BUSINESS & CORPORATE SYSTEMS

ATTACHMENT A

2 BIRIPI WAY TAREE OFFICE RELOCATION INVESTIGATIONS IPDATE

ORDINARY MEETING

31 OCTOBER 2018

Draft Financing Strategy

(Public copy with commercially sensitive information removed)

Proposed Office Relocation
2 Biripi Way, Taree

Contents

Notes:

This version of the strategy has been altered from the original version to ensure that commercially sensitive information has been removed. The redacted information is not available to the public as it comprises information relating to property realisation values which form part of the strategy. Disclosure of confidential information in the strategy would disadvantage Council in obtaining best value from the sale or lease of properties referred to in the strategy.

We note that this strategy references reports prepared by Knight Frank Newcastle. These reports are not available to the public for the same reason referenced above in relation to the strategy redactions.

1 Executive Summary

This strategy has been prepared to document the various funding options available for the proposed office relocation to 2 Biripi Way, Taree currently being considered by Council.

At this time, it is estimated that $20 million is required (including contingency) to develop the property for office relocation purposes (this figure does not include the site acquisition cost or AV/IT costs).

This strategy involves a rationalisation of cash reserves, which in the main, are the result of efficiencies in reserve fund holdings as a result of the Council merger, the sale of property assets and loan funds (with loans to be repaid from rental income received from leasing out retained properties surplus to Council's needs as a result of the office relocation to Biripi Way).

In this strategy, Option 3 is identified as the recommended funding model and comprises the following:

Cash Reserves	$7.2 Million
Sale of Property Assets	$4.8 Million
Loans (repaid from rent received)	$8 Million
Total	**$20 Million**

2 Background

In November 2017, Council resolved to acquire the former Masters building and site located at 2 Biripi Way Taree. The building had been identified as having the potential to become the administrative headquarters of MidCoast Council and would allow for the centralisation of staff.

Council adopted a Gateway Process for the development of the project whereby a series of decision points exist. This allows for Council to receive and consider information and determine whether it wishes to proceed with the project.

The project has now reached a decision point where a financing strategy is required. This strategy will consider the estimated cost to fit-out the site, the various sources of funds that may be allocated to the project, identify the longer term operating costs of the project, consider an asset disposal strategy of existing council properties and consider the impact of the project on Council's Long Term Financial Plan.

3 Site Purchase and Funding

The site at 2 Biripi Way was purchased for $7 million (plus GST) and was funded through loan borrowings.

These funds were borrowed from the Commonwealth Bank of Australia for a 20 year term with a variable rate of interest.

Council generally borrows on a fixed rate basis over a ten year period. In this instance a variable rate was chosen to provide flexibility as Council proceeded through the various phases that would lead to a final decision on the project.

Should Council resolve not to proceed with the proposal, it would need to consider the options for the site which may include disposal or leasing as a commercial investment.

Retaining the ability to repay the borrowings early and without incurring significant break costs was a key consideration in entering into a variable rate loan.

Principal and interest repayments (approximately $500,000 per annum) on this loan are being met from Council's Commercial Development Reserve which holds the rental income received from the Woolworths Tuncurry lease.

4 Cost to Fit-out

The following costs are taken from the Cost Plan dated 20 July 2018 prepared by Slattery Australia Pty Ltd. These are the figures that were presented to Council during August 2018.

The Cost Plan was developed to align with the test fit option that accommodates 350 staff. The test fit excludes fit out of the western end of the building referred to as the former Trade Centre ('out of scope' area of approximately 2,000 m2), other than replacing the existing roller door with a wall to match the existing wall.

The estimated total overall cost of the proposed test fit is **$18,093,941**.

This is broken down into the following components:

- Building Costs $14,661,357
- Consultancy Fees $1,852,992
- Contingency $1,579,592

There are a number of **Cost Options** that have been identified within the report that will need to be considered and a decision on these will impact on the final estimated cost. These cost options total $1,691,511 (being items that are optional and not essential elements for the project, e.g. fit out of additional workstations for future growth).

Value Engineering Options have also been identified which could reduce construction costs if adopted. Whether or not one or more of these options will be adopted will be considered during the detailed design phase and total $1,145,000 (i.e. wall height of offices, area of glazing).

