Parliamentary Budget Office - Election Policy Costing

NSW Parliament • Parliament House, Macquarie Street Sydney NSW 2000

Referred By:	Australian Labor Party	Proposal No:	B330
Date Referred:	5/02/2019	Date Published:	18/03/2019

Proposal Title: Establish a Central Coast Advantage Fund

Cluster: Treasury

General Government Sector Impacts

	2018-19 $'000	2019-20 $'000	2020-21 $'000	2021-22 $'000	4 year Total $'000
Expenses (ex. depreciation)	-	6,340	6,590	6,590	19,520
Depreciation	-	-	-	-	-
Less: Offsets	-	-	-	-	-
Revenue	-	6,340	6,590	6,590	19,520
Net Operating Balance:	**-**	**-**	**-**	**-**	**-**
Capital Expenditure	-	-	-	-	-
Capital Offsets	-	-	-	-	-
Net Capital Expenditure:	**-**	**-**	**-**	**-**	**-**
Net Lending/(Borrowing):	**-**	**-**	**-**	**-**	**-**

Total State Sector Impacts

Net Lending/(Borrowing):	**-**	**-**	**-**	**-**	**-**

Notes and costing assumptions

The policy proposes to set up a $100 million (m) Fund from July 2019, with net returns spent on job creation and large scale business investment in the Central Coast. The $100 m initial cost would be funded from government issued bonds.

The Fund would be modelled on current NSW Government funds with the highest risk tolerance. The Fund would distribute net returns each year after bond costs and management fees.

Based on NSW Treasury advice, the PBO has used the following assumptions:

- the Fund would be expected on average to generate a return similar to the Australian Future Fund with an estimated return of the Consumer Price Index (CPI) + 4.5% per year (though returns each year would be volatile)
- returns are distributed at the end of the year after subtracting management fees and bond costs
- management fees are estimated at 0.41% per year
- CPI is assumed to be 2.25% in 2019-20 and 2.5% thereafter
- bond costs are estimated to be 3% or $3 million per year, and
- the cost of overseeing the Fund would be absorbed by NSW Treasury.

Notes and costing assumptions continued:

Table 1: Distributions from the Central Coast Advantage Fund

Financial year	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28	2028-29
Fund $ m	100	100	100	100	100	100	100	100	100	100
CPI	2.25%	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%
Return above CPI	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%
Management fee	-0.41%	-0.41%	-0.41%	-0.41%	-0.41%	-0.41%	-0.41%	-0.41%	-0.41%	-0.41%
Net return	6.34%	6.59%	6.59%	6.59%	6.59%	6.59%	6.59%	6.59%	6.59%	6.59%
Total distributed return $ m	6.3	6.6	6.6	6.6	6.6	6.6	6.6	6.6	6.6	6.6
Bond costs $ m	3	3	3	3	3	3	3	3	3	3
Net distributed return $ m	3.3	3.6	3.6	3.6	3.6	3.6	3.6	3.6	3.6	3.6

Table 1 shows the return calculations for the Fund. In Year 1 the Fund generates a 6.34% return on $100 million (m) or $6.3 m. After subtracting bond costs of $3m, the Fund makes a net distribution of $3.3m that is spent on job creation and business investment. Hence, net revenues and costs exactly offset each other.

The net distribution is $10.5 m over the forward estimates. The Fund does not grow in size because all returns after costs are spent. Hence, the Fund has no effect on Total State Sector Net Lending/(Borrowing) over the forward estimates.

Key assumptions and qualifications:
The costing shows consistent returns over the 10 year period. However, in practice the Fund's returns would be quite volatile because it is invested in high risk/high return assets. However, this volatility cannot be predicted on a year on year basis.

Based on NSW Treasury advice, the Fund would be expected to have a negative return once in every 4.2 years on average, with an underlying average volatility of +/- 8.5% per year.

The Fund would not be able to make a distribution in particular years if it makes a negative return, and it may take some time for the Fund to restore its capital after a negative return. If negative returns occur in any year, the policy would increase Total State Sector Net Lending/(Borrowing) in that year.

A fund of this nature where all net returns are distributed may require investments in assets with good liquidity. However, a fund with an investment objective to return 6.3% per year after management fees may require a strategic asset allocation in higher risk assets that are less liquid. It may be difficult to meet the objective of high distributed returns with liquid assets.

The issuing of $100m of bonds may raise borrowing costs to the NSW Government and the private sector by a small amount. This increase in the cost of financing, an indirect effect, has not been included in the costing.

We have assumed the Fund is held by the Government as an equity interest in the General Government Sector (GGS) based on NSW Treasury advice.