



Independent Pricing and Regulatory Tribunal

Newcastle City Council's application for a special variation 2012/13

Local Government — Determination
June 2012



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1 Determination

The Independent Pricing and Regulatory Tribunal of NSW (IPART) is responsible for setting the amount by which councils can increase their general income, which mainly includes rates income. Each year, we determine a standard increase that applies to all NSW councils, based on our assessment of the annual change in their costs and other factors. This increase is known as the rate peg.

However, councils can apply to us for a special variation that allows them to increase their general income by more than the rate peg. We are required to assess these applications against criteria in the Guidelines provided by the Division of Local Government (DLG),¹ and may allow special variations under either section 508(2) or section 508A of the *Local Government Act 1993* (the Act).

Newcastle City Council applied for a special variation of 8.6% in 2012/13. After assessing the council's application, we decided to approve the special variation as requested. We have made this decision under section 508(2) of the Act.

1.1 Our decision

IPART decided that Newcastle City Council can increase its general income by 8.6% in 2012/13. This increase includes the rate peg of 3.6% that is available to all councils, and will be retained permanently in the council's income base. We have attached conditions to the decision.

Table 1.1 sets out our decision and Box 1.1 lists the conditions attached to it.

¹ *Guidelines for the preparation of an application for a special variation to general income in 2012/2013* were issued by Division of Local Government, Department of Premier and Cabinet, September 2011.

Table 1.1 IPART's decision on Newcastle City Council's application for a special variation in 2012/13 (%)

| Component | Amount |
|--|---------------|
| Increase to fund Civic Priority Projects | 5.0 |
| Rate peg | 3.6 |
| Total increase | 8.6 |

Box 1.1 Conditions attached to IPART's decision on Newcastle City Council's application for a special variation in 2012/13

IPART's approval of Newcastle City Council's application for a special variation in 2012/13 is subject to the following conditions:

- ▼ The council uses the additional income from the special variation for the purpose of providing funding towards the 9 Civic Projects outlined in the council's application, and listed in Appendix A.
- ▼ The council reports in its annual report for each rating year over the period from 2012/13 to 2021/22:
 - the program of expenditure on the Civic Projects listed in Appendix A
 - the outcomes achieved as a result of the special variation
 - its asset renewal and maintenance expenditure
 - its productivity savings achieved, and
 - any significant variations from its financial results as forecast in its Long Term Financial Plan and any corrective action taken or to be taken.

1.2 What did the council request and why?

Newcastle City Council requested a special variation of 8.6% in 2012/13, and to permanently incorporate this increase into its general income base.² The requested special variation included an increase of 5.0% to partially fund a 10-year civic project program, plus the rate peg of 3.6%.³

² Newcastle City Council, *Section 508(2) Special Variation Application (Newcastle Application) Part A, Worksheet 1.*

³ The rate peg set by IPART for 2012/13 is 3.6%. The rate peg for 2013/14 will be determined by IPART in December 2012.

The council estimated that the increase above the rate peg would generate extra revenue of \$4.6m in 2012/13, and a cumulative \$45.6m to 2020/21.⁴ It proposed to use the additional revenue to provide about a quarter of the \$178.1m in funds needed to implement 9 civic projects (which was Scenario 4 in the council's *Delivery Program 2011/2012 – 2014/2015*).⁵

The programs are:

- ▼ Revitalisation of Hunter Street - \$16.7m

Revitalisation of the coast - \$35.9m

- ▼ Swimming pool upgrades - \$25.7m
- ▼ Libraries upgrades - \$42.9m
- ▼ New cycle ways - \$15.7m
- ▼ Newcastle Art Gallery expansion - \$19.4m⁶
- ▼ Blackbutt Reserve upgrade - \$8.7m
- ▼ On-street parking strategy - \$2.9m
- ▼ Off-street parking strategy - \$10.3m.⁷

1.3 How did we reach our decision?

We assessed Newcastle City Council's application against the criteria included in the Guidelines. We found that the application satisfactorily meets these criteria. Table 1.2 overleaf summarises our findings against each of the criteria.

⁴ Newcastle Application Part A, Worksheets 1, 4, and 6. It is not possible to determine the council's future general income with precision. A council's actual general income is affected by many factors, including the number of rateable properties and adjustments for previous under-collection or over-collection of rates made by councils. The DLG is responsible for monitoring and ensuring compliance.

⁵ The proposed projects are forecast for the 10 years 2011/12 to 2020/21. Additional income above the rate peg to 2020/21 is estimated at \$45.6m.

⁶ Newcastle Application Part A, Worksheet 6 and Newcastle Application Part B, Attachment 11, *Long Term Financial Plan 2011-21*, p 18 reflect costs of \$19.4m for the Art Gallery project. The council advises that the budget has been revised to \$21m, however an updated cash flow has not been provided.

⁷ Newcastle Application Part A, Worksheet 6 and Part B, Attachment 11, *Long Term Financial Plan 2011-21*, p 18. See Appendix A for details of the council's Priority Projects program.

Table 1.2 Summary of IPART’s assessment against the criteria in the Guidelines

| Criterion | IPART findings |
|---|---|
| 1. Demonstrated need for the rate increase implied by the special variation | The council’s application demonstrated that the 9 civic projects to be partially funded by the special variation are consistent with its community strategic plan. The council has considered, and also plans to utilise, other revenue sources to fund these projects. The rate increase will improve the net operating position of the council, however it will not, by itself, resolve the council’s projected operating deficits. |
| 2. Adequate community consultation regarding the special variation | The council has undertaken an extensive consultation program with the community on the proposed program of works and special variation application. A telephone survey of a random sample of residents found that 62% were at least ‘somewhat supportive’ of the proposed special rate variation. |
| 3. Reasonable impact on ratepayers | The special variation will have a moderate impact on ratepayers and the council has a hardship policy in place to assist pensioners and those in financial hardship. |
| 4. Sustainable financing strategy consistent with the principles of intergenerational equity | The council intends to utilise several different revenue sources including the special variation to fund the 9 civic projects. Separate to the special variation, the council intends to undertake a borrowing program to reduce its infrastructure backlog. These borrowing plans are consistent with the principles of intergenerational equity and appear financially sustainable. |
| 5. An explanation of the productivity improvements and cost containment strategies the council has implemented in past years, and is planning over the requested special variation period | The council has achieved productivity savings since 2009 through its Sustainability Review and is continuing to seek further savings through its review of statutory and non-statutory services. We encourage it to continue exploring opportunities for further productivity improvements. We suggest that the council clearly communicates to residents the nature and value of the productivity improvements it achieves. |

Note: In accordance with the Guidelines, IPART may also consider any other matters it considers relevant in assessing a council’s application for a special variation. In the case of Newcastle, no other matters were identified.

