MorrisonLow

City of Canterbury
City of Cultural Diversity

Canterbury City Council

Modelling of the Independent Local Government Review Panel Recommendation of a Merger of the St George and Canterbury Councils

May 2015

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1. EXECUTIVE SUMMARY

Canterbury City Council (Council) has commissioned Morrison Low to undertake financial modelling of the Independent Local Government Review Panel's (ILGRP) preferred option of a merger between the three St George Councils (Kogarah, Rockdale and Hurstville) and Canterbury Council.

This executive summary provides the key outcomes from the analysis. However, the full report needs to be read as it sets out the analysis and assumptions that underpin the modelling.

1.1 Scale and capacity

The Government has made it clear that the key criteria in demonstrating a council is Fit for the Future is "scale and capacity", with the starting point for every council being the ILGRP recommendation. In the case of Canterbury, Kogarah, Rockdale and Hurstville Councils, the ILGRP's recommendation was that these four councils should merge.

At the time of writing this report, we understand that the four councils have not reached agreement to proceed to a merger business case (Template 1). While Council will need to make an argument that they meet the scale and capacity criteria, Council would need to do so recognising the stated government position that runs contrary to that.

1.2 Fit for the Future benchmarks

The Government has established a set of Fit for the Future benchmarks which all councils are being assessed against.

The table below summarises the assessment of the status quo scenario against the Fit for the Future benchmarks (for each of the Councils) and an assessment of the merged council scenario against the Fit for the Future benchmarks. These assessments are based on publicly available data from Long Term Financial Plans and Financial Statements for all councils. Canterbury Council's estimated required maintenance has been revised, for the purposes of this study, based on our knowledge and expertise as well as consideration of ratios of similar councils as benchmark comparisons; so differs from those in public documents.

Table 1 Overall comparison of councils against Fit for the Future benchmarks

Council	Canterbury City Council	Kogarah City Council	Rockdale City Council	Hurstville City Council	Merged Council	
					Day one	Modelling period
Operating Performance	From 2017	No	No	No	No	No
Own Source Revenue	Yes	Yes	Yes	Yes	Yes	Yes
Debt Service Cover	Yes	Yes	Yes	Yes	Yes	Yes
*Asset Maintenance	No	Yes	No	Yes	No	No
Asset Renewal	From 2018	Until 2017	No	Until 2016	No	No
Infrastructure Backlog	No	Yes	No	Until 2020	No	No
Real Operating Expenditure	Yes	Yes	Yes	Yes	Yes	Yes

*Canterbury's asset maintenance budgets have been revised, so differ from those in public documents

1.3 Scenario One: Status Quo

Table 1 shows that under the status quo scenario, Canterbury, Kogarah, Rockdale and Hurstville Councils would not meet all of the Fit for the Future benchmarks over the ten year period modelled (2014-2024).

1.4 Scenario Two: Meeting the Benchmarks

To meet all of the Fit for the Future benchmarks over the period modelled each council will need to address a funding gap.

The table below identifies the extent of the funding gap for the infrastructure benchmarks that each of the councils will need to address to meet the infrastructure renewal ration, asset maintenance ratio, and to bring the infrastructure backlog[1] to the benchmark of 2% within five years.

Table 2 Summary of infrastructure funding gap

Council[2]	Average funding required per annum (5 years) ($000)	Average funding required per annum (5 years+) ($000)
Canterbury Council	-3,254	-1,600
Kogarah Council	798	-225
Rockdale Council	-9,406	-7,997
Hurstville Council	-254	-1,139

The table below identifies the average annual gap (deficit or surplus) between operating revenue and operating expenditure (as per the operating performance ratio guidelines) over the time period within each council's LTFP. Canterbury is the only council in the group showing a surplus over the period. Each of the other councils is projected to have a funding gap over the period which would need to be addressed by each council if they are to meet the benchmark requirements.

Table 3 Operating performance funding gap

Council	Average gap ($000)
Canterbury Council	2,078
Kogarah Council	-4,647
Rockdale Council	-4,938
Hurstville Council	-2,987

1 Based on condition 3 being satisfactory and as calculated using the Morrison Low methodology
2 Infrastructure funding gap does not take into account any potential SRV applications

1.5 Scenario Three: Merged Council

1.5.1 Fit for the Future benchmarks

Table 1 shows that a merged St George and Canterbury Council would meet three of the Fit for the Future benchmark requirements from day one:

- The Own Source Revenue Ratio which remains steady at an average of just over 86% for the period modelled, above the benchmark of 60%
- The Debt Service Cover Ratio which remains steady at an average of 1.3% for the period modelled, well within the benchmark of between 0% and 20%
- The Real Operating Expenditure Ratio which steadily declines from a high of $739 per capita to a low of $574 per capita, in line with the benchmark requirements to show a decrease over time

The merged council would not meet the following benchmark requirements:

- The Operating Performance Ratio, drops to a low of -13.3% in 2017 (reflecting early transition costs of a merger) before steadily climbing to -1.3%, and then starting to decline again. This is below the required benchmark of being greater or equal to break-even averaged over three years for the period modelled
- The Asset Maintenance Ratio remains steady at an average of 82% throughout the period modelled, below the required benchmark of greater than 100% average over 3 years
- The Asset Renewal Ratio remains steady at an average of 90% throughout the period modelled; below the required benchmark of greater than 100% average over 3 years
- The Infrastructure Backlog steadily increases from 3.2% in 2016, rising to 4.5% in 2023 at the end of the modelled period; remaining above the benchmark requirement of less than 2%

1.5.2 Debt

All councils in the group carry low levels of debt which would be taken over by a merged council. As a result, all councils meet the Fit for the Future benchmark for the debt service ratio, as does the merged council.

Table 4 Comparison of debt[3]

Council	Debt ($000)	Debt Service Ratio	Debt per Capita ($)
Canterbury Council	$7,769	2.0%	$53.15
Kogarah Council	$0	0.0%	$0
Rockdale Council	$7,242	2.0%	$69.80
Hurstville Council	$7,500	1.9%	$93.49
Merged Council	$22,511	1.6%	$58.36

3 Based on 2014 Actual

1.5.3 Funding shortfall

The merged council is the sum of its parts. This means that the existing asset and financial position of each council directly contributes to the overall asset position of the merged council. As shown in Table 1, the merged council does not meet all of the asset related benchmarks. Therefore a funding gap exists in order to address the asset renewal and infrastructure backlog ratios, which is set out in the table below.

Table 5 Merged council asset funding gap

Council	Average funding required per annum (5 years) ($000)	Average funding required per annum (5 years+) ($000)
Merged Council	-10,266	-8,667

1.5.4 Representation

A council resulting from a merger of Canterbury, Kogarah, Rockdale and Hurstville Councils would have a population of around 400,835. The maximum number of councillors currently allowable under the NSW Local Government Act is 15. If we assume that the merged Canterbury and St George Council would have the maximum of 15 councillors, each councillor would represent approximately 26,722 residents. This level of representation is much lower than for the current Canterbury (14,885 residents per councillor), Kogarah (5,034 residents per councillor), Rockdale (7,114 residents per councillor) and Hurstville (7,072 residents per councillor) Councils.

It may be possible to put in place measures to address the loss of representation for each of the council areas through local or community boards, but at present the Government has not set out in detail any proposal that Council could consider.

1.5.5 Costs and savings of the merger

The costs and savings of the merger arising throughout the period have been modelled and should be considered in conjunction with the infrastructure funding gap identified above and the overall financial performance of the merged council when making a decision as to its merits.

Transition costs are, in the context of the councils, a significant cost in the early and mid-periods of the newly merged council and arise from costs associated with:

- creating the single entity (structure, process, policies, systems and branding)
- redundancy costs
- the implementation of a single IT system.

Over the longer term costs rise as a result of increased services and service levels together with an increase in staff numbers, which is typical of merged councils.

Savings initially arise in the short term through the reduction in the number of senior staff and councillors. Natural attrition is used to reduce staff numbers in the short term with a focus on removing the duplication of roles across the councils and creating greater efficiency in operation, however the overall decrease in staff numbers is small. Procurement and operational expenditure savings are also expected due to the size and increased capacity of the larger council but again these are small given the increase in size is modest and the existing SSROC waste contract which minimises opportunity for procurement savings in a high potential area. In the medium and longer term savings continue to rise but the new council once elected would be in a position to address increased costs.

Overall the modelling projects a net financial benefit to the councils and their communities arising from the merger of an estimated $86.6 million (Net Present Value of projected costs and savings raising from the merger projected until 2023 with a discount rate of 7%, as per the NSW Treasury Guidelines). It should be noted however that even with this financial benefit, the merged council still does not reach a breakeven operating position.

The projected benefits should be seen in context of the timeframe over which they arise and the overall financial performance of the merged council and in particular the need for the organisation to increase asset expenditure to meet the Fit for the Future benchmarks.

1.5.6 Risks arising from merger

There are a number of significant potential financial and non-financial risks arising from any merger that will need to be considered, including the following which have been outlined in this report:

- Transitional costs may be more significant than set out in the business case
- The efficiencies projected in the business case may not be delivered
- The implementation costs maybe higher and the anticipated savings may not be achieved
- Decisions subsequent to the merger about the rationalisation of facilities and services may not reduce the cost base of the merged organisation as originally planned
- The cultural integration of the council organisations may not go well resulting in low morale, increased staff turnover rate, reducing business performance and prolonging the time it takes for the predicted efficiencies to be achieved
- Where a number of councils of different sizes merge, there is a danger it is seen not as a merger but as a takeover by the largest of the existing councils
- Service levels rise across the merged council, standardising to the highest level of those services that are being integrated
- New services are introduced that are not currently delivered in one or more of the former council areas
- The financial performance of the merged council is less than that modelled, resulting in the need to either reduce services, find further efficiency gains and/or increase rates to address the operating deficit

2. INTRODUCTION

2.1 Fit for the Future

Three years ago, local councils from throughout NSW gathered for a summit, Destination 2036, to plan how local government could meet the challenges of the future. As a result, councils agreed that change was needed and that they wanted to be strong and sustainable and to make a positive difference in their respective communities. However, there were various views as to how this could be achieved and in April 2012 the State Government appointed an independent expert panel to carry out a review of the sector. That Independent Local Government Review Panel (ILGRP) consulted widely in developing its final recommendations which were presented to the Government in late 2013.

The panel concluded that for councils to become strong and sustainable, both the NSW Government and the local government sector would have to play a part. The State indicated its preparedness to change the way it works with councils and to support them through meaningful reform. Local councils must also be prepared to consider new ways of working and new structural arrangements. The Fit for the Future program brings these changes together to lay the foundations for a stronger system of local government and stronger local communities.

The Fit for the Future program requires councils to actively assess their scale and capacity in achieving long term sustainability and for councils to submit proposals to the Government indicating how they will achieve these objectives.

Canterbury City Council (Council) commissioned Morrison Low to undertake financial modelling of the Independent Local Government Review Panel's preferred option of a merger between the three St George Councils (Kogarah, Rockdale and Hurstville) and Canterbury Council. This modelling will help Council to understand the implications of the merger of the councils as proposed by the Review Panel particularly as it compares to Canterbury's standalone position.

IPART's proposed assessment methodology, released for consultation in April 2015, requires councils to demonstrate that they first consider making a proposal on the basis of the ILGRP's preferred option. We understand that Canterbury City Council has made (so far unsuccessful) attempts to enter into discussions with both the St George Councils, and Bankstown Council as the alternate merger option. A merger between Canterbury City Council and Bankstown Council was not modelled as part of this study.

With the 30 June 2015 deadline for submissions approaching, this merger modelling will supplement Canterbury Council's Template 2 Improvement Proposal in demonstrating that it explored the proposed merger option, and its arguments for its standalone position.

2.2 Modelling Approach

The modelling has been undertaken on behalf of Canterbury Council. As the three St George Councils did not participate, the financial data used in the model is based on publicly available information. Where the data is inconsistent or unclear it has not been included and will be recorded as either 'no data' or 'no result'. Canterbury Council's estimated required maintenance has been revised, for the purposes of this study, based on our knowledge and expertise as well as consideration of ratios of similar councils as benchmark comparisons; so differs from those in public documents.

The modelling is intended to allow Council to understand the relative benefits and dis-benefits of the proposed merger of the four councils. It has involved analysing historic, current and forecast performance. Information from other jurisdictions which have undergone local government reform has been used to inform estimates of costs (for example transitional costs) and efficiencies.

The study is not intended to advise Council of the best option for them. It provides information that will enable Council to undertake informed decision-making when considering the best course of action and to support Council to make a submission to IPART by 30 June 2015.

2.3 Timeframes

The timeframes for this project have been challenging but we appreciate that the work has been required to allow plenty of time for the council to work through issues and prepare a submission by 30 June 2015.

Notwithstanding that we fully understand the need for those tight timeframes, that understanding is tempered with a recognition that the data available for modelling has some limitations as a result. The standardisation of the data, particularly as it relates to assets across the merger councils, has been conducted on a best efforts basis under those particular timing constraints.

The public data used in the model is drawn from a variety of sources however, it is acknowledged that the timeframe limits our capacity to refine both the available data and the model itself to a fine level of detail. For consistency across the councils, publicly available information has formed the basis of the analysis. Council's information has been refined and modified through discussions and workshops with the council.

3. SCOPE

3.1 Scenarios Modelled

For the purpose of this study, the modelling evaluates the following scenarios:

1. **Status Quo**

   The status quo or baseline scenario evaluates the extent to which each Council would meet the Fit for the Future benchmarks based on what each Council has reported its current and future financial position to be. This analysis is based on the published Financial Statements and Long Term Financial Plans of each of the councils.

2. **Meeting the Benchmarks**

   This scenario answers the question as to what each Council would need to do to meet the Fit for the Future benchmarks. It does not address the question of scale and capacity and concentrates on the seven Fit for the Future benchmarks.

   This scenario is built up by separately considering each Councils operating result, asset renewal, asset maintenance, and the infrastructure backlog. It identifies what, if any, funding gap exists, but does not identify how the gap is to be resolved as that is a question for Council. For the purposes of the modelling and to enable comparability between the respective councils and the merged council, a standardised approach was utilised in the case of some asset benchmarks.

We acknowledge the work Council has done to understand its assets and community priorities and our analysis and assessment should be understood as applying to that context.

3. **Merged Council**

This scenario models a merger of the three St George councils (Kogarah, Rockdale and Hurstville) and Canterbury Council and assesses the advantages and disadvantages of this against a series of largely financial criteria.

3.2 Reporting

This report is intended to provide information that Council can use to determine what is in the best interests of the council and community. As such, it does not seek to recommend any one option over another option.

The report compares options and highlights advantages and dis-advantages of each option. Council will need to determine itself any relative weighting it will apply to the information presented.

4. SCENARIO ONE: STATUS QUO

The St George and Canterbury areas represent a total population of just over 400,000, with the population forecast to grow by a further 24% to around 491,600 by 2031.

Table 6 Council comparator information

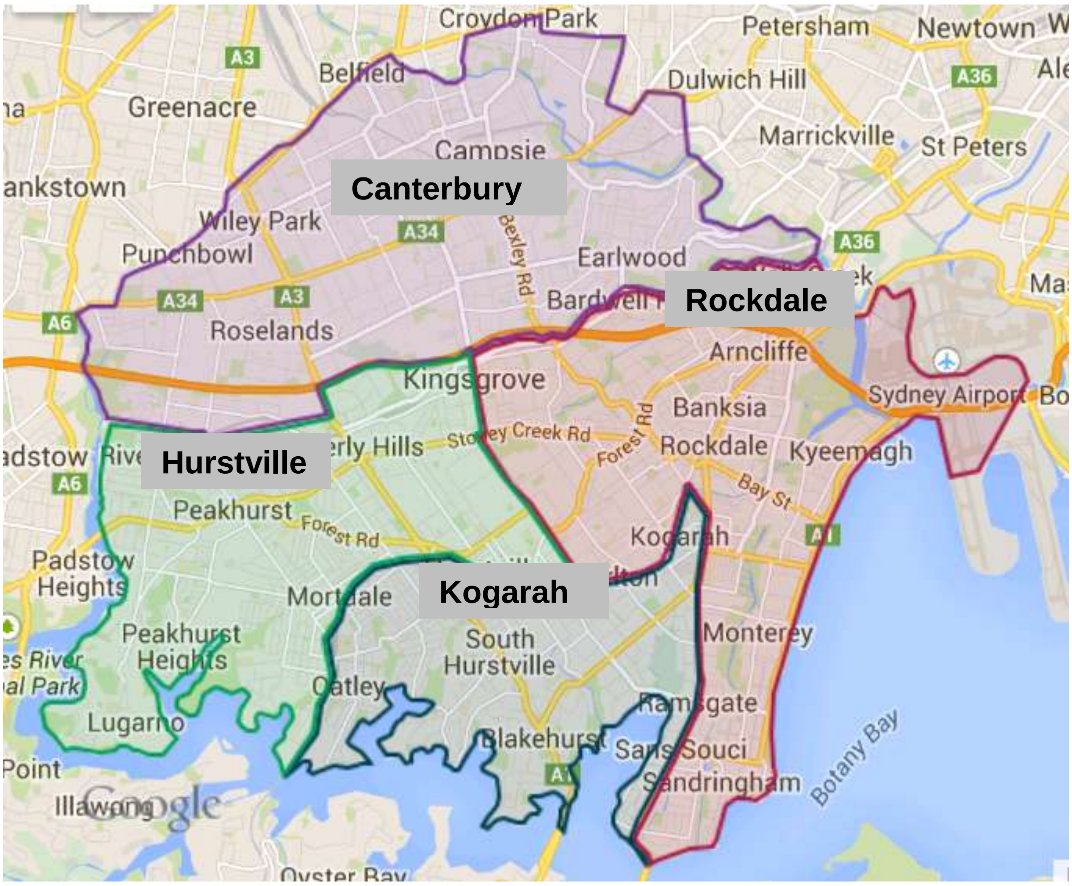
	Canterbury City Council	Kogarah City Council	Rockdale City Council	Hurstville City Council
Full time equivalent staff	525	242	341	317
Geographic area	33.6 km^2	15.6 km^2	28.2 km^2	22.7 km^2
Population[4]	148,853	60,411	106,712	84,859
Population projection 2031[5]	181,850	76,350	134,350	104,950
Annual expenditure	$97,577	$47,596	$82,867	$66,255
Number of councillors	10	12	15	12

A map of the area is set out below and shows each council area.

