums).

Summary

- The community gives a high priority to garbage collection, road maintenance, City planning, beaches, parks, and environmental programs, but has least satisfaction with CBD parking, CBD management, community involvement in decision-making, road maintenance, and City planning.

Summary

- With infrastructure, the public particularly wants better footpaths, nature strips, roads and associated infrastructure, parks, gardens, sporting ovals and playgrounds, ocean baths and beaches, but only 39% are prepared to pay more for it. Those opposed to higher rates want Council to cut other spending, reduce waste and achieve greater efficiencies to help pay for it.

Summary

- Three Council spending scenarios are developed. The first reflects a restrained approach, the second a more responsive one and the last projects current spending trends forward.
- The funding requirements of each scenario are tested against three possible revenue raising options.

Summary

- The Restrained Spending Scenario assumes that:
 - Existing infrastructure backlog and future renewals are fully funded, but infrastructure stock and ordinary services are increased by only just over a quarter of the expected local economic growth rate (i.e. 0.7% per annum).
- This scenario could be easily funded by the ambitious revenue option, but not by the modest option or existing revenue policy.

Summary

- The Responsive Spending Scenario assumes that:
 - Existing infrastructure backlog and future renewals are fully funded and infrastructure stock and ordinary services are increased by two thirds of the expected local economic growth rate (i.e. 1.7% per annum).
- This scenario was not financially sustainable on any of the revenue options canvassed.

Summary

- The Existing Spending Policy (based on current spending trends) assumes that:
 - Infrastructure backlog and future renewals are funded by just over a third of what is required and infrastructure stock and ordinary services are increased by only a quarter of the expected local economic growth rate (i.e. 0.7% per annum).
- This scenario could be funded by all revenue options, but would intensify the infrastructure crisis by accepting a bigger backlog and not fully meeting future renewal needs.

Summary

- The NCC's existing spending policy will result in continued slow growth per services per resident and a massive deterioration in public infrastructure that would cost more to fix at a later stage.
- Facilities would not keep pace with rising resident, commuter, visitor and business expectations.
- The next generation would be forced to pick up the tab for the present generation's neglect.

Summary

- A restrained (let alone responsive) spending scenario that addressed the infrastructure problem would require a greater revenue raising effort for the NCC to remain financially sustainable.
- Such a revenue effort lies somewhere between the existing and the ambitious revenue options.
- Another revenue option considered by the review (called the modest one) proved too inadequate for funding any scenario.

Summary

- The existing revenue policy involves rate increases outpacing CPI inflation until they exceed it by about a third from 2008/09 and the proportion of costs recovered by fees and charges and the share of infrastructure enhancements recovered from developer charges remaining almost unchanged.
- This policy will see rates, fees and charges, and developer charges increase by 3.2% to 3.3% per annum over the next ten years.

Summary

- The ambitious revenue option assumes within five years rates rise to achieve a 2.5% operating surplus ratio and thereafter rates revenue increases by 1.7% per annum in real terms. Meanwhile fees and charges would rise to the minimum of the top quartile of comparable councils and developer charges would be restored to their previous level.
- This would see average annual rises over the next ten years of 6.3% for rates (assuming a restrained spending scenario) and 4.2% for fees and charges plus a tripling of developer charges.

Summary

- Higher rates, fees and charges are not the only way to fund the fixing of infrastructure. NCC estimate current and proposed initiatives could improve Councils financial position by about \$5.5 million per annum. This could be achieved through operational efficiencies, reordering service priorities, selling or partnering public assets etc.
 - Community surveys show that there is a much higher priority for rehabilitating and renewing existing infrastructure than expanding their capacity. Perhaps this reflects that the city is already rich in assets, albeit it aged ones.
-

Summary

- Halting future infrastructure expansion could save \$11 million per annum compared with the restrained strategy. This too would help contain any revenue hikes, but may result in greater pressures on infrastructure in future.
- These combined savings of \$16.5 million would help contain any rise in rates, fees and charges by 14.6% over the next ten years (almost 1.5% per annum).

Summary

- However, increases in rates, fees and charges in excess of normal price inflation are still unavoidable if NCC is to fix its infrastructure and deliver better service to a growing community.
- With an adequate revenue base, NCC could afford to take on more debt within the limits prescribed in this report without jeopardising its credit-worthiness.

Summary

- Increased borrowings could be used to overcome the infrastructure backlog and renew assets that are coming to the end of their useful life.
- An Annuity Index Linked Bond would be the most cost effective way to fund NCC's \$134 million infrastructure backlog provided extra resources could be found to meet the annual loan payments.

Summary Recommendations

- It is recommended that NCC use Review Today's finding to develop an appropriate long term spending, revenue, savings and borrowings strategy to overcome the city's infrastructure crisis within sustainable financial limits. The proposed strategy should be incorporated in NCC's draft management plan for consultation with the community.

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Summary Recommendations

- Based on this feedback the Council should review and update its 10 year financial plan and rolling infrastructure works program to:
 - ❑ Rehabilitate infrastructure that is already decrepit;
 - ❑ Renew infrastructure when it degrades below an acceptable standard in future;
 - ❑ Expand the total infrastructure stock by enough to adequately cater for residential and business growth;
 - ❑ Develop services in line with population growth and changing community needs;

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Summary Recommendations

- Based on this feedback the Council should review and update its 10 year financial plan and rolling infrastructure works program to also:
 - Generate additional resources from revenue measures, operational savings, re-ordering of spending priorities, infrastructure enhancement deferrals, asset leases or disposals and extra borrowings that would be sufficient to fund such a program; and
 - Ensure that the outcome complies with sustainable financial targets (e.g. the recommended minimum surplus ratio and maximum debt ratio) during this period.

Definitions

- Infrastructure: Council's physical (i.e. non-financial) assets excluding land
 - Asset Group: a group of infrastructure assets that serve a particular purpose (e.g. culture)
 - Maintenance: the cost of upkeep and repair to an asset so it does not deteriorate prematurely
 - Backlog: the cost of rehabilitating an asset to a recognised minimum standard of service
 - Asset Renewal: the cost of restoring an asset to its original service capacity using current standards and technology
 - Enhancement: the cost of expanding an asset beyond its original service capacity
 - Growth: the cost of expanding the Council's total stock of assets
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Definitions

- Restrained Spending Scenario: assumes Council overcomes any infrastructure backlog and renews assets when necessary, but limits expansion of total facilities and services to just over a quarter of forecast local economic growth (0.7% per annum in real terms).
- Responsive Spending Scenario: assumes Council overcomes any infrastructure backlog, renews assets when necessary and expands Council facilities and services in line with two thirds of forecast local economic growth (1.7% per annum in real terms).
- Existing Spending Policy: assumes Council's \$29.3 million annual infrastructure spending and budgeted 0.8% annual services growth continues over the long run.

Definitions

- Modest Revenue Option: assumes rates, fees, user and developer charges rise in line with forecast CPI inflation of 2.5% per annum (i.e. experience no real growth).
- Ambitious Revenue Option: assumes (a) rates increase sufficiently over 5 years to give Council a 2.5% operating surplus and thereafter grow by two thirds the rate of the local economy (1.7% in real terms), and by the 5th year (b) fees and charges rise to the minimum of the top quartile of comparable councils and thereafter track inflation, and (c) developer charges rise to their previous level and thereafter grow in step with capital expenditure.
- Existing Revenue Policy: assumes Council's current revenue policies and plans remain in place.

NCC's Profile - Key Features

- NCC governs the second largest commercial centre and port in NSW.
- Its resident population of 146,000 puts it on par with Sydney City Council, making it one of the 15 largest municipalities in NSW.
- It has 12 Councilors and a popularly elected Lord Mayor (John Tate).
- It is administered by a General Manager (Janet Dore) with the help of six Group Managers and about 900 staff (FTE).
- It's total operating budget this year is \$163 million.
- In addition it is investing \$27 million this year on public infrastructure (mainly local roads and special purpose buildings and structures).

NCC's Profile - Key Features

- In terms of expenditure it is the sixth largest Council in NSW.
- Since it covers the CBD of Newcastle it is heavily dependent on rates and charges levied on businesses.
- Newcastle is the regional capital of the Hunter Valley so acts as its social, cultural and economic hub, which puts considerable strain on its infrastructure.
- Its future population growth is projected at 0.3% per annum, which is below that forecast for NSW (0.8% per annum).
- Its future annual economic growth (excluding inflation) is forecast at 2.5% compared with 3.0% for the state.

NCC's Profile - Services

- NCC's main services by order of spending in 2005/06 were:
 - **Recreation and culture**, including parks and gardens, public libraries, museums and galleries, sports grounds, swimming pools and public halls. \$35.5M
 - **Transport**, including roads, parking areas, footpaths, aerodromes and street lighting. \$34.3M
 - **Property and community amenities**, including waste disposal, environmental protection, stormwater drainage, town planning and street cleaning. \$29.8M
 - **Governance and administration**, including engineering works, corporate support and council meetings. \$26.8M
 - **Economic affairs**, including tourism, area and industrial promotion and business undertakings including caravan parks. \$4.7M
 - **Public order and safety**, including State fire service levy and beach control. \$6.2M
 - **Building control** including reviewing and approving building applications. \$4.7M
 - **Community services** including family day care, child care, youth services and aged and disabled services. \$4.3M
 - **Health**, including food control and insect, vermin and noxious plant eradication. \$1.9M

Total service spending: \$148.2M

Note: Economic affairs (73%), Building controls (66%), Transport (66%) and Property and Community services (60%) are largely funded from user charges and commonwealth/state grants.

NCC's Profile - Infrastructure

- NCC's major asset groups are:
 - Regional and local roads (inc pavements, street lighting, bridges, etc) \$552M
 - Natural assets (e.g. street and park trees, urban creeks) \$127M
 - Storm water (e.g. pits, pipes, culverts) \$460M
 - Buildings and structures (e.g. retaining and river walls, bridges and culverts) \$471M
 - Recreational assets (e.g. parks and sports grounds) \$6M
 - Cultural assets (e.g. art works and museum exhibits) \$69M
- Total replacement value of infrastructure: \$1,685M**

NCC's Profile - Public Opinion

- Council's 2006 community survey shows garbage collection, road maintenance, long-term city planning, maintenance of beaches, parks and recreation areas, environmental protection, traffic regulation and CBD parking are considered as very important.
- The same survey found a relatively low satisfaction with CBD parking, CBD management, community involvement in council decisions, road maintenance, city planning, youth facilities, footpath maintenance and buildings and asset maintenance.
- Highest satisfaction was expressed with library services, garbage collection, swimming pools, beach maintenance, parks and recreation areas, sporting and cultural facilities even though a number of these services were considered of relatively lower priority.

NCC's Profile - Public Opinion

- Another 2006 Council survey shows that infrastructure assets that people most wanted to see improved are footpaths/ nature strips, roads, parks, gardens, sporting ovals and playgrounds, ocean baths and beaches.
- 39% supported an annual contribution to improve infrastructure, while 45% opposed it. Opponents said existing rates were already too high and better infrastructure should be funded by diverting existing spending and obtaining greater efficiencies and less waste.

NCC's Profile - Income

- NCC's 2005/06 income was mainly from:
 - Rates and annual garbage charges \$ 77m
 - User charges and fees (e.g. tipping fees & RTA charges) \$36m
 - C/w & State operating grants and contributions \$ 21m
 - Interest on investments \$ 7m
 - Other revenues (e.g. rental incomes & fines) \$ 5m
 - Proceeds from asset sales \$ 1m
 - Subtotal - operating revenues \$147m*
 - C/w & State capital grants and contributions \$6m
 - Total operating and capital revenues \$153m**

NCC's Profile - Income

- NCC's rating structure in 2005/06 was as follows:
 - Residential: 56,758 households paid an average rate of \$710
 - Commercial: 4,204 businesses paid an average rate of \$5,867
 - Farming: 21 farms paid an average rate of \$1,333
 - Other: everyone paid an environmental levy averaging \$19 and some properties paid special business rates which varied between districts.

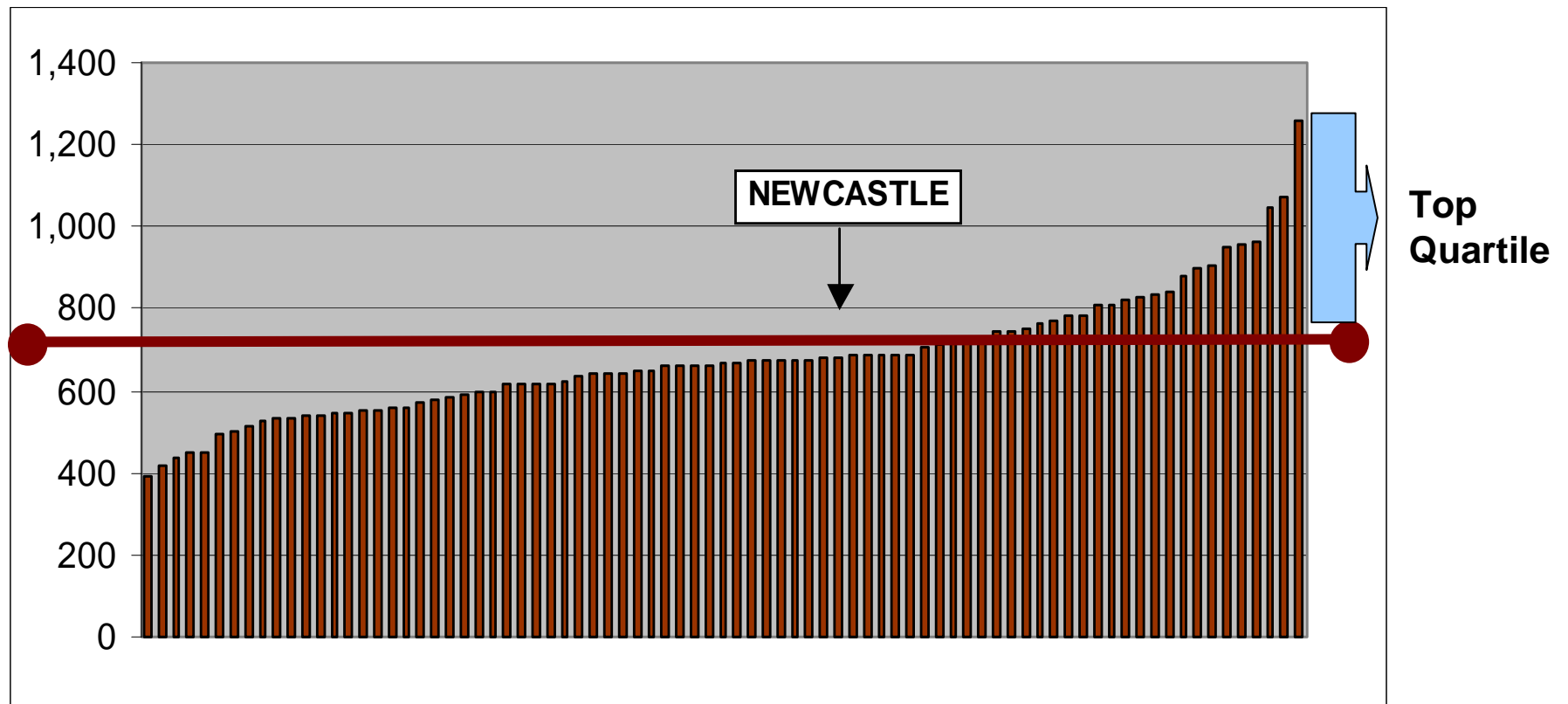
NCC's Profile - Income

- Newcastle's revenue raising efforts compared with the minimum efforts of the top quartile of revenue raisers in metropolitan and larger regional councils were as follows:
 - Its average residential rate was 8.8% below this benchmark
 - Its average business rate was a one-third higher than this benchmark.
 - Its fees and charges ratio* was 1.3% below this benchmark.
- Its developer charges ratio* was only 38% of its average over the past 6 years.

* See Access Economics Report, pages 24 and 26 for an explanation of these ratios.

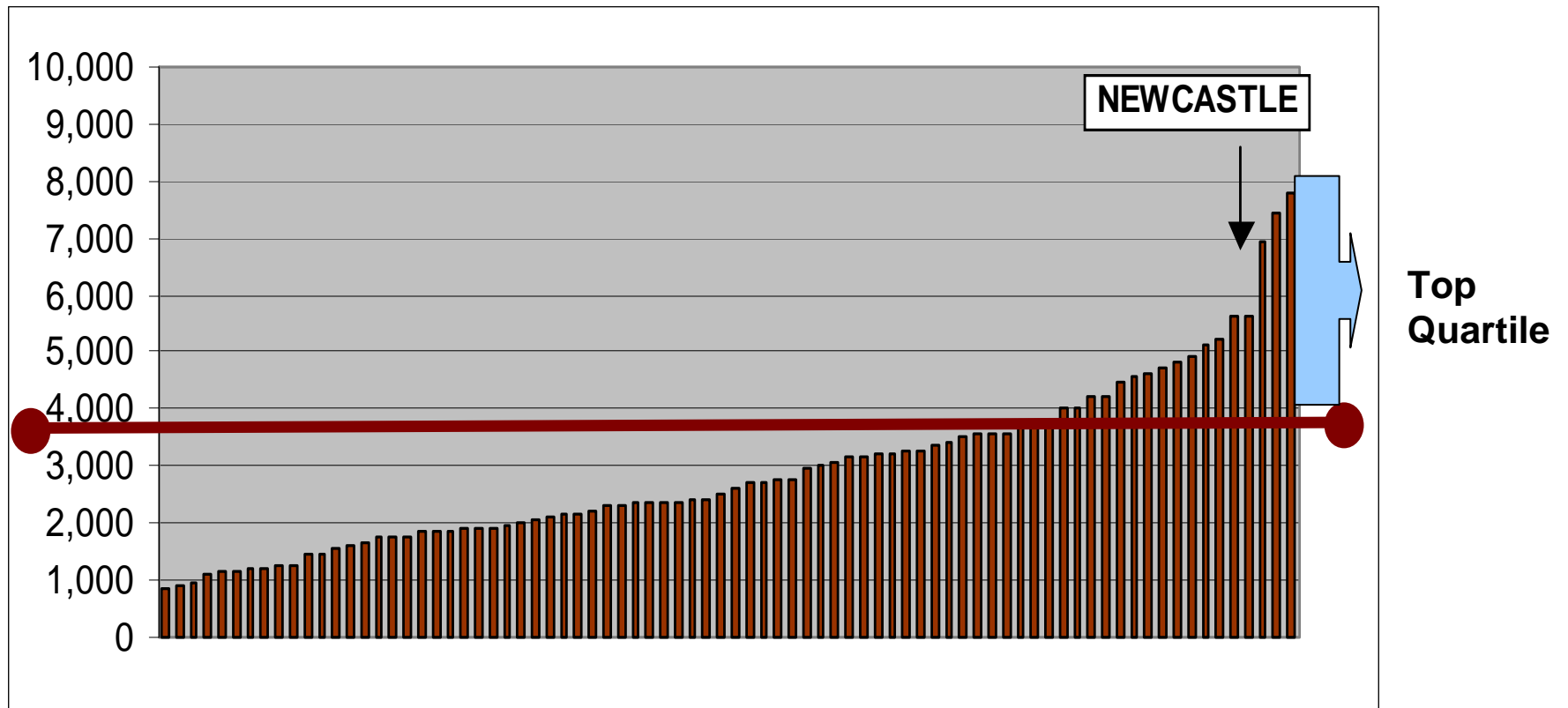
NCC's Profile - Income

Average Residential Rates of NSW Metropolitan and Larger Regional Councils, \$ per assessment, 2004/05