1.4 What does our determination mean for the council?

Our decision means that the council is able to increase its general income by around \$7.9m in 2012/13.⁸ After this year, other things being equal, this income will increase by the annual rate peg unless we approve further special variations.⁹ Over the next 9 years, the council will generate extra income of about \$45.6m for its civic projects.¹⁰

⁸ Newcastle Application Part A, Worksheet 1. Increase in general income includes the rate peg and the additional 5%.

⁹ As stated in footnote 4, the actual general income in future years will be influenced by a range of factors apart from the rate peg.

¹⁰ Newcastle Application Part A, Worksheet 6. Cash flows for the civic projects are projected for 2011/12 to 2020/21 which includes 9 years of the special variation.

1.5 What does our decision mean for ratepayers?

While IPART sets the allowable increase in general income, each individual council determines how it will allocate this increase to different categories of ratepayer. Councils usually set their rates in June or July for the coming year.

In its application, Newcastle City Council indicated it intended to allocate the rate increases implied by the requested special variation fairly evenly across its ordinary rating categories and sub-categories. Average rates in most categories will increase by between 8.51% and 8.89%. Rates for the Kooragang Industrial Coal Zone and Carrington Industrial Coal Zone will increase by 12.62% and 12.47% respectively.¹¹

In 2012/13, the average residential rate will increase by \$81, the average general business rate by \$463 (\$623 when the business sub-categories are included on a weighted average basis) and the average farmland rate by \$148.¹² The majority of residential and business ratepayers will pay less than these average increases.¹³

However, these rate increases are indicative only and the actual impact on rates is a matter for the council to decide, consistent with this decision.

1.6 What does the rest of this report cover?

The rest of this report discusses the council's application and our assessment of it in more detail:

- ▼ Chapter 2 focuses on the council's application
- ▼ Chapter 3 discusses our assessment against the criteria.

The appendices provide the council's proposed program of expenditure on the civic projects, and a summary of the comparative data we considered in our assessment – such as average local government area (LGA) income levels and council labour costs.

¹¹ Newcastle Application Part A, Worksheet 5.

¹² Newcastle Application Part A, Worksheet 5, and IPART calculations.

¹³ Newcastle Application Part A, Worksheets 3 and 5, and IPART calculations.

2 Newcastle City Council's application

Newcastle City Council applied to increase its general income by 8.6% (including the rate peg of 3.6%) in 2012/13, and to retain this increase permanently in its general income.¹⁴

The sections below provide some brief background information on the council and its history of special variations. The subsequent sections outline its application for a special variation in 2012/13, how the council proposes to use the additional income it would raise, and how the necessary rate increases would affect different ratepayers.

2.1 About the council

Newcastle City Council serves the area on the Hunter River about 120km north of Sydney, including Newcastle, the suburbs of Merewether, Kotara and Adamstown in the south, Elmore Vale, Wallsend, and Maryland in the west, and Beresfield, Hexham and Stockton in the north. Previously based on heavy industry, it is now a city with a diverse commercial, cultural, trade and industrial economy.¹⁵

The council is in DLG Group 5, which indicates it is classified as an "urban, large to very large regional town/city". IPART considers that this group is the most suitable peer grouping for the purpose of comparing it with other councils.¹⁶ However, as there are only 6 councils in the group, comparisons with the DLG Group average need to be interpreted with caution.

The Newcastle LGA has a SEIFA ranking of 107, which positions it among the top third of councils by socioeconomic status in NSW.¹⁷

¹⁴ Newcastle Application Part A, Worksheet 1.

¹⁵ Newcastle Application Part B, Attachment 2 *Special Rate Variation Community Engagement Strategy*, p 3.

¹⁶ DLG, *Snapshot of NSW Councils: Comparative Information on NSW Local Government Councils 2008/09*, pp 11-17. The Australian Classification of Local Governments (ACLG) system classifies councils into 22 categories according to their socio-economic characteristics and their capacity to deliver a range of services to the community. The DLG has reduced this to 11 groups because some of the ACLG categories contained few or no councils in NSW. There are 6 councils in DLG Group 5. The other 5 are Coffs Harbour City Council, Lake Macquarie City Council, Shoalhaven City Council, Tweed Shire Council and Wollongong City Council.

¹⁷ SEIFA is the Socio-Economic Index for Areas published by the Australian Bureau of Statistics. It ranks LGAs from 1 to 153 (includes 1 ranking for "unincorporated NSW"). A ranking of 1 means the council is the most disadvantaged relative to all the other councils in NSW. A ranking of 153 means it is the most advantaged relative to all the other councils in NSW.

In 2010/11, average residential rates in this LGA were \$875, which is slightly lower than the average for DLG Group 5 (\$889) but higher than the average for all councils in NSW (\$659).¹⁸

In 2010/11, revenue from rates and annual charges was the council's largest single revenue source, and accounted for 46.0% of its General Fund revenue.¹⁹ This percentage is slightly below the average for DLG Group 5 (48.0%) and similar to the average for NSW (46.7%).²⁰

Newcastle City Council's other non-rate sources of revenue include tipping fees, Newcastle Airport fees, and parking station and meter fees.²¹ These user charges and fees generated 24.2% of the council's operating revenue in 2010/11. This is higher than the DLG Group 5 and NSW average (both of which were 14.9%), and indicates the council has a relatively high level of cost recovery.²²

2.2 History of special variations

In the past 10 years, Newcastle City Council has had 2 special variations approved under the Act:

- ▼ In 2002/03, the Minister for Local Government approved a 4.97% increase under section 508(2) for a fixed term of 5 years, to fund environmental programs.
- ▼ In 2007/08, the Minister approved an increase of 9.95% under section 508(2) to be permanently incorporated in the rate base, for infrastructure maintenance and renewal.²³

2.3 Requested special variation in 2012/13

Newcastle City Council applied for a special variation of 8.6% in 2012/13, to be permanently incorporated into its income base. If approved, the council estimates this would increase its total permissible general income for 2012/13 by around \$7.9m²⁴ (Table 2.1). This estimate has been verified by the DLG.²⁵

¹⁸ DLG, unpublished comparative data, 2010/11.

