Independent Pricing and Regulatory Tribunal

Assessment of Council Fit for the Future Proposals

Local Government — Final Report
October 2015

IPART
New South Wales

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Summary

The NSW Government has asked IPART to undertake the role of the Expert Advisory Panel in assessing local government Fit for the Future (FFTF) proposals.[1] The FFTF reforms aim to improve the strength and effectiveness of local government in providing services and infrastructure that communities need.[2]

This report sets out our assessment of whether local councils are fit or not fit for the future based on the proposals submitted. In undertaking the assessments we have used the Independent Local Government Review Panel's (ILGRP's) options for reform as a starting point for our analysis.

The NSW Government has announced that councils which are assessed as fit will have access to a range of benefits including a streamlined rate variation process, a State Government borrowing facility, priority for other government funding and grants, and eligibility for additional devolved planning powers.[3] Funding will also be provided by the NSW Government to assist with the transitional costs of merging, establishing regional Joint Organisations (JO), and assisting regional and rural councils.[4]

The assessments will now be considered by the NSW Government in determining the next stage of the reform process.

Key findings

We received 139 local council proposals from 144 councils including:

- four Merger Proposals (involving nine councils)
- 115 Council Improvement Proposals, and
- 20 Rural Council Proposals.[5]

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1 The NSW Government's terms of reference for the review is at Appendix A.

2 Office of Local Government (OLG), *Fit for the Future – A roadmap for Stronger, Smarter Councils*, September 2014, p 15.

3 OLG, *Fit for the Future – A roadmap for Stronger, Smarter Councils*, September 2014, pp 14-15.

4 Ibid.

5 Council proposals can be found on the IPART website at www.ipart.nsw.gov.au

We assessed 52 proposals as being fit for the future, which represents 37% of the proposals received.[6] To be assessed as fit, councils must have demonstrated they have sufficient scale and capacity and are financially sustainable.

All four Merger Proposals we received were assessed as fit because they:

- would deliver substantial benefits to their local communities when compared to the councils standing alone, and
- were generally the best available options for the relevant councils as neighbouring councils did not elect to join the Merger Proposals.

We assessed 87 proposals as not being fit for the future, which represents 63% of the proposals received.

Of the 87 proposals assessed as not fit:

- 60 were assessed as not having sufficient scale and capacity, but did meet the financial criteria
- 18 were assessed as having sufficient scale and capacity, but did not meet the financial criteria, and
- 9 were assessed as not having sufficient scale and capacity and not meeting the financial criteria.

The main reasons for councils being assessed as not having sufficient scale and capacity were because:

- A merged entity would have greater scale and strategic capacity to better partner with other levels of government in providing key infrastructure and social services.
- A merged entity could better integrate planning and development, resulting in improved planning decisions and enhanced economic growth.
- The merger option and the business case for the merger commissioned by the council showed substantial gains. Despite this, most councils did not submit a Merger Proposal.
- Our analysis and the analysis undertaken by our independent economic consultants, Ernst & Young, indicated the merger option would provide large net benefits to the local communities.
- The council's proposal to remain a stand-alone council was not at least as good as the preferred merger option.
- The efficiency improvements in the council's proposal could be realised under the merger option, and the merger option could provide significant further benefits to residents.

6 Details of the assessment for each council can be found in Chapter 2 and Appendix C.

In addition to these reasons, in non-metropolitan areas, a number of councils were assessed as not having sufficient scale and capacity because the council's population is declining or static and is forecast to be below 10,000 by 2031. A population of this size would be likely to affect a council's efficiency and strategic capacity to meet the future needs of its community.

For both Metropolitan Sydney and non-metropolitan councils, the main reason councils did not meet the financial criteria was generally because they forecast an operating deficit throughout the period, including in the benchmark year of 2019-20, and other factors suggest the council has a weak financial position.[7]

As discussed further below, most Metropolitan Sydney councils were assessed as not fit because they did not demonstrate they had sufficient scale and capacity. In contrast, in non-metropolitan areas, a number of councils were assessed as not fit as they did not meet the financial criteria.

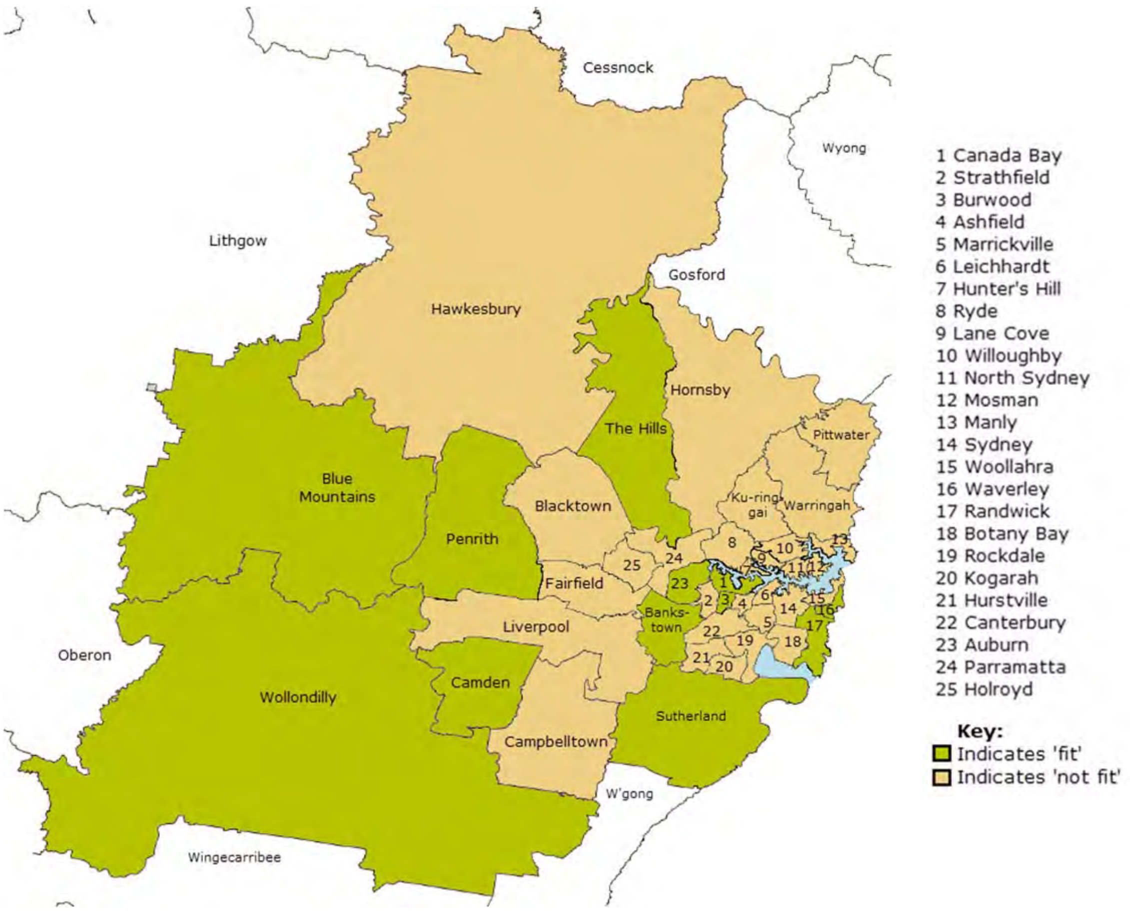
The assessment for each council can be found in Tables 1 to 7 below.

Metropolitan Sydney

In Metropolitan Sydney, we received 38 proposals, which included two Merger Proposals and 36 Council Improvement Proposals. As set out in Figure 1 below, we assessed 9 proposals as fit and 29 proposals as not fit in Metropolitan Sydney.

7 For rural councils (councils in OLG Groups 8 to 11 and those choosing to submit a Rural Council Proposal) the benchmark year for the operating performance ratio was 2024-25. However, for all other measures and councils the benchmark year was 2019-20.

Figure 1 Metropolitan Sydney assessments



Metropolitan Sydney: Merger Proposals

We received Merger Proposals from:

- Randwick City Council (Randwick) and Waverley Council (Waverley), and
- Auburn City Council (Auburn), Burwood Council (Burwood) and City of Canada Bay Council (Canada Bay).

We have assessed the merger of Randwick and Waverley as fit because the merger:

- Would deliver substantial benefits to their local communities when compared to the councils standing alone.
- Does not preclude the ILGRP's preferred option of a Global City Council should this merger be adopted. However, we note Waverley and Randwick have indicated they do not support a merger with the Council of the City of Sydney (City of Sydney).

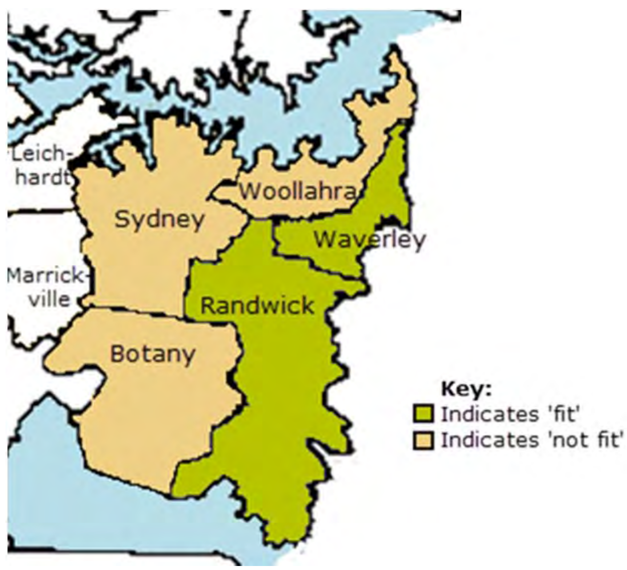
- Was the best available option for these councils given neighbouring councils did not elect to join the Merger Proposal.
- Builds on existing collaborations between Waverley and Randwick, which share communities of interest and similar geography.

Nonetheless, we observe that greater benefits would be realised from including the other neighbouring councils in this merger, including Woollahra Municipal Council (Woollahra), City of Botany Bay Council (Botany Bay), and the City of Sydney, should the Government adopt the Global City Council option.

Over a 20-year timeframe, Ernst & Young's analysis suggests:

- a merger of Randwick and Waverley could provide net present value (NPV) benefits of $99 million
- a merger of Randwick, Waverley, Woollahra and Botany Bay could provide NPV benefits of $218 million, while
- a merger of Randwick, Waverley, Woollahra, Botany Bay and City of Sydney to form a Global City Council could provide NPV benefits of $283 million.

Figure 2 Global City Council



We have also assessed the Merger Proposal from Auburn, Burwood and Canada Bay as fit because the merger:

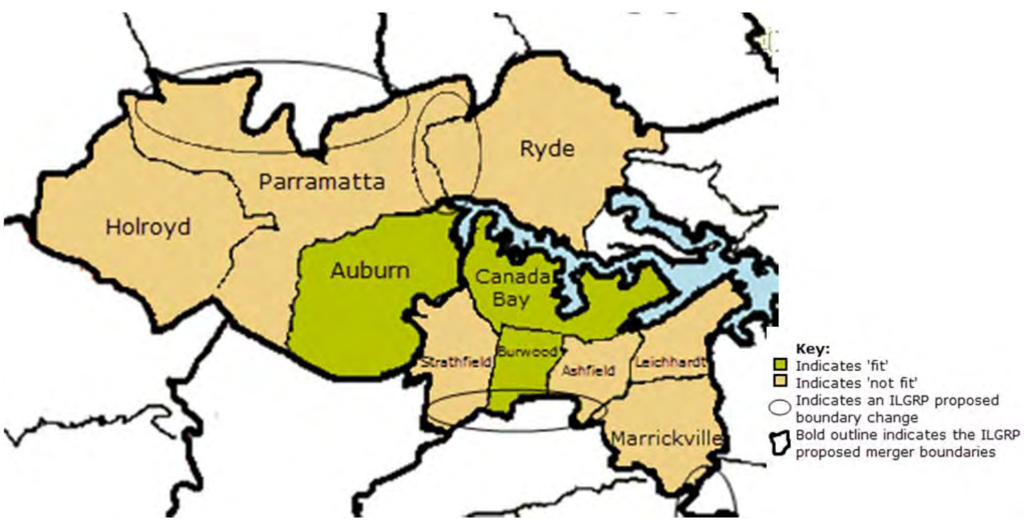
- Would deliver substantial benefits to their local communities when compared to the councils standing alone.
- Is forecast to improve the operating performance of the councils compared with each council standing alone, and in the absence of rate increases.
- Was the best available option for these councils given neighbouring councils did not elect to join the Merger Proposal.

This merger is consistent with the NSW Government's *Fit for the Future – A roadmap for Stronger, Smarter Councils*, which identifies voluntary mergers as an option to become FFTF.[8] As noted above, the Government is also providing incentives and support to enable councils to pursue voluntary mergers.[9]

We understand Auburn, Burwood and Canada Bay consider the Merger Proposal would result in better outcomes for the community with Strathfield Municipal Council (Strathfield) included and they are advocating for its inclusion in the merger.

Over a 20-year timeframe, our analysis, using information provided by the councils, suggests a merger of Auburn, Burwood and Canada Bay could provide NPV benefits of $114 million. A merger which includes Strathfield is likely to yield additional benefits.

Figure 3 Auburn, Burwood and Canada Bay merger proposal



8 OLG, *Fit for the Future – A roadmap for Stronger, Smarter Councils*, September 2014, p 10.

9 Ibid.

Metropolitan Sydney: City of Sydney

City of Sydney submitted a Council Improvement Proposal to remain a stand-alone council. City of Sydney meets the financial criteria overall as a stand-alone council and its current and projected financial performance is strong. It also demonstrated it has the ability to proactively partner with the government to undertake significant infrastructure and urban renewal projects, such as the Green Square development.

However, we have assessed City of Sydney as not meeting the scale and capacity criterion against the Global City Council option, and therefore as not fit.

A Global City Council may better integrate planning and development across the eastern suburbs and central Sydney as the central business district (CBD) expands. It would also provide for better partnering with other levels of government for key infrastructure, such as the Sydney Light Rail Project and the second Sydney Harbour rail crossing.

Should the Government adopt the Global City Council option, the following issues might require consideration:

- The extent to which the Global City Council should be given control over key infrastructure such as the Sydney Opera House, Barangaroo, Port Botany, Circular Quay and Darling Harbour to enable it to operate effectively as a Global City Council, as this infrastructure is currently administered by bodies separate to local councils.
- How to ensure the development and growth of the CBD and surrounding areas continues. This may require changes and enhancements to the *City of Sydney Act 1988*. In addition, the implications for business voting within the Global City Council may need to be considered, as the *City of Sydney Act 1988* will allocate two votes to businesses in local council elections in the City of Sydney from 2016.
- Measures to ensure the significant council revenues generated from businesses in the Sydney CBD are spent efficiently to realise the key objectives of the Global City Council.

If the Global City Council option is not adopted, City of Sydney has sufficient scale and capacity to stand alone and would be fit as a stand-alone council.

Metropolitan Sydney: Council Improvement Proposals

Of the 36 Council Improvement Proposals we received in Metropolitan Sydney (including City of Sydney), we assessed seven as fit and 29 as not fit.

Councils assessed as fit

We assessed seven Council Improvement Proposals as fit in Metropolitan Sydney. All of these councils are in Outer Metropolitan Sydney, other than Bankstown City Council. These councils include:

- Bankstown City Council
- Blue Mountains City Council
- Camden Council
- The Hills Shire Council
- Penrith City Council
- Sutherland Shire Council, and
- Wollondilly Shire Council.

These councils were assessed as fit because:

- remaining a stand-alone council was consistent with the ILGRP's preferred option, or
- our analysis did not identify a merger alternative that was better than remaining a stand-alone council, and
- they met the financial criteria overall.

In the case of Blue Mountains City Council and Wollondilly Shire Council, whilst their current financial performance is poor, their projected financial performance shows significant improvement. This is due primarily to recently approved large special variations which increased the general income Blue Mountains City Council and Wollondilly Shire Council can collect from their communities, by 28.5% and 38.8% respectively above the rate peg, over the next few years.

In the case of Camden Council, the council is managing large increases in its population which has adversely affected its short term financial performance. We have taken this into account in undertaking the assessment against the financial criteria and have assessed it as meeting the financial criteria overall.

Councils assessed as not fit due to insufficient scale and capacity

We assessed all Inner Metropolitan Sydney councils that had a preferred merger option, but submitted a stand-alone proposal, as not fit, as they did not meet the scale and capacity criterion. As outlined in Table 2 below, we assessed 26 of the 36 Council Improvement Proposals in Metropolitan Sydney as not fit, because the alternative merger option identified and considered in business cases by the councils showed substantial gains that were greater than each council remaining a stand-alone council. For these councils, it is likely that structural changes would be required to enable these councils to be assessed as meeting the scale and capacity criterion.

The ILGRP's preferred mergers could provide a range of benefits to the community including:

- more effective and efficient service delivery
- improved delivery of major infrastructure
- more integrated strategic planning and policy development
- more effective partnering with government, and
- stronger advocacy for local communities.

In addition to these benefits, our indicative analysis suggests \$1.8 billion to \$2.0 billion in NPV benefits could be realised over 20 years if the ILGRP's preferred Metropolitan Sydney mergers occurred. This analysis was undertaken by using the merger business cases provided by councils and estimating the NPV benefits using a consistent 20-year timeframe and discount rate.[10]

We have also commissioned Ernst & Young to develop its own estimates of the potential financial benefits of the Metropolitan Sydney mergers. This analysis indicated \$1.3 billion in NPV benefits could be realised over 20 years. The differences between IPART's estimates and Ernst & Young's estimates represent differences in the assumptions and methodologies used by the councils' consultants and Ernst & Young. However, both estimates suggest substantial net financial gains are likely to arise from these mergers.

Some councils, such as Hornsby Shire Council and Warringah Council, supported the ILGRP's proposed reforms, but were unable to submit a Merger Proposal as they could not reach agreement with neighbouring councils to merge.

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10 A discount rate of 9.5% nominal (7% real) was used in the IPART estimates, with an assumption that the merger takes effect from 2016-17. We note the merger business cases commissioned by councils, which formed the basis of the IPART estimates, have been undertaken by a range of different consultants, using different assumptions, methodologies and timeframes. As a result, our estimates have recalculated the NPVs for these business cases using a consistent 20-year timeframe and discount rate.

A number of councils commissioned business cases of alternative merger options and structural changes to those identified by the ILGRP. Some of these alternative merger options showed there could be substantial benefits from these options. However, despite these potential gains, most Metropolitan Sydney councils did not submit a Merger Proposal.

Hunter's Hill Council, Lane Cove Municipal Council and City of Ryde Council submitted a proposal for a Joint Regional Authority (JRA) as an alternative to a merger. Under the proposed JRA, the councils would share services and centralise planning and development. Our analysis suggests the preferred merger, which would also include Mosman Municipal Council, North Sydney Council and Willoughby City Council, would improve the capacity of the relevant councils to partner effectively with government and undertake strategic planning and development for the Lower North Shore region. The JRA is also likely to provide a lower level of efficiency savings compared to the large gains available from the preferred merger of $280 million over 20 years on a NPV basis.[11] As we assessed standing alone in the proposed JRA would not be as good as, or better than, the preferred merger, we assessed Hunter's Hill Council, Lane Cove Municipal Council and City of Ryde Council as not meeting the scale and capacity criterion, and not fit.

Councils assessed as not fit due to not meeting the financial criteria

We assessed three Council Improvement Proposals in Metropolitan Sydney as not fit because they did not demonstrate they met the financial criteria overall. These councils are all in Outer Metropolitan Sydney and include:

- Blacktown City Council
- Campbelltown City Council, and
- Hawkesbury City Council.

As these councils were assessed as satisfying the scale and capacity criterion, strategies to improve their financial performance should enable them to become fit. This could include measures to promote financial sustainability, by reducing costs and increasing revenues. However, the strategies that could be adopted will depend on each council's circumstances and the Government's priorities.

In general, most Metropolitan Sydney councils demonstrated their current and forecast financial performance was relatively strong.

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11 This analysis was based on a business case jointly commissioned by Lane Cove Municipal Council, Hunter's Hill Council, City of Ryde Council, Mosman Municipal Council and Willoughby City Council. North Sydney Council was also part of the preferred ILGRP merger, but was not involved in the commissioning of this business case.

Non-metropolitan councils

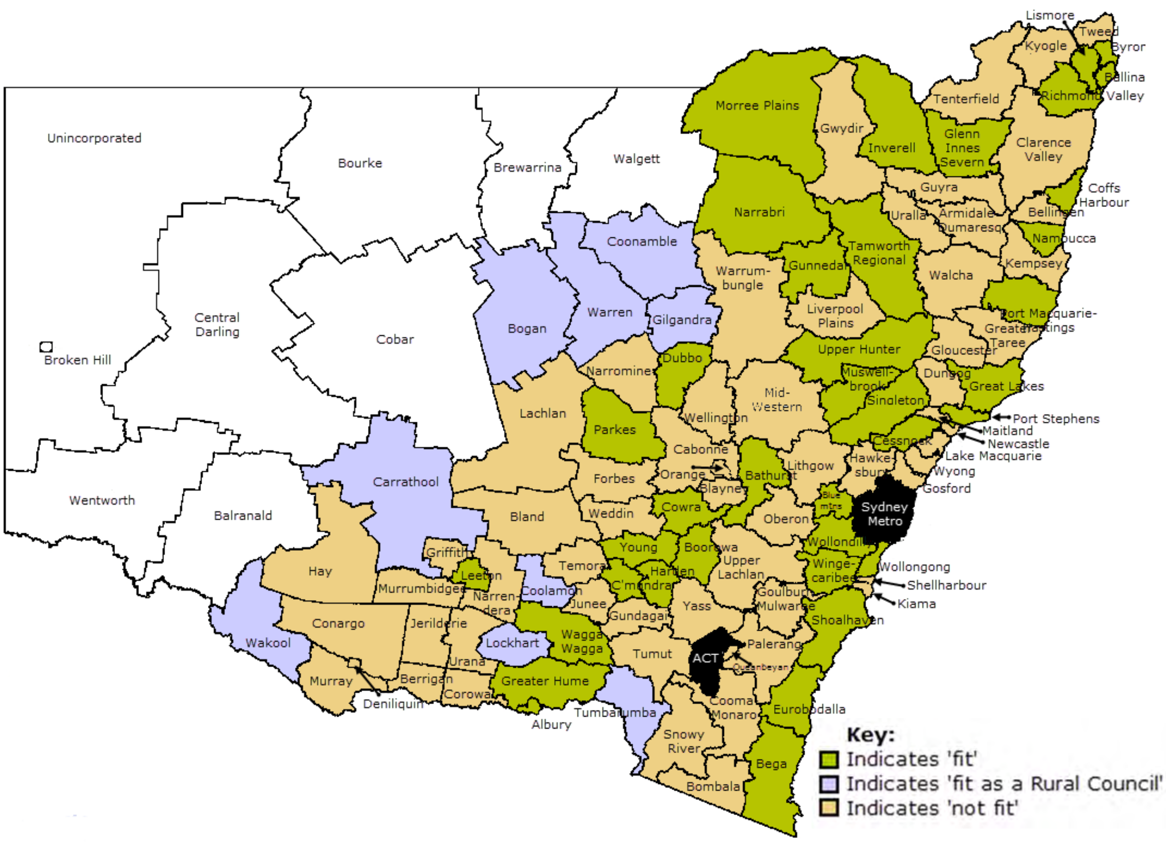
Outside of Metropolitan Sydney, we received:

- 2 Merger Proposals
- 79 Council Improvement Proposals, and
- 20 Rural Council Proposals.

As set out in Figure 4 below, of these 101 proposals:

- 43 proposals were assessed as fit (including nine Rural Council Proposals which were assessed as fit as Rural Councils), and
- 58 proposals were assessed as not fit for the future.

Figure 4 Non-metropolitan assessments



Non-metropolitan councils: Merger Proposals

We received Merger Proposals from:

- Young Shire Council (Young) and Boorowa Council (Boorowa). This Merger Proposal also included Harden Shire Council without its agreement.
- Cootamundra Shire Council (Cootamundra) and Harden Shire Council (Harden).

We assessed both these Merger Proposals as fit because:

- the mergers would deliver substantial benefits to their local communities when compared to the councils standing alone
- the proposed merger populations are projected to be consistent with the ILGRP's rule of thumb of close to or above 10,000 for non-metropolitan council populations by 2031, and
- in the case of Young and Boorowa, it was the best available option for these councils given neighbouring councils did not wish to join the Merger Proposal.

Our assessment of fit for the Young and Boorowa Merger Proposal is dependent on Young and Boorowa resolving to merge in the absence of Harden. In the event agreement cannot be reached, we find the councils are deemed not fit, as they have not demonstrated scale and capacity as stand-alone councils.

Over a 20-year timeframe, our analysis, based on information provided by the merging councils, suggests:

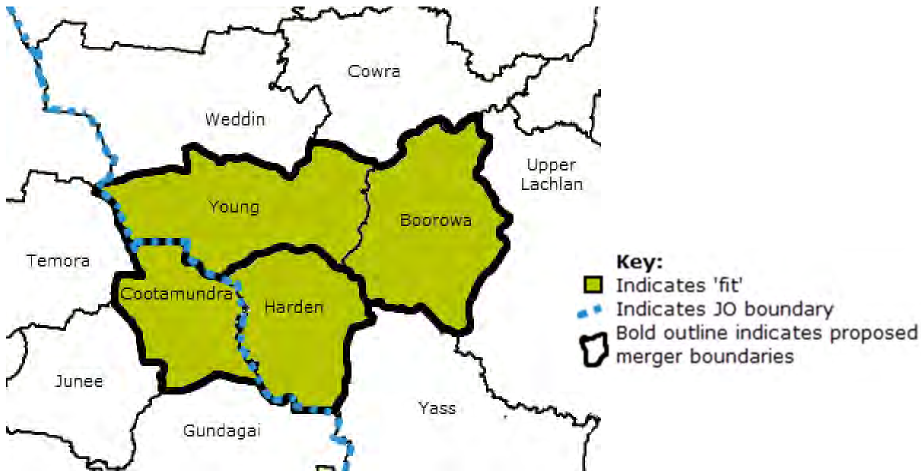
- a merger of Young and Boorowa could provide benefits of $31 million on a NPV basis,[12] while
- a merger of Cootamundra and Harden could provide benefits of $11 million on a NPV basis.[13]

Young has indicated it supports a four-way merger between Young, Boorowa, Harden and Cootamundra. However, Cootamundra has rejected this option on the basis that it changes the focus of Cootamundra and the southern half of Harden away from the Riverina region. Based on the information provided by the councils we consider a four-way merger is likely to deliver larger gains to the community than the current two Merger Proposals.

12 This NPV is based on an estimate by IPART using the business case provided by Young and Boorowa in their Merger Proposal.

13 This NPV is based on an estimate by IPART using the business case provided by Cootamundra and Harden in their Merger Proposal.

Figure 5 Merger proposals from Young/ Boorowa and Cootamundra/Harden



Non-metropolitan councils: Council Improvement Proposals

In relation to the 79 Council Improvement Proposals we received in non-metropolitan areas, we assessed 32 as fit and 47 as not fit.

Councils assessed as fit

We assessed 32 Council Improvement Proposals as fit in non-metropolitan areas. The councils that were assessed as fit are spread across all regions in NSW. These councils were generally assessed as fit because:

- remaining a stand-alone council was consistent with the ILGRP's options for reform or
- our analysis has not identified evidence for a better alternative to the council's proposal to stand alone, and
- they met the financial criteria overall.

Councils in non-metropolitan areas were generally more likely to meet the scale and capacity criterion than councils in Metropolitan Sydney. This is because the ILGRP identified fewer preferred merger options in non-metropolitan areas. Councils that did not have a preferred merger option were still required to explore the merger option. However, these councils were not required to demonstrate that standing alone was as good as, or better than, the merger option. As a result, less evidence was required from councils in non-metropolitan areas in relation to these merger options.

We also observe the efficiency gains from enhanced service delivery, integrated planning and development, and partnering with other levels of government in non-metropolitan areas will typically not be as large relative to those in Metropolitan Sydney.

Councils assessed as not fit due to insufficient scale and capacity

We assessed 28 Council Improvement Proposals in non-metropolitan areas as not fit because they did not have sufficient scale and capacity. This was generally because:

- the alternative merger option showed substantial gains that were greater than the council remaining a stand-alone council, or
- the council's population was forecast to decline to below 10,000 by 2031, which would be likely to undermine its scale to efficiently deliver services to the local community, and its long term strategic capacity to partner with other levels of government.

It is likely structural changes would be needed to enable these councils to be assessed as meeting the scale and capacity criterion.

Councils assessed as not fit due to not meeting the financial criteria

We assessed 13 Council Improvement Proposals as not fit in non-metropolitan areas as they did not meet the financial criteria overall. For these councils, improvements to their financial performance could enable them to become fit. For example, this could include measures to reduce costs through structural changes or by sharing services with neighbouring councils. However, as noted above, the appropriate strategies for each council will depend on their circumstances and the Government's policies.

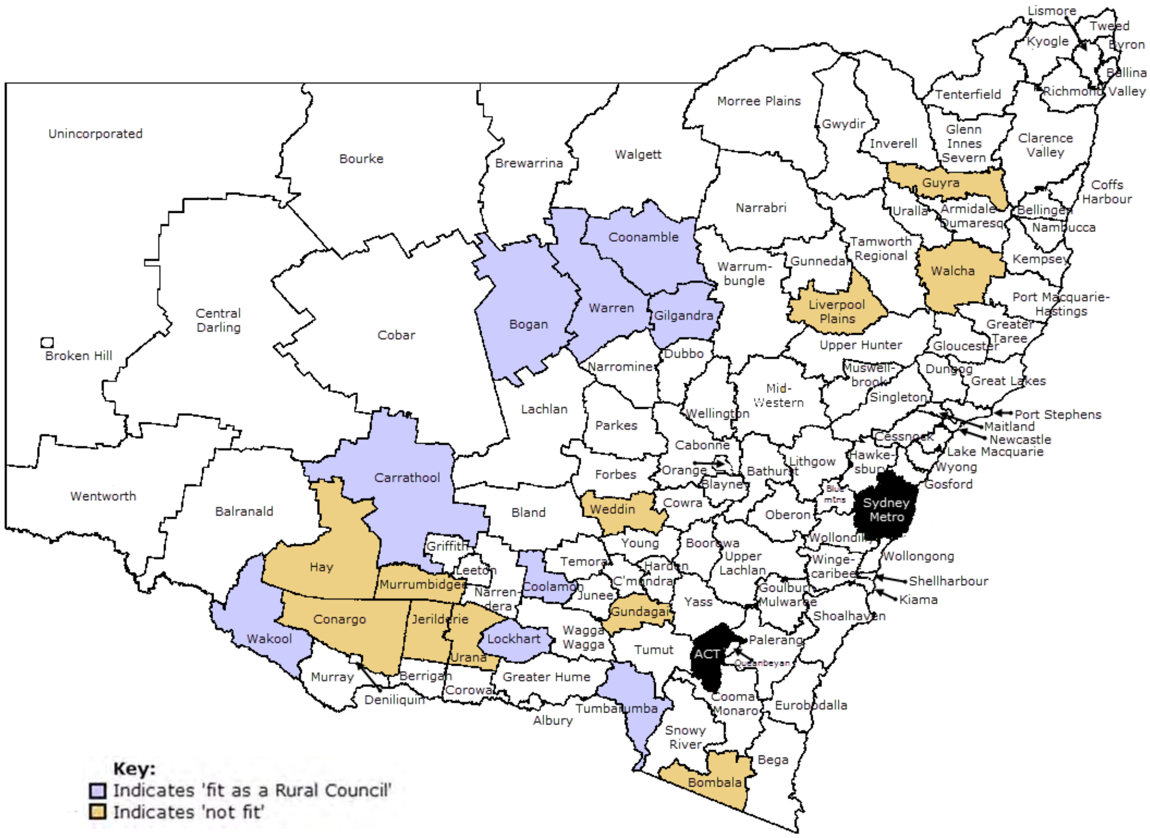
Councils assessed as not fit due to not meeting the financial criteria and insufficient scale and capacity

We assessed six Council Improvement Proposals in non-metropolitan areas as not fit because they did not meet both the scale and capacity criterion and the financial criteria overall. For these councils, both structural changes and improvements to financial performance may be required to enable these councils to become fit.

Non-metropolitan councils: Rural Council Proposals

In relation to the 20 Rural Council Proposals we received, we assessed nine proposals as being fit as Rural Councils and 11 proposals as not fit. Figure 6 sets out a map outlining the councils which submitted Rural Council Proposals and the assessments for these councils.

Figure 6 Rural Council Proposals assessments



To be assessed as meeting the scale and capacity criterion, and fit as a Rural Council, councils were required to demonstrate:

- they met the majority of the Rural Council Characteristics, including they had limited options for mergers, and
- how they planned to achieve real change and improve their capacity and sustainability.

Councils were also required to demonstrate they met the financial criteria overall to be assessed as fit. However, rural councils were provided with greater flexibility in meeting some of the measures for these criteria, as were all OLG Group 8 to 11 councils.

The assessment of Rural Councils as meeting the scale and capacity criterion is contingent on the Government adopting a Rural Council Model. This model is based on reducing the regulatory and compliance burden on Rural Councils, by the JO performing most of the higher level functions of the Rural Council. If a Rural Council model is not adopted, it is likely that most Rural Councils would be assessed as not meeting the scale and capacity criterion, and as a result, not fit.

Under such circumstances, structural changes would be required to enable these councils to become fit.

We assessed 11 Rural Council Proposals as not fit. Of these 11 Rural Council Proposals:

- Six proposals did not meet the scale and capacity criterion. This was because in most cases there was an alternative merger option that showed substantial gains that were greater than the council standing alone as a Rural Council.
- Two proposals did not meet the financial criteria overall.
- Three proposals did not meet either the scale and capacity criterion or the financial criteria overall.

For the councils that did not meet the financial criteria overall, it is likely substantial changes would be required to enable these councils to become fit. This is because these councils did not meet the financial criteria overall, in spite of the greater flexibility provided to rural councils under the assessment approach.

What process have we followed?

Consistent with the NSW Government's Terms of Reference and our Methodology Paper[14], we assessed the council proposals against the following criteria:

1. scale and capacity to engage effectively across community, industry and governments, and
2. sustainability
3. effectively managing infrastructure and delivering services for communities
4. efficiency.

The NSW Government has established the 'scale and capacity' criterion as the threshold criterion for councils, which requires councils to meet this criterion to be assessed as fit. Further, councils must also meet the remaining three financial criteria on an overall basis to be assessed as fit.

[14] Our final methodology paper for this review was published on 5 June 2015. See: IPART, *Methodology for Assessment of Council Fit for the Future Proposals - Methodology Paper,* June 2015.

What does the rest of this report cover?

The report is structured as follows:

- Chapter 1 discusses our approach to the assessments and the proposals we received
- Chapter 2 outlines the assessments for each council on a regional basis
- Chapter 3 sets out monitoring and reporting issues on FFTF projections
- Appendix A sets out the NSW Government's Terms of Reference
- Appendix B outlines the FFTF financial criteria and issues we have considered in assessing proposals against the financial criteria
- Appendix C provides further detail on the assessment for each council against the FFTF criteria
- Appendix D provides further detail on the merger business cases
- Appendix E includes Ernst & Young's consultant report on the benefits of the Metropolitan Sydney mergers.

Assessment of councils: Metropolitan Sydney councils

Table 1 Metropolitan Sydney Merger Proposals

Councils	ILGRP preferred option	Assessment
Randwick City and Waverley	**Merge to form a Global Sydney council**	Fit
Auburn City Burwood City of Canada Bay	**Auburn to merge with Holroyd, Parramatta, Ryde (part) and The Hills (part);** **Burwood and Canada Bay to merge with Ashfield, Leichhardt, Marrickville and Strathfield**	Fit

Note: Bold indicates an ILGRP preferred option.