It should also be noted that the Cost Plan does not include any allowance for AV/IT equipment. It has been estimated that the relevant amount for this component is $2,656,336. It has been excluded from the estimates on the basis that AV/IT costs will be incurred irrespective of whether Council makes a decision to proceed with a move to the Biripi Way site or to adopt a 'campus' model utilising existing sites. The required upgrades for either option will be funded through Council's regular budgeting process. It should be noted that the estimate for AV / IT equipment in respect of a 'campus' model is $3,911,336 due to the need to duplicate equipment at multiple locations.

The Cost Plan also identifies a number of **Exclusions** that will need to be re-confirmed and costed if a decision is made that they are applicable to the project.

These Cost Options, Value Engineering Options and Exclusions will need to be considered to determine a final Cost Plan Estimate and as part of the process of developing the specification that may ultimately be put to the market through the procurement process.

5 Funding for the Project

For the purposes of this Financial Strategy a total project cost of $20 million has been assumed for the fit-out and relocation. It should be noted that this figure does not include the site purchase or AV / IT costs.

It is noted that the test fit estimate in the cost plan is $18 million and this figure includes a significant contingency provision. However final design of the internal layout is required and the actual price will not be known until an external procurement process in the market has been conducted. On this basis, it is prudent to adopt a more conservative estimate of total funding required to undertake the project.

This higher estimate of required funding (i.e. $20 million) should not be taken as an indicator that there is room for scope creep within the project budget. Every effort will be put into ensuring that value for money is achieved and that all components are fit for purpose.

Should Council resolve to proceed to the next stage of the Gateway process - the Ready to Design stage - the focus will be on the governance arrangements of the project including addressing probity of procurement, completeness of specifications, detailed identification of project risks and benefits, refining of cost estimates etc.

Initial reports indicated Council could utilise borrowings to fund the fit-out of the 2 Biripi Way site. Further investigations confirmed that Council has the capacity within its General Fund to undertake additional borrowings to fund this project.

The sources of funding available to Council include:

- Funds from Asset Sales - Council will have 4 office buildings that may be surplus to needs at the end of this project. They could be offered to the market and sold with the proceeds applied to the project. Council also has a number of other property holdings that could be considered for disposal.

- Rental Income from Lease of Council Assets - As stated above, Council may have 4 office buildings that are surplus to needs assuming that the relocation to 2 Biripi Way occurs. As an alternative to disposing of certain surplus assets, several (or all) of these buildings may be suitable for lease to the private or public sector on commercial terms. This revenue stream could be allocated to the repayment of borrowings undertaken to fund the project.

- Re-allocation of existing Internal Reserves - Council has significant Internal Reserves set aside for various capital and operating purposes. As a result of the merger, efficiencies can be realised from rationalising some Reserves – a review could be undertaken to determine whether some can be re-allocated to the project.

- Re-allocation of existing budgets - Council has a number of opportunities to consider its current and upcoming budget with a view to allocating funds to this project. It may choose to review its current 2018-2019 budget and identify areas where it wishes to re-allocate funds or it may choose allocate any savings identified through the Quarterly Budget Review process or Re-Votes process to this project. The 2019-2020 budget development process represents a similar opportunity. Council may also need to undertake this exercise to identify savings that could be re-allocated towards the operating and maintenance expenses associated with the occupation of the Biripi

Way site particularly while the other sites remain vacant and in Council's ownership (holding costs).

- Government grants - Council should continue to liaise with both Federal and State Government bodies to identify opportunities for financial contributions to the project. Any success in this area would allow Council to reduce its proposed borrowings for the project. However given the uncertainty in respect of this funding source it is not being considered as a principal source of funding for the project.

In identifying funding sources for the Financing Strategy Council has made the following decisions and assumptions:

1. That Council will not be seeking a Special Rate Variation to raise funds for the project either as a direct contribution or to service borrowings taken out for the project.
2. That building assets that may become surplus to needs will be disposed of or offered to the public and private sector as commercial premises available for occupation for a commercial return. Proceeds from either option will be allocated to the reduction of borrowings taken out for the project.
3. That where possible the Balance Sheet should be the preferred source of funding for this project through use of cash investments, utilisation of vacant building assets for a commercial revenue stream and disposal of selected surplus properties.

6 Borrowings

Borrowings are one of the available funding options and it is appropriate that the project (being capital in nature) utilises some level of debt financing as a way of allocating the capital cost across generations and the life of the asset. Council could also consider funding the entire project with debt financing.