¹⁹ General Fund refers to all council activities except Water and Sewer. In some cases, a council's General Fund may also exclude its other separate business activities eg, waste services or airports, but these General Fund data do not exclude this type of service revenue.

²⁰ DLG, unpublished comparative data, 2010/11.

²¹ Newcastle Application Part B, Attachment 13, *Annual Financial Statements 2010/11*, Note 3b, p 24.

²² DLG, unpublished comparative data, 2010/11.

²³ DLG, *Special Variation Master Record*, copy provided to IPART in October 2010.

²⁴ Newcastle Application Part A, Worksheet 1.

²⁵ DLG, *Assessment of Newcastle City Council's s508(2) Special Variation Application – Part A*, March 2012.

Table 2.1 Estimated impact of Newcastle City Council's requested special variation on its general income in 2012/13

| Adjusted notional general income 2011/12 (\$) | Annual increase in general income (%) | Annual increase in general income (\$) | Permissible general income 2012/13 (\$) ^a |
|---|---------------------------------------|--|--|
| 91,680,626 ^b | 8.60 | 7,884,534 | 99,572,429 |

^a Permissible general income refers to the maximum general income that the council can generate in the year. It equals the previous year's notional general income level adjusted for any expiring special variation, other adjustments (prior year catch ups, excesses, valuation objections and income adjustments for Crown land) plus the annual dollar increase permitted by the proposed special variation percentage. Newcastle City Council's proposed permissible general income in 2012/13 includes an increase of \$7,269 for a prior year catch up.

^b The 2011/12 adjusted notional general income is not part of the council's application and is only included here to indicate the size of the base to which the special variation applies.

Source: Newcastle Application Part A, Worksheets 1 and 4.

The council indicated that the special variation consists of 2 components:

- ▼ a 5.0% increase to partially fund the 9 civic projects identified in Scenario 4 of the council's *Long Term Financial Plan and Delivery Program 2011/2012 – 2014/2015*
- ▼ the 3.6% rate peg.

In setting the rate peg, we included a carbon price advance of 0.4% to assist councils to meet higher prices arising from the introduction of the carbon price from 1 July 2012.²⁶

Table 2.2 sets out the components of the council's requested special variation.

Table 2.2 Components of Newcastle City Council's requested special variation in 2012/13 (%)

| Component | Amount |
|--|------------|
| Increase to fund Civic Priority Projects | 5.0 |
| Rate peg | 3.6 |
| Total increase | 8.6 |

Source: Newcastle Application Part A, Worksheets 1 and 4.

²⁶ Given that the effects of the carbon price will eventually be captured in the Local Government Cost Index (LGCI), we will reverse the upfront adjustment we have made in the 2012/13 rate peg over 2 years. We will deduct 0.1% in 2013/14 and 0.3% in 2014/15 from the rate pegs in these years. See IPART, *Effects of the carbon price on local councils - Information Paper*, December 2011 for more information.

2.4 How the council proposes to use the income raised

The council indicated that it will use the additional income raised by this special variation to fund around a quarter of the estimated costs of 9 civic projects in the *Long Term Financial Plan*. The balance will be funded from other sources including grants, developer contributions, and asset sales. The projects are listed below in priority order, with their total proposed costs over 10 years:²⁷

- ▼ **Revitalising Hunter Street** - a joint venture in which the council, the NSW Government and the private sector aim to implement 44 identified priority action items to revitalise Hunter Street. The council plans to spend \$16.7m on the project.
- ▼ **Revitalising the coast** - planning and infrastructure projects including improvements to facilities and parkland at Merewether, Bar Beach, Dixon Park, King Edward Park, Shortland Esplanade and Newcastle baths, Nobbys Beach and Stockton. The council plans to spend \$35.9m on the project.
- ▼ **Swimming pool upgrade program** - upgrading pools at Beresfield, Mayfield, Stockton and Wallsend, and constructing the new Newcastle Aquatic and Leisure Centre at Lambton. The council plans to spend \$25.7m on the project.
- ▼ **Libraries upgrade program** - upgrading library facilities and building new libraries in Mayfield, New Lambton, Beresfield and Stockton, and an internal restructure and external expansion of the city's Central Library. Old libraries at New Lambton, Adamstown, Hamilton and Stockton will close and be sold once the new libraries are open. The council plans to spend \$42.9m on the project.
- ▼ **New cycle ways** - the provision of new cycle ways and upgrading existing cycle ways and shared pathways. State and Federal Government grants and Section 94 funds will complement council funding. The council plans to spend \$15.7m on the project.
- ▼ **Newcastle Art Gallery expansion** - to increase display space, education workshop space and storage facilities. New features will include a café and function space/ boardroom facilities. The council plans to spend a total of \$19.4m on the project.²⁸
- ▼ **Blackbutt Reserve upgrade** - Stage 1 includes redevelopment works at the Carnley Avenue facility with the construction of a playground and toilet block, kiosk, education centre and BBQ facilities. Stage 2 includes works at Richley Reserve, with new playground, shade shelters, shared pathways and a lookout platform. The council plans to spend \$8.7m on the project.

²⁷ Newcastle Application Part B, pp 2-5 and pp 8-13, and Newcastle Application Part B, Attachment 11, *Long Term Financial Plan 2011-21*, pp 17-21. Project costs are for the years 2011/12 to 2020/21 and cover 9 years of the special variation.