Table 2 Inner Metropolitan Sydney Councils

Region	ILGRP preferred option	Councils	Assessment
Global City	**Amalgamate with Randwick City and Waverley Council**	City of Botany Bay	Not fit
		City of Sydney	Not fit as a Global City Council
		Woollahra Municipal	Not fit
Inner West	**Amalgamate with City of Canada Bay and Burwood**	Ashfield	Not fit
		Leichhardt Municipal	Not fit
		Marrickville	Not fit
		Strathfield	Not fit
West Central	**Amalgamate with Auburn, City of Ryde (part) and The Hills (part)**	Holroyd City	Not fit
		Parramatta City	Not fit
Lower North Shore	**Amalgamate**	Hunter's Hill	Not fit
		Lane Cove	Not fit
		Mosman Municipal	Not fit
		North Sydney	Not fit
		City of Ryde	Not fit
		Willoughby City	Not fit
Northern Suburbs	**Amalgamate**	Hornsby Shire	Not fit
		Ku-ring-gai	Not fit
Northern Beaches	**Amalgamate**	Manly	Not fit
		Pittwater	Not fit
		Warringah	Not fit
South West	**Amalgamate**	Fairfield City	Not fit
		Liverpool City	Not fit
Southern	**Amalgamate**	City of Canterbury	Not fit
		Hurstville City	Not fit
		Kogarah City	Not fit
		Rockdale City	Not fit
Bankstown	**No change**	Bankstown City	Fit

Note: Bold indicates an ILGRP preferred option.

Table 3 Outer Metropolitan Sydney Councils

Council	ILGRP preferred option	Assessment
Blacktown City	**No change**	Not fit
Blue Mountains City	**No change**	Fit
Camden	**No change**	Fit
Campbelltown City	**No change**	Not fit
Hawkesbury	**No change**	Not fit
Penrith City	**No change**	Fit
Sutherland Shire	**No change**	Fit
The Hills Shire	**No change**	Fit
Wollondilly Shire	**No change**	Fit

Note: Bold indicates an ILGRP preferred option.

Assessment of councils: Non- metropolitan councils

Table 4 Non- metropolitan Merger Proposals

Councils	ILGRP preferred option	Assessment
Young Shire and Boorowa	**Merge with Boorowa, Harden and Young**	Fit
Cootamundra Shire and Harden Shire*	**Merge with Boorowa and Young**	Fit

Notes: Bold indicates an ILGRP preferred option. *The ILGRP did not have a preferred option for Cootamundra.

Table 5 Hunter, Central Coast and Illawarra Councils

Region	Council	ILGRP options	Assessment
Hunter	Cessnock City	Council in JO	Fit
	Dungog Shire	**Merge with Maitland** or Council in JO[a]	Not fit
	Lake Macquarie City	**Amalgamate with Newcastle** or Council in JO[a]	Not fit
	Maitland City	**Merge with Dungog** or Council in JO[a]	Not fit
	Muswellbrook Shire	Council in JO	Fit
	Newcastle City	**Amalgamate with Lake Macquarie** or Council in JO [a]	Not fit
	Port Stephens	Council in JO	Fit
	Singleton	Council in JO	Fit
	Upper Hunter Shire	Council in JO	Fit
Central Coast	Gosford City	Amalgamate with Wyong or a multi-purpose JO (no separate water corporation until other options properly evaluated)	Not fit
	Wyong City	Amalgamate with Gosford or a multi-purpose JO (no separate water corporation until other options properly evaluated)	Not fit
Illawarra	Kiama Municipal	Council in a JO (if future amalgamation – with Shoalhaven, noting its inclusion in South East-Tablelands region)	Not fit
	Shellharbour City	Council in a JO (amalgamate if future options need to be revisited)	Not fit
	Wollongong City	Council in a JO (amalgamate if future options need to be revisited)	Fit

[a] Possible boundary change included.

Notes: Bold indicates an ILGRP preferred option. JO stands for Joint Organisation.

The ILGRP did not include a table of options for the Hunter, Central Coast and Illawarra regions. Instead, the ILGRP included a discussion of these councils in its report.

Table 6 Non- metropolitan councils[15]

Region	Council	ILGRP options	Assessment
Northern Rivers	Ballina Shire	Council in Northern Rivers JO	Fit
	Byron Shire	Council in Northern Rivers JO	Fit
	Lismore City	Council in Northern Rivers JO or merge with Kyogle	Fit
	Richmond Valley	Council in Northern Rivers JO or merge with Kyogle	Fit
	Tweed Shire	Council in Northern Rivers JO	Not fit
North Coast	Bellingen Shire	Council in North Coast JO	Not fit
	Clarence Valley	Council in North Coast JO	Not fit
	Coffs Harbour City	Council in North Coast JO	Fit
	Nambucca Shire	Council in North Coast JO	Fit
Mid-North Coast	Gloucester Shire	Council in Mid-North Coast JO or merge with Great Lakes and/or Greater Taree	Not fit
	Great Lakes Shire	Council in Mid-North Coast JO or merge with Gloucester	Fit
	Greater Taree City	Council in Mid-North Coast JO or merge with Gloucester	Not fit
	Kempsey Shire	Council in Mid-North Coast JO	Not fit
	Port Macquarie-Hastings	Council in Mid-North Coast JO	Fit
New England	Armidale Dumaresq	Council in New England JO or **merge with Guyra**	Not fit
	Glen Innes Severn	Council in New England JO	Fit
	Inverell Shire	Council in Namoi JO	Fit
	Tenterfield Shire	Council in New England JO	Not fit
	Uralla Shire	Council in New England JO or **merge with Walcha**	Not fit
Namoi	Gunnedah Shire	Council in Namoi JO	Fit
	Gwydir Shire	Council in Namoi JO or merge with Moree Plains	Not fit
	Liverpool Plains Shire	Council in Namoi JO or merge with Gunnedah	Not fit
	Moree Plains Shire	Council in Namoi JO or merge with Gwydir	Fit
	Narrabri Shire	Council in Namoi JO	Fit
	Tamworth Regional	Council in Namoi JO	Fit
Orana	Dubbo City	Council in Orana JO or merge with Wellington and/or Narromine	Fit
	Narromine Shire	Council in Orana CC or merge with Dubbo	Not fit
	Warrumbungle Shire	Council in Orana JO	Not fit
	Wellington	Council in Orana JO or merge with Dubbo	Not fit

15 This excludes Rural Council Proposals and councils in the Hunter, Central Coast and Illawarra.

Region	Council	ILGRP options	Assessment
Central West	Bathurst Regional	Council in Central West JO or merge with Oberon	Fit
	Blayney Shire	Council in Central West JO or merge with Orange	Not fit
	Cabonne	Council in Central West JO or **merge with Orange**	Not fit
	Cowra	Council in Central West JO or merge with Weddin	Fit
	Forbes Shire	Council in Central West JO; merge with Weddin	Not fit
	Lachlan Shire	Council in Central West JO or merge with Parkes	Not fit
	Lithgow City	Council in Central West JO	Not fit
	Mid-Western Regional	Council in Central West JO	Not fit
	Oberon	Council in Central West JO or merge with Bathurst	Not fit
	Orange City	Council in Central West JO or **merge with Cabonne** and/or Blayney	Not fit
	Parkes Shire	Council in Central West JO or merge with Lachlan	Fit
Tablelands	Goulburn Mulwaree	Council in Tablelands JO	Not fit
	Upper Lachlan Shire	Council in Tablelands JO or merge with Goulburn-Mulwaree	Not fit
	Wingecarribee Shire	Council in Tablelands JO	Fit
	Yass Valley	Council in Tablelands JO	Not fit
Riverina	Bland Shire	Council in Riverina JO or merge with Coolamon and/or Temora	Not fit
	Junee Shire	Council in Riverina JO or merge with Cootamundra	Not fit
	Temora Shire	Council in Riverina JO or merge with Coolamon and/or Bland	Not fit
	Tumut Shire	Council in Riverina JO or **merge with Gundagai** and Tumbarumba	Not fit
	Wagga Wagga City	Council in Riverina JO or merge with Lockhart	Fit
Murrumbidgee	Griffith City	Council in Murrumbidgee JO or **merge with Murrumbidgee**	Not fit
	Leeton Shire	Council in Murrumbidgee JO or merge with Narrandera	Fit
	Narrandera Shire	Council in Murrumbidgee JO or merge with Leeton	Not fit
Mid-Murray	Berrigan Shire	Council in Mid-Murray JO or **merge with Jerilderie**	Not fit
	Deniliquin	Council in Mid-Murray JO or **merge with Conargo/Murray** and Wakool	Not fit
	Murray Shire	Council in Mid-Murray JO or **merge with D'quin/Conargo** and Wakool	Not fit

Region	Council	ILGRP options	Assessment
Upper Murray	Albury City	Council in Upper Murray JO or merge with Greater Hume (part or all)	Fit
	Corowa Shire	Council in Upper Murray JO or **merge with Urana**	Not fit
	Greater Hume Shire	Council in Upper Murray JO or merge part or all with Albury	Fit
South East	Bega Valley Shire	Council in South East JO	Fit
	Cooma-Monaro Shire	Council in South East JO or **merge with Bombala** and Snowy River	Not fit
	Eurobodalla Shire	Council in South East JO	Fit
	Palerang	Council in South East JO or **merge with Queanbeyan**	Not fit
	Queanbeyan City	Council in South East JO or **merge with Palerang**	Not fit
	Shoalhaven City	Council in South East JO	Fit
	Snowy River Shire	Council in South East JO or merge with Bombala/Cooma-M	Not fit

Note: Bold indicates an ILGRP preferred option. JO stands for Joint Organisation.

Table 7 Rural Council Proposals

Region	Council	ILGRP options	Assessment
Northern Rivers	Kyogle[a]	Council in Northern Rivers JO or merge with Lismore or Richmond Valley	Not fit
New England	Guyra Shire	Council in New England JO or **merge with Armidale**	Not fit
	Walcha Shire	**Merge with Uralla** or Rural Council in New England JO	Not fit
Orana	Bogan Shire	Rural Council in Orana JO or merge with Warren	Fit as a Rural Council
	Coonamble Shire	Rural Council in Orana JO or merge with Gilgandra	Fit as a Rural Council
	Gilgandra Shire	Rural Council in Orana JO or merge with Coonamble	Fit as a Rural Council
	Warren Shire	Rural Council in Orana JO or merge with Bogan	Fit as a Rural Council
Central West	Weddin Shire	Rural Council in Central West JO or merge with Forbes or Cowra	Not fit
Riverina	Coolamon Shire	Rural Council in Riverina JO or merge with Bland and/or Temora	Fit as a Rural Council
	Gundagai Shire	**Merge with Tumut** or Rural Council in Riverina CC	Not fit
	Lockhart Shire	Rural Council in Riverina JO or merge with Wagga Wagga	Fit as a Rural Council
	Tumbarumba Shire	Rural Council in Riverina JO or merge with Tumut/Gundagai	Fit as a Rural Council
Mid-Murray	Conargo Shire	**Merge with Deniliquin and Murray** or Rural Council in Mid-Murray JO	Not fit
	Jerilderie Shire	**Merge with Berrigan** or Rural Council in Mid-Murray JO	Not fit
	Wakool Shire	Rural Council in Mid-Murray JO or merge with Murray/Conargo/Deniliquin	Fit as a Rural Council
Murrumbidgee	Carrathool Shire	Rural Council in Murrumbidgee JO or merge with Griffith	Fit as a Rural Council
	Hay Shire	Rural Council in Murrumbidgee JO	Not fit
	Murrumbidgee Shire	**Merge with Griffith** or Rural Council in Murrumbidgee JO	Not fit
Upper Murray	Urana Shire	**Merge with Corowa** or Rural Council in Upper Murray JO	Not fit
South East	Bombala	**Merge with Cooma-M** and Snowy R or Rural Council in South East JO	Not fit

[a] Kyogle submitted a Rural Council Proposal. However, the ILGRP did not identify this as one of the options for the council. We assess Kyogle as not fit as a Rural Council nor fit as a stand-alone council.

Note: Bold indicates an ILGRP preferred option. JO stands for Joint Organisation.

1 Assessment approach and proposals received

This chapter sets out:

- the context for this review
- the approach we have undertaken in assessing councils' proposals
- details of the proposals we received, and
- public consultation on the proposals received.

1.1 Context for the review

The NSW Government has asked IPART to undertake the role of the Expert Advisory Panel in assessing local government FFTF proposals.[16] The FFTF reforms aim to improve the strength and effectiveness of local government in providing services and infrastructure that communities need.[17]

The starting point for our analysis is the review of the sector undertaken by the ILGRP in 2012 and 2013. The ILGRP outlined a range of options for governance models, structural arrangements, and boundary changes to increase the strategic capacity of councils and reform the local government sector.

For communities, high capacity local councils can more effectively:

- deliver quality services and infrastructure
- prepare soundly-based plans for the future
- help support local jobs and economic growth
- represent the diverse needs of different groups
- influence state and federal government decisions to achieve local and regional objectives, for example in transport and housing, and
- keep rates and charges at affordable levels and maximise the benefits from spending those revenues.[18]

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16 The Terms of Reference for the review are included in Appendix A.

17 OLG, *Fit for the Future – A roadmap for Stronger, Smarter Councils*, September 2014, p 5.

18 ILGRP, *Revitalising Local Government: Final Report of the NSW Independent Local Government Review Panel (*ILGRP Final Report), October 2013, p 30.

The NSW Government has announced that councils which are assessed as fit for the future will have access to a range of benefits including a streamlined rate variation process and a State Government borrowing facility, priority for other government funding and grants, and eligibility for additional devolved planning powers.[19] There is also funding being provided by the NSW Government to assist with the transitional costs of merging, establishing regional JOs, and assisting regional and rural councils.[20]

1.2 The assessment approach

Our role as the Expert Advisory Panel is to ensure a consistent, impartial and balanced assessment of councils' FFTF proposals. We assessed council proposals in line with:

- the NSW Government's Terms of Reference, which require us to provide a report to the NSW Government by 16 October 2015
- our Methodology Paper, which set out how we would assess council proposals, and
- previous papers relating to the reform of the NSW local government sector, including the ILGRP's Final Report.

Each council was required to submit one of the following types of proposals for assessment after considering the ILGRP's proposed reform options:

- Merger Proposal - for councils proposing to merge with one or more other councils to achieve sufficient scale and capacity.
- Council Improvement Proposal - for councils that currently have sufficient scale and capacity without any structural change, or are proposing improvements to achieve scale and capacity without merging with another council.
- Rural Council Proposal - for councils with 'Rural Council Characteristics', which need to demonstrate plans to achieve real change and improve their capacity and sustainability.[21]

Council proposals were required to be submitted to IPART by 30 June 2015.[22]

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19 OLG, *Fit for the Future – A roadmap for Stronger, Smarter Councils*, September 2014, pp 14-15.

20 Ibid, p 14.

21 OLG developed templates for councils to use for each proposal type, in addition to other resources and guidance to assist councils in assessing their options and preparing their proposals.

22 The eight councils in Far Western NSW (Balranald Shire Council, Bourke Shire Council, Brewarrina Shire Council, Broken Hill City Council, Central Darling Shire Council, Cobar Shire Council, Walgett Shire Council, and Wentworth Shire Council) were not required to submit a proposal and no proposals were received from these councils. County councils were also not required to submit a proposal as they are not part of the Fit for the Future process.

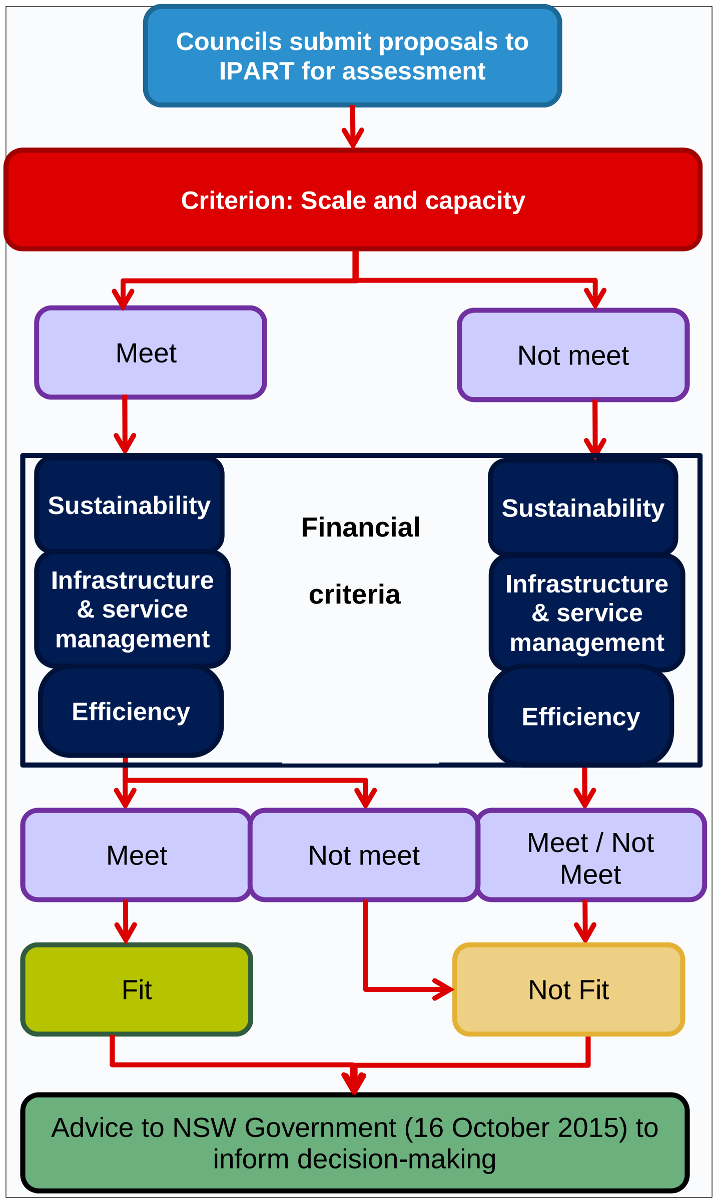
We assessed each proposal in relation to whether they have the scale and capacity criterion to engage effectively across community, industry and governments. We also assessed proposals against three financial criteria:

- sustainability
- effectively managing infrastructure and delivering services for communities, and
- efficiency.

Figure 1.1 outlines how we assessed proposals against these criteria in making our assessment of whether each council is fit or not fit for the future.

The assessment of each council is set out in Chapter 2, with further detail in Appendix C.

Figure 1.1 IPART's FFTF assessment process



1.2.1 Criterion 1: Scale and capacity

As shown in Figure 1.1, the NSW Government established 'scale and capacity' as the threshold criterion for councils. As a result, councils must demonstrate they satisfy the scale and capacity criterion to be considered fit. Accordingly, we assessed councils that did not satisfy the scale and capacity criterion as not fit, even if they met the remaining financial criteria (sustainability, infrastructure and service management and efficiency).

Our analysis of proposals against the scale and capacity criterion considered whether:

- the council's proposed option is at least as good as the ILGRP's preferred option
- the council explored merger options where they were identified
- the proposal demonstrates the council can achieve the key elements of strategic capacity in Box 1.1, and
- the proposal demonstrates the council has sufficient scale.

In considering the Merger Proposals we received, we also took into account whether the proposed mergers would strengthen the ability for councils to provide the services and infrastructure that communities need, relative to remaining a stand-alone council. This is consistent with the NSW Government's reform agenda.[23]

For non-metropolitan councils, we have taken into account the scale objectives identified by the ILGRP. The ILGRP identified a 'rule of thumb', which indicated the great majority of councils should have populations close to or greater than 10,000 by 2036.[24] The ILGRP also noted that a population of less than around 5,000 is unlikely to support a stand-alone council as governance costs will consume too great a proportion of total revenue.[25]

For a number of non-metropolitan councils, the ILGRP identified an option for the council to remain a stand-alone council in a JO. The NSW Government is currently working with local councils on the pilot of five JOs.[26] These pilots will assist the NSW Government in developing the final JO Model which will be implemented from September 2016, with 15 JOs to be established across NSW.[27]

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23 OLG, *Fit for the Future – A roadmap for Stronger, Smarter Councils*, September 2014, p 5.

24 ILGRP Final Report, p 111. In general, we used the NSW Department of Planning and Environment's current and forecast populations for each council in assessing a council's scale, but have also considered other forecasts provided by councils.

25 Ibid.

26 JOs are currently being piloted in the Central NSW, Hunter, Illawarra, Namoi and Riverina. For further details on these JOs see: http://www.fitforthefuture.nsw.gov.au/joint-organisations

27 OLG, *Joint Organisations: Emerging Directions Paper*, September 2015; OLG, *Joint Organisations: A roadmap for intergovernmental collaboration in NSW*, September 2014.

Box 1.1 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.

Source: ILGRP Final Report, p 32.

Rural Council Proposals

In assessing Rural Council Proposals against the scale and capacity criterion, we considered if:

- the majority of Rural Council Characteristics, set out below in Box 1.2, were met[28], and
- the plans the council proposed to improve its capacity and sustainability were reasonable and likely to be achievable in the timeframes proposed.

The 'Rural Council Model' developed by the ILGRP was considered to be an alternative to mergers in some rural and remote areas. This model is based on reducing the regulatory and compliance burden on Rural Councils, by the JO or a partner council performing most of the higher level functions of Rural Councils.[29]

The assessment of Rural Councils against the scale and capacity criterion is contingent on the Government adopting a Rural Council model. If a Rural Council model is not adopted, it is likely that most Rural Councils would be assessed as not meeting the scale and capacity criterion, and as a result, not fit.

[28] As noted in the Methodology Paper, we have placed particular emphasis on whether the council has demonstrated it has: a small and static or declining population spread over a large area (Characteristic 1) and, there are limited options for mergers (Characteristic 9).

[29] For example, the ILGRP noted Rural Councils could either fully share administration with an adjoining council or have extensive resource-sharing as part of a JO. See: ILGRP Final Report, pp 92-93.

Box 1.2 Rural Council Characteristics

1. Small and static or declining population spread over a large area.
2. Local economies that are based on agricultural or resource industries.
3. High operating costs associated with a dispersed population and limited opportunities for return on investment.
4. High importance of retaining local identity, social capital and capacity for service delivery.
5. Low rate base and high grant reliance.
6. Difficulty in attracting and retaining skilled and experienced staff.
7. Challenges in financial sustainability and provision of adequate services and infrastructure.
8. Long distance to a major (or sub-regional centre).
9. Limited options for mergers.

Source: FFTF Guidance material for Completing Template 3: Rural Council Proposal pp 11-12.

1.2.2 Criteria 2 to 4: sustainability, infrastructure and service management and efficiency

The other three criteria we used to assess council proposals are financial criteria. Each of these criteria includes one or more measures. These criteria include:

- **Sustainability**. This criterion reflects whether the council will generate sufficient funds over the long term to provide the agreed level and scope of services and infrastructure for communities. The measures for this criterion include:
  - Operating Performance Ratio.
  - Own Source Revenue Ratio.
  - Building and Infrastructure Asset Renewal Ratio.
- **Effective infrastructure and service management.** This reflects the council's ability to maximise return on resources and minimise unnecessary burden on the community and business, while working to leverage economies of scale and meet the needs of communities. The measures for this criterion include:
  - Infrastructure Backlog Ratio.
  - Asset Maintenance Ratio.
  - Debt Service Ratio.
- **Efficiency.** This reflects the council's ability to provide services and deliver infrastructure in a manner that achieves value for money for current and future ratepayers. The measure for this criterion includes:
  - Real Operating Expenditure.

The assessment for each council against the financial criteria was based on the council's forecast performance against defined benchmarks for each measure. In general, councils were required to demonstrate that they met the benchmarks or demonstrated improvement towards meeting the benchmarks within five years, ie, by 2019-20.[30]

We have assessed councils on whether they have met these financial criteria on an overall basis, taking into account:

- which financial benchmarks are met
- the degree to which any financial benchmarks are not met
- the degree of improvement in meeting some of the benchmarks[31], and
- long term sustainability factors.[32]

We consider a council's operating performance ratio provides a key measure of financial sustainability and is a benchmark FFTF councils should meet. As a result, we have emphasised the importance of a council meeting the operating performance ratio in assessing whether councils have met the financial criteria overall.

Appendix B provides further details on these criteria and the considerations we have taken into account in assessing council proposals against these criteria.

Data issues

We were largely dependent on the information provided by the councils in assessing each council against the financial criteria overall. Where possible, we have tried to test and verify the assumptions made by the councils in their proposals through examination of long term financial reports, other available data, and discussions with councils.

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30 As set out in our Methodology Paper, rural councils (councils in OLG Groups 8 to 11 and those choosing to submit a Rural Council Proposal) were given longer timeframes, i.e., a further five years to 2024-25 to demonstrate they met the benchmark for the operating performance ratio. Councils in OLG Groups 8 to 11 were also provided with greater flexibility in meeting the own source revenue and real operating expenditure measures. As noted in our Methodology Paper, we have considered the inclusion of Federal Assistance Grants in assessing own source revenue for these councils. We have also taken into account the impact of falling populations on the real operating expenditure measure. Further, we have taken into account that operational savings may not be practical in the short term for rural councils and councils submitting a Merger Proposal. See: Methodology Paper, pp 42-43, 47.

31 As set out in Appendix B, some of the measures in the financial criteria require councils to meet the benchmark or improve their performance against the benchmark, while for other measures the council must meet the benchmark.

32 We note that OLG and the NSW Treasury Corporation (TCorp) have advised councils in FFTF workshops that they should be aiming for improvement in their overall sustainability rather than meeting all the benchmarks. This was identified in TCorp's submission (see TCorp submission to IPART Consultation Paper, May 2015, pp 1-2). We consider our approach to assessing how councils satisfy the other criteria overall is consistent with TCorp's advice.

When attributing a level of confidence to a council's figures, we have assessed the council's overall approach, the reasonableness of assumptions, and sourced independent material. Where necessary, we have re-calculated ratios based on differing assumptions from those used by councils, where the assumptions used might not be considered reasonable.

1.2.3 Other considerations

During our assessment of proposals, we have also considered other factors in addition to the four criteria discussed above. These included:

- the social and community context of the council
- how the council consulted with its community regarding its proposal or alternative options as relevant, and the outcomes from these consultations
- the impact of the council's water utility and sewer business on its General Fund performance and overall scale and capacity, where the council also has a water utility and sewer function, and
- the submissions received on each council's proposal.[33]

We have also requested additional information from most councils and held in person meetings with a number of councils either at their request, or to clarify and illuminate key issues. We met with all councils that requested meetings. A list of all the councils we met with during the assessment process is set out in Table 1.1.

[33] Copies of submissions received on each council's proposal are available on the IPART website at www.ipart.nsw.gov.au

Table 1.1 Council meetings held during IPART's assessment process

Council	Date
Holroyd City Council	May 2015
Lake Macquarie City Council	
Great Lakes Council	
Warringah Shire Council	
Lane Cove Municipal, Hunter's Hill Council, City of Ryde Council	
Liverpool City Council	
Gosford City Council	
Randwick City Council and Waverley Council	July 2015
Fairfield City Council	August 2015
Armidale Dumaresq Council	
Bankstown City Council	
Queanbeyan City Council	
Auburn, Burwood and Canada Bay	
The Hills Shire Council	September 2015
City of Sydney Council	
Penrith City Council	
Pittwater Council	
Snowy River Shire Council	October 2015

1.3 Council proposals received

We received 139 council proposals from 144 councils including:

- Four Merger Proposals (involving nine councils)
- 115 Council Improvement Proposals, and
- 20 Rural Council Proposals.

The proposals we received differed significantly from the options identified by the ILGRP. Most councils decided to remain a stand-alone council and submitted a Council Improvement Proposal or a Rural Council Proposal, rather than a Merger Proposal.

Only 3% of the proposals we received were Merger Proposals. In comparison, 41% of the ILGRP's options for reform were preferred mergers and a further 29% were merger options that should be equally explored with the stand-alone option.

The ILGRP identified a preference for 30% of councils to remain stand-alone councils. In contrast, 83% of the proposals we received were Council Improvement Proposals, with a further 14% of proposals received for councils to stand-alone as a Rural Council.

A number of councils commissioned business cases, which explored the preferred merger as well as alternative merger options. As councils used different consultants, the business cases provided used different assumptions, timeframes and methodologies in estimating the NPV of the costs and benefits of particular mergers. We have undertaken additional analysis to estimate the NPV of these business cases on a more consistent basis, which has also involved adjusting underlying assumptions in some cases.

We have also commissioned economic consultants, Ernst & Young, to independently estimate the NPV of a number of merger options for Metropolitan Sydney councils. This analysis by Ernst & Young was used to sensitivity test the business cases provided by the councils. Ernst & Young also reviewed the merger business cases submitted by Metropolitan Sydney councils and IPART's analysis of these business cases. There are some differences in the approaches used by councils, and therefore IPART, and Ernst & Young. For instance, Ernst & Young has used a top down approach to independently estimate the NPV of merger options, while IPART's approach was based on standardising the business cases provided by councils. Further detail in relation to our analysis of these business cases is set out in Chapter 2 and Appendix D. A copy of Ernst & Young's report is at Appendix E.

1.3.1 Improvements proposed by councils in their proposals

Councils included a range of strategies in their proposals to improve their scale and capacity and financial performance. We note if these strategies were not adopted, a number of councils would be unlikely to meet the financial criteria overall based on their current performance. As outlined in Chapter 3, OLG will undertake monitoring of councils' performance, which will be a key component in managing the reform process.[34]

Common strategies proposed by councils to improve their performance included:

- Increases to their general income through special variations (SVs)[35] and/or increasing user fees and charges.
- Changes to the approach used to determine asset maintenance requirements, to reduce the cost and volume of asset maintenance and renewals.
- Efficiency improvements, such as reviews of services and functions, to reduce costs.
- Sharing services with neighbouring councils or through a JO to improve the council's capacity and reduce costs.

34 OLG undertakes reporting of council performance each year in the 'Your Council' report.

35 See sections 508A and 508(2) of the *Local Government Act 1993.*

Some councils that submitted a Rural Council Proposal have identified projects to improve their performance that they consider may be suitable for grants under the NSW Government's Innovation Fund. This Fund is open to councils in regional NSW with a population of less than 10,000, with priority given to councils which have been assessed as fit.[36] This Fund is subject to a separate application process.[37] We have not referred any projects to this Fund as part of our process.

In assessing the improvement strategies proposed by councils, we considered whether they were reasonable and likely to be achievable in the timeframes proposed. Where we have assessed these as not reasonable or unrealistic, we have sometimes assessed councils as not meeting the financial criteria overall, and as a consequence, not fit.

1.3.2 Assumptions relating to proposed SVs in proposals

Where a council has assumed a future SV in its proposal, as well as considering the reasonableness of this assumption, we have also taken into account:

- other actions taken by the council to reduce costs or increase revenue
- the amount and frequency of any previously approved SVs
- their current rates relative to the average rates of their peers
- whether there were alternative options to improve general income, and
- whether the council has included its assumed SV in its long term financial plan and commenced community consultation on the proposed SV.

However, if a council has assumed a future SV and we have assessed the council as fit, this does not mean we will approve this future SV. SV applications are subject to a separate approval process and criteria, which is outside the FFTF process.

Some councils have not assumed SVs in their proposals. In these cases, we have assessed the council proposals as they are, on the basis of the council's own financial planning and projections.

Whilst some councils may have been assessed as meeting the financial criteria and fit on the basis of assumed SV increases, it does not mean this course of action is necessarily the best option for local communities under the current reform agenda.

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36 OLG, *Innovation Fund Guidelines*, May 2015.

37 The application process for the Innovation Fund will commence in November 2015. See: OLG, *Innovation Fund Guidelines*, May 2015.

A large number of councils have proposed substantial future increases to general income to meet the financial criteria. There is a risk councils have proposed future SVs to improve their financial performance, and may not have fully considered whether alternative structures for the local government area, such as a merger, may be a better outcome. Structural changes could achieve similar or larger improvements to a council's general income and reduce the need for, and size of, potential SV increases, which could limit the impact of higher rates on the community.

This was apparent during the assessment process. For example:

- The merger of Auburn, Burwood and Canada Bay is forecast to result in an improvement in the operating performance ratio of the merged council from -0.4% in 2014-15 to 3.1% in 2019-20, and 4% over the long term because of merger efficiencies.
- Similarly, the merger of Randwick and Waverley is forecast to result in an improvement in the operating performance ratio of the merged council from 1.7% in 2014-15 to 11.4% in 2019-20, mainly driven by merger efficiencies.
- In addition, Young and Boorowa have provided analysis to IPART showing a merger between the councils (and including Harden) would result in an improvement in the operating performance ratio from -3.7% in 2014-15 to 6.5% in 2019-20[38], and about 5% over the long term due to merger efficiencies.

1.4 Public consultation on council proposals

Public consultation on council's FFTF proposals was undertaken over July 2015 and 1570 submissions were received by the 31 July 2015 closing date.[39] In addition, 52 submissions were received either before the consultation process or following the closing date.[40] All of the submissions received were considered as part of the assessment process.[41]

Close to 90% of the submissions received during the consultation process related to councils in the Metropolitan Sydney area, with a third of all submissions received relating to City of Sydney Council's proposal. Table 1.2 sets out the top 10 council areas which received the most submissions during the consultation process. A number of council proposals received no submissions, with 75 out of the 139 council proposals receiving no submissions on their proposals.[42]

38 The operating performance ratio figures are annual figures, as the proposal did not include three year averages.

39 Submissions received during the consultation process are published on the IPART website at www.ipart.nsw.gov.au. Confidential submissions have not been published.

40 This takes into account late submissions received as at 10 October 2015.

41 However, only those submissions received during the consultation process were published on the IPART website.

42 This takes into account early and late submissions received outside of the consultation process.

Table 1.2 Top 10 council areas by number of submissions received[43]

Council	Number of submissions received
City of Sydney Council	520
Strathfield Municipal Council	204
Leichhardt Municipal Council	190
Auburn City Council	121
Bankstown City Council	94
Pittwater Council	47
Marrickville Council	40
Lake Macquarie City Council	31
Woollahra Municipal Council	27
Hunter's Hill Council	23

Most submissions received were from private individuals and community groups, with some businesses and councils also providing submissions.

The themes across submissions received across all council areas were relatively consistent, with the majority of submissions supporting their council's position to remain a stand-alone council. This is broadly consistent with the community consultation conducted by councils in developing their FFTF proposals. The main reasons outlined in submissions for supporting their council's position to stand-alone included:

- satisfaction with their council's current performance
- concern about the potential for loss of representation and focus on local issues following a merger
- concern about the potential costs of a merger and doubt that the anticipated efficiency benefits of a merger would arise, and
- concerns about the potential for reduced services and higher rates following a merger.

Some submissions supported their council merging with other councils. This was generally because the stakeholder considered their council was performing poorly and a merger would assist to improve services, financial management, and the quality of leadership.

However, most of the submissions received in relation to the voluntary mergers proposed by Randwick/Waverley and Auburn/Burwood/Canada Bay did not support these mergers. In relation to both of these voluntary mergers, stakeholders raised concerns about the lack of community consultation that had been undertaken. No submissions were received in relation to the two other Merger Proposals we received from Young/Boorowa, and Cootamundra/Harden.

43 The submissions in this list do not include early and late submissions received outside of the consultation process.

2 Assessments by region

In this chapter, we provide further detail on our assessment of whether each council is fit or not fit for the future. We discuss our findings by the NSW regions including:

- Metropolitan Sydney, which we discuss by the following areas:
  - Global City
  - Inner Metropolitan Sydney
  - Outer Metropolitan Sydney
- Central Coast, Hunter and Illawarra, and
- Non-metropolitan regions.[44]

The individual council assessments can be found in Appendix C.

2.1 Metropolitan Sydney

There are 41 councils in Metropolitan Sydney. For the majority of these (31), the ILGRP proposed merger options for investigation, as a preferred starting point. The remaining 10 councils include a number of councils in Outer Metropolitan Sydney. The ILGRP suggested these councils could remain stand-alone and did not propose preferred mergers for these councils, although it noted some merger options could be considered in the longer term.

Many Metropolitan Sydney councils submitted business cases with their proposals, which assessed the costs and savings of the merger options identified by the ILGRP. We conducted additional analysis where this information was provided and estimate $1.8 billion to $2.0 billion in NPV benefits could be realised over 20 years if the ILGRP's preferred Metropolitan Sydney mergers were to occur. Ernst & Young also estimates these mergers could yield substantial financial gains with $1.3 billion in NPV benefits over 20 years.