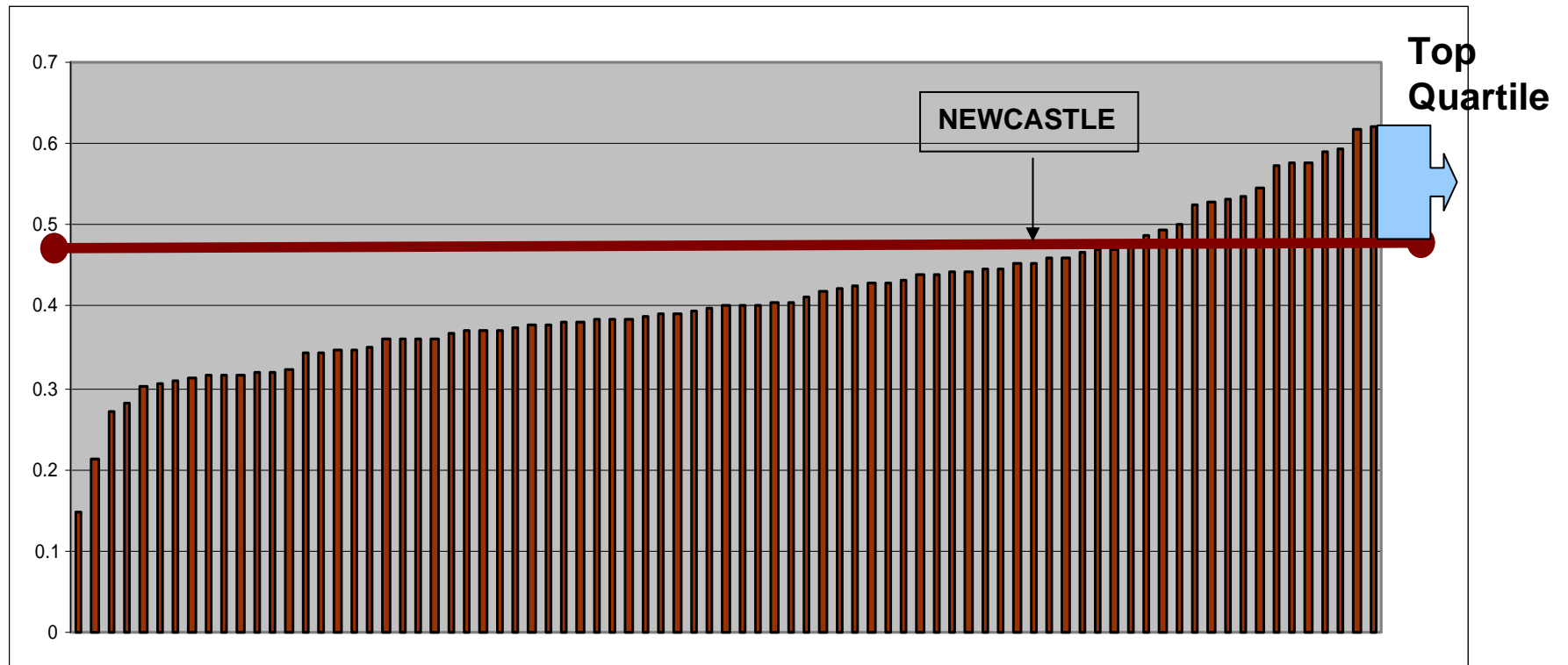
NCC's Profile - Income

Average Business Rates of NSW Metropolitan and Larger Regional Councils, \$ per assessment, 2004/05



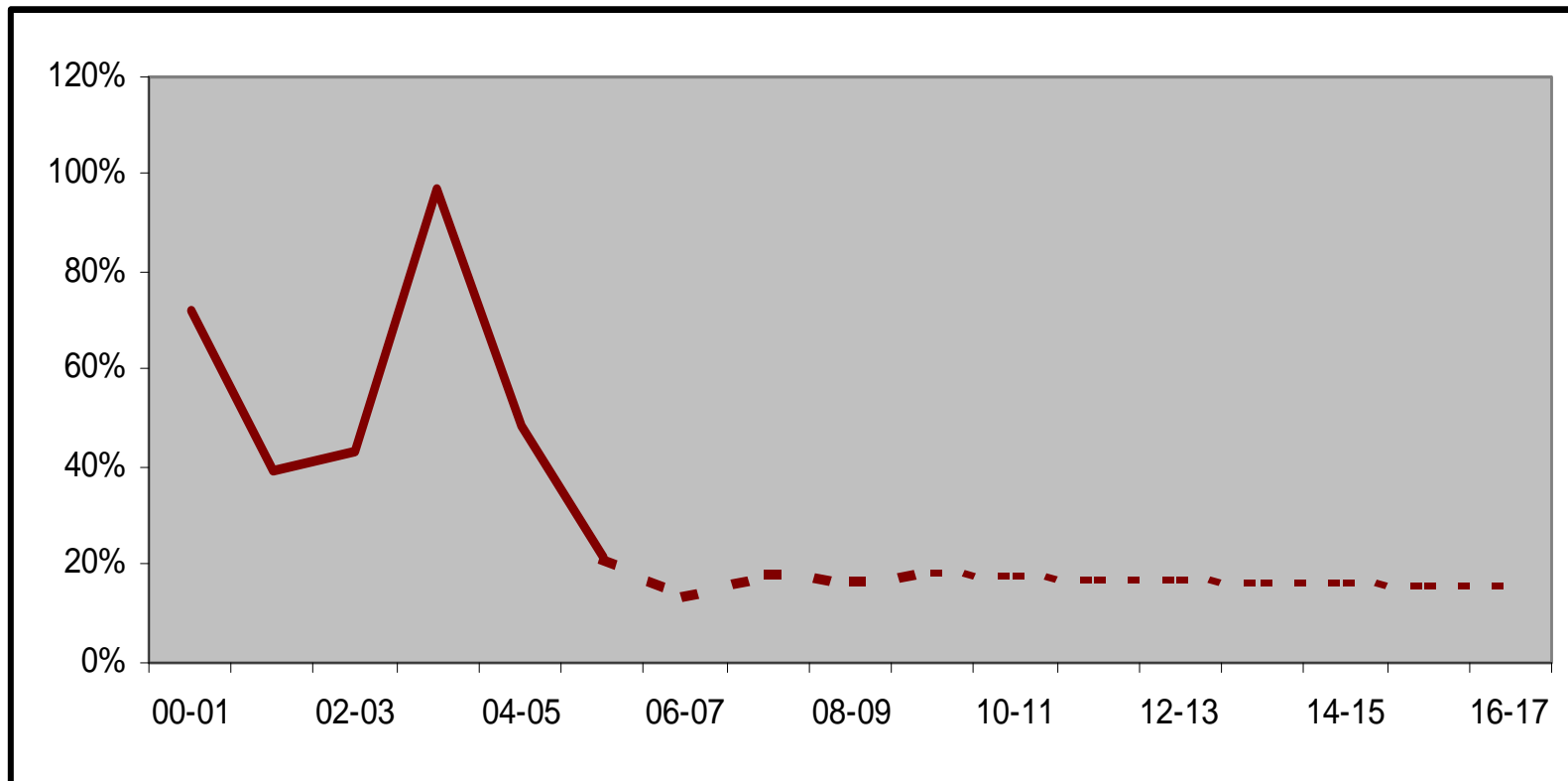
NCC's Profile - Income

Fees and Charges Ratios of NSW Metropolitan and Larger Regional Councils, 2004/05



NCC's Profile - Income

Developer Charges Ratio of Newcastle City Council, 2000/01-2009



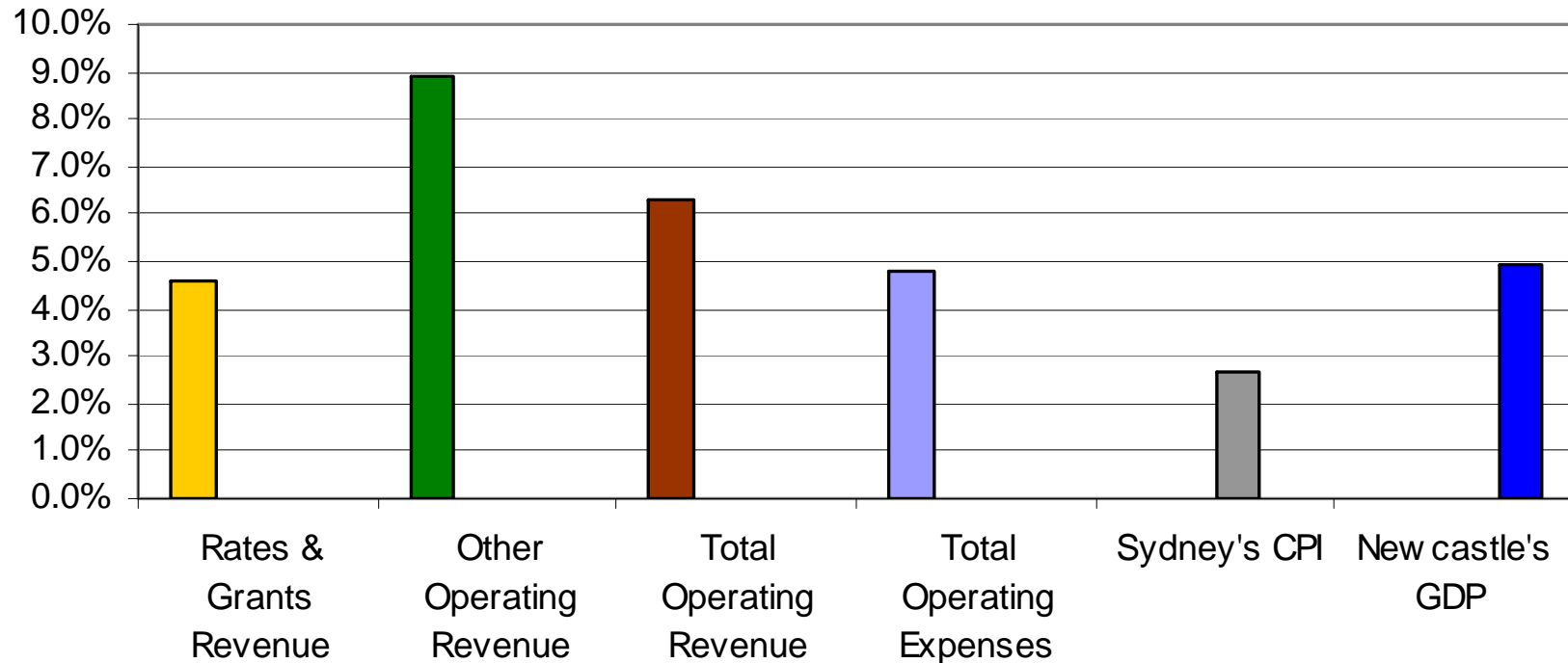
NCC's Profile - Growth

- Over the past five years NCC's:
 - Operating revenue has grown by 6.3% per annum, with rates and grants revenue up by 4.6% a year, while other forms of income (e.g. fees, user charges, fines, interest earnings) have risen by a strong 8.9% a year.
 - Operating expenses have grown by 4.8% per annum
 - Capital spending has grown by 13.6% a year.
 - These figures compare with annual price inflation of 2.7% and annual economic growth (including inflation) of 4.9% for Newcastle*.

* Note that annual real economic growth (excluding inflation) was 1.4%. Both the nominal and real economic growth rates are estimates by Review Today.

NCC's Profile – Growth

Annual Growth Rates of NCC's Revenues and Operating Expenditures compared with Annual Increases in the Sydney CPI and Newcastle's estimated GDP at current prices, 2000/01– 2005/06



Finances - Overview

- NCC has a strong balance sheet (i.e. low debt and other financial liabilities).
- As a result NCC has very low interest payments.
- However, its operating account (after excluding capital grants) is in deficit.
- In most recent years, the deficit on its operating account has been offset by a surplus on its capital account, which results in capital funds being used for non-infrastructure purposes.
- However, a capital spending surge in 2005-06 resulted in a capital deficit that year, producing an overall budget deficit of \$13.6 million.

Finances - Balance Sheet

Balance Sheet	NCC 30.6.06	Floor Target	Ceiling Target
Net debt	22.7		
Plus			
Other financial liabilities	35.5		
Equals			
Net financial liabilities	58.2	N.A.	N.A.
Divided by			
Financial and non-financial assets (i.e. capital)	1,655.1		
Equals			
Net financial liabilities ratio	3.5%	8%	12%
Net interest expense	0.6	N.A.	N.A.
Divided by			
Operating revenue (exc. capital transfers, etc)	145.7		
Equals			
Net interest expense ratio	0.4%	3%	5%

Finances - Operating Account

Operating Account	NCC 30th June 2006	Floor Target	Ceiling Target
Operating revenue (excluding capital revenue)	145.7		
Less			
Operating expenses (including net interest and asset depreciation expenses)	147.8		
Equals			
Operating surplus / (deficit)	-2.2	N.A.	N.A.
Divided by			
Own-source operating revenue	127.8		
Equals			
Operating surplus/ (deficit) ratio	-1.7%	2.5%	7.5%

Finances - Capital Account

Capital Account	NCC 30th June 2006	Floor Target	Ceiling Target
Capital revenue (including capital grants and contributions)	36.6		
Less			
Capital expenditures	48.0		
Equals			
Capital surplus / (deficit)	-11.4	N.A.	N.A.

Infrastructure

- Infrastructure includes all physical assets such as:
 - Roads (inc. pavements)
 - Natural Assets (inc. trees)
 - Storm Water Assets
 - Buildings & Structures (inc. bridges and sea walls)
 - Recreational Assets (inc. parks & sporting grounds)



Infrastructure - Condition

- Infrastructure needs to be:
 - **Maintained** (i.e. routine repairs);
 - **Renewed** (i.e. refurbished or replaced) when it deteriorates to an unacceptable standard; and
 - **Enhanced** (i.e. expanded beyond its original capacity/ service level) when it can no longer keep up with community demands.
- Example for a local road:
 - **Maintained** - Potholes are regularly repaired;
 - **Renewed** - Surface is renewed every few years; and
 - **Enhanced** - Capacity may be expanded by introducing over or underpasses and extra driving lanes, when traffic congestion becomes excessive.

Infrastructure - Condition

- For a typical asset:
 - Condition will degrade with age;
 - This degradation starts gradually and accelerates towards the end of the asset's life;
 - As the asset's condition degrades the level of service it provides also declines;
 - The cost to maintain the asset increase with time;
 - When service levels fall below a certain standard, the condition of the asset must be improved (i.e. renewed or refurbished);
 - Eventually the cost to maintain the asset will exceed the benefit of keeping it in service and the asset must be replaced.

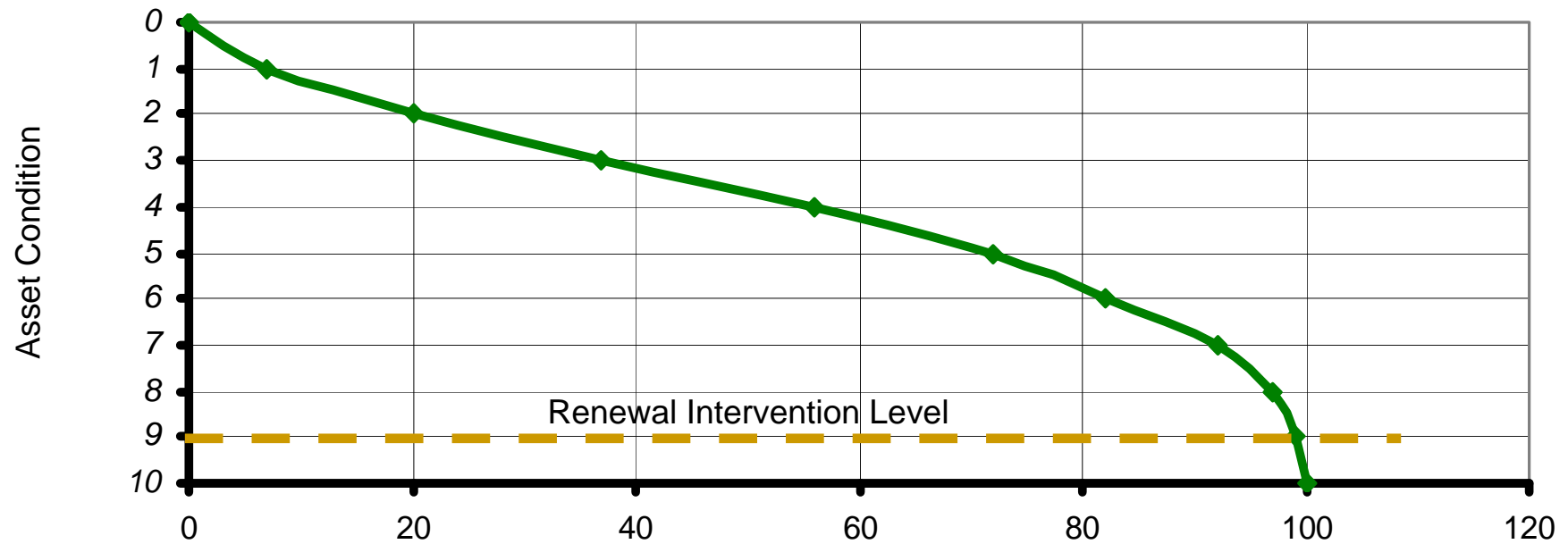
Infrastructure – Condition

Asset Condition Ratings

10	An asset that has failed is no longer serviceable and should not remain in service. There would be an extreme risk in leaving the asset in service.
9	An asset in extremely poor condition with severe serviceability problems and needing rehabilitation immediately. Could also be a risk to remain in service
8	An asset in very poor overall condition with serviceability now being heavily impacted upon by the poor condition. Maintenance cost would be very high and the asset would be at a point where it needed to be rehabilitated.
7	An asset in poor overall condition deterioration would be quite severe and would be starting to limit the serviceability of the asset. Maintenance cost would be high
6	An asset in Fair to poor overall condition. The condition deterioration would be quite obvious. Asset serviceability would now be affected and maintenance cost would be rising.
5	An asset in fair overall condition deterioration in condition would be obvious and there would be some serviceability loss.
4	An asset in good overall condition but with some obvious deterioration evident, serviceability would be impaired very slightly.
3	An asset in very good overall condition but with some early stages of deterioration evident, but the deterioration still minor in nature and causing no serviceability problems.
2	An asset in excellent overall condition. There would be only very slight condition decline but it would be obvious that the asset was no longer in new condition.
1	A near new asset with no visible signs of deterioration often moved to condition 1 based upon the time since construction rather than observed condition decline.
0	A new asset or an asset recently rehabilitated back to new condition.

