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Introduction

We own and operate [redacted] a small [redacted] business.

We do not support Port Stephens Councils current SRV application. We support a moderate increase subject to Council remedying the issues we outlined in this submission.

Our reasons for not supporting the SRV are as follows:

Criteria 1. The need and purpose for the SRV.

(a) Council, to justify the SRV, presented a portfolio of projects and initiatives that were dominated by refurbishment capital works. My estimate is that refurbishment capital works represented approximately 80% of the value of the portfolio presented. These should be depreciation funded.

Councils, Annual Report 2015-16, Income Statement has a depreciation and amortisation allocation of $14.6M for a non-current asset base of $854.5M. This calculates to a ratio of 1.7%.

This ratio is comparative for long life linear assets, as bench marked with like Councils. Lake Macquarie operates on 1.4% and currently reports no refurbishment capital backlog.

Council in its 2017-18 Annual Report references that that they are gradually decreasing the backlog of refurbishment capital works. Proving the annual allocation is adequate.

<u>Conclusions:</u> Council has an adequate allocation of funds to finance its annual refurbishment program.

(b) Councils primary financing issue is funding the refurbishment backlog. Council has not explained to the Community why the refurbishment backlog exists.

Refurbishment backlogs can only occur for the following reasons:

1) The CRC valuation is incorrect. Unlikely
2) The life cycle planning and scheduling of refurbishments is incorrect. Unlikely
3) Councils productivity & project management capability is not competitive /competent
4) Depreciation funds have inappropriately been diverted.

Council staff at an SRV session attributed the backlog as a legacy issue of funds diverted elsewhere. There is evidence that this statement is correct and that Council has diverted significant finances to its commercial businesses and other initiatives (refer response to Criteria 5).

Productivity is a management issue and not an SRV issue.

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Conclusions: if Council is diligent in ensuring depreciation funds are not diverted from their intended purpose, the backlog funding is a quantifiable once off cost. The proposed SRV rates increase is overstated on this premise.

Council has made no attempt to explain why surplus funds are being prioritised into the commercial business activities instead of being used to reduce the backlog. Premised on commercial businesses should be self-funding for depreciation and debt funded for ROI investments with commercial payback periods.

(c) SRV proposed levels of service has not been quantified.
The SAMP defines the average life cycle replacement of assets to achieve specified levels of service. Council has not appropriately defined;
1) Its own delivery performance (backlog) in achieving these targeted levels of service.
3) Quantified and compared the costs and benefits of the SRV proposed "higher/more frequent" levels of service again the historical service levels.

Council, during the community consultation, asked the community if they wanted "higher/more frequent" re-surfacing of roads, replacement of toilet blocks etc. The community response was an obvious yes to remedying the refurbishment backlog.

It was not made evident that the life cycle replacement service levels would be increased above original SAMP targets. The proposed new service levels were never quantified.

To do so is in effect gold plating with resulting increased refurbishment and depreciation costs above what is required or justified from service performance, engineering or economic perspectives.

Conclusion: The community was misled.

(d) Council did not present an option to reduce the backlog by accepting lower service levels in low service risk areas. Our street is a low traffic street. The road was in good to fair condition with no degradation. It would have remained so for at least 2-3 more years before the cost of resurfacing increased. It has just been resurfaced because it was time due. We would have accepted deferment to sweat the existing asset and reduce costs.

Conclusion: Council can reduce its backlog by optimising its refurbishment program to lower service levels without requiring additional funds.

(e) Councils planning approach to the development of the SRV is inadequate and ensures the outcomes are neither prudent nor efficient. The steps of sound planning practices are to establish a:
1) Shared community Vision for the future
2) Master Plan that articulates the vision
3) Investment Strategy to deliver on the master plan
4) Enabling financing strategy

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Council's SRV approach was the reverse. The SRV with preferred Option was presented to the community when:

1) The Community Plan was in draft format,
2) No documented Vision and master plan for Port Stephens exists (reference Lake Macquarie for good practice and community engagement),
3) No economic development plan in place,
4) A wish list of individual projects without business cases or coherence to a bigger picture.