Table 2.1 provides a summary of the business case analysis for selected merger options for Sydney Metropolitan councils.

44 The assessments are based on council proposals which can be accessed on the IPART website at: www.ipart.nsw.gov.au.

Table 2.1 Estimates of NPV - Selected merger options for the Sydney Metropolitan area

Merger option	Council consultant	IPART 20-year NPV estimate using standardised assumptions based on council consultant business cases	Ernst & Young 20-year independent NPV estimate using standard assumptions (mid-point of range)
ILGRP preferred merger options		**$ million**	**$ million**
Randwick, Waverley, Woollahra, Botany Bay, City of Sydney Council	Randwick Council	416	283
Ashfield, Burwood, Canada Bay, Leichhardt, Marrickville, Strathfield	Morrison Low	396	194
Hunter's Hill, Lane Cove, Mosman, North Sydney, Willoughby, Ryde (part)	Morrison Low[a]	280	187
Auburn, Holroyd, Parramatta, The Hills (part), Ryde (part)	Morrison Low[a]	254	150
Hornsby, Ku-ring-gai	KPMG	61	88
Manly, Warringah, Pittwater	KPMG	116	116
	SGS Economics & Planning	265	
Canterbury, Kogarah, Rockdale, Hurstville	Morrison Low	280	172
Fairfield, Liverpool	Fairfield City Council	NA[b]	131
Total benefits		**1,803 – 1,953**[c,d]	**1,323**
Other selected mergers		$ million	$ million
Bankstown, Canterbury	Bankstown City Council	70	86
The Hills, Hawkesbury	NA	NA	60
Gosford, Wyong	Third Horizon	101	196

a Uses efficiency realised scenario.

b Fairfield estimated cumulative costs of $27 million from a merger with Liverpool. We consider assumptions underlying the estimate to be based on a limited sample and contrary to other information provided to IPART regarding benefits from mergers.

c The summation of the IPART calculations for the ILGRP mergers reflects the different underlying methodologies used by the different consultants.

d The sum of the IPART calculations excludes Fairfield – Liverpool.

Note: The council consultants and Ernst & Young note there is an array of risks about the estimates. The IPART calculation of net present value uses the consultant's information and base data, with adjustments to some assumptions, and a consistent 20-year forecast period and a 9.5% nominal (7.0% real) discount rate. The IPART calculations are based on submitted business cases and are subject to the limitations of the models and data on which they are based. Refer to Appendix D for a full list of assumptions and limitations.

Source: IPART, Ernst & Young.

Notwithstanding the estimated NPV of the ILGRP's preferred mergers is high, we received only two Merger Proposals (involving five councils) in Metropolitan Sydney and 36 Council Improvement Proposals for councils to stand-alone.

Our analysis finds:

- both Merger Proposals are fit
- seven councils submitting Council Improvement Proposals are fit, and
- 29 councils submitting Council Improvement Proposals are not fit.

2.1.1 Global City

The ILGRP considered the expansion of the cities of Sydney and Parramatta to be a centerpiece of local government reform.[45] It argued against a small 'CBD council' and discussed the concept of a 'Global Capital City' with attributes listed in Box 2.1.

Figure 2.1 Global City Council

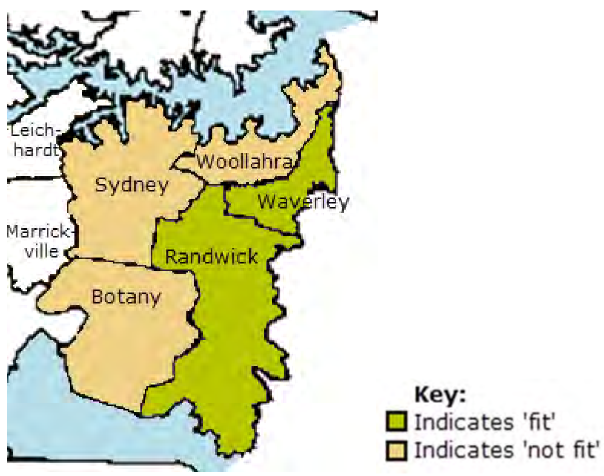

Figure 2.1 shows the five metropolitan councils that were identified to merge into a 'Global Capital City', ie, City of Sydney, Randwick City Council, City of Botany Bay Council, Waverley Council and Woollahra Municipal Council.

45 ILGRP Final Report, p 99.

A merger of these councils results in a forecast population of 653,250 by 2031.[46] The prospective Global City Council incorporates the whole of the eastern suburbs, south to Sydney Airport, Port Botany, nearly all the iconic locations and features that contribute to Sydney's global identity[47] and much of the supporting infrastructure. The ILGRP suggested that a Global City Council could 'become a highly capable and well-resourced partner of the State government in projecting Sydney's image, fostering economic development and providing essential infrastructure.'[48]

Our assessment of this group of councils considers if each submitted proposal is consistent with, or better than, the option to merge to form a Global City Council. This is in line with our published assessment methodology.

Box 2.2 Key Attributes of a Global Capital City

Physical size – area encompasses a broad area and cross-section of inner metropolitan suburbs, including iconic locations of global significance.

Hierarchy – include major infrastructure and facilities that are at the peak of the hierarchy for that function (government, transport, health, education, business, recreation, culture etc).

Leadership – 'first amongst equals' of metropolitan councils due to the importance of its decisions, geographic scale, budget and responsibilities, reputation and profile, and relationship to political, business and civic leaders.

Strategic capacity – ability to manage major regional facilities and undertake or facilitate major economic and infrastructure development to address the changing needs of the inner metropolitan region.

Global credibility – a leader in the Asia Pacific and maximise opportunities to partner or compete as required with other global capital cities in the race for capital investment and international reputation.

Governability – attracts the best of candidates for political leadership, with a broad, diverse and balanced constituency that will facilitate good governance.

Partnership with the State- not be so large as to challenge the primacy of the State, but have the stature, maturity and skills to be a respected partner and to develop a productive working relationship with state and federal agencies.

Source: ILGRP Final Report, Box 36, p 100.

46 DP&E.

47 As discussed below, the Government would need to consider the extent to which the Global City Council should be given control over key infrastructure.

48 ILGRP Final Report, p 100.

City of Sydney

The City of Sydney submitted a Council Improvement Proposal to remain a stand-alone council. We find the council is not fit for the future as it does not meet the scale and capacity criterion when compared to a Global City Council, although it meets the financial criteria overall.

The City of Sydney demonstrated it is a high performing council in the Sydney region as:

- It maintains low residential rates while achieving high financial performance indicators.
- It was the only council to receive a 'strong' financial sustainability rating with a 'positive' outlook when reviewed by TCorp.
- It proactively partners with the Government and has made large contributions to infrastructure and urban renewal, such as the Green Square development.
- It is one of the few Local Government Areas (LGAs) in NSW to exceed the housing targets set by the NSW Government. The City of Sydney has achieved an annual growth rate in housing supply of 3.4% per annum since 1993, 250% above the Sydney average.[49]

We also note City of Sydney received the highest number of public submissions of any council regarding its proposal. The majority of the more than 500 submissions received, supported the council remaining a stand-alone council.

Nevertheless, we assess that City of Sydney does not meet the scale and capacity criterion when compared to a Global City Council because:

- It did not show that its stand-alone option is as good as or better than a Global City Council.
- A Global City Council would deliver greater benefits for the people of NSW by better integrating planning and development across central Sydney and the eastern suburbs as the CBD expands.
- It would also facilitate better partnering with other levels of government to develop and deliver key infrastructure, such as the Sydney Light Rail Project and the second Sydney Harbour rail crossing.
- The estimated benefits from a Global City Council merger is $283 million over 20 years based on Ernst & Young's mid-point range of NPV benefits.

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49 NSW Department of Planning & Environment, *New South Wales State and Local Government Area Population, Household and Dwelling Projections: 2014 Final* (DP&E).

Should the Government adopt the Global City option, the following issues may require consideration:

- The extent to which the Global City Council should be given control over key infrastructure such as the Sydney Opera House, Barangaroo, Port Botany, Circular Quay and Darling Harbour to enable it to operate effectively as a Global City Council, as this infrastructure is currently administered by bodies separate to local councils.
- Measures to ensure the development and growth of the CBD and surrounding areas continue. This may require changes and enhancements to the *City of Sydney Act 1988*. In addition, the implications for business voting within the Global City Council may need to be considered, as the *City of Sydney Act 1988* will allocate two votes to businesses in local council elections in the City of Sydney from 2016.
- Measures to ensure the significant council revenues generated from businesses ($189 million in 2012-13) in the Sydney CBD are efficiently spent to realise the key objectives of the Global City Council.

If the Global City Council option is not adopted, City of Sydney has sufficient scale and capacity to stand alone and would be fit as a stand-alone council.

Randwick City Council and Waverley Council

We find the Merger Proposal submitted by Randwick and Waverley is fit for the future. It meets the scale and capacity criterion and the financial criteria overall.

A merger of Randwick and Waverley would deliver substantial scale and capacity benefits to their local communities compared to the councils standing alone. The merger builds on existing collaborations between the councils which share communities of interest and similar geography.

We calculate, drawing on information provided by Randwick, that the merger of Randwick and Waverley could produce benefits of around $139 million over 20 years. The mid-point of Ernst & Young's estimated benefits of the merger is $99 million on an NPV basis over 20 years.

The merged council is forecast to perform better financially than the councils individually, particularly with respect to the operating performance ratio. The operating performance ratio is forecast to reach 11.4% by 2019-20 under the merger, compared to 3.3% for Randwick and 3.0% for Waverley respectively without a merger. The merged council will also meet all the other financial benchmarks by 2019-20.

The merger is the best available option for the councils given neighbouring councils did not want to merge. The merger does not preclude a Global City Council should the NSW Government elect to adopt this option. However, we note Randwick and Waverley have indicated they do not support a merger with City of Sydney.

Woollahra Municipal Council and the City of Botany Bay

Woollahra and Botany Bay submitted Council Improvement Proposals to remain as stand-alone councils. We find both councils are not fit for the future as neither council meets the scale and capacity criterion, although Woollahra and Botany Bay both meet the financial criteria overall.

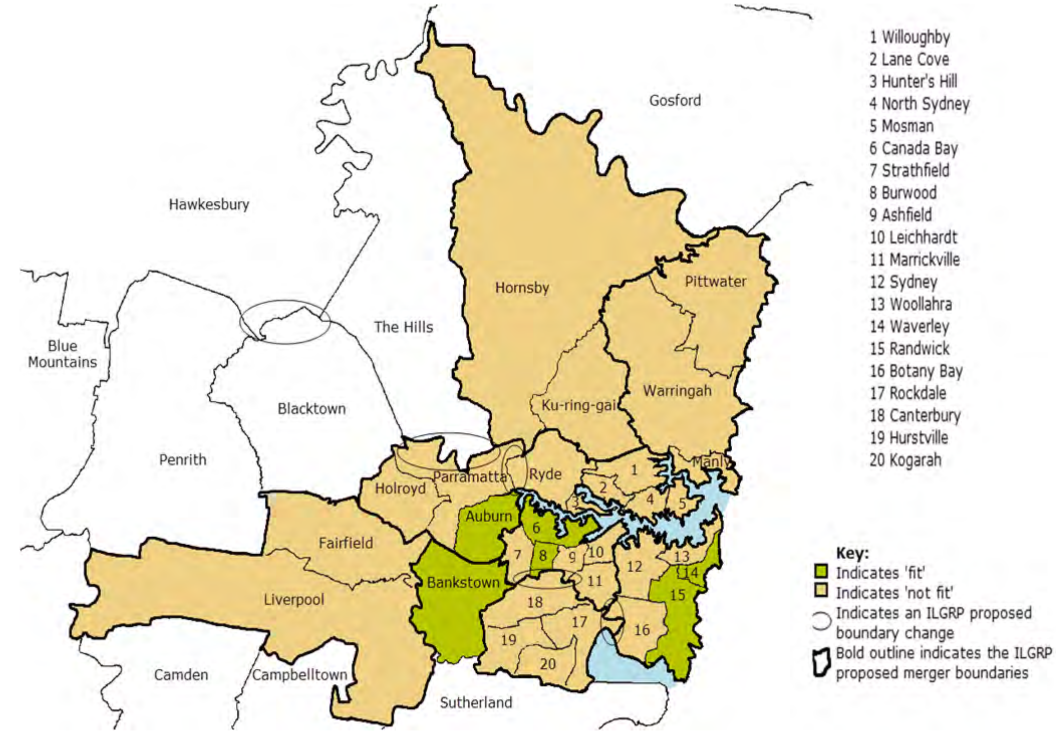
Our analysis suggests the councils do not have sufficient scale and capacity to effectively partner with governments compared to the merger. Further, the efficiency improvements in the councils' proposals can be realised under the merger option. We find merging these councils with similar neighbouring councils would produce significant benefits. For example, over a 20-year timeframe, Ernst & Young's analysis suggests:

- a merger of Randwick, Waverley, Woollahra and Botany Bay could provide NPV benefits of $218 million, while
- a merger of Randwick, Waverley, Woollahra, Botany Bay and City of Sydney to form a Global City Council could provide NPV benefits of $283 million.

2.1.2 Inner Metropolitan Sydney Councils

As illustrated in Figure 2.2, Inner Metropolitan Sydney includes 27 councils situated roughly between the Global City area and the Outer Metropolitan Sydney area.

Figure 2.2 Inner Metropolitan Sydney council assessments



With the exception of Bankstown City Council (Bankstown), the ILGRP proposed a merger as the preferred option for all councils in this group.

From the Inner Metropolitan Sydney councils, we received:

- one Merger Proposal from Auburn, Burwood and Canada Bay, and
- 24 Council Improvement Proposals to stand alone, including a proposal from Hunter's Hill Council (Hunter's Hill), Lane Cove Council (Lane Cove) and City of Ryde Council (Ryde) to form a Joint Regional Authority (JRA) as an alternative to a merger.

Merger Proposal - Auburn, Burwood and Canada Bay

Figure 2.3 Merger proposal from Auburn, Burwood and Canada Bay

We find the proposed merger of Auburn, Burwood and Canada Bay fit for the future as it meets the scale and capacity criterion and the financial criteria overall (Figure 2.3).

These councils submitted a voluntary, alternative merger to the options identified by the ILGRP. The ILGRP's preferred options were for:

- Auburn to merge with Holroyd City Council (Holroyd), Parramatta City Council (Parramatta), City of Ryde Council (Ryde) (part) and The Hills Shire Council (The Hills) (part).
- Burwood and Canada Bay to merge with Ashfield Council (Ashfield), Leichhardt Municipal Council (Leichardt), Marrickville Council (Marrickville) and Strathfield.

Our assessment of the Auburn, Burwood and Canada Bay Merger Proposal finds:

- The merged council's population would provide the new council with sufficient scale to capably partner with state and federal agencies on regionally significant projects such as major transport infrastructure.
- This arrangement would likely be a desirable outcome in that a voluntary merger would facilitate a faster progression towards achieving efficiencies when transitioning to a new council.
- The merger is expandable, and the councils inform us it would be possible and desirable to include Strathfield, and possibly Ashfield.

- Auburn notes it prefers not to merge with Parramatta, as it has concerns that any increase in rates would be used to fund Parramatta's growth as a strategic centre and it has a lack of communities of interest with Parramatta. These issues were not stated as concerns under the proposed voluntary merger with Burwood and Canada Bay.
- The merger could provide estimated NPV benefits of $114 million over 20 years to the merged communities, after accounting for merger implementation costs.
- The merged council meets all the financial criteria, and in particular, the operating performance ratio is forecast to improve from -0.4% in 2014-15 to 3.1% in 2019-20 through efficiency gains from the merger.

Our analysis suggests there are considerable benefits to the community from a merger between Auburn, Burwood and Canada Bay. As noted by the councils, these benefits could be increased further if the merger includes other councils, such as Strathfield.

Council Improvement Proposals from Inner Metropolitan Sydney Councils

The remaining 24 Inner Metropolitan Sydney councils submitted Council Improvement Proposals to stand-alone. With the exception of Bankstown, the ILGRP proposed a merger as the preferred option for all of the councils in this group.

Bankstown

We find Bankstown meets the scale and capacity criterion and the financial criteria overall. The preferred option presented for Bankstown by the ILGRP was 'No change'. The council's proposal is consistent with this option.

However, Bankstown has provided IPART with estimated cost savings from a merger with Canterbury. We calculate, drawing on information provided by Bankstown, that the merger of Bankstown and Canterbury City Council (Canterbury) could produce benefits of around $70 million over 20 years. The mid-point of Ernst & Young's estimated range of NPV benefits is $86 million over 20 years. While it was not included as an option for Bankstown, the ILGRP noted:[50]

> …a merger of Bankstown and Canterbury could offer considerable benefits, and this option needs to be kept open.

The benefits of a merger of Bankstown and Canterbury, including the increase in the scale and capacity of Bankstown, would need to be considered in light of the ILGRP's preferred options for both Bankstown and Canterbury.

50 ILGRP Final Report, p 101.

Inner West

The ILGRP's preferred option in the Inner West was a merger between Ashfield, Burwood, Canada Bay, Leichhardt, Marrickville and Strathfield.

Figure 2.4 Ashfield, Burwood, Canada Bay, Leichhardt, Marrickville and Strathfield

In this group of councils we find Burwood and Canada Bay are fit for the future as part of the Auburn, Burwood and Canada Bay merger proposal discussed in the section above.

We find Ashfield, Leichhardt, Marrickville and Strathfield not fit for the future as they did not meet the scale and capacity criterion although each council met the financial criteria overall.

These councils did not demonstrate that their proposals to stand alone would be as good as or better than the merger. For example, an Inner West Council would have greater scope to undertake new functions and major projects, conduct regional planning for the entire Inner West and collaborate with the government on projects that span the six LGAs.

The councils, except Strathfield, commissioned a business case for an Inner West merger. Based on this model, our analysis estimated the merger could produce NPV benefits of $396 million over 20 years. Ernst & Young estimated NPV benefits from the merger of $194 million over 20 years. These analyses showed large gains to the local community from a merger.

West Central

The ILGRP's preferred option in the West Central was a merger between Auburn, Holroyd, Parramatta, Ryde (part), and The Hills (part).[51]

Figure 2.5 Auburn, Holroyd, Parramatta, Ryde (part) and The Hills (part)

We find Holroyd, Parramatta and Ryde are not fit for the future as they do not meet the scale and capacity criterion. They did not demonstrate that their proposals to stand alone are as good as or better than the merger. However, each council met the financial criteria overall. In the case of Holroyd, the additional revenue from the SV approved in 2014 of 44.2% (29.1% above the rate peg) assists the council to meet the benchmark for the operating performance ratio.

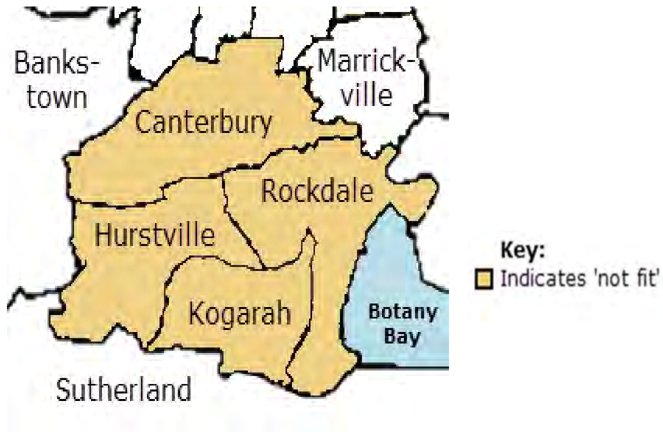
Holroyd submitted a business case for a merger of this group of councils. Based on this model, our analysis suggests the merger could produce NPV benefits of $254 million over 20 years. Ernst & Young estimated NPV benefits from the merger of $150 million over 20 years. These analyses showed large gains to the local community from a merger. An enlarged council in the West Central area of Metropolitan Sydney will have a more robust revenue base, better regional collaboration and greater scope to undertake functions and projects that span several LGAs.

Southern Suburbs

The ILGRP's preferred option in the Southern Suburbs was for a merger of Canterbury, Hurstville City Council (Hurstville), Kogarah City Council (Kogarah) and Rockdale City Council (Rockdale).

51 We discuss Auburn in the previous section as part of the Auburn, Burwood, Canada Bay Merger Proposal and The Hills in the following section on the Outer Metropolitan Sydney councils.

Figure 2.6 Canterbury, Hurstville, Kogarah, and Rockdale



We find Canterbury, Hurstville, Kogarah and Rockdale not fit for the future, as they did not meet the scale and capacity criterion. Each council submitted a proposal to remain a stand-alone council. However, we find the councils did not demonstrate that standing alone was as good as, or better than the preferred merger option.

The merger could assist the councils to:

- partner more effectively with government
- provide significant benefits to communities in delivering infrastructure consistent with the South Subregion plan, and
- better manage the Georges River catchment.

The councils each commissioned a business case of the merger. Based on this model, our analysis suggests the preferred merger could produce benefits of $280 million over 20 years in NPV terms. Our independent consultants, Ernst and Young estimated benefits from the merger of $172 million over 20 years in NPV terms.

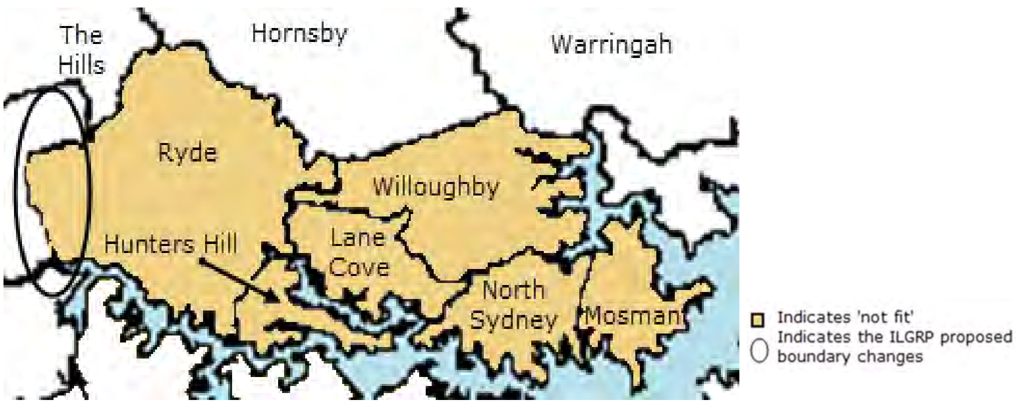
The ILGRP included an alternative for Canterbury to merge with Bankstown. As noted above, our analysis, based on information provided by Bankstown, suggests a merger between Canterbury and Bankstown could provide benefits of $70 million over 20 years in NPV terms, with $86 million of benefits in NPV terms for this alternative merger also estimated by Ernst & Young.

Canterbury, Hurstville, Kogarah and Rockdale met the financial criteria overall. The forecast improvement in Canterbury, Kogarah and Rockdale's financial performance over the outlook period is driven by approved SVs for asset renewal and to improve financial sustainability.

Lower North Shore

The ILGRP's preferred option in the Lower North Shore was a merger between Hunter's Hill Council (Hunter's Hill), Lane Cove Municipal Council (Lane Cove), Mosman Municipal Council (Mosman), North Sydney Council (North Sydney), Ryde (part), and Willoughby City Council (Willoughby).

Figure 2.7 Hunter's Hill, Lane Cove, Mosman, North Sydney, Ryde (part) and Willoughby



We find these councils' proposals to stand alone, including the JRA proposal from Hunter's Hill, Lane Cove and Ryde, are not fit for the future as they did not meet the scale and capacity criterion although each council met the financial criteria overall. These councils did not demonstrate that their proposal was as good as, or better than the merger.

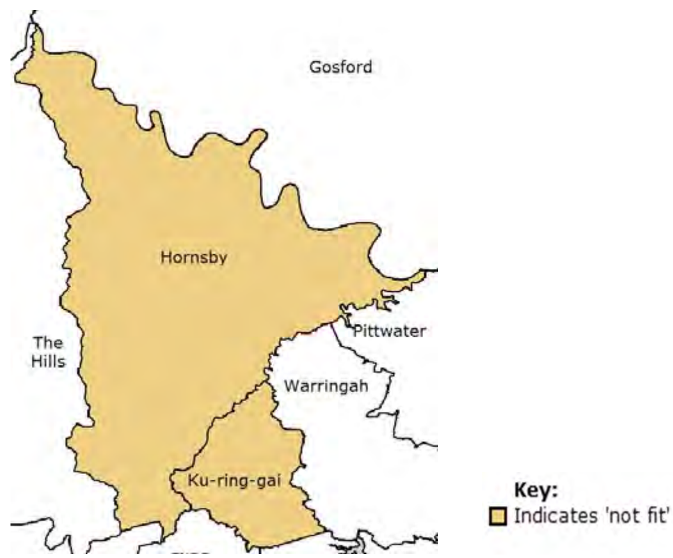
Hunter's Hill, Lane Cove and Ryde submitted a JRA proposal as an alternative to a merger. This proposal indicates the JRA would provide benefits from shared services and centralised planning and development without the disruption of a merger. The proposal indicates the JRA would generate net benefits over 15 years of $0.5 million, or $3.4 million if it also included Mosman, North Sydney and Willoughby. The proposal does not fully quantify any efficiency savings that may also eventuate under the JRA.

Our analysis suggests a merger of all councils in this group would improve their capacity to partner effectively with government and undertake strategic planning and development for the Lower North Shore region. The councils (except North Sydney) also commissioned a business case for a merger of all six councils. Based on this model, we estimated the merger could produce NPV benefits of $280 million over 20 years. Ernst & Young estimated NPV benefits from the merger of around $187 million over 20 years. The preferred merger is likely to provide a higher level of efficiency savings than the JRA.

Northern Suburbs

In the Northern Suburbs, the ILGRP's preferred option was for Hornsby Shire Council (Hornsby) and Ku-ring-gai Council (Ku-ring-gai) to merge with each other.

Figure 2.8 Hornsby and Ku-ring-gai



We find Hornsby and Ku-ring-gai not fit for the future as they did not meet the scale and capacity criterion, although both councils met the financial criteria overall. Each council submitted a proposal to remain a stand-alone council. However, we find the councils did not demonstrate standing alone was as good as, or better than the preferred merger.

A study commissioned by Ku-ring-gai indicated Hornsby and Ku-ring-gai have similar economic and demographic links, although Ku-ring-gai considers it is more closely linked with Warringah Council.

Hornsby indicated it was willing to further investigate a merger by developing a business case together with a neighbour to allow proper assessment. However, Hornsby could not reach an agreement to complete a merger business case with other councils. Ku-ring-gai has indicated it would prefer to merge with Warringah Council and for Hornsby to merge with The Hills Shire Council.

Hornsby submitted a business case which investigated the preferred merger, and an alternative merger with The Hills. Based on this model, our analysis suggests the preferred merger could produce benefits of $61 million over 20 years in NPV terms. Ernst & Young estimated benefits from the merger of around $88 million over 20 years in NPV terms.

Our analysis suggests the alternative merger between Hornsby and The Hills Shire Council could produce net benefits of $85 million over 20 years in NPV terms. This was not an option identified by the ILGRP and we have not undertaken any further analysis of the regional impacts of this alternative merger. The Hills did not seek to pursue this option.

All merger options showed significant gains to the local communities that were better than the stand alone options for each council.

Northern Beaches

In the Northern Beaches, the ILGRP's preferred option was for a merger of Manly Council (Manly), Pittwater Council (Pittwater) and Warringah Council (Warringah).

Figure 2.9 Manly, Pittwater and Warringah

We find Manly, Pittwater and Warringah not fit for the future, as they did not meet the scale and capacity criterion. Each council submitted a proposal to remain a stand-alone council. However, we find the councils did not demonstrate that standing alone was as good as, or better than the preferred merger. We consider a merger would improve the capacity of the councils to partner more effectively with governments and undertake better strategic planning and development for the Northern Beaches region.

Analysis of the preferred merger was undertaken separately by Manly and Pittwater, Warringah, and Ernst & Young. This analysis shows over a 20-year timeframe in NPV terms, the preferred merger could produce:

- net benefits of $116 million, using business cases provided by Manly and Pittwater
- net benefits of $265 million, using business cases provided by Warringah
- net benefits of $116 million, based on estimates by Ernst & Young.

Each of these merger assessments was based on different inputs and underlying methodologies, however all of them suggest a merger could provide substantial net benefits to the local community.

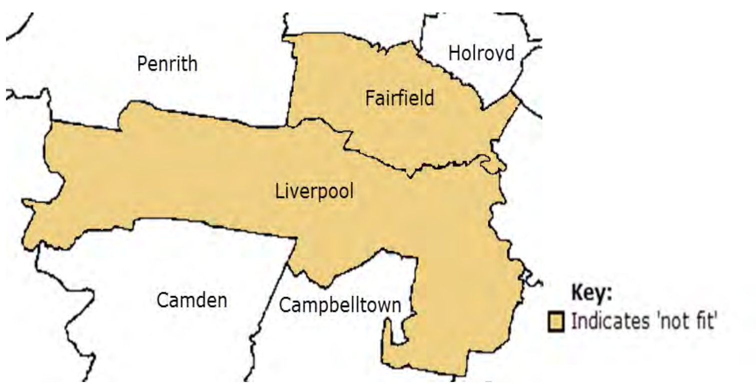
Manly and Pittwater commissioned additional analysis relating to the creation of two new councils, Greater Manly and Greater Pittwater, from the existing three councils. Manly has indicated this would be its preference if a merger was required. However, our analysis suggests this alternative merger is unlikely to provide net benefits which are as large as the preferred merger. Warringah noted it does not support this alternative merger option and supports the preferred three-way merger, but could not reach agreement for the preferred merger with Manly and Pittwater.

All three of these councils meet the financial criteria overall. Manly's proposal assumes a moderate SV in 2017-18 of 2.2% above the rate peg for one year (4.7% including the rate peg).

South West

The ILGRP preferred a merger between Fairfield City Council (Fairfield) and Liverpool City Council (Liverpool) in the South West.

Figure 2.10 Fairfield and Liverpool



We find Fairfield and Liverpool are not fit for the future as they do not meet the scale and capacity criterion. The councils did not demonstrate their proposals to stand alone are as good as or better than the merger. A merged council would have enhanced scale to partner more effectively with governments compared to the stand alone option.

Liverpool conducted analysis of merger options which showed over 10 years[52]:

- a merger with Campbelltown and Camden produces NPV benefits of $243 million, and
- a merger with Fairfield produces NPV benefits of $64 million.

52 SGS Economics & Planning, Fit for the Future: Options for Liverpool, Lead Council model.

In addition, Ernst & Young estimated NPV benefits from the merger of Liverpool and Fairfield of $131 million on a top down basis, over 20 years.

Each council met the financial criteria overall. Fairfield's operating performance ratio is forecast to reach 1.6% by 2019-20 which is just above the benchmark. The improvement in its operating performance is primarily due to the approved SV in 2014-15 of 10% (7.7% above the rate peg), proposed efficiency savings and adjustments for depreciation. Liverpool's operating performance ratio is also forecast to improve, to 0.3% by 2019-20, which meets the benchmark. Both councils included interest income on section 94 reserves. We adjusted the operating performance ratio by removing interest income on section 94 reserves as we do not consider this inclusion appropriate. Nevertheless, both councils still meet the sustainability criterion.

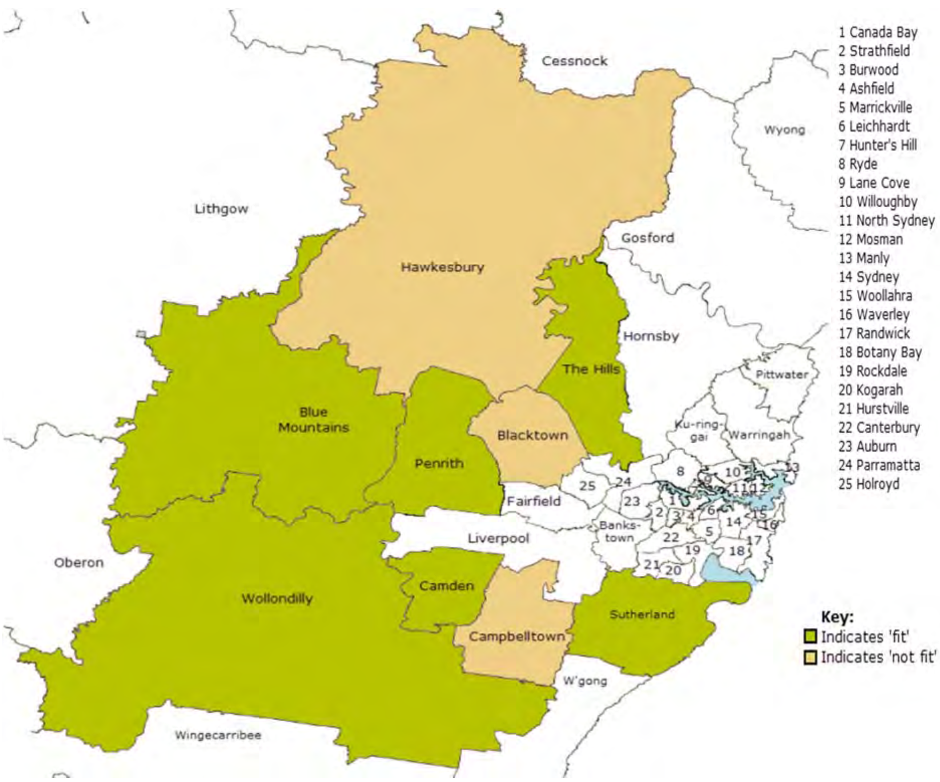
Both councils suggested that socio-economic differences and divergent strategic directions would create issues if they were merged. Both councils suggested that if necessary, alternative merger options would be preferred. Fairfield expressed concerns that a merged council's focus would shift to the Liverpool CBD which would undermine Fairfield's current growth strategies and social objectives. Liverpool City Council indicated that due to its growth profile, a merger with a council in the south west growth centre might provide better outcomes.

Fairfield estimated cumulative costs of $27 million from a merger with Liverpool.[53] However, neither Fairfield nor Liverpool undertook sufficient financial analysis for a possible merger. Ernst & Young estimated NPV benefits from a merger of the two councils of around $131 million over 20 years.

53 As noted in Table 2.1, we consider assumptions underlying the estimate to be based on a limited sample and contrary to other information provided to IPART regarding benefits from mergers.

2.1.3 Outer Metropolitan Sydney

Figure 2.11 Outer Metropolitan Sydney council assessments



There are nine councils on Sydney's fringes which we assessed as part of Outer Metropolitan Sydney (Figure 2.11).

For some councils in this group, the ILGRP noted there was merit in retaining them as stand-alone councils, as they are responsible for a mix of growing urban centres and rural or natural areas (including water catchments) that provide important 'green spaces' around the metropolitan complex.[54] However, the ILGRP also noted some merger options could be considered in the longer term.

54 ILGRP Final Report, p 102.

Blue Mountains, Camden, Penrith, Sutherland, The Hills and Wollondilly

We find Blue Mountains City Council (Blue Mountains), Camden Council (Camden), Penrith City Council (Penrith), Sutherland Shire Council (Sutherland), The Hills and Wollondilly Shire Council (Wollondilly) are fit for the future. All of these councils meet the scale and capacity criterion as well as the financial criteria overall.

In 2015-16, relatively large SVs were approved for Blue Mountains and Wollondilly respectively, of 28.5% and 38.8% above the rate peg, over four years (40.3% and 50.7% respectively including the rate peg). This additional revenue assists these councils to meet the operating performance benchmark by 2019-20.

Although Camden is not expected to meet the benchmarks for a number of measures by 2019-20, including the operating performance benchmark, its reported financial performance has been adversely affected by its forecast population growth. Camden is forecast to be the fastest growing council in NSW and expected to grow by 5.1% on average a year, which will increase its population from 58,450 in 2011 to 162,350 in 2031.[55] This results in growth of almost 180% between 2011 and 2031. We assess Camden as meeting the financial criteria overall as its inability to meet a number of benchmarks has been affected by its expected high population growth as opposed to underlying structural issues. In the long term, as Camden's growth rates moderate to more normal levels, it would likely meet the operating performance benchmark based on current data.

