MANLY 2015 FINAL REPORTS & KEY CONCERNS

(This assessment of Manly 2015 Due Diligence Reports has been prepared by Peter Greentree and Bruce Kitson on behalf of the Good for Manly Association. The report is in two parts: Part 1 is an executive summary, Part II is a more detailed analysis.)*

PART 1 – Executive Summary:

Manly Council publicly released three final reports relating to the Manly 2015 project feasibility just prior to Xmas 2013. Those reports are:

1. KPMG Financial & Commercial Review of Manly Council Analysis,
2. Bitzios Manly Oval Car Park Demand Forecasting Study, and
3. HillPDA Manly 2015 Masterplan Economic Assessment.

The scope of the reports has not been publicly released, nor have many of the supporting reports (eg. WT Partnership Quantity Survey, Whistler St Skidata report).

No independent analysis of the proposed Whistler St development has been released (previously prepared by KPMG).

The reports go some way to justifying the Manly 2015 development but despite the KPMG report being based on lower traffic figures there remain significant concerns surrounding the financials of the Oval Car Park project.

The major issues we have identified are:

1. KPMG use a $14 figure for $ per stay when modeling the Oval Car Park. Actual $ per stay for Whistler Street car park for the 12 months to June 2013 was only $9.43 according to a Council Car Park Audit tabled in August 2013. The near 50% increase in parking fees could account for nearly 5% of the 6.6% IRR for the Manly Oval Car Park and the increase needs to be explained;

2. There is a major inconsistency between the forecast growth in commercial space between the Bitzios report (+42%), and HillPDA (+25%). Bitzios makes no reference to the HillPDA report, nor does it cite the source of its assumptions. These two reports need to be reconciled as the forecast growth in commercial space would be a major driver of the Bitzios traffic study, and;

3. KPMG's report is based on the assumption that starting utilisation will average 353 vehicles per day which is above the findings of Bitzios (225-341 vehicles per day), and needs to be reduced or justified.

Given that the Oval Car Park IRR has been reduced from 12.9% to 6.6% compared with Council's cost of funds of 5%, any of these individual issues has the potential to reduce the IRR to below cost of funds. Which means the Council could incur a loss on the Oval car park.

What does a 6.6% really IRR mean?

Council had previously been assuming that the Oval Car Park would generate $3.3m per annum in revenue, based on 600 cars per day paying $15 each. The $3.3m of revenue

would have comfortably serviced the car park's operating costs and loan servicing requirements from its first year of operation.

However, KPMG's latest report is based on revenues of $1.8m, or 353 cars per day paying $14 each. This represents a shortfall of $1.5m on Council forecasts. We estimate that the revenue from the Car Park will now barely cover loan repayments, let alone operating costs in its early years. Based on KPMG assumptions it could take in excess of 10 years for the Car Park to contribute positively to Council cash flows, after loan repayments, in our view. If the starting $ per stay were only $10 (which is current fee), this would take nearly 20 years.

Quantifying these assumptions, the Oval Car Park could cost ratepayers anywhere between $8m - $15m after loan repayments in its first 10 years of operation alone. Considering that Council will lose the profit from the Whistler St car park ($700,000 per annum), ratepayers would be $15m - $22m worse off over the same period.

Whilst the IRR has been assessed above the cost of funds, ratepayers will most likely see no return until 2030.

A more detailed analysis of the reports follows as Part II. (See Table page 7)

PART II – More Detailed Analysis

1. KPMG Financial & Commercial Review of Manly Council Analysis

KPMG has updated its initial analysis of the Oval Car Park. In summary, the major changes from the original document are a reduction in the cost of constructing the car park from $38.9m to $33.6m, and a reduction in the number of vehicles from 2,204 cars per day to 1,178 cars per day, of which only 353 cars pay for parking (based on the fact that 70% of parking in Council's carparks is free). The result of these changes is a major reduction in the project internal rate of return (IRR) from 12.9% to 6.6%.

The report concludes that given *"Manly Council's cost of funds is 5%.....the project **potentially** exceeds the required return."* The report makes no recommendation whether Council should proceed or not, nor does it state whether a 6.6% return is acceptable.

Despite what appears to be more conservative assumptions, there remain a number of major outstanding concerns, particularly as the economics of the project have been proven by KPMG to be marginal at best.