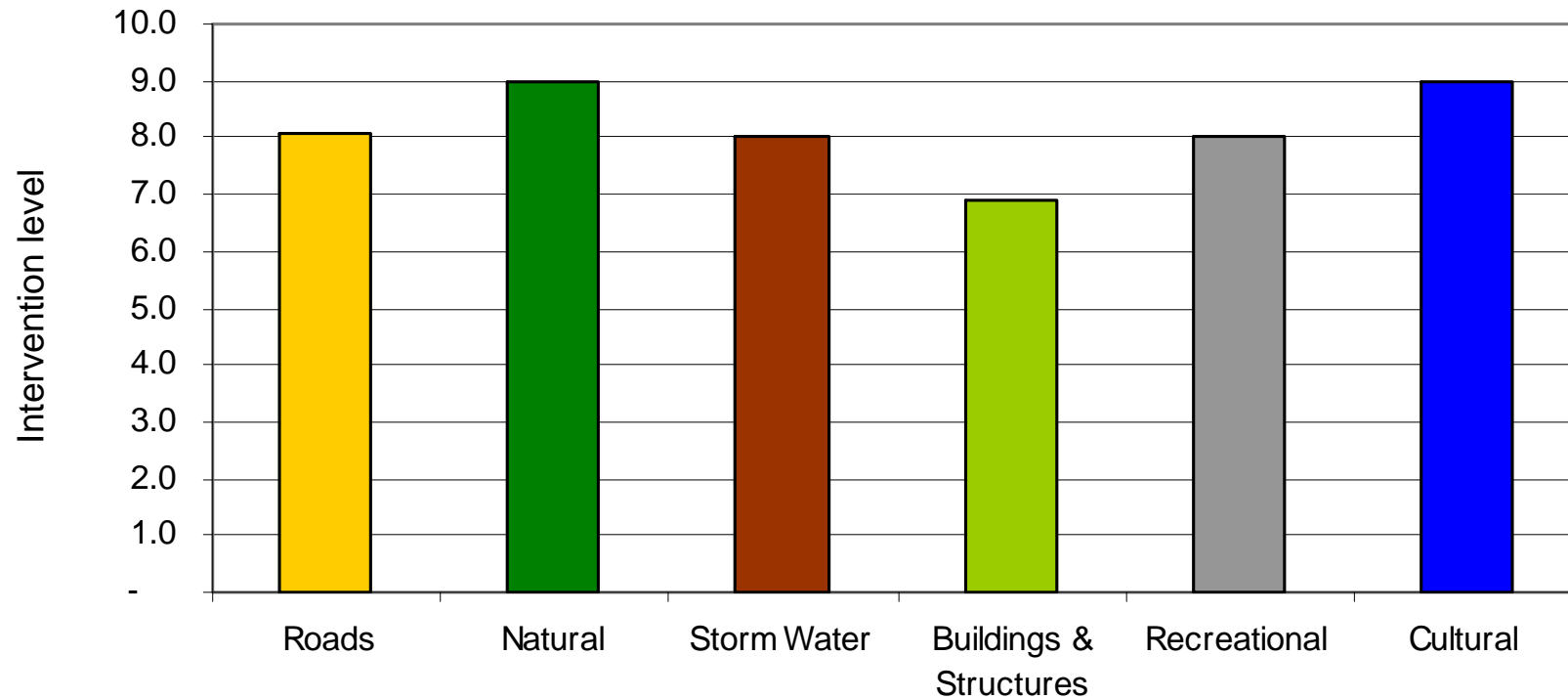
Infrastructure - Condition

Asset Degradation Curve showing NCC's Intervention Level for Kerbs and Gutters



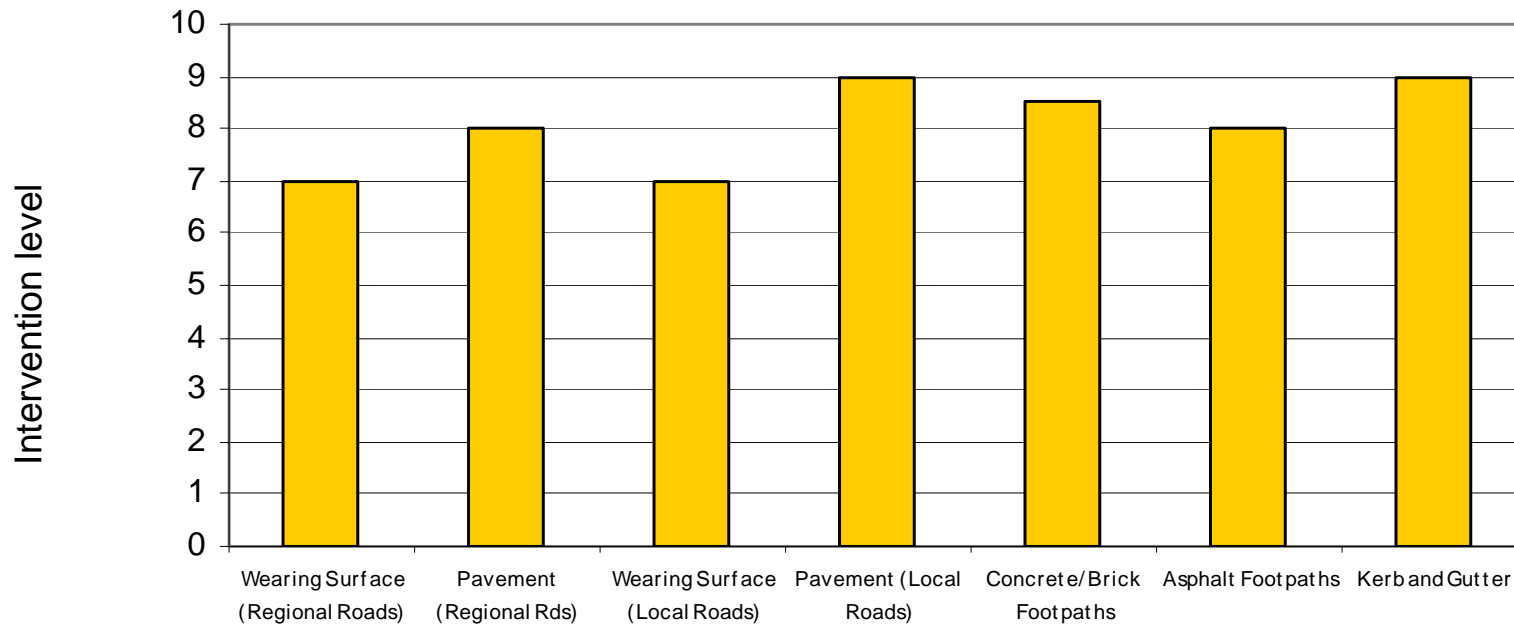
Infrastructure - Condition

NCC's Average Renewal Intervention Level for each Asset Group



Infrastructure - Condition

NCC's Renewal intervention Level for each Asset Set within the Roads Group



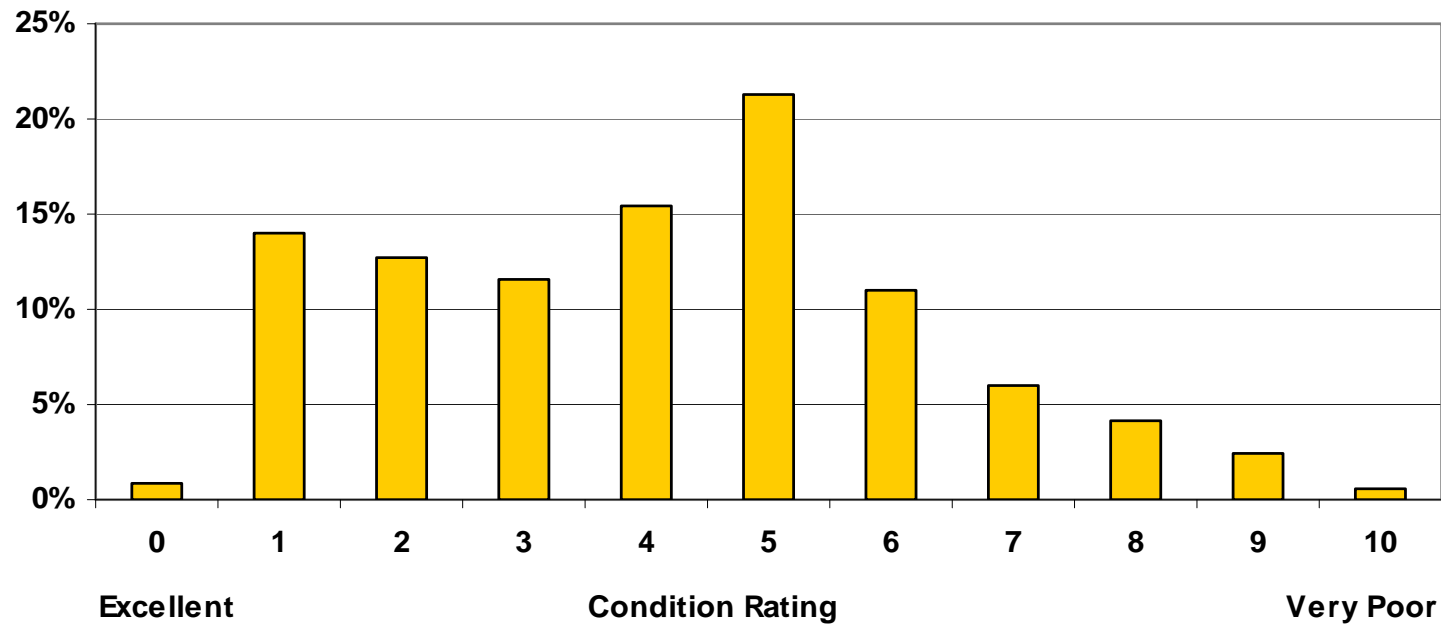
Infrastructure - Condition

- The present condition of NCC's overall infrastructure is as follows:
 - ❑ 8% is in very poor condition
 - ❑ 17% is in poor condition
 - ❑ 38% is in fair condition
 - ❑ 14% is in good condition
 - ❑ 11% is in very good condition
 - ❑ 12% is in excellent condition

Infrastructure - Condition

NCC's percentage of infrastructure within each Condition Rating

Percent of Assets

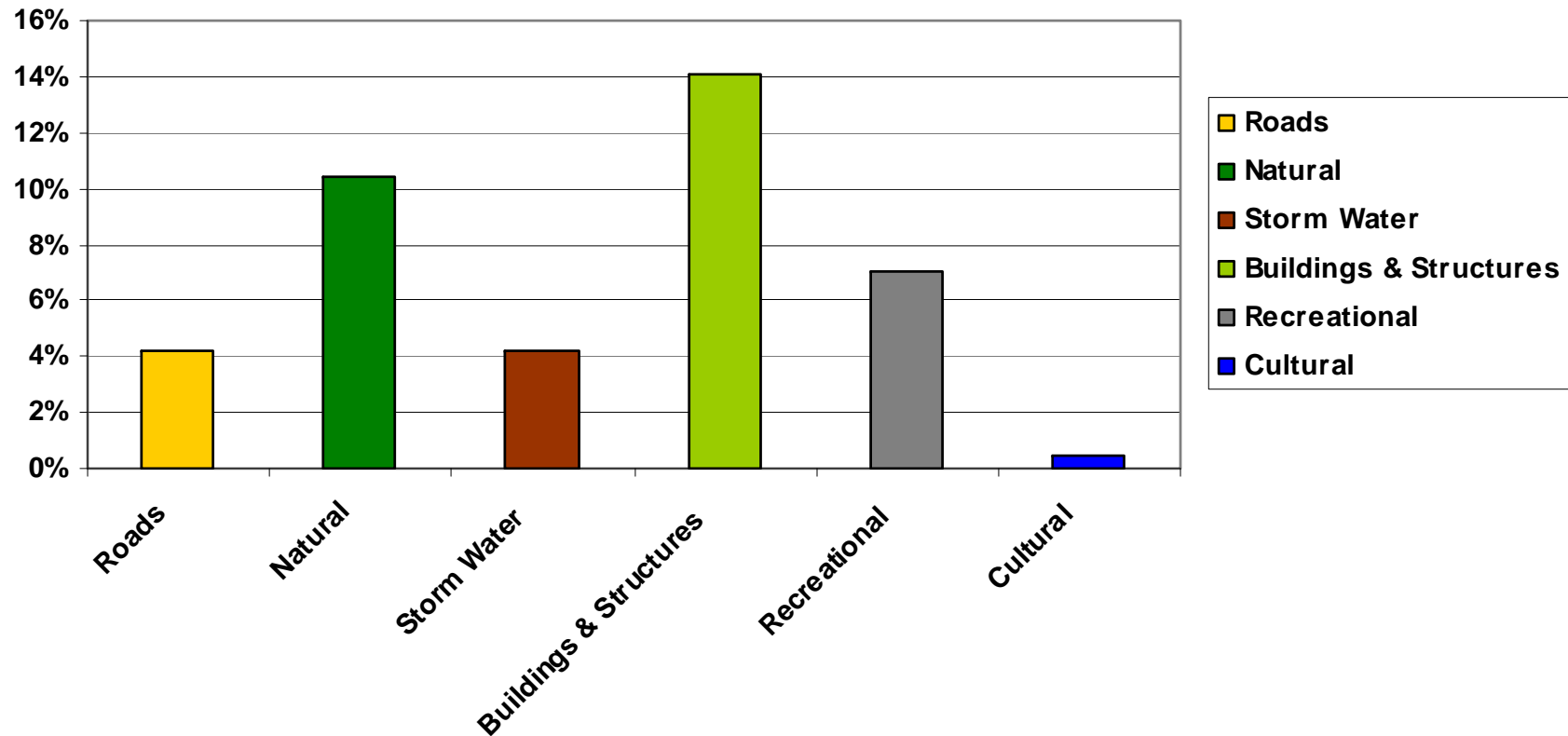


Infrastructure - Condition

- The share of each major asset group that is currently in an unacceptable condition is:
 - ❑ Roads = 4.2%
 - ❑ Natural Assets = 10.5%
 - ❑ Storm Water Assets = 4.2%
 - ❑ Buildings and Structures = 14.1%
 - ❑ Recreational Assets = 7.0%
 - ❑ Cultural Assets = 0.5%

Infrastructure - Condition

Proportion of each NCC Asset Group in an unacceptable condition

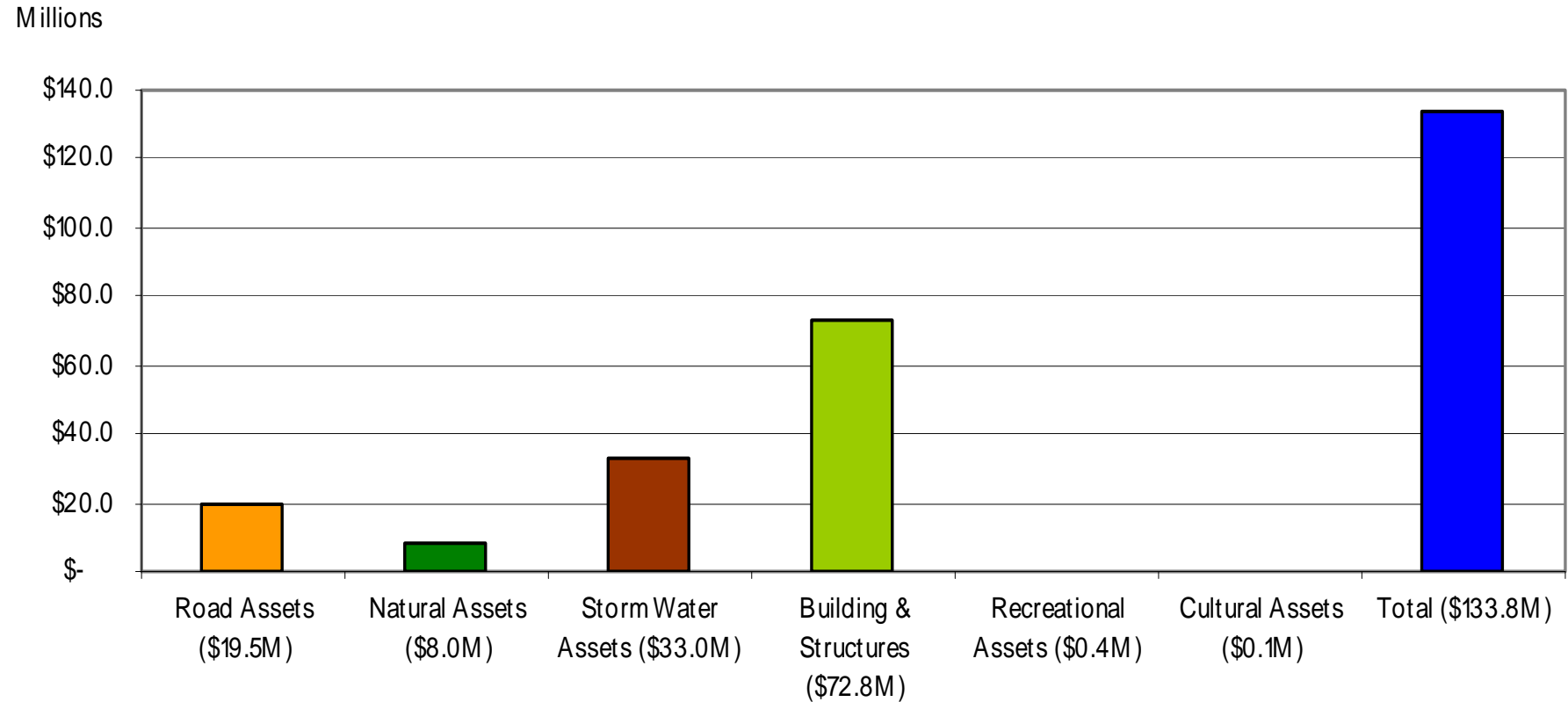


Infrastructure - Condition

- A number of Newcastle's public assets are reaching the end of their economic life.
- Many infrastructure assets have fallen below an acceptable standard and require renewal.
- The estimated cost to recover this infrastructure backlog is **\$134.1M** attributable to:
 - Roads = \$19.5M
 - Natural Assets = \$8M
 - Storm Water Assets = \$33.1M
 - Buildings and Structures = \$73M
 - Recreational Assets = \$0.4M
 - Cultural Assets = \$0.1M

Infrastructure - Backlog

Present Infrastructure Backlog [2006]



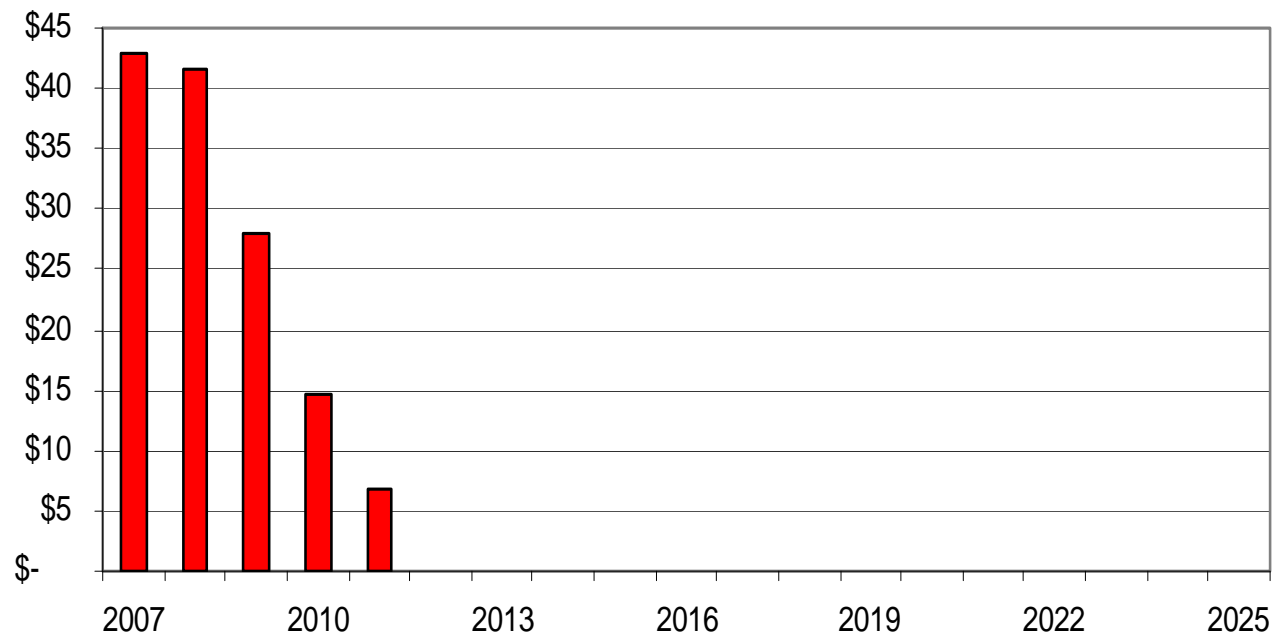
Infrastructure - Backlog

- If this infrastructure backlog of \$134.1 million was restored over 5 years the annual rehabilitation expenditure might take the form shown in the next chart.

Infrastructure - Backlog

Infrastructure Backlog Recovery over a 5 Year Period

Millions

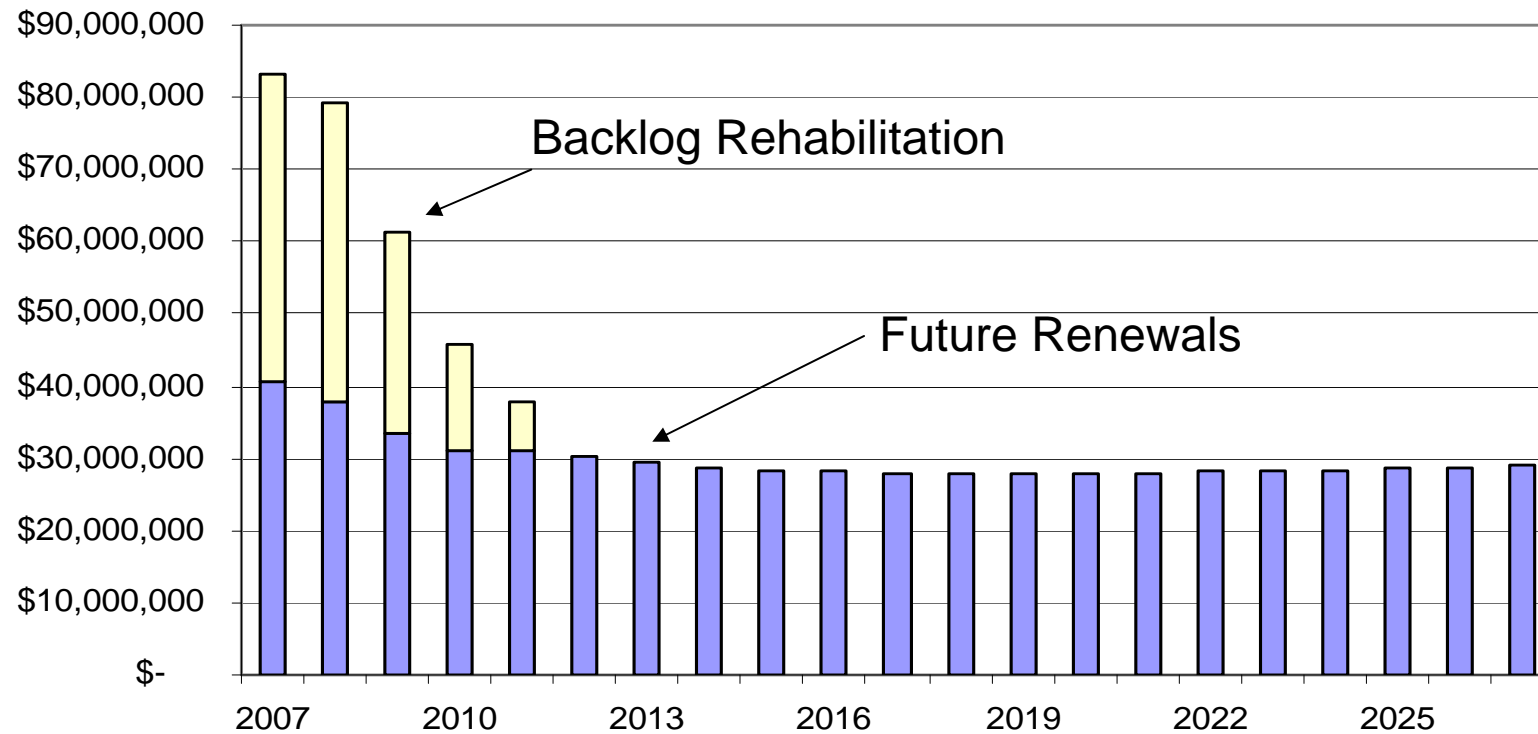


Infrastructure - Renewal

- A further \$630M needs to be invested in infrastructure renewals over the next 20 years.
- Failure to meet these renewals as required will result in further degradation of the asset base condition and would increase the current infrastructure backlog of \$134.1M.