The Hills' proposal to stand alone is consistent with the ILGRP's preferred option of 'no change'. We therefore assess that it meets the scale and capacity criterion.[56]

The ILGRP's report included a possibility for The Hills to merge with Hawkesbury in the longer term. Ernst & Young calculated that a merger between these two councils could produce benefits of $60 million over 20 years in NPV terms. The Hills also submitted its preferred option for boundary changes, but we did not assess the NPV of these changes due to insufficient information.

Blacktown, Campbelltown and Hawkesbury

We find Blacktown City Council (Blacktown), Campbelltown Council Campbelltown) and Hawkesbury City Council (Hawkesbury) are not fit for the future based on these councils not meeting the financial criteria overall. However, all three councils met the scale and capacity criterion.

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55 NSW Department of Planning and Environment, *New South Wales State and Local Government Area Population Projections 2014*.

56 However, we note there may be alternative merger options which could yield significant net benefits.

While Blacktown satisfies the infrastructure and service management criterion and the efficiency criterion, it does not satisfy the sustainability criterion based on its forecast of continuing operating deficits and a building and infrastructure renewal ratio significantly below the benchmark by 2019-20. For this reason it does not satisfy the financial criteria overall.

Blacktown's operating performance ratio is forecast to decrease from -5.6% in 2014-15 to -8.4% in 2019-20. If the interest income on section 94 reserves is removed, this ratio decreases further to -10% in 2019-20. The trend in growing operating deficits will have a significant impact on the council's financial sustainability and ability to address asset renewals over the long term. The council has forecast its building and infrastructure renewal ratio will be 38.6% by 2019-20, which is significantly below the benchmark of 100%. Blacktown's long term financial plan forecasts a significant asset renewal funding gap of around $140 million by 2025-26, which is expected to increase further to $626 million by 2035.

A factor adding to the council's poor operating performance is its depreciation expense, which is forecast to grow because of the accumulation of new assets to support population growth. Blacktown's depreciation rates are based on weighted average useful asset lives of approximately 60 years, which is reasonable.[57] The accumulation of new assets is normal for a growth council.[58] Given its scale and capacity and revenue raising ability we consider that there are many options for Blacktown to become fit in future years. This includes exploring revenue and cost-reduction opportunities, refinements to asset management planning, and efficient use of debt for capital and infrastructure projects.

Campbelltown did not meet the financial criteria overall based on a negative and declining operating performance ratio which does not meet the benchmark by 2019-20. Its operating performance ratio is forecast to improve from -0.9% in 2014-15 to 2.0% in 2016-17, but then declines significantly to -2.4% by 2019-20. It is then forecast to deteriorate further to -3.5% by 2024-25. It also forecasts not meeting the building and infrastructure asset renewal benchmark, although it reports it is funding 100% of its renewal requirements in accordance with its Asset Management Plan.

57 Accounting standards require councils to regularly review assumed useful asset lives and the depreciation methodology and rates used. This enables the reliability of annual depreciation estimates to be enhanced based on past actual asset performance.

58 The forecast population growth in the Blacktown LGA is 51.5% based on DPE projections over the period from 2011 to 2031. This is not as large as other councils such as Camden which is projected to grow by 178% over the same period.

Campbelltown notes its modelling assumes no significant new capital expenditure over the outlook period which may not be reasonable. It notes its focus is on eliminating the infrastructure backlog and annual maintenance gap. Campbelltown's need to undertake additional new capital expenditure to meet population growth may be mitigated to some extent, as a number of infrastructure projects will likely be delivered by other government agencies and developers. However, additional capital expenditure will likely be required to meet Campbelltown's population growth, which would have an adverse impact on its operating performance ratio through increased depreciation.

Growth in Campbelltown may be bolstered over the long run by the Glenfield to Macarthur Priority Urban Renewal Corridor initiative and the Greater Macarthur Land Release Preliminary strategy. These developments, if progressed, will provide scope for significant additional dwellings. The timing of most of the potential housing development is uncertain, with additional preparatory work required before much of the development could proceed.

For these reasons, and the recent announcement of the strategy, Campbelltown's forecasts in its long term financial plan and proposal do not include the substantive part of these potential developments. These developments will require additional infrastructure spending. The funding mechanism for the additional infrastructure is uncertain, but it is expected Campbelltown will draw on state government funding and voluntary planning agreements to fund this infrastructure.

We assessed Hawkesbury as meeting the scale and capacity criterion as its proposal is consistent with the ILGRP's preferred option for no change. However, Hawkesbury did not meet the financial criteria overall based on its negative operating performance ratio of -1.1% in 2019-20. In addition, the improvement in its operating performance relies on a proposed SV of 16.0% above the rate peg over five years from 2017-18 (29.7% including the rate peg) to approach break-even, as well as unspecified service level reductions to fund asset maintenance and renewals.

As shown in Table 2.1 above, analysis by Ernst & Young suggests a merger between Hawkesbury and The Hills may be a better alternative to Hawkesbury's proposal to stand alone.

2.2 Central Coast, Hunter and Illawarra

Figure 2.12 Central Coast, Hunter and Illawarra Regions

Unlike the metropolitan and non-metropolitan councils, the options for the Central Coast, Hunter and Illawarra regions were not specifically set out by the ILGRP. However, it stated:

> The Hunter and Illawarra regions are vital 'engine rooms' of the NSW economy, and local government has an essential role to play in ensuring sound regional development. This requires improved frameworks for local and regional governance. The Central Coast has important links with both the Hunter and the Sydney metropolitan region, is experiencing significant growth pressures, and would also benefit from stronger governance.[59]

In addition, the ILGRP's Final Report discussed potential mergers for specific councils in these regions. Table 2.2 provides the options set out in our Methodology Paper for the Central Coast, Hunter and Illawarra based on the ILGRP's discussion of these regions.[60]

59 ILGRP Final Report, pp 108.
60 Methodology Paper, p 64; and ILGRP Final Report, pp 108 -110.

Table 2.2 ILGRP recommendations for Hunter, Central Coast and Illawarra

Council/s	Options (preferred option in bold)
Central Coast	
Gosford, Wyong	Amalgamate or a multi-purpose Joint Organisation (no separate water corporation until other options properly evaluated)
Hunter Region	
Dungog, Maitland	**Merge** or Council in Joint Organisation (possible boundary change)
Newcastle, Lake Macquarie	**Amalgamate** or Council in Joint Organisation (possible boundary changes)
Cessnock	Council in Joint Organisation
Muswellbrook	Council in Joint Organisation
Port Stephens	Council in Joint Organisation (possible boundary change)
Singleton	Council in Joint Organisation
Upper Hunter	Council in Joint Organisation
Illawarra	
Kiama	Council in a Joint Organisation (if future amalgamation – with Shoalhaven, noting its inclusion in South East-Tablelands region)
Shellharbour, Wollongong	Council in a Joint Organisation (amalgamate if future options need to be revisited)

Source: Adapted from Methodology Paper, p 64; and ILGRP Final Report, pp 108-110.

Central Coast Councils – Gosford and Wyong

In the Central Coast, we find Gosford City Council (Gosford) and Wyong Shire Council (Wyong) are not fit for the future. Gosford and Wyong's proposals did not meet the scale and capacity criterion although both proposals met the financial criteria overall.

We observe that for the Central Coast, the ILGRP stated:[61]

> The potential for an amalgamation warrants further investigation, but if that option is rejected or deferred indefinitely, then a Joint Organisation *should* be established and should assume responsibility for water along with other strategic functions [emphasis added].

We have approached the assessment of the Central Coast councils on the basis that a merger should be explored first. However, if this is not progressed, then the alternative option identified by the ILGRP is for the councils to participate in a multi-purpose JO.

61 ILGRP Final Report, p 109.

Gosford noted there were net present value benefits from a merger but ruled it out on the basis of the risks, upfront costs and time lags for benefit realisation. It proposes to stand alone and join a Hunter JO rather than to join a Central Coast JO with Wyong.

Wyong ruled out a merger based on its consultant's report and proposes to stand alone with 'business improvements'. It notes that it is open to exploring shared services with Gosford similar to a JO, but does not propose to form a Central Coast JO with Gosford.

We consider a merger of Gosford and Wyong would give the councils greater scope to undertake new functions and projects, more capacity to effectively partner with governments and effectively advocate on behalf of their communities. Further, the efficiency improvements in the councils' proposals could be better realised under the merger option.

We find:

- The proposals submitted by Gosford and Wyong are not consistent with the FFTF objectives for stronger and more strategic governance for the Central Coast as the councils propose to stand-alone and not participate in a Central Coast JO.
- Based on our indicative analysis, up to $101 million over 20 years in NPV benefits could be realised from a Gosford and Wyong merger. In addition, Ernst & Young estimated NPV benefits from a merger of Gosford and Wyong is $196 million over 20 years.

For these reasons we consider that Gosford and Wyong did not demonstrate their stand-alone proposal was as good as or better than the merger option.

Hunter region

In the Hunter region, we find Cessnock City Council (Cessnock), Muswellbrook Shire Council (Muswellbrook), Port Stephens Council (Port Stephens), Singleton Council (Singleton) and Upper Hunter Shire Council (Upper Hunter) are fit for the future. All of these councils met the scale and capacity criterion as well as the financial criteria. We note for all these councils, the only option presented was to remain stand-alone councils in a Hunter JO, and these council proposals were consistent with this option.

We find Lake Macquarie City Council (Lake Macquarie), Newcastle City Council (Newcastle), Dungog Shire Council (Dungog) and Maitland City Council (Maitland) not fit for the future. These councils did not meet the scale and capacity criterion. However, with the exception of Dungog, these councils met the financial criteria overall. In particular, Dungog did not meet the sustainability criterion. The council has proposed a significant SV of 108.2%

(92.2% above the rate peg) over six years to achieve the operating performance benchmark which may not be reasonable.

Lake Macquarie and Newcastle did not show that their proposals to stand alone were as good as, or better than, the merger option. We consider a merger of Lake Macquarie and Newcastle is likely to provide system-wide benefits to their communities, better strategic capacity and broader benefits to NSW. We calculated significant NPV benefits over 20 years from a merger of the two councils.

Maitland and Dungog did not show that their proposals to stand alone were as good as, or better than, the merger option. In particular, given Dungog's small and stagnant population, limited capacity to increase revenue and challenges in overcoming infrastructure backlogs, we consider a merger would strengthen the region's ability to be fit for the future. Our analysis suggests the area in aggregate is likely to be better off with a merger. We calculated NPV benefits of an estimated $5 million over 20 years from a merger of the two councils.

Illawarra

In the Illawarra region, we find Wollongong City Council (Wollongong) is fit since it meets both the scale and capacity criterion and the financial criteria overall. The only option presented for Wollongong by the ILGRP is to remain a stand-alone council in the Illawarra JO, and its proposal is consistent with this option. In addition, Wollongong, Shellharbour, Shoalhaven and Kiama have successfully applied to form a pilot JO.

We find that Shellharbour City Council (Shellharbour) and Kiama Municipal Council (Kiama) are not fit. Both councils meet the scale and capacity criterion since their proposals are consistent with the option presented to stand-alone in an Illawarra JO. However, neither of these councils meet the financial criteria.

Shellharbour does not satisfy the financial criteria, primarily due to its operating performance ratio falling short of the benchmark in 2019-20. It forecasts operating deficits despite a relatively large rate increase over four years from 2013-14. A merger between Wollongong and Shellharbour could be explored, consistent with the ILGRP's suggestion.

Kiama does not meet the financial criteria due to consistent operating deficits, despite a proposed SV to increase revenue by 17.4% over three years from 2018-19. It does not meet the efficiency criterion as it forecasts an increase in real operating expenditure per capita over time. This is partly due to plans for a new aged care facility which may be over extending the council financially.

The ILGRP suggested that Kiama and Shoalhaven could amalgamate if future options need to be revisited. A merged council would likely perform better in terms of long-term financial sustainability and in particular for Kiama given the potential efficiencies available from a merger.

2.3 Non-Metropolitan Regions

2.3.1 Northern Rivers[62]

Figure 2.13 Northern Rivers Region

There are six councils in the Northern Rivers region as seen in Figure 2.13.

In the Northern Rivers region we find Ballina Shire Council (Ballina), Byron Shire Council (Byron), Lismore City Council (Lismore) and Richmond Valley Council (Richmond Valley) are fit for the future. These councils met the scale and capacity criterion and the financial criteria overall. Only one option was identified for each of Ballina and Byron - to remain stand-alone councils in a Northern Rivers JO. In contrast, two options were presented for Lismore and Richmond Valley – to either merge with Kyogle Shire Council (Kyogle) or stand alone in a Northern Rivers JO. Lismore and Richmond Valley both submitted stand-alone proposals consistent with the options identified.

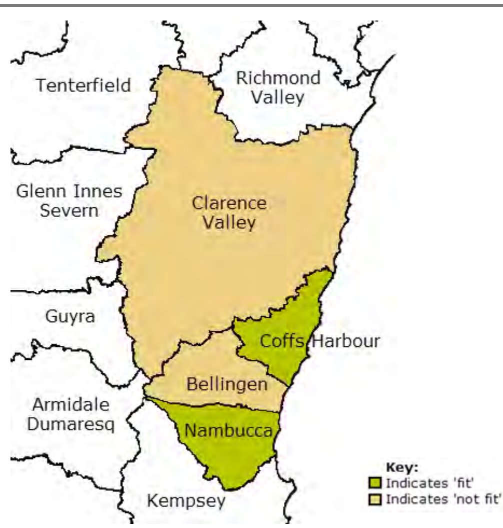
62 This chapter discusses councils on the basis of the regional allocations by the ILGRP in its Final Report.

We find Tweed Shire Council (Tweed) is not fit for the future. It meets the scale and capacity criterion as no evidence was provided for an alternative that was better than its proposal to stand-alone in a Northern Rivers JO. However, it does not meet the financial criteria. This is because Tweed forecasts that its performance in 2019-20 will be below the benchmark for the operating performance ratio at -4.9% and the building and infrastructure asset renewal ratio at 52.2%. Moreover, the council forecasts a high and increasing infrastructure backlog of 8.9% and a below benchmark asset maintenance ratio of 71.3% in 2019-20.

We find Kyogle is not fit for the future as it does not meet the scale and capacity criterion. However, it does meet the financial criteria overall. The council was presented with an option to stand alone in a Northern Rivers JO or merge with either Lismore or Richmond Valley. Kyogle submitted a Rural Council Proposal, which was not an option identified for this council. The council did not demonstrate it meets the majority of the Rural Council Characteristics, in particular two key characteristic for a Rural Council, that is, 'small and static or declining population' and 'limited options for mergers'. The council's population of around 9,550 (2011) is significantly higher than most other councils identified as suitable for being a Rural Council'.[63] Additionally, Kyogle has merger options with Lismore or Richmond Valley as identified by the ILGRP.

2.3.2 North Coast

Figure 2.14 North Coast Region



There are four councils in the North Coast region as seen in Figure 2.14.

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63 We note in particular that Groups B and C councils that the ILGRP identified as suitable to be Rural Councils have populations below 5,000. ILGRP Final Report, pp 114-115.

In the North Coast region, we find Coffs Harbour City Council (Coffs Harbour) and Nambucca Shire Council (Nambucca) are fit for the future. These councils meet the scale and capacity criterion and the financial criteria overall. The only option identified for each of the North Coast councils was to stand alone within a North Coast JO. These councils' proposals are consistent with this option.

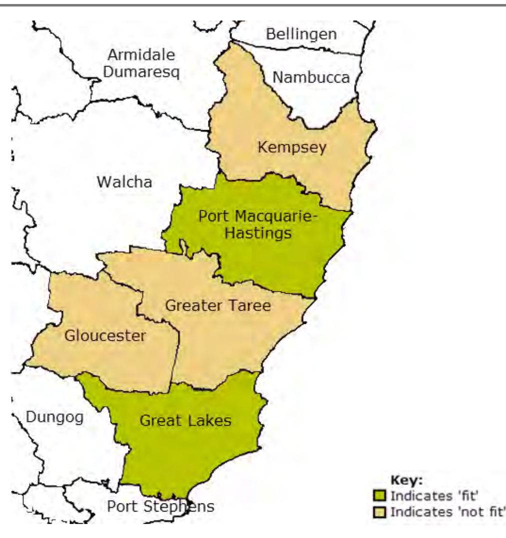
We find Clarence Valley Council (Clarence Valley) and Bellingen Shire Council (Bellingen) are not fit for the future. These councils meet the scale and capacity criterion as their proposals to stand-alone were consistent with the ILGRP's identified option, however, they do not meet the financial criteria overall.

Clarence Valley proposes to increase rates by 34.0% above the rate peg over five years commencing in 2016-17. Despite this proposed rate increase, Clarence Valley forecasts it will have an operating performance ratio in 2019-20 of -5.7%, which is below the benchmark. Clarence Valley also does not meet the infrastructure backlog benchmark of 2% or lower.

Bellingen forecasts its operating performance ratio will be -7.2% in 2024-25, which is below the benchmark, despite proposing a SV from 2016-17 of 44% above the rate peg over nine years (69% including the rate peg). In addition, its building and asset renewal ratio is forecast to be below the 100% benchmark.

2.3.3 Mid North Coast

Figure 2.15 Mid North Coast Region



There are five councils in the Mid-North Coast region as seen in Figure 2.15.

In the Mid-North Coast region, we find Great Lakes Council (Great Lakes) and Port Macquarie-Hastings Council (Port Macquarie) are fit for the future. These councils met the scale and capacity criterion as well as the financial criteria overall. Port Macquarie-Hastings was presented with only one option by the ILGRP – to stand-alone in a Mid-North Coast JO. Great Lakes was presented with an option to merge with Gloucester Shire Council (Gloucester) or to stand-alone in a Mid-North Coast JO. Great Lakes undertook a business case for a merger with Gloucester but considered it provided no financial benefit to the council.

We find Greater Taree Council (Greater Taree) and Kempsey Shire Council (Kempsey) are not fit for the future. These councils meet the scale and capacity criterion but not the financial criteria overall. Greater Taree was also presented with an option to merge with Gloucester or remain a stand-alone council in the Mid-North Coast JO. It considered the merger but found it would not be beneficial to its financial sustainability. Kempsey was presented with only an option to remain a stand-alone council in the Mid-North Coast JO. Both councils submitted a stand-alone proposal. Our analysis did not find sufficient evidence for a better alternative than the stand-alone option. However, both councils do not meet a number of the financial benchmarks. In particular, neither council meets the benchmark for the operating performance ratio which is a key financial sustainability benchmark. Both councils forecast a negative operating performance ratio in 2019-20, which is below the benchmark.

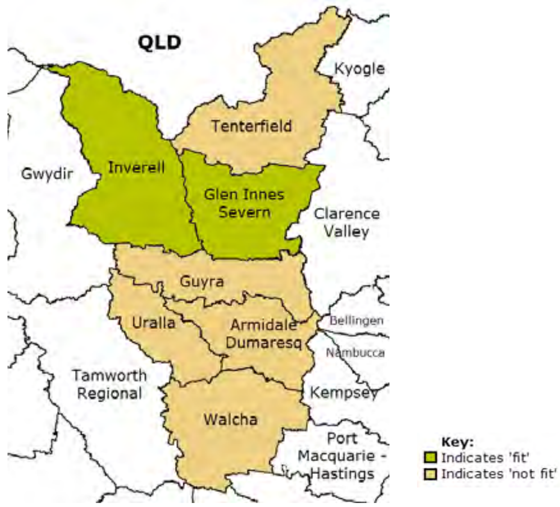
We find Gloucester is not fit for the future. The council does not meet the scale and capacity criterion nor the financial criteria overall. Our analysis suggests the council has insufficient scale to deliver services efficiently to its community and to partner effectively with government. The council's population in 2011 was 5,000 and is forecast to decline to 4,850 by 2031. In addition, our analysis of the merger business case submitted by the council suggests a merger with Great Lakes may generate benefits to the local communities of $11 million over 20 years.[64]

Gloucester also does not satisfy the financial sustainability criterion. It forecasts an improvement in its operating performance ratio from -47.5% in 2014-15 to 6.1% in 2024-25. The improvement relies on the approval of a SV of 36.6% above the rate peg, from 2018-19. This would immediately follow a similarly large SV approved in 2015-16, which would amount to a cumulative rate increase over six years of 92% above the rate peg. The proposed increases are not considered a reasonable assumption and are unlikely to be in the public interest given the other options available to the council.

64 Gloucester and Great Lakes councils commissioned Morrison Low to undertake a business case for a potential merger which returned an NPV of the costs and benefits of -$1 million. However, our analysis of this modelling suggests the merger may generate a positive NPV.

2.3.4 New England

Figure 2.16 New England Region



There are seven councils in the New England region as seen in Figure 2.16.

In the New England region we find Glen Innes Severn Council (Glen Innes) and Inverell Shire Council (Inverell) are fit for the future. These councils meet the scale and capacity criterion and the financial criteria overall. The only option identified for each of these councils was to remain stand-alone councils within the New England JO. Both councils' proposals are consistent with this option.

We find Armidale Dumaresq Council (Armidale), Tenterfield Shire Council (Tenterfield), Uralla Shire Council (Uralla) and Walcha Council (Walcha) are not fit for the future. Armidale does not meet the scale and capacity criterion nor the financial criteria overall. Uralla and Walcha do not meet the scale and capacity criterion but meet the financial criteria overall. Tenterfield meets the scale and capacity criterion but does not meet the financial criteria overall.

Armidale was presented with two options - a merger with Guyra Shire Council (Guyra) as the preferred option or to stand alone in a New England JO. Armidale's proposal suggests it favours a merger with Guyra and Uralla, and possibly Walcha. As this option was not available and Guyra rejected a merger with Armidale, the council submitted a proposal to stand alone. We find Armidale's stand-alone proposal is not as good as or better than the merger option with Guyra because there is limited evidence it could meet the elements of strategic capacity needed to stand-alone compared to the merger option.

Uralla and Walcha were also presented with a preferred option to merge with each other. Uralla did not demonstrate its proposal to stand alone in a New England JO is as good as or better than the proposed merger. Walcha submitted a Rural Council Proposal but did not demonstrate its proposal is as good as or better than the merger. In particular, given Uralla and Walcha are exploring sharing services and staff, the merger potential between the councils is likely to be possible and beneficial. However, both councils meet the financial criteria overall.

Tenterfield was presented with only one option - to remain a stand-alone council in a New England JO. The council would prefer to stand alone within the Northern Rivers JO. We assessed it as meeting the scale and capacity criterion as its proposal is consistent with the identified option. However, it did not meet the financial criteria overall because:

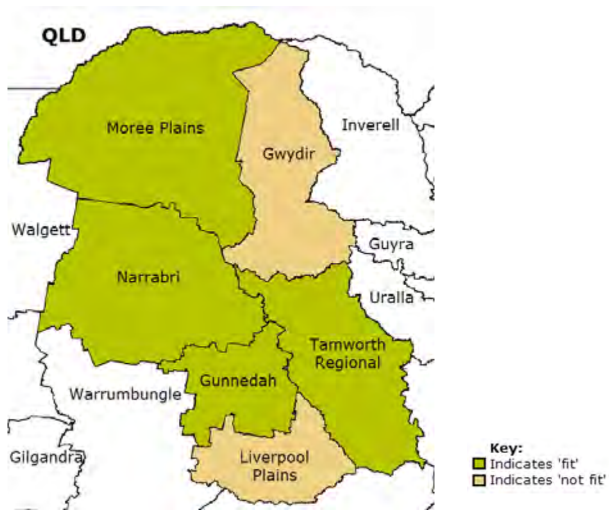
- Its operating performance ratio is -7.2% in 2014-15. To achieve the benchmark by 2024-25 it proposes a cumulative SV from 2018 over seven years of 31.5% above the rate peg (50.4% including the rate peg). In addition to an SV approved in 2014 of 43% above the rate peg, this assumption represents combined increases over 11 years of 99% above the rate peg, which we consider is unreasonable.
- Even with this additional revenue it would not meet the infrastructure backlog ratio which is forecast to be 3.8% in 2019-20 which is above the benchmark of less than 2%.
- With a small, stagnant population and a Socio-Economic Indexes for Areas rating in the bottom decile of the state, it has limited scope to increase its revenue to improve its financial performance.

We also find Guyra Shire Council (Guyra) is not fit as a Rural Council. The ILGRP identified two options for Guyra - a merger with Armidale or to stand alone in a New England JO. The merger option was preferred by the ILGRP. Guyra prefers to stand alone and submitted a Rural Council Proposal. The council does not meet some key Rural Council Characteristics, in particular in relation to the characteristics of having ‘limited options for mergers’ and a ‘long distance to a major (or sub) regional centre. As the council already outsources some functions to Armidale, a merger between Armidale and Guyra is feasible and likely to be beneficial. In addition, the council’s major centre (Guyra), with more than 50% of the LGA’s population, is close to Armidale (30 mins). Guyra did not demonstrate its proposal to stand-alone is as good as or better than the preferred merger option.

Guyra also does not meet the criterion for sustainability based on its forecasts for the operating performance ratio which depends on approval for a significant SV to take effect in 2016-17, as well as unrealistic depreciation assumptions. Using more realistic assumptions, Guyra’s operating performance ratio would be negative throughout the period to 2024-25.

2.3.5 Namoi

Figure 2.17 Namoi Region



There are six councils in the Namoi region as seen in Figure 2.17.

In the Namoi region, we find Gunnedah Council (Gunnedah), Moree Plains Council (Moree Plains), Narrabri Council (Narrabri), and Tamworth Regional Council (Tamworth), are fit for the future. All of these councils meet the scale and capacity criterion as well as the financial criteria overall. The ILGRP presented only a stand-alone option for Gunnedah, Narrabri and Tamworth and these councils' proposals were consistent with this option. It presented two options for Moree Plains to either merge with Gwydir Council (Gwydir) or to stand alone, but neither option was preferred. Moree Plains discussed a merger with Gwydir but did not pursue it. The council meets the scale and capacity criterion as there was insufficient evidence for a better alternative than the stand-alone option.

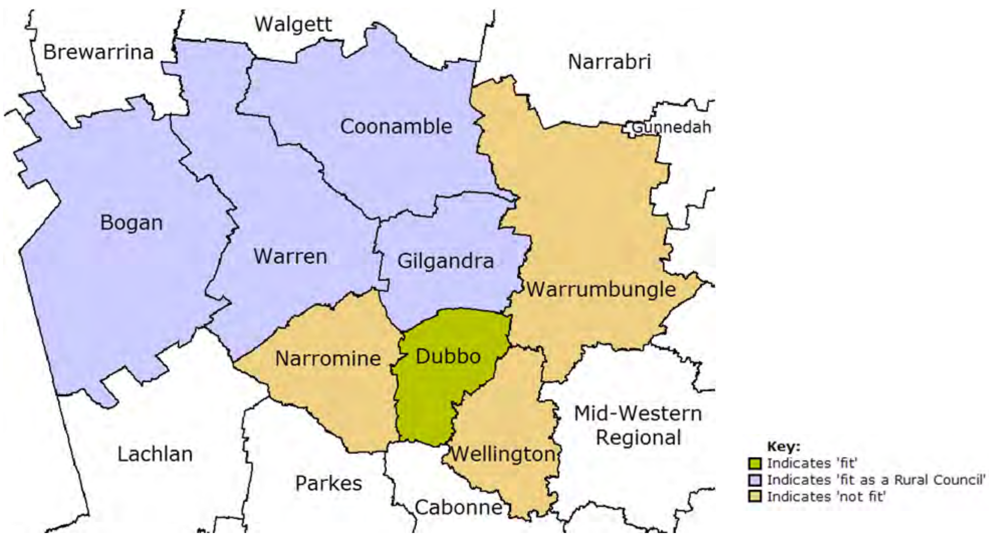
We find Gwydir and Liverpool Plains Council (Liverpool Plains) are not fit. We consider Gwydir is not fit, as it does not meet the scale and capacity criterion nor the financial criteria overall. In particular, Gwydir's small, declining and aging population, which is forecast to fall by 1% a year to 4,200 by 2031[65], is unlikely to be sufficient to support a stand-alone council. Gwydir also has a weak financial position with large operating deficits. Gwydir has proposed a relatively large rate increase of 29.8% above the rate peg over one year and reducing service levels to improve its financial position. However, our analysis finds the council is unlikely to be sustainable in the long term as a stand-alone council.

65 DP&E.

We find Liverpool Plains is not fit, as it does not meet the scale and capacity criterion. Its small population (forecast to reach 7,950 in 2031)[66] is likely to affect the council's future strategic capacity. Further, the council does not appear to have a robust revenue base and its resources to cope with complex and unexpected change appear limited. The council also did not fully explore a merger with Gunnedah, which could have improved its scale and capacity. However, Liverpool Plains meets the financial criteria overall, provided it successfully applies for and implements its proposed SV of 11.4% above the rate peg from 2017-18.

2.3.6 Orana

Figure 2.18 Orana Region



There are eight councils in the Orana region as seen in Figure 2.18.

In the Orana region, we find Dubbo City Council (Dubbo) is fit for the future. The council meets the scale and capacity criterion as well as the financial criteria overall. Dubbo was presented with an option to merge with Wellington and/or Narromine or to stand alone, but neither option was preferred by the ILGRP. Dubbo explored a merger but did not pursue it. However, as Dubbo's proposal is consistent with the options identified, we find it meets the scale and capacity criterion.

66 DP&E.

In this region, we also find Bogan Shire Council (Bogan), Coonamble Council (Coonamble), Gilgandra Shire Council (Gilgandra) and Warren Shire Council (Warren) are fit as Rural Councils. These councils were presented with options to merge or become a Rural Council in the Orana JO, but no preference was identified by the ILGRP. These councils' proposals to become Rural Councils are consistent with the options presented and they met the financial criteria overall. However, should a Rural Council Model not be adopted by Government, these councils would likely be found not fit against the scale and capacity criterion.

We find Warrumbungle Shire Council (Warrumbungle) is not fit for the future. It meets the scale and capacity criterion as its proposal was consistent with the only option presented by the ILGRP - to remain a stand-alone council in the Orana JO. However, the council does not meet the financial criteria overall, in particular it does not meet the benchmark for the operating performance ratio. The council forecasts its operating performance ratio would reach 0.1% by 2024-25 to meet the benchmark, based on an assumption that FAGs would increase by $1 million in 2017-18 which our analysis indicates is not reasonable. Our revised estimate suggests the operating performance ratio will be -2.2% in 2024-25 which does not meet the benchmark. The council also does not meet the criterion for efficiency based on our estimate of an increasing real opex per capita over time.

We find Narromine Shire Council (Narromine) and Wellington Council (Wellington) are not fit for the future. These councils do not meet the scale and capacity criterion although they meet the financial criteria overall. We find they are not fit as stand-alone councils primarily due to their low populations which are forecast to decline to 6,300 and 8,100 by 2031 respectively. Our analysis suggests the councils' relative size could restrict their regional capacity and place them at risk of becoming unsustainable.

As noted above, a potential merger between Dubbo, Wellington and Narromine was identified as an option to explore by the ILGRP because of the close functional inter-relationships between a regional centre (ie, Dubbo) and adjoining council areas (Narromine and Wellington).[67] The councils undertook some evaluation of a merger, however, did not pursue this option.

[67] ILGRP Final Report, p 85.

2.3.7 Central West

Figure 2.19 Central West Region

There are 12 councils in the Central West region as seen in Figure 2.19.

In the Central West region we find Bathurst Regional Council (Bathurst), Cowra Shire Council (Cowra) and Parkes Shire Council (Parkes) are fit for the future. These councils meet the scale and capacity criterion as well as the financial criteria overall. Bathurst, Cowra and Parkes were presented with options for mergers or to stand alone in a Central West JO, but neither option was preferred. The proposals submitted were consistent with the options identified.

We find, Blayney Shire Council (Blayney), Cabonne Shire Council (Cabonne), Forbes Shire Council (Forbes), Lachlan Shire Council (Lachlan), Lithgow City Council (Lithgow), Mid-Western Regional (Mid-Western), Oberon Council (Oberon), Orange City Council (Orange) and Weddin Shire Council (Weddin) are not fit for the future.

Blayney, Forbes, Lachlan and Oberon did not satisfy the scale and capacity criterion due to the councils' low and/or declining populations. These councils' populations are forecast to be 7,800, 8,750, 5,500 and 4,950 respectively by 2031. Our analysis suggests that these councils have insufficient scale to deliver services efficiently to the community and to partner effectively with government. They are unlikely to remain sustainable.

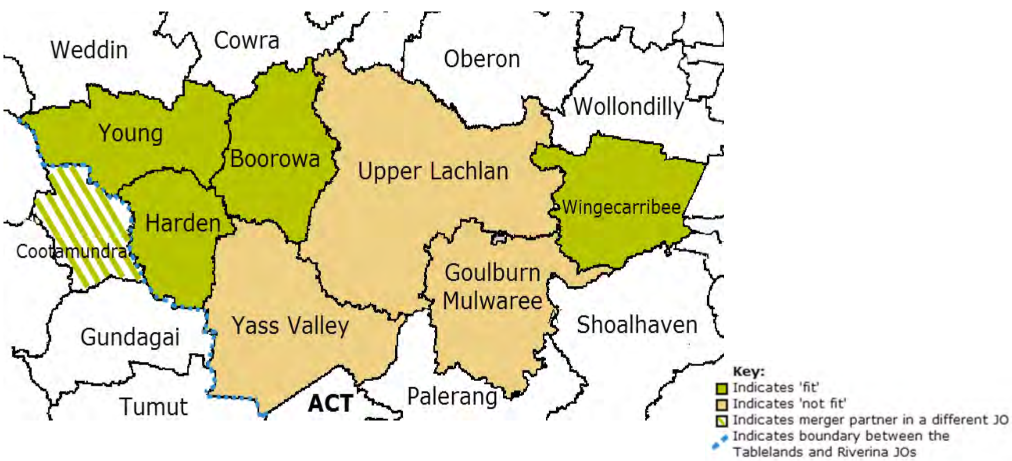
Cabonne and Orange did not satisfy the scale and capacity criterion because the councils did not demonstrate their proposals are at least as good as or better than the preferred merger option for these councils to merge with each other. We calculate, drawing on information in the business case provided by these councils, the merger could produce benefits of around $27 million over 20 years.

Lithgow and Mid-Western satisfy the scale and capacity criterion but did not satisfy the financial criteria overall. We note, in particular, their operating performance ratios will not reach break-even by the benchmark year. Mid-Western also did not satisfy the asset maintenance and infrastructure backlog ratios and Lithgow is not able to meet the building and asset renewal ratio and efficiency criterion.

Weddin submitted a Rural Council Proposal and met the majority of the Rural Council Characteristics as required for a Rural Council. The council projected that it would also meet all the financial criteria. However, we consider its assumption of an increase in FAGs in 2016-17 of $1.5 million is unrealistic. Our recalculation, based on removing the FAGs assumption, finds its operating performance ratio will likely be below benchmark in 2024-25 at around -0.4%. Further, the council forecasts no improvement in its infrastructure backlog ratio which remains around 4.4% by 2019-20, which does not meet the benchmark. We find the council does not meet the financial criteria overall.

2.3.8 Tablelands

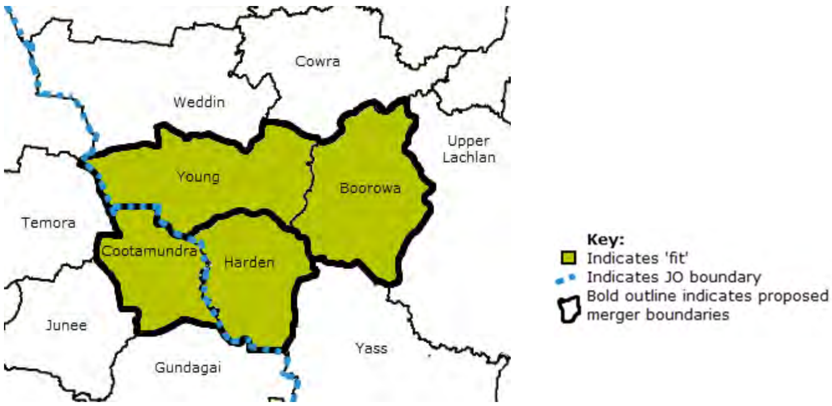
Figure 2.20 Tablelands Region



There are seven councils in the Tablelands region as seen in Figure 2.20. The region includes three councils; Young, Boorowa and Harden that are the subject of Merger Proposals. Cootamundra Shire Council is also included in this discussion on the Tablelands region as it has proposed a merger with Harden. We first discuss our findings on these Merger Proposals and the remaining councils in the following section.