The ability to repay these borrowings is the primary consideration in determining the level of debt to taken on for the project. Council has several options to meet the repayments, including:

- identify new revenue sources
- provide a new budget allocation from existing revenue streams, or
- reduce / re-allocate existing budgets.

The annual repayments applicable to a $1 million loan taken over a 20 year period (with quarterly repayments) at a fixed rate between 4.00% and 5.50% are shown below.

Interest Rate	Annual Repayment (Principal & Interest) per $1 million
4.00%	$72,875
4.25%	$74,474
4.50%	$76,092
4.75%	$77,730
5.00%	$79,386
5.25%	$81,060
5.50%	$82,753

Council needs to be conscious of the impact of borrowings on its financial ratios when undertaking additional borrowings - particularly the Debt Service Cover Ratio and the Debt Service Ratio. At 30 June 2018 Council's Debt Service Ratio for General Fund was 8.28% while the Debt Service Cover Ratio was 3.93. These ratios are satisfactory and well within the benchmark ranges identified by the Office of Local Government (Benchmarks: Debt Service Cover Ratio - greater than 2, Debt Service Ratio - <10% = satisfactory, 10% to 20 % = fair).

Recent modelling within Council's Long Term Financial Plan considers the impact of borrowing an additional $8 million for this project. This model also includes borrowings of $50 million over 4 years associated with Council's contribution to a $100 million Roads Program in partnership with the NSW State Government. It should be noted that the loan repayments associated with the $50 million Road Program are funded from the Special Rate Variation (SRV) previously approved by the IPART. The SRV funds are restricted for this purpose.

Assuming that an additional $8 million is borrowed for this project, the model projects that the Debt Service Ratio will increase to 10.31% in 2019/2020 with a Debt Service Cover Ratio of 2.43. These ratios then improve in 2020/2021 as other loans are finalised. The calculation of this ratio is also based upon Council receiving annual rental income equivalent to the loan repayments on the $8 million from the lease of surplus Council properties.

The use of loan funding for the project (particularly during the fit-out and early occupancy stage) provides Council with some flexibility to take a considered approach in respect of the future of the surplus administration buildings. Some (or all) of these buildings may present attractive commercial leasing opportunities to the private or public sector which may earn Council a competitive market return. These funds would then be applied to servicing the relevant loan repayments.

It may be preferable to utilise debt funding as the balancing source of funding for the project. The objective is to carry the lowest amount of borrowings as possible at the completion of the project and to be paying the lowest amount of interest possible. To enable this Council would identify other funding sources that can be allocated to the project, with the outstanding unfunded amount sourced from borrowings.

The structure of any debt financing will need to be considered from the perspective of fixed versus variable interest rates. A fixed rate over a 20 year period in the current low interest rate environment provides certainty for budgeting of repayments over the long term. However it does limit the ability to make lump sum repayments off the principal should Council decide to dispose of properties in the future.

At this point in time Council should be looking towards retaining flexibility with its borrowings for this project and as such a variable rate loan structure is preferred. This provides time for Council to consider the various options for property retention / disposal and for decisions to be implemented.

7 Asset Disposals

Council presently owns 4 administration buildings in Forster and Taree that will become vacant if the move to 2 Biripi Way Taree is approved. Those properties are:

- 4-10 Breese Parade, Forster (former Great Lakes Council Administration Building)
- 16 Breese Parade, Forster (former MidCoast Water Administration Building)
- 26 Muldoon Street, Taree (former MidCoast Water Administration Building)
- 2 Pulteney Street, Taree (former Greater Taree City Council Administration Building)

Council engaged Knight Frank Newcastle to provide Property Advice and a Disposal Strategy in respect of the above properties. The scope of the engagement was extended to include the site at 2 Biripi Way, Taree.

Council also owns a number of other properties that could be offered to the market and Knight Frank was also asked to provide advice on some of these properties.

26 Muldoon Street Taree

The property at 26 Muldoon Street Taree is presently leased to the NSW Police - Manning - Great Lakes Local Area Command (LAC) for approximately 2 years while the reconstruction of the Taree Police Station occurs.

The 26 Muldoon Street property is operated in two portions (but not formally subdivided) – the first of which is the front administration building (being the subject of the lease to the LAC) and the second is the Taree Water Services Depot and treatment plant located behind the Administration Building (which is not included in the leased area to the LAC). The Knight Frank report only considers the current leased area.