Our concerns are:

i) Independent report not independent

The KPMG report is presented as a letter to Henry Wong (CEO). The letter begins by outlining the basis of preparation. It states that KPMG was engaged to perform a financial and commercial review of Council's analysis. The letter is described as a "summary" and a more comprehensive document may exist but has not been released. Importantly, KPMG state that the report has relied on the information presented to them by Council

"without independently verifying it". The KPMG report cannot be regarded as truly independent. Note that KPMG does not use the word 'independent' in their report.

ii) Forecast Car park revenue could still be too high
KPMG has assumed that the average $ per stay is $14. The justification for using this figure is based on a Manly Council Skidata Report for the period 11/2012 to 10/2013. On 5 August 2013 an Audit of Usage of Council's Existing Car Parks was tabled to Council. From that document it can be calculated that the average $ per stay for the Whistler St car park was only $9.43, and $10.13 across all Council car parks for the year ending 30 June 2013. The average $ per stay used by KPMG is 48% and 38% higher respectively than data previously tabled by Council. If the actual $ per stay was say, $10 not $14, revenues from the car park would be 29% lower than forecast by KPMG. This would have the impact of reducing the project IRR an estimated 4-5% (or more) to 2-3%, or well below Council's cost of funds.

KPMG also bases its modeling on starting paying vehicles per day of 353. Again, according to Council's Car Parking Audit, only 325 vehicles per day use Whistler St. It is difficult to see why there would be an immediate uplift in car numbers given that the Whistler St site would not be developed at that stage, and the full benefits of Manly 2015 would be another 5 years away at least. There may be an increase in usage as motorists use the oval car park in preference to existing car parks, however this should not be included in the analysis as there is no new revenue generated to Council. Lower traffic numbers could reduce the IRR by a further 1-2%.

KPMG use an escalation factor of 3.5% for daily vehicle usage. Over 20 years this is a 99% increase in vehicles and conflicts with the estimated growth in commercial floor space estimated by Bitzios (+42%), and HillPDA (+25%).

KPMG has adopted a utilisation rate of 30% (% of vehicles paying for parking). This is consistent with the utilisation of Whistler St and could be justified on this basis. However given the size of the car park and the [apparent] desire of Council to remove significant amounts of on street parking, a larger proportion of non-paying vehicles may eventuate. In addition, the subsequent introduction of a Resident Card for ratepayers, which entitles the holder to up to 3 hours free parking in Council car parks, could impact on this assumption.

iii) Construction costs are low by industry standards
To arrive at a total build cost of $33.6m KPMG has relied on a quantity surveyor's estimate from WT Partnership of $30.4m. The quote is $3.9m below the previous quantity surveyor estimate by Cardno Engineering in February 2011. Professional fees and contingencies have also been reduced on advice from WT Partnership. KPMG notes all these figures are at the low end of what would be considered appropriate but *"reflects the relatively simplistic design"* and KPMG were advised by Council *"that there is limited risk associated with the proximity of the construction to the water table."*

2. Bitzios Manly Oval Car Park Demand Forecasting Study

The Bitzios report models the estimated usage of the Manly Oval Car Park based on three scenarios:

High Scenario

- 10 minute congestion to access other car parks;
- 220 on-street parking bays removed from Manly CBD; and
- 20% discount in Manly Oval Parking fees;

Medium Scenario

- 5 minute congestion to access other car parks;
- 140 on-street parking bays removed from Manly CBD; and
- no discount parking at Manly Oval;

Low Scenario

- no congestion to access other car parks;
- 62 on-street parking bays removed from the Manly CBD; and
- no discount parking at Manly Oval.

The conclusions of the study are that peak (Saturday) utilisation of the Oval Car Park will increase from an estimated 225-341 bays in 2013 to 498-747 bays in 2033 – depending on the scenario. The "medium" scenario is for utilisation to increase from 286 bays to 606 bays in 2033.

Our concerns are:

i) Demand is predicated on a 42% increase in commercial space
Bitzios assume that gross commercial floor area will increase from 111,124m^2 to 157,907m^2 in 2033, an increase of 46,783m^2 or 42%. The Bitzios data is not sourced and conflicts with the HillPDA report which states there is only *"over 36,000m^2 of retail and commercial floor space"* in the Manly CBD and that only an additional 9,000m^2 of space is required by 2033 to meet forecast population growth, an increase of only 25%.

The discrepancy in the data would have a major impact on the Bitzios demand forecasts. Note also that KPMG has relied on the Bitzios study to forecast long term utilisation of the car park, and do not appear to have cited the HillPDA study.

ii) How many cars is Council going to remove from the streets?
The Bitzios modeling scenarios implies that the number of car spaces to be removed from the streets is fluid. Does this imply that Council will keep removing on-street parking till the Oval Car Park is paying its way?

iii) Where is the urgency?
The Bitzios report confirms that the car park will be not reach acceptable utilisation for at least 10 years. In fact, in the early years over 50% of the parking bays (ie. one whole level) will not be needed.

3. HillPDA Masterplan Economic Assessment

The Hill PDA report is an economic assessment of the outlook for the Manly LGA likely space requirements and an economic benefit analysis from the Whistler St development. Critically, the report is not a comprehensive retail demand study, nor is it a cost/benefit analysis. No attempt has been made to relate the stated benefits to the substantial cost of Manly 2015.