Merger Proposals included in Tablelands - Boorowa and Young; Harden and Cootamundra

Figure 2.21 Boorowa/Young and Harden/Cootamundra Merger Proposals



The ILGRP indicated a preferred 'Hilltops' merger option between Young, Boorowa and Harden. Young and Boorowa submitted a three-way Merger Proposal without the endorsement of Harden. We have assessed the two-way Merger Proposal between Young and Boorowa based on the available information in the proposal.

Harden endorsed and submitted a Merger Proposal with Cootamundra from the Riverina region rather than with Young and Boorowa. Cootamundra was given options to stand alone within a Riverina JO or to merge with Junee Shire Council (Junee). Neither option was preferred by the ILGRP.

We find the Young-Boorowa Merger Proposal is fit for the future. We find that this merger satisfies the scale and capacity criterion and the financial criteria overall. Our reasons for this assessment are that:

- The proposed merger population is projected to be consistent with the ILGRP's rule of thumb of close to or above 10,000 for non-metropolitan council populations by 2031.
- The merger will provide better ability to employ a wider range of skilled staff, more effective regional collaboration and credibility for more effective advocacy than each council as stand-alone councils.
- The merger is superior to each council as stand-alone councils based on the efficiencies and cost savings highlighted in the business case. We calculate the merger would generate net present value benefits of $31 million over 20 years, based on the LKS Quaero's business case for the councils.
- It is the best option available to the councils, given the preferred option is unable to be proposed without Harden's consent.

Young and Boorowa's merger proposal is contingent on the inclusion of Harden. Further, Boorowa resolved to not support a two-way merger with Young. Therefore, our assessment of fit is dependent on Young and Boorowa resolving to merge in the absence of Harden. In the event agreement cannot be reached, we find the councils are deemed not fit, as they have not demonstrated scale and capacity as stand-alone councils.

We find the Cootamundra-Harden Merger Proposal is fit for the future as it satisfies the scale and capacity criterion and the financial criteria overall. Our reasons for this assessment are that:

- The community consultation supported the proposed merger and there are likely to be communities of interest.
- The proposed population is projected to be consistent with the ILGRP's rule of thumb of close to or above 10,000 for non-metropolitan council populations by 2031.
- The merger is superior to each council as stand-alone councils based on the efficiencies and cost savings highlighted in the business case. We calculate the merger would generate net present benefits of about $11 million over 20 years.
- The councils' proposal appears to be based on improving service delivery or the suite of services provided rather than reducing costs. This has not been captured in the business case, but would further benefit the community.

Young's next preferred option for a merger includes expanding the proposed 'Hilltops' merger to include Cootamundra. However, Cootamundra has rejected this option on the basis that it changes the focus of Cootamundra and the southern half of Harden away from the Riverina region. Based on the information provided by the councils we consider a four-way merger between Young, Boorowa, Harden and Cootamundra is likely to deliver larger gains to the community than the current two Merger Proposals.

Other Tableland Councils

Among the other councils in the Tablelands region, we find Wingecarribee Shire Council (Wingecarribee) is fit for the future, as it meets the scale and capacity criterion as well as the financial criteria overall. The ILGRP identified only one option for Wingecarribee - to remain a stand-alone council in the Tablelands JO, and the council's proposal was consistent with this option. The council has a proposed SV from 2016-17 of 41% over four years (around 30.8% above the rate peg) which enables it to just meet the benchmark for the operating performance ratio.

We find Goulburn Mulwaree Council (Goulburn), Upper Lachlan Shire Council (Upper Lachlan) and Yass Valley Council (Yass Valley) are not fit. The ILGRP identified only one option for Goulburn and Yass Valley - to remain stand-alone councils in the Tablelands JO. However, Upper Lachlan had the option to stand-alone or to merge with Goulburn with no ILGRP preference indicated for either option.

We find that while Goulburn's proposal to stand alone is consistent with the option identified for the council, it does not meet the financial criteria overall. In particular, its operating performance ratio of -4.3% in 2019-20 could affect its continued ability to provide services to its community. We find that Goulburn is not financially sustainable despite its current and proposed strategies for improvement.

Goulburn considered a merger with Upper Lachlan Shire. We find that Goulburn's forecast 2031 population of 33,550 represents 86% of a possible merger, which would provide strategic capacity to Upper Lachlan. The council notes it held discussions in relation to a possible amalgamation with all neighbouring councils but that each council decided to stand alone.

We find Upper Lachlan is not fit, as it does not meet the scale and capacity criterion although it meets the financial criteria overall. Its projected population in 2031 of 7,500 suggests the council may be at risk of becoming unsustainable which may affect its future strategic capacity. Further, the council's relative size means it is unlikely to be able to undertake major projects of regional or state significance.

Yass Valley's stand-alone proposal was consistent with the identified option and therefore meets the scale and capacity criterion, but it does not meet the financial criteria as it has a weak financial position. We note that even with a proposed SV of 37.2% above the rate peg over five years, its operating performance ratio falls below the benchmark in the assessment period. Its infrastructure backlog ratio also does not meet the benchmark by 2019-20. However, the council has adequate own source revenue relative to the 60% benchmark, and is funding asset maintenance to stabilise the infrastructure backlog, which provides a basis for future improvement.

2.3.9 Riverina

Figure 2.22 Riverina Region

There are 10 councils in the Riverina region as seen in Figure 2.22.

In the Riverina region we find Wagga Wagga City Council (Wagga) is fit for the future as a stand-alone council. The council was presented with two options - to merge with Lockhart Shire Council (Lockhart) or to stand alone in a Riverina JO, but neither option was preferred. Wagga and Lockhart did not undertake a robust or detailed analysis of a merger, but, as the proposals were consistent with the options identified we assessed them as meeting the scale and capacity criterion. However, Wagga has forecast operating deficits in the short term and only just meets the benchmark for the operating performance ratio by 2019-20 at 1.2%, which is assisted by a proposed SV in 2016-17 of 4.1% (6.6% including the rate peg). Additionally, it does not satisfy the infrastructure and service management criterion. While it meets the financial criteria overall, Wagga could make some improvements in its financial performance, particularly in relation to the management of its assets.

We find Coolamon Shire Council (Coolamon), Lockhart and Tumbarumba Shire Council (Tumbarumba) are fit as Rural Councils. These councils' proposals were consistent with the options presented, met the majority of the Rural Council Characteristics and met the financial criteria overall. However, should a Rural Council Model not be adopted by Government, these councils would likely be found not fit against the scale and capacity criterion.

We find Bland Shire Council (Bland), Gundagai Shire Council (Gundagai), Junee Shire Council (Junee), Temora Shire Council (Temora), and Tumut Shire Council (Tumut) not fit for the future.

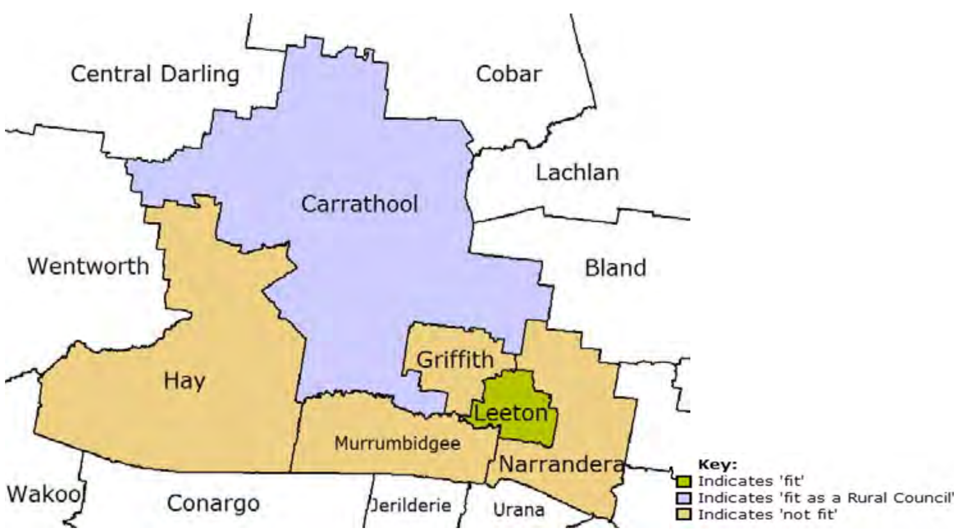
The preferred option for Gundagai and Tumut was to merge with each other. Tumut corresponded with Gundagai regarding a merger, but this was not progressed due to Gundagai's preference to stand alone. Gundagai submitted a Rural Council Proposal, but neither council demonstrated their proposal is as good as or better than the merger option. Our analysis suggests a merger of these councils could provide greater scale and capacity compared to the councils standing alone. While Tumut meets the financial criteria overall, Gundagai does not. In particular, Gundagai's operating performance ratio does not meet the benchmark by 2024-25.

Temora and Bland were presented with an option to merge or stand alone as councils in the Riverina JO. Junee was presented with an option to merge with Cootamundra or stand alone in the Riverina JO. Junee investigated the merger option with Cootamundra, but the councils identified the Bethungra Range as an impediment to efficiently providing services across the councils and a natural divide between the communities of interest. Temora, Bland and Junee each proposed to stand-alone, but do not meet the scale and capacity criterion. Each of these councils has a low population that is forecast to decline by 2031. Their capacity to undertake new functions or major projects as stand-alone councils in the future is likely to be limited by their declining populations. We find these councils meet the requirements of the financial criteria overall.

Cootamundra is discussed in the Tablelands section as it has proposed a merger with Harden.

2.3.10 Murrumbidgee

Figure 2.23 Murrumbidgee Region



There are six councils in the Murrumbidgee region as seen in Figure 2.23.

In the Murrumbidgee region, we find Leeton Shire Council (Leeton) is fit for the future as it meets the scale and capacity criterion and financial criteria overall. The council was presented with two options – a merger with Narrandera Shire Council (Narrandera) or to remain a stand-alone council in a Murrumbidgee JO. Neither option was preferred by the ILGRP. Leeton investigated a merger with Narrandera but did not pursue it as it considered there was little benefit based on the results of the business case it commissioned. It submitted a stand-alone proposal which was consistent with the identified options.

We find Carrathool Shire Council (Carrathool) is fit as a Rural Council. It meets most of the Rural Council Characteristics, has proposed some improvement strategies and met the financial criteria overall. Carrathool was presented with two options – to merge with Griffith or become a Rural Council in a Murrumbidgee JO. It ruled out the merger as a large majority of the community preferred the council to stand alone. However, should a Rural Council Model not be adopted by Government, Carrathool would likely be found not fit against the scale and capacity criterion.

We find Griffith City Council (Griffith), Murrumbidgee Shire Council (Murrumbidgee), Hay Shire Council (Hay) and Narrandera Shire Council (Narrandera) not fit for the future.

Griffith and Murrumbidgee do not meet the scale and capacity criterion as they did not sufficiently explore the preferred option for these councils to merge. The councils indicated a discussion on the merger was held, but no agreement was reached to explore the merger. Further Murrumbidgee's proposal to be a Rural Council did not satisfy the majority of the Rural Council Characteristics.

The ILGRP identified only one option for Hay, which was to be a Rural Council in a Murrumbidgee JO. Its Rural Council Proposal met most of the Rural Council Characteristics, but it does not meet the financial criteria overall. In particular, we consider the improvement to its operating performance ratio is based on optimistic assumptions. The council has a high dependence on FAGs and the Federal Roads to Recovery Grant to deliver a break even result by the benchmark year of 2024-25 for Rural Councils. The council assumes that these federal grants would not only continue, but increase in real terms in the future even though its population is forecast to decline. It forecasts a small operating surplus by 2024-25, but our adjusted estimates forecast a deficit of -0.4% which does not meet the benchmark.

We find Narrandera does not meet the scale and capacity criterion as our analysis indicates its proposed improvements are not sufficient for achieving long term sustainability. In particular, its low population which is forecast to decline to 4,950 in 2031, is unlikely to be sufficient to support a stand-alone council and may affect its future strategic capacity.[68]

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[68] NSW Department of Planning and Environment, *New South Wales State and Local Government Area Population Projections 2014*.

However, Griffith, Murrumbidgee and Narrandera meet the financial criteria overall, based on forecast modest surpluses to meet the benchmark for the operating performance ratio. This is assisted by an SV in 2017-18 and 2018-19 proposed by Murrumbidgee and by sustainability strategies and improvements proposed by Griffith and Narrandera. We note that each council has reviewed its asset management strategy to achieve the infrastructure and service management ratios, but faces challenges in meeting the efficiency benchmark largely due to declining populations in the area.

2.3.11 Mid-Murray

Figure 2.24 Mid-Murray Region

There are six councils in the Mid-Murray region as seen in Figure 2.24.

In the Mid-Murray region we find Wakool Shire Council (Wakool) fit as a Rural Council. The council meets most of the Rural Council Characteristics, has proposed strategies for improvement, which it forecasts will provide annual savings/revenue of $432,000 a year by 2019-20 and met the financial criteria overall. However, should a Rural Council Model not be adopted by Government, Wakool would likely be found not fit against the scale and capacity criterion.

We find Berrigan Shire Council (Berrigan), Conargo Shire Council (Conargo), Deniliquin Council (Deniliquin), Jerilderie Shire Council (Jerilderie) and Murray Shire Council (Murray) are not fit for the future. These councils do not meet the scale and capacity criterion although Berrigan and Conargo meet the financial criteria overall. Jerilderie does not meet the financial criteria overall.

The ILGRP preferred Berrigan and Jerilderie to merge together. Berrigan submitted a proposal to stand alone and Jerilderie submitted a Rural Council Proposal which were the alternative options presented by the ILGRP. We found neither proposal was as good as the merger option. When compared to the merger, Jerilderie is unlikely to be able to cost-effectively provide services to the community, given its small and declining population, which is forecast to be 1,250 in 2031. We consider a merged council is likely to have improved capabilities, a more robust revenue base and greater scope to undertake new functions and projects for the area. The SGS merger business case commissioned by Berrigan, calculated NPV savings between $1.4 million and $12.5 million (not including the $5 million government funding) from a merger.

The ILGRP's preferred option for Conargo, Deniliquin and Murray was to merge together. None of these councils submitted a Merger Proposal. Deniliquin and Murray submitted proposals to stand-alone, while Conargo submitted a Rural Council Proposal. These councils did not demonstrate their proposed option was at least as good as a merger. Our analysis of the information provided by the councils indicates there could be significant benefits of around $16 million over 20 years for a merger of Murray with Deniliquin. In particular, Conargo and Deniliquin's small and declining populations of 1,700 and 5,700 (2031) respectively suggests the councils are unlikely to provide services cost-effectively to the local communities, advocate credibly, and partner effectively with government when compared to a merged council.

2.3.12 Upper Murray

Figure 2.25 Upper Murray Region

There are four councils in the Upper Murray region as seen in Figure 2.25.

In the Upper Murray region, we find Albury City Council (Albury) and Greater Hume Shire Council (Greater Hume) are fit for the future. These councils meet the scale and capacity criterion as well as the financial criteria. Two options were identified for these councils – to stand-alone in an Upper Murray JO, or for Albury and Greater Hume to merge in-part or in full. Albury strongly opposes further amalgamations and this view appears to have influenced Greater Hume's proposal. Both Albury and Greater Hume submitted proposals to stand-alone and did not explore the merger option. Both councils' proposals are consistent with the identified options.

We find Corowa Shire Council (Corowa) and Urana Shire Council (Urana) are not fit for the future. These councils did not meet the scale and capacity criterion, although they met the financial criteria overall. The two options identified for Corowa and Urana were to merge or to stand-alone in an Upper Murray JO, but the merger of the two councils was preferred. The councils' proposals to stand-alone did not demonstrate they were at least as good as a merger.

We consider Corowa made an effort to explore merger options with neighbouring councils. In the absence of willing partners, Corowa did not undertake a business case for the merger option and resolved to stand-alone. Corowa's population is forecast to decline by 0.2% a year from 2011 to 2031. Our analysis shows a merged council would yield a modest improvement in scale and capacity relative to Corowa's current performance.

Urana's business case focused on the council becoming a Rural Council in a Riverina JO and it is currently a member of the pilot Riverina JO. Urana's population of 1,200 in 2011 is forecast to fall by a third to 800 by 2031. This is unlikely to be sufficient to support a stand-alone council. Urana proposes a cumulative SV of 63.1% above the rate peg over four years from 2016-17 to improve its financial sustainability. Its declining population means it will increasingly rely on rate increases to maintain its operations because of its small scale. We consider a merger with Corowa as preferred by the ILGRP would provide scale and capacity for Urana and would improve the system of local government in the area.

2.3.13 South East

Figure 2.26 South East Region

There are eight councils in the South East region as seen in Figure 2.26.

In the South East region we find Bega Valley Shire Council (Bega), Eurobodalla Shire Council (Eurobodalla) and Shoalhaven City Council (Shoalhaven) fit for the future. These councils were presented with only one option - to remain stand-alone councils in the South East JO - and the councils' proposals were consistent with this option.[69] Bega, Eurobodalla and Shoalhaven also meet the financial criteria overall. However, Shoalhaven meeting the sustainability criterion is contingent on the approval of an assumed rate increase of 21% (15.9% above the rate peg) over two years.

We find Bombala Council (Bombala), Cooma-Monaro Shire Council (Cooma), Palerang Council (Palerang), Queanbeyan City Council (Queanbeyan) and Snowy River Shire Council (Snowy River) not fit, as they do not meet the scale and capacity criterion. Further, Cooma and Snowy River do not meet the financial criteria overall.

Bombala and Cooma were presented with a preferred option to merge with each other, with a secondary option to stand alone in the South East JO (as a Rural Council for Bombala).[70] Snowy River was presented with the options to merge with Cooma/ Bombala or stand alone in the South East JO. These councils jointly commissioned a business case for a three-council merger, but decided not

69 We note Shoalhaven may not be part of a future South East JO as it is currently part of the pilot Illawarra JO with Kiama, Wollongong and Shellharbour.

70 We note Cooma has indicated it intends to seek State Government approval to join the Canberra Region JO (CBRJO) rather than the South East JO. The CBRJO currently has 12 member councils plus the ACT Government and excludes Shoalhaven and Bega.

to pursue it, preferring to stand alone and adopt a shared services option. Cooma and Snowy River submitted Council Improvement Proposals, while Bombala submitted a Rural Council Proposal.

We consider a merger between Bombala, Cooma and Snowy River could assist to improve regional collaboration, advocacy, and planning and enable more effective partnerships with state and federal government. Our analysis of the business case, using information provided by the councils, shows there could be benefits of $22 million over 20 years on a NPV basis. Additionally, each council's small population (below 10,000), may affect its longer term strategic capacity and financial sustainability as stand-alone councils. Cooma and Snowy River did not demonstrate that standing alone would be as good as, or better than, a merger. Bombala meets most of the Rural Council Characteristics, however we assess standing alone as a Rural Council is not as good as, or better than, the preferred merger with Cooma. As a result, for these reasons, we assess Cooma, Snowy River and Bombala as not meeting the scale and capacity criterion.

We find Bombala meets the financial criteria but Cooma and Snowy River do not. Both Cooma and Snowy River have assumed the approval of large SVs to assist in meeting the financial benchmarks, in particular the operating performance ratio benchmark. In both cases, we consider this may not be a reasonable assumption, based on the magnitude of the proposed SVs.

In relation to Palerang and Queanbeyan, we consider a merger would provide greater benefits for Palerang and Queanbeyan, than each council standing alone. Our analysis suggests that, using the information in the business case jointly commissioned by Palerang and Queanbeyan, a merger would provide benefits of $51 million in NPV terms over 20 years. We also assess a merger would improve regional collaboration, operational efficiencies and longer term financial sustainability for Palerang. Queanbeyan has proposed a 'Regional Services Model', which would involve the provision of back office functions for Palerang and a coordinating leadership role for neighbouring councils. However, this model was not supported by Palerang or acknowledged by other neighbouring councils. We also consider this model is unlikely to generate the same level of benefits as the preferred merger.

Both Palerang and Queanbeyan were assessed as meeting the financial criteria overall. However, we note Palerang meeting the sustainability criterion is based on the approval of an SV of 24% above the rate peg over five years (40% including the rate peg). In addition, Queanbeyan meeting the financial criteria is based on the assumption of transitioning to its Regional Services Model, which it has assumed would include significant efficiency gains and a revised organisational structure.

3 Monitoring and reporting of FFTF projections

This chapter sets out issues relating to the monitoring and reporting of councils' FFTF projections following our assessment process.

3.1 Monitoring and reporting process

Becoming a FFTF council is a process that will take time, particularly if structural change is proposed. There are also benefits from assessing a council's performance over time to ensure continued financial sustainability and effective and efficient service delivery.

As discussed in Chapter 1, most councils have proposed a range of strategies to improve their performance in their proposals. The assessment of whether a council is fit has been predicated on the assumption these strategies would be implemented. In some instances, these strategies will require significant change to implement new structures, approaches, and functions which may be challenging and require an extended transition period.

The NSW Government has indicated that strengthening the audit requirements for the local government sector will assist to identify trends and opportunities for improvement.[71] The Government has also noted it recognises the potential value in giving the Auditor-General responsibility for the audit of councils' financial statements to:

- improve quality, consistency, timeliness and financial management more generally, and
- ensure the provision of reliable data that can be used for sustainability assessments and benchmarking.

71 OLG, NSW Government Response – *Independent Local Government Review Panel recommendation – Local Government Acts Taskforce recommendations*, September 2014, p 8.

OLG expects to implement this new regime following further consultation with the local government sector and legislative change.[72] OLG is currently developing a new performance measurement framework to help communities understand how well their council is performing.[73]

In response to our Consultation Paper, various stakeholders made a number of suggestions regarding how the auditing process for FFTF performance should be implemented. Stakeholders generally considered this should occur:

- after other sector reforms are implemented, including the Integrated Planning and Reporting (IP&R) Guidelines and legislative reforms, and
- with established performance guidelines, developed in consultation with the sector.[74]

Other stakeholders noted:

- auditing should not commence until there is a review of the most appropriate asset-related measures to report on
- there should be reporting of council skill levels, and
- any monitoring should have a positive focus, like the Promoting Better Practice Program.

3.1.1 Proposed monitoring and reporting process

Following the assessment process, the monitoring and reporting of councils' performance against their FFTF proposals could operate as follows:

- Councils would report their performance in their Annual Reports.[75]
- OLG would monitor councils' performance. Councils' FFTF projections and performance against these projections will be collected annually by OLG.[76] The performance of councils would be publicly reported each year by OLG.[77]
- The Auditor-General would be empowered to undertake performance audits of the NSW local government sector.[78]

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72 OLG, NSW Government Response – *Independent Local Government Review Panel recommendation – Local Government Acts Taskforce recommendations*, September 2014, pp 4-8.

73 OLG, *Local Government Performance Measurement Framework* at: http://www.olg.nsw.gov.au/strengthening-local-government/supporting-and-advising-councils/local-government-performance-measurement-framework, accessed on 7 October 2015.

74 A number of submissions including metropolitan and regional councils, some ROCs and an Engineering Association.

75 Councils are required to report their financial performance in their Annual Report. See: OLG, 2013, *Strengthening councils and communities: Discussion Paper*, November 2013, pp 4-5.

76 OLG has requested councils' provide their FFTF projections and financial performance against these projections in its financial data collection for 2014-15.

77 OLG undertakes reporting of council performance each year in the 'Your Council' report.

78 OLG, NSW Government Response – *Independent Local Government Review Panel recommendation – Local Government Acts Taskforce recommendations*, September 2014, p 8.

OLG is currently working with the Audit Office of NSW to facilitate the implementation of the audit function.[79] The scope of audits would need to be clearly defined to ensure the costs do not exceed the benefits.

The implications of the assessments and of a council not meeting its FFTF projections will be matters for the NSW Government.

[79] Ibid.

Appendices

A Terms of reference

Premier of New South Wales

Reference: A1172026

Dr Peter J Boxall AO
Chairman
Independent Pricing and Regulatory Tribunal
PO Box K35
Haymarket Post Shop
SYDNEY NSW 1240

Peter

Dear Dr ~~Boxall~~

I write to request that the Independent Pricing and Regulatory Tribunal fulfil the role of the Fit for the Future Expert Advisory Panel, and undertake a review of NSW councils' 'fit for the future' proposals in accordance with the attached Terms of Reference.

Should you require further information please contact Mr David Tow, Executive Director of Cities Branch, Department of Premier and Cabinet on (02) 9228 4353 or david.tow@dpc.nsw.gov.au.

Yours sincerely

MIKE BAIRD MP
Premier

Terms of Reference for a review of local council Fit for the Future proposals by an Expert Advisory Panel

I, the Hon Mike Baird MP, Premier of New South Wales, pursuant to section 9 of the *Independent Pricing and Regulatory Tribunal Act 1992* request that the Independent Pricing and Regulatory Tribunal act as the Expert Advisory Panel to review local council Fit for the Future proposals, in accordance with these terms of reference:

Introduction

Based on the recommendations of the Independent Local Government Review Panel (ILGRP), the NSW Government has agreed to an approach to local government reform that seeks to create councils that are strategic and Fit for the Future. A Fit for the Future council is one that:

1. Has the scale and capacity to engage effectively across community, industry and government;
2. Is sustainable;
3. Is efficient;
4. Effectively manages infrastructure and delivers services for communities.

All councils have been called upon to submit a Fit for the Future proposal by 30 June 2015 for assessment by the Expert Advisory Panel (except the eight councils in the Far West, where submitting a proposal is optional).

The Office of Local Government has prepared three templates and associated guidance for the use of councils in making their proposals:

> ***Template 1: Council Merger Proposal*** – where a group of councils have agreed to merge, broadly consistent with the scale and capacity recommendations of the ILGRP.
>
> ***Template 2: Council Improvement Proposal*** – where councils with demonstrated sufficient scale and capacity, using the Panel's recommendation as a starting point, identify the strategies and actions they will implement to ensure they are Fit for the Future against the sustainability, efficiency, and effective management of infrastructure and services criteria and associated measures and benchmarks.
>
> ***Template 3: Rural Council Proposal*** – for councils in Group C of the Panel's final report i.e. where the option of a Rural Council was presented with no preferred alternative or other small councils that want to adopt the options and can demonstrate they meet the Rural Council Characteristics.

The guidance documents supporting each template explain what is required from councils in preparing their proposal and in demonstrating they are Fit for the Future.

Task

The Expert Advisory Panel (the Panel) will assess the Fit for the Future proposals of NSW councils, and prepare a report to the Minister for Local Government with a recommendation on whether each council is Fit for the Future.

Procedure

The Panel is to:

1. Develop a methodology for assessing Fit for the Future proposals.
   The assessment methodology must:
   a. be consistent with the Government's local government reform agenda, as outlined in the Fit for the Future documentation
   b. include an assessment of the scale and capacity criteria as a threshold criterion
   c. include an assessment of the performance against the fit for the future measures and benchmarks, that takes into account:
      i. the material published in the template guidance
      ii. the relative importance of each measure in a council becoming Fit for the Future and relative robustness of the measure
      iii. the social and community context and outcomes for each council
   d. include an assessment of the consultation process undertaken by the council
   e. consider advice provided by the Ministerial Advisory Group
   f. identify timescales and approach to consultation
   g. be published for public consultation for a minimum of 28 days
   h. be finalised and made available to councils no later than week commencing 1 June 2015.

2. Undertake an assessment of whether each council is Fit for the Future, consistent with the published methodology.
   In undertaking this assessment the Panel must:
   a. operate with consistency, fairness and impartiality
   b. have in place an online portal for all councils to submit their Fit for the Future proposals
   c. publish all proposals and supporting documentation (subject to confidentiality requirements) received from councils online as soon as practicable after 30 June 2015
   d. ensure local government knowledge and expertise in the technical assessment of each proposal
   e. rely on the evidence provided by councils through the online submission process, as required by the relevant template and any additional relevant information
   f. give councils the opportunity to provide additional information. This may include the opportunity for councils to present in person.

3. Provide the Minister for Local Government and the Premier with a final report by 16 October 2015 identifying whether or not each council is Fit for the Future and the reasons for this assessment, to be publicly released following Cabinet approval.

B Fit for the Future financial criteria

This appendix outlines:

- a table with the FFTF financial criteria and benchmarks that were used to assess council proposals, and
- a discussion of the considerations we have taken into account in assessing proposals against these criteria.

Table B.1 Fit for the Future Financial Criteria

Criteria	Performance measure	Definition	Benchmark	Metropolitan/ regional councils	Rural councils[a]	Merger case[b]
Sustainability	Operating Performance Ratio	Net continuing operating result[a] (excl capital grants and contributions) / Total continuing operating revenue[a] (excl capital grants and contributions)	Greater than or equal to break-even average over 3 years	Must meet within 5 years	Plan to meet within 10 years	Must meet within 5 years for non-rural councils Plan to meet within 10 years for rural councils
	Own Source Revenue	Total continuing operating revenue[a] (excl all grants and contributions) / Total continuing operating revenue[a] (incl capital grants and contributions)	Greater than 60% average over 3 years	Must meet within 5 years	Plan to improve within 5 years and consideration of FAGs	Must meet within 5 years for non-rural councils Plan to improve within 5 years and consideration of FAGs for rural councils
	Building & Infrastructure Asset Renewal Ratio	Asset renewals (building and infrastructure) / Depreciation, amortisation and impairment (building and infrastructure)	Greater than 100% average over 3 years	Meet or improve within 5 years	Meet or improve within 5 years	Meet or improve within 5 years

Criteria	Performance measure	Definition	Benchmark	Metropolitan/ regional councils	Rural councils[a]	Merger case[b]
Infrastructure and service management	Infrastructure Backlog	Estimated cost to bring assets to satisfactory condition Total written down value of infrastructure, buildings, other structures, depreciable land, and improvement assets	Less than 2%	Meet or improve/ inform within 5 years	Meet or improve/ inform within 5 years	Meet or improve/ inform within 5 years
	Asset Maintenance	Actual asset maintenance Required asset maintenance	Greater than 100% average over 3 years	Meet or improve/ inform within 5 years	Meet or improve/ inform within 5 years	Meet or improve/ inform within 5 years
	Debt Service	Cost of debt service (interest expense and principal repayments) Total continuing operating revenue[a] (excl capital grants and contributions)	Greater than 0% and less than or equal to 20% average over 3 years	Meet within 5 years	Meet within 5 years	Meet within 5 years

Criteria	Performance measure	Definition	Benchmark	Metropolitan/ regional councils	Rural councils[a]	Merger case[b]
Efficiency	Real operating expenditure per capita[b]	$\frac{\text{Operating expenditure}^{a}}{\text{Population}^{c}}$	A decrease in Real Operating Expenditure per capita over time	Must demonstrate operational savings (net of IP&R supported service improvements) over 5 years	Must demonstrate operational savings (net of IP&R supported service improvements) over 5 years but may not be practical in short term	Demonstrate operational savings (net of IP&R supported service improvements) over 5 years but may not be practical in short term

a Where applicable, excludes fair value adjustments, reversal of revaluation decrements, net result on sale of assets and net share/loss of interests in joint ventures.

b Expenditure is deflated by the CPI (for 2009 to 2011) and the Local Government Cost Index (2011 to 2014), as published by IPART.

c ABS, Regional Population Growth, Australia. The data should be averaged over 2 calendar years, except for 2013-14, where the data for the 2013 calendar year should be used.

Note: The benchmarks are to be applied as rolling averages. All measures, where applicable, should be consistent with the Accounting Code/TCorp measures. The measures should also be based on General Fund data and exclude Water and Sewer Funds.

Rural councils include rural councils classified in OLG Groups 8, 9, 10 and 11 and those councils which submit a Rural Council Proposal. For mergers, we have also considered whether meeting each of the benchmarks is practical in the short term for the new council.

Source: OLG, Completing Template 3: Rural Council Proposal, January 2015, p 15.

B.1 Considerations in assessing the financial criteria

This section sets out a discussion of the considerations we have used in assessing council proposals against each of the financial criteria.

B.1.1 Criterion 2: Sustainability

Table B.2 Sustainability criterion – measures and definitions

Measure	Definition
Operating Performance Ratio	Core measure of financial sustainability – indicates a council's capacity to meet ongoing operating expenditure requirements.
Own Source Revenue Ratio	Councils with higher own source revenue have a greater ability to control their own operating performance and financial sustainability.
Building & Infrastructure Asset Renewal Ratio	Measures whether a council's assets are deteriorating faster than they are being renewed – indicator of whether a council's infrastructure backlog is likely to increase.

Some considerations:

- The Operating Performance Ratio is a key measure councils should be aiming to meet over time. However, this measure is influenced by depreciation, which is an accounting measure of the estimated consumption of the service potential of an entity's asset base during a period. It can often represent about 25% of a council's annual operating expenses. Thus, changes to a council's approach in estimating depreciation may have a material effect on the Operating Performance Ratio.
- We have also taken into account the impact of interest income from works-in-kind agreements and voluntary planning agreements provided by developers to deliver infrastructure. Interest income from developer contributions may overstate a council's operating performance as this income cannot be used for council operations, but is included in operating performance figures.
- Depreciation is based on ex-ante estimates of an asset's useful life. As a result, it may not reflect ex-post consumption of an asset's service potential within periods or over time. However, accounting standards do require councils to regularly review assumed useful asset lives and the depreciation methodology and rates used based on actual asset performance, in order to enhance the reliability of annual depreciation estimates. There is nevertheless currently considerable difference in the approaches used to calculate depreciation between councils.

- The Own Source Revenue Ratio may be below the benchmark for different reasons in metropolitan and non-metropolitan areas. Metropolitan growth councils may be receiving capital grants from developers which adversely affect their performance in relation to this measure. For non-metropolitan councils, the legislated Federal Assistance Grants (FAGs) provide a large source of relatively stable and reliable income, and their exclusion may artificially reduce a council's measured relative performance. For this reason, we have considered the impact of FAGs in considering the Own Source Revenue performance of regional and rural councils in OLG Group 8 to 11.
- The Building & Infrastructure Asset Renewal Ratio does not take into account that councils may experience peaks and troughs in renewal needs over time, and it may not be prudent to bring forward renewal expenditure to meet the benchmark. In practice, renewal expenditure programs should be based on a sound Asset Management Plan. Further, councils should ensure the community supports and is willing to pay for the scale of renewals proposed by routinely seeking their views on service standards.

B.1.2 Criterion 3: Effective Infrastructure and Service Management

Table B.3 Infrastructure and service management criterion – measures and definitions

Measure	Definition
Infrastructure Backlog Ratio	Measures how effectively the council is managing its infrastructure. Increasing backlogs may affect the council's ability to provide services and remain sustainable.
Asset Maintenance Ratio	Measures whether the council is spending enough on maintaining its assets to avoid increasing its infrastructure backlog.
Debt Service Ratio[a]	Indicates whether the council is using debt wisely to share the life-long cost of assets and avoid excessive rate increases.

[a] We consider that debt is used wisely when it is used reasonably in conjunction with established, sound, Asset Management Plans.

Some considerations:

- The Infrastructure Backlog Ratio is difficult to measure objectively because condition assessments are subjective and should be based on the community's preferences regarding asset quality, cost and service levels, their willingness to pay, and a risk based assessment and approach to the provision of community infrastructure. We consider councils with a sound financial position should not be reporting a significant infrastructure backlog over the long term. Infrastructure provision by a council is a balance between the community's wants compared with its needs and the ability of the council to raise sufficient revenue to pay for assets.

- We have exercised care when assessing the Infrastructure Backlog Ratio because it is clear that there are widespread differences between councils in their approach to its determination.
- The Asset Maintenance Ratio has been used to inform our holistic assessment of the seven measures in the financial criteria. A council may spend on maintenance yet not renew its assets. As a result, the Infrastructure Backlog Ratio may increase even though the Asset Maintenance Ratio is technically being met.
- The Debt Service Ratio should be based on sound treasury management, which needs to distinguish between how debt is used and the extent of debt taken on by the council. A council that takes on debt to meet the benchmark is not necessarily in a better financial position than a council that does not take on debt where it may be able to fund its needs through recurring income and reserves. Debt should also be used to share the cost of long lived assets between current and future users to maintain inter-generational equity.