If Council determines to dispose of 26 Muldoon Street, then at that time, Council would need to consider whether the property should be subdivided and potentially only the front administration building being offered to the market, or whether the site should be offered to the market englobo (i.e. the two portions being sold together) having regard to the range of potential buyers. The inclusion of the depot site with the front administration building represents a different configuration of the property that may attract a higher return.

This would also require Council to consider its future strategy for the location and number of Works Depots across the local government area.

At this stage the area occupied by the depot and treatment plant has not been included in the consideration of potential asset disposals. Any decision to put all or part of the property to the market would require a subdivision.

4-10 Breese Parade Forster

For the purposes of this strategy and market valuations, the 4-10 Breese Parade Forster site does not include the current Forster Library Building or the buildings occupied by the Arts & Crafts Centre, Senior Citizens Group or MidCoast Assist. The Knight Frank property assessment deals only with the current Administration Building footprint. Market estimates / valuations have not been obtained for the balance of the site.

As the Forster Civic Precinct project proceeds to construction over the next 12-18 months the future use of the Forster Library building will also need to be considered given the eventual relocation of the Library to that site. A disposal strategy that incorporates both the existing Administration Building and the Library may be an option for consideration, or there may be opportunities to lease the Library building and dispose of the Administration building.

16 Breese Parade Forster

Knight Frank has provided market realisation estimates for the disposal of this property.

2 Pulteney Street Taree

The Knight Frank report considers this building from a sale or sale and leaseback perspective. It is a 2 storey building (with basement level parking) in the Taree CBD. Alternate uses for the property (including redevelopment) have not been considered at this point in time.

Knight Frank Summary

Working on the assumption that Council will dispose of the 4 properties identified above, Knight Frank has provided advice in respect of each property on the basis of disposal with vacant possession, disposal with a nominal 1 year lease and disposal with a 5 year lease. This information is commercially sensitive and has been provided to Councillors on a confidential basis.

As mentioned above, there are several other property holdings of Council that could be considered for disposal. There are advantages and disadvantages associated with the potential disposal of each of these properties. As this information is commercially sensitive, it is not publicly available.

8 Re-allocation of Existing Cash Reserves (General Fund)

Council has a large amount of money allocated to Internal Reserves being funds set aside for a variety of purposes. This practice assists with budget management over the medium term by setting aside cash annually for lumpy expenditure requirements eg Election Reserve, or to deal with unexpected large price fluctuations eg Workers Compensation Reserve. In combining the Internal Reserves of the 3 former General Purpose Councils some opportunities exist to rationalise the quantum of funds allocated.

A review of Internal Reserve balances at 30 June 2018 has identified several sources of funding that could be allocated to this project to reduce the impact on the annual budget and to reduce the amount that would need to be borrowed for the project. These include:

- A $1 million allocation from the **Employee Leave Entitlement (ELE) Reserve**. At 30 June 2018 the ELE Reserve has a balance of $5,290,000 (excluding funds held within the Water Services Division). Council's ELE liability (on-costed) at 30 June 2018 is $15.9 million. The allocation of funds would still see Council have available funds of 27% of the total liability held to meet unexpected cash outflows.
- A $1 million allocation from Council's **Plant Reserve**. At 30 June 2018 the Plant Reserve held in excess of $6 million. An assessment of the amount held in the Plant Reserve by the Director Engineering & Infrastructure Services shortly after the amalgamation identified that there were excess funds within the Reserve that could be re-allocated.
- A $1 million allocation from Council's **Waste Reserves**. It is appropriate that the Waste fund contribute to the costs of the new building and sufficient funds are

available within the combined reserves held for this purpose. Current Waste Reserves exceed $30 million.

- A $1 million reallocation of **miscellaneous reserves** including the Local Infrastructure Renewal Scheme (LIRS) Reserve, Workers Compensation Premium Reserve and Swimming Pool Inspection Reserve.
- **Property Development Reserves** - All former councils held a Property Development Reserve. Approximately $700,000 is held in these Reserves in the former Taree and Gloucester systems with the former Great Lakes Reserve already utilised on preliminary expenditure on this project. This $700,000 would be available for allocation.
- An amount of $470,000 has been collected in **Section 94 contributions** in the former Great Lakes area for Administration building extensions / replacement and this amount should be allocated to the project.

The above equates to approximately $5.2 million in cash investments that is currently available and that can be allocated to the project by way of Council resolution. This would be sufficient for the initial cash flow requirements associated with the project should it proceed.