²⁸ Newcastle City Council's *Long Term Financial Plan 2011-21* and Newcastle Application Part A, Worksheet 6 reflect costs of \$19.4m for the Art Gallery project. The council advises that the budget has been revised to \$21m. An updated cash flow has not been provided.

- ▼ **Parking Strategy (on-street)** – staged expansion of parking meters to suburban areas, with a proposed 189 new meters installed between 2012 and 2014, aimed at providing parking spaces more equitably in the Newcastle LGA. The council plans to spend \$2.9m on the project.
- ▼ **Parking Strategy (off-street)** – to modernise parking stations for sale to the private sector. Currently these stations require significant ongoing maintenance. The council plans to spend \$10.3m on the project. We note that since the council's application was received, the car parking stations have been tendered for sale. If the sale proceeds, the parking station upgrade will not be required, apart from the upgrade of the heritage façade on the Bolton Street parking station.

Appendix A sets out the council's proposed Civic Priority Projects program of expenditure.

2.5 How the council proposes to allocate the special variation among ratepayers

The council levies ordinary residential, business and farmland rates. It has 18 sub-categories of business rate which apply to specific shopping centres, commercial and industrial centres and industrial coal zones. It also levies 17 business special rates.

In its application, the council indicated that it proposes to increase rates for most of its ordinary rating categories and sub-categories by between 8.51% to 8.89%. The exceptions are the business sub-categories for the Kooragang Industrial Coal Zone and the Carrington Industrial Coal Zone. It proposes to increase these rates by 12.62% and 12.47% respectively. The council indicated that higher rates increases for these sub-categories are justified because the affected ratepayers are significant users of council infrastructure and they have a relatively high capacity to pay.²⁹

The council proposes to increase its business special rates only by the rate peg of 3.6%. As there are no additional works, services, facilities or activities being provided to these special ratepayers, the council sees no justification in increasing these rates above the rate peg.³⁰

Table 2.3 shows the council's estimate of the impact of the requested special variation on average rate levels in its ordinary rating categories and subcategories only.

²⁹ Newcastle Application Part B, pp 40-44.

³⁰ Newcastle Application Part B, p 44.

Table 2.3 Impact of the requested special variation on average rate levels in each ordinary rates category and sub-category

| Rate category | Average rate 2011/12 (\$) | Requested Increase (\$) | Requested increase (%) | Average rate 2012/13 (\$) |
|--|--------------------------------------|--|---------------------------------------|--------------------------------------|
| Residential | | | | |
| Ordinary Residential | 939 | 81 | 8.59 | 1,020 |
| Business | | | | |
| Ordinary Business | 5,445 | 463 | 8.51 | 5,908 |
| Inner City Suburban Shopping Centre | 68,437 | 5,886 | 8.60 | 74,323 |
| Suburban Shopping Centres | 65,269 | 5,613 | 8.60 | 70,882 |
| Kotara Major Commercial | 901,581 | 79,536 | 8.82 | 981,117 |
| Major Commercial (Inner City) | 132,717 | 11,414 | 8.60 | 144,131 |
| Kotara Homemaker's Centre | 116,422 | 10,346 | 8.89 | 126,768 |
| Jesmond Major Commercial | 357,496 | 31,245 | 8.74 | 388,741 |
| Waratah Major Commercial | 251,523 | 21,958 | 8.73 | 273,481 |
| Wallsend Major Commercial | 286,308 | 25,123 | 8.77 | 311,431 |
| The Junction Major Commercial | 134,589 | 11,575 | 8.60 | 146,164 |
| Kooragang Industrial Coal Zone | 171,172 | 21,604 | 12.62 | 192,776 |
| Kooragang Industrial Centres | 18,827 | 1,615 | 8.58 | 20,442 |
| Mayfield North Heavy Industrial Centre | 104,834 | 9,016 | 8.60 | 113,850 |
| Mayfield North Industrial Centre | 20,273 | 1,744 | 8.60 | 22,017 |
| Carrington Industrial Centre | 32,328 | 2,836 | 8.77 | 35,164 |
| Broadmeadow Industrial Rate | 95,751 | 8,235 | 8.60 | 103,986 |
| Hexham Light Industrial Centre | 11,251 | 968 | 8.60 | 12,218 |
| Hexham Industrial Centre | 84,471 | 7,265 | 8.60 | 91,735 |
| Carrington Industrial Coal Zone | 245,940 | 30,675 | 12.47 | 276,615 |
| Farmland | | | | |
| Ordinary Farmland | 1,715 | 148 | 8.60 | 1,863 |

Source: Newcastle Application Part A, Worksheet 5.

3 | IPART's assessment

To make our decision on Newcastle City Council's application for a special variation in 2012/13, we assessed this application against each of the 5 criteria set out in the Guidelines. We found that the application satisfactorily meets all these criteria and therefore decided to approve the special variation.

Table 1.2 (in Chapter 1) summarised our findings in relation to each of the criteria. The sections below discuss our assessment of each criterion in more detail.

3.1 Criterion 1 - Demonstrated need for the rate increases implied by the special variation

Councils seeking special variations must demonstrate that their requested increase in general income is necessary. This includes:

- ▼ supporting their application with relevant strategic, asset management and long-term financial planning information
- ▼ providing evidence that the income raised by the special variation will be used to fund an efficient and feasible program of expenditure, and
- ▼ if possible, providing evidence that the special variation will improve their financial sustainability.

Newcastle City Council requested the special variation to partially fund a program of 9 civic projects, worth a total of approximately \$178.1m over 10 years. These projects are listed as Scenario 4 in the council's *Long Term Financial Plan*. They each link to 2 or more of the 7 strategic directions identified in the *Newcastle 2030 Community Strategic Plan*, which was developed after 18 months of community consultation.³¹ Therefore, we are satisfied that the special variation is consistent with the community's objectives and reflects the community's priorities.

³¹ Newcastle Application Part B, p 15.