4 Australian Bureau of Statistics, Estimated Resident Population 2013

5 NSW Department of Planning and Environment, New South Wales State and Local Government Area Population Projections: 2014 Final

Figure 1 **Map of Kogarah, Rockdale, Hurstville and Canterbury Councils**



4.1 Current position of the councils

As a starting point, the councils' current performance against the Fit for the Future benchmarks[6] has been considered and is set out in Table 7 below. We believe it is important to understand the current position of each of the respective councils.

The analysis of current position is based on the results reported in each council's 2014 Financial Statements. Figures in red are those where the council does not meet the benchmark. We note that previously councils have not been required to report on the real operating expenditure ratio so these results were not published in the 2014 Financial Statements.

An explanation of each indicator and the basis of the calculation are set out in Appendix A. Each benchmark has been calculated in accordance with the requirements set down by the Office of Local Government. The ratios are a reduced set of benchmarks drawn from those used by TCorp in its 2013 analysis of the Financial Sustainability of the New South Wales Local Government Sector.

6 Reported in the 2013/14 Financial Statements for the respective councils

Table 7 Fit for the Future benchmarks 2014

Council	Operating Performance (%)	Own Source Revenue (%)	Debt Service (%)[7]	Asset Maintenance (%)	Infrastructure Backlog (%)	Asset Renewal (%)
Canterbury	- 0.80	80.8	5.6	39	3	53.8
Hurstville	- 0.72	86.3	6.97	106	1	49.2
Kogarah	- 1.79	86.3	8,50	104	1	73.7
Rockdale	- 10.51	78.60	6.29	42	3	52.9

Based on each Council's reported 2014 Financial Statements none of the councils meets all of the Fit for the Future benchmark measures. None of the councils achieve the Operating Performance or Asset Renewal benchmarks. While Kogarah and Hurstville meet the other four measures, neither Canterbury nor Rockdale meet the Asset Maintenance measure or the Infrastructure Backlog measures.

4.2 Fit for the Future indicators: Forecast performance

While looking at the 2014 Financial Statements provides a historic view of performance, Fit for the Future concentrates on forecast performance. We have undertaken an analysis of each council's current financial statements, projected financial performance and applied a standardised approach to the calculation of infrastructure ratios to provide consistency and comparability for the purposes of this assessment.[8]

The tables below provide a summary of each council's performance against the benchmarks while the figures that follow show the trends of the benchmarks over time for each council. The IPART methodology specifies that:

- operating performance, debt service and own source revenue ratios must be met by 2019/20
- all other benchmarks are required to either be met or to show an improving trend by 2019/20.

[7] Prior to Fit for the Future there were different approaches to calculating the debt service ratio hence the different scale of number represented by Kogarah. All Councils are well below the benchmark

[8] The explanation for each is set out in Appendix A

Table 8 Individual Council performance against Fit for the Future benchmarks

	Kogarah City Council	Rockdale City Council	Hurstville City Council	Canterbury City Council
Operating Performance	Does not meet	Does not meet	Does not meet	From 2017
Own Source Revenue	Meets	Meets	Meets	Meets
Debt Service Cover	Meets	Meets	Meets	Meets
Asset Maintenance	Meets	Does not meet	Meets	Does not meet
Asset Renewal	Until 2017	Does not meet	Until 2016	From 2018
Infrastructure Backlog	Meets	Does not meet	Until 2020	Does not meet
Real Operating Expenditure	Meets	Meets	Meets	Meets

The forecast result for each council against the benchmarks is represented in the following graphs.

Figure 2 Operating performance ratio

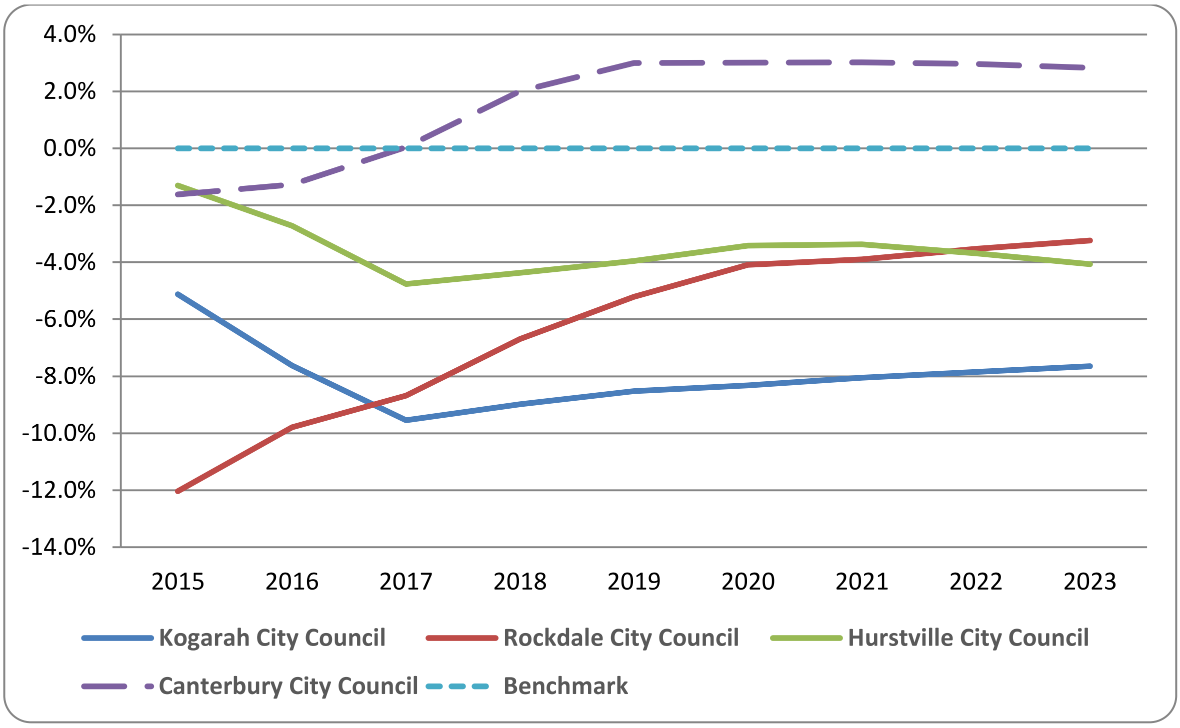


Figure 3 Own source revenue

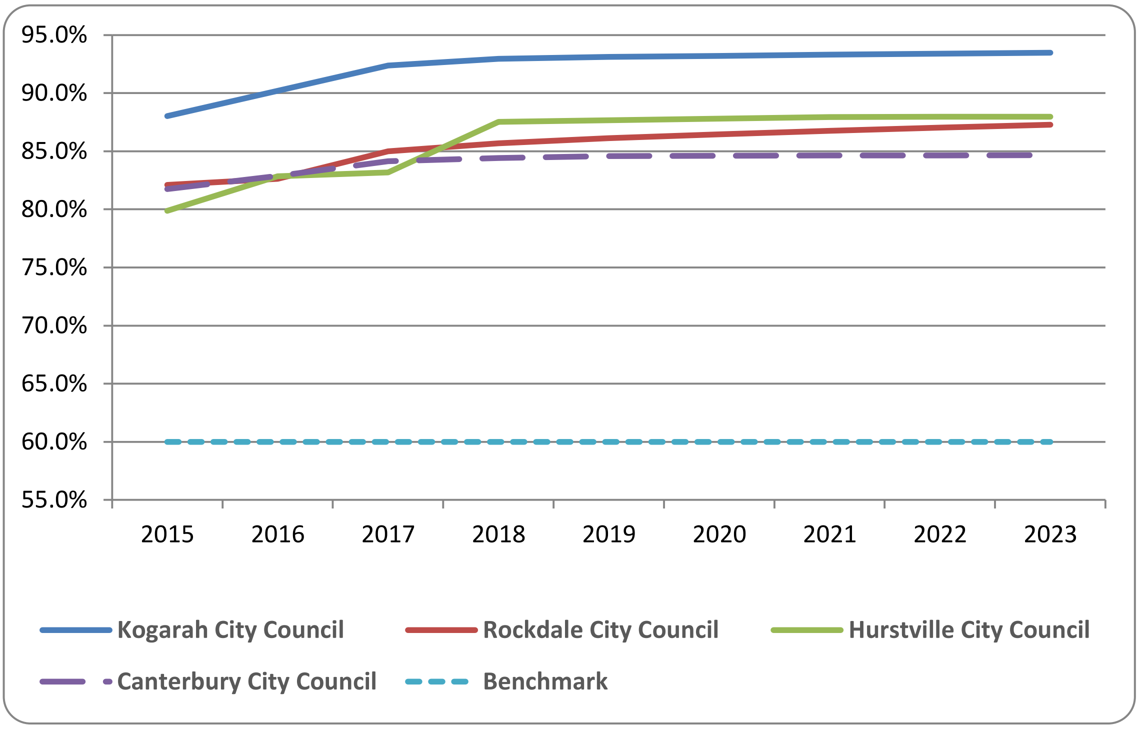


Figure 4 Debt service ratio
(Benchmark - Between 0 and 20% averaged over 3 years)