Infrastructure - Renewal

Required Infrastructure Backlog and Renewal Expenditure

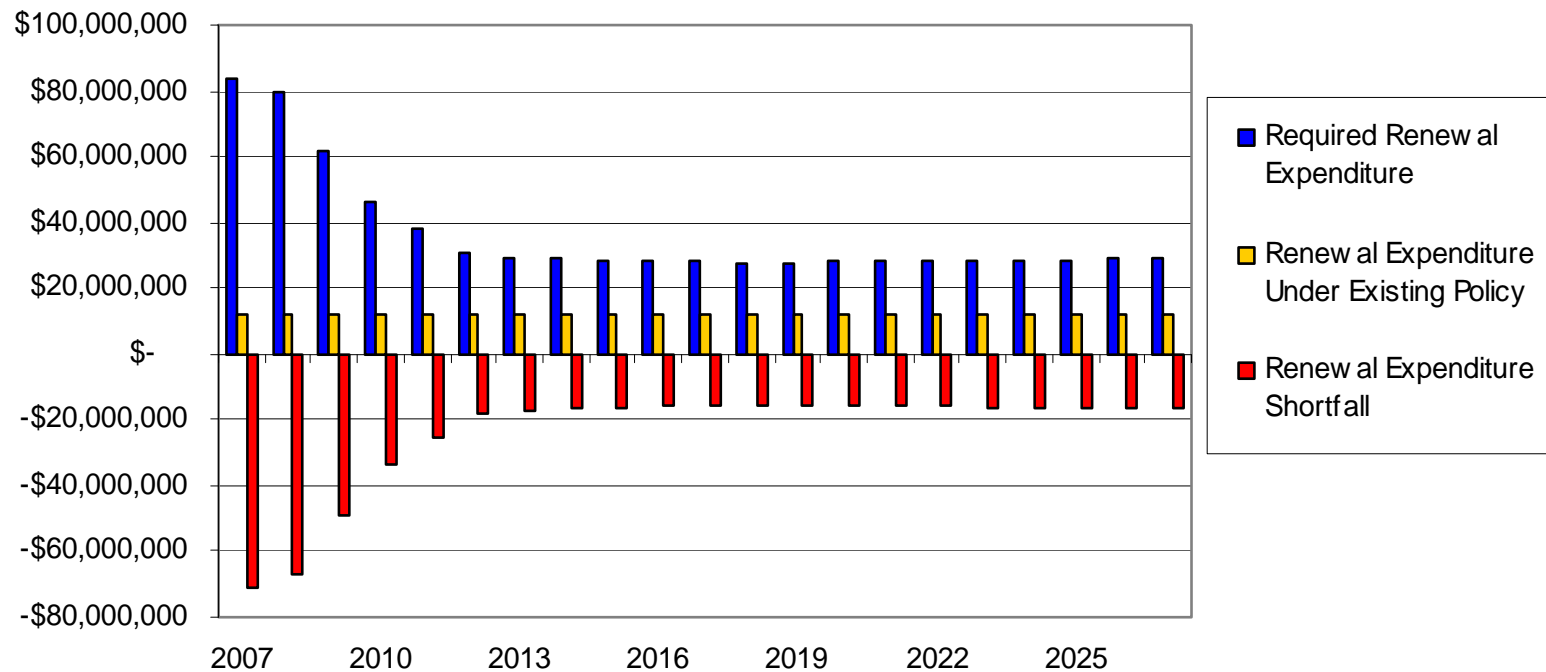


Infrastructure - Renewal

- The NCC spends about \$12.1M per annum on infrastructure renewals.
- As can be seen in the following chart this falls far short of what is required at present or in the future.

Infrastructure - Renewal

Infrastructure Renewal Expenditure Under Existing Spending Policy versus Required Renewal Expenditure

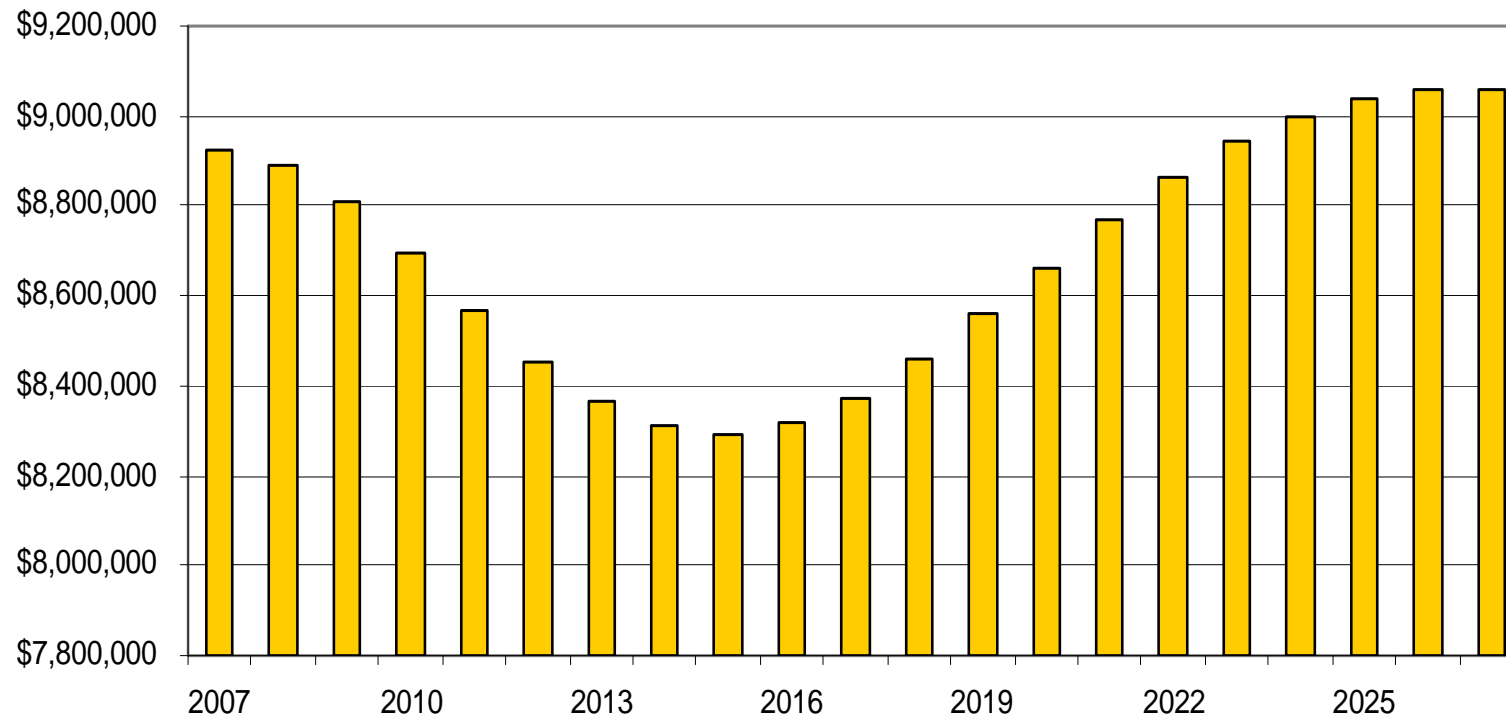


Infrastructure - Maintenance

- The required level of infrastructure renewal implies a certain level of asset maintenance if infrastructure is to remain at an acceptable standard.

Infrastructure - Maintenance

Required Infrastructure Maintenance Expenditure

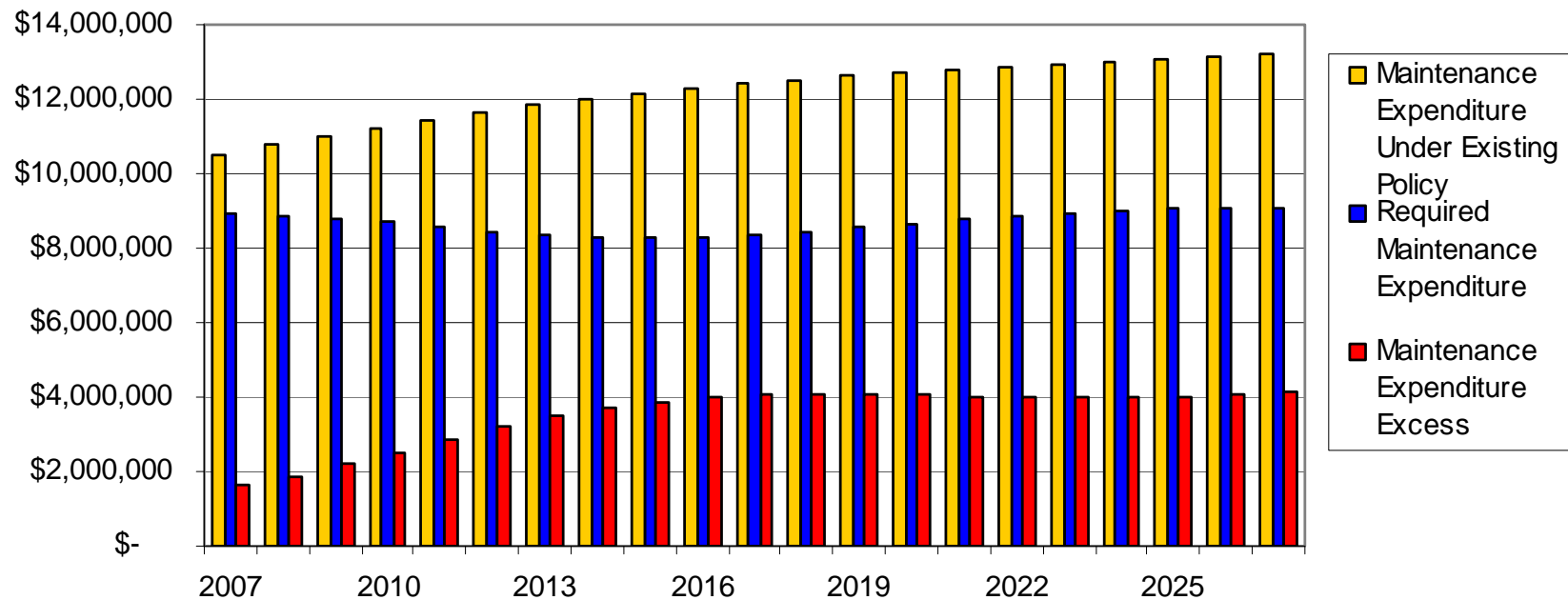


Infrastructure - Maintenance

- Because the NCC with current policies is projected to under-spend on future renewals, its maintenance bill will be on average \$3.5 million per annum higher than otherwise required. See next chart.

Infrastructure - Maintenance

Infrastructure Maintenance under Existing Spending Policy Versus Required Infrastructure Maintenance Expenditure



Infrastructure - Renewals

- Should the NCC's current infrastructure renewals and maintenance policy continue:
 - The future infrastructure backlog by 2027 would be in the order of \$475.1 million.
 - This would be \$341.1 million higher than at present.

Infrastructure - Enhancement

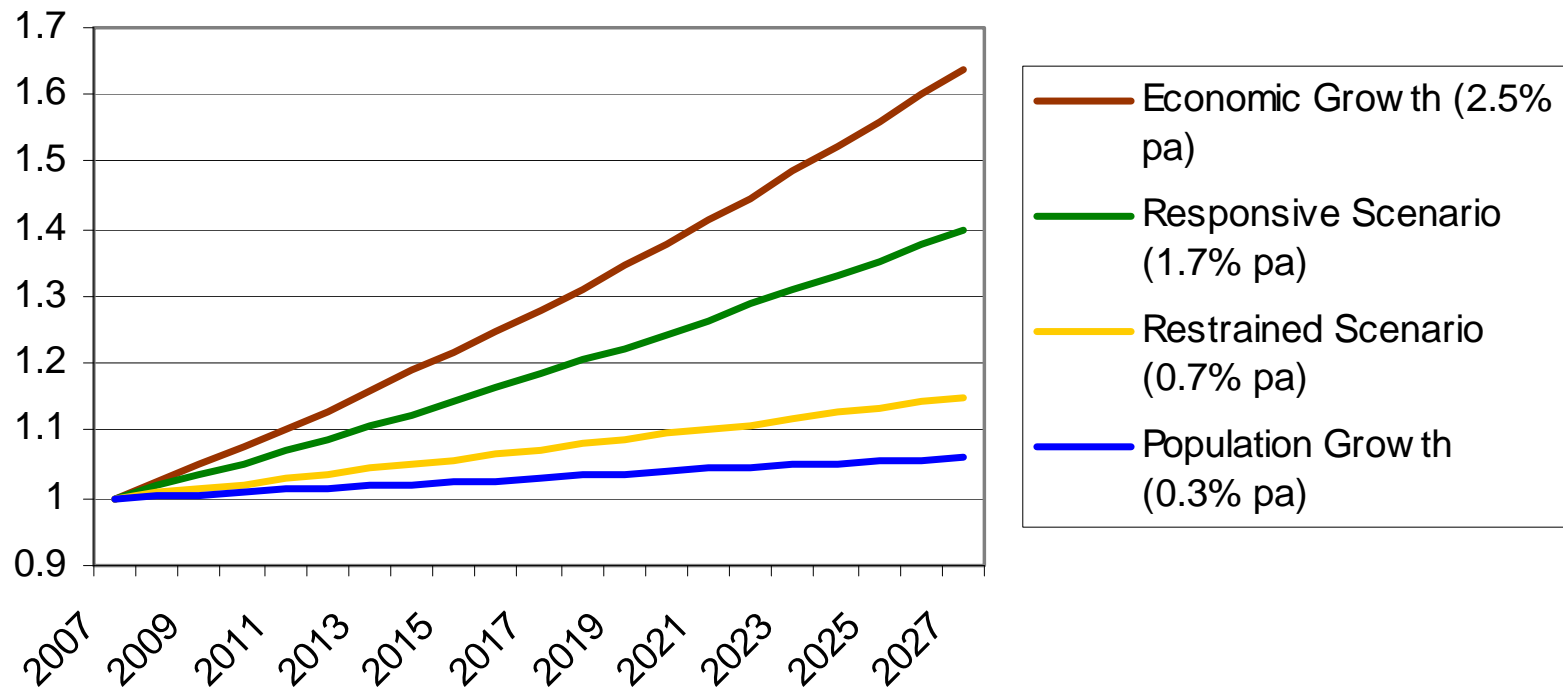
- Besides fixing existing infrastructure the NCC must also expand the capacity of its infrastructure assets to meet the demands of new residents and businesses moving into the area.
- Expanding the capacity of the Council's physical assets (e.g. widen a two lane bridge to a four lane one or building an additional community centre) is called infrastructure enhancement. It results in the growth of the total infrastructure stock.

Infrastructure - Enhancement

- There is no agreed level of infrastructure enhancement (i.e. additions to existing infrastructure stock).
- *Review Today* has adopted two distinct scenarios for depicting what might be required in extra infrastructure capacity.
- These infrastructure growth scenarios fall between Newcastle's projected population growth (0.3% per annum) and its forecast real economic growth (2.5% per annum).

Infrastructure - Enhancement

NCC's Spending Scenario Growth Rates compared with Newcastle's Population and Economic Growth Rates

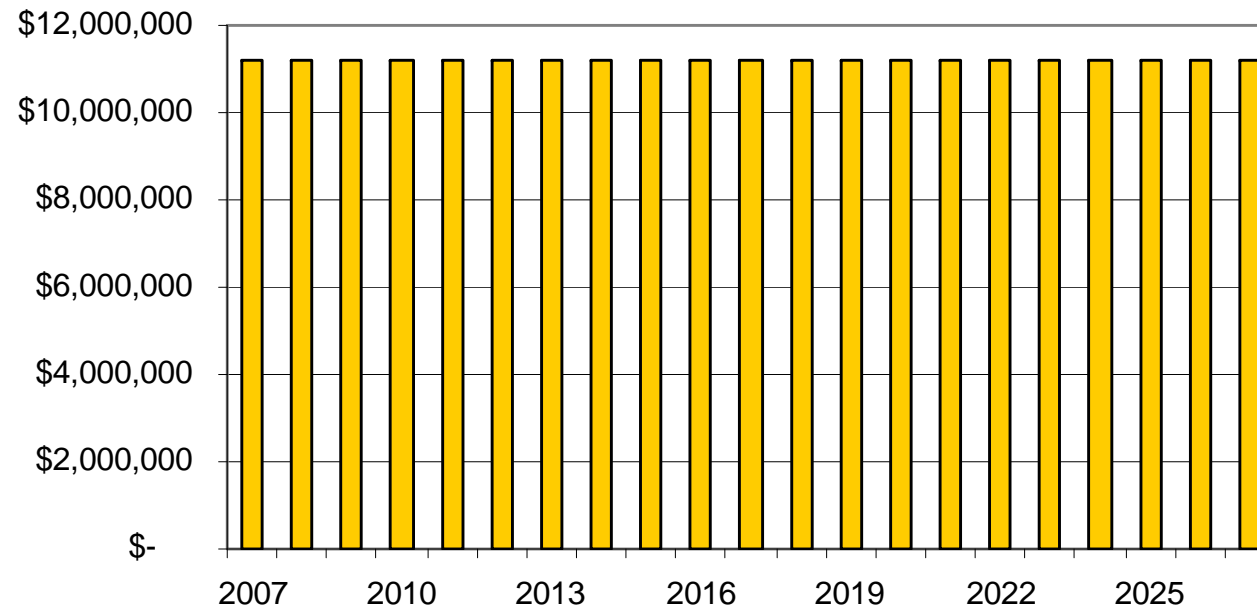


Infrastructure - Enhancement

- **Restrained Spending Scenario**
 - Those who want to keep rates and charges to a minimum may be content to fix the infrastructure backlog and renew assets as they fall due and expand the total infrastructure stock by only a quarter of the forecast rate of growth for the local economy (0.7% per annum excluding inflation).

Infrastructure - Enhancement

Infrastructure Enhancements under Restrained Spending Scenario

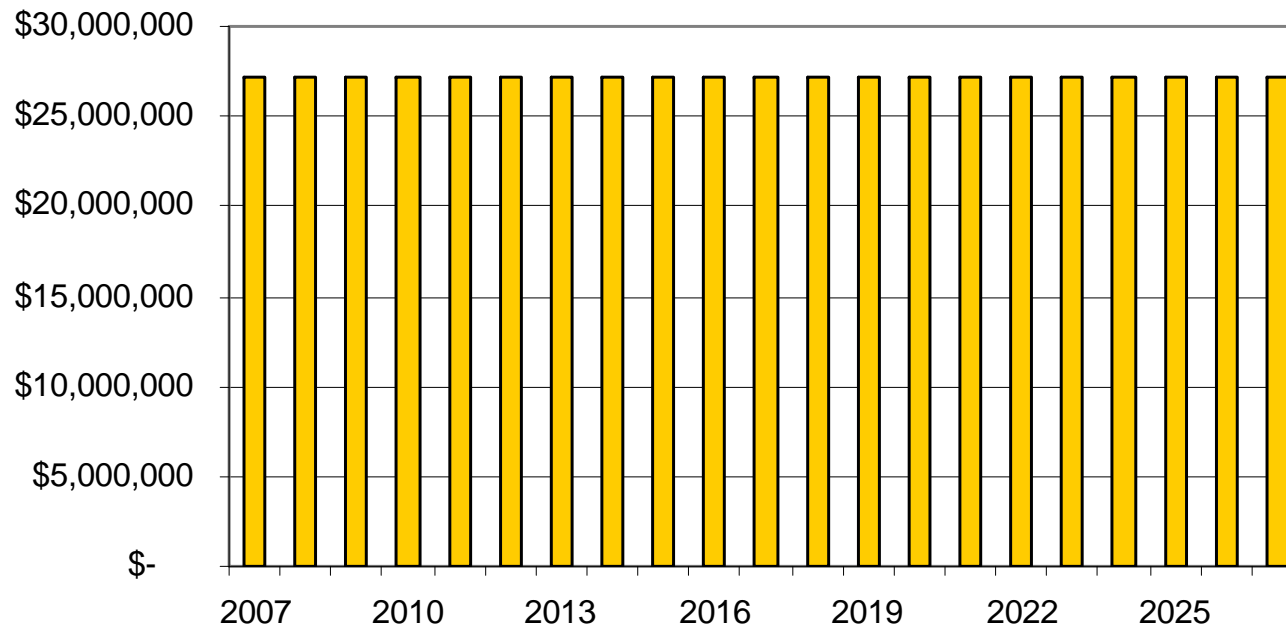


Infrastructure - Enhancement

- Responsive Spending Scenario
 - An alternative approach is to avoid pressures on infrastructure (e.g. traffic congestion) by ensuring that infrastructure stock keeps pace with at least two thirds of forecast economic growth (1.7% per annum excluding inflation).