B.1.3 Criterion 4: Efficiency

Table B.4 Efficiency criterion – measures and definitions

Measure	Definition
Real Operating Expenditure (Opex) per capita	Indicates how well the council is using economies of scale and managing service levels to achieve efficiencies.

Some considerations:

- The Real Opex per capita ratio measures the council's performance over time. Due to differences in the level, standard and range of services provided, it is difficult to compare this ratio across councils.
- Councils should not reduce service levels or quality in order to decrease their expenditure and meet this benchmark.

Increases in this ratio are permissible, where it efficiently reflects the local community's desire for increased levels of service from their local council. Increases may also occur where the council's population is declining.

B.2 Methodological changes in asset maintenance and renewals

We note a number of councils are consulting with their community to determine if a lower standard of assets (such as roads) is acceptable. If so, under the OLG's IP&R Guidelines, councils may then maintain or renew assets to a 'satisfactory' condition (condition 3), rather than a 'good' condition (condition 2).

This altered approach to asset management effectively reduces both the costs and volume of asset maintenance and renewals over the medium term. This has the effect of improving a council's performance against the financial criteria by:

- Extending asset lives and reducing depreciation on a yearly basis. This improves performance against the Operating Performance Ratio and the Building & Infrastructure Asset Renewal Ratio.
- Reducing the expenditure required to bring assets to an acceptable standard, which decreases the council's Infrastructure Backlog Ratio.
- Possibly reducing required asset maintenance, which improves performance against the Asset Maintenance Ratio without increasing current expenditure.

As a result, many councils are showing improvements across a number of the ratios. In considering these changes, we have examined whether the assumptions used by the council are reasonable. Some councils have also had their altered approach to asset management externally reviewed by consultants. In undertaking the assessments, we have generally accepted these improvements, notwithstanding the fact they are largely a result of a changed approach to asset maintenance and renewal. This is because the new practices are likely to be acceptable to the community, more efficient, and consistent with the OLG's IP&R Guidelines.

C Council assessments

This appendix sets out tables summarising the assessment of each council as follows:

- Metropolitan Sydney councils:
  - Merger Proposals
  - Inner Metropolitan Sydney
  - Outer Metropolitan Sydney.
- Non-metropolitan councils
  - Merger Proposals
  - Hunter, Central Coast and Illawarra
  - Non-metropolitan proposals
  - Rural Council Proposals.

The appendix also includes detail on the assessment for each council against each criteria, which are set out in alphabetical order in the accompanying document.

C.1 Metropolitan Sydney assessments

Table C.1 Merger Proposals

Councils	ILGRP preferred option	Assessment	Scale and capacity	Financial criteria overall	Sustainability	Infrastructure and service management	Efficiency
Randwick City and Waverley	**Merge to form a Global Sydney council**	Fit	✓	✓	✓	✓	✓
Auburn City Burwood City of Canada Bay	**Auburn to merge with Holroyd, Parramatta, Ryde (part) and The Hills (part);** **Burwood and Canada Bay to merge with Ashfield, Leichhardt, Marrickville and Strathfield**	Fit	✓	✓	✓	✓	✓

Note: Bold indicates an ILGRP preferred option.

Table C.2 Inner Metropolitan Sydney

Region	ILGRP preferred option	Council	Assessment	Scale and capacity	Financial criteria overall	Sustainability	Infrastructure and service management	Efficiency
Global City	**Amalgamate with Randwick City and Waverley Council**	City of Botany Bay	Not fit	×	✓	✓	✓	✓
		City of Sydney	Not fit as a Global City Council	×	✓	✓	✓	✓
		Woollahra Municipal	Not fit	×	✓	✓	✓	✓
Inner West	**Amalgamate with City of Canada Bay and Burwood**	Ashfield	Not fit	×	✓	✓	✓	×
		Leichhardt Municipal	Not fit	×	✓	✓	✓	✓
		Marrickville	Not fit	×	✓	✓	✓	✓
		Strathfield	Not fit	×	✓	✓	✓	✓

Region	**ILGRP preferred option**	**Council**	**Assessment**	**Scale and capacity**	**Financial criteria overall**	Sustainability	Infrastructure and service management	Efficiency
West Central	**Amalgamate with Auburn, City of Ryde (part) and The Hills (part)**	Holroyd City	Not fit	×	✓	✓	✓	✓
		Parramatta City	Not fit	×	✓	✓	✓	✓
Lower North Shore	**Amalgamate**	City of Ryde	Not fit	×	✓	✓	✓	✓
		Hunter's Hill	Not fit	×	✓	✓	✓	✓
		Lane Cove	Not fit	×	✓	✓	✓	✓
		Mosman Municipal	Not fit	×	✓	✓	✓	✓
		North Sydney	Not fit	×	✓	✓	✓	×
		Willoughby	Not fit	×	✓	✓	×	✓
Northern Suburbs	**Amalgamate**	Hornsby	Not fit	×	✓	✓	✓	✓
		Ku-ring-gai	Not fit	×	✓	✓	✓	✓
Northern Beaches	**Amalgamate**	Manly	Not fit	×	✓	✓	✓	✓
		Pittwater	Not fit	×	✓	✓	✓	✓
		Warringah	Not fit	×	✓	✓	✓	✓
South West	**Amalgamate**	Fairfield	Not fit	×	✓	✓	✓	✓
		Liverpool	Not fit	×	✓	✓	✓	✓
Southern	**Amalgamate**	Canterbury	Not fit	×	✓	✓	✓	✓
		Hurstville	Not fit	×	✓	✓	✓	✓
		Kogarah	Not fit	×	✓	✓	✓	✓
		Rockdale	Not fit	×	✓	✓	✓	✓
Bankstown	**No change**	Bankstown	Fit	✓	✓	✓	✓	✓

Note: Bold indicates an ILGRP preferred option.

Table C.3 Outer Metropolitan Sydney

Council	ILGRP preferred option	Assessment	Scale and capacity	Financial criteria overall	Sustainability	Infrastructure and service management	Efficiency
Blacktown City	**No change**	Not fit	✓	×	×	✓	✓
Blue Mountains City	**No change**	Fit	✓	✓	✓	✓	✓
Camden	**No change**	Fit	✓	✓	✓	✓	✓
Campbelltown City	**No change**	Not fit	✓	×	×	✓	✓
Hawkesbury	**No change**	Not fit	✓	×	×	✓	✓
Penrith City	**No change**	Fit	✓	✓	✓	✓	✓
Sutherland Shire	**No change**	Fit	✓	✓	✓	✓	✓
The Hills Shire	**No change**	Fit	✓	✓	✓	✓	✓
Wollondilly Shire	**No change**	Fit	✓	✓	✓	✓	✓

Note: Bold indicates an ILGRP preferred option.

C.2 Non-metropolitan councils

Table C.4 Merger Proposals

Councils	ILGRP preferred option	Assessment	Scale and capacity	Financial criteria overall	Sustainability	Infrastructure and service management	Efficiency
Young Shire and Boorowa	**Merge with Boorowa, Harden and Young**	Fit	✓	✓	✓	✓	✓
Cootamundra Shire and Harden Shire*	**Merge with Boorowa and Young**	Fit	✓	✓	✓	✓	✓

Note: Bold indicates an ILGRP preferred option. *The ILGRP did not have a preferred option for Cootamundra.

Table C.5 Hunter, Central Coast and Illawarra

Region	**Council**	**ILGRP options**	**Assessment**	**Scale and capacity**	**Financial criteria overall**	Sustainability	Infrastructure and service management	Efficiency
Hunter	Cessnock City	Council in JO	Fit	✓	✓	✓	✓	✓
	Dungog Shire	**Merge with Maitland** or Council in JO[a]	Not fit	×	×	×	✓	×
	Lake Macquarie City	**Amalgamate with Newcastle** or Council in JO[a]	Not fit	×	✓	✓	✓	✓
	Maitland City	**Merge with Dungog** or Council in JO[a]	Not fit	×	✓	✓	✓	✓
	Muswellbrook Shire	Council in JO	Fit	✓	✓	✓	✓	✓
	Newcastle City	**Amalgamate with Lake Macquarie** or Council in JO [a]	Not fit	×	✓	✓	✓	✓
	Port Stephens	Council in JO	Fit	✓	✓	✓	✓	✓
	Singleton	Council in JO	Fit	✓	✓	✓	✓	✓
	Upper Hunter Shire	Council in JO	Fit	✓	✓	✓	✓	✓
Central Coast	Gosford City	Amalgamate with Wyong or a multi-purpose JO (no separate water corporation until other options properly evaluated)	Not fit	×	✓	✓	✓	✓
	Wyong City	Amalgamate with Gosford or a multi-purpose JO (no separate water corporation until other options properly evaluated)	Not fit	×	✓	✓	✓	✓

Region	Council	ILGRP options	Assessment	**Scale and capacity**	**Financial criteria overall**	Sustainability	Infrastructure and service management	Efficiency
Illawarra	Kiama Municipal	Council in a JO (if future amalgamation – with Shoalhaven, noting its inclusion in South East-Tablelands region)	Not fit	✓	×	×	✓	×
	Shellharbour City	Council in a JO (amalgamate if future options need to be revisited)	Not fit	✓	×	×	✓	✓
	Wollongong City	Council in a JO (amalgamate if future options need to be revisited)	Fit	✓	✓	✓	✓	✓

a Possible boundary change included.
Note: Bold indicates an ILGRP preferred option. JO stands for Joint Organisation.
*The ILGRP did not include a table of options for the Hunter, Central Coast and Illawarra regions. Instead the ILGRP included a discussion of these councils in its report.

Table C.6 Non-metropolitan councils[80]

Region	Council	ILGRP options	Assessment	**Scale and capacity**	**Financial criteria overall**	Sustainability	Infrastructure and service management	Efficiency
Northern Rivers	Ballina Shire	Council in Northern Rivers JO	Fit	✓	✓	✓	✓	✓
	Byron Shire	Council in Northern Rivers JO	Fit	✓	✓	✓	✓	✓
	Lismore City	Council in Northern Rivers JO or merge with Kyogle	Fit	✓	✓	✓	×	✓
	Richmond Valley	Council in Northern Rivers JO or merge with Kyogle	Fit	✓	✓	✓	✓	✓
	Tweed Shire	Council in Northern Rivers JO	Not fit	✓	×	×	×	✓

80 This excludes Rural Council Proposals and councils in the Hunter, Central Coast and Illawarra.

Region	**Council**	**ILGRP options**	**Assessment**	**Scale and capacity**	**Financial criteria overall**	Sustainability	Infrastructure and service management	Efficiency
North Coast	Bellingen Shire	Council in North Coast JO	Not fit	✓	×	×	✓	✓
	Clarence Valley	Council in North Coast JO	Not fit	✓	×	×	×	✓
	Coffs Harbour City	Council in North Coast JO	Fit	✓	✓	✓	✓	✓
	Nambucca Shire	Council in North Coast JO	Fit	✓	✓	✓	✓	✓
Mid-North Coast	Gloucester Shire	Council in Mid-North Coast JO or merge with Great Lakes and/or Greater Taree	Not fit	×	×	×	✓	✓
	Great Lakes Shire	Council in Mid-North Coast JO or merge with Gloucester	Fit	✓	✓	✓	✓	✓
	Greater Taree City	Council in Mid-North Coast JO or merge with Gloucester	Not fit	✓	×	×	×	✓
	Kempsey Shire	Council in Mid-North Coast JO	Not fit	✓	×	×	×	✓
	Port Macquarie-Hastings	Council in Mid-North Coast JO	Fit	✓	✓	✓	×	✓
New England	Armidale Dumaresq	Council in New England JO or **merge with Guyra**	Not fit	×	×	×	✓	✓
	Glen Innes Severn	Council in New England JO	Fit	✓	✓	✓	✓	✓
	Inverell Shire	Council in Namoi JO	Fit	✓	✓	✓	✓	✓
	Tenterfield Shire	Council in New England JO	Not fit	✓	×	×	✓	✓
	Uralla Shire	Council in New England JO or **merge with Walcha**	Not fit	×	✓	✓	✓	✓

Region	Council	ILGRP options	Assessment	Scale and capacity	Financial criteria overall	Sustainability	Infrastructure and service management	Efficiency
Namoi	Gunnedah Shire	Council in Namoi JO	Fit	✓	✓	✓	✓	✓
	Gwydir Shire	Council in Namoi JO or merge with Moree Plains	Not fit	×	×	×	✓	✓
	Liverpool Plains Shire	Council in Namoi JO or merge with Gunnedah	Not fit	×	✓	✓	✓	✓
	Moree Plains Shire	Council in Namoi JO or merge with Gwydir	Fit	✓	✓	✓	✓	✓
	Narrabri Shire	Council in Namoi JO	Fit	✓	✓	✓	✓	✓
	Tamworth Regional	Council in Namoi JO	Fit	✓	✓	✓	✓	✓
Orana	Dubbo City	Council in Orana JO or merge with Wellington and/or Narromine	Fit	✓	✓	✓	✓	✓
	Narromine Shire	Council in Orana CC or merge with Dubbo	Not fit	×	✓	✓	✓	✓
	Warrumbungle Shire	Council in Orana JO	Not fit	✓	×	×	✓	×
	Wellington	Council in Orana JO or merge with Dubbo	Not fit	×	✓	✓	✓	✓

Region	**Council**	**ILGRP options**	**Assessment**	**Scale and capacity**	**Financial criteria overall**	Sustainability	Infrastructure and service management	Efficiency
Central West	Bathurst Regional	Council in Central West JO or merge with Oberon	Fit	✓	✓	✓	✓	✓
	Blayney Shire	Council in Central West JO or merge with Orange	Not fit	✗	✓	✓	✓	✓
	Cabonne	Council in Central West JO or **merge with Orange**	Not fit	✗	✓	✓	✓	✓
	Cowra	Council in Central West JO or merge with Weddin	Fit	✓	✓	✓	✓	✓
	Forbes Shire	Council in Central West JO; merge with Weddin	Not fit	✗	✓	✓	✓	✓
	Lachlan Shire	Council in Central West JO or merge with Parkes	Not fit	✗	✓	✓	✓	✓
	Lithgow City	Council in Central West JO	Not fit	✓	✗	✗	✓	✗
	Mid-Western Regional	Council in Central West JO	Not fit	✓	✗	✗	✗	✓
	Oberon	Council in Central West JO or merge with Bathurst	Not fit	✗	✓	✓	✓	✓
	Orange City	Council in Central West JO or **merge with Cabonne** and/or Blayney	Not fit	✗	✓	✓	✓	✓
	Parkes Shire	Council in Central West JO or merge with Lachlan	Fit	✓	✓	✓	✓	✗
Tablelands	Goulburn Mulwaree	Council in Tablelands JO	Not fit	✓	✗	✗	✓	✓
	Upper Lachlan Shire	Council in Tablelands JO or merge with Goulburn-Mulwaree	Not fit	✗	✓	✓	✓	✓
	Wingecarribee Shire	Council in Tablelands JO	Fit	✓	✓	✓	✓	✓
	Yass Valley	Council in Tablelands JO	Not fit	✓	✗	✗	✓	✓

Region	Council	ILGRP options	Assessment	Scale and capacity	Financial criteria overall	Sustainability	Infrastructure and service management	Efficiency
Riverina	Bland Shire	Council in Riverina JO or merge with Coolamon and/or Temora	Not fit	×	✓	✓	×	✓
	Junee Shire	Council in Riverina JO or merge with Cootamundra	Not fit	×	✓	✓	✓	✓
	Temora Shire	Council in Riverina JO or merge with Coolamon and/or Bland	Not fit	×	✓	✓	✓	✓
	Tumut Shire	Council in Riverina JO or **merge with Gundagai** and Tumbarumba	Not fit	×	✓	✓	✓	✓
	Wagga Wagga City	Council in Riverina JO or merge with Lockhart	Fit	✓	✓	✓	×	✓
Murrumbidgee	Griffith City	Council in Murrumbidgee JO or **merge with Murrumbidgee**	Not fit	×	✓	✓	✓	✓
	Leeton Shire	Council in Murrumbidgee JO or merge with Narrandera	Fit	✓	✓	✓	✓	✓
	Narrandera Shire	Council in Murrumbidgee JO or merge with Leeton	Not fit	×	✓	✓	✓	×
Mid-Murray	Berrigan Shire	Council in Mid-Murray JO or **merge with Jerilderie**	Not fit	×	✓	✓	✓	✓
	Deniliquin	Council in Mid-Murray JO or **merge with Conargo/Murray** and Wakool	Not fit	×	✓	✓	✓	✓
	Murray Shire	Council in Mid-Murray JO or **merge with D'quin/Conargo** and Wakool	Not fit	×	✓	✓	✓	✓
Upper Murray	Albury City	Council in Upper Murray JO or merge with Greater Hume (part or all)	Fit	✓	✓	✓	✓	✓
	Corowa Shire	Council in Upper Murray JO or **merge with Urana**	Not fit	×	✓	✓	✓	✓
	Greater Hume Shire	Council in Upper Murray JO or	Fit	✓	✓	✓	✓	✓

Region	Council	ILGRP options	Assessment	Scale and capacity	Financial criteria overall	Sustainability	Infrastructure and service management	Efficiency
		merge part or all with Albury						
South East	Bega Valley Shire	Council in South East JO	Fit	✓	✓	✓	✓	✓
	Cooma-Monaro Shire	Council in South East JO or **merge with Bombala** and Snowy River	Not fit	×	×	×	✓	✓
	Eurobodalla Shire	Council in South East JO	Fit	✓	✓	✓	✓	✓
	Palerang	Council in South East JO or **merge with Queanbeyan**	Not fit	×	✓	✓	✓	✓
	Queanbeyan City	Council in South East JO or **merge with Palerang**	Not fit	×	✓	✓	✓	✓
	Shoalhaven City	Council in South East JO	Fit	✓	✓	✓	✓	✓
	Snowy River Shire	Council in South East JO or merge with Bombala/Cooma-M	Not fit	×	×	×	✓	✓

Note: Bold indicates an ILGRP preferred option. JO stands for Joint Organisation.

Table C.7 Rural Council Proposals

Region	Council	ILGRP options	Assessment	Scale and capacity	Financial criteria overall	Sustainability	Infrastructure and service management	Efficiency
Northern Rivers	Kyogle[a]	Council in Northern Rivers JO or merge with Lismore or Richmond Valley	Not fit	×	✓	✓	✓	✓
New England	Guyra Shire	Council in New England JO or **merge with Armidale**	Not fit	×	×	×	✓	×
	Walcha Shire	**Merge with Uralla** or Rural Council in New England JO	Not fit	×	✓	✓	✓	✓
Orana	Bogan Shire	Rural Council in Orana JO or merge with Warren	Fit as a Rural Council	✓	✓	✓	✓	✓
	Coonamble Shire	Rural Council in Orana JO or merge with Gilgandra	Fit as a Rural Council	✓	✓	✓	✓	✓
	Gilgandra Shire	Rural Council in Orana JO or merge with Coonamble	Fit as a Rural Council	✓	✓	✓	✓	×
	Warren Shire	Rural Council in Orana JO or merge with Bogan	Fit as a Rural Council	✓	✓	✓	✓	×
Central West	Weddin Shire	Rural Council in Central West JO or merge with Forbes or Cowra	Not fit	✓	×	×	✓	✓
Riverina	Coolamon Shire	Rural Council in Riverina JO or merge with Bland and/or Temora	Fit as a Rural Council	✓	✓	✓	✓	✓
	Gundagai Shire	**Merge with Tumut** or Rural Council in Riverina CC	Not fit	×	×	×	✓	×
	Lockhart Shire	Rural Council in Riverina JO or merge with Wagga Wagga	Fit as a Rural Council	✓	✓	✓	✓	✓
	Tumbarumba Shire	Rural Council in Riverina JO or merge with Tumut/Gundagai	Fit as a Rural Council	✓	✓	✓	✓	✓

Region	Council	ILGRP options	Assessment	Scale and capacity	Financial criteria overall	Sustainability	Infrastructure and service management	Efficiency
Mid-Murray	Conargo Shire	**Merge with Deniliquin and Murray** or Rural Council in Mid-Murray JO	Not fit	✗	✓	✓	✓	✓
	Jerilderie Shire	**Merge with Berrigan** or Rural Council in Mid-Murray JO	Not fit	✗	✗	✗	✓	✗
	Wakool Shire	Rural Council in Mid-Murray JO or merge with Murray/Conargo/Deniliquin	Fit as a Rural Council	✓	✓	✓	✓	✓
Murrumbidgee	Carrathool Shire	Rural Council in Murrumbidgee JO or merge with Griffith	Fit as a Rural Council	✓	✓	✓	✓	✗
	Hay Shire	Rural Council in Murrumbidgee JO	Not fit	✓	✗	✗	✓	✓
	Murrumbidgee Shire	**Merge with Griffith** or Rural Council in Murrumbidgee JO	Not fit	✗	✓	✓	✓	✓
Upper Murray	Urana Shire	**Merge with Corowa** or Rural Council in Upper Murray JO	Not fit	✗	✓	✓	✓	✓
South East	Bombala	**Merge with Cooma-M** and Snowy R or Rural Council in South East JO	Not fit	✗	✓	✓	✓	✓

[a] Kyogle submitted a Rural Council Proposal. However the ILGRP did not identify this as one of the options for the council. We assess Kyogle as not fit as a Rural Council not fit as a stand-alone council.

Note: Bold indicates an ILGRP preferred option. JO stands for Joint Organisation.

D Analysis of merger business cases

This appendix provides a summary of the estimated benefits of selected merger options for Metropolitan Sydney councils. It includes the estimated benefits set out in the merger business cases provided in council proposals, as well as additional analysis of these mergers undertaken by IPART and Ernst & Young.

D.1 Business Case overview

A number of councils provided business cases and related submissions with respect to options for council mergers and various forms of joint organisation or shared service arrangements. In addition, some councils provided submissions on broader issues of the potential economies and diseconomies arising from council mergers. The submissions provided useful information.

As well, we commissioned Ernst & Young to undertake an independent study of the potential costs and benefits of selected council mergers in Metropolitan Sydney and review information included in council business cases. Specifically, IPART commissioned Ernst & Young to:

- To provide an estimate of the NPV of the benefits associated with the merger options identified by the ILGRP or councils for the Sydney metropolitan area.
- To review the business cases submitted by Sydney metropolitan councils with respect to estimated benefits.
- To review and critique IPART's assessment of the estimated NPV of the benefits of merger options included in submissions by councils with respect to the Sydney metropolitan area.

D.2 Estimating the value of merger benefits

Ernst & Young undertook a review of relevant literature on the potential benefits from mergers. Ernst & Young's broad conclusions were:

- The empirical evidence of economies from local council mergers is not clear cut. The measurement of benefits following a merger is often difficult because councils may redirect cost savings into service expansion. An implication of this action is that directly observed falls in costs may underestimate the total benefits from a merger.
- The extent of scale economies following a merger is likely to vary according to activity and the size of the councils.
- The studies identify a number of potential risks associated with local council amalgamations including costs of disruption and workplace cultural barriers.

Some submissions to IPART presented different views on whether council mergers would generate benefits. In a submission by Woollahra Municipal Council, Percy Allan & Associates argued that Sydney metropolitan councils showed no significant scale economies.[81] The City of Ryde Council also submitted a report by Professor Brian Dollery which argued that there is little evidence that forced council amalgamations will achieve cost savings.[82] However, a number of councils provided business cases which demonstrated that there were benefits associated with merger options.

D.2.1 Comparing the business cases

A number of the business cases submitted by councils to IPART provided estimates for the NPV and/or the undiscounted value of net benefits (or costs) of structural options including mergers and joint organisations. The estimates of net benefits are, by their nature, driven by input assumptions and the precise values are subject to some uncertainty.

The estimates of merger benefits and costs produced by different consultants and councils are not directly comparable because of the differences in methodology and assumptions used. For example, the time period over which benefits are assessed varied. Also, the discount rate used to calculate NPV varied between business cases. Typically, in the case of a council merger, a lower discount rate would give rise to a larger estimated NPV of benefits. In addition, fundamentally different approaches were used to estimate merger costs and potential merger related efficiencies.

81 Percy Allan & Associates Pty Ltd, *Fit For The Future Research Report*, March 2015.

82 Professor Brian Dollery, *Compulsion Versus a Collaborative Regional Approach: An Emperical Analysis of Forced Amalgamation versus a Regional and Shared Services Approach,* May 2015.

Normalising the business cases

We have recalculated the estimates of NPV by using the information in the business cases provided and adjusting the assumptions to use a consistent 20-year time period, a discount rate of 9.5% nominal (7.0% real), and the assumption that the merger takes effect in 2016-17. The merger assistance grant from the NSW is also included in the IPART recalculations of the estimated NPV of benefits. We consider that extending the period of estimation to 20 years allows a better reflection of the long term benefits and costs of a merger.

We have also varied other selected assumptions underlying the consultant estimates, which have been identified in Table D.2.

We do not necessarily endorse other assumptions made by the consultants, but for this exercise we have retained the other assumptions in order to recalculate the estimate of net benefits. The recalculated estimates are subject to most of the assumptions and limitations that the original estimates were subject to.

The purpose of the recalculation was to standardise some elements of the business cases submitted. However, differences in underlying methodologies still make it difficult to directly compare the business case estimates submitted by different councils and different consultants.

Ernst & Young reviewed the assumptions used by IPART in the analysis of the metropolitan Sydney councils and found the assumptions were within the bounds of reasonableness, noting that IPART had applied a ceiling to the level of savings in one case to err on the side of conservatism, and that IPART has included merger grant funding and, where used by the original consultants and relevant, borrowing costs.

Ernst & Young's own independent assessment of the merger business cases prepared by local councils calculated net outcomes not materially different to IPART's calculations, after adjusting for the above three considerations.

Analysing the business cases

We also commissioned Ernst & Young to undertake a review of the business cases that provided estimates of merger costs and benefits that were submitted with respect to metropolitan Sydney mergers and to estimate the NPV associated with selected mergers.

The original estimates of the NPV of council merger benefits by consultants/councils, the recalculated estimates produced by IPART and the independent estimates produced by Ernst & Young for selected merger options for the Sydney metropolitan region are summarised in Table D.1.

The NPV of benefits as recalculated by IPART and those estimated by Ernst & Young are generally higher than those estimated by consultants and councils in their submissions. This result partly reflects the fact that the recalculations by IPART and estimated by Ernst & Young are for a longer time period (20 years) than used by the consultants and councils. Also, the IPART calculations include recognising benefits from mergers that were evident in either cost savings or, where they can be estimated, enhanced services.

The information provided in Table D.1 shows that the majority of business cases undertaken by consultants and councils with respect to specific merger options suggest that the NPV of benefits from the mergers are positive. Summing the projected NPV of merger benefits estimated by Ernst & Young for the eight preferred merger options for metropolitan Sydney gives a total of $1.3 billion.

In analysing the estimated NPVs:

- The estimated benefits are dependent on assumptions made. The estimated benefits will therefore vary according to assumptions made and are subject to some uncertainty.
- There are uncertainties about whether the potential benefits will be realised. For example, it will depend on the willingness of councils to pursue potential efficiency gains.
- The measured NPVs mostly relate to council finances. The calculations do not capture matters such as:
  - prospective gains from better partnering with government
  - potential gains from more integrated planning
  - likely gains from improved regional collaboration
  - possible diseconomies of scale from loss of local identity, and
  - potential diseconomies of scale from reduced local representation.

In summary, we consider that analysis of the business cases for metropolitan Sydney councils suggests that there are significant net benefits to be obtained from the mergers identified by the ILGRP.

Table D.1 Estimates of net present value of selected merger options for the Sydney metropolitan area

ILGRP preferred options				
Council Merger Option	**Council consultant estimate of NPV of merger: Various timeframes and assumptions used $m**	**Council Consultant**	**IPART 20-year NPV estimate using standardised assumptions based on council consultant business cases $m**	**Ernst & Young 20-year NPV estimate using standard assumptions (mid-point of range) $m**
Randwick, Waverley, Woollahra, Botany Bay, City of Sydney Council	146 (2017-2026)	Randwick City Council	416	283
Ashfield, Burwood, Canada Bay, Leichhardt, Marrickville, Strathfield	143 (2015-2023)	Morrison Low	396	194
Hunter's Hill, Lane Cove, Mosman, North Sydney, Willoughby, Ryde (part)	59[a] (2016-2023)	Morrison Low	280	187
Auburn, Holroyd, Parramatta, The Hills (part), Ryde (part)	42[a] (2016-2023)	Morrison Low	254	150
Hornsby, Ku-ring-gai	NA	KPMG	61	88
Manly, Warringah, Pittwater	48[b] (2015-2024)	KPMG	116	116
	234 (2015-2024)	SGS Economics & Planning (reference council model)	265	
Canterbury, Kogarah, Rockdale, Hurstville	98 (2016-2023)	Morrison Low	280	172
Fairfield, Liverpool	NA[c]	Fairfield City Council	NA	131
Total benefits	**NA**	**NA**	**1,803 – 1,953**[d,e]	**1,323**

a Efficiencies realised scenario

b Updated estimate forwarded by Manly Council. Not original KPMG branded estimate.

[c] Fairfield City Council estimated cumulative costs of $27 million from a merger of Fairfield and Liverpool. We consider the assumptions underlying the estimate to be based on a limited sample and to be contrary to other information provided to IPART regarding benefits from mergers.

[d] The summation of the IPART recalculations for the ILGRP mergers reflects the different underlying methodologies used by the different consultants.

[e] The sum of the IPART recalculations excludes Fairfield – Liverpool.

Notes:

The councils' consultants use different methodologies, forecast periods, and discount rates to estimate the net present value of the benefits of the mergers.

The councils' consultants and Ernst & Young note there is an array of risks about the estimates.

The IPART calculation of net present value uses the consultant's information and base data, with adjustments to some assumptions, and a consistent 20-year forecast period and a 9.5% nominal (7.0% real) discount rate. The IPART calculations are based on submitted business cases and are subject to the limitations of the models and data on which they are based.

D.3 Adjustments made by IPART to standardise the business case estimates

We made adjustments to the business cases submitted by councils. In all cases, the following adjustments were made:

- The estimates were rebased so as to present the data as if the merger option was effective from 2016-17.
- The NPV estimates are in 2015-16 base year terms. The discount rate used was 9.5% nominal or 7.0% real.
- The term over which the NPV is calculated was extended to 20 years. An inflation factor was applied to index the estimates of costs and savings.
- The merger assistance grant was included.
- Table D.2 details other adjustments that were made to the individual business case estimates.

Table D.2 Adjustments made by IPART to standardise the business case estimates

Merger options evaluated	Business case prepared by	Adjustments made by IPART in addition to standardising the discount rate, term, and base year
Randwick/Waverley	Randwick City Council	Removed cost of meeting FFTF ratios, as not a merger related cost.
Randwick/Waverley/ Woollahra/Botany Bay	Randwick City Council	Removed cost of meeting FFTF ratios, as not a merger related cost.
Randwick/Waverley/ Woollahra/Botany/ Sydney	Randwick City Council	Removed cost of meeting FFTF ratios, as not a merger related cost. Removed adjustment for rent foregone, as not a necessary consequence of merger.
Auburn/Burwood/ Canada Bay	Morrison Low	Removed the cost associated with an increase in staff over the long run from the cost-benefit calculations. The increase in staff costs is stated to be linked to an increase in services, which represents an offsetting benefit to the community.
Auburn/Holroyd/ Parramatta/The Hills (part)/ Ryde (part)	Morrison Low	Removed the cost associated with an increase in staff over the long run from the cost-benefit calculations. The increase in staff costs is stated to be linked to an increase in services, which represents an offsetting benefit to the community.
Botany Bay/Marrickville/ Rockdale	Morrison Low	Removed the cost associated with an increase in staff over the long run from the cost-benefit calculations. The increase in staff costs is stated to be linked to an increase in services, which represents an offsetting benefit to the community. Removed assumption of reduction in waste levy is a cost as this still represents a benefit to the community.
Hunter’s Hill, Lane Cove, Mosman, North Sydney, Ryde (part), Willoughby.	Morrison Low	Removed the cost associated with an increase in staff over the long run from the cost-benefit calculations. The increase in staff costs is stated to be linked to an increase in services, which represents an offsetting benefit to the community.
Ashfield/Burwood/ Canada Bay/Leichhardt/ Marrickville/Strathfield (ILGRP merger)	Morrison Low	Removed the cost associated with an increase in staff over the long run from the cost-benefit calculations. The increase in staff costs is stated to be linked to an increase in services, which represents an offsetting benefit to the community.. Removed assumption of reduction in waste levy is a cost as this still represents a benefit to the community.
Hornsby, Ku-ring-gai	KPMG	Consultant data showed savings for selected years. IPART extrapolated the estimated savings using an inflation factor. IPART added merger assistance grant.

Merger options evaluated	Business case prepared by	Adjustments made by IPART in addition to standardising the discount rate, term, and base year
Manly/Warringah/ Pittwater	KPMG	Adjusted borrowing costs resulting from merger to reflect impact of merger assistance grant where relevant.
Manly/Warringah/ Pittwater	SGS Economics and Planning	Based on reference council model. Added merger assistance grant. Applied a ceiling to estimated savings.
Fairfield/Liverpool	Fairfield City Council	Fairfield City Council estimated cumulative costs of $27 million from a merger of Fairfield and Liverpool. We consider the assumptions underlying the estimate to be based on a limited sample and to be contrary to other models provided to IPART regarding benefits from mergers.
Canterbury/Kogarah/ Rockdale/Hurstville	Morrison Low	Removed the cost associated with an increase in staff over the long run from the cost-benefit calculations. The increase in staff costs is stated to be linked to an increase in services, which represents an offsetting benefit to the community.
Bankstown/Canterbury	Bankstown City Council	The information provided by Bankstown City Council only extended to annual estimates of savings. In order to estimate an indicative NPV of benefits, IPART included assumptions for the timing of costs/benefits, assumptions for inflation effects and assumptions for merger implementation costs. Given the assumptions used, the calculated NPV should be regarded as indicative.
Maitland/Dungog	Morrison Low	Removed the cost associated with an increase in staff over the long run from the cost-benefit calculations. The increase in staff costs is stated to be linked to an increase in services, which represents an offsetting benefit to the community.
Gosford/Wyong	Third Horizon	Scaled NPV results from Wyong.
Bombala/Cooma-M /Snowy River	KPMG	Consultant data showed savings for selected years. IPART extrapolated the estimated savings using an inflation factor. IPART added merger assistance grant.
Gloucester/Great Lakes	Morrison Low	Removed the cost associated with an increase in staff over the long run from the cost-benefit calculations. The increase in staff costs is stated to be linked to an increase in services, which represents an offsetting benefit to the community.
Orange/Cabonne	Morrison Low	Removed the cost associated with an increase in staff over the long run from the cost-benefit calculations. The increase in staff costs is stated to be linked to an increase in services, which represents an offsetting benefit to the community.

Merger options evaluated	Business case prepared by	Adjustments made by IPART in addition to standardising the discount rate, term, and base year
Parkes/Lachlan	Morrison Low	Insufficient information in business case to make adjustment.
Leeton/Narrandera	Morrison Low	Removed the cost associated with an increase in staff over the long run from the cost-benefit calculations. The increase in staff costs is stated to be linked to an increase in services, which represents an offsetting benefit to the community.
Murrumbidgee/ Jerilderie	SGS Economics and Planning	Insufficient information in business case to make any adjustment.
Queanbeyan, Palerang	LKS Quaero	Assumptions were made for the timing of merger related benefits and costs.
Berrigan/Jerilderie	SGS Economics and Planning	Insufficient information in business case to make any adjustment.
Deniliquin/Murray/ Wakool	LKS Quaero	Assumptions were made for the timing of merger related benefits and costs.
Deniliquin/Murray	LKS Quaero	Assumptions were made for the timing of merger related benefits and costs.
Boorowa/ Young merger	NA	Derived from LKS Quaero report on Boorowa/Harden/Young. Adjustment made to account for removal of Harden from merger.
Cootamundra/Harden	Council	Adjustment made to remove selected non-merger related costs.