In addition to the estimated \$45.6m³² the requested special variation will generate over the 9 years to 2020/21, the council proposes to fund its civic projects program through:

- ▼ the sale of underutilised or redundant council assets (estimated to raise \$51.55m)
- ▼ increased grant income for capital works projects (\$19.83m)
- ▼ section 94 Developer Contributions (\$7.61m)
- ▼ a loan for the coastal revitalisation project (\$2.19m)
- ▼ using reserves and unspent funds carried forward from previous years (\$10.28m).³³

However, the council acknowledged that, even with the special variation and these other funding sources, there will be a shortfall in meeting the costs of the proposed civic projects. It indicated that further asset sales and efficiency gains will be required.³⁴

The council has estimated that it needs to spend \$112.8m to bring its assets up to a satisfactory standard, and \$44.8m per annum on maintenance. It is currently spending \$34.7m per annum on maintenance, resulting in a growing infrastructure backlog. The vast majority of this backlog is in the buildings and structures the council owns, and to bring these up to a satisfactory standard requires an estimated \$85.3m.³⁵

In its application, the council indicated that separate from the civic priority projects, it proposes to spend \$234.2m over 10 years on a major asset preservation program (roads, drains, buildings, natural assets) and reducing the infrastructure backlog.³⁶ In addition, it estimated that the proposed asset sales to raise funds for the civic projects will also reduce the infrastructure backlog, by around \$30.5m over the first 3 years. This will drive a reduction in its Broad Liabilities Ratio from 85% in 2010/11 to 75% in 2014/15. In the base case, the ratio would increase to 91% over the same period.³⁷

Furthermore, it indicated that upgrading facilities such as libraries, improving coastal amenities, and providing new and upgraded cycle ways will reduce its maintenance costs.³⁸

³² Newcastle Application Part A, Worksheet 6. Over 10 years the special variation will raise an estimated \$51.4m above the rate peg. The cash flows for the civic projects are for the 10 years 2011/12 to 2020/21 - which includes 9 years of special variation income.

³³ Newcastle Application Part B, p 52.

³⁴ Newcastle Application Part B, p 53.

³⁵ Newcastle Application Part B, Attachment 13, *Annual Financial Statements 2010/11*, Special Schedule 7.

³⁶ Newcastle Application Part B, Attachment 11 *Long Term Financial Plan 2011/2021*, pp 18-19.

³⁷ Newcastle Application Part B, p 31 and p 33. The broad liabilities ratio is the sum of the council's debt and estimated infrastructure backlog relative to its operating revenue.

³⁸ Newcastle Application Part B, p 21.

A major risk to the proposed civic projects program of works is the reliability of the non-rate sources of funding for the program. For example, assets sales may not proceed as planned or realise the expected revenues, and grant funding from the State and Federal Governments or developer contributions may be lower than anticipated. The council's application did not indicate how it would manage this risk, and what insufficient revenues may mean for the proposed 9 civic projects.

Nevertheless, we are satisfied that the council has demonstrated that it needs to generate some of the additional revenue it requires for these projects through rate increases, and that it has considered, and plans to utilise, alternative revenue sources as part of its funding proposal. The council considers that without the special variation these projects will not be able to proceed.³⁹

The council has a dedicated project management team made up of engineers, architects, construction managers and project officers, experienced in undertaking major projects.⁴⁰ While we have not undertaken a detailed evaluation of the council's expenditure items, we consider the proposed expenditure estimates are based on appropriate research and feasibility work contained in the following documents:

- ▼ the Hunter Street Revitalisation Final Strategic Framework
- ▼ the Coastal Revitalisation Master Plan
- ▼ the Pool Service Delivery Model
- ▼ the Library Service Delivery Model
- ▼ the draft Newcastle Cycling Strategy and Action Plan
- ▼ the Blackbutt Reserve Draft Plan of Management 2011.⁴¹

The council has forecast increasing operating deficits in both the base case and special variation scenarios over the 10 years of its *Long Term Financial Plan*.⁴² This is because it assumes that its rates income will increase at a slower rate than expenses.⁴³ In particular, it expects that expenses will grow due to the acceleration of its infrastructure backlog reduction program (from \$12m to \$25m), cost shifting from other government agencies, and increases in the NSW Government Waste Levy.⁴⁴

³⁹ Newcastle Application Part B, p 53.

⁴⁰ Newcastle Application Part B, p 27.

⁴¹ Newcastle Application Part B, Attachments 28–33.

⁴² In this report, we refer to the operating balance exclusive of capital grants and contributions.

⁴³ Newcastle Application Part B, Attachment 24, *Delivery Program 2011/12 – 2014/15 and Operational Plan 2011/12*, p 81. For forecasting its rates income, the council has assumed 'CPI minus 0.2%' for future rate pegs in its *Long Term Financial Plan*. This results in an estimated average rate peg of 2.5% through to 2020/2021. IPART usually assumes future annual average rate pegs of 3.0%.

⁴⁴ Newcastle City Council paid a Waste Levy of \$12.82m in 2010/11: Newcastle Application Part B, Attachment 13, *Annual Financial Statements 2010/11*, Note 4, p 30. Newcastle Application Part B, pp 29-30.

The council indicated that although the requested special variation will not resolve its recurrent sustainability⁴⁵ issues, it should reduce the size of its operating deficit, largely as a result of increased rates income.⁴⁶ In the base case, the operating deficit is expected to grow to \$26.4m by 2020/21, compared to \$19.5m in the special variation scenario.⁴⁷ The council will need to take further action to address its projected operating deficits.

The council's civic projects are of a discretionary nature and do not by themselves address issues of financial sustainability. However, the projects form part of a restructuring of the council's asset base that is in line with community priorities. The restructuring of the council's asset base, if successful, will directly reduce the maintenance backlog. Moreover, as discussed in section 3.4, the council is taking further action to reduce its backlog of infrastructure maintenance.

Overall, we are satisfied that the council has demonstrated a need for the rate increases implied by the special variation.

3.2 Criterion 2 - Adequate community consultation

Councils seeking special variations must demonstrate that they have undertaken adequate community consultation regarding the special variation and the associated program of expenditure. The consultation material should be clear and accurate and explain what the rate increase will be used for and the impact on ratepayers.

