Commercial Management Policy

A principal function of the Land Development Corporation (LDC) is to deliver strategic land and investment opportunities to the Northern Territory market. In performing this function, and as specified under Part 2 Section 9 Clause 1 of the *Land Development Corporation Act 2014*, LDC must conduct its activities in a commercial manner. This policy outlines a series of measures employed by LDC to ensure it consistently achieves this legislative requirement:

- Minimum Cash Balance
- Debt to Equity Ratio
- Overhead Rate
- Hurdle Rate
- Target Rate

Minimum Cash Balance

One measure of operating a business in a commercial manner is to ensure sufficient cash funds are available to pay all outstanding costs, when required. The minimum cash balance sets this benchmark, being the least amount of available cash that management requires to avoid cash shortfalls during an accounting period.

In establishing and maintaining a minimum cash balance LDC avoids cash outflows exceeding cash inflows in a given period, ensuring cash maintenance and planning objectives can be met. Other benefits of maintaining a minimum cash balance include ensuring loan compliance; demonstrating awareness of the business's future and mid-term cash flow needs; and being able to take advantage of opportunities that arise requiring quick access to funds.

LDC's Financial Controller undertakes cash flow analysis forecasting to determine the organisation's minimum cash balance at least once a year.

Debt to Equity Ratio

The debt to equity ratio evaluates a company's financial leverage, measuring the degree to which a company is financing its operations through debts rather than their own funds. This is an important measure in highlighting the ability of a company to cover all outstanding debts in the event of a business downturn and is calculated by dividing the company's total liabilities by its total equity. Accordingly, higher leverage ratios typically indicate greater financial risk for the company.

A similar measure is the loan to equity ratio, which looks specifically at the borrowed funds or loans a company relies on for financing, rather than the company's overall liabilities.

Each industry has different debt to equity ratio benchmarks, and considering the unique position of LDC as a government business division, comparison with other government land organisations can be an effective benchmark to use.

LDC's Financial Controller calculates the company's debt to equity ratio annually using the end of financial year accounts.

Overhead Rate

An overhead rate measures the costs allocated to revenue-generating projects, products or services that are not directly associated with production. This includes costs such as office rent, utilities, insurance and administrative salaries, which can also be referred to as indirect costs. By comparison, direct costs are

those that can be directly tied to the production of a good or service, such as construction materials purchased or development management costs on a project.

Overhead expenses are generally fixed costs, meaning the costs are incurred whether or not the company produces any products or services. By spreading or allocating these costs as a rate across direct expenditure products and services can be priced appropriately.

While LDC does not currently evaluate overhead rates according to a set method, further refinement of this process would enable more accurate measurement and demonstration of profitability for the business's projects and services. This could be achieved through evaluation of the company profit and loss ledger to highlight indirect company expenses and an allocation of individual employee salaries to specific projects, according to time spent.

Hurdle Rate

In order to act commercially LDC should operate within an expected range of return on the organisation's business activities, specifically development projects. As a minimum, LDC should achieve a break-even yield on its activities, with this minimum rate of return known as a Hurdle Rate. The Hurdle Rate, as a break-even yield, acts as a benchmark to ensure that individual projects and investments undertaken by the company are not loss-making activities. The Hurdle Rate is determined by assessing a number of factors including: the cost of capital, time value of money, risk involved, and rates of return in comparison to other investments.

Importantly, any potential projects or investments proposed by LDC should have an Internal Rate of Return (IRR) equal to or higher than the Hurdle Rate, in order to be commercially acceptable. Where the IRR does not achieve the Hurdle Rate the project will not be able to proceed under standard procedures and consideration must be given to acting in a manner other than commercial, as specified in Part 2 Section 9 Clause 2 of the *Land Development Corporation Act.*

The Weighted Average Cost of Capital (WACC) is considered an effective Hurdle Rate for LDC investment activities as it:

- is regarded as an objective measurement of investment feasibility
- enables a single hurdle rate to be used for all projects under assessment
- considers both the market context in which the project is occurring as well as the current financial position of LDC.

The process for determining an acceptable Hurdle Rate for LDC is detailed in the Standard Operating Procedure: *Determination of LDC Hurdle Rate.*

In order to maintain currency of the WACC as an appropriate Hurdle Rate, LDC commits to undertaking an annual review of the WACC. This annual review process includes re-calculation of the WACC utilising updated inputs, as outlined under the Hurdle Rate heading in the *Determination of LDC Hurdle Rate* document.

Target Rate

When engaging commercial land development there is the expectation of a reasonable profit yield on activities undertaken. This expected rate of return is known as the Target Rate.

The Target Rate, or anticipated profit yield, is a subjective measure dependent on a business's desired rate of return on its commercial activities, above the break-even yield. Factors influencing this rate in commercial land development are dependent on the current market and include: the strength of real estate demand; the expense of developing land, such as construction pricing and; the benchmark profit expectations set by other land developers.

A profit margin of between 15% and 20% is typical for property development activities, dependent on the current economic circumstances. In situations where the real estate market is performing strongly a target rate of 20% or higher may be achievable, whereas a lower margin of around 15% is more acceptable where the real estate market is weak.

As with the Hurdle Rate, in order to maintain the currency of an accurate Target Rate in constantly changing economic circumstances, LDC commits to undertaking an annual review of the Target Rate and agreement by the Management Team to this rate.

In line with LDC's Land Sales Policy (SLPO0001) and Treatment of Land Valuations Policy (SLPO002), the feasibility for a project or development will consider the appropriate market value in contemplating a potential revenue or margin outcome.

Competitive Neutrality

LDC is committed to meeting and complying with its competitive neutrality obligations. To demonstrate this transparently a Competitive Neutrality statement will be prepared annually and included within LDC's Annual Report. More specifically, the statement will provide details on LDC's activities for competitive neutrality compliance for the relevant year.

Related Policies

There are a number of policies related to LDC's business activities, including:

- SLPO001 - Land Sales Policy
- SLPO002 - Valuer Appointment & Process Policy
- SLPO003 - Treatment of Land Valuations Policy
- SLPO004 - Introduction Program Policy
- SLPO006 - Leasing Security Bond Policy
- SLPO007 - Overdue Lease and Licence Fees Policy
- SLPO008 - Freehold Land Transfer Policy

Summary

By regularly conducting the above described activities LDC will be more readily able to demonstrate operating in a commercial manner, as specified in the *Land Development Corporation Act 2014.*

The Chief Executive is responsible for the effective implementation of this policy and all employees, workers, service providers, other persons and those otherwise engaged at LDC workplaces are expected to reasonably comply with the requirements of this policy.

Tony Stubbin
Chief Executive
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