Infrastructure - Enhancement

Infrastructure Enhancements under Responsive Spending Scenario



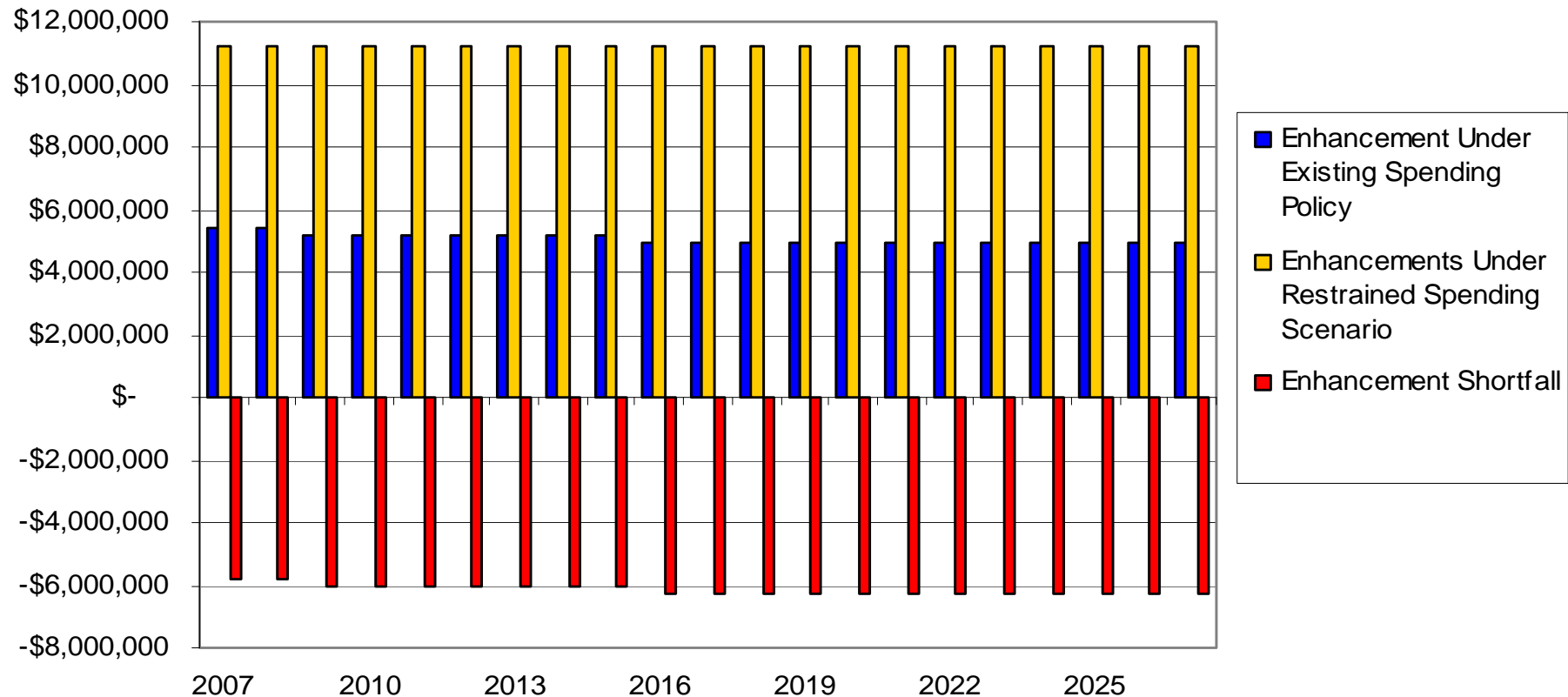
Infrastructure - Enhancement

■ Existing Spending Policy

- ❑ NCC spend about \$5 million per annum on enhancing infrastructure.
- ❑ Should this policy continue, proposed enhancements would fall short of a restrained enhancement scenario by an average of \$6.2 million per annum as shown in the following chart.
- ❑ As already stated a restrained scenario is where the total infrastructure growth is limited to just over one quarter the forecast growth of the Newcastle economy (0.7% per annum in real terms).

Infrastructure - Enhancement

Infrastructure Enhancement Shortfall -
Existing Spending Policy versus Restrained Spending Scenario

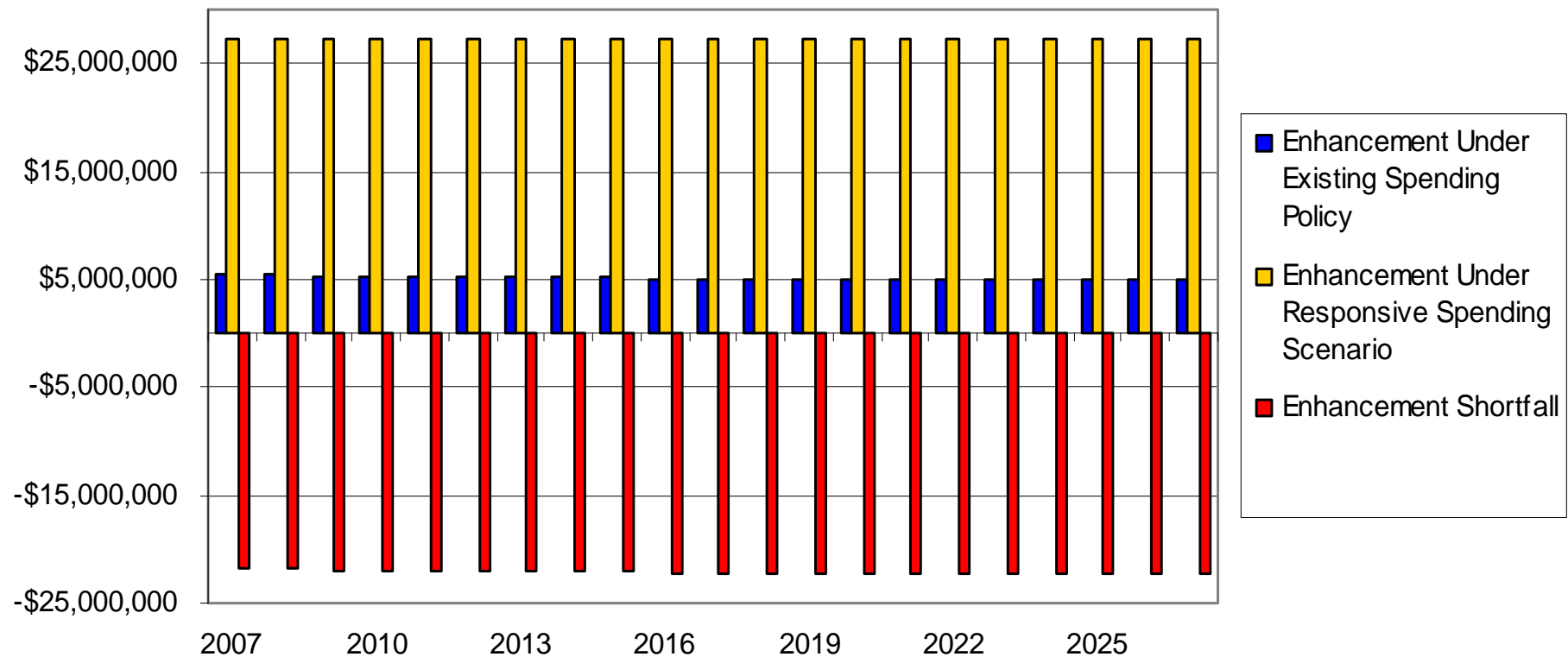


Infrastructure - Enhancement

- ❑ Existing spending policy enhancements would fall short of a responsive enhancement scenario by a much larger margin - an average of \$22.2 million per annum as shown in the following chart.
- ❑ As previously mentioned, a responsive scenario is where total infrastructure stock is enhanced by two thirds the forecast growth of the Newcastle economy (1.7% per annum excluding inflation).

Infrastructure - Enhancements

Infrastructure Enhancement Shortfall -
Existing Spending Policy versus Responsive Spending Scenario



Infrastructure - Total Spend

- The sum of backlog infrastructure rehabilitation, required future renewals, consequential maintenance and possible enhancements equals total infrastructure spending.
- *What will total infrastructure spending look like under the Restrained and Responsive Scenarios?*
- *How does total infrastructure spending under the Existing Policy outcome stack up against these two distinct scenarios?*

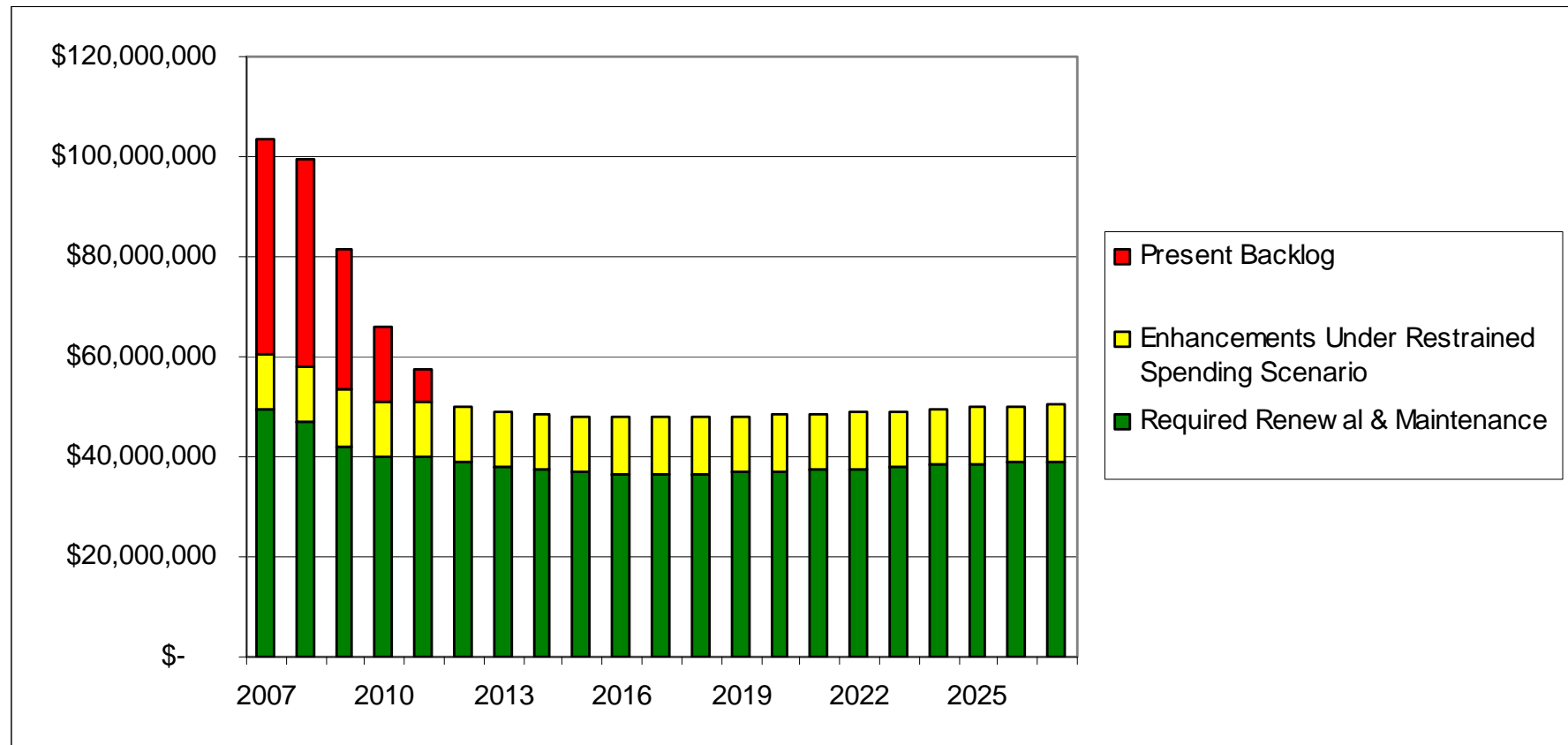
Infrastructure - Total Spend

- **Restrained Scenario**

- Under this scenario NCC's total infrastructure spending (excluding land acquisitions) would average \$56.7 million per annum over the next 20 years.
- The pattern of spending is depicted in the following chart.

Infrastructure - Total Spend

Total Infrastructure Requirement under Restrained Spending Scenario

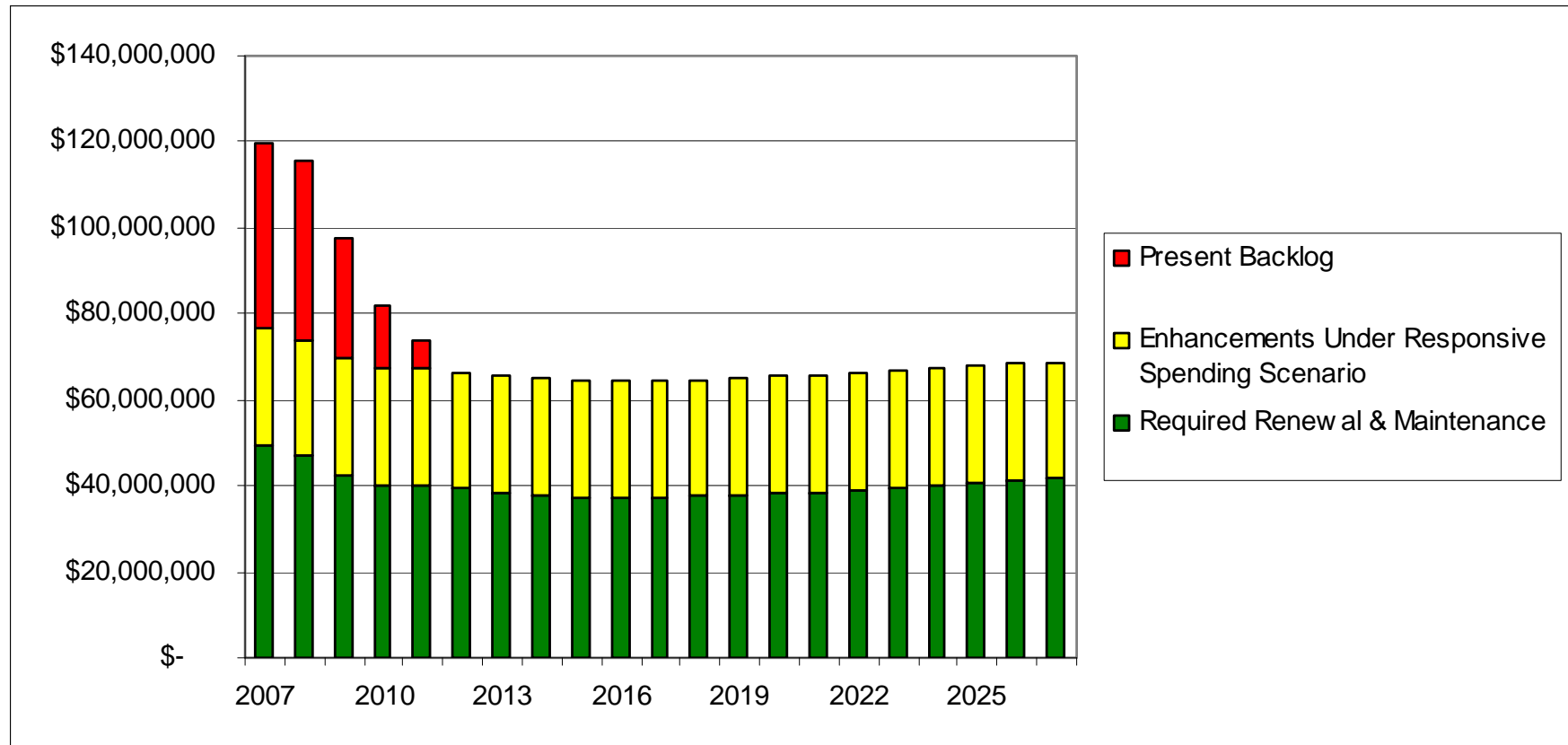


Infrastructure - Total Spend

- **Responsive Scenario**
 - Under this scenario NCC's infrastructure spending would average \$73.6 million per annum over the next 20 years.
 - The pattern of spending is depicted in the following chart.

Infrastructure - Total Spend

Total Infrastructure Requirement under Responsive Spending Scenario

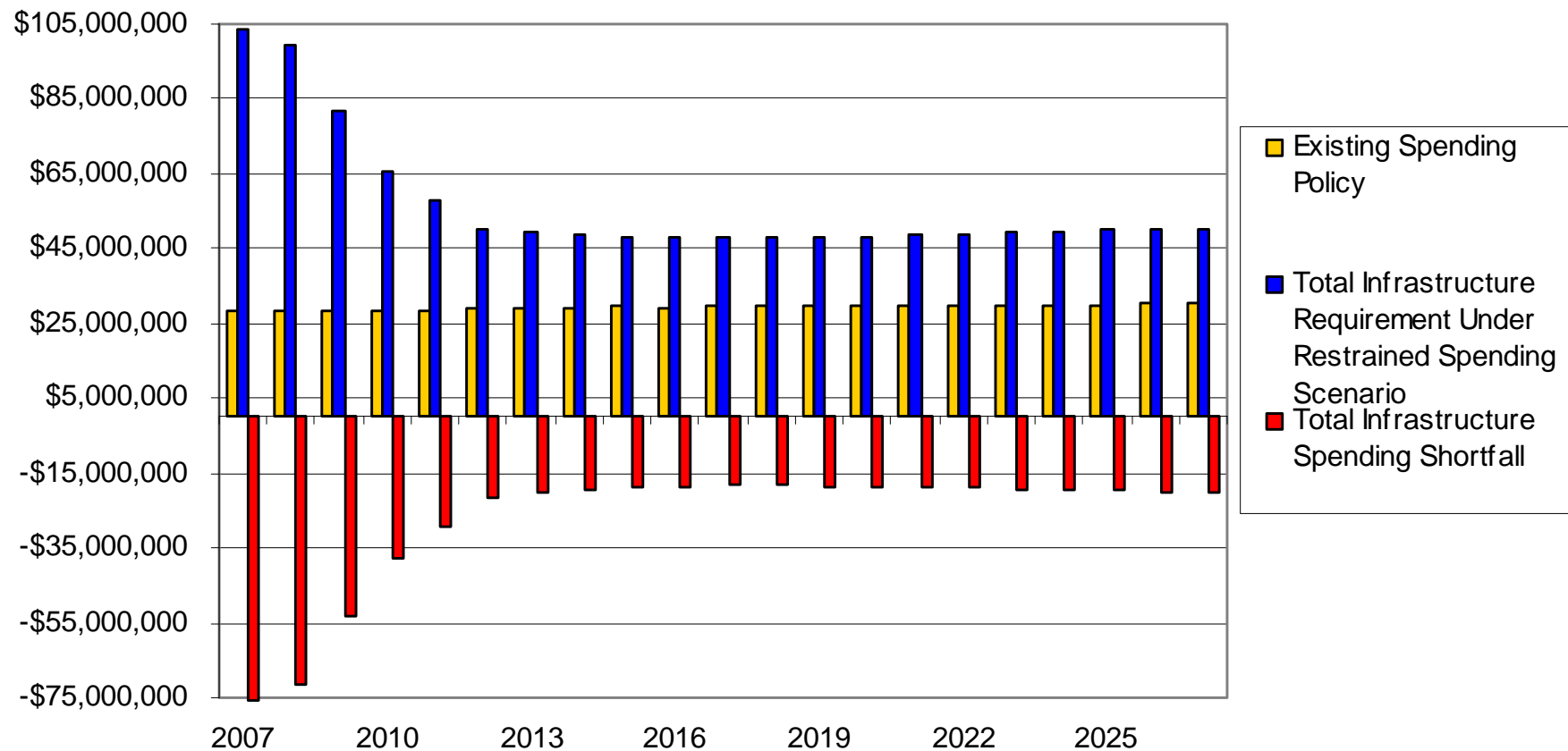


Infrastructure - Total Spend

- Existing Spending Policy Outcome
 - Under current policy, the NCC would continue to spend on average about \$29.3 million per annum on its backlog, renewals, maintenance and enhancement of infrastructure.
 - This would result in a shortfall in spending against a restrained infrastructure scenario of about \$27.4 million on average per annum. This is shown in the next chart.