Prior to consulting on the proposed special variation, Newcastle City Council engaged with its community to develop a Community Vision and Community Strategic Plan, Delivery Program and Operational Plan. These earlier consultation programs led to the adoption of Scenario 4 as the community's preferred program of works, and the proposal to seek a special variation of 5% above the rate peg to help fund this program.⁴⁸

⁴⁵ A council's financial sustainability is based on a combination of its operating (or recurrent) performance and its capital performance. Recurrent sustainability means that councils are able to fund their recurrent expenditures from recurrent revenues, and so avoid using capital revenues for this purpose or running recurrent operating deficits.

⁴⁶ Newcastle Application Part B, p 34.

⁴⁷ Newcastle Application Part B, Attachment 11 *Long Term Financial Plan 2011/2021*, pp 27 and 30.

⁴⁸ Newcastle Application Part B, Attachment 2 *Special Rate Variation Community Engagement Strategy*, pp 8-10.

To inform the community about the key civic projects and their link to the Community Strategic Plan, and the proposed 5% special variation above the rate peg and its impact on ratepayers, the council undertook a comprehensive information campaign that involved:

- ▼ print and radio advertising
- ▼ media releases and opinion pieces
- ▼ a special edition of the Council News
- ▼ a series of 4 fact sheets
- ▼ a poster series and flyers on the key civic projects, and
- ▼ information on the council's website.

To determine the level of support for the civic projects and rates increase, it conducted a telephone survey, an open community survey, an online forum, 2 community workshops, 4 stakeholder meetings and sought written submissions.

The telephone survey, conducted by Micromex research on the council's behalf, involved of a random sample of 424 residents.⁴⁹ The results were that:

- ▼ 62% of respondents were at least 'somewhat supportive' of the proposed special rate variation (12% 'very supportive', 23% 'supportive', and 27% 'somewhat supportive')
- ▼ 74% felt it was at least 'somewhat important' that the council be allowed to introduce the special variation (11% thought it very important, 31% important, and 32% somewhat important).⁵⁰

The open community survey was conducted on the council's website. The results were less supportive of the special variation. Of the 663 anonymous responses, 48% were at least 'somewhat supportive' of the proposed rate increase to fund the promised delivery program, and 53% felt it was at least 'somewhat important' that the council be allowed to introduce the special variation.⁵¹

The online forum received 275 unique visitors from 20 September to 17 October 2011, who made 48 comments. The council also received 34 written submissions from the public about the special variation. Of these, 6 were in support and 28 were opposed to it.⁵² These non-random results are likely to be subject to a degree of self-selection bias.

⁴⁹ This sample size, with a population of 154,777, is statistically significant and has a margin of error of 4.75% at the 95% confidence level, based on a response distribution of 50% endorsement. IPART calculation using sample size calculator, <http://www.raosoft.com/samplesize.html> (accessed 26 March 2012).

⁵⁰ Newcastle Application Part B, Attachment 2 *Special Rate Variation Community Engagement Strategy*, p 14.

⁵¹ Newcastle Application Part B, Attachment 2 *Special Rate Variation Community Engagement Strategy*, pp 15-16.

⁵² Newcastle Application Part B, Attachment 2 *Special Rate Variation Community Engagement Strategy*, p 16.

Common themes that emerged from the open community survey, online guest book and written submissions were:

- ▼ the need for city improvement
- ▼ the Laman Street figs issue
- ▼ efficiency of funds
- ▼ priority of projects
- ▼ trust in the council.

The council reports that it is taking steps to address all these issues.⁵³

Attendance at the community workshops was relatively low, with a total of 32 people at the 2 workshops. The council was invited to speak at 4 meetings, following invitations being sent to 67 stakeholder groups.⁵⁴ This low response and attendance could be interpreted as a lack of strong opposition to the proposed special variation.

We also received 11 direct representations in response to the council's requested special variation and considered the concerns raised as part of our assessment. These concerns broadly reflected the common themes identified above.

Overall, we are satisfied that the council has met Criterion 2 and has consulted extensively with the community regarding the proposed special variation. It has also assessed the feedback it received and is addressing the various issues raised.

3.3 Criterion 3 - Reasonable impact on ratepayers

This criterion is important, given that the primary purpose of regulating council revenues is to protect ratepayers from unreasonable increases in rates. To assess whether a council's application meets the criterion, we consider the magnitude of the impact of rate rises resulting from the requested special variation, the ratepayers' capacity to pay the increased rates, and outcomes from the council's community consultation.

We found that Newcastle City Council's requested special variation and the associated rate increases will have a reasonable impact on ratepayers given that:

- ▼ 60% of residential ratepayers will pay less than \$41 above the rate peg, and 87% will pay less than \$52 above the rate peg.⁵⁵

⁵³ Newcastle Application Part B, Attachment 2 *Special Rate Variation Community Engagement Strategy*, pp 17-21.

⁵⁴ *ibid*, pp 16-17.

⁵⁵ Newcastle Application Part A, Worksheets 3 and 5 and IPART calculations.

- ▼ 47% of general business ratepayers will pay less than \$101 above the rate peg, and 73% will pay less than \$234 above the rate peg.⁵⁶ This does not include the sub-categories of business rates, which, on average, pay significantly higher rates.
- ▼ The council has various rates assistance measures available for pensioners and those on low incomes experiencing difficulty in paying their rates.⁵⁷
- ▼ Over the last 4 years, the council has had about 5.1% of rates and annual charges outstanding at the end of each financial year. This is slightly lower than the averages for DLG Group 5 and NSW (5.7% and 7.3% respectively),⁵⁸ which suggests that Newcastle ratepayers in general are not having significant difficulty paying their rates on time.

The council does not have a minimum rate level for ordinary residential rates or special rates. The minimum rate for business (including all sub-categories) and farmland rates will increase from \$619.50 in 2011/12 to \$672.70 with the special variation of 8.6%. The council states that there will be no change in the number of ratepayers paying the minimum amount with the special variation.⁵⁹

Average residential rates in the Newcastle LGA are slightly lower than the DLG Group 5 average, although higher than the NSW average. However, capacity to pay indicators for LGA such as its relatively high SEIFA index ranking and above average income levels suggest a modest rate increase is affordable. (Appendix B provides a range of comparative data on the council, including average income levels and the council's SEIFA index ranking.)