The major findings of the report are that:

1. There are economic benefits of proactively implementing centre improvement programs versus wait and see approaches;
2. Growth in the demograhic will generate additional retail expenditure of $342m in Manly LGA, and $85m in the suburb of Manly;
3. An additional 9,000sqm of retail and commercial floor space will be required to 2033 to cater for forecast population growth;
4. The net increase in parking could generate an additional $15m of retail spending annually; and
5. The Whistler St site could add 50 new dwellings, 42 jobs, and $15m in new investment.

Our concerns are:

i) HillPDA does not assess the Manly 2015 plan
HillPDA notes that the objectives of the Manly 2015 plan are consistent with good planning but does not go as for as saying that the plan is consistent with the objectives. In other words, the HillPDA report could have been largely identical regardless of what plan was put before them. This again raises the issue that alternative plans could also be considered.

ii) How big will the Whistler St development be?
It now appears that Council is going to develop the Whistler St site on a best-use DA, including residential apartments. This would imply a structure significantly larger and taller than the existing site. The introduction of residential to the development also reduces the amenity of the plaza as noise and opening/closure restrictions would need to be put in place.

iii) Manly 2015 only goes part of the way
As stated by HillPDA, the Whistler St development will only provide 1,000sqm of retail space and similar commercial space. Beyond this, there is no co-ordinated, cohesive master plan that deals with the forecast increase in demand for commercial space in Manly. Note that if Bitzios numbers are right, that is an increase in gross commercial floor area of 46,783m2. This would equate to over three new Balgowlah Stockland Shopping Centres built in Manly CBD. How realistic is this?

Conclusion

There remain significant shortcomings in the Manly 2105 Plan. Importantly, our longstanding concerns regarding the viability of the Oval Car Park remain unchanged after analysing the three reports.

Our remaining concerns are:

1. KPMG use a $14 figure for $ per stay when modeling the Oval Car Park. Actual $ per stay for Whistler St was only $9.43 according to Council's Car Park Audit for the year ending June 2013. Council needs to release the Skidata report and provide a reconciliation between the Skidata numbers and its own financials;

2. KPMG's assumption that starting utilisation will average 353 vehicles per day is above the findings of Bitzios (225-341 vehicles per day), and needs to be reduced;

3. There is a major inconsistency between the forecast growth in commercial space between the Bitzios report (+42%), and HillPDA (+25%). Bitzios makes no reference to the HillPDA report so it can be assumed they have not sighted the report (nor has KPMG). These two reports need to be reconciled and a common view used for modeling purposes.

The reduction in the KPMG IRR to 6.6% has significant implications for Council cash flows. The Mayor and General Manager have justified borrowing $92m of debt on the basis that the car park and pool centre and the sale proceeds from the sale of the Whisltler St car park site would generate income to repay the debt. In its 10 Year Plan, Council forecasts starting revenue of $3.3m based on 600 cars per day paying $15 each. KPMG now forecasts revenue to be only $1.8m, a shortfall of $1.5m. Revenue could also potentially be lower still, as demonstrated above.

The starting revenue of $3.3m covered operating costs and loan repayments. However, the reduction in IRR to 6.6% means that the car park will be cash flow negative to Council every year for at least a decade, after loan repayments. The car park revenue will barely cover its loan repayments, let alone operating costs. The table below examines the annual financial impact to Council based on $ per stay of $14, and $10 respectively.

	$14 per stay	**$10 per stay**
Revenue	1.803m	1,288m
Operating costs	1.250m	1.250m
Cash profit	**0.554m**	**0.038m**
Loan repayments	1.831m	1.831m
Net cash flow to Council	**-1.277m**	**-1.793m**

Cash flow is forecast to be negative $1.3m initially and our modeling of the KPMG assumptions show that there will be no cash contribution to Council until Year 12 of operation. If the $ per stay is changed to $10 the result will a $1.8m cash drain, and in Year 12 will still be losing $1m. The cash breakeven does not occur until 20 years.

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Qualifications
Bachelor of Business (Accounting & Finance) (University of Technology)

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Experience
He has worked in the Banking and Asset Management industries for over 30 years and has held senior management positions in both global and local organisations including Commonwealth Bank, Deutsche Asset Management and Challenger Ltd .

Bruce Kitson
Qualifications
Master of Forensic Accounting (University of Wollongong)
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Over 30 years in senior commercial positions both in public practice and in public and private companies. Positions include Company Secretary, Chief Financial Officer and Chief operating officer; also preparation of independent expert reports for Supreme Court of NSW matters, and forensic accounting assignments (litigation support, valuations, fraud investigations).