Infrastructure - Total Spend

Total Infrastructure Spending Shortfall -
Existing Spending Policy versus Restrained Spending Scenario

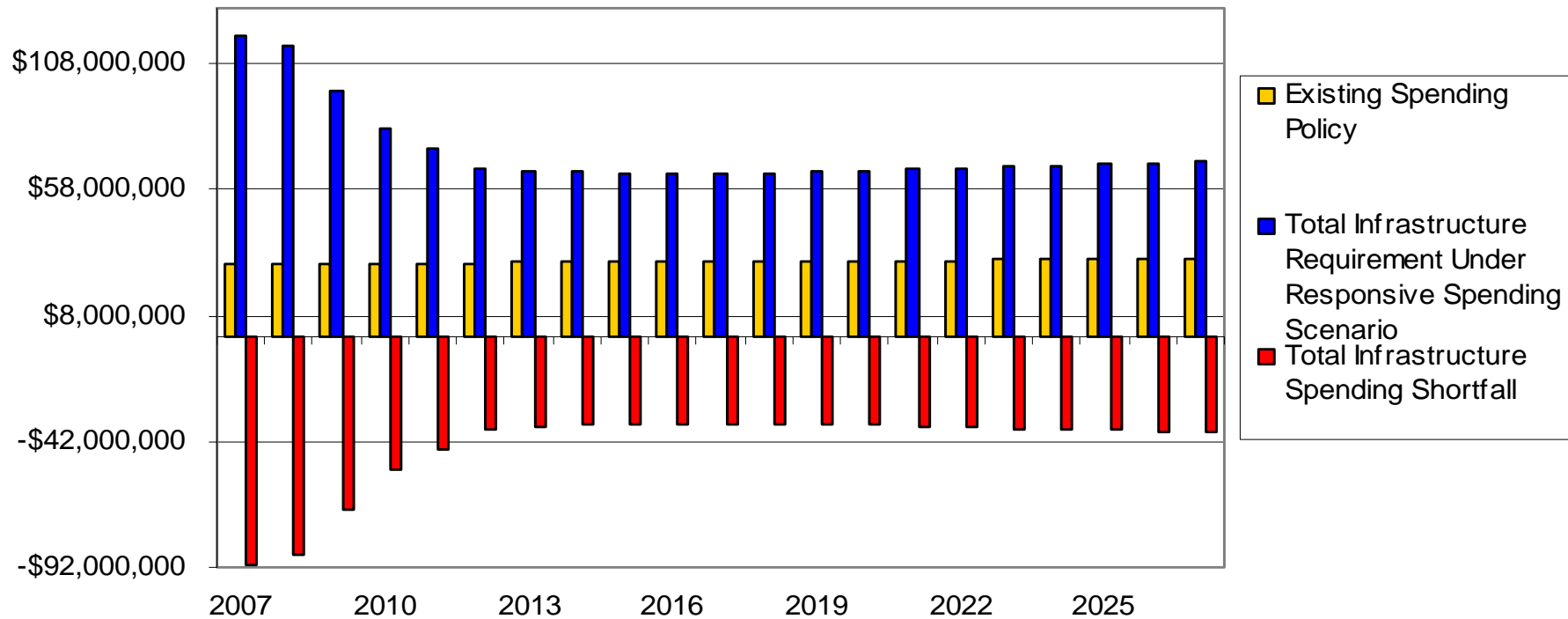


Infrastructure - Total Spend

- Existing Spending Policy Outcome
 - The shortfall in existing policy infrastructure spending would be much greater relative to a responsive infrastructure scenario – about \$44.3 million on average per annum as shown in the following chart.

Infrastructure - Total Spend

Total Infrastructure Spending Shortfall -
Existing Spending Policy versus Responsive Spending Scenario



Services

- Besides fixing its infrastructure, NCC is also under pressure to improve and expand its normal services*.
- Here too the community has two distinct choices.

*Services is defined as operating expenditure excluding infrastructure maintenance, depreciation and interest payments on net debt.



Services

- **Restrained Scenario**

- This assumes services grow by only just over a quarter of the rate of growth of the economy (0.7% per annum in real terms).

- **Responsive Scenario**

- This supposes services grow by two thirds the rate of growth of the economy (1.7% per annum in real terms).

Services

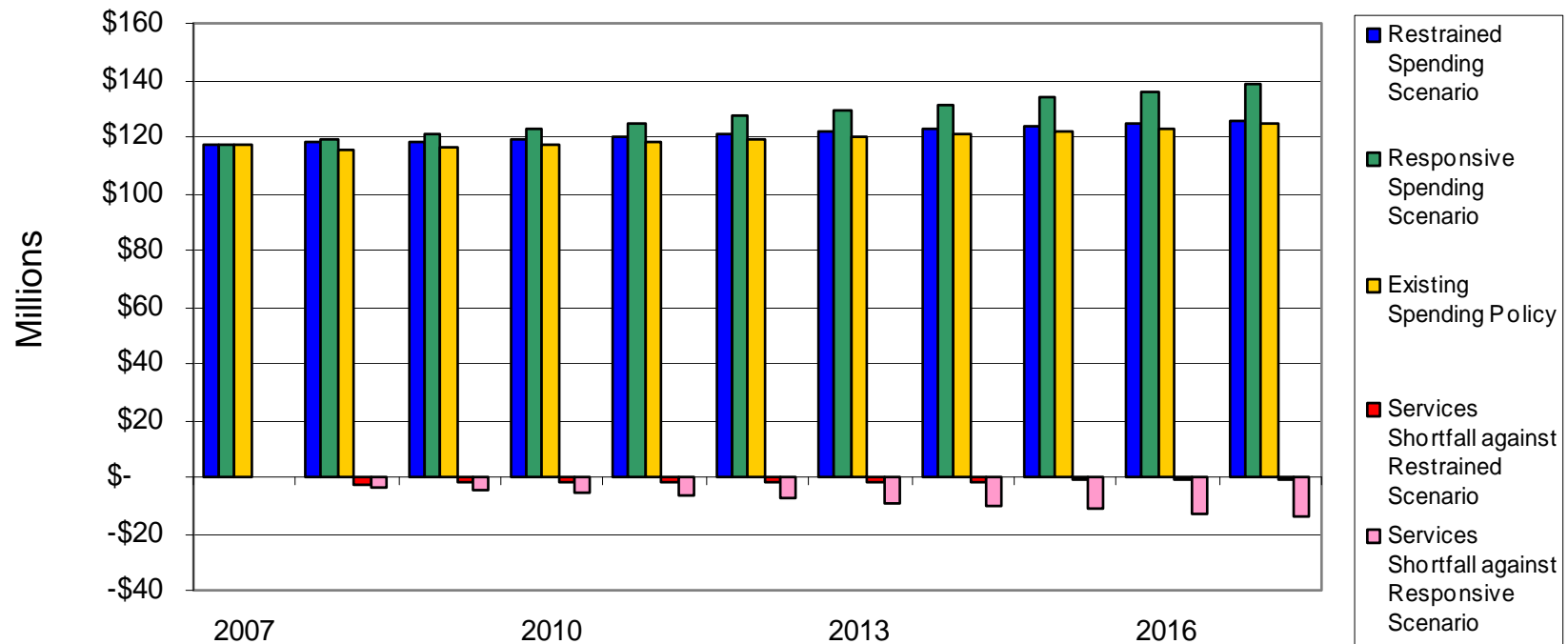
- **Existing Spending Policy Outcome**

- Under current policy the Council expands its services by almost 0.8% per cent per annum which is fractionally higher than the restrained scenario. Note, however, that Council is planning to trim services by 1.5% (2008) before recommencing their expansion (2009).

- The next chart shows how services spending, if continued at the same growth rate for the next ten years, would compare with the restrained and responsive scenarios.

Services

Services Spending Shortfall – Existing Spending Policy versus Alternative Services Spending Scenarios



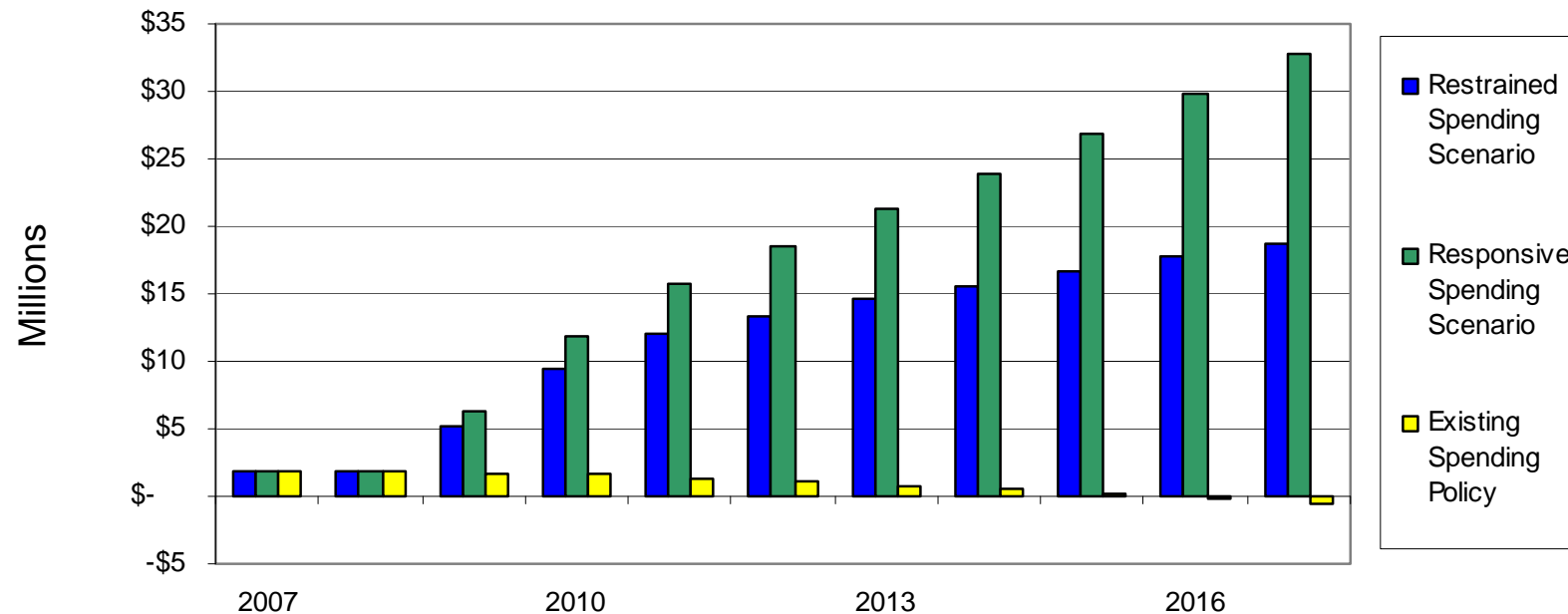
Interest Payments

- Besides services, Council's operating expenditure must also take account of net interest payments on outstanding net debt.
- For purposes of scenario analysis a no-policy-change assumption is used for revenue policy. This is later relaxed to explore what revenue measures are needed to stop the Council's debt ratio rising above a responsible level.



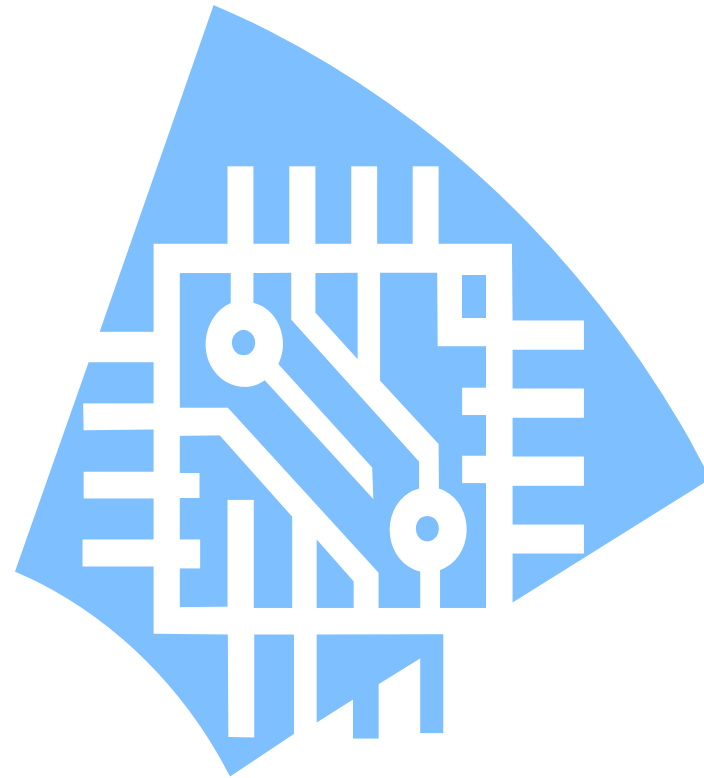
Interest Payments

Interest Payments under Existing Spending Policy and Alternative Spending Scenarios



Total Spending

- Adding together infrastructure, services and interest expenses gives total spending.



Total Spending

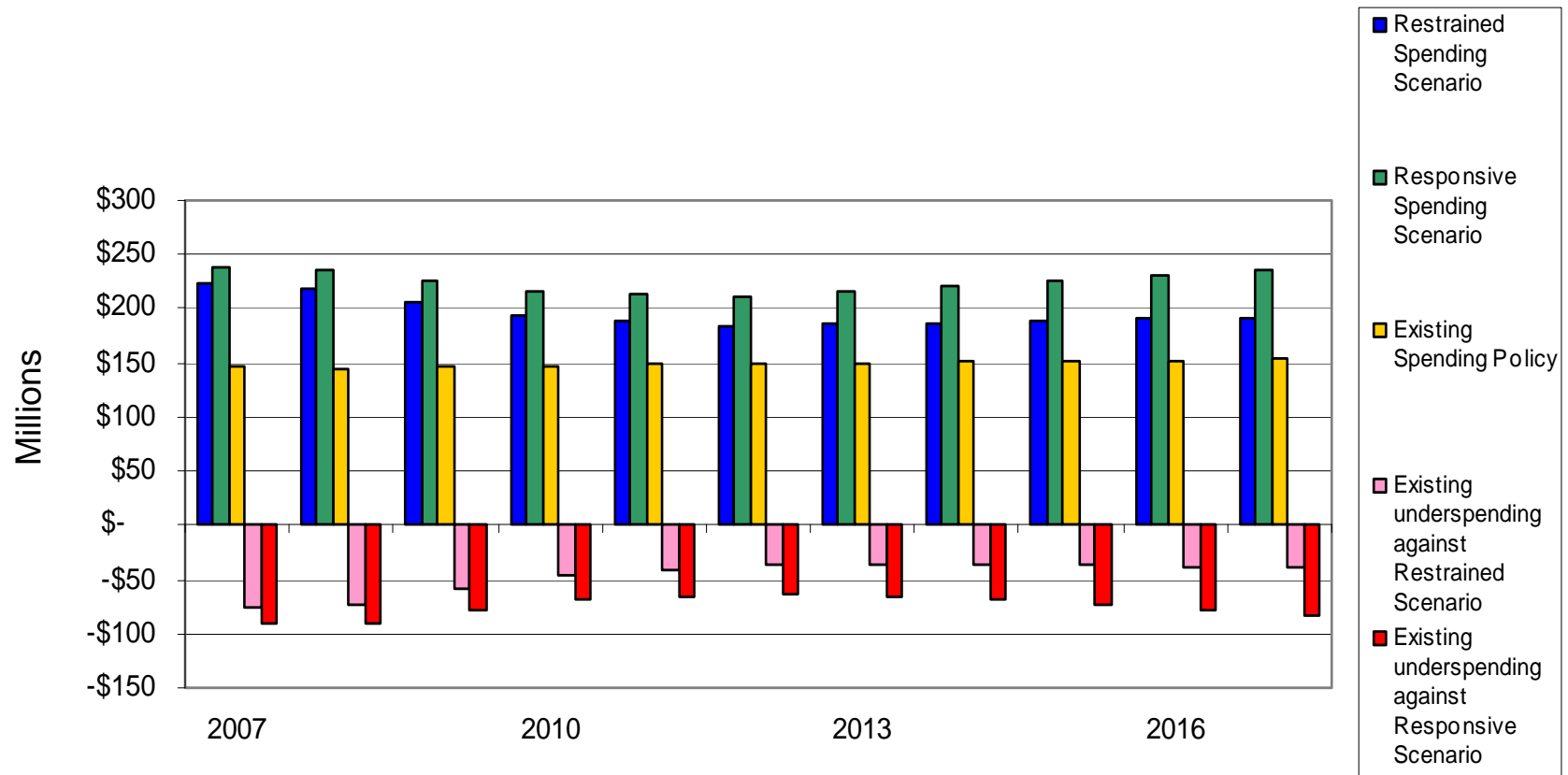
- The next chart shows how existing total spending on infrastructure and services under existing Council policies would compare with that under the restrained and responsive infrastructure and services scenarios.
- In each case interest payments have been also been included. They have been calculated on the basis that any funding shortfalls would be met by increasing debt rather than raising rates, charges, fees or other forms of revenue.

Total Spending

- Under the existing spending policy outcome, total annual spending over the next ten years would rise from \$156.8 million to \$161.9 million (excluding price inflation).
- Over this period it would fall short of total annual spending under the restrained scenario by an average of \$30.5 million.
- Against the responsive scenario the average annual under-spending would be more than double this amount (\$69.8 million).

Total Spending

Total Spending Shortfall –
Existing Spending Policy versus Alternative Total Spending Scenarios



Financial Goalposts

- So far we have assumed that achieving infrastructure requirements on the one hand and meeting service demands and interest obligations on the other would be funded by increasing debt rather than other fiscal measures (e.g. increased rates).
- *However, is such an approach possible within responsible fiscal parameters?*



Financial Goalposts

- The Local Government Inquiry (LGI) recommended a set of broad financial goalposts for Councils to ensure that they are financially sustainable without sacrificing infrastructure.
- These goalposts have been refined to reflect NCC's larger and more developed status. They are summarised in the next chart.

Financial Goalposts

Goalpost	Floor Target	Ceiling Target
Net financial liabilities ratio	8%	12%
Net interest expense ratio	3%	5%
Operating surplus ratio	2.5%	7.5%
Net borrowing ratio	25%	50%
Renewals deficiency ratio	-10%	10%
Unfunded backlog ratio	-5%	5%

Financial Goalposts

■ **Restrained and Responsive Scenarios**

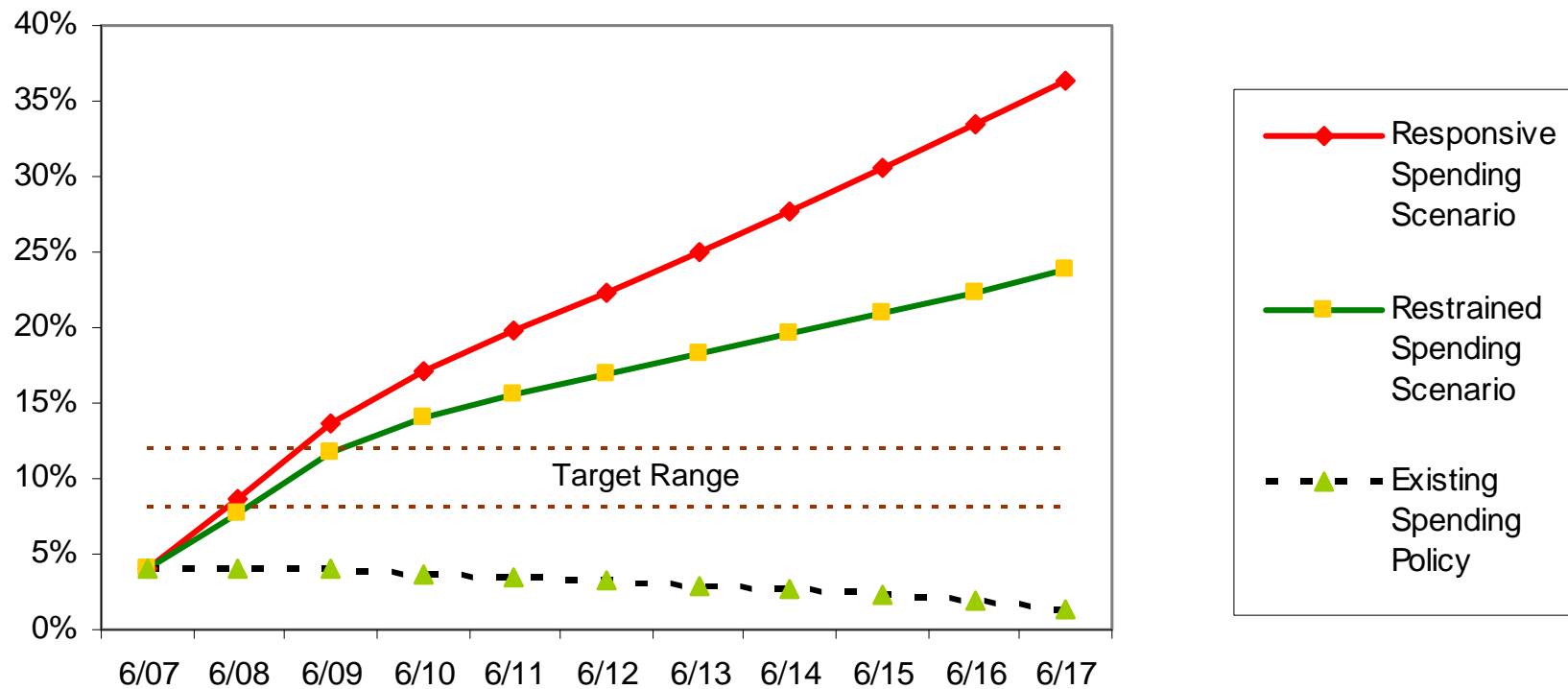
- Without a change to existing Council revenue policies these spending scenarios would result in the net financial liabilities ratio hitting 24% and 36% respectively in ten years time; well above the target ceiling of 12%. Infrastructure would be up to scratch, but the Council would be financially unsustainable.