3.4 Criterion 4 - Sustainable financing strategy consistent with the principles of intergenerational equity

Councils seeking special variations must demonstrate that they have considered the use of all available financing options to address their capital expenditure requirements. Their financing strategy must be both sustainable and ensure intergenerational equity. The concept of intergenerational equity means that the costs of long lived assets (like infrastructure) are shared between current and future users, based on their share of the use of these assets over their life. For example, this may be achieved by council borrowings, which spread the financing costs of infrastructure over a long period, rather than meeting these costs through large rate increases in the short to medium term.

⁵⁶ *ibid.*

⁵⁷ Newcastle Application Part B, Attachment 26 *Rates Assistance Mechanisms*.

⁵⁸ DLG, unpublished comparative data, 2010/11.

⁵⁹ Newcastle Application Part B, p 46.

The council estimated that the requested special variation will contribute around a quarter of the funds required to fund the 9 civic projects. It also intends to use asset sales, increased grant funding, developer contributions, reserves, and a loan of \$2.19m for the coastal revitalisation project to fund these projects. The loan and its repayment strategy will be supported by commercial activity of the Stockton Beach Tourist Park.⁶⁰

The mix of funding sources means that the burden of funding for the proposed civic projects (which are predominately capital works) is shared between current and future ratepayers. This is appropriate for long-lived assets.

Separate to this application, the council is also intending to borrow a further \$10m per annum for 10 years to reduce its infrastructure backlog. It is estimated that total borrowings will increase from \$55.3m in 2011/12 to \$120.6m in 2020/21. These borrowings will occur regardless of the special variation and will increase the debt service ratio from 2.6% in 2011/12 to 4.5% in 2020/21. This is still well within the DLG's accepted benchmark for the debt service ratio (less than 10% is satisfactory).⁶¹ Once the backlog has been reduced to a satisfactory level, the council intends to maintain it at this level from operating revenues and not rely on further borrowing.⁶²

Reducing the backlog will reduce the level of future debt required. Asset sales will also reduce the level of the backlog and in turn reduce the level of borrowing required.⁶³

Overall we are satisfied that, in relation to this special variation, Newcastle City Council has considered and is pursuing other methods of financing its proposed expenditure program as part of its long-term financial plan.

3.5 Criterion 5 - Productivity improvements and cost containment strategies

Councils seeking special variations must demonstrate that they have implemented a program of productivity or efficiency improvements and cost containment strategies to ease expenditure pressures before considering an increase in rates. In particular, they need to provide details of the productivity improvements, efficiencies and cost containment strategies that they have implemented over the past 2 or more years, and details of those that they propose to realise over the period of the special variation.

⁶⁰ Newcastle Application Part B, p 54.

⁶¹ DLG, *Snapshot of NSW Councils: Comparative Information on NSW Local Government Councils 2009/10*, p 93.

⁶² Newcastle Application Part B, pp 54-55.

⁶³ Newcastle Application Part B, p 57.

In its application, Newcastle City Council indicated that it has undertaken a number of performance improvement programs aimed at achieving long-term sustainability, and improvements in its operations, service delivery efficiency and customer satisfaction.⁶⁴

The council began a comprehensive Sustainability Review of operations in 2009. This achieved operational savings of \$1.1m in 2009/10 and a further \$0.9m in 2010/11. These savings have been removed from the council's base operating budget.⁶⁵ The savings in 2010/11 represented around 0.38% of the council's total operational expenses (\$227.9m⁶⁶).

They were achieved by:⁶⁷

- ▼ Organisational restructuring. Centralising human resources and training resulted in savings of \$300,000 per annum, and centralising customer service by introducing Newcastle Voice led to savings of \$100,000 per annum. Centralising all legal services and developing in-house legal capability is expected to lead to further savings of up to \$1.5m per annum.
- ▼ Changing service standards. Modifying service standards for parks and reserves saved \$110,000 per annum.
- ▼ Benchmarking. This identified \$2.0m in future savings in areas such as road construction, digital print and trades.

The council is also pursuing productivity improvements and cost containment strategies in areas such as:⁶⁸

- ▼ Information Communications Technology
- ▼ Visitors Information Centre (using online information kiosks)
- ▼ tourism product development
- ▼ payroll (eg, moving from a weekly to fortnightly pay system is expected to save \$120,000 per annum).

In addition, the council is currently undertaking a review of services to seek opportunities for divestment, commercialisation or business improvements. The review of non-statutory services has already identified \$2m in operational savings. The review of statutory services is to report to the council in April 2012.⁶⁹

⁶⁴ Newcastle Application Part B, p 58.

⁶⁵ Newcastle Application Part B, p 59.

⁶⁶ Newcastle Application Part B, Attachment 13, *Annual Financial Statements 2010/11*, Income Statement p 1.

⁶⁷ Newcastle Application Part B, pp 58-61.

⁶⁸ Newcastle Application Part B, p 60.

⁶⁹ Newcastle Application Part B, p 59.

The council advises that staff numbers will be reviewed in line with the recommendations from the Sustainability Review. Benchmarking with similar councils will also be undertaken.

As part of our assessment, we examined comparative data on productivity from the DLG for 2010/11 (Appendix B). The council's ratio of population to FTE staff is in line with the average for DLG Group 5 and higher than the average for all NSW councils.⁷⁰ In short, there is no sign of inefficiency in the council based on this indicator.

However, the council has the highest average labour cost per FTE staff in the Group, although its total employee costs are no higher relative to ordinary expenditure than the average for the Group or NSW councils as a whole. Its consultancy and contractor expenses are the third lowest in DLG Group 5, although they are much higher than the NSW average.⁷¹

Overall, we are satisfied that the council has achieved productivity savings in the past and is endeavouring to do so in the future. It is appropriate for the council to continue exploring opportunities for further productivity improvements and cost containment strategies and to clearly communicate to its residents the nature and value of productivity improvements it makes.