<u>Conclusion:</u>
Councils planning approach to the development of the SRV is inadequate and ensures the outcomes are sub-optimal. A proper application of the planning process would ensure:
a) high levels of community ownership of the long-term vision for Port Stephens
b) a supporting investment plan for enhancement capital projects that is strategic and:

- time optimised and sequenced in line with demand and uptake,
- is a cohesive suite of initiatives contributing to the vision & the communities' priorities?
- is affordably and sustainable.

(f) Council has presented no modelling in its discussions with the community with respect to the financial allocation of how the future rate increases will be used e.g.:

- Refurbishment capital (depreciation)
- Enhancement capital for new projects
- Recurrent budget - operations

The Mayor in all sessions and worded in the presentations introduce capital infrastructure projects being a "one off cost". This is factual wrong. All projects add to the Current Replacement Cost (CRC) of Councils asset base. They add to the annual depreciation allocation. They add to operation, administration and maintenance costs.

The Mayors proposal to have "higher service levels, more frequent replacements" also means an increase in the annual depreciation allocation. E.g. resealing a road more frequently than is required per the 2017-18 SAMP service levels will result in higher rates for no appreciable gain in service level. Not prudent or efficient use of funds.

<u>Conclusion:</u>
The community cannot make an informed decision on the true future position of its rates base and the value it might receive.

Criteria 2. Community awareness of need for and extent of rate rise.

The Mayor spoke to the SRV at 5 separate public forums we attended. Council, for the SRV, promoted setting higher levels of service than in the 2016-17 SAMP. The Mayor spoke and used slide show presentations with qualitative language to define the service levels e.g. "more frequent, higher frequency…"

Council should have provided SRV options against quantitative changes to service levels, not qualitative.

Conclusion:
The community was misled. The backlog is an issue of Councils delivery performance and not service levels. Council did not demonstrate why the existing targets needed to increase or the financial consequences of doing so.

Raising the service levels will result in unnecessary early retirement or refurbishment of assets. This is not economically and engineering prudent nor efficient use of public funds.

Criteria 3. The impact on affected ratepayers must be reasonable.

Council modelled the SRV rates increases, which in our case is in the order of an additional $7,000 per annum.

They have not:

a) Conducted economic analysis.
Council has not completed or provided any economic analysis to that quantifies the impacts on small business or their capacity to pay. Nor quantified any economic benefits that will result from the proposed SRV investments. Understandable given there was no Economic Development Plan to inform the SRV development.

We are a small business. Without substantial increases in tourism the SRV costs will have to be absorbed operationally.

The SRV impact on the capital value of our business, based on a 10% rate of return, represents a $70,000 write down in the value of the business.

b) Council has undertaken no analysis or consultation with respect to the double impact of on our accommodation business of;
   - increased rates, and
   - the impacts of subsidised direct competition from Councils commercial Holiday Park Tourist operations.

Our small business has to operate with full commercial risk, absorb the SRV increase and directly compete with subsidised Council owned Holiday Parks.

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The Council commercial holiday park businesses do not operate on competitive neutrality principals or operate to industry commercial performance bench marks. There is significant evidence of non-commercial performance and gross subsidisation from general rates.

We provide analysis to the effect under criteria 5.

Conclusion: Council is intending to substantial increase our costs through the SRV while squeezing our revenue through heavily subsidised competition from Councils commercial business.

Criteria 4. *A sustainable financing strategy.*

A sustainable financing strategy follows the development of a prudent and efficient investment strategy. Council's current investment portfolio is a wish list of politically formulated projects with plug estimates. It is not strategically formulated or cohesive.

Conclusions:
Sustainable financing only comes from a sound investment strategy. Council has developed the SRV without the appropriate investment planning in place.

Criteria 5. Council productivity improvements.

(a) Council operates tourist parks. Most other councils lease these operations to the private sector, who are better commercially structured.

Councils annual report demonstrates that its commercial holiday park operations do not generate a commercial rate of return on Councils investment.