■ **Existing Spending Policy Outcome**

- Current Council's spending policies would see the ratio fall to 1%, which is well below the target floor of 8%. This unnecessarily low level of indebtedness would result in an unfunded infrastructure backlog of 19% compared with 8% at present.

Financial Goalposts

Net Financial Liabilities Ratios for Existing Policy and Alternative Spending Scenarios

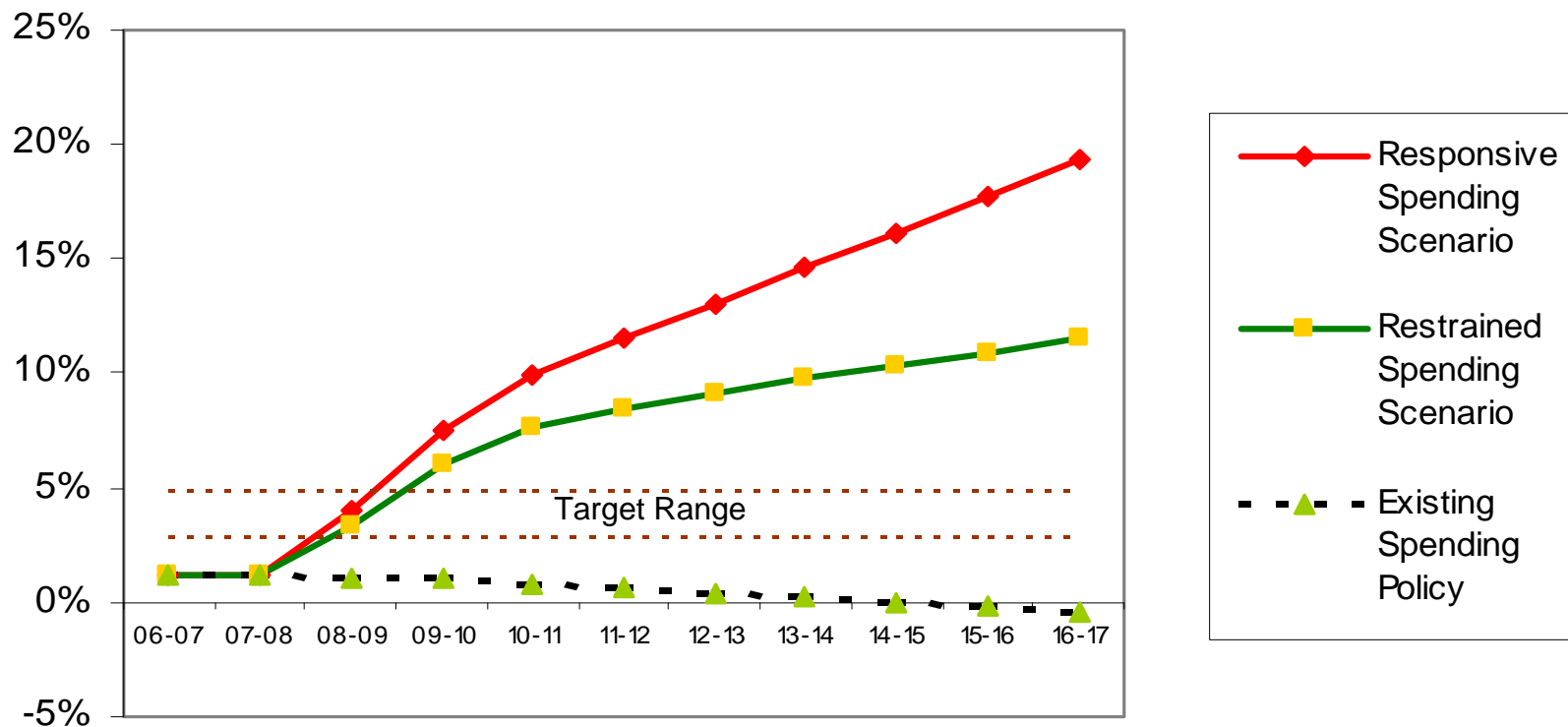


Financial Goalposts

- The Restrained and Responsive spending scenarios under existing revenue policies would cause the net interest expense ratio to surpass prudent limits.
- By contrast net interest payments would be completely extinguished within nine years under existing spending policies even though it is not necessary to fall below 3% of operating revenue. Tolerating an escalating infrastructure backlog problem would deliver this perverse outcome.

Financial Goalposts

Net Interest Expense Ratios for Existing Spending Policy and Alternative Spending Scenarios

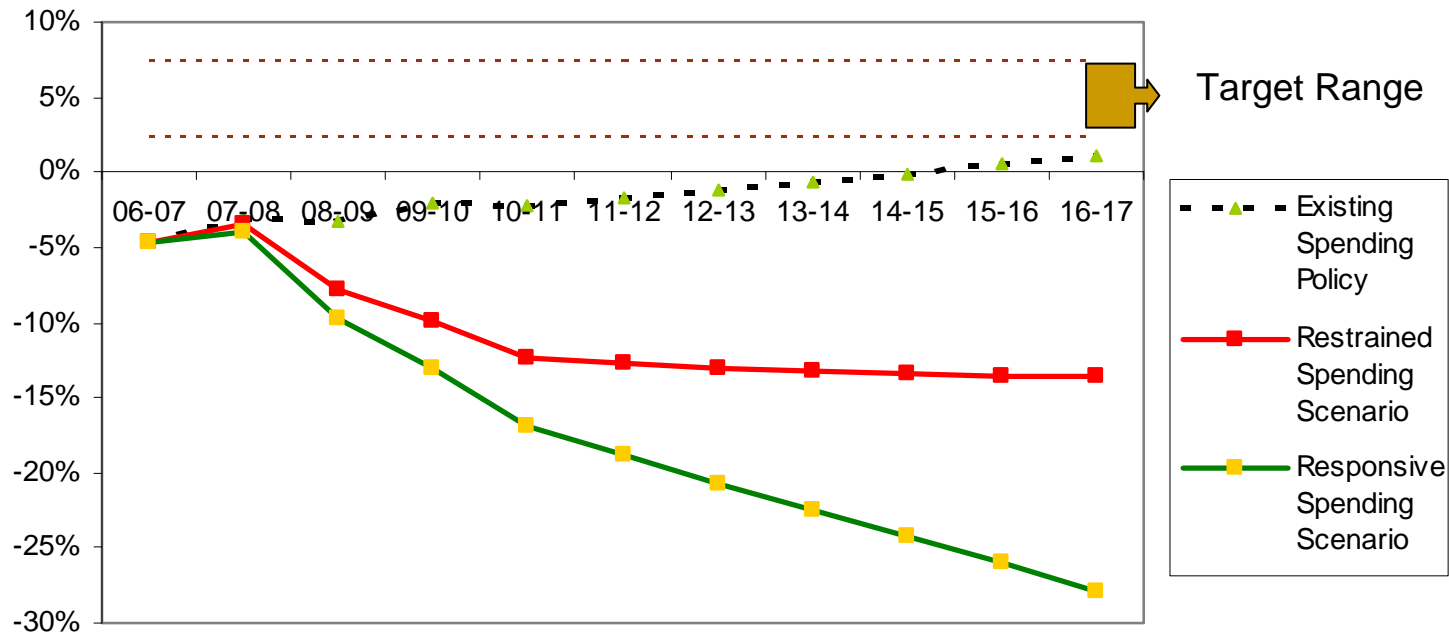


Financial Goalposts

- Without new revenue measures the restrained and responsive spending scenarios would increase the operating deficit well beyond the bounds of sustainability.
- With existing spending policy the Council's operating deficit would be extinguished within nine years, but at the expense of severely neglecting infrastructure rehabilitation, renewal and enhancement.

Financial Goalposts

Operating Surplus Ratios for Existing Spending Policy and Alternative Spending Scenarios



Fiscal Options

- The previous charts show that NCC faces a huge funding shortfall with unsustainable debt levels if it attempts to overcome its infrastructure problems without boosting its revenue and / or cutting its costs and services.



Fiscal Options

- Three revenue options are canvassed by the review. Two are hypothetical and the third is the existing Council policy.



Fiscal Options

- **Modest Revenue Option**

- NCC's rates would be restricted to CPI increases and the cost recovery effort on fees, user charges and developer charges would be maintained at current levels.

Fiscal Options

■ **Ambitious Revenue Option**

- Within 5 years rates would be raised to achieve a 2.5% operating surplus ratio. Thereafter rates revenue would increase at two thirds the forecast rate of growth of Newcastle's economy (1.7% per annum in real terms).
- By the 5th year:
 - Fees and charges would be raised to the minimum of the top quartile of comparable councils and thereafter keep pace with costs.
 - Developer charges would rise to their previous level and thereafter grow in line with relevant capital expenditure.

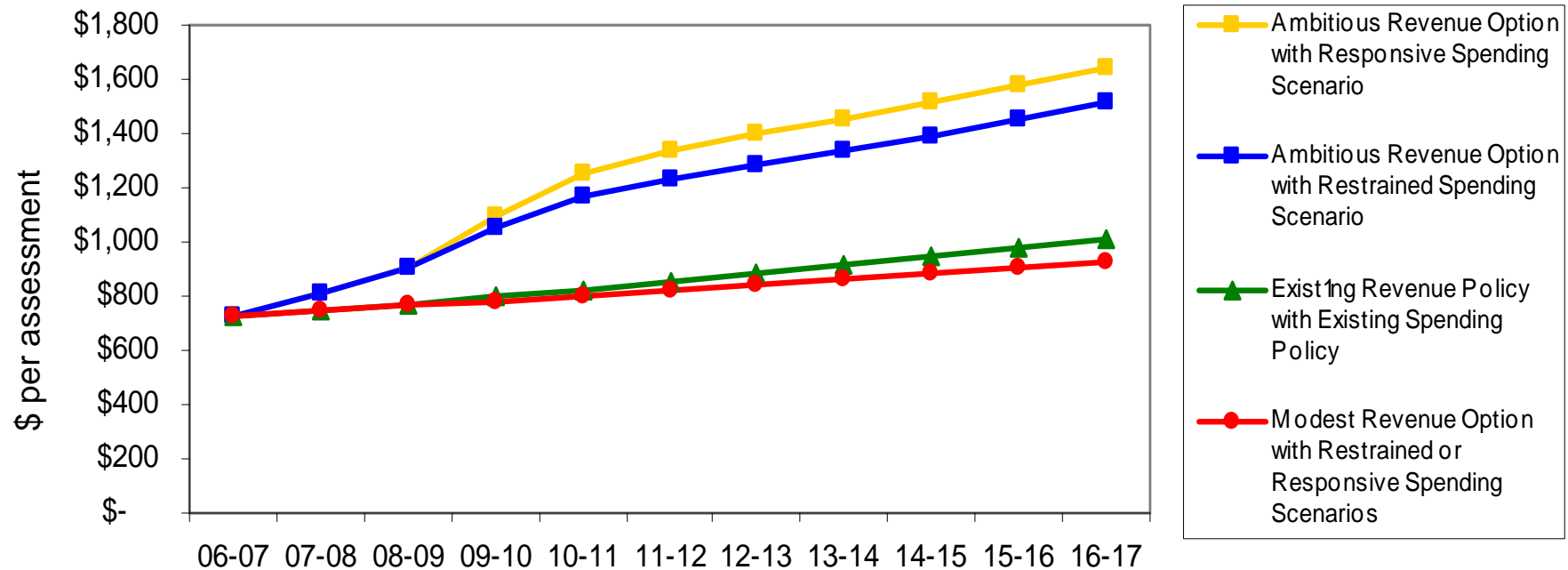
Fiscal Options

■ Existing Revenue Policy

- ❑ Rate increases outpace annual CPI growth until they exceed it by about a third from 2008/09;
- ❑ The proportion of costs recovered by fees and charges rises from 42% to 44% by 2009/10 and stays at that share thereafter; and
- ❑ The proportion of infrastructure enhancements recovered from developer charges remains around 19% compared with an average of 53% in the previous 5 years.

Fiscal Options

Average Residential Rates under alternative Revenue Options

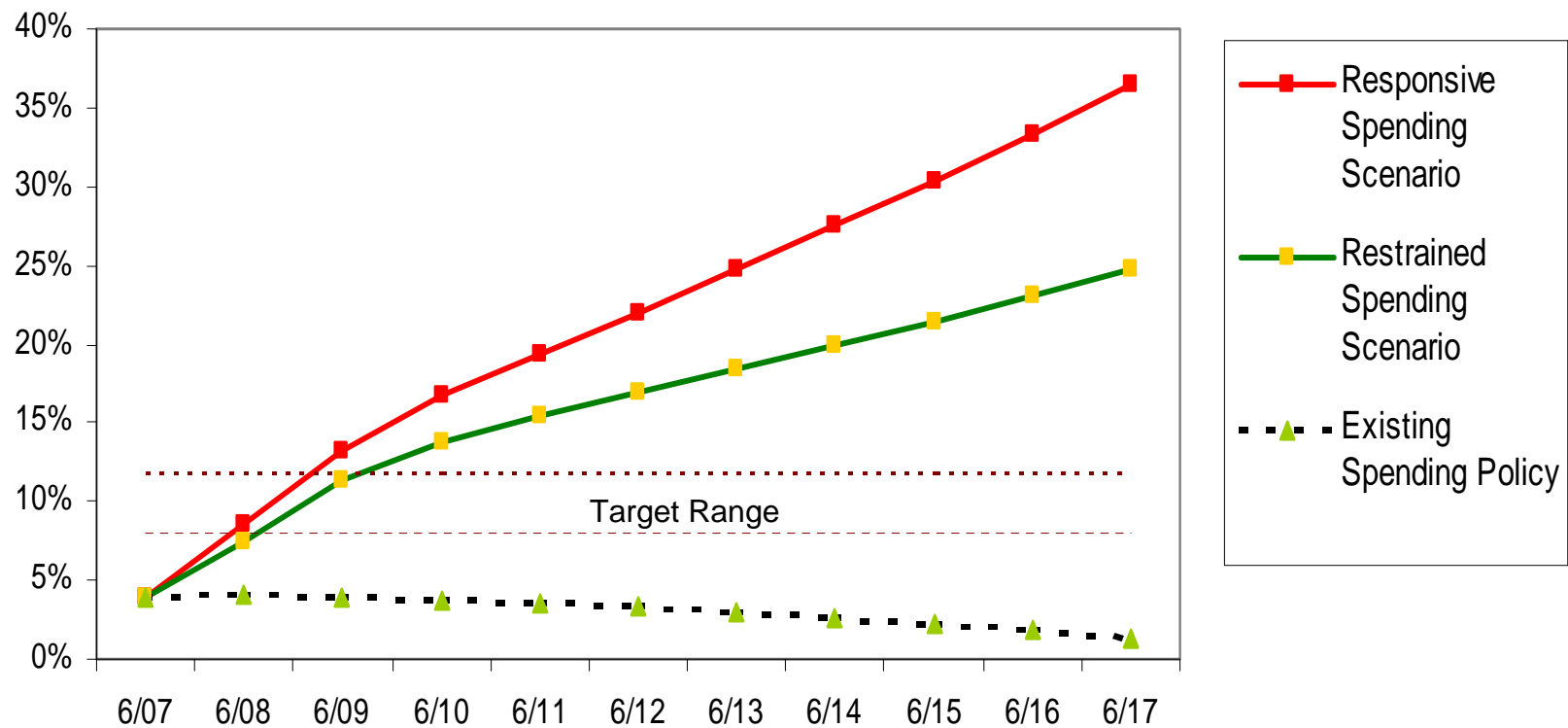


Fiscal Options

- *What would happen to NCC's net financial liabilities ratio if it financed the restrained, responsive or existing spending scenarios using the modest or ambitious revenue options?*
- The responsive spending scenario would result in unsustainable financial liabilities under either revenue option.
- The restrained spending scenario would easily work under the ambitious revenue option, but not under the modest one.
- The existing outcome would produce excessively low financial liabilities under either revenue option and would not address the infrastructure crisis.

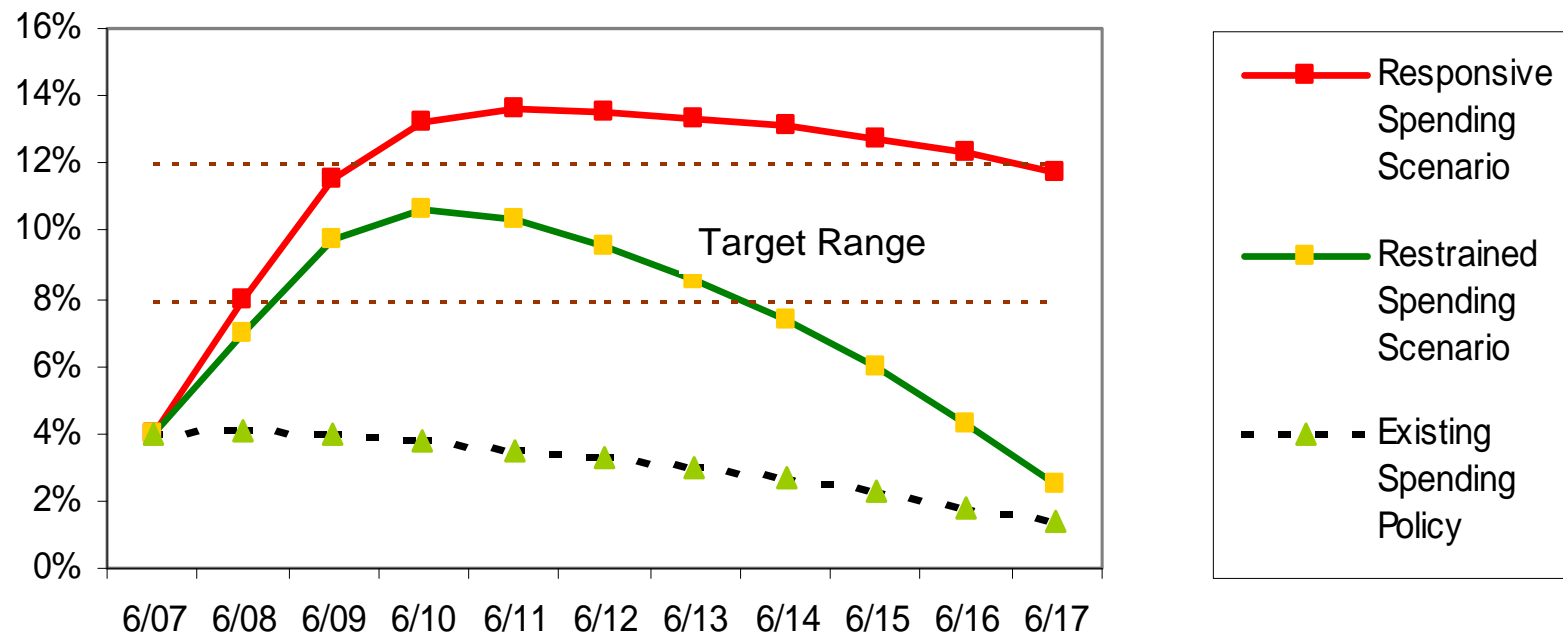
Fiscal Options

Net Financial Liabilities Ratio under Modest Revenue Option



Fiscal Options

Net Financial Liabilities Ratio under Ambitious Revenue Option

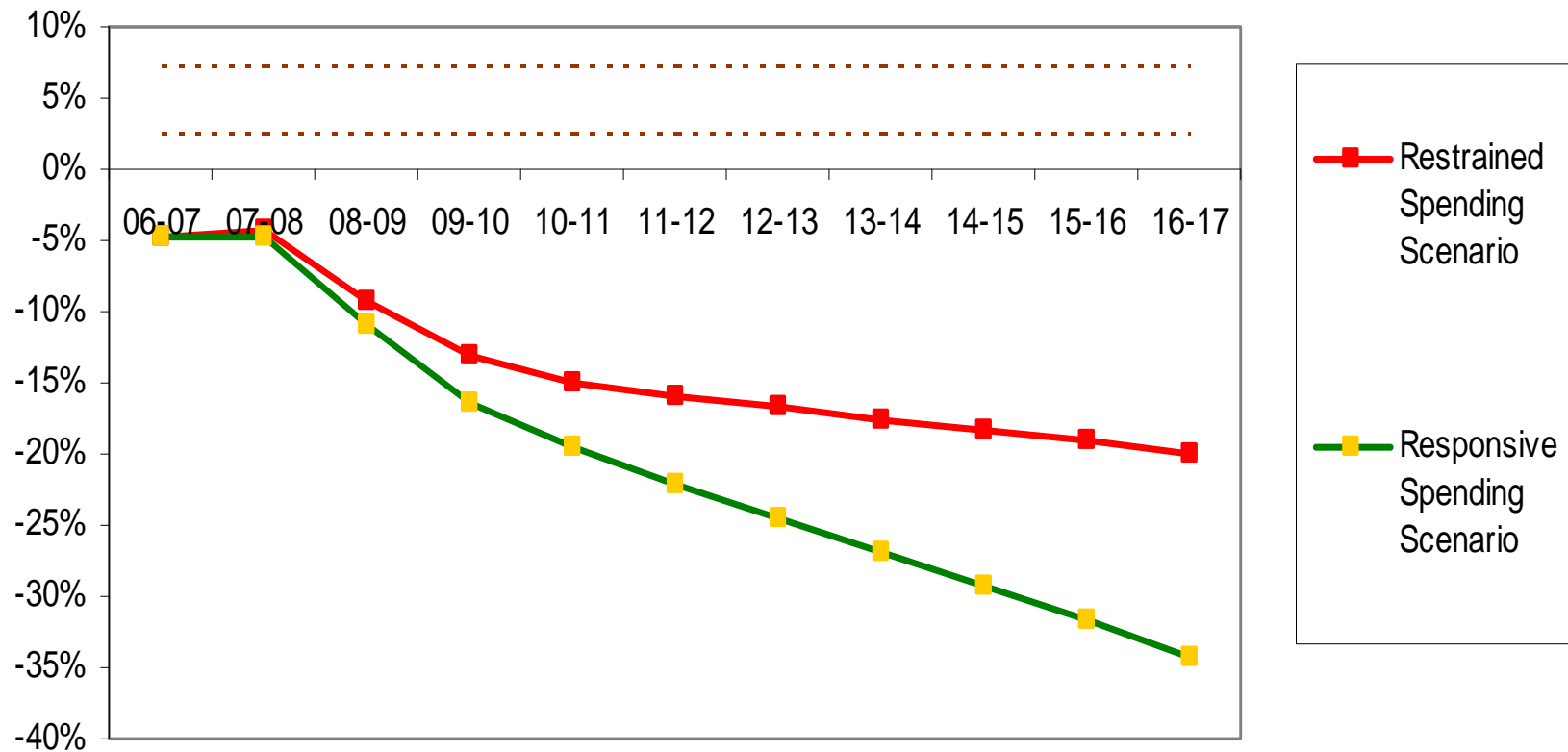


Fiscal Options

- *What would happen to NCC's operating budget balance if it financed the restrained and responsive spending scenarios with the modest or ambitious revenue options?*
- With the modest revenue option the operating deficit would grow worse each year reaching an unsustainable 20%-35% of own source operating revenue by 2017 depending on the spending scenario followed.
- With the ambitious revenue option the operating budget would go into surplus by 2011 and thereafter exceed the target floor on either of the two spending scenarios.