⁷⁰ This ratio indicates the number of residents in the population per council FTE. A higher ratio indicates that there are fewer council staff for each person in the community whereas a lower ratio indicates that there are more council staff.

⁷¹ The significant variation between the 6 councils in DLG Group 5, particularly in contracting and consultancy expenses, means that group averages should be interpreted cautiously.



Appendices

A Newcastle City Council Proposed Program of Expenditure

Table A.1 below shows the projected cash flows for the 9 civic projects to be partially funded by the special variation. As many of the projects start in 2011/12, this year is also shown. Year 1 of the special variation is 2012/13.

Table A.1 Newcastle City Council proposed program of expenditure for the 9 civic projects (\$)

| | Year 1 | Year 2 | Year 3 | Year 4 | Year 5 | Year 6 | Year 7 | Year 8 | Year 9 | Total | |
|-------------------------------|------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|------------------|-------------------|------------------|--------------------|
| Project Name | 2011/12 | 2012/13 | 2013/14 | 2014/15 | 2015/16 | 2016/17 | 2017/18 | 2018/19 | 2019/20 | 2020/21 | |
| Hunter Street Revitalisation | 175,000 | 2,000,000 | 2,440,000 | 1,230,000 | 1,950,000 | 3,000,000 | 2,625,000 | 1,500,000 | 1,250,000 | 500,000 | 16,670,000 |
| Coastal Revitalisation | 3,060,000 | 4,956,000 | 4,512,000 | 2,270,000 | 5,375,000 | 5,755,000 | 4,520,000 | 2,840,000 | 1,990,000 | 660,000 | 35,938,000 |
| Swimming Pool Upgrade | 102,602 | 2,030,000 | 8,048,914 | 12,014,457 | 3,533,869 | - | - | - | - | - | 25,729,842 |
| Parking Strategy - On-Street | 1,102,000 | 760,000 | 1,035,500 | - | - | - | - | - | - | - | 2,897,500 |
| Parking Strategy - Off-Street | 70,000 | 200,000 | 1,744,000 | - | 500,000 | 3,750,000 | 4,076,499 | - | - | - | 10,340,499 |
| Art Gallery Expansion | 1,000,000 | 8,018,683 | 6,338,317 | 4,000,000 | - | - | - | - | - | - | 19,357,000 |
| Libraries Upgrade Program | - | - | 100,000 | 2,300,000 | 6,500,000 | 15,360,000 | 4,640,000 | 1,200,000 | 7,100,000 | 5,700,000 | 42,900,000 |
| Blackbutt Reserve Upgrade | 500,000 | 800,000 | 1,650,000 | 500,000 | 800,000 | 600,000 | 2,000,000 | - | 800,000 | 1,000,000 | 8,650,000 |
| Cycle ways | - | 2,760,000 | 2,400,000 | 250,000 | 750,000 | 1,000,000 | 2,500,000 | 2,000,000 | 2,000,000 | 2,000,000 | 15,660,000 |
| Total | 6,009,602 | 21,524,683 | 28,268,731 | 22,564,457 | 19,408,869 | 29,465,000 | 20,361,499 | 7,540,000 | 13,140,000 | 9,860,000 | 178,142,841 |

Note: 2011/12 is not part of the special variation, but is shown for completeness.

Source: Newcastle Application Part A, Worksheet 6 and revised cash flow provided to IPART, 16 May 2012.

B Comparative indicators

Table B.1 Select comparative indicators for Newcastle City Council, 2010/11

| | Newcastle City Council | DLG Group 5 average | NSW average ^e |
|--|---------------------------|------------------------|-----------------------------|
| General profile indicators | | | |
| Area (km ²) | 187.1 | - | - |
| Population | 154,777 | - | - |
| General Fund operating expenditure (\$m) | 227.9 | 155.5 | 54.8 |
| General Fund revenue per capita (\$) | 1,461 | 1,282 | 2,006 |
| Rates revenue % total General Fund revenue | 46 | 48 | 47 |
| Average rate indicators^a | | | |
| Average rate level – residential (\$) | 875 | 889 | 659 |
| Average rate level – business (\$) | 6,891 | 4,421 | 2,450 |
| Average rate level – farmland (\$) | 1,647 | 1,694 | 2,121 |
| LGA socio-economic/capacity to pay indicators | | | |
| Average annual income, 2009 (\$) | 45,239 | 39,048 | 41,376 |
| Growth in average annual income, 2006-2009 (%) | 4.8 | 4.6 | 4.4 |
| Average residential rates (2010/11) to average annual income, 2009 (%) | 1.9 | 2.1 | 1.5 |
| SEIFA, 2006 (NSW rank) ^b | 107 | - | - |
| Outstanding rates ratio (%) ^c | 5.1 | 5.7 | 7.3 |
| Productivity indicators | | | |
| FTE staff (no) ^{c,d} | 938 | 795 | 294 |
| Ratio of population to FTEs ^c | 165 | 165 | 126 |
| Average cost per FTE (\$) ^c | 93,742 | 78,982 | 71,155 |
| Employee costs as % ordinary expenditure – General Fund | 39 | 37 | 37 |
| Contractor expenses (\$) ^c | 19,571,000 | 24,125,833 | 6,238,288 |
| Contractor expenses as % ordinary expenditure ^c | 9 | 13 | 8 |

^a Average rates equal total rates revenue in a given category divided by the number of assessments in that category.

^b See footnote 17 for SEIFA index.

^c Based upon total council finances and operations ie, General Fund and if applicable, Water and Sewer and other funds (eg, Airport). Note: the outstanding rates ratio is 5.35% in the council's *Annual Financial Statements 2010/11*, p 45.

^d The total number of FTEs at 30 June 2010, as reported in the council's consolidated financial reports. It is noted that the total number of FTEs as at 30 June 2011 was 926.

^e NSW averages exclude Snowy River Shire Council because data was not yet available.

Note: General Fund refers to all council activities except Water and Sewer and, in some cases, other activities eg, airports.

Source: DLG, unpublished comparative data, 2010/11 and ABS, National Regional Profiles, NSW, November 2011.