E Ernst & Young consultant report - Fit for the Future: Review of Business Case Estimates of Merger Net Benefits for Sydney Metropolitan Councils

Fit for the future

Review of Business Case Estimates of Merger Net Benefits for Sydney Metropolitan Councils

IPART

Confidential Final Report

October 2015

Building a better working world

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1. Executive summary

1.1 Background

The NSW Government has been working with NSW councils since 2011 to achieve a shared vision of stronger local communities. As part of this process, in March 2012, the State appointed the Independent Local Government Review Panel (ILGRP) to review Local Government in NSW and make recommendations for reform.

The ILGRP's report was completed in October 2013.[1] Amongst a range of Fit for the Future ("FFTF") reforms, the ILGRP's preferred option was the merger of 32 Sydney metropolitan councils into 8 larger councils. This would replicate reforms undertaken in most other states.

Amalgamation Options							
Ashfield, Burwood, Canada Bay, Leichardt, Marrickville, Strathfield	Auburn, Holroyd, Parramatta, Ryde (part), The Hills (part)	Botany Bay, Randwick, Sydney, Waverley, Woollahra	Fairfield, Liverpool	Hornsby, Ku-Ring-Gai	Hunters Hill, Lane Cove, Mosman, North Sydney, Ryde (part), Willoughby	Canterbury, Hurstville, Kogarah, Rockdale	Manly, Pittwater, Warringah

The NSW Government had requested all councils in NSW to submit a proposal demonstrating how they meet the criteria by 30 June 2015, which would then be assessed by IPART, as the appointed Expert Advisory Panel.

1.2 Scope and approach

EY has been instructed by IPART to:

- Model and estimate the long term costs and benefits in Net Present Value (NPV) terms, of the 8 council merger combinations in the Sydney Metropolitan Area identified as preferred merger options as outlined in the ILGRP report. In addition, IPART has requested EY undertake similar analysis for other sets of mergers:
  - Botany Bay, Randwick, Waverley and Woollahra Councils (without the City of Sydney Council)
  - Gosford and Wyong Councils, Bankstown and Canterbury Councils, Hawkesbury and the Hills Councils – these three merger scenarios did not form part of the ILGRP's preferred options but the Panel recommended that they be further explored.
  - Randwick and Waverley Councils, and Auburn, Burwood and Canada Bay Councils – these are not part of the ILGRP's preferred options but these councils have put forward voluntary merger proposals and business cases that IPART would like to further explore

[1] Final Report of the NSW Independent Local Government Review Panel, Revitalising Local Government, October 2013

- Review and critique the merger business case models that have been put forward by Local Councils in Sydney. This includes providing an NPV estimate of the business cases, and reviewing and critiquing IPART's staff assessment of council merger business cases.

In essence, the task is to provide a comparative financial analysis of the merger proposals to inform IPART's response to the Government.

We have not been requested to review or compare the findings from our analysis with Council Improvement Proposals ("CIP") submitted by local councils and make no comment on these issues. Further, our review has been performed only on the merger business case models which presented estimates of the costs and benefits of the merger.

The key features of our approach are set out below:

- The focus of our work is on assessing the relative financial merits of the merger options presented based on the information provided. The focus is not on the absolute merits of any merger *per se*.
- Due to information and time constraints, our work necessarily:
  - Primarily involved on a 'top-down' review of the available evidence in respect of the relative merits of the options. In commercial practice the merits of a particular merger would typically be assessed by undertaking a detailed deep 'bottom-up' review of the costs, benefits and risks of a merger in the particular circumstances of the parties. It was not possible to adopt this approach within the constraints of this engagement.
  - Relies on the evidence provided and the other publically available information reviewed. While there is a large body of work on these issues, the available evidence presents a mixed picture of the extent of net benefits from a merger.
  - Focuses on the relative scope for efficiency improvements the merger options might provide, but also considers the non-financial benefits and costs the merger options might provide. Our work does not look at other gains from mergers such as better partnering with State and Federal Governments or more integrated planning.

Further details on the methodology we have applied to assess the business case for the ILGRP preferred merger options are outlined in Section 5 of this report.

To undertake our analysis we have:

- Relied on publicly available information in relation to the council merger business cases
- Conducted a literature review on the available evidence on the costs and benefits arising from local council mergers. This material included information on the experience from local council amalgamations undertaken elsewhere in Australia and overseas
- Obtained data on 2013/14 operating expenses of the relevant local councils, as reported in relevant published annual reports or annual financial statements
- Reviewed the merger business cases included in the submissions by the Sydney metropolitan local councils, focusing on the reasonableness of the assumptions employed and the methodology for quantifying the costs and benefits. All merger business cases were reviewed even if the merger was not supported by the relevant local council. As part of this review:

- We have made inquiries with staff at IPART to confirm, clarify or request additional information. Where additional information was requested, this was only provided to the extent that IPART was able to obtain that information
- We were not asked to and have not had any direct consultations with the Sydney metropolitan local councils or the authors of the relevant merger business cases. For this reason, our analysis does not take into account the specific operating circumstances and business characteristics of each of the local council merger scenarios examined, which is typically important in identifying the extent to which merger cost savings may be achievable in any particular instance
- We have relied on the information presented within the business cases and have not undertaken an audit of the available information.

- Reviewed the preferred merger options made in the ILGRP report:
  - In this regard, we note while the ILGRP expressed a preference for a number of mergers, quantitative analysis was not undertaken to test the economic merits of the proposals
  - In estimating the long term costs and benefits of the ILGRP's preferred merger options, we have therefore considered the evidence from the available literature, the evidence based on our commercial experience with corporate acquisitions and/or mergers, as well as our consideration of the extent to which those savings are likely to be achievable for public sector organisations. We have also considered the analysis in the councils' merger business cases.
- Estimated the NPV of the merger costs and savings identified over a 20 year timeframe, applying a real discount rate of 7% which is consistent with the requirements of the NSW Government Guidelines for Economic Appraisals. We have also undertaken sensitivity analysis of the NPV outcomes using real discount rates of 4% and 10%.

1.3 Limitations

We have not independently verified, or accept any responsibility or liability for independently verifying, any information provided to us by IPART or information obtained in the public domain for the purpose of this review, nor do we make any representation as to the accuracy or completeness of the information.

Our work in connection with this assignment is of a different nature to that of an audit or a review of information, as those terms are understood in Australian Auditing Standards applicable to audit and review engagements. Our report to you is based on inquiries of and discussions with IPART, a review of the business and other documents made available to us, and analytical procedures applied to data provided.

Our work commenced on 18 August 2015 and was completed on 9 October 2015. In that time, we assessed the ILGRP preferred merger options (and 5 variations around those options) and reviewed 29 merger business cases presented by the councils. It was undertaken as a desktop exercise and we relied on the information submitted in the relevant merger business cases. As a result, there may be findings or information not included in this report, or our investigations may not have revealed, all relevant matters. The reliance that can be placed on our report may therefore be limited in that regard.

1.4 Key findings

1.4.1 Literature review

As part of this engagement, EY has reviewed a large amount of literature and empirical research on the impact of local government structural reform to inform our estimation of potential merger costs and benefits. Some of this literature has been generated from previous local government financial sustainability reviews in various Australian states. Others have been generated from council reorganisations outside of Australia.

Full details of our review are documented in Section 3 of this report.

To briefly summarise, the key findings from our literature review are as follows:

- The extent to which cost savings have been achieved in previous local council reforms may be difficult to measure particularly over the longer term as any cost savings generated are most likely to have been re-directed towards service expansion over that timeframe. As such, the capacity of long term outcomes from actual experience to inform estimates of potential cost savings from local council amalgamations may be limited, without also including the cost savings that would have been put into enhanced service delivery.

- The available empirical evidence on the extent to which local council amalgamations will yield net savings in costs is mixed and tends to vary by activity. Econometric analysis does not provide strong support. Evidence from the Auckland local governance reforms suggests that potentially large opex savings could be achievable (although translation of New Zealand evidence into an Australian context must be done with caution).

- In principle, it is reasonable to expect that opportunities for cost savings to flow from the scale effects associated with local council amalgamations, however, their magnitude is likely to vary by type of activity and may diminish for councils that are already large. The available evidence suggests the key sources of savings are from removal of duplicated activities / functions, IT and in procurement. Governance and administration is potentially a key area where cost savings would materialise.

- There is limited evidence available on the financial costs associated with local council amalgamations.

  - The evidence from the QTC's assessment of merger costs in Queensland is the most relevant Australian evidence available. This indicated assessed merger costs of $195m over 4 years. The benefits shown in the report, however, did not provide sufficient data as to the time profile of the $129m of estimated merger benefits. If it is assumed that $15m is realised in year 1, $25m in year 2, $40m in year 3 and $49m in year 4, this would imply that merger costs were approximately 4x estimated annualised merger benefits. Alternatively, a more conservative ramp up profile – for example $10m in year 1, $20m in year 2, $40m in year 3 and $59m in year 4 – would yield a ratio of merger costs to estimated annualised merger benefits of 3.3x.

  - The Auckland Transition Authority in Auckland had incurred transition costs of $36.2m when it was dis-established in October 2010 however, this figure is likely to understate transition costs that would have been incurred post Day 1 of the new merged Auckland Council. Original estimates of merger costs indicated a range of 1.0x to 3.1x annualised efficiency gains.

  - The estimates from the proposed Wellington (NZ) local council amalgamations indicates very high ratios of merger costs to benefits (around 5x-7x for the preferred option) and it has been acknowledged that the approach has been to over-estimate costs and to under-estimate savings.

- There are a range of potential risks associated with local council amalgamations that are identified in literature, most commonly, costs of disruption, workplace cultural barriers, decreased local democracy and representation and other challenges associated with implementation. Whilst these exist, they can potentially be minimised through proper planning and implementation.

- There is a view the costs associated with amalgamation are large and often under-estimated, particularly costs associated with new systems, cultures and operating structures.

1.4.2 Benchmarks from corporate transactions

EY has considered the key takeaways from our literature review against our own experience on cost savings that are potentially achievable from corporate transactions. These benchmarks are summarised in the table below.

Table 1: Benchmark synergies from corporate transactions

Rate of expenditure cost savings	15-25% of the target cost base in synergies	In a corporate transaction with similar businesses, synergies up to 30% of the target's cost base are often targeted. On average, 15% of the target cost base is targeted. Synergies are often highest in the support functions and overheads – the savings frequently reach 50% to 60% of the target's costs in some areas (e.g. the executive teams, back office support costs)
Time taken to achieve synergies	2-3 years average time for the full run rate of synergies to be realised	The time to fully realise synergies differs depending on the transaction complexity. The range for full synergy realization is between 2 to 5 years. Where the synergies are related to major infrastructure, capital expenditure or IT, these will typically be towards the upper end of the range. In most transactions the alignment of the core operating system or ERP has the longest lead time
Merger integration costs	0.9 – 1.1 average typical ratio of one-off integration costs to annualized synergy value	In some cases the implementation costs can be prohibitive to realising the potential synergies, particularly in cash flow constrained sectors.
Communication rate	~ 60% of companies announce successful achievement of synergies	Where transaction business case involves a synergy component, companies are often obliged to communicate the synergy targets. The communicated targets do not typically 'pay away' the full synergy estimate. Ongoing communication of synergy targets is highly variable and can be impacted by failure to achieve the targets, change in integration priorities or simply a lack of robust and reliable tracking.

Notwithstanding these broad benchmarks, in our experience, we would expect mergers in the public sector:

- To achieve more conservative levels of synergies in costs (e.g. the lower end of our scale may be the higher end of an achievable range). With local councils, concerns about risks to service levels may imply less aggressive cost reduction targets, or may result in cost savings being ploughed back into better services. In the case of the latter, the benefits are less visible but are nevertheless real benefits.

- To achieve realization of full benefits over a longer time frame (i.e. closer to 5 years)

- To incur larger one-off integration costs due to more complex stakeholder management and other factors.

1.4.3 Assessment of merger options

ILGRP preferred merger options

EY has estimated the potential costs and benefits associated with the merger options preferred by the ILGRP primarily using a "top-down" approach, over a 20 year timeframe. Our data on operating expenditure is based on those publicly reported for each council for 2013-14 financial year.

This approach requires us to estimate a range of inputs to estimate the potential costs and benefits of the ILGRP merger options. In estimating the long term costs and benefits of the ILGRP preferred merger options, we have used the 'top down' method outlined in Section 1.2.

- We have conservatively estimated that potential opex savings of 10% to 15% p.a. of a cost base which comprises the total opex of the entities merging, less the opex of the entity with the largest cost base. This rate of efficiency gain is below the 15-25% rate usually targeted in corporate transactions. We have assumed a lower rate of savings in view of the mixed evidence around the achievement of efficiency gains in local council amalgamations. Whilst we expect that a large proportion of the potential opex savings will relate to rationalisation of back-office functions, we have applied the rate of savings to the total opex line. An alternative approach is to apply varying rates of cost savings to different categories of costs. For example, our experience with corporate transactions indicates that in the executive and corporate governance function, reduction in council members and consolidation of the executive team could potentially generate savings of 60-80%, supplier rationalisation could potentially generate savings of 15-25% in procurement costs and consolidation of IT functions and applications could potentially generate savings of 20-30%. It has not been possible to take a more disaggregated approach to identifying cost savings in this instance as we do not have access to cost data that have been appropriately deconstructed.

- Potential opex savings are assumed to be realised in full over a period of 5 years. The ramp-up rate we have assumed over the 5 year period is 30% by year 1, 60% by year 2, 80% by year 3, 90% by year 4 and 100% by year 5.

- Having considered the evidence in merger integration costs as summarised in Section 1.4.1 above, we have estimated once-off merger integration costs at the rate of 3.0 times the annualised expenditure saving. The exception to this are the mergers involving Marrickville, Ashfield, Burwood, Canada Bay, Leichardt and Strathfield Councils, Auburn, Holroyd and Parramatta Councils together with parts of the Hills and Ryde Councils, Botany Bay, Sydney, Waverley, Randwick and Woollahra Councils and Hunters Hill, Lane Cove, Mosman, North Sydney, Willoughby and part Ryde. We understand these four merger options were regarded by the NSW Parliamentary Budget Office, based on advice from the Office of Local Government, as being of "very high" complexity in their costing of council mergers. For these four merger options, we have therefore assumed merger integration costs at the rate of 4.0 times the annualized expenditure saving.[2]

- Merger integration costs are assumed to be incurred over 5 years, and front end loaded over this period. Specifically, we have assumed that 60% of these costs will be incurred in year 1, 20% in year 2, 10% in year 3, 7% in year 4 and 3% in year 5. This expenditure profile reflects our experience that the majority of the costs will be incurred in the first two years and will relate to initial setting up of the merger implementation program, staffing changes, integration of back office functions, initial business process redesign and consolidation of IT functions and applications. Costs incurred in years 3 to 5 will likely reflect residual costs associated with ongoing IT integration.

These estimates form our base case NPV analysis. The base case NPV of net merger benefit / (cost) outcomes for each ILGRP preferred merger scenario is summarised in Table 2 below. As mentioned earlier, our NPVs are calculated using real discount rates.

[2] NSW Parliamentary Budget Office (PBO) costing of council mergers, Briefing Note.

Table 2: Top down analysis of ILGRP metropolitan local council preferred merger options over 20 years (Base Case)

	Merger scenario	NPV range 4% @ 2016 $'000	NPV range 7% @ 2016 $'000	NPV range 10% @ 2016 $'000
	ILGRP preferred merger options			
1	Manly + Warringah +Pittwater	131,470 - 197,204	92,589 - 138,883	66,177 - 99,266
2	Hornsby + Ku-ring-gai	100,408 - 150,611	70,713 - 106,070	50,542 - 75,812
3	Fairfield + Liverpool	148,921 - 223,381	104,879 - 157,318	74,961 - 112,442
4	Canterbury + Kogarah + Rockdale + Hurstville	195,898 - 293,847	137,963 - 206,945	98,608 - 147,912
5	Hunters Hill + Lane Cove + Mosman + North Sydney + Ryde (2/3) + Willoughby	221,023 - 331,535	149,624 - 224,437	101,384 - 152,076
6	Randwick + Waverley + Woollahra + Botany Bay + Sydney	335,015 - 502,522	226,793 - 340,189	153,672 - 230,508
7	Ashfield + Burwood + Canada Bay + Leichhardt + Marrickville + Strathfield	229,663 - 344,495	155,473 - 233,210	105,347 - 158,020
8	Auburn + Holroyd + Parramatta + The Hills (15%) + Ryde (1/3)	177,434 - 266,151	120,116 - 180,174	81,389 - 122,084
	Additional merger options identified by ILGRP or councils and requested by IPART			
9	Randwick + Waverley + Woollahra + Botany Bay	247,159 - 370,739	174,065 - 261,097	124,411 - 186,617
10	Bankstown + Canterbury	97,170 - 145,755	68,433 - 102,650	48,912 - 73,368
11	Gosford + Wyong	222,831 - 334,247	156,931 - 235,397	112,165 - 168,248
12	Randwick + Waverley	112,555 - 168,832	79,268 - 118,902	56,656 - 84,984
13	Auburn + Burwood + Canada Bay	100,262 - 150,393	70,611 - 105,916	50,468 - 75,703
14	Hawkesbury + The Hills	68,069 - 102,104	47,938 - 71,908	34,263 - 51,395

Our base case analysis indicates all of the ILGRP preferred merger options have large NPV positive estimate and will produce net merger benefits, lending strong support to the public interest for the mergers. Our NPV range for each merger scenario is reasonably wide and reflects the combination of assumptions we have adopted on potential merger benefits and costs. We expect the degree to which net merger benefits will be achievable in each scenario will depend on the specific circumstances of the relevant councils in each merger scenario. In some cases, it could be that potential net merger benefits would be closer to the low end of the range, whilst in other cases, net merger benefits may be higher.

To understand the NPV impact of variations around our key assumptions, we have examined three hypothetical scenarios:

1. A delay in the achievement of merger cost savings – We have modelled a scenario where savings ramp up to full realisation at a constant rate over 5 years.
2. Understatement of merger costs – We have modelled the impact of a 50% increase in merger costs
3. A combination of the above two scenarios.

As modelled, the delay in achieving potential merger benefits reduces the NPV (@ 7%) of net merger benefits by 8.1%, on average across all merger options, whilst a 50% rise in estimated merger costs reduces NPV outcomes by 24.3%, on average across all merger options.

Nevertheless, in all of the above 3 scenarios, net merger outcomes remain positive for all merger options. The sensitivity analysis suggests the case for the mergers generating significant positive benefits is likely under a range of scenarios.

Merger options explored by local councils

We have reviewed the merger options submitted by the local councils. Some of the submissions explored alternative merger options to the ILGRP preferred options, even though most of the local councils did not support amalgamation. Where cost-benefit analysis was undertaken, the majority of the options we were instructed to review were prepared by Morrison Low, SGS Consulting and KPMG, with a handful either self-assessed or prepared by other consultants.

The extent of detail provided in the submitted merger business cases varied significantly. In some cases, forecast cash flows reflecting estimated merger costs and benefits were provided but no NPV result was calculated. In these cases, where possible, EY has inferred an NPV estimate based on the data provided. In a few cases, merger costs and merger benefits were not separated but net merger cash flows were provided. Additionally, in some cases, the merger costs and benefits were revised by the relevant council or its consultant subsequent to the original submission in response to inquiries made by IPART.

There were also variations in the level of discount rate applied and some of the merger business case analyses were undertaken in real terms whilst others were undertaken in nominal terms. The length of the cash flow period also varied between business cases.

All of the merger business cases we reviewed incorporated assumptions on merger integration costs, with the exception of the merger business case prepared by Bankstown Council for the merger of Bankstown and Canterbury. Key sources of costs include staff redundancies, ICT transition costs, branding and remuneration harmonisation.

All of the merger business cases we reviewed also identified net merger benefits except for the merger business case prepared by Fairfield Council for the merger of Fairfield and Liverpool Councils. Key sources of cost savings included staffing where there were duplicated functions and roles, reduction of governance costs due to having a governance structure which was scaled to the size of the merged council, savings in procurement functions through rationalisation of works units and materials, reduced IT costs through ICT consolidation and certain property-related savings due to a reduction in number of office sites.

NPVs reported (or inferred by EY) for all business cases were positive except for two mergers – the merger business case prepared by SGS assessing the impact of splitting Warringah Council into two, merging one half with Manly and one half with Pittwater to create two new councils, and the business case prepared by Fairfield and Liverpool Councils.

Adjustments made by EY

EY has made two types of adjustments to the business cases submitted by the local councils:

- Standardisation adjustments - Due to the degree of variation in methodology between the submitted business cases, EY has applied a number of standardisation adjustments to the business cases to facilitate more meaningful comparison between the business cases as well as with our analysis of the ILGRP preferred merger options.

- Other adjustments to address specific assumptions. These are outlined in more detail in Section 5.3.2 and relate mainly to a small number of assumptions in specific merger business cases which were open to question.

The adjusted NPV outcomes of the business cases submitted by the local councils are summarised in Table 3 below.

Table 3: Local council merger options explored by local councils incorporating all EY adjustments (over 20 years)

Merger option	NPV 4% @ 2017 $'000	NPV 7% @ 2017 $'000	NPV 10% @ 2017 $'000
Kogarah + Rockdale + Hurstville	183,031	126,201	87,689
Canterbury + Kogarah + Rockdale + Hurstville	355,010	252,298	182,451
Kogarah + Hurstville	106,096	71,325	47,839
Botany Bay + Marrickville + Rockdale	322,114	229,641	166,650
Ashfield + Burwood + Canada Bay + Leichhardt + Marrickville + Strathfield	504,717	364,157	268,277
Hunters Hill + Lane Cove + Mosman + North Sydney + Ryde (part) + Willoughby	368,871	255,199	178,420
Willoughby + Lane Cove+ North Sydney	210,824	146,237	102,597
Willoughby + North Sydney	176,377	123,948	88,403
Auburn + Burwood + Canada Bay	144,009	99,548	69,508
Auburn + Holroyd + Parramatta + The Hills + Ryde (part)	323,578	220,160	150,408
Hornsby + The Hills	98,159	74,112	57,539
Hornsby + Ku-ring-gai	67,782	50,820	39,143
Hornsby + Ku-ring-gai + The Hills	216,055	164,369	128,715
Manly + Warringah + Pittwater (KPMG)	139,188	103,158	78,440
Manly Part Warringah + Pittwater Part Warringah (KPMG)	61,377	43,386	31,103
Manly+ Warringah (KPMG)	76,562	56,357	42,506
Manly + Warringah + Pittwater (SGS)	447,336	328,320	247,180
Manly + Warringah (SGS)	237,075	173,812	130,694

Merger option	NPV 4% @ 2017 $'000	NPV 7% @ 2017 $'000	NPV 10% @ 2017 $'000
Pittwater + Warringah [Additional Option] (SGS)	227,595	166,777	125,332
Manly Part Warringah + Pittwater Part Warringah (SGS)	(335,096)	(247,788)	(188,177)
Fairfield + Liverpool	167,779	124,462	95,049
Bankstown + Canterbury	116,512	82,055	58,648
Gosford + Wyong	179,967	126,363	90,527
Randwick + Waverley + Woollahra + Botany Bay + Sydney	523,554	389,275	297,062
Randwick + Waverley	176,250	127,308	93,800
Randwick + Waverley + Woollahra + Botany Bay	497,300	365,084	274,499

Following the adjustments we have made, NPV outcomes have improved for all merger scenarios except for the scenario (prepared by SGS) where Warringah Council is split into two, merging one half with Manly and one half with Pittwater to create two new councils, which remains negative. We note there remain substantial variations between the merger business cases prepared by KPMG and SGS in relation to the various combinations of merger involving Manly, Pittwater and Warringah Councils. For example, based on the adjusted figures reported in the table above, the merger scenario which involves splitting Warringah Council has a negative NPV (at 7%) of $247m as assessed by SGS and a positive NPV of $43m as assessed by KPMG.

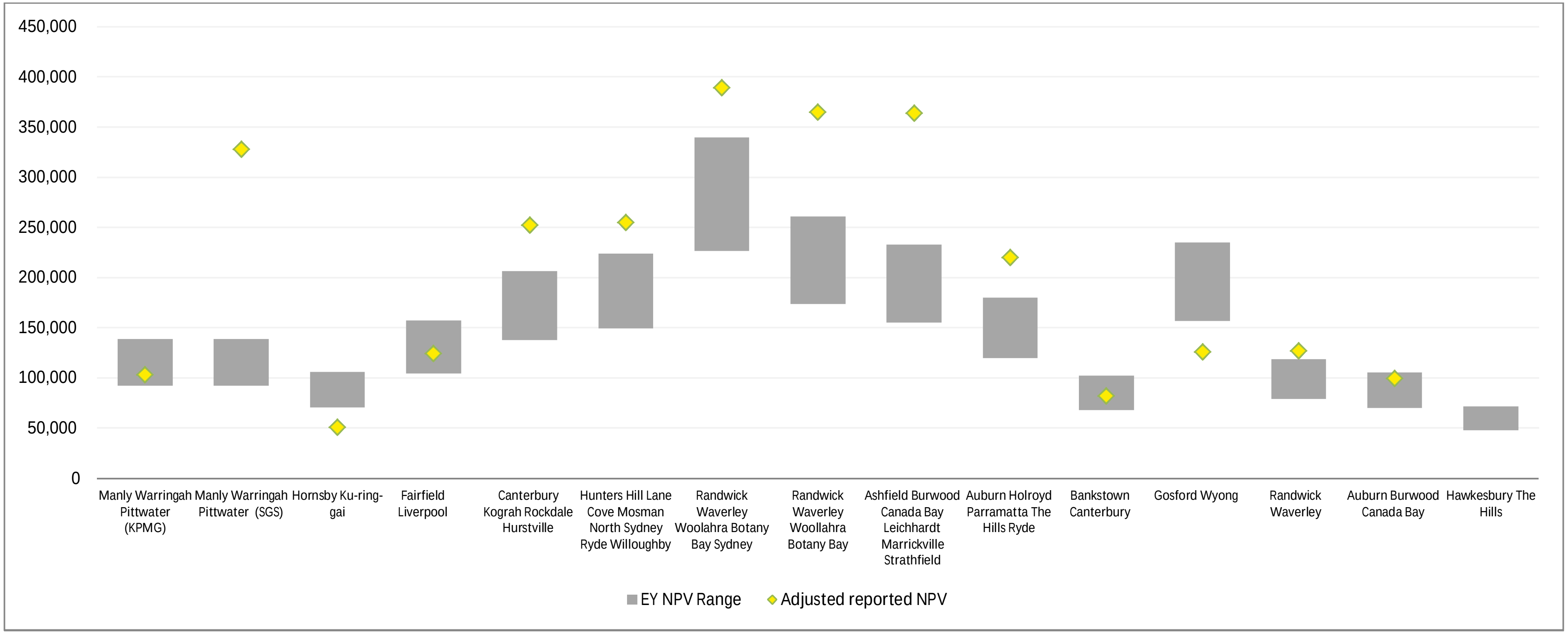
Overall findings on ILGRP preferred options

The chart below compares:

- The NPV outcomes for the ILGRP preferred merger options and the additional Bankstown + Canterbury, Gosford + Wyong, Randwick + Waverley, Auburn + Burwood + Canada Bay, and Hawkesbury + The Hills options that we have been asked to assess, based on EY's top-down methodology ("EY top-down approach"); with

- The NPV outcomes for the same options where they have been explored in local council submissions, incorporating the adjustments made by EY ("adjusted reported NPV").

Figure 1: Comparison of EY NPV range against adjusted reported NPVs ($'000)



The adjusted reported NPV of net merger outcomes are all positive. In addition, they are higher than or within the NPV range based on EY's top down approach except for the mergers involving Hornsby+Ku-ring-gai Councils and Gosford+Wyong Councils.

Further analysis on the level of merger costs versus merger benefits in these scenarios indicates there is more variation around views on merger costs and merger benefits. In most cases, local councils' estimates of merger costs are lower than EY's, but there appears to be reasonable level of alignment in views on merger benefits with a few exceptions.

We are of the view our analysis is conservative but prudently so in light of the work that has been undertaken.

Irrespective of differing views on the size of potential merger benefits and merger costs, there is strong consensus that net merger outcomes are positive in all of the listed scenarios above. They are also robust based on our sensitivity analysis.

2. Introduction

2.1 Background

The NSW Government has been working with NSW councils since 2011 to achieve a shared vision of stronger local communities. As part of this process, in March 2012, the State appointed the Independent Local Government Review Panel (ILGRP) to review Local Government in NSW and make recommendations for reform.

The ILGRP's report was completed in October 2013.[3] It established four key criteria which define a Fit for the Future (FFTF) council and proposed a range reforms to meet this objective.[4] Of most relevance to this report, the ILGRP preferred option was the merger of 32 Sydney metropolitan councils into 8 larger councils. This would replicate reforms undertaken in most other states.

Amalgamation Options							
Ashfield, Burwood, Canada Bay, Leichardt, Marrickville, Strathfield	Auburn, Holroyd, Parramatta, Ryde (part), The Hills (part)	Botany Bay, Randwick, Sydney, Waverley, Woollahra	Fairfield, Liverpool	Hornsby, Ku-Ring-Gai	Hunters Hill, Lane Cove, Mosman, North Sydney, Ryde (part), Willoughby	Canterbury, Hurstville, Kogarah, Rockdale	Manly, Pittwater, Warringah

In response to the ILGRP Report, the State announced a $1 billion reform package to provide support and incentives to help councils become more sustainable.

The State Government expected that each council would use the ILGRP's proposals for their council as a point of commencement and consideration, and assess its current situation and demonstrate how it intends to become FFTF.

The NSW Government requested all councils in NSW to submit a proposal demonstrating how they meet the criteria by 30 June 2015, which will then be assessed by IPART, as the appointed Expert Advisory Panel.

2.2 Scope of work

EY has been instructed by IPART to:

- Model and estimate the long term costs and benefits in Net Present Value (NPV) terms, of the 8 council merger combinations in the Sydney Metropolitan Area identified as preferred merger options in the ILGRP report. In addition, IPART has requested EY to undertake similar analysis for three other sets of mergers – Gosford and Wyong

[3] Final Report of the NSW Independent Local Government Review Panel, Revitalising Local Government, October 2013
[4] These are scale and capacity, financial sustainability, effective infrastructure and service management, and efficiency.

Councils, Bankstown and Canterbury Councils, and Hawkesbury and The Hills Councils. These three merger scenarios did not form part of the ILGRP's preferred options but the Panel recommended that they be further explored.

- Review and critique the merger business case models that have been put forward by Local Councils in Sydney. This includes providing an NPV estimate of the business cases, and reviewing and critiquing IPART's staff own assessment and analysis of the council merger business cases.

In essence, the task is to provide a comparative financial analysis of the merger proposals to inform IPART's response to the Government.

We have not been requested to review or compare the findings from our analysis with CIPs submitted by local councils and make no comment on such issues.

This report documents our analysis and findings.

2.3 Approach

The key features of our approach are set out below:

- The focus of our work is on assessing the relative financial merits of the merger options presented based on the information provided. The focus is not on the absolute merits of any merger *per se*.
- Due to information and time constraints, our work necessarily:
  - Primarily involved on a 'top-down' review of the available evidence in respect of the relative merits of the options. In commercial practice the merits of a particular merger would typically be assessed by undertaking a detailed deep 'bottom-up' review of the costs, benefits and risks of a merger in the particular circumstances of the parties.
  - Relies entirely on the evidence provided and the other publically available information reviewed. While there is a large body of work on these issues, there is a relatively limited amount of commercial evidence on the practical impacts of council mergers.
  - Focuses on the relative scope for efficiency improvements that the merger options might provide, but also considers the non-financial benefits and costs the merger options might provide.

Further details on the methodology we have applied to assess the business case for the ILGRP preferred merger options are outlined in Section 5 of this report.

To undertake our analysis we have:

- Relied on publicly available information in relation to the council merger business cases
- Conducted a literature review on the available evidence on the costs and benefits arising from local council mergers. Some of this material included information on the experience from local council amalgamations undertaken elsewhere in Australia and overseas
- Obtained data on 2013/14 operating expenses of the relevant local councils, as reported in relevant published annual reports or annual financial statements

- Reviewed the merger business cases included in the submissions by the Sydney metropolitan local councils, focusing on the reasonableness of the assumptions employed and the methodology for quantifying the costs and benefits. All merger business cases were reviewed even if the merger was not supported by the relevant local council. As part of this review:
    - We have made inquiries with staff at IPART to confirm, clarify or request additional information. Where additional information was requested, this was only provided to the extent that IPART was able to obtain that information
    - We have not had any direct consultations with the Sydney metropolitan local councils. For this reason, our analysis does not take into account the specific operating circumstances and business characteristics of each of the local council merger scenarios examined, which is typically important in identifying the extent to which merger cost savings may be achievable in any particular instance
    - We have relied on the information presented within the business cases and have not undertaken an audit of the available information.
- Reviewed the preferred merger options in the ILGRP report:
    - In this regard, we note that while the ILGRP expressed preference for a number of mergers, quantitative analysis was not undertaken to test the economic merits of the proposals
    - In estimating the long term costs and benefits of the ILGRP preferred merger option, we have therefore considered the evidence from the available literature, the evidence based on our commercial experience with corporate acquisitions and/or mergers, as well as our consideration of the extent to which those savings are likely to be achievable for public sector organisations.
- Estimated the NPV of the merger costs and savings identified over a 20 year timeframe, applying discount rates which are consistent with the requirements of the NSW Government Guidelines for Economic Appraisals. We have also undertaken sensitivity analysis of the NPV outcomes using real discount rates of 4% and 10%.

2.4 Limitations

2.4.1 Restrictions on Report Use

The Report may only be relied upon by IPART pursuant to the terms and conditions referred to in the Agreement. Any commercial decisions taken by IPART are not within the scope of our duty of care and in making such decisions IPART should take into account the limitations of the scope of our work and other factors, commercial or otherwise, of which you should be aware of from sources other than our work.

EY disclaims all liability to any party other than IPART for all costs, loss, damage and liability the third party may suffer or incur arising from or relating to or in any way connected with the provision of the Report to the third party without our prior written consent. If others choose to rely in any way on the Report they do so entirely at their own risk.

Liability is limited by a scheme approved under professional standards legislation.

2.4.2 Basis of Our Work

We have not independently verified, or accept any responsibility or liability for independently verifying, any information provided to us by IPART or information obtained in the public domain for the purpose of this review, nor do we make any representation as to the accuracy or completeness of the information.

Our work in connection with this assignment is of a different nature to that of an audit or a review of information, as those terms are understood in Australian Auditing Standards applicable to audit and review engagements. Our report to you is based on inquiries of and discussions with IPART, a review of the business and other documents made available to us, and analytical procedures applied to data provided.

Our work commenced on 18 August 2015 and was completed on 2 October 2015. In that time, we assessed the ILGRP preferred merger options (and 5 variations around those options) and reviewed 29 merger business cases presented by the councils. It was undertaken as a desktop exercise and we relied on the information submitted in the relevant merger business cases. As a result, there may be findings or information not included in this report, or our investigations may not have revealed, all relevant matters. The reliance that can be placed on our report may therefore be limited in that regard.

In undertaking the work we have acted under the direction of IPART to complete the agreed scope of work and have not considered the interests of any other parties.

2.4.3 Information received

All the information we have received is the responsibility of IPART and the relevant councils. We have not sought to establish the reliability of information given to us except as specifically stated in the report. Consequently, we give no assurance on such financial information.

References to EY in the report relate to our advice, recommendations and analysis and do not indicate that we take any responsibility for the information concerned or are assembling or associating ourselves with any financial information including prospective financial information. Appendix A provides a full list of the documents we have reviewed.

The underlying assumptions and projections contained with this Report are subject to significant uncertainties and contingencies often outside the control of EY or IPART. If events do not occur as assumed, actual financial information may vary significantly from that in this Report. Accordingly, EY does not confirm or guarantee the achievement of the forecast financial information in this Report, as future events by their very nature, are not capable of independent substantiation.

3. Potential impacts of local government structural reform

There is a significant amount of available academic and empirical research on the impact of local government structural reform. Some of this literature has been generated from previous local government financial sustainability reviews in various Australian States. This section of our report provides a brief summary of the literature that we have reviewed.