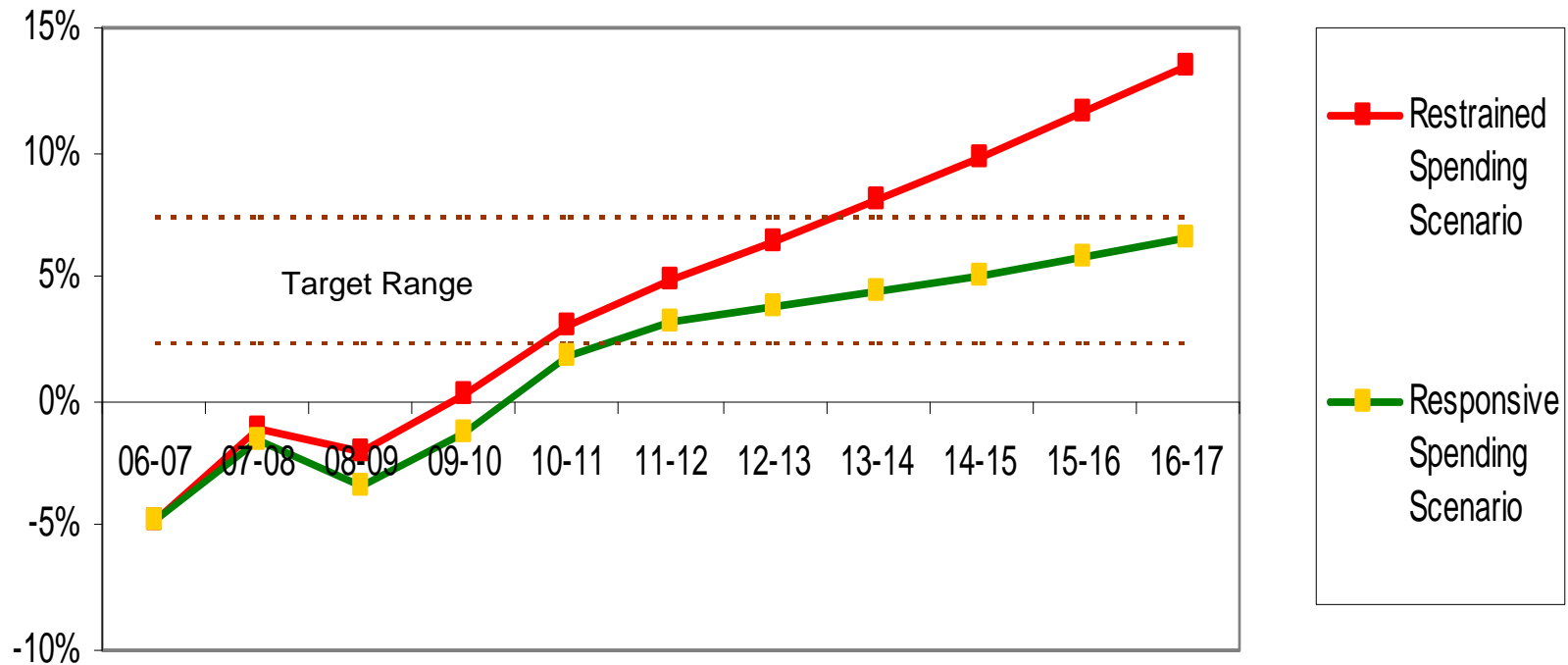
Fiscal Options

Operating Surplus Ratio under Modest Revenue Option



Fiscal Options

Operating Surplus Ratio under Ambitious Revenue Option



Fiscal Options

- It is clear from the previous charts that only the restrained spending scenario looks affordable within the recommended financial goalposts.
- Such a scenario would require revenue hikes somewhere between existing policy and the ambitious option.

Fiscal Options

- This might suggest average annual revenue increases of the following order if no expenditure savings were sought:
 - Rates – 3.3% to 6.3%
 - Fees and charges – 3.2% to 4.2%
 - Developer charges – 3.2% to 17.6%*

* Note that the high a upper range for developer charges is because they would return to previous levels under the ambitious revenue option.

Fiscal Options

- On the expenditure and asset management side, five possible measures for generating savings and extra commercial revenue have been floated by Council management.



Fiscal Options

- **Improve Council's operational efficiency**
 - Four independent benchmarking exercises on the NCC's overall work practices and performance, back-office costs, asset management and financial governance would suggest that it is reasonably efficient and effective by both public and private sector standards.
 - According to NCC management, annual cost savings of \$1.5 million were achieved after the adoption of the 2006/07 budget and these should be able to be sustained in the future. But savings in excess of this may be hard to obtain given that NCC is already lean by public sector standards.

Fiscal Options

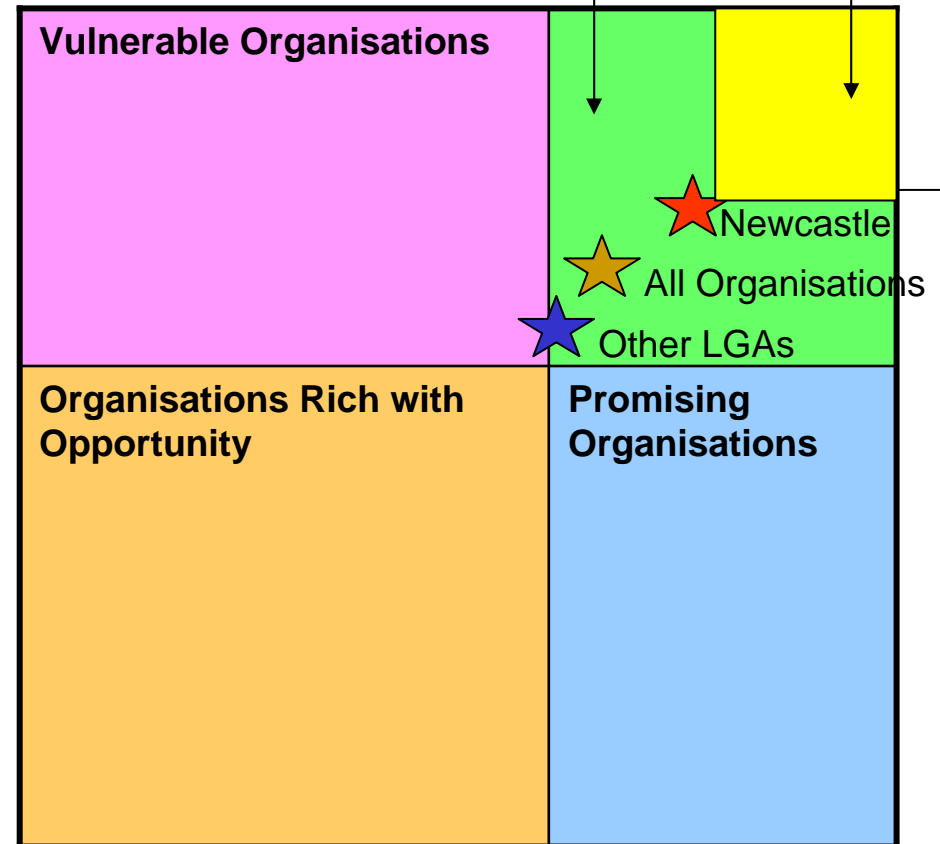
■ QMI's Performance Benchmarking Report

- Newcastle's overall management score is not yet world class, but is very close to it.
- It is significantly better than that of 16 other local government authorities here and abroad that QMI benchmarked.

Overall Mgt. Performance

World Class Contenders

World Class Organisations

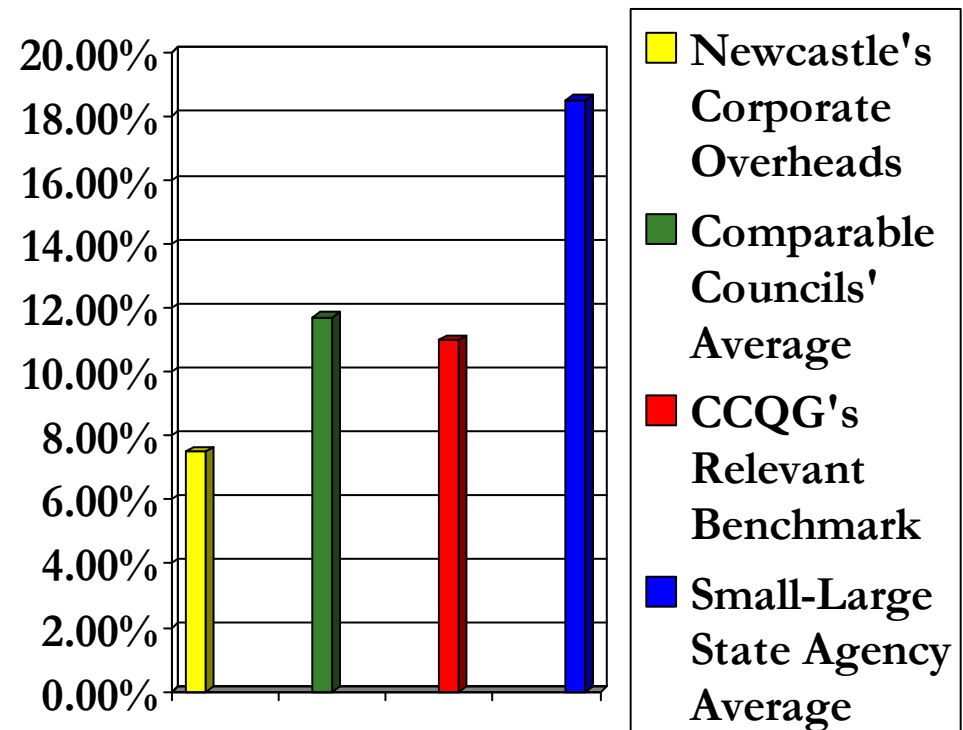


Source: LGI Final Report, 2006, pages 245-248

Overall Mgt. Practices

Fiscal Options

- **Maxwell's Corporate Overhead Analysis**
 - Council's corporate overhead expenses are 7.5% of its total operating expenses.
 - This is low by comparison with:
 - Other Councils of comparable staff size (average 11.7%).
 - Small to large State agencies (average 18.5%)
 - The CCQG's best practice benchmark for bodies of this size (10% -12%)*.



Source: DG & AB Maxwell, NCC – Analysis of Corporate Overheads, 2006

* CCQG: Council on the Cost & Quality of Government, 2005/06 Annual Report, page 22.

Fiscal Options

■ **GHD's Asset Management Review**

- NCC is performing close to best practice across the seven asset management elements of its business.
- Nevertheless there remains scope to realise incremental performance improvements especially in the asset management quality element:
 - Asset data requirement definition
 - Re-alignment of asset management information systems
 - People strategy
 - Managing service levels and customer expectation
 - Asset management planning

Source: GHD, *Review of Asset Portfolio of NCC*, Dec 2006

Fiscal Options

- **Access Economics' Financial Governance Review**
 - Overall NCC's financial governance policies and processes are "satisfactory".
 - Improvements are still possible in the following areas:
 - Lifting awareness of Councillor's financial governance roles
 - Developing long term financial planning
 - Clarifying Council's service philosophy and delivery methods
 - Developing an infrastructure funding policy
 - Setting financial targets and rules
 - Reconciling variations in financial projections
 - Putting long term financial data and projections on its website

Source: Access Economics, *Newcastle's Finances - What Role Improved Financial Governance?*, Dec 2006.

Fiscal Options

■ Commercialising public assets

- There is scope for NCC to:
 - Promote greater use of Council's income earning properties;
 - Increase rents for Council's commercial properties;
 - Sell or lease Council assets that no longer serve a strong public purpose; and
 - Rezone and redevelop under-utilised Council assets into income earning commercial assets using private capital.
- According to NCC management additional income from the above measures could be able to reach \$3 million per annum after 5 years.
- Proceeds from asset sales might constitute \$0.5 million of this amount, but are likely to be used to strategically acquire new land for future expansion of the city rather than fix infrastructure.

Fiscal Options

- **Reorder spending priorities**

- This might reduce community pressures on services and infrastructure. But a survey of Newcastle community attitudes reinforces what the LGI found for NSW as a whole – people don't want to sacrifice existing services to help pay for new ones. Hence the scope for radically changing the mix of services is limited.
- NCC management believes that savings from relinquishing certain services will not reach more than \$0.5 million per annum over the next five years while savings from not servicing disposed assets could reach an additional \$0.5 million per annum over the same period.

Fiscal Options

- **Freezing the size of infrastructure stock**
 - ❑ Surveys show that the community wants public infrastructure to be rehabilitated and renewed rather than expanded. This may reflect the established nature Newcastle which means it has ample, albeit aged, public facilities.
 - ❑ Halting further infrastructure expansion could save \$11 million per annum compared with the restrained strategy. This too would help contain any revenue hikes, but may result in infrastructure shortages over the longer term.

Fiscal Options

- The above possible savings total \$16.5 million per annum. They would help contain rates, fees and charges by 14.6% (almost 1.5% per annum over the next ten years) compared with the ambitious revenue option.
- However, such savings would not be sufficient to avoid increases in rates and other revenues if NCC is to fix its infrastructure and deliver better service to a growing number of residents, businesses, commuters and visitors.

Fiscal Options

- With an adequate package of revenue and savings measures NCC could afford to take on more debt within the limits prescribed in this report. Capacity for further borrowing by Council was acknowledged in the recent Standard and Poors report.*
- The exact size and mix of this package requires further work by Council using the financial model developed as part of this Review.

*NCC's present rating is A++

Funding Options

- Increased borrowings serviced by extra revenue and expenditure savings could be used to overcome the infrastructure backlog and renew assets that are coming to the end of their useful life.
- An Annuity Index Linked Bond would be the most cost effective way to fund NCC's \$134 million infrastructure backlog provided extra resources could be found to meet the annual loan payments.

Funding Options

- Such a funding instrument would:
 - ❑ Better share infrastructure costs between existing and future ratepayers;
 - ❑ Reduce upfront debt servicing costs and thereby allow Council to be more ambitious in tackling its infrastructure problems;
 - ❑ Enable Council to better match its liabilities to its long-life infrastructure assets; and
 - ❑ Significantly cut costs of funding long-term infrastructure compared with traditional forms of borrowing.

Funding Options

- Council's investment portfolio of \$125 million has performed well above benchmark (UBS 90 day Bank Bill Index). However except for Council's working capital most of these are tied funds so can not be used for discretionary purposes.
- Council has \$25 million of traditional loans which were obtained at competitive interest rates. The average loan term of 7.75 years could be lengthened to more closely match the average remaining life of the assets funded by this debt.

Next Steps

- It is recommended that NCC use Review Today's finding to develop an appropriate long term spending, revenue, savings and borrowings strategy to overcome the city's infrastructure crisis within sustainable financial limits. The proposed strategy should be incorporated in NCC's draft management plan for consultation with the community.

(continued next page)

Next Steps

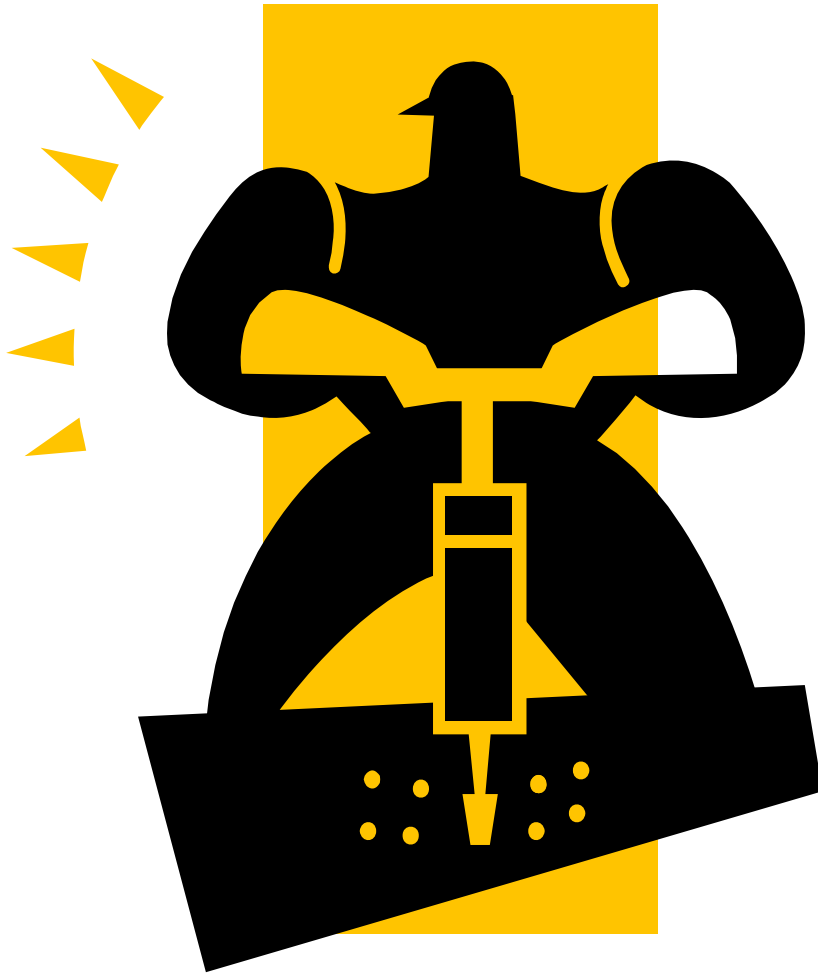
- Based on this feedback the Council should review and update its 10 year financial plan and rolling infrastructure works program to:
 - ❑ Rehabilitate infrastructure that is already decrepit;
 - ❑ Renew infrastructure when it degrades below an acceptable standard in future;
 - ❑ Expand the total infrastructure stock by enough to adequately cater for residential and business growth;
 - ❑ Develop services in line with population growth and changing community needs;

(continued next page)

Next Steps

- Based on this feedback the Council should review and update its 10 year financial plan and rolling infrastructure works program to also:
 - Generate additional resources from revenue measures, operational savings, re-ordering of spending priorities, infrastructure enhancement deferrals, asset leases or disposals and extra borrowings that would be sufficient to fund such a program; and
 - Ensure that the outcome complies with sustainable financial targets (e.g. the recommended minimum surplus ratio and maximum debt ratio) during this period.

Financial Sustainability Review



■ **THE END**