Alternatively these funds could be allocated to the current $7 million loan that was taken out in respect of the initial purchase of the site. That would have the effect of reducing current borrowings and reducing the amount of interest currently being paid.

The current source of funds for the repayment of this loan is the Commercial Development Reserve. If this loan was paid out in the near future then it would be prudent to allow the funds that were allocated to meeting current repayments to accumulate within the Reserve. The accumulated funds would then be allocated to the future loan repayments that would need to be met for the larger borrowing required to fund the fit-out of the building.

9 Water Services Division Contribution

Council's Water Services Division will also be required to contribute to the cost of the proposed Biripi Way project as a corporate overhead. This contribution will comprise approximately $2 million in cash and a contribution from Water Services properties by way of lease or sale.

10 Total Cash Contribution (Cash Reserves and Water Services)

Based on the analysis above, the combined available cash reserves (including Water Services Contribution) of approximately $7.2 million could be allocated to funding the 2 Biripi Way Taree Office Relocation should Council wish to proceed with the project.

11 Operational Savings / Efficiencies

It needs to be recognised that operational savings and efficiencies will not, in the first instance, provide the large sums of funding required to proceed with this project. However, they are an important aspect of the longer term success of the proposed relocation. Assumptions have been made in the Business Case of the level of savings and efficiencies that may be achieved from this project. They have not been subject to further consideration in this Financing Strategy.

The Business Case identified that there would be savings in operating and maintenance expenditures on administration buildings as a result of a move to a single site compared with operating a 'campus' model. These savings would be realised over time as the former offices were sold or leased.

In the short to medium term Council will incur additional expenditure as the new facility comes on-line. At this point in time it is difficult to estimate with any certainty the level of savings in operational expenditure arising from the proposed relocation to the 2 Biripi Way site. There are a number of options around a property usage / disposal strategy that impact on this aspect. Should Council choose to retain its existing administrative properties and seek a commercial return then this will go some way to off-setting the new costs incurred through the operation of the Biripi Way location. Any increase in operational and maintenance expenditure will need to be accommodated and considered within Council's existing budget structure.

Opportunities exist for operational savings to be achieved as identified in the Business Case through operational efficiencies. The operation of 4 legacy computer systems contributes to inefficiency in operations and the migration to a single computer system, currently underway, will contribute to improved efficiencies which will enable a realignment of resourcing levels.

12 Funding Options

Taking the above information into consideration there are several options to fund the 2 Biripi Way Office Relocation project. All options are a variation on using cash reserves, proceeds from asset sales, rental revenue from leasing and borrowings. The 2 opposite options are to sell all surplus properties or to sell none of the surplus properties.

Council has discussed a number of these options/variations at 2 workshops held with Councillors during October 2018. The particular funding options are discussed below.

Option 1 - Cash Reserves + Disposal of all surplus properties

This option would see Council progressively dispose of various surplus properties. The reallocation of cash reserves in the vicinity of $7.2 million would also be required for this option. Council would need to borrow on a short term basis to fund the fit-out but loan borrowings would be reduced by lump sum payments as each property was sold. Repayments in the interim period would need to be sourced from Council's operational budget.

This option would result in the disposal of significant assets in Council’s property portfolio in a condensed timeframe (to accommodate the project funding requirements). During workshops with Council on this matter they have indicated that this is not their preferred option.

Recommendation: No further consideration of Option 1

Option 2 - Cash Reserves + Borrowings + Lease Existing Buildings

This option would see Council utilise cash reserves of approximately $7.2 million and borrow the remaining funds (approximately $12.5 - $12.8 million). Repayments on the borrowings would need to come from rental income generated from offering the surplus properties to the market. Council's operational budget would need to meet loan repayments until rental income was generated and when rental was insufficient to meet the repayments.

Modelling indicates that rental income from surplus properties would be insufficient to meet loan repayment requirements.

Recommendation: No further consideration of Option 2

Option 3 - Cash Reserves + Borrowings + Property Sales + Explore Options for Lease /Sale of Existing Buildings

Council would allocate approximately $7.2 million in cash reserves to this project. It has identified that a select number of surplus Council owned properties could be offered to the market. Borrowings of between $7 - $8 million would be required with repayments to be met from rental income from the lease of existing properties or from Council's current budget.

Recommendation: Proceed with Option 3 as the basis of the financing strategy moving forward and for the purpose of undertaking community engagement

13 Conclusion

By adopting this financing strategy, the project will proceed to the next Gateway decision point with Option 3 as the funding model.