3.1 ILGRP Report

As noted earlier, the ILGRP 's preferred option was the merger of 32 Sydney metropolitan councils into 8 large councils. Whilst the recommendation was not supported by quantitative analysis, it noted there was evidence that amalgamations were an effective way of achieving efficiency and economies of scale, service improvements and strategic capacity. The evidence cited by the Panel is reproduced in the table below.

Table 4: Summary of Attributes of Different Forms of Consolidation.

	Amalgamation	Boundary Change	Shared Services	Regional Collaboration
Efficiency and Economies of Scale	Strong link	Potentially strong link subject to size/disposition of re-shaped councils	Strong link	Weak link
Strategic Capacity	Strong link	As above – benefits will flow to larger 'new' councils	Potential medium-strong link subject to organisation structure and governance	Weak link
Service improvement and innovation	Strong link	As above	Strong link (but limited to services that are effectively shared)	Potential link subject to nature and scope of collaboration
Potential Diminution of Local Democracy	Distinct risk, but can be managed	Some risk depending on nature of 'new' councils – can be managed	Risk where extensive decision-making is ceded to joint authority – may be difficult to manage	Little or no risk

Source: Table 4, Revitalising Local Government, Final Report of the NSW Independent Local Government Review Panel, October 2013, page 72.

The Panel also noted that:

> *"The principal arguments used against amalgamations are that there is no direct, general relationship between council size and the efficiency of service delivery; that mergers will fail to produce worthwhile cost savings; that local identity and representation will suffer; and that regional cooperation and shared services can deliver the desired outcome."*[5]

[5] Revitalising Local Government, Final Report of the NSW Independent Local Government Review Panel, October 2013, page 73

However, it considered (amongst other things):

- The evidence shows for some local government functions, notably infrastructure and back-office functions, increased scale can and does bring efficiencies and cost savings
- A number of before and after case studies of individual amalgamations have shown significant efficiency gains, although not necessarily in the form of rate cuts because savings have been ploughed back into other service and infrastructure improvements
- Mechanisms such as Community Boards and new approaches to place management, community engagement and customer service make it possible to maintain local representation and identity within larger council areas.

3.2 Evidence from previous Australian local government inquiries

As has been observed in a number of articles, since 2000, Australian local government has been exhaustively evaluated by a range of national and state-based public inquiries. These include:

- The House of Representatives Standing Committee on Economics, Finance and Public Administration (2004) *Rates and Taxes: A Fair Share for Responsible Local Government* ("Hawker Report")
- The South Australian Financial Sustainability Review Board inquiry into the long term financial performance of South Australian local government (2005)
- The Financial Sustainability of NSW Local Government ('Allan Report') (2006) Are Councils Sustainable?
- The Local Government Association of Tasmania ("LGAT") (2007), Review of the Financial Sustainability of Local Government in Tasmania
- The Queensland Local Government Reform Commission ("QLGRC") (2007) Report of the Local Government Reform Commission, which began with the Size, Shape and Sustainability ("SSS") program launched by the Local Government Association of Queensland ("LGAQ") in early 2005 and concluded with the final report of the Queensland Treasury Corporation ("QTC") on Financial Sustainability in Queensland Local Government (October 2008).

Whilst the principal focus of most of these inquiries was on the financial sustainability of local government, they also sought to examine structural reform options through amalgamation. Some of the observations and findings of these inquiries that are relevant to this report are summarised in Table 5 below.

Table 5: Selected Australian local government inquiries

Inquiry	Relevant observations and findings
Hawker Report (2004)	• In general, large councils had a 'more secure and adequate financial base, are better able to plan and contribute to economic development, are more effective community advocates, and interact more effectively with government and business. • Structural reform can deliver economies of scale and can enable councils to employ a wider range of professionals so they can offer a wider range and usually higher quality of services • Amalgamations yielded savings as evidence in the South Australian and Victorian amalgamation episodes, Western Australian projections that structural reform of small councils could produce notional annual savings equating to 5.2 per cent of total municipal expenditure, and sizeable savings projections from five NSW mergers • The report also cautioned that amalgamation may not be viable in the case of small remote councils or large (geographically) councils in sparsely settled areas. Furthermore, cost-shifting by state governments could diminish the efficiency enhancing effects of amalgamation. • The overall conclusion from the report was that in some circumstances, amalgamations of local government bodies is the most direct way of achieving a more efficient and cost effective local government sector.
South Australian Financial Sustainability Review Board (FSRB)	• The inquiry focused on the long term financial performance of South Australian local government and was commissioned by the state's Local Government Association. • In relation to structural reform, the report noted that there was no strong relationship between a council's organisational size and either a strong financial position or a good annual financial performance' • The report expressed the view that amalgamation involves significant costs and often displayed "exaggerated benefits". In this context, it questioned the validity of forecasts of recurrent cost savings of $19.4m per annum and one-off savings of $3.9m from the mid-1990s amalgamations in SA.
Allan Report (2006)	• This report was the outcome of a NSW Local Government and Shires Association inquiry into the financial sustainability of NSW Local Government. • Many of the report's recommendations reflected in those made by the Hawker Report and the FSRB Report. • The inquiry also considered the administration and management of local councils and benchmarked the administrative performance of nine volunteer councils against other councils, public institutions and private enterprises worldwide. It concluded that the results showed that local government was capable of performing as well as or better than other public and private organisations. • In relation to size and efficiency, the report questioned the empirical basis for the concept and concluded that the available evidence was inconclusive, except perhaps for the smallest councils. It offered that an alternative approach would be cooperative service provision for those services with scale economies through service sharing, joint processing and external outsourcing, notably financial transaction processing, IT and procurement.
LGAT (2007)	• The LGAT commissioned Access Economics to examine the financial sustainability of Tasmanian local government. • The report advocated a preference for increased cooperation and resource sharing amongst councils over amalgamations. It was observed that forced amalgamations offered limited prospects of achieving lasting community benefit and that the main benefits of amalgamation can usually be achieved by other means.
LGAQ (2005), QLGRC (2007)	• The LGAQ's 2004 study considered the long run viability of councils. It identified a number of challenges faced by local government and made a number of recommendations for local council consolidation including resource sharing, merger/amalgamation and major boundary changes. • With respect to amalgamation, the LGAQ argued that the benefits which can flow from council amalgamation could include a 'sufficient resource base', a reduction in the 'total costs of government', scale economies, lower staff levels, an 'opportunity to review' operations, rationalization of assets, 'cross-border' facility and service utilization, better promotion of economic development, improved growth management, the 'formalization' of communities of interest, increased political lobbying power, and potential for 'full-time' elected representatives. However, it also recognised that the potential costs embraced 'exposure' to liabilities of other local authorities, addressing 'major difference in rates', fewer grants, high costs of 'integrating' constituent councils, dealing with 'widely differing organisational cultures', creating 'differing levels of service in some areas', diluting existing representation, and the loss of direct representation by small

Inquiry	Relevant observations and findings
	areas. • The Queensland Government subsequently abandoned the LGAQ's program and moved in favour of forced amalgamations. The QLGRC was appointed to review all councils (except City of Brisbane). • The QLGRC recommended the reduction of the number of local councils from 157 to 73, and this was accepted by government. • The QLGRC rejected the notion of a one size fits all response, but acknowledged the need to take a region-by-region approach.
QTC (2008)	• The QTC reviewed 24 claims for amalgamation cost funding lodged by councils and tabled its report in October 2008. • It observed that savings from local government amalgamations 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. That is, they are subsequently less visible in terms of impact on profitability or operating surpluses (particularly since they are not for profit organisations) • The QTC report also referred to a 2007 report by Alan Morton, *Outcomes from Major Structural Change of Local Government*, which estimated administrative cost savings from the Cairns, Ipswich and Gold Coast amalgamations of 1992/93 to be between 1.1 per cent and 3.1 per cent per annum. • QTC's final assessment was based on total costs claimed of $194.8m, which were offset by actual savings identified of $118.1m and estimated potential future benefits of $11.1m (i.e. total benefits of $129m) over a period of 4.3 years. Before taking into account funding for amalgamation, this yielded $65.6m in net cost. • Based on the claims submitted to and assessed by the QTC, the key sources for efficiency savings were in IT (31%), councilor remuneration (25.5%), senior officer / staff costs (31.9%), and buildings / relocations (3.8%). Future potential benefits identified included asset utilisation / procurement (~12%), combined town plans (19.2%), and a range of other benefits (election costs, group insurance, IT savings etc.) (69%).

In summary, the evidence examined suggests that state and territory local government policy makers have shown support for amalgamations as a means of achieving more efficient local government authorities.

There is considerable precedent for structural reform of local government in Australia. This includes Victoria (1993), South Australia (mid-1990s), Queensland (2008) and more recently, Western Australia. Whilst there is debate as to the precise magnitude of potential benefits and costs in these reforms, there does not appear to evidence of systemic failure.

3.3 Academic research

Academic research both internationally and in Australia overall presents a mixed picture of the relationship between size and economies of scale in local government amalgamations. Whilst theory suggests that economies of scale should exist where fixed costs constitute a large proportion of total cost, this concept is supported, but not always, by empirical findings. One school of thought that has emerged from these findings is that local council amalgamation cannot be argued to more effective than other alternative models of council cooperation in achieving economies of scale and scope. Aulich et al (2011) provides a convenient summary of the findings of a range of studies, which is reproduced in Table 6 below.

Table 6: Econometric research into economies of scale in local government, 2000-2010

Author / Date	Data	Estimation technique	Dependent variable	Explanatory variable	Findings
Soul (2000)	177 NSW LGAs 1995-1996	Simple regression analysis	Gross per capital expenditure; per capita expenditure on economic services	Population	Evidence of both economies of scale and diseconomies of scale
Byrnes et al (2003)	177 NSW LGAs, 2001-2001	Standard regression analysis	Average cost of collecting domestic waste bins	No. of bins; population; income; bin density; No. of bins per square kilometre	Limited evidence of economies of scale
McDavid (2001)	327 Canadian local governments, 1996-1997	Standard regression analysis	Residential solid waste collection cost	Households served per truck	Evidence of economies of scale
Callan and Thomas (2001)	110 Massachusetts municipalities for 1997	Seeming unrelated regression	Total annual cost of disposal and recycling	Housing density; Provider; Frequency; Grants	No evidence of economies of scale
Bradbury and Stephenson (2003)	154 countries in the United States, 1992-1997	Standard regression analysis	Government expenditures per capita and net government expenditures per capita	Demographics; Income; wealth; commission size; government transfers, ideology	Evidence of economies of scale in highway expenditure
Bel and Costa (2006)	189 Spanish municipalities	Standard regression analysis	Total cost of waste management services	Quantity of waste; per cent recycling; wage level; frequency of collection; population density; tourism; landfill; and mode of production	Evidence of economies of scale for lower population
Dijkgraaf and Gradus (2007)	453 Dutch municipalities for the year 2002	Standard regression analysis	Total cost of waste management services	Pick up points; Inhabitants per point; density; unsorted waste; glass; paper; vegetable waste; public and private competition; neighbouring municipality	Evidence of economies of scale for lower populations
Holcombe and Williams (2009)	487 municipalities with populations > 50,000 in USA, 1990 to 2000	Standard regression analysis	Total per capita municipal government expenditure; disaggregated function government expenditure	Demographics; population densities; and municipal functions	Constant returns to scale; diseconomies in policing and water services while highway services inversely related to population density
Bel and Fageda (2009)	65 municipalities of Galicia 2005	Standard regression analysis	Total cost of waste management services	Volume of waste; recycling; frequency of waste collection; tourist activity; incineration; mean wage; and contracted	Evidence of economies of scale in smaller municipalities

Source: Aulich, Gibbs, Gooding, McKinley, Pillora & Samson, May 2011, Consolidation in local government, A fresh look, Table A2

One of the criticisms against some of the existing studies is the use of population as a proxy for output. It is suggested that this approach is only valid if there is a positive correlation between population and service output. However, service outputs for different local government areas with similar size populations may vary because residents have different needs depending on their demographic and economic profiles.

Most of the academic research in Australia around the relationship between size and efficiency has been undertaken by Professor Brian Dollery of the University of New England. Key findings from some of Professor Dollery's more recent research are summarised below.

- Drew, Kortt and Dollery (2014), Economies of scale and local government expenditure: Evidence from Australia:
  - The study acknowledges the findings from existing empirical evidence are mixed. Whilst the evidence suggests that amalgamation may improve the administrative and technical capacity of local government, it is not only costly but also has other adverse, disruptive, and often unintended consequences such as the loss of "local voice" and "local democracy".
  - The study also found that after controlling for population density, there is little evidence to support a relationship between council size (as proxied by population size) and economies of scale.
- Dollery, Kortt and Sinnewe (2015), Is Biggest Best? A Comparative Analysis of the Financial Viability of the Brisbane City Council
  - This research paper was recently published in the Australian Journal of Public Administration and submitted to the NSW Parliamentary Inquiry into the Fit for Future Reforms. It seeks to compare the performance of the Brisbane City Council (being the largest local council in Australia with an aggregate population of 1,079,392 persons (or around 380,000 households) as at 30 June 2011) with that of the City of Sydney Council.
  - Based on a comparison of four financial performance indicators, the study found that the Brisbane City Council was outperformed in 3 of the 4 indicators. The study concluded this evidence casts considerable doubts over the "bigger is better" assumption.

3.3.1 Other evidence

In August 2011, Deloitte Access Economics ("Deloitte") prepared an analysis which explored the impacts of local government structural reform in Tasmania for the Property Council.[6] The report noted that Tasmania is the only state or territory where no council has a population greater than 75,000. In terms of average geographic size, Tasmania's councils are the nation's smallest (and this is without taking account of the vast mass of land which is state or national park).

A key conclusion emerging from the report was that:

> *"The characteristics of Tasmania's councils coupled with the experiences of past reforms suggest that, if well conceived and effectively managed, efficiency gains in the order of 10% to 20% of operating expenses are achievable from local government structural reform in Tasmania."*[7]

[6] Deloitte Access Economics, Local Government Structural Reform in Tasmania, Property Council of Australia – Tasmania, August, 2011.
[7] Ibid, page iii

Furthermore, Deloitte considered that there was potential to exceed this level of cost savings:

"...econometric analysis suggests that the gains could potentially exceed this. Indeed, under a stylised reform scenario modelled in this report, whereby 12 councils in the state's south are consolidated into a single council, the analysis finds that:

- *Efficiency gains of up to 35% could be achieved.*
- *Based on the operating expenses of these councils in 2009-10, a $110 million annual saving in the aggregate cost of administering local government across these regions could be realised."*[8]

Deloitte also reported presented evidence of potential cost savings associated with range of past local council structural reforms in Australia. This data is reproduced below.

Table 7: Estimates of savings associated with council structural reform

Source	Description of structural reform / analysis	Area of saving	Quantification of saving
Local Government Boundary Reform Board (1998)	Voluntary structural reform of 118 councils to 68 councils in South Australia	Recurrent savings	$19.4m (1998 dollars
		Estimated one-off savings	$3.9m (1998 dollars)
Local Government Boundary Reform (1998)	Estimated possible savings from further structural reform in South Australia. Looked only at councils with a population of less than 80,000 in metro areas	Metro councils – total costs in waste, management, sport & recreation, road maintenance, footway maintenance, stormwater drainage maintenance and road& footpath construction	9%
		Metro councils – per capita development management costs	44%
		Non-metro councils – per capita administration costs	2.5%
		Non-metro councils – per capita development management councils	10%
		Non-metro councils (with population of more than 10,000 prior to structural reform) – total costs in waste, management, sport & recreation, road maintenance, footway maintenance, stormwater drainage maintenance and road & footpath construction	4.5%
		Non-metro councils (with population of less than 10,000 prior to structural reform) – total costs in waste, management, sport & recreation, road maintenance, footway maintenance, stormwater drainage maintenance and road & footpath construction	9%
Department of Local	Voluntary consolidation of Cities of Geraldton	Northam – recurrent saving	$422,256

[8] Ibid, page iii.

Source	Description of structural reform / analysis	Area of saving	Quantification of saving
Government (2010)	and Greenough (new council created 1 July 2007) and voluntary consolidation of the Town and Shire of Northam (new council created 1 July 2007) in Western Australia		
KPMG (2002)	Estimation of savings that would result from consolidation of Waratah Wynyard Council and Burnie City Council, both in Tasmania, based on consultation with councils	Saving on operating expenditure	5%
KPMG analysis, reported in Local Government Board Report (1997)	Estimation of savings achieved from different structural reform options in Tasmania (Southern Tasmania and Greater Hobart reported here)	Southern Tasmania: • Works & maintenance • Community & development • Administration • Governance Greater Hobart: • Works & maintenance • Community & development • Administration • Governance	 • 9% • 4% • 45% • 35% • 8% • 5% • 30% • 40%

We note that the merger business case submission by Woollahra Council includes a report by Percy Allan & Associates which pointed to evidence that increasing population yields a lower level of gross expenditure per capita up to a point, after which increasing population results in higher levels of gross expenditure per capita. It concluded that no significant efficiency gain would be generated by merging Woollahra Municipal Council with other councils as proposed by the ILGRP as it was already above the optimal size where savings would be expected.[9]

3.4 Evidence from New Zealand local council amalgamations

The experience from local council amalgamations in other countries can provide some insights into the potential level of costs and savings that can emerge from amalgamation. EY fully acknowledges that caution should be exercised in translating such overseas experience to Australian local council amalgamations. Nevertheless, we consider that such case studies can provide useful insights to the potential sources of costs and benefits arising from amalgamations.

3.4.1 Auckland Council

In 2007, the government established the Royal Commission on Auckland Governance ("the Commission") to examine governance arrangements in the Auckland region. Following the release of the its findings in March 2009, the government decided to extinguish the existing city, district and regional councils and replace them with a single local authority – the new Auckland Council. The new council was established in November 2010 and replaced the previous 8 local authorities of the Auckland region. The

[9] Woollahra Municipal Council, Fit for the Future Research Report, Percy Allan & Associates, March 2015.

Auckland Transition Agency ("ATA") was also established to plan and manage all matters in relation to the reorganisation to ensure that the Auckland Council was ready to function as of 1 November 2010.

Estimates of potential efficiencies to be generated by the amalgamation of the 8 local authorities in February 2009 are outlined in the table below.[10] The reorganisation efficiencies, estimated by Taylor Duignan Barry ("TDB"), were assumed to be progressively realised from 1 January 2012 through to 1 January 2015.

Table 8: TDB's analysis of the Commission's preferred option for reorganization of Auckland Local Governance

Commission's preferred option indicative range of efficiency gains	Low $m p.a.	% of total planned expenditure by predecessor councils for 2008/09	High $m p.a.	% of total planned expenditure by predecessor councils for 2008/09	Medium $m p.a.
Capex efficiency gains	22	2%	37	3%	30
Opex efficiency gains	54	3%	77	4%	65
Total efficiency gains	76	2.5%	113	3.5%	95

Source: Taylor Duignan Barry, 28 October 2010, Securing Efficiencies from the Reorganisation of Local Governance in Auckland, page 13

Total integration costs were estimated to range from around 1x annual efficiency gains under an optimistic scenario, to just over 3x annual efficiency gains under a pessimistic scenario.[11]

Table 9: TDB's estimated merger integration costs for the re-organisation of the Auckland Councils

	Pessimistic	Optimistic	Base Case
Annual efficiency gains	$76m	$113m	$95m
Total integration costs	$237m	$118m	$178m
Merger costs / Annualised efficiency gain	3.1x	1.0x	1.9x

Source: Taylor Duignan Barry, 9 February 2009, Financial Analysis of the Re-organisation of the councils in the Auckland region, page 6.

In 2010, TDB reviewed the extent to which efficiencies had already been achieved by the ATA up to October 2010. It was noted that the ATA had by that stage put in place plans for FTE reductions to occur by 1 July 2012 by eliminating duplication of roles. Specifically:

- In the first 12 months, the ATA had achieved FTE reductions of around 13% of FTEs employed by the predecessor councils pre-merger

[10] Taylor, Duignan Barry, Securing Efficiencies from the Reorganisation of Local Governance in Auckland, October 2010, Auckland Transition Agency.
[11] The low (high) scenario combined high (low) integration costs with low (high) savings. As such the ratio of integration costs to savings was 3.1x in the low scenario and 1.0x in the high scenario.

- By 1 July 2012, the ATA was expecting to fully realise FTE reductions totalling 16% of FTEs employed by the predecessor councils pre-merger.

Almost all of these reductions were anticipated to occur in managerial/supervisory positions. The number of employees in front line or public facing positions was to remain virtually unchanged. Cost savings were also expected to occur in a number of specific administrative processes, including:

- One rather than eight Long Term council Community Plans was required under the new structure
- One audit process, albeit for a larger entity
- Rationalisation of insurance providers.

The ATA's financial statements up to the date it was disestablished in October 2010 (i.e. after 17 months of operation) indicated that it had incurred approximately $36.2m in transition costs.

TDB reported that the ATA's plans that would yield opex-related efficiencies of some $95m p.a. (i.e. exceeding the 2009 "high" estimate of $77m by $19m) when fully realised in 2012/13, comprising personnel savings of $91m p.a. and non-personnel savings of around $4m p.a. $75m of this would be realised in 2011/12. These efficiencies were described as being well in excess of the efficiencies originally estimated in TDB's 2009 report.[12] Additional savings ($47m) were also expected in the areas of procurement and business processes, tighter budgeting and capex, although at October 2010, these had not been specifically identified and initiated. Temporary transition-related costs in 2011/12 were forecast to be around 1.5% of total rates revenue.

Auckland Council's 2013/14 Annual Plan noted that it had managed to achieve operational savings of $145m per year and that "*Much of this cost reduction has been achieved with little impact on council services, with our focus on reducing corporate costs and delivering services by staff rather than consultants*."[13]

3.4.2 Wellington region local government reorganisation

In December 2014, the Local Government Commission announced a proposal to form a Greater Wellington Council which would combine existing nine councils (Masterton District Council; Carterton District Council; South Wairarapa District Council; Upper Hutt City Council; Hutt City Council; Wellington City Council; Porirua City Council; Kapiti Coast District Council, and the Greater Wellington Regional Council). The Greater Wellington Council will have all of the responsibilities of the regional council and the city and district councils. Decision-making will be shared between the governing body (mayor and councillors) and eight local boards. The mayor and councillors would be responsible for high-level decisions affecting all of Wellington. The local boards would control council budgets and decisions for local matters in established communities. Local boards would be created for Wairarapa; Upper Hutt; Lower Hutt; Kapiti Coast; Porirua-Tawa; Ohariu; Lambton; and Rongotai.

[12] Taylor, Duignan Barry, Securing Efficiencies from the Reorganisation of Local Governance in Auckland, October 2010, Auckland Transition Agency, page 18. Exceeding the "high" case estimate by $19m implies that the opex savings achieved was just under 5% of 2009 council opex.
[13] Auckland Council, 2013-14 Annual Plan, Vol. 1 page 6.

The Local Government Commission identified and evaluated a number of other alternative options for reform but identified a single Greater Wellington Council as its preferred option. It noted that:

> *"This approach provides the greatest scope to improve the performance of local government in Wellington Region. Across each of the evaluation criteria, this option is either the best option, or near the best option, of those considered. It is the most expensive option to implement, but offers substantial potential for financial savings of just over $30 million per annum."*[14]

In undertaking its evaluation, the Local Government Commission was required to consider potential savings from the change. It considered work that was previously undertaken by NZIER for the Hutt City Council in 2012, which explored scale and cost effectiveness. The Commission expressed agreement with NZIER's observation that savings from local council mergers are often thought to arise from 3 sources – savings from economies of scale, strategic capacity improvement through economies of scope and service delivery improvements. However, of these, only the first is capable of being objectively measured and quantified. The Commission also expressed the view that whilst such potential savings are possible, the opportunities to secure benefits by scale will:

- Vary with activity
- Depend on how the amalgamated council will run
- Depend on the levels of service it chooses to provide.

It also considered that there were a range of non-financial benefits that could accrue from amalgamation including:

- Potential benefits from better aligning decision-making with perceptual, political and functional communities of interest
- Potential benefits from arrangements that enable more timely and better decision-making which is not subject to on-going re-litigation.

Whilst these benefits were difficult to measure, the Commission considered that they were real benefits.

With respect to the potential for future reductions in rates, the Commission offered a view on why reductions in rates are unlikely to emerge:

> *"One of the observations and criticisms that frequently emerges in relation to estimates of potential savings from amalgamation is that few if any have demonstrated reductions in rates as a consequence of the change. All of the councils in the "affected area" are forecasting ongoing rates increases. All face significant future capital works programmes to deal with the renewal of infrastructure. All face rising environmental standards and increasing service level expectations from residents. These factors mean that it is most unlikely that any potential savings from local government reform would be passed on to ratepayers through rates reductions. It is far more likely that savings provide the scope to address the many issues that current councils are unable to deal with, or to reduce the level of risk that the Wellington*

[14] Local Government Commission, Draft proposal for reorganisation of local government in Wellington, Vol 2, Technical Report: Evaluation of the options and the draft proposal, December 2014 with Feb 2015 adjustment, Page 13. Estimates from the same report suggest that total opex of the nine councils pre-merger amount to around $933m.

communities are exposed to, or to reduce debt, or to improve service standards."[15]

In quantifying the potential impacts of the amalgamation, the Commission drew on advice of its consultants (McGredy Winder & Co, Brian Smith Advisory Services, Stimpson & Co, and Deloitte). Brian Smith Advisory Services produced the estimates of the savings that could be achieved under each option. Stimpson & Co developed the estimates of the transition costs and co-ordinated the financial assumptions between the different pieces of work. Deloitte produced estimates of the IT related costs that would be associated with the transition to each of the options. Deloitte's work was then integrated into the estimates of total transition cost reported by Stimpson & Co.

The framework for estimating merger cost savings assumed:

- A rapid approach to transition will be adopted, seeking to do as much integration and set-up as possible during the transition period before the first election for a new council
- Where possible the new council will adopt the 'best of breed' approach from within the merging councils rather than develop a new platform approach critical systems that support paying staff, paying suppliers, managing accounts receivable and accounts payable, financial planning and performance, and managing rates collection must be in place on day one of any new council
- To support critical systems, IT infrastructure will need to be consolidated by day one of operation
- The second priority is for those that provide customer facing systems, including complaints, customer contact and online channels, etc.
- A transition board will be in place and manage the process of appointing an interim chief executive so that transition decisions can be made in the most timely way.

The assessment of savings was based on the experience with the establishment of the Auckland Council, management experience, expert assessments (that is, the Deloitte work on IT costs), and insights or investigations by others, including the applicants, consultants who did work to support the applications or alternative applications, and work that New Zealand Transport Agency has done on opportunities for savings in relation to roading, etc. In estimating savings, the approach was to work on the basis of a range of possible savings and to err on the side of underestimating savings. In estimating transition costs the approach was to err on the side of overestimating them.[16]

Some of the key assumptions driving potential savings are outlined below.

- *"Regulatory savings will be gradually realised, but will not be fully realised until year 4 with the introduction of a new district (or unitary) plan.*
- *No savings will be made with respect to solid waste, property, harbour and coastal management, public transport services, flood protection, or economic development.*

[15] Local Government Commission, Draft proposal for reorganisation of local government in Wellington, Vol 2, Technical Report: Evaluation of the options and the draft proposal, December 2014 with Feb 2015 adjustment, Page 213
[16] Ibid., Page 214.

- *Savings in operating and capital costs for water, wastewater and stormwater will be gradual and no more than 2% of current operating costs and 1% of forecast capital expenditure by year 4. These savings will arise from streamlined management, the removal of duplication, economies of scale in asset management, rationalised operating, management and construction contracts and better capital project planning and delivery.*
- *Savings in operating and capital costs for roading will be gradual and no more than 1% of current operating costs and 1% of forecast capital expenditure by year 4. These savings will arise from streamlined management, the removal of duplication, economies of scale in asset management, rationalised operating, management and construction contracts, and better capital project planning and delivery.*
- *Savings in community facilities expenditure will be gradual but no more than 1% of operating expenditure and capital works, and will arise from streamlined management, economies of scale, and rationalised operating, maintenance and construction contracts.*
- *Part of the reduction in staffing for corporate and support functions will take place on the establishment of the new council, but the balance will not be able to be achieved for a year or more as the transition is made to new business systems and operating practices.*
- *Governance and senior management costs for each new entity will reflect the current market for similar roles and the number of councillors will reflect the nature of the option.*
- *The potential costs of the operation of local boards in the One Wellington Council with local boards option, reflect the scale of support structure likely to be required to support the operation of local boards, drawing on the experience of Auckland Council in evolving these structures." (page 215-6)*

Table 10: Comparison of the "reasonably practicable options" regarding the costs of transition and potential savings

	Enhanced Local Efficiency						One Wellington Council	
	One Wairarapa Territorial Authority	One Hutt Valley Territorial Authority	One Western Territorial Authority	Three Territorial Authorities	One Wairarapa & One Hutt Valley Territorial Authority, plus WCC, PDC & KCI	Stronger Regional Delivery	Without Local boards	With local boards
Annual savings, year 4/5 ($m)	1.3	5.5	24.8	31.6	6.9	36.3	40.4	30.4
Transition Costs								
Transition Board	1.0	2.0	5.0	8.0	3.0	7.6	10.1	10.3
New council start-up	1.0	2.0	5.0	8.0	3.0	7.6	10.1	10.3
IT system delivery costs	25.0	40.0	67.5	133.0	65.5	79.0	127.5	127.5
Business process change	4.0	6.0	9.8	20.0	10.2	23.7	48.2	48.2
Other	0.2	0.4	1.0	1.6	0.6	1.5	2.0	2.0
HR costs	0.1	1.6	6.6	8.3	1.7	10.2	11.3	11.3
Total estimated cost of transition	32	52	95	179	84	129	209	210
Net present value ($m) @ 7%	-13.7	8	143			199	154	58
Payback period (years)	25	10	5	6	12	5	7	9

Source: Local Government Commission, Draft proposal for reorganisation of local government in Wellington, Vol 2, Technical Report: Evaluation of the options and the draft proposal, December 2014 with Feb 2015 adjustment, page 216

The Commission observed that:

- The largest potential saving of around $40 million per annum equates to 4% of total current local government operating expenditure in the region. This also equates to slightly more than the 16% p.a. rates increases planned in the first three years of the 2012-2022 long term plans.

- The most significant transition cost under each option is the cost of delivering IT systems and infrastructure. IT costs assume that merging councils would migrate to the best of breed solution in one of the current councils. These costs account for more than 80% of the estimated transition costs for each option other than the Stronger Regional Delivery option of transferring functions to the Greater Wellington Regional Council. Total cost estimates were derived by developing the programme of work that was expected to be required prior to the go-live date for a new council and the ongoing work that would follow over the subsequent 3-5 years to complete the migration from separate systems to a common set of council-wide systems.

- HR costs reflect potential redundancy costs and a provision for harmonising employment and remunerations conditions across merging councils. This accounts for between less than 1% (for the merger of the Wairarapa councils under the Enhanced Local Efficiency option) and 5% of transition costs for the larger amalgamation options under the One Wellington Council options. Estimates are based on the experience of the Auckland Transition Agency which equated to one third of the estimated savings from staffing.

Overall, it was observed that "*the case for change in Wellington is not as compelling as it was in Auckland*", however, overall this option was considered to most enable Wellington to develop the level of leadership to lift its global competitiveness and attractiveness.

3.5 Summary of findings from literature review and NZ experience

We summarise the key takeaways from the material reviewed in this section as follows:

- The extent to which cost savings have been achieved in previous local council reforms may be difficult to measure given that councils are most likely to re-direct cost savings to service expansion. As such, the capacity of outcomes from actual experience to inform estimates of potential cost savings from local council amalgamations may be limited.

- The available empirical evidence on the extent to which local council amalgamations will yield net savings in costs is mixed and tends to vary by activity. Econometric analysis does not provide strong support. Evidence from the Auckland local governance reforms suggests that opex savings close to 5% could potentially be achievable (although translation of New Zealand evidence into an Australian context must be done with caution).

- In principle, it is reasonable to expect that opportunities for cost savings to flow from the scale effects associated with local council amalgamations, however, their magnitude is likely to vary by type of activity and may diminish for councils that are already regarded as being large. The available evidence suggests that the key sources of savings are from removal of duplicated activities / functions and in procurement. As such, governance and administration is potentially a key area where cost savings would materialise.

- There is limited evidence available on the financial costs associated with local council amalgamations.

    - The evidence from the QTC's assessment of merger costs in Queensland is the most relevant Australian evidence available. This indicated assessed merger costs of $195m over 4 years. The benefits shown in the report, however, did not provide sufficient data as to the time profile of the $129m of estimated merger benefits. If it is assumed that $15m is realised in year 1, $25m in year 2, $40m in year 3 and $49m in year 4, this would imply that merger costs were approximately 4x estimated annualised merger benefits. Alternatively, a more conservative ramp up profile – for example $10m in year 1, $20m in year 2, $40m in year 3 and $59m in year 4 – would yield a ratio of merger costs to estimated annualised merger benefits of 3.3x. Assuming benefits would ramp up to full levels over time rather than emerge after one year suggests that merger costs in the Queensland local council amalgamations could have been in the range 3x – 4x annualised expenditure savings.

- The Auckland Transition Authority in Auckland had incurred transition costs of $36.2m when it was dis-established in October 2010 however, this figure is likely to understate transition costs that would have been incurred post Day 1 of the new merged Auckland Council. Original estimates of merger costs indicated a range of 1.0x to 3.1x annualised efficiency gains.
- The estimates from the proposed Wellington local council amalgamations indicates very high ratios of merger costs to benefits (around 5x-7x for the preferred option) and it has been acknowledged that the approach has been to over-estimate costs and to under-estimate savings.

- There are a range of potential risks associated with local council amalgamations that are identified in literature, most commonly, costs of disruption, workplace cultural barriers, decreased local democracy and representation and other challenges associated with implementation. Whilst these exist, they can potentially be minimised through proper planning and implementation.
- There is a view that the costs associated with amalgamation are large and often under-estimated, particularly costs related to new systems, cultures and operating structures.

3.6 Implications for EY analysis

EY has considered the key takeaways from our literature review against our own experience on cost savings that are potentially achievable from corporate transactions. These benchmarks are summarised in the table below.

Table 11: Benchmark synergies from corporate transactions

Benchmarks	
15-25% of the target cost base in synergies	In a corporate transaction with similar businesses, synergies up to 30% of the target's cost base are often targeted. On average, 15% of the target cost base is targeted. Synergies are often highest in the support functions and overheads – the savings frequently reach 50% to 60% of the target's costs in some areas (e.g. the executive teams, back office support costs)
2-3 years average time for the full run rate of synergies to be realised	The time to fully realise synergies differs depending on the transaction complexity. The range for full synergy realization is between 2 to 5 years. Where the synergies are related to major infrastructure, capital expenditure or IT, these will typically be towards the upper end of the range. In most transactions the alignment of the core operating system or ERP has the longest lead time
0.9 – 1.1 average typical ratio of one-off integration costs to annualized synergy value	In some cases the implementation costs can be prohibitive to realising the potential synergies, particularly in cash flow constrained sectors.
~ 60% of companies announce successful achievement of synergies	Where transaction business cases involve a synergy component, companies are often obliged to communicate the synergy targets. The communicated targets do not typically 'pay away' the full synergy estimate. Ongoing communication of synergy targets is highly variable and can be impacted by failure to achieve the targets, change in integration priorities or simply a lack of robust and reliable tracking.

Notwithstanding these broad benchmarks, in our experience, we would expect mergers in the public sector:

- To achieve more conservative levels of synergies in costs (e.g. lower end of our scale may be higher end of an achievable range). With local councils, concerns about risks to service levels may imply less aggressive cost reduction targets, or may result in cost savings being ploughed back into better services. In the case of the latter, the benefits are less visible but are nevertheless real benefits that should be included in any NPV analysis.

- To achieve a realization of the full benefits over a longer time frame (i.e. closer to 5 years)

- To incur larger one-off integration costs due to more complex stakeholder management and other factors.

We consider that the findings from our literature review lend broad support for these assumptions.

4. The merger options

4.1 The Independent Local Government Review Panel Report