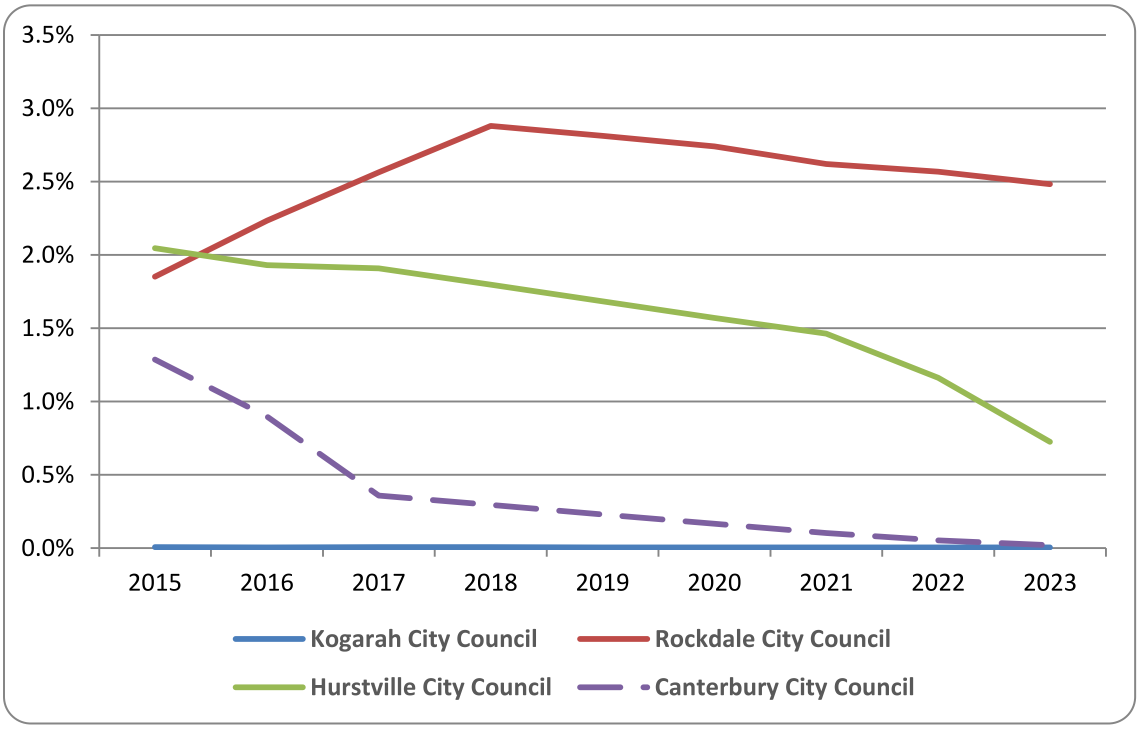


Figure 5 Asset renewal ratio

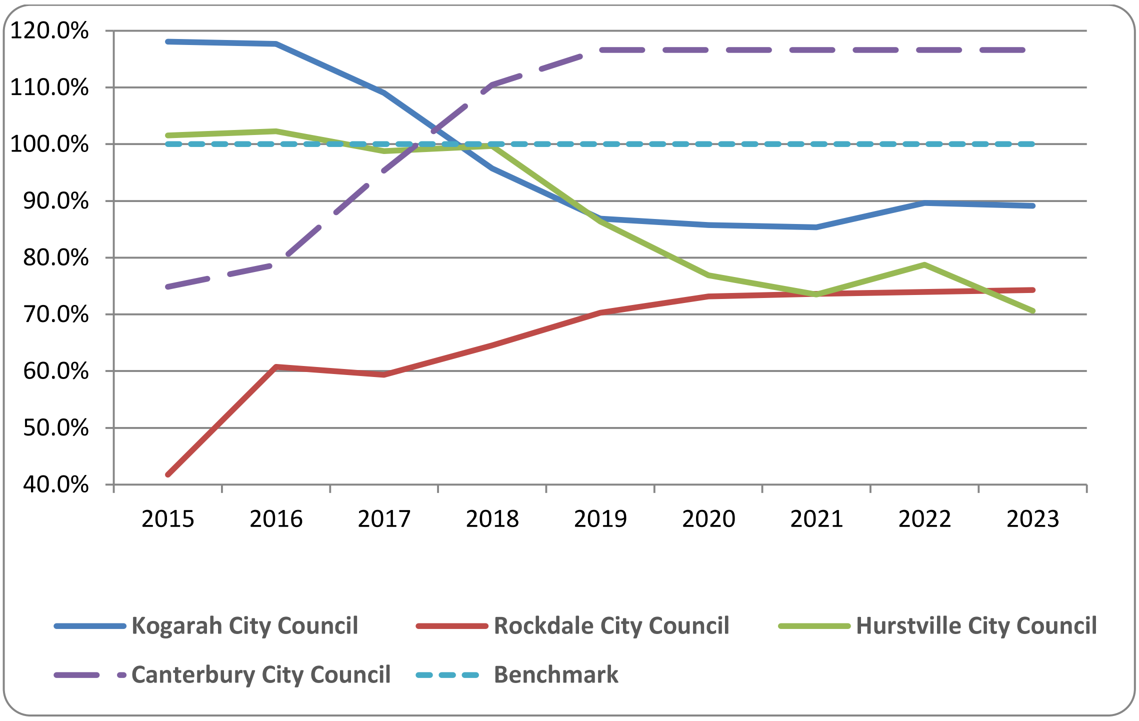


Figure 6 Infrastructure backlog ratio

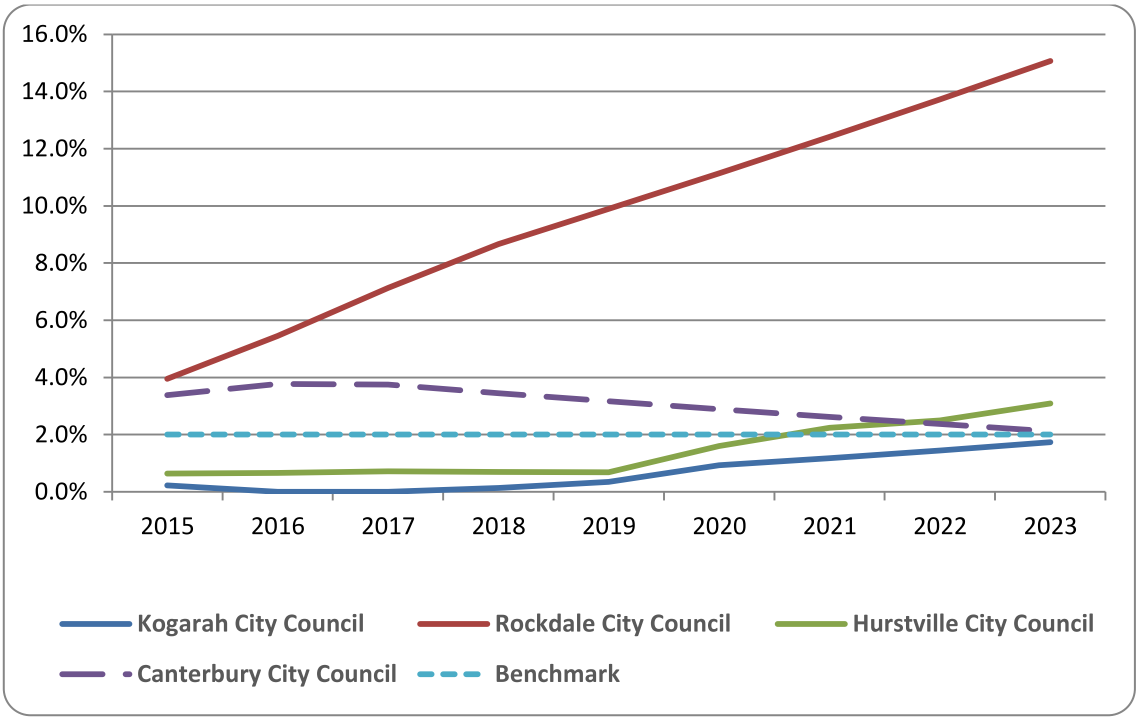


Figure 7 Asset maintenance ratio

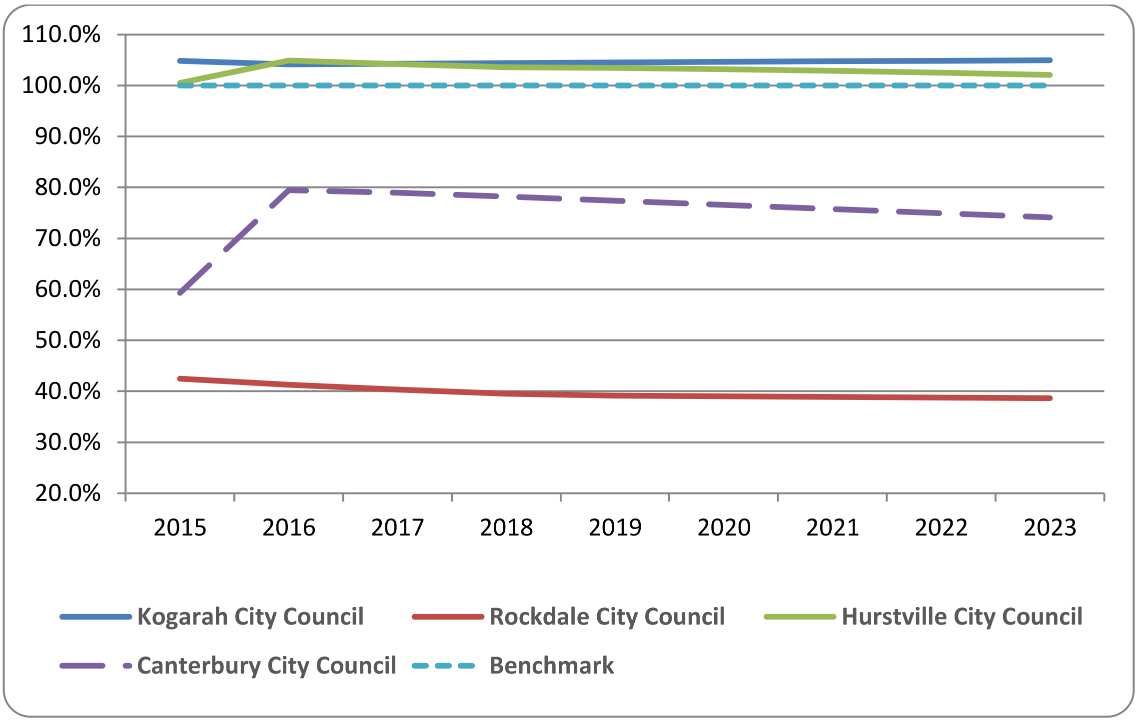
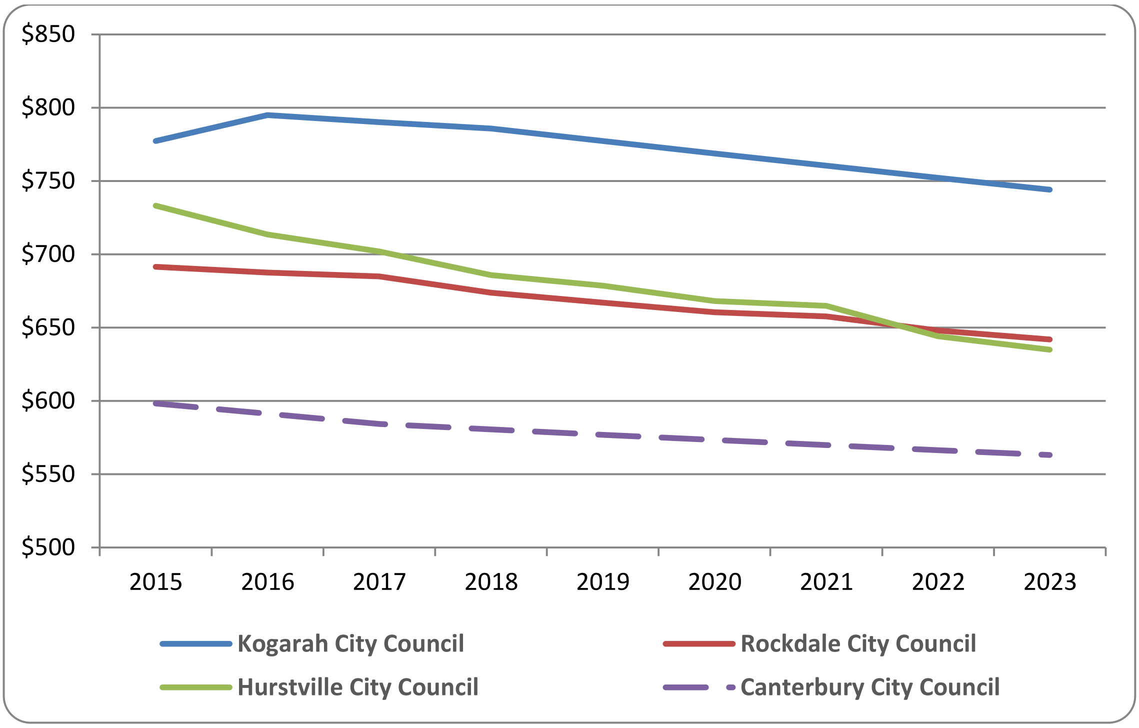


Figure 8 Real operating expenditure



5. SCENARIO TWO: MEETING THE BENCHMARKS

An analysis of what would need to be done in order for each council to meet the Fit for the Future benchmarks has been undertaken. The analysis is against each council's base case scenario. The asset based ratios (asset maintenance, asset renewal and infrastructure backlog) have been considered as has the operating performance ratio. Each aspect has been separated out in the following sections before being combined into an overall figure which identifies what, if any, funding gap exists that if satisfied would enable the council to meet the Fit for the Future benchmarks.

Where such a gap has been identified and should a council choose to pursue a standalone response to Fit for the Future, then the council will then need to determine how they best address that gap. We would expect that this would be either through additional revenue, a reduction in operating expenses, or a combination of both.

5.1.1 Operating performance

The operating result of each Council (calculated on the same basis as the operating performance ratio and so excluding capital grants and contributions) has been reviewed and the gap, if any, between the operating revenue and operating expenses identified below. For simplicity, this is presented as an average of the years projected in each council's LTFP.

The table below identifies the average annual gap or surplus between operating revenue and operating expenditure (as per the operating performance ratio guidelines) over the time period within each council's LTFP. Only Canterbury shows a surplus over the period. Each of the other councils are projected to experience a significant funding gap.

Table 9 Operating performance funding gap

Council	Gap ($000)
Canterbury Council	2,078
Kogarah Council	-4,647
Rockdale Council	-4,938
Hurstville Council	-2,987

5.1.2 Asset maintenance

The maintenance ratio is based in part on the number each council reports as 'required maintenance'. However there are no guidelines on how required maintenance is to be calculated and when the required maintenance figures from across the councils were considered, some significant variations were identified. Canterbury Council's estimated required maintenance has been revised, for the purposes of this study, based on our knowledge and expertise as well as consideration of ratios of similar councils as benchmark comparisons; so differ from those in public documents.

The table below sets out the results of the modelling for each council. For simplicity, this is presented as an average of the years projected in each council's LTFP.

Table 10 Asset maintenance funding gap

Council	Actual Annual Maintenance ($000)	Estimated Required Maintenance ($000)	Gap ($000)
Canterbury Council	7,900	10,308	-2,408
Kogarah Council	4,006	3,829	177
Rockdale Council	1,778	4,522	-2,744
Hurstville Council	8,446	8,189	257

Based on the modelling, Rockdale and Canterbury are facing a funding gap between what is spent currently and what we estimate to be needed. The figures in red show the annual additional amount, based on our standardised approach, that they would need to spend annually on maintenance to satisfy the asset maintenance ratio.

5.1.3 Asset renewal

The asset renewal ratio is based on each council's assessment of annual depreciation on buildings and infrastructure and their actual expenditure on building and infrastructure renewals. If asset depreciation is calculated appropriately then this represents the loss of value of an asset on an annual basis and a renewal ratio of 100% reflects (at an overall level) restoring that lost value.

While the calculation of depreciation varies across all councils, it is not possible to simply standardise depreciation in the same way that the required maintenance number can be. The assessment of depreciation is integral to the financial management of each council and their LTFP. Any change requires a proper assessment of the assets, condition, lives and values. The assessment of required asset renewals is therefore based on each council's own assessment of depreciation and required renewals.

The table below sets out the gap between the required annual renewals and projected renewals expenditure. Negative figures are highlighted in red and show the annual additional amount a council (based on our standardised approach) would need to spend on renewal to satisfy the asset renewal ratio.

Table 11 Asset renewal gap

Council	Average predicted annual renewals ($000)	Average required annual renewals ($000)	Average Annual Gap ($000)
Canterbury Council	9,312	8,504	808
Kogarah Council	6,468	6,869	-401
Rockdale Council	11,876	17,130	-5,253
Hurstville Council	6,147	7,542	-1,396

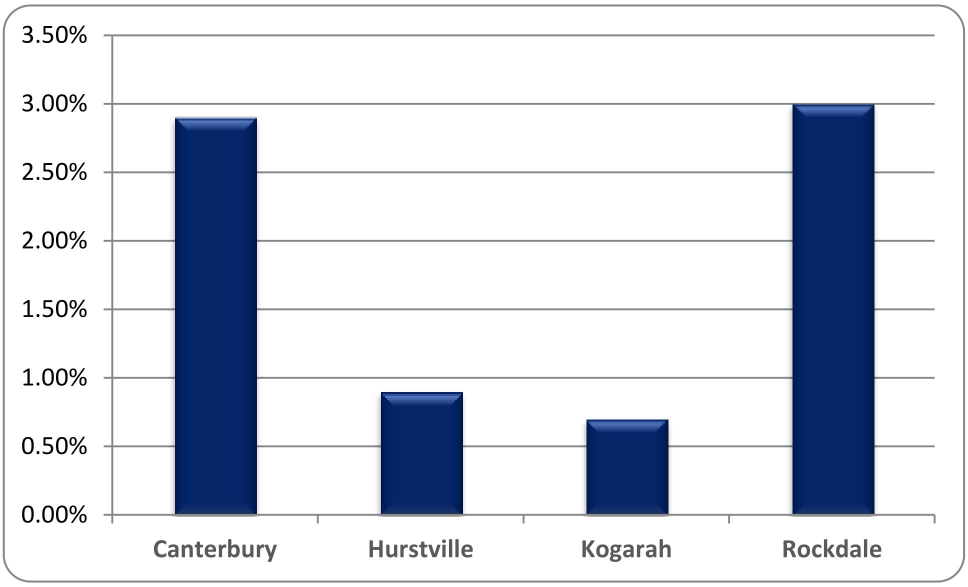
Based on the modelling, Canterbury Council is funding more that is required while each of the other councils has a renewals funding gap. The figure in red shows the annual additional amount, that each council would need to spend on asset renewals to satisfy the asset renewals ratio.

5.1.4 Calculating the estimated cost to meet satisfactory

For comparative purposes the figure below compares the infrastructure backlog ratio reported by each Council in 2014 highlighting the range across the four councils, with two councils below (and therefore meeting) the benchmark (Kogarah and Hurstville) and two above (and therefore failing) the benchmark (Rockdale and Canterbury).

Given the analysis in this report is based on publically available information, each council's assessment of their costs to satisfactory has had to be accepted as representing the true cost to satisfactory.

Figure 9 Reported infrastructure backlog as at 30 June 2014



The table below sets out what each council would need to spend on additional renewals (i.e. over and above maintaining a 100% asset renewal ratio) to reduce the infrastructure backlog ratio to the benchmark within five years.

Table 12 Cost to bring assets to satisfactory

Council	Total value of assets[9] ($000)	Cost to satisfactory ($000)	Target Backlog ($000)	Reduction Required ($000)	Per year (5 years) ($000)
Canterbury Council	875,076	20,203	11,932	-8,271	-1,654
Kogarah Council	451,933	630	5,745	5,115	1,023
Rockdale Council	694,074	14,284	7,239	-7,045	-1,409
Hurstville Council	554,271	2,073	6,497	4,424	885

5.2 Annual funding gap

The table below summarises the expenditure required by each council, in order to meet all three asset based ratios within five years. Once the infrastructure backlog is brought to the benchmark then the required expenditure for each councils falls.

We have not included the funding gap related to the operating performance ratio in this table as that would not present a realistic picture of the required expenditure. Any increase in expenditure on maintenance or renewals will flow through to affect the operating revenue and expenses of the council and therefore the Operating Performance Ratio. Additionally, a council may choose to address the funding gaps identified in this report by increasing revenue, shifting funding from another service or activity, reducing overall costs or a combination of all the above. This will all affect the other ratio. It is not therefore considered possible to simply add the Operational Funding Gap and the Asset Funding Gap identified below together into a single figure.

Table 13 Combined asset funding gap

Council	Asset Maintenance	Renewals	Infrastructure Backlog	Average funding required per annum (5 years)	Average funding required per annum (5 years+)
Canterbury Council	-2,408	808	-1,654	-3,254	-1,600
Kogarah Council	177	-401	1,023	798	-225
Rockdale Council	-2,744	-5,253	-1,409	-9,406	-7,997
Hurstville Council	257	-1,396	885	-254	-1,139

9 Current replacement costs (2014)

6. SCENARIO THREE: MERGED COUNCIL

6.1 Description

The merging of the councils into one council would create a council of roughly twice the geographic area serving a reasonably densely populated urban environment.

To give some scale to the proposed council organisation, set out below are some broad indicators of the attributes of a new merged council and a comparison to Sutherland Shire Council[10].

Table 14 Comparison of proposed merged council and Sutherland Shire Council

	Merged Council	Sutherland Shire Council
Full time equivalent staff	1,425	1,409
Geographic area	100.1 km^2	240.1 km^2
Population	400,835	325,000
Annual expenditure	$294,295	$286,482

6.2 Services

The range of services and facilities provided by any council to its community varies significantly from place to place. Not only do the types of services vary, but the levels of service will often be quite different from council to council.

The reasons for these variations are numerous. For many councils, the suite of services that they offer in the present day is a reflection of decisions made by councils past. Those decisions are generally based on community desires and needs, funding availability or strategic business choices. Figure 10 highlights the locations of some key council services including council offices, libraries, depots, swimming pools and recreation centres.

10 OLG Comparative Performance Data 2012-13

Figure 10 Key services and facilities of the councils

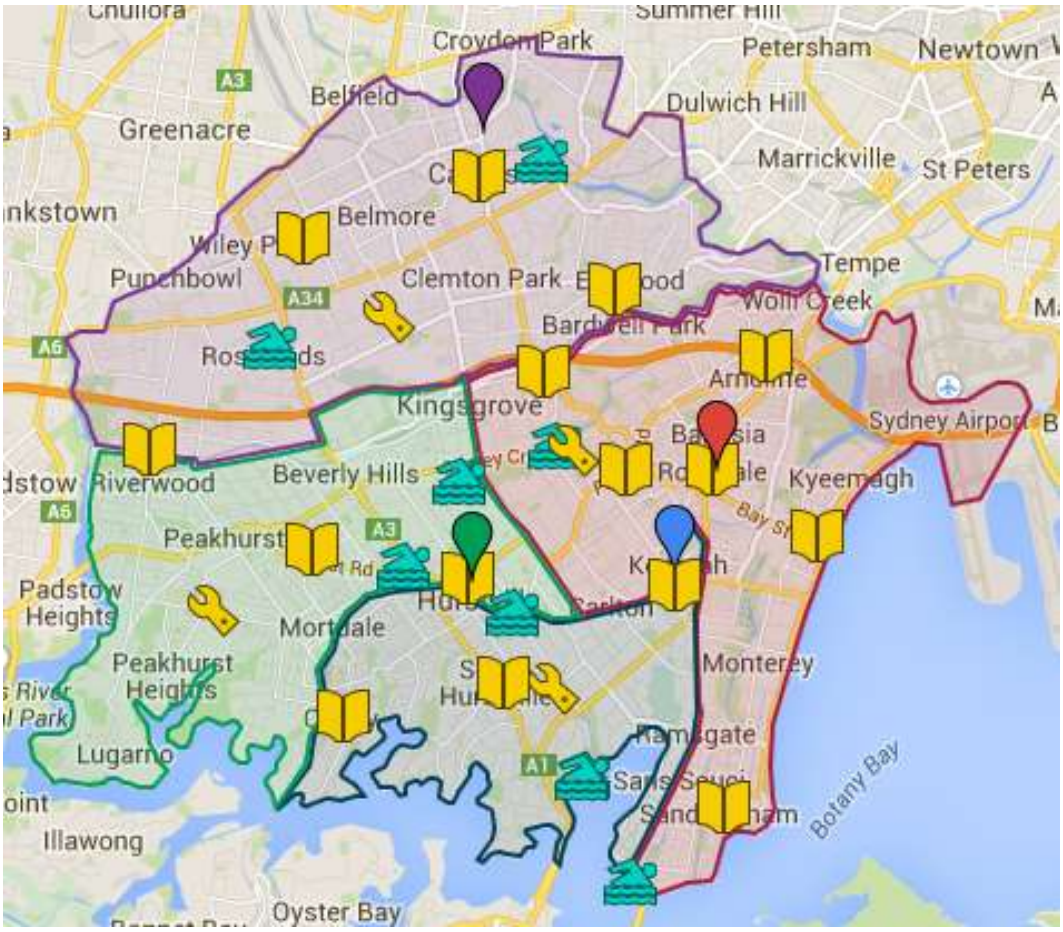


Table 15 Key to map of council services

	Council Offices
	Public Libraries
	Swimming Pools
	Council Depots

Regardless of the original rationale for service types, levels and delivery decisions, councils need to continue to make regular and structured revisions to their service portfolios in order to meet emerging or changing community needs, capacity to pay issues or regulatory change. There are a range of examples where services vary across council borders and those variations can be in the form of:

- providing a particular service or not doing so
- differing methods of delivering services (in house, outsourced, collaborative)
- variety in the levels of service delivered (frequency, standard)
- pricing.

However, it is difficult to compare council services and service levels on publically available information as councils describe services differently and the information across the four councils is not presented consistently.

The location of the libraries and swimming pools of the councils are set out in Figures 11 and 12 below. Each facility has a representative catchment drawn around the location of facility. The size and nature of the facilities varies and the catchments are not scaled to demonstrate an oversupply or identify a facility or facilities for rationalisation. The purpose is to highlight the different challenge that a council or the councils will be faced with in regards to the provision and the location of services and facilities. Having responsibility for a larger area without the existing internal boundaries will require a different approach and likely lead to changes in services and service delivery.