These commercial parks should be run on full competitive neutrality principals to ensure:

- that when competing with ratepayer businesses, there is a level playing field.
- tariffs are established on commercial terms,
- investments have a commercial return to Council, costs are accounted for and managed.
- Rate payers are not subsidising Councils' commercial businesses.

The industry commercial KPI's are

- 10% rates of return on capital.
- 50% cost to 50% revenue ratio
- 2.5% depreciation for fixed assets
- 5-year depreciation pool for short term assets.

The annual report financials do not adequately separate Councils investment and operations from that of the State, which owns the parks in most instances. The lack of transparency and Councils poor performance in this aspect of their operations is hidden from public accountability.

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Council should be obtaining a 10% rate of return. It is not. Council should be valuing its ownership in these businesses commercially. It is not. Council should be managing its costs to industry targets. It is not. Refurbishment should be self-funding. It is not. Council should be setting its tariffs using economic pricing and market principals. It is not.

As a case study – Treescape Holiday Park:

- Council in 2017-18, for this Park, reported a doubling of revenue to $718K, incurred costs of $706K, and achieving their first ever positive financial operating return of $12K. An economic loss on a reported $19M in accumulative losses to date. Noting the Tomaree Rate Payers Association has tracked and reported these cumulative losses.

- Treescapes; routinely sells rooms with tariffs at below short run marginal cost (SRMC). Lowering the tourist market expectations on reasonable tariffs.

  Our SRMC is $90 per single night stay, excluding GST. The long run marginal cost (LRMC) including depreciation and GST is $155 per single night stay.

  Councils cost structures are higher than ours, yet in winter they advertise rooms from $77 per night and in summer months from $100. These tariffs are below the operating cost to provide the rooms.

- Councils SAMP shows capital expenditures for its holiday parks well in excess of deprecation rates. Commercial operations only make refurbishment capital investments within ATO parameters and enhancement capital only if there is a demonstrated 10% rate of return.

- Council is currently spending a further $3M of public money to develop Treescapes occupancy levels in direct competition with local private sector accommodation providers. They aim to increased tourist occupancy by 20%, leveraging off the Federal Government funded new and adjacent koala hospital and sanctuary. This demand, if materialised, will impact on our business negatively as it will draw predominantly from the existing tourist market.

- Council business case for this investment, is solely premised on their staff's professional judgement for forecast revenue increases. There is no NPV analysis. Nor analysis of the seasonal occupancy profile, costs, market and competitor analysis commercial risk analysis, or ROI.

  If the investment is successful, Council will have effectively spent $21M of public money on this enterprise with a maximum valuation of $6M.

- Australia wide industry practice as used by; the ATO, NSW State Revenue, all financing institutions, insurance companies, business valuers, and commercial operators in the calculation of the valuation of a holiday park business is "Earnings Before Interest Tax and Depreciation" (EBITda) x 10% rate of return.

On this premise Treescapes salvage value would be greater than its commercial value of a $120K.

Council, in its annual report, manufactures an alternate capital valuation for its commercial parks, resulting in incorrect and misleading rates of return.

- Council should publish a full set of independent financial statements for its commercial holiday parks. Public transparency should be at the forefront of these operations.

Conclusions: The SRV should not be approved to support underperforming commercial activities and losses, poor investment. The commercial operations should be self-funding. Non-performing enterprises should be sold to fund the backlog or sub-leased.

Council can only operate in this sphere ethically if it operates to full competitive neutrality principals and is independently audited annually to this effect.

(b) Council continues to undertake the delivery of many services inhouse that most local governments have outsourced because of inhouse cost inefficiencies and service quality. Predominant examples include: holiday parks, grass cutting, events management, routine maintenance, and waste services.

Council does not publicly report its service performance against comparatively industry bench marks that are readily available through the LGA. Assessing services and reporting against these bench marks would demonstrate areas for productivity improvement.

Conclusions:
Council cannot claim to be a productive organisation without undertaking bench marking of its services.

Submission from

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