Figure 11 Location of the libraries of the councils

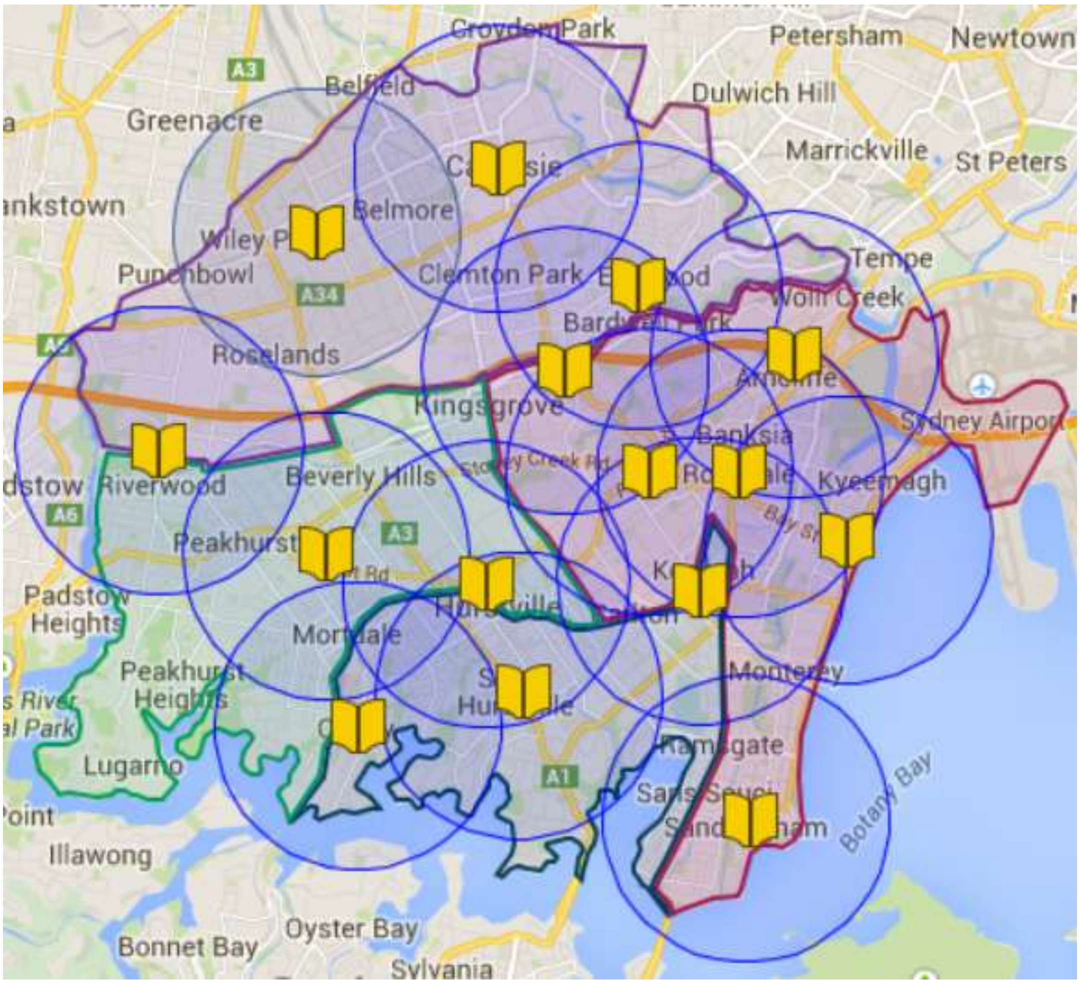


Figure 12 Location of the swimming pools of the councils

Establishing a uniform, or at least consistent, service offering through the mechanisms of service standard setting, pricing and delivery will be a challenging exercise for any merged council however it does provide opportunities for service review and re-evaluation. Often in a merged council the desire to ensure an equitable and fair service across the entire local government area can result in an immediate and sometimes dramatic increase in services, services levels and therefore costs. In assessing the advantages and disadvantages of the merger options the assumption has been made that current service levels will continue until such time as the merged council makes a decision otherwise.

6.3 Representation

Assuming a merged council has less councillors than exist currently, which is a total of 49 councillors across the four councils, the number of people represented by each councillor would increase for all areas, with the representation figures being dependent on the number of councillors in a new merged council. The table below shows the effect if there were 15 councillors in a new council, which is the maximum allowable under the current NSW Local Government Act.

Table 16 Comparison of representation

Council	Number of Councillors	Representation (population / Councillor)
Canterbury Council	10	14,885
Kogarah Council	12	5,034
Rockdale Council	15	7,114
Hurstville Council	12	7072
Merged	15	26,722[11]

The impact will be greatest for Kogarah residents, however all four council areas will see a dramatic decrease in levels of representation.

It may be possible to put in place measures to address the loss of representation for each of the council areas through local or community boards, but at present the Government has not set out in detail any proposal that the communities could consider.

6.4 Financials

The estimated costs and savings of a merger of the councils have been modelled with the results set out in the section below, with the detailed assumptions set out in Appendix B. The Net Present Value of the costs and savings is set out below and arise from the merger in comparison to the current operating costs of the combined councils.

The merged council is modelled on the basis of a combined base year (2015) where each council's costs and revenues set out in the LTFP are brought together, common assumptions are then modelled forward for increase in revenue and costs (2016). Overlaid are the costs and savings of the merger with Short (1-3 years), Medium (4 – 5 years) and Long Term (6 – 10 years) time horizons. For simplicity all transitional costs are modelled as taking place within the first three years.

[11] Assumes 15 Councillors for a merged council; the maximum number allowed under the NSW Local Government Act

Table 17 High level description of financial costs and savings arising from merger

Item	Short Term (1 – 3 years)		Medium term (4 – 5 years)		Long Term (6-10 years)	
	Cost	Benefit	Cost	Benefit	Cost	Benefit
Governance		Reduction in total cost of councillors				
Staff	Redundancy costs associated with Senior Staff Harmonisation	Reduction in total costs of Senior Staff	Redundancy costs associated with any reduction in staff numbers Increase in staff costs associated with typical increase in services and service levels from merger	Reduction in staff numbers in areas of greatest duplication	Increase in staff costs associated with typical increase in services and service levels from merger	
Materials and Contracts		Savings from Procurement and network level decisions over asset expenditure		Savings from Procurement and network level decisions over asset expenditure Savings from moving to large regional waste contract		Savings from Procurement and network level decisions over asset expenditure
IT	Significant costs to move to single IT system across entire council					Benefits arise from single IT system and decrease in staff
Assets		Rationalisation of plant and fleet		Rationalisation of plant and fleet		
Transitional Body	Establish council and structure, policies, procedures Branding and signage	Government grant				

Table 18 Summary of financial costs and savings [12][13]

	Year 1 15/16	Year 2 16/17	Year 3 17/18	Year 4 18/19	Year 5 19/20	Year 6 20/21	Year 7 21/22	Year 8 22/23
Governance		-260	-268	-277	-286	-295	-304	-314
Staff		0						
-Redundancies		1,451	0	0	1,128	0	0	0
-Staff cost changes		-2,179	-4,423	-6,566	-8,289	-7,437	-6,569	-5,684
IT								
-Transition costs		24,000	12,000	4,000	0	0	0	0
-Long term benefits		0	0	0	0	0	0	0
Materials and Contracts		-503	-519	-535	-1,090	-1,125	-1,161	-1,198
Assets								
-Plant and fleet		0	0	0	1,564	0	0	0
-Buildings		0	0	0	5,489	0	0	0
Grants and Government Contributions		10,500	0	0	0	0	0	0
Transitional Costs								
-Transitional body		3,875	0	0	0	0	0	0
- Rebranding		400	0	0	0	0	0	0
Total		37,285	6,790	-3,378	-1,483	-8,856	-8,033	-7,196

12 The table provides a simple representation of costs and benefits which in the modelling are subject to appropriate inflationary adjustments
13 Costs are shown as negative figures, benefits as positive

The NPV of the costs and benefits over the period being modelled (2023[14]) has been calculated and set out below.

Overall the modelling projects a net financial benefit to the councils and their communities arising from the merger of an estimated $86.6 million (Net Present Value of projected costs and savings raising from the merger projected until 2023 with a discount rate of 7%, as per the NSW Treasury Guidelines). The projected benefits should be seen in context of the timeframe over which they arise and the overall financial performance of the merged council and in particular the need for the organisation to increase asset expenditure to meet the Fit for the Future benchmarks.

Table 19 Summary of costs and savings

Net Present Value at 4%	Net Present Value at 7%	Net Present Value at 10%
$104,354,000	$86,602,000	$72,036,000

[14] 2023 is the period being modelled to match the time covered by each councils LTFPs

Table 20 Summary of financial impacts of merger

Selected Councils Combined LTFP - 2014/15 Extrapolated	2013 (000s)	2014 (000s)	2015 (000s)	2016 (000s)	2017 (000s)	2018 (000s)	2019 (000s)	2020 (000s)	2021 (000s)	2022 (000s)	2023 (000s)
Operating Results											
Income Statement	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**
Source: Council Financial Statements and Long Term Financial Plan	**(000s)**	**(000s)**	**(000s)**	**(000s)**	**(000s)**	**(000s)**	**(000s)**	**(000s)**	**(000s)**	**(000s)**	**(000s)**
Rates & Annual Charges	194,890	203,309	211,971	218,330	224,880	231,626	238,575	245,732	253,104	260,698	268,519
User Fees & Charges	27,224	28,889	27,650	28,540	29,459	30,407	31,386	32,396	33,438	34,515	35,626
Grants & Contributions - Operations	29,662	23,340	26,438	42,974	26,699	26,958	27,302	27,654	28,015	28,385	28,766
Grants & Contributions for Capital	26,072	32,778	28,568	16,842	16,925	17,060	17,196	17,287	17,266	17,475	17,572
Interest and Investment Income	10,566	10,711	8,324	3,247	3,247	3,247	3,247	3,247	3,247	3,247	3,247
Gains from disposal assets	1,535	2,517	413	406	416	425	435	445	455	466	476
Other Income	17,813	19,246	18,705	18,402	18,825	19,258	19,701	20,154	20,618	21,092	21,577
Total Income	**307,762**	**320,790**	**322,069**	**328,741**	**320,450**	**328,981**	**337,842**	**346,915**	**356,144**	**365,877**	**375,783**
Income excl Gains\losses	306,227	318,273	321,656	328,335	320,035	328,556	337,407	346,470	355,688	365,411	375,306
Income excl Gains\losses & Capital Grants	280,155	285,495	293,088	311,493	303,110	311,496	320,211	329,183	338,422	347,936	357,734
Expenses											
Borrowing Costs	1,271	1,342	1,111	1,414	1,330	1,243	1,156	1,062	974	901	844
Employee Benefits	117,669	121,869	133,872	130,568	131,130	129,815	130,215	131,594	139,130	147,091	155,499
Gains & losses on disposal	301	-	-	-	-	-	-	-	-	-	-
Depreciation & Amortisation	48,168	47,395	51,794	52,712	53,543	54,515	55,711	56,911	58,242	59,534	60,920
All other Expenses	126,705	123,689	125,715	176,507	150,116	141,238	137,955	142,087	145,358	149,710	154,191
Total Expenses	**294,114**	**294,295**	**312,492**	**361,201**	**336,119**	**326,811**	**325,037**	**331,653**	**343,705**	**357,236**	**371,454**
Operating Result	**13,648**	**26,495**	**9,577**	**- 32,460**	**- 15,668**	**2,170**	**12,805**	**15,262**	**12,439**	**8,641**	**4,328**
Operating Result before grants & contributions for capital purposes	**- 12,424**	**- 6,283**	**- 18,991**	**- 49,302**	**- 32,593**	**- 14,890**	**- 4,391**	**- 2,025**	**- 4,827**	**- 8,834**	**- 13,244**

6.4.1 Rates

Given the differing rating structures among the councils it is difficult to model the impact of a merger on rate revenue and in particular the impacts on individual land owners. As a starting point the current rates for the four councils are set out below highlighting the existing differences as well as the different approaches.

Figure 13 Average residential rate (2014)

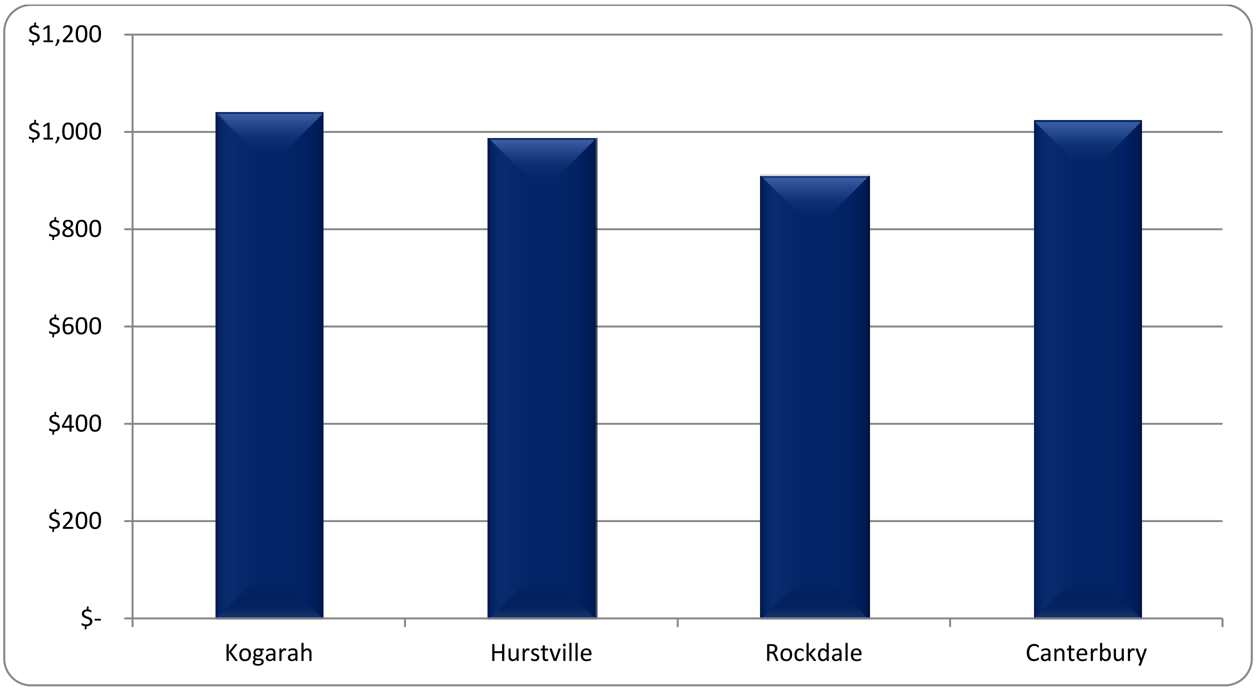


Figure 14 Average business rate (2014)

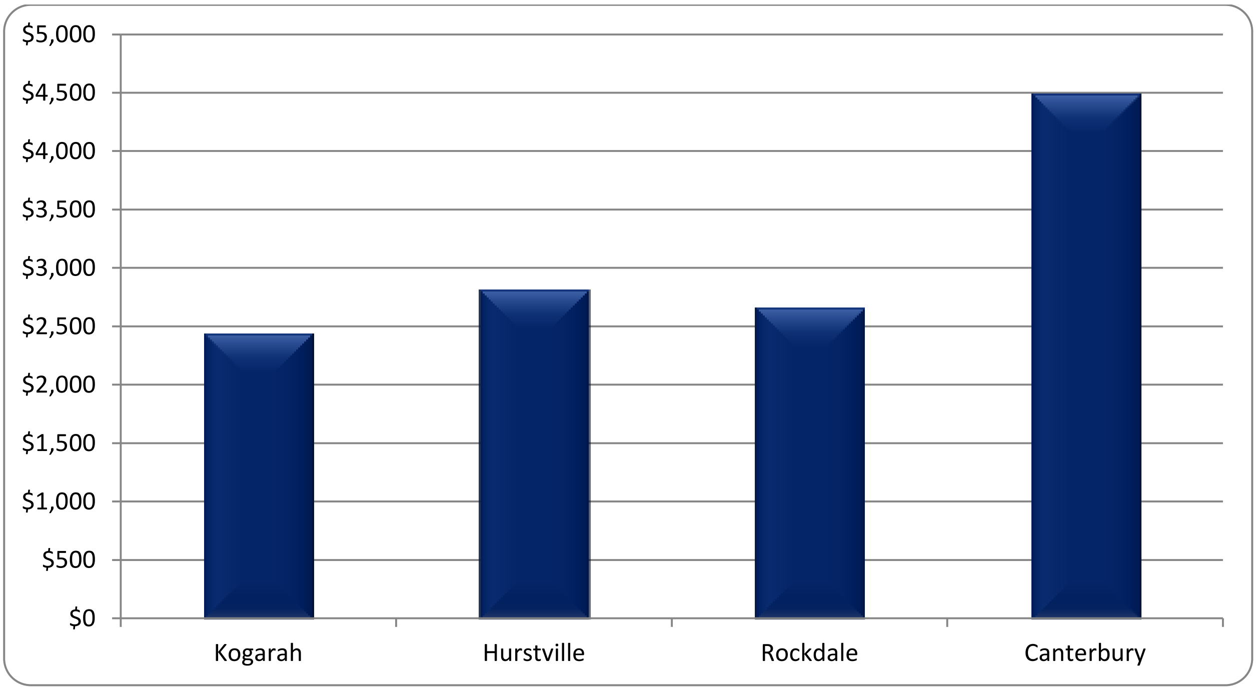


Figure 15 Comparison of minimum rates (2014)

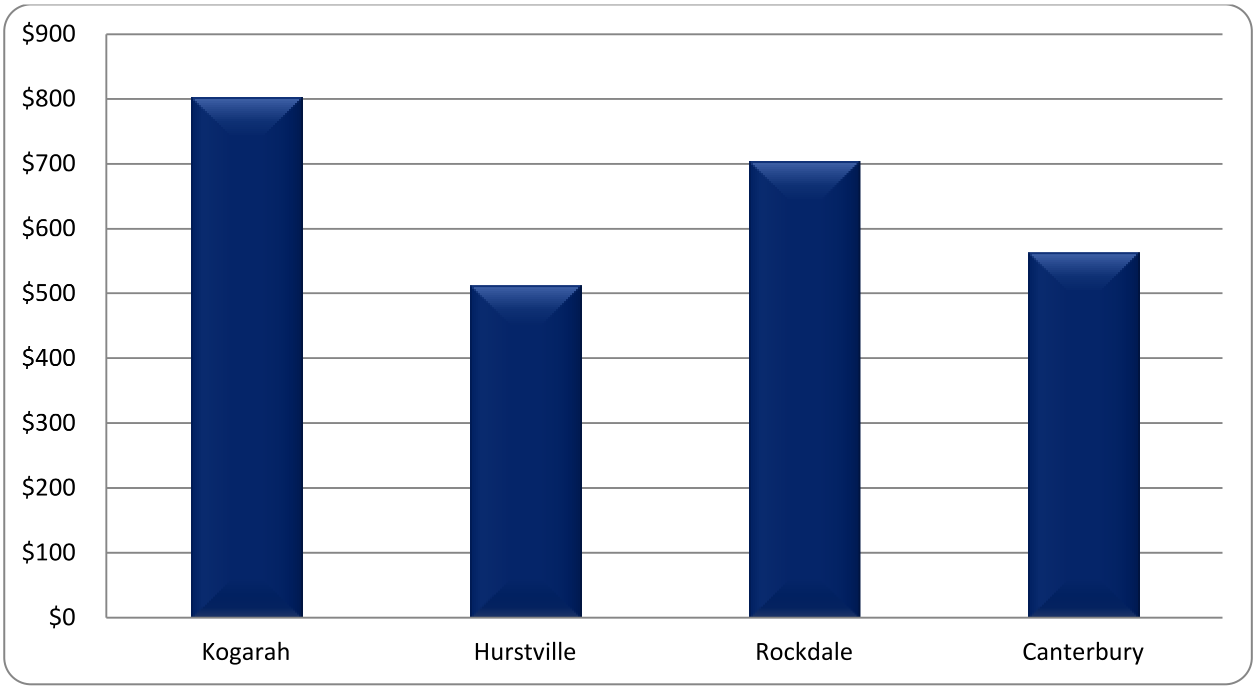


Table 21 Comparison of proportion of residential and business rates

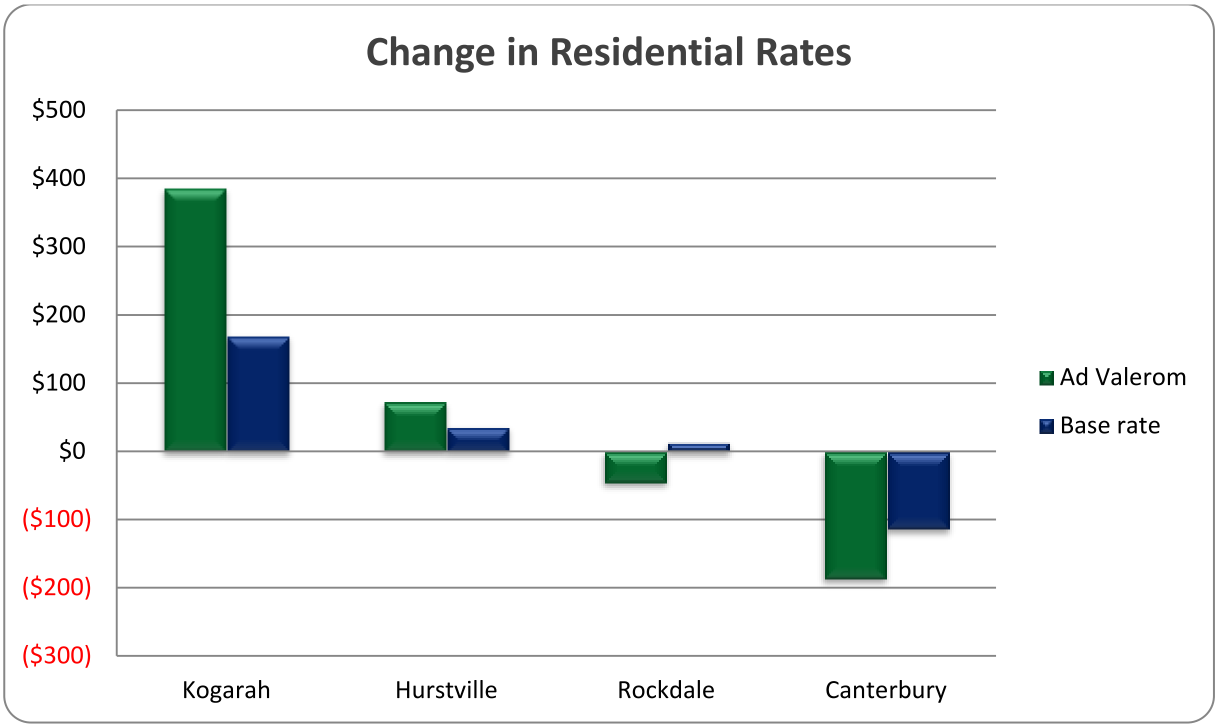
Proportion of rates	Canterbury	Hurstville	Kogarah	Rockdale
Residential	78%	82%	88%	88%
Business	22%	18%	12%	12%

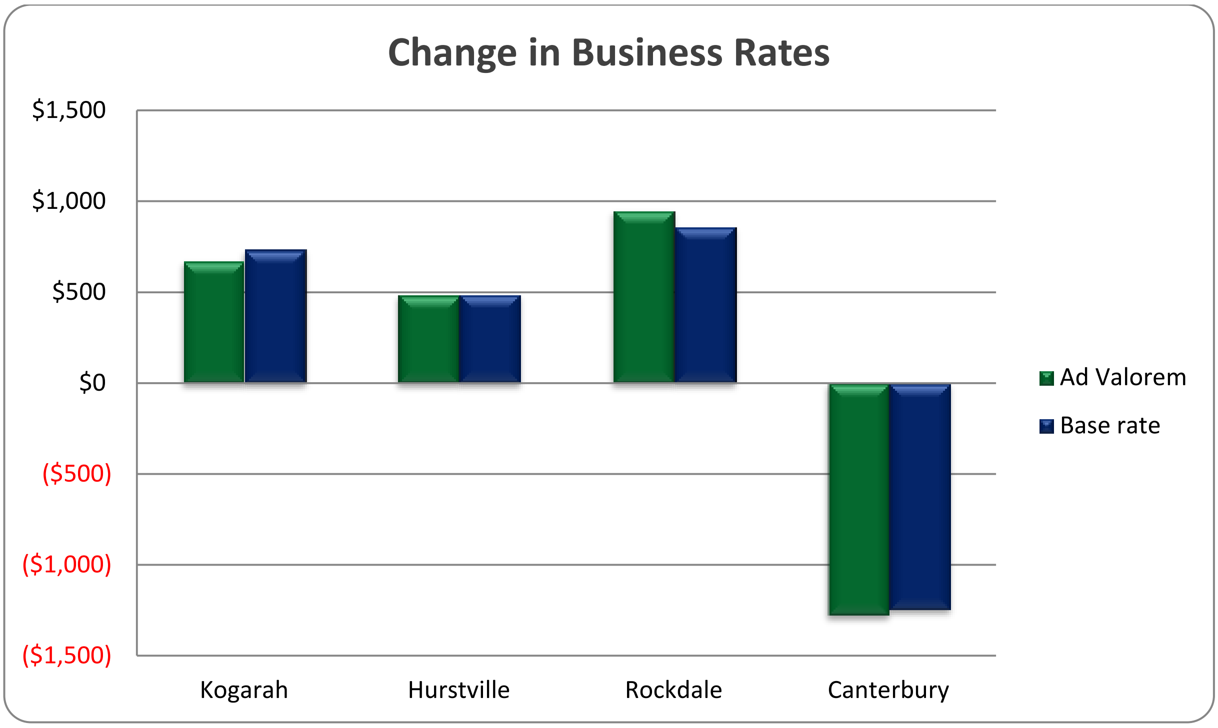
In order to provide information on what the potential impact of a merger on rates would be, representative examples have been modelled by redistributing the 2014/15 rates without adjusting the rating structures. Two scenarios have been used based on the total rate revenue (residential and business) of the four councils. In each scenario the total rates (residential or business) are apportioned across the councils consistently. Scenario 1 is entirely ad valorem and Scenario 2 provides for a base charge to be set at the maximum level with the remainder ad valorem.

The key drivers are therefore land values and the differences in the way in which councils currently allocate rates between categories. The actual impact on any property or properties will be the result of the actual rating structure chosen by any new council and how quickly a merged council decided to adopt and then implement a single rating structure. Within each council area there will be individual properties that are affected in different ways by the changes due to categorisation and land valuation issues.

The changes are described in the figures below by reference to a change from the 2014-15 rate and expressed as either an increase or decrease from the current average rate set out above.

Figure 16 Change in rates under a merger





6.4.2 Debt

Each council carries comparatively low levels of debt which would be taken over by a merged council and each council meets the Fit for the Future benchmarks debt servicing ratios, as does the merged council.

Table 22 Comparison of debt

Council	Debt ($000)	Debt Service Ratio	Debt per Capita ($)
Canterbury Council	$7,769	2.0%	$53.15
Kogarah Council	$0	0.0%	$0
Rockdale Council	$7,242	2.0%	$69.80
Hurstville Council	$7,500	1.9%	$93.49
Combined	$22,511	1.6%	$58.36

6.5 Scale and capacity

Scale

Scale has not been defined or given a threshold by either the ILGRP, the Office of Local Government, or more recently IPART. The Government has asked each council to begin with the recommendation proposed by the Independent Review Panel as that is considered to be the appropriate scale and capacity for the council.

On the basis that the independent panel recommendation proposed that the councils merge, it can be assumed that a merged council would achieve the scale and capacity requirements.

Given that at the time of writing this report we understand all four councils to be in the process of completing Template 2 Submissions, the councils will need to make an argument that they can meet scale and capacity under their existing structural arrangements, recognising the stated government position which runs contrary to that.

Capacity

The panel report articulated the Key Elements of Strategic Capacity as follows.[15]

[15] Box 8, Page 32 of Revitalising Local Government

Figure 17 Scale and capacity

Box 8: Key Elements of Strategic Capacity

- More robust revenue base and increased discretionary spending
- Scope to undertake new functions and major projects
- Ability to employ wider range of skilled staff
- Knowledge, creativity and innovation
- Advanced skills in strategic planning and policy development
- Effective regional collaboration
- Credibility for more effective advocacy
- Capable partner for State and federal agencies
- Resources to cope with complex and unexpected change
- High quality political and managerial leadership.

The performance of the merger option against each of the key elements is set out in the following table. The assumption is that in a strict application of capacity each council on its own does not meet the capacity elements because each council was put into a potential merger group by the ILGRP. We have also noted the extent to which there is any real change from the status quo when the criteria are compared to a single council.

Table 23 Scale and capacity in the merged councils

Criteria	Merged Council	Degree of change
More robust revenue base and increased discretionary spending	Yes	Limited change
Scope to undertake new functions and major projects	Yes	Limited change
Ability to employ wider range of skilled staff	Yes	Limited change
Knowledge, creativity and innovation	Yes	Limited change
Effective regional collaboration	Yes	Limited change
Credibility for more effective advocacy	Yes	Limited change
Capable partner for state and federal agencies	Yes	Limited change
Resources to cope with complex and unexpected change	Yes	Limited change
High quality political and managerial leadership	Yes	No change

6.6 Fit for the Future Indicators

A merged council would meet three of the benchmark requirements from day one.

- The Own Source Revenue Ratio which remains steady at an average of just over 86% for the period modelled, well above the benchmark of greater than 60% averaged over three years
- The Debt Service Cover Ratio which remains steady at an average of 1.3% for the period modelled, well within the benchmark of greater than 0% and less than or equal to 20% averaged over three years
- The Real Operating Expenditure Ratio which steadily declines from a high of $739 per capita to a low of $574 per capita, in line with the benchmark requirements to show a decrease over time

Of the other four measures where the merged council would not meet the benchmark requirements:

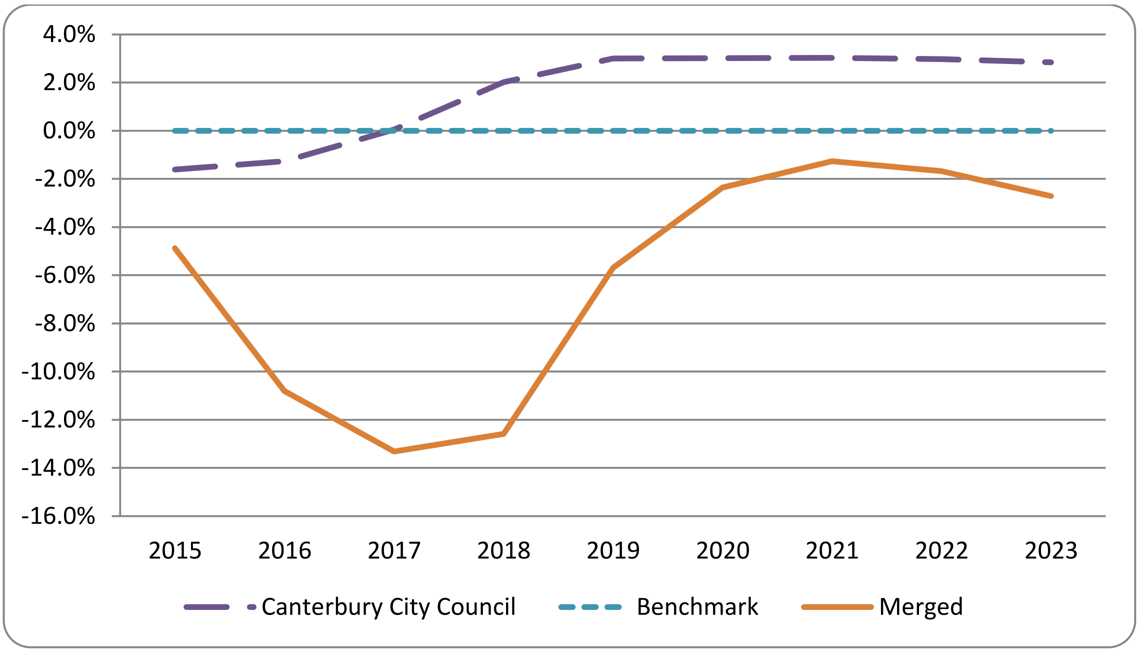
- The Operating Performance Ratio drops to a low of -13.3% in 2017 before steadily climbing to -1.3% before starting to decline again, below the required benchmark of being greater or equal to break-even averaged over three years for the period modelled
- The Asset Maintenance Ratio remains steady at an average of 82% throughout the period modelled, well below the required benchmark of greater than 100% average over 3 years
- The Asset Renewal Ratio remains steady at an average of 90% throughout the period modelled, below the required benchmark of greater than 100% average over 3 years
- The Infrastructure Backlog steadily increases from 3.2% in 2016, rising to 4.5% in 2023 at the end of the modelled period, remaining above the benchmark requirement of less than 2%.

Table 24 Summary of merged council using Fit for the Future indicators

Indicator	At Day One	Over Modelling Period
Operating Performance	Does not meet the benchmark	Does not meet the benchmark
Own Source Revenue	Meets the benchmark	Meets the benchmark
Debt Service Cover	Meets the benchmark	Meets the benchmark
Asset Maintenance	Does not meet the benchmark	Does not meet the benchmark
Asset Renewal	Does not meet the benchmark	Does not meet the benchmark
Infrastructure Backlog	Does not meet the benchmark	Does not meet the benchmark
Real Operating Expenditure	Meets the benchmark	Meets the benchmark

The following graphs demonstrate the performance of the merged council against the Fit for the Future benchmarks compared to Canterbury's performance.

Figure 18 Merged council operating performance ratio



The sharp dip in the operating performance ratio for the merged council reflects the early transition costs of the merged entity, rising from 2019 when efficiencies become realised. Despite the financial benefits of the merger, the merged council does not match that forecast for Canterbury.

Figure 19 Merged council own source revenue

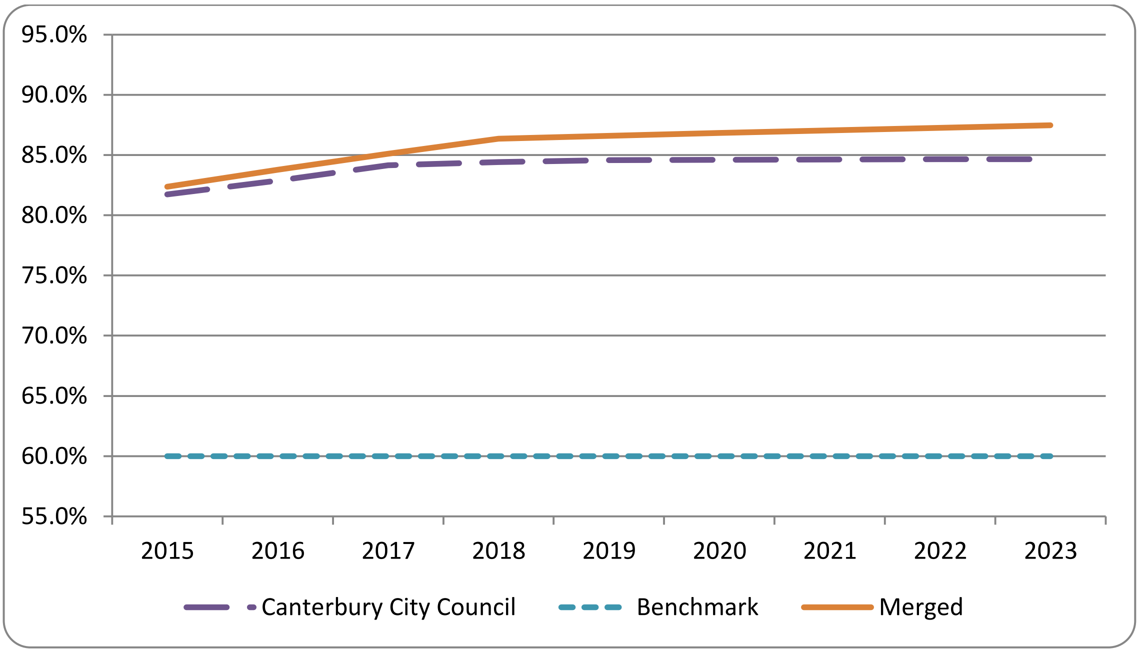


Figure 20 Merged council debt service ratio
(Benchmark - Between 0 and 20% averaged over 3 years)

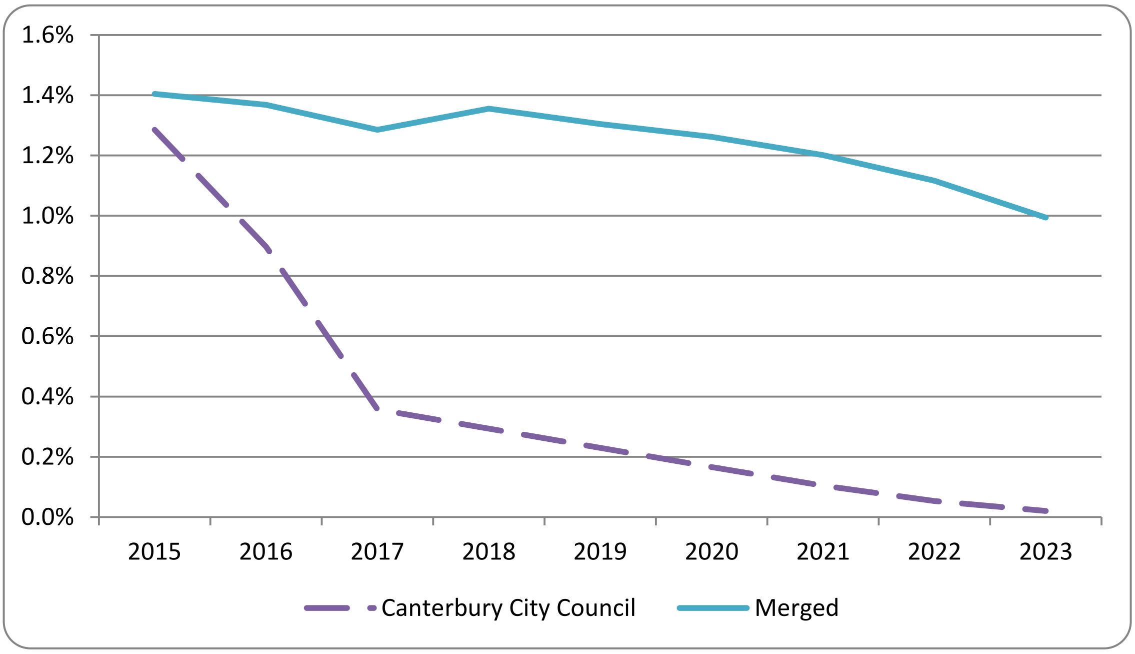


Figure 21 Merged council asset renewal ratio

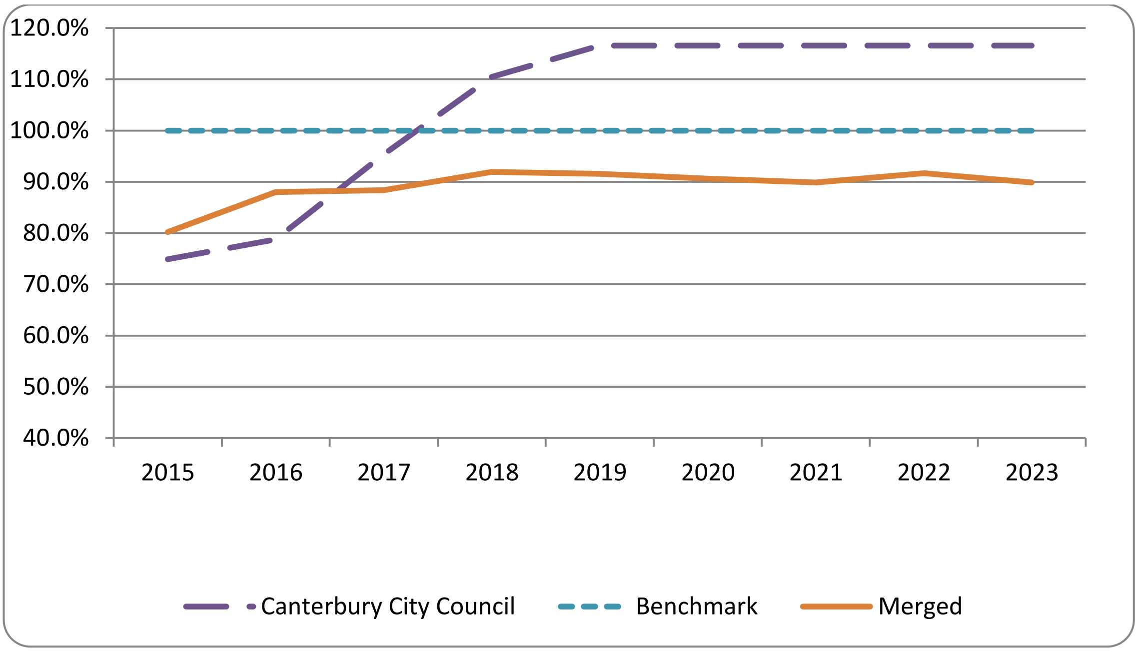


Figure 22 Merged council infrastructure backlog ratio

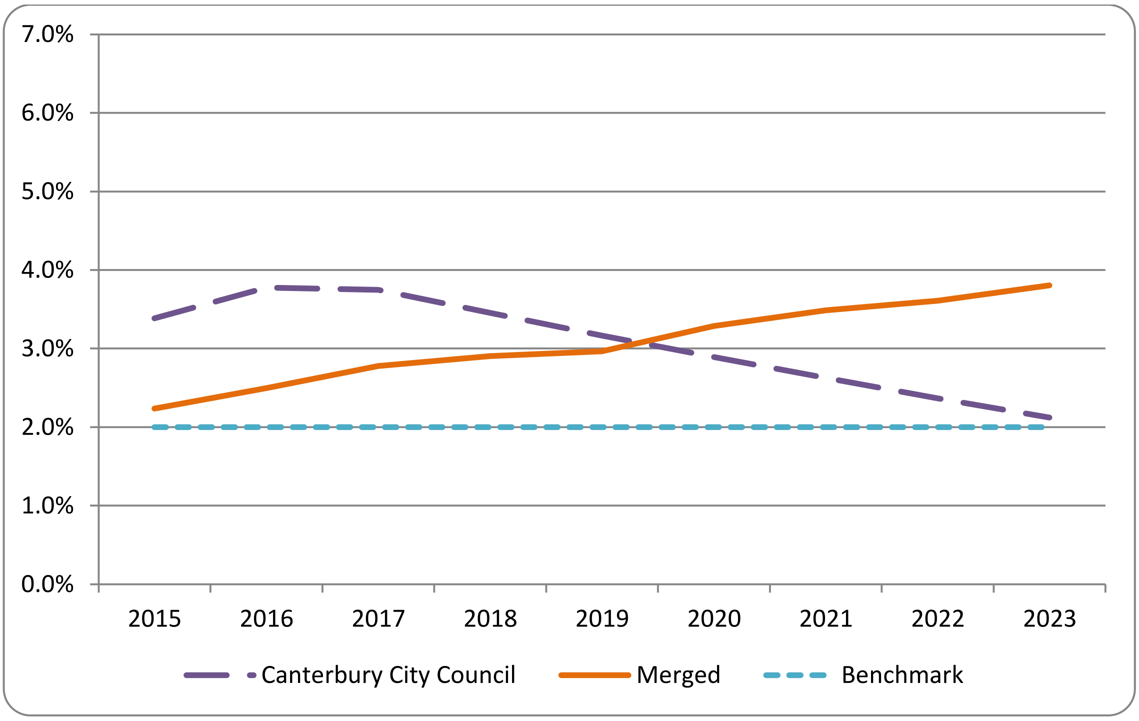


Figure 23 Merged council asset maintenance ratio

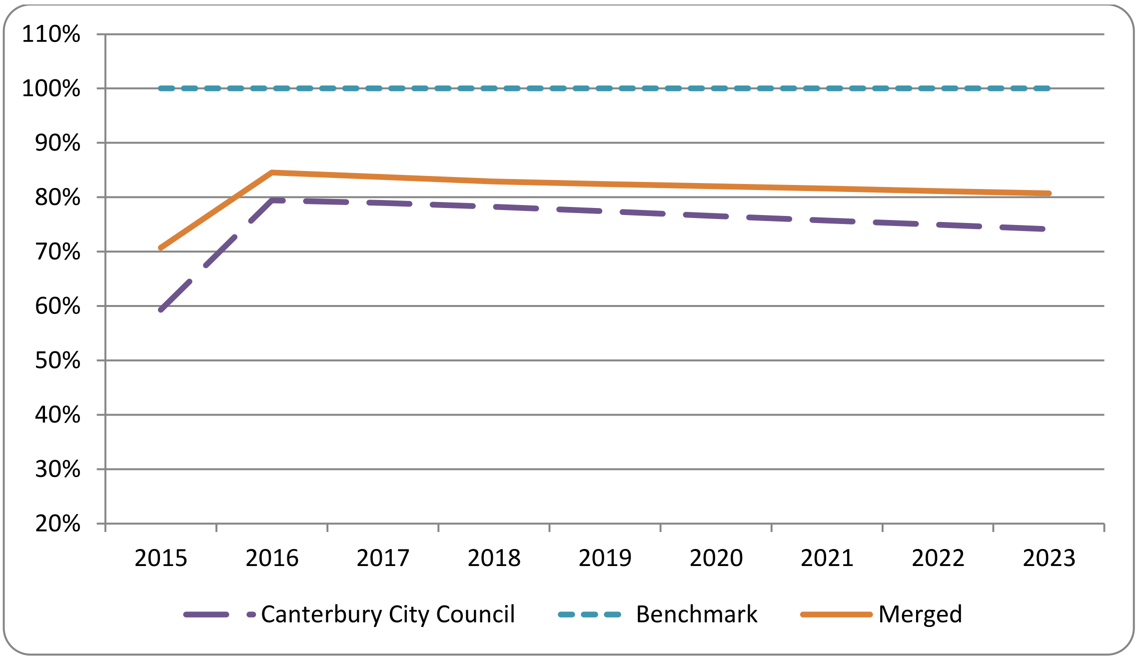
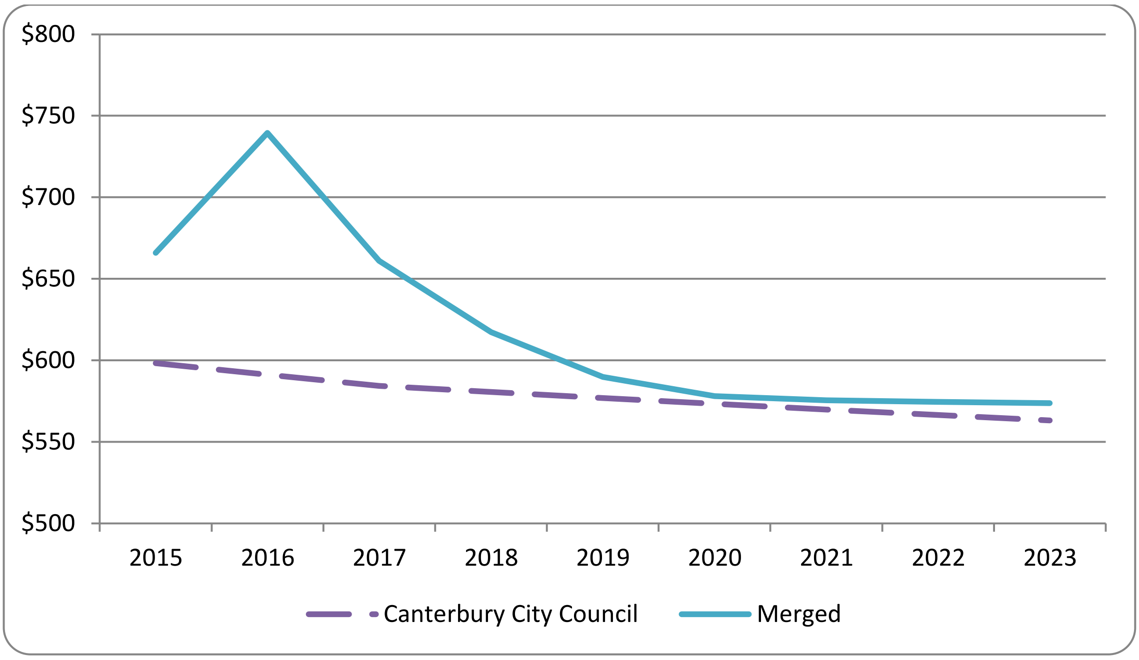


Figure 24 Merged council real operating expenditure



The spike in the merged council's operating expenditure is a result of the early transition costs of the new entity.

6.6.1 Asset Maintenance

The same approach to the calculation of required annual maintenance used for each individual council was applied to a merged council to identify what, if any, gap in maintenance expenditure would exist. For the purposes of the modelling it is assumed that the combined expenditure on maintenance for the merged council is the total of the existing/predicted maintenance budgets.

For simplicity, the figures in the table below are presented as an average of the years projected in each council's LTFP while the model projects actual expenditure year by year.

Table 25 Merged council asset maintenance funding gap

Council	Actual Annual Maintenance ($000)	Estimated Required Maintenance ($000)	Maintenance Gap ($000)
Merged Council	22,130	27,032	-4,902

6.6.2 Asset Renewal

The required annual renewal expenditure for the merged council is based on the combined calculation of the depreciation on building and infrastructure assets. For the purposes of the modelling it is assumed that the combined expenditure on building and infrastructure renewals for the merged council is the total of the existing/predicted renewal budgets for these assets.

For simplicity, this is presented as an average of the years projected in each council's LTFP while the model projects actual expenditure year by year.

Table 26 Merged council asset renewal funding gap

Council	Average predicted annual renewals ($000)	Average required annual renewals ($000)	Renewal Gap ($000)
Merged Council	34,287	38,051	-3,764

Given that most of the councils individually did not meet this benchmark, the resultant merged council similarly would need to address a funding gap. In order to reduce the infrastructure backlog, we have then calculated what the merged council would need to spend on additional renewals (i.e. over and above maintaining a 100% asset renewal ratio) to reduce the backlog ratio to the benchmark within five years and set that out in the table below.

For simplicity, this is presented as an average of the years projected in each council's LTFP while the model projects actual expenditure year by year.

Table 27 Merged council infrastructure backlog

Council	Cost to satisfactory ($000)	Target Backlog ($000)	Infrastructure Backlog ($000)	Per year (5 years) ($000)
Merged Council	40,159	32,161	-7,998	-1,600

6.6.3 Funding shortfall

Table 28 Merged council asset funding gap

Council	Asset Maintenance ($000)	Renewals ($000)	Infrastructure Backlog ($000)	Average funding required per annum (5 years) ($000)	Average funding required per annum (5 years+) ($000)
Merged Council	-4,902	-3,764	-1,600	-10,266	-8,667

6.7 Operating Performance

The operating result of the merged council (calculated on the same basis as the operating performance ratio and so excluding capital grants and contributions) has been reviewed and the merged council has a deficit of operating revenue over operating expenses, as identified below which would need to be addressed by the merged council. For simplicity, this is presented as an average of the years projected in each council's LTFP.

Table 29 Operating performance funding gap

Council	Gap ($000)
Merged Council	-16,263

6.8 Costs and Savings of the merger

The costs and savings of the merger arise throughout the period being modelled. The costs and savings should not be considered in isolation. They only form part of the information on which a decision should be made and in particular they should be considered in conjunction with the infrastructure funding gap identified above.

Initially in the transition from four councils into one there are costs associated with creating the single entity (structure, process, policies, systems and branding), costs continue to arise through redundancies of senior staff and the implementation of a single IT system across the new council which has significant cost implications. Costs of the merger continue to arise in the medium and longer term largely from redundancy costs (one off) and as a result of increased services and service levels together with an increase in staff numbers, which is typical of merged councils.

Savings initially arise in the short term through the reduction in the number of senior staff and Councillors required in comparison to the councils combined. Natural attrition is initially applied meaning that overall staff numbers fall in the short term, although the reduction is a small one. Savings are also projected to arise in relation to procurement and operational expenditure due to the size and increased capacity of the larger council but again these are modest. In the medium and longer term benefits arise through reducing the overall staff numbers with a focus on removing the duplication of roles and creating greater efficiency in operations and some rationalisation of plant (one off).

The NPV of the costs and savings over the period being modelled (2023[16]) has been calculated and set out below and identifies a net financial benefit to the councils and community arising from the merger.

Table 30 Summary of costs and savings

Net Present Value at 4%	Net Present Value at 7%	Net Present Value at 10%
$104,354,000	**$86,602,000**	**$72,036,000**

6.9 Risks arising from merger

There are significant potential risks arising from the merger both in a financial and non-financial sense. The obvious financial risks are that the transitional costs may be more significant than set out in the business case or that the efficiencies projected in the business case are not delivered. The business case is high level and implementation costs and attaining the savings will be difficult to achieve.

16 2023 is the period being modelled to match the time covered by each council's LTFPs

If, for example, the council chooses not to follow through with the projected efficiencies, this will affect the financial viability of the merged council. Similarly, decisions made subsequent to the merger about the rationalisation of facilities and services may not reduce the cost base of the merged organisation as originally planned.

Careful consideration of the issue of cultural integration will be required and the most consistent remedy to these particular risks is in our view strong and consistent leadership. Corporate culture misalignment during the post-merger integration phase often means the employees will dig in, form cliques, and protect the old culture. In addition to decreased morale and an increased staff turnover rate, culture misalignment reduces business performance. It also prolongs the time it takes for the predicted efficiencies to be achieved.

The integration of services with differing service levels often leads to standardising those service levels at the highest level of those services that are being integrated. This is quite often a response to a natural desire to deliver the best possible services to communities as well as the need to balance service levels to community expectations across the whole area. However it does pose the risk of increased delivery costs and/or lost savings opportunities. Similarly, introducing services that are not currently delivered in one or more of the former council areas to the whole of the new council area will incur additional costs.

Alongside these typical risks arising from a merger any reduced financial performance would be likely to lead to the new council having to review services and service levels to seek significant further efficiency gains and/or increase rates to address the operating deficit.

APPENDIX A Fit For The Future Benchmarks[17]

Operating Performance Ratio

$$\frac{\textit{Total continuing operating revenue (exc. capital grants and contributions) less operating expenses}}{\textit{Total continuing operating revenue (exc. capital grants and contributions)}}$$

Description and Rationale for Criteria:

TCorp in their review of financial sustainability of local government found that operating performance was a core measure of financial sustainability.

Ongoing operating deficits are unsustainable and they are one of the key financial sustainability challenges facing the sector as a whole. While operating deficits are acceptable over a short period, consistent deficits will not allow Councils to maintain or increase their assets and services or execute their infrastructure plans.

Operating performance ratio is an important measure as it provides an indication of how a Council generates revenue and allocates expenditure (e.g. asset maintenance, staffing costs). It is an indication of continued capacity to meet on-going expenditure requirements.

Description and Rationale for Benchmark:

TCorp recommended that all Councils should be at least break even operating position or better, as a key component of financial sustainability. Consistent with this recommendation the benchmark for this criteria is greater than or equal to break even over a 3 year period.

Own Source Revenue Ratio

$$\frac{\textit{Total continuing operating revenue less all grants and contributions}}{\textit{Total continuing operating revenue inclusive of capital grants and contributions}}$$

Description and Rationale for Criteria:

Own source revenue measures the degree of reliance on external funding sources (e.g. grants and contributions). This ratio measures fiscal flexibility and robustness. Financial flexibility increases as the level of own source revenue increases. It also gives councils greater ability to manage external shocks or challenges.

Councils with higher own source revenue have greater ability to control or manage their own operating performance and financial sustainability.

[17] Office of Local Government Fit for the Future Self-Assessment Tool

Description and Rationale for Benchmark:

TCorp has used a benchmark for own source revenue of greater than 60 per cent of total operating revenue. All Councils should aim to meet or exceed this benchmark over a three year period.

It is acknowledged that many councils have limited options in terms of increasing its own source revenue, especially in rural areas. However, 60 per cent is considered the lowest level at which councils have the flexibility necessary to manage external shocks and challenges.

Debt Service Ratio

$$\frac{\textit{Cost of debt service (interest expense \& principal repayments)}}{\textit{Total continuing operating revenue (exc. capital grants and contributions)}}$$

Description and Rationale for Criteria:

Prudent and active debt management is a key part of Councils' approach to both funding and managing infrastructure and services over the long term.

Prudent debt usage can also assist in smoothing funding costs and promoting intergenerational equity. Given the long life of many council assets it is appropriate that the cost of these assets should be equitably spread across the current and future generations of users and ratepayers. Effective debt usage allows councils to do this.

Inadequate use of debt may mean that councils are forced to raise rates that a higher than necessary to fund long life assets or inadequately fund asset maintenance and renewals. It is also a strong proxy indicator of a council's strategic capacity.

Council's effectiveness in this area is measured by the Debt Service Ratio.

Description and Rationale for Benchmark:

As outlined above, it is appropriate for Councils to hold some level of debt given their role in the provision and maintenance of key infrastructure and services for their community. It is considered reasonable for Councils to maintain a Debt Service Ratio of greater than 0 and less than or equal to 20 per cent.

Councils with low or zero debt may incorrectly place the funding burden on current ratepayers when in fact it should be spread across generations, who also benefit from the assets. Likewise high levels of debt generally indicate a weakness in financial sustainability and/or poor balance sheet management.

Asset Maintenance Ratio

$$\frac{\textit{Actual asset maintenance}}{\textit{Required asset maintenance}}$$

Description and Rationale for Criteria:

The asset maintenance ratio reflects the actual asset maintenance expenditure relative to the required asset maintenance as measured by an individual council.

The ratio provides a measure of the rate of asset degradation (or renewal) and therefore has a role in informing asset renewal and capital works planning.

Description and Rationale for Benchmark:

The benchmark adopted is greater than one hundred percent, which implies that asset maintenance expenditure exceeds the council identified requirements. This benchmark is consistently adopted by the NSW Treasury Corporation (TCORP). A ratio of less than one hundred percent indicates that there may be a worsening infrastructure backlog.

Given that a ratio of greater than one hundred percent is adopted, to recognise that maintenance expenditure is sometimes lumpy and can be lagged, performance is averaged over three years.

Building and Infrastructure Renewal Ratio

$$\frac{\textit{Asset renewals (building and infrastructure)}}{\textbf{Depreciation, amortisation and impairment (building and infrastructure)}}$$

Description and Rationale for Criteria:

The building and infrastructure renewals ratio represents the replacement or refurbishment of existing assets to an equivalent capacity or performance, as opposed to the acquisition of new assets or the refurbishment of old assets that increase capacity or performance. The ratio compares the proportion spent on infrastructure asset renewals and the asset's deterioration.

This is a consistent measure that can be applied across councils of different sizes and locations. A higher ratio is an indicator of strong performance.

Description and Rationale for Benchmark:

Performance of less than one hundred percent indicates that a Council's existing assets are deteriorating faster than they are being renewed and that potentially council's infrastructure backlog is worsening. Councils with consistent asset renewals deficits will face degradation of building and infrastructure assets over time.

Given that a ratio of greater than one hundred percent is adopted, to recognise that capital expenditures are sometimes lumpy and can be lagged, performance is averaged over three years.

Infrastructure Backlog Ratio

$$\frac{\textit{Estimated cost to bring assets to a satisfactory condition}}{\textit{Total (WDV) of infrastructure, buildings, other structures and depreciable land improvement assets}}$$

Description and Rationale for Criteria:

The infrastructure backlog ratio indicates the proportion of backlog against the total value of the Council's infrastructure assets. It is a measure of the extent to which asset renewal is required to maintain or improve service delivery in a sustainable way. This measures how councils are managing their infrastructure which is so critical to effective community sustainability.

It is acknowledged, that the reliability of infrastructure data within NSW local government is mixed. However, as asset management practices within councils improve, it is anticipated that infrastructure reporting data reliability and quality will increase.

This is a consistent measure that can be applied across councils of different sizes and locations. A low ratio is an indicator of strong performance.

Description and Rationale for Benchmark:

High infrastructure backlog ratios and an inability to reduce this ratio in the near future indicate an underperforming Council in terms of infrastructure management and delivery. Councils with increasing infrastructure backlogs will experience added pressure in maintaining service delivery and financing current and future infrastructure demands.

TCorp adopted a benchmark of less than 2 per cent to be consistently applied across councils. The application of this benchmark reflects the State Government's focus on reducing infrastructure backlogs.

Reduction in Real Operating Expenditure

Description and Rationale for Criteria:

At the outset it is acknowledged the difficulty in measuring public sector efficiency. This is because there is a range of difficulty in reliably and accurately measuring output.

The capacity to secure economies of scale over time is a key indicator of operating efficiency. The capacity to secure efficiency improvements can be measured with respect to a range of factors, for example population, assets, and financial turnover.

It is challenging to measure productivity changes over time. To overcome this, changes in real per capita expenditure was considered to assess how effectively Councils:

- can realise natural efficiencies as population increases (through lower average cost of service delivery and representation); and

- can make necessary adjustments to maintain current efficiency if population is declining (e.g. appropriate reductions in staffing or other costs).

Assuming that service levels remain constant, decline in real expenditure per capita indicates efficiency improvements (i.e. the same level of output per capita is achieved with reduced expenditure).

Description and Rationale for Benchmark:

The measure 'trends in real expenditure per capita' reflects how the value of inflation adjusted inputs per person has grown over time. In the calculation, the expenditure is deflated by the Consumer Price Index (for 2009-11) and the Local Government Cost Index (for 2011-14) as published by the Independent Pricing and Regulatory Tribunal (IPART). It is acknowledged that efficiency and service levels are impacted by a broad range of factors, and that it is unreasonable to establish an absolute benchmark across Councils. It is also acknowledged that council service levels are likely to change for a variety of reasons however, it is important that councils prioritise or set service levels in conjunction with their community, in the context of their development of their Integrated Planning and Reporting.

Councils will be assessed on a joint consideration of the direction and magnitude of their improvement or deterioration in real expenditure per capita. Given that efficiency improvements require some time for the results to be fully achieved and as a result, this analysis will be based on a 5-year trend.

APPENDIX B Costs and Benefits Arising from a Merger of the Kogarah, Rockdale, Hurstville, and Canterbury Councils – Detailed Assumptions

Costs and benefits identified below form the basis of the modelling referred to throughout the report. Costs outlined below are one off unless stated otherwise whereas benefits continue to accrue each year unless stated otherwise.

Assumptions have been made using the best available information including analysis of various reports on and estimates of merger costs in other similar situations. This has been supplement with professional opinion of Morrison Low staff based on experience including with the Auckland Transition Authority.

Queensland Treasury Corporation August 2009 Report

In an August 2009 report[18] from the Queensland Treasury Corporation reporting on costs associated with the amalgamation of the Western Downs Regional Council, the report said:

> *A net cost outcome in the first local government term is likely, as local governments will incur most of their amalgamation costs prior to, and in the two to three years subsequent to, amalgamation. These costs then taper off. However, the savings resulting from amalgamation are likely to gradually increase over time through:*
>
> - *Greater efficiency (i.e., a reduction in costs through improved economies of scale)*
> - *Improved decision making capability, and*
> - *Improved capacity to deliver services.*
>
> *While Western Downs only identified minor potential future benefits, it is likely that benefits will be generated from a reduction in CEO wages, natural attrition and procurement efficiencies etc., while providing existing services at current service standards. It is noted that Western Downs has been able to extend the delivery of certain services across the local government area.*

Queensland Treasury also provided comment on the reality that local government is different from businesses and that it can be difficult to measure benefits from mergers on a commercial basis:

> *Businesses generally undertake amalgamations and mergers on the basis of a number of factors such as cost savings, increased market share, improved synergies and improved decision making capability. Generally, these factors are measured in the context of reduced staff numbers, reduced operating costs, improved profitability, increased market share and higher share prices.*
>
> *With local government these benefits are more difficult to measure as local governments may utilise savings achieved from improved economies of scale to increase the range and/or to improve the quality of services offered. As a consequence, the cost savings of amalgamation of local governments do not generally show up as improved profitability (i.e., operating surpluses). Similarly, improved decision making capability results in more effective decisions and better outcomes to residents but may not be reflected in a local government's bottom line. This is because local governments, unlike the private sector, are not in the business of making profits. Therefore, it is more difficult to measure the cost savings resulting from amalgamation*

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18 Queensland Treasury Corporation - Review of Amalgamation Costs Funding Submission of Western Downs Regional Council, August 2009

of local governments than it is for corporations, as the benefits will generally be utilised by the amalgamated local government in the provision of services.

Alan Morton in his report titled Outcomes from Major Structural Change of Local Government, which was released in July 2007, estimated administrative cost savings from the Cairns, Ipswich and Gold Coast amalgamations of 1992/93 were between 1.1 per cent and 3.1 per cent. The report also stated that the South Australian Government estimated savings of 3.0 per cent to 5.0 per cent of expenditure resulting from amalgamation.

These estimates focused on administrative efficiency rather than the outcomes achieved through improved local government decision-making capability. A potential measure of improved local government capability is ratepayer satisfaction. Alan Morton, together with the company Market Facts, undertook a survey of ratepayers of the five amalgamated local governments in 1992/93. The outcome of this survey was very positive and it indicated that over double the number of ratepayers considered the amalgamations were successful compared to those that thought the amalgamations were unsuccessful. This is considered a good outcome considering the main ratepayer concerns surrounding amalgamation are loss of jobs and loss of access to elected officials. QTC has not been asked to comment on improved capability.

The costs and benefits that Morrison Low has modelled for a possible merger of Kogarah, Rockdale, Hurstville, and Canterbury Councils are described below. Costs are one off unless stated otherwise whereas benefits continue to accrue each year unless stated otherwise.

1 Governance and executive team

The formation of a new entity is likely to result in some efficiencies resulting from a new governance model and rationalisation of the existing executive management teams. For the purposes of this review the governance category includes the costs associated with elected members, Council committees and related democratic services and processes, and the executive team.

The table below summarises the expected efficiencies together with the associated timing for governance.

	Staff	Duplicated Services	Elected Members	On Costs
Transition Period	Nil	Nil	Nil	Nil
Short Term (1 to 3 years)	Streamlined Management (General Managers and Directors) Natural attrition (voluntary)	General Managers, Directors, Mayoral/GM support Council/Committee Secretarial Support	Reduced councillors and remuneration	Staff Associated Costs e.g. HR, Accommodation, Computers, Vehicles
Medium Term (3 to 5 years)	Streamlined Management and staff Natural attrition (voluntary)			Staff Associated Costs e.g. HR, Accommodation, Computers, Vehicles
Long Term (5 years plus)				

1.1 Governance ($548,000)

The formation on a new entity is expected to result in efficiencies resulting from a new governance model and a reduction in the number of existing Mayors and Councillors. However, this will depend directly on the adopted governance structure including the number of councillors. Estimated governance costs for the new entity have been based on the Lord Mayor and Councillor fees from the City of Sydney as reported in the Annual Report 2014. The Independent Review Panel has envisaged a full time Mayor and there will be higher costs associated with such a role than the current Mayor and Councillors of the councils receive. It is assumed that there would be 14 councillors and a Mayor.

The total governance costs across the councils is based on the respective council's annual reports 2013/14 and there is the potential ongoing efficiency of $290 - $550,000 depending on the merger option.

1.2 Executive management ($2.4 million)

The formation of a single entity is likely to result in efficiencies due to an overall rationalisation in the total number of executive managers required at the Tier 1 (General Managers) and Tier 2 (Directors). Revised remuneration packages for the new General Manager and Directors for the new entity have been informed and assumed to be similar to the executive remuneration packages of councils of similar size and scale to that of the proposed new entities.

The General Managers total remuneration for the councils is based on the council's respective annual reports 2013/14, and the amalgamation to a single entity with a single General Manager has the potential saving of approximately $950,000.

In addition there would be a rationalisation of the existing director position. Based on the Annual Reports for 2013/14 combined remuneration for directors and assuming that the new entity has four – five director positions, the estimated savings are in the order of $1.5 million.

It is important to note that while ongoing efficiencies have been identified effective from the short term, there is the one off cost of redundancies of approximately $1.5 million that in our experience is a cost incurred during the transition period. This redundancy cost is based on 38 weeks.

1.3 Rationalisation of services

Under a single entity a number of the existing governance services would be duplicated and there would be an opportunity to investigate rationalising resourcing requirements for a single entity and realise efficiencies in the medium term.

As an example the councils currently have the resources necessary to support the democratic services and processes including council and committee agendas and minutes. Under a new entity there is likely to be a duplication of democratic resources and the new entity would need to determine the number of resources required to deliver this service.

Based on our previous experience one would expect resource efficiencies of between 5 and 15%. The reduction in resources is only likely to occur in the medium term due to the form of employment contracts, however having said that there is the potential not to replace positions vacated in the short term if they are considered to be duplicate positions under the new entity (natural attrition policy). The expected efficiencies relative to this area are realised in the Corporate Services Section.

Corporate services

In the formation of a new entity there is likely to be a reduction in staffing numbers across the corporate services in the medium term. The corporate services incorporates most of the organisational and corporate activities such as finance and accounting, human resources, communication, information technology, legal services, procurement, risk management, and records and archive management. Across the councils there is likely to be some element of duplication so there should be efficiency opportunities as it relates to administrative processes and staffing levels.

The potential opportunities for efficiency within the corporate services category are summarised in the table below along with the indicative timing of when the efficiency is likely to materialise.

<table>
<tr><th></th><th>Staff</th><th>Duplicated Services</th><th>Contract/ Procurement</th><th>Information Technology</th><th>On Costs</th></tr>
<tr><td>Transition Period</td><td>Natural attrition (voluntary)</td><td rowspan="3">Finance
ICT
Communications
Human Resources
Records
Customer Services
Risk Management</td><td></td><td></td><td></td></tr>
<tr><td>Short Term
(1 to 3 years)</td><td>Natural attrition (voluntary)</td><td></td><td></td><td>Staff Associated Costs e.g. HR, Accommodation
Computers, Vehicles</td></tr>
<tr><td>Medium Term
(3 to 5 years)</td><td>Streamlined Management (Tier 3)
Natural attrition (voluntary)</td><td></td><td></td><td>Staff Associated Costs e.g. HR, Accommodation
Computers, Vehicles</td></tr>
<tr><td>Long Term
(5 years plus)</td><td></td><td></td><td></td><td></td><td></td></tr>
</table>

1.4 Rationalisation of duplicate services ($2.8 million)

Consistent with the dis-establishment of three Councils and the creation of a single entity, there are a number of back office duplicated services that would be replaced, standardised and simplified. The rationalisation and streamlining of back office services means that there would an opportunity to rationalise financial reporting, business systems, administrative processes and staff numbers. A comparison of FTEs per head of population and FTE to service expenditure of NSW Councils also indicates the newly formed council would be higher than the average on both measures which confirms the need to reduce total FTE numbers.

Examples for the rationalisation of corporate services include:

- Finance - A reduction in finance service costs with the rationalisation of financial reporting and financial planning with a single, rather than separate Resourcing Strategies, Long Term Financial Plans, Asset Management Strategies, Workforce Management Plans , Annual Plans and Annual Reports needing to be prepared, consulted on and printed. In addition the centralisation of rates, accounts receivable, accounts payable and payroll, including finance systems will reduce resourcing requirements and costs.
- Human Resources (HR) – The size of the HR resource would be commensurate with the number of FTEs in the new entity based on industry benchmarks. The number of HR resources would be expected to reduce proportionately to the reduction in organisational staff numbers.

- Communications – The resourcing would be expected to reduce since there would be a single website and a more integrated approach to communication with less external reporting requirements.
- Customer Services – No reduction in the 'front of house' customer services has been assumed on the basis that all existing customer service centres would remain operative under a single entity and the existing levels of service would be retained. However there is potential to reduce the number of resources in the 'back office' such as the staffing of the call centre.

The potential efficiency in the corporate services category is difficult to determine largely due to the fact that ICT accounts for a large cost through the transition into the new entity both in terms of resources and actual cost. However it is expected that ICT would be implemented in the medium term and due to existing employment contracts, the corporate service efficiencies would therefore only be realised in the medium term. The starting point for the assumption underpinning the efficiency for corporate services was a 35%[19] reduction in corporate support personnel. A review of the organisational charts of the three councils means that in this case our views is that the opportunity for reductions in corporate is significantly less than the starting point and in the region of 5 – 15%. On costs are considered to be included as the figure used are based on total employee costs as reported by the councils.

There is the potential to reduce FTE numbers in the short term through not replacing positions vacated if they are considered to be duplicate positions through the transition and under the new entity (natural attrition policy). Following the end of the natural attrition period redundancies would be applied to reduce staffing levels to those outlines above.

In order to achieve the opportunities identified would require detailed scoping, investigation and ownership to ensure that they are implemented and realised post amalgamation. The development of a benefit realisation plan would quantify the cost of implementing any identified efficiencies and establish when such efficiencies are likely to accrue.

Redundancy costs have been modelled on an average of 26 weeks[20]

2 Areas for further efficiency

Based on the experience from previous amalgamations in local government there are other areas where we would expect there to be opportunity to achieve efficiencies. These areas include management, staff turnover, procurement, business processes, property/accommodation, waste and works units.

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19 Securing Efficiencies from the Reorganisation of Local Governance in Auckland, Taylor Duigan Barry Ltd, October 2010

20 The Local Government (State) Award provides a sliding scale for redundancy pay-outs from 0 for less than 1 year, 19 weeks for 5 years and 34 weeks for 10 years. An average of 26 weeks has therefore been used throughout the modelling.

	Staff	Duplicated Services	Contract/ Procurement	Information Technology	On Costs
Transition Period					
Short Term (1 to 3 years)	Staff Turnover	Property/ Accommodation, Works Units	Printing, stationary, ICT systems/ licences, legal	ICT Benefits	Staff Associated Costs e.g. HR, Accommodation, Computers, Vehicles
Medium Term (3 to 5 years)	Streamlined Management (Tier 3 & 4)	ICT Resourcing	Waste	ICT Benefits	Staff Associated Costs e.g. HR, Accommodation, Computers, Vehicles
Long Term (5 years plus)					

2.1 Management tier 3 and 4 ($4.9 million)

The Auckland amalgamation resulted in an FTE reduction of almost 60%[2] across the total Tier 1 through to Tier 4 positions. While Section 1 addresses the Tier 1 and Tier 2 efficiencies, there is further opportunity for efficiencies in regard to the Tier 3 and Tier 4 managerial positions although these would only be realised in the medium term.

The extent of efficiencies for Tier 3 and Tier 4 is directly dependent on the organisational structure of the new entity, types of services and the manner in which these services are to be delivered in the future, i.e. delivered internally or contracted out. On the basis that between two and four councils are being disestablished and a single entity created, the assumption is that there will be at least a 10 - 20% reduction across the existing Tier 3 and Tier 4 positions achieving an ongoing efficiency of $$4.9 million on remuneration and on costs.

2.2 Staff Turnover ($5.8 million)

The industry average turnover is approximately 9% and on the basis that the new entity adopts a 'natural attrition' policy not to fill positions in the short term, there is an estimated annual efficiency of $5.8 million on staff remuneration.

2.3 ICT Benefits ($6.4 million)

Without a full investigation into the current state of the three councils ICT infrastructure and systems, and without an understanding of the future state the ICT benefits cannot be quantified at this stage. However benefits would include improved customer experience, operational cost saving and reduced capital expenditure, higher quality of IT service and increased resilience of service provision. It is also necessary to model a value for the benefits to balance the costs that have been allowed for in the transition.

The operational cost savings and reduction of capital expenditure would be as a direct result of rationalising the number of IT systems, business applications, security and end user support from three councils to a single entity. The cost of IT and the number of staff resources required to support it would be expected to decrease over time. FTEs are assumed to reduce by 40%[21] over time in line with reduced IT applications and systems. Without the ICT FTE remuneration for the three councils, the 40% efficiency is unable to be determined at this time.

Through the work undertaken as part of the Wellington reorganisation, Stimpson and Co have undertaken a sensitivity analysis on the ICT costs for two options and based on an ICT cost of $90 million have estimated the Net Present Value at $200 million and payback period of five years. Without a detailed investigation of systems, processes and the future state of the IT system and support it is not considered possible to model the benefits as arising at a similar rate however to retain consistency with the estimated costs and the basis for them benefits have been modelled as arising over the long term and a rate of $4.0 – 7.9M per annum.

Sensitivity Analysis

Due to the high level of uncertainty associated with the realisation of IT benefits one additional scenario has been modelled to demonstrate the overall impact on the financial sustainability of the IT benefits being realised.

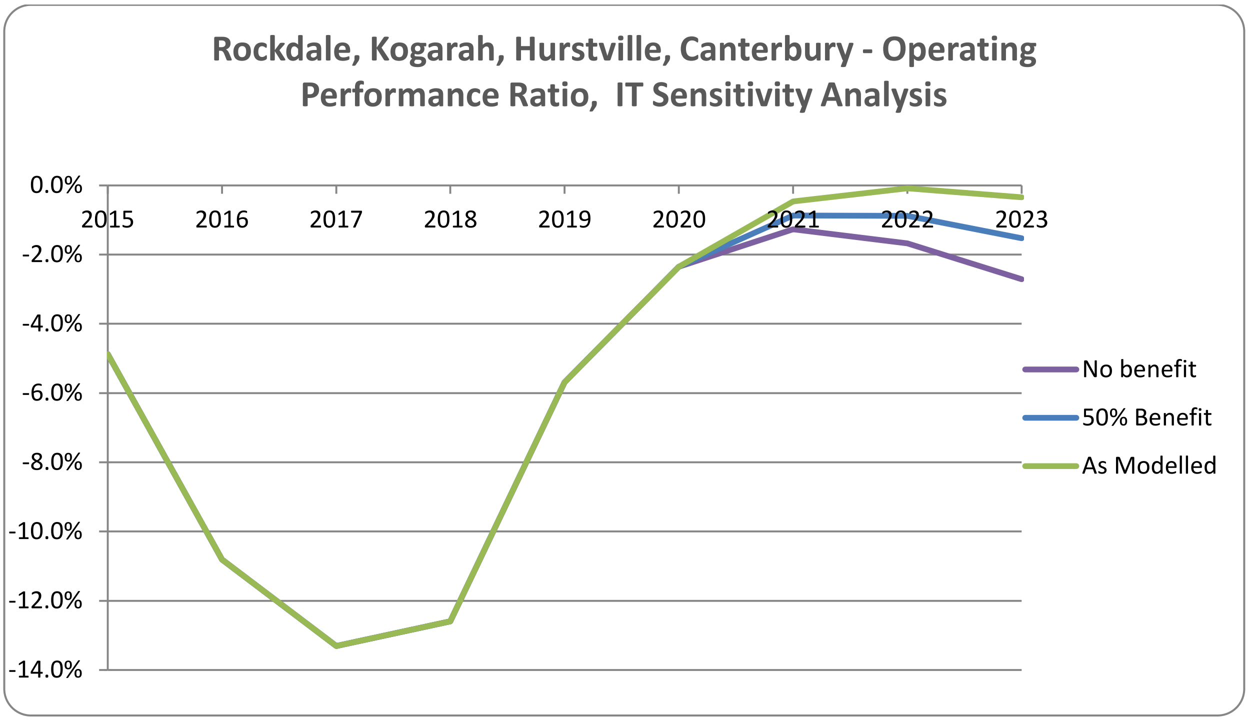
The impact on the merged council is set out by reference to the Operating Performance Ratio and a summary of the Financial Impacts.

Benefits at 50%

Realising only 50% of the IT benefits affects the merged council's operating performance by further magnifying the poor operating result in the long term. It reduces the annual benefits by $34M per annum.

The impact of this is demonstrated by reference to the operating performance ratio, real operating expenditure per capita ratio and summary of the financial performance of the merged council.

[21] Report to the Local Government Commission on Potential Savings of a Range of Options for the Re-organisation of Local Government in the Wellington Region, Brian Smith Advisory Services Limited, November 2014



2.4 Materials and contracts ($3.1 million)

The opportunity for efficiencies in procurement is created through the consolidation of buying power and the ability to formalise and manage supplier relationships more effectively when moving from four councils to one. An estimate needs to take into account that the councils currently engage in some collective procurement including through SSROC shared and panel contracts but that the process also identified a large number of services contracted out by the councils which are not aligned or co-ordinated.

The increased scale and size of the infrastructure networks managed by the merger options would in our view lead to opportunities to reduce operational expenditure through making better strategic decisions (as distinct from savings arising from procurement).

Based on the analysis during the project and our experience the combined savings have been modelled in the short term at 2% and rising to 4% over the medium and longer term.

2.5 Properties ($11.3 million – one off)

There is an opportunity to rationalise and consolidate the property portfolio through assessing the property needs of the new entity and disposing of those properties no longer required for Council purposes. The rationalisation of buildings in the first instance is likely to be corporate accommodation associated with the reduction in staff, other obvious areas would include the work depots (refer to Section 3.7).

For the purposes of modelling the merged council it is assumed that the council would dispose of 5% of the combined buildings portfolio by value in the medium term. In the longer term savings in properties are achievable but should be carried out in a more strategic manner across the combined entity.

2.6 Works units

Staff ($9.6 million)

Based on our experience of reviewing a large number of works units across NSW we have found significant savings in all organisations that we have reviewed. As such it is reasonable to assume that a reduction in staff in the order of 20% across the works areas will be easily achieved in the medium term to reflect the duplication of services across the depots.

Redundancy costs have been modelled in for all works staff based on an average of 26 weeks with an assumption on the number of affected staff at Kogarah, Rockdale and Hurstville based on proportion of staff in works units in Canterbury and other similar Sydney councils.

Following the end of the natural attrition period redundancies would be applied to reduce staffing levels to those identified above.

Plant and Fleet ($5.6 million – one off)

Based on our experience of reviewing a large number of works units across NSW most councils as are have significantly more plant and equipment than reasonably required to undertake it day to day functions. As such it is reasonable to assume that a reduction in plant and fleet in the order of 30% would be achievable should there be an amalgamation of councils.

3 Services and Service Levels ($1.5 million)

Typically merged councils see an increase in staff associated with rises in services and service levels. Research conducted for the Independent Review Panel noted that each of the councils involved in the 2004 NSW mergers had more staff after the merger than the combined councils together[22] and an average over the period of 2002/3 to 2010/11 of 11.7%.

An allowance has been made for a 2% increase in staff from year 4 onwards (i.e. after the period of natural attrition.

4 Transition costs

The formation of the new entity from the current state of three Councils to one will require a transition to ensure that the new entity is able to function on Day 1. This section identifies tasks to be undertaken and estimates transitional costs that are benchmarked against the Auckland Transition Agency (ATA) results and the costs as estimated by Stimpson & Co.[23] for the proposed Wellington reorganisation.

In the transition to an amalgamated entity there are a number of tasks that need to be undertaken to ensure that the new entity is able to function from Day 1 with minimal disruption to customers and staff. The types of tasks and objectives are summarised in the following table.

22 Assessing processes and outcomes of the 2004 Local Government Boundary Changes in NSW, Jeff Tate Consulting
23 Report to Local Government Commission on Wellington Reorganisation Transition Costs, Stimpson & Co., 28 November 2014

Governance	• Developing democratic structures (council committees) • Establishing the systems and processes to service and support the democratic structure • Developing the governance procedures and corporate policy and procedures underlying elected member and staff delegations • Developing the organisational structure of the new organisation
Workforce	• Developing the workforce-related change management process including new employment contracts, location and harmonisation of wages • Establishing the Human Resource capacity for the new entity and ensuring all policies, processes and systems are in place for Day 1 • Ensuring that positions required
Finance and Treasury	• Ensuring that the new entity is able to generate the revenue it needs to operate • Ensuring that the new entity is able to satisfy any borrowing requirements • Ensuring the new entity is able to procure goods and services • Developing a methodology for interim rates billing and a strategy for rates harmonisation • Developing a plan for continued statutory and management reporting requirements • Developing a financial framework that complies with legislative requirements
Business Process	• Planning and managing the integration and harmonisation of business processes and systems for Day 1 including customer call centres, financial systems, telephony systems, office infrastructure and software, payroll, consent processing etc. • Developing an initial ICT strategy to support the Day 1 operating environment that includes the identification of those processes and systems that require change • Developing a longer term ICT strategy that provides a roadmap for the future integration and harmonisation of business processes and systems beyond Day 1
Communications	• Ensuring that appropriate communication strategies and processes are in place for the new entity • Developing a communication plan for the transition period that identifies the approach to internal and external communication to ensure that staff and customers are kept informed during the transition period
Legal	• Ensuring any legal risks are identified and managed for the new entity • Ensuring that existing assets, contracts etc. are transferred to the new entity • Ensuring all litigation, claims and liabilities relevant to the new entity are identified and managed
Property and Assets	• Ensuring that all property, assets and facilities are retained by the new entity and are appropriately managed and maintained • Ensuring the ongoing delivery of property related and asset maintenance services are not adversely impacted on by the reorganisation • Facilitating the relocation of staff accommodation requirements as required for Day 1
Planning Services	• Ensuring the new entity is able to meet its statutory planning obligations from Day 1 and beyond • Ensuring that the entity is able to operate efficiently and staff and customers understand the planning environment from Day 1 • Developing a plan to address the statutory planning requirements beyond Day 1

Regulatory Services	• Ensuring that Day 1 regulatory requirements and processes including consenting, licensing and enforcement activities under statute are in place • Ensuring that business as usual is able to continue with minimum impact to customers from Da1 and beyond
Customer Services	• Ensuring no reduction of the customer interaction element – either face to face, by phone, e-mail or in writing from Day 1 and beyond • Ensuring no customer service system failures on Day 1 and beyond • Ensuring that staff and customers are well informed for Day 1 and beyond
Community Services	• Ensuring that the new entity continues to provide community services and facilities • Ensuring that current community service grant and funding recipients have certainty of funding during the short term

Note - This is not an exhaustive list but provides an indication of the type of work that needs to be undertaken during the transition period.

The transition costs are those costs incurred, during the period of transition, to enable the establishment of the new entity and to ensure that it is able to function on Day 1. The estimated transition costs for establishment of a new entity are discussed below.

4.1 Transition body ($9 million)

In the case of Auckland, the ATA was established to undertake the transition from nine councils to one entity. In order to undertake the transition the ATA employed staff and contractors and it had other operational costs such as rented accommodation, ICT and communications. The cost of the ATA in 2009 was reported at $36 million and it is important to note that a substantial number of staff were seconded to the ATA from the existing councils to assist with undertaking the transition tasks. The cost of these secondments and support costs was at the cost of the existing councils and not the ATA.

The work undertaken for the reorganisation of Wellington identified the cost of the transition body as $20.6 million[24] and on the assumption of FTEs to transition body costs for Wellington, the estimated cost of the transition body for the merger options is $6.8 – $10 million. This figure may be understated and is dependent on the governance structure adopted and other unknown factors that may influence the cost of the transition body. The cost of staff secondment and support costs from existing councils to the transition body is not included in the cost estimate.

4.2 ICT ($53 to $75 million)

The costs associated with ICT for the new entity relate to rationalising the existing councils ICT infrastructure, business applications, security and end user support for the single entity. The full rationalisation of IT systems based on other amalgamation experience will not occur for Day 1 of the new entity and could take anywhere between three to five years to finalise depending on the complexities of the preferred system. However there are some critical aspects for the new entity to function on Day 1 including the ability to make and receive payments, procurement and manage staff so there are ICT costs incurred during the transition.

Estimating the costs for ICT is inherently difficult due to the complexities associated with integrating systems and applications, and not knowing what the new entity may decide on as a future system. With the limited time to undertake this report the ICT costs have thus been based on the proposed Wellington reorganisation and tested against other potential merges of different

[24] Report to Local Government Commission on Wellington Reorganisation Transition Costs, Stimpson & Co., 28 November 2014

sizes. A number of ICT scenarios were explored by Deloitte[25] for Wellington and the WNTA scenario most closely resembles the merger options. Scaling these costs based on the size of the merger options provides an estimated ICT cost of between $30 million and $75 million. The estimated cost are spread across the initial years of the councils operations with the majority falling in the first two years.

Given the respective size of the councils and the populations they serve in the context of the studies cited it is considered that the most likely costs are in the middle.

4.3 Business Process (existing Council budget)

As part of ensuring the entity is functional on Day 1 is the requirement to redesign the business processes of the existing councils to one that integrates with the ICT systems. This would include the likes of consents, licensing and forms to replace that of the four existing councils. In the case of Auckland these tasks were largely undertaken by staff seconded to the transition body, the cost of which was not identified as it was a cost picked up by the nine existing councils.

4.4 Branding ($2 million)

The new entity will require its own branding and as part of this a new logo will need to be designed. Once agreed there will be a need to replace the existing signage of the four councils for Day 1 of the new entity on buildings, facilities and vehicles. In addition it will be necessary to replace the existing staff uniforms, letterheads, brochures, forms and other items. The estimated cost for branding is $1 – $2 million based on other amalgamation experience.

4.5 Redundancy Costs ($1.9 million)

Through the transition period the Tier 1 and Tier 2 positions would be made redundant and based on employment contracts with a redundancy period of 38 weeks, the one off cost of redundancies is estimated at between $630,000 and $1.5 million based on the Councils' respective Annual Reports 2013/14.

4.6 Remuneration Harmonisation ($2.3 million)

The remuneration, terms and conditions for staff would need to be reviewed as part of the transition as there is currently a variation in pay rates and conditions across the three councils. In order to estimate the cost of wage parity for moving to a single entity, the average employee costs for similar sized councils have been compared to that of the four councils as well as between the councils.

4.7 Elections ($0 million)

There is a possibility of proportional savings in existing council budgets as instead of four separate elections there will be one for the new entity. However the costs of the election are likely to be higher than for future elections as there will need to be additional communication and information provided to voters to inform them of the new arrangements. The costs will also be dependent on the future governance structure, as was the case in the Auckland amalgamation the election costs were more than the budgeted amounts from the previous councils. For the purposes of the transition costs, no additional budget has been allowed for assuming there is sufficient budget in the three councils.

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[25] Wellington Local Government Reorganisation Options – Transition Costs and Benefits for Technology Changes, Deloitte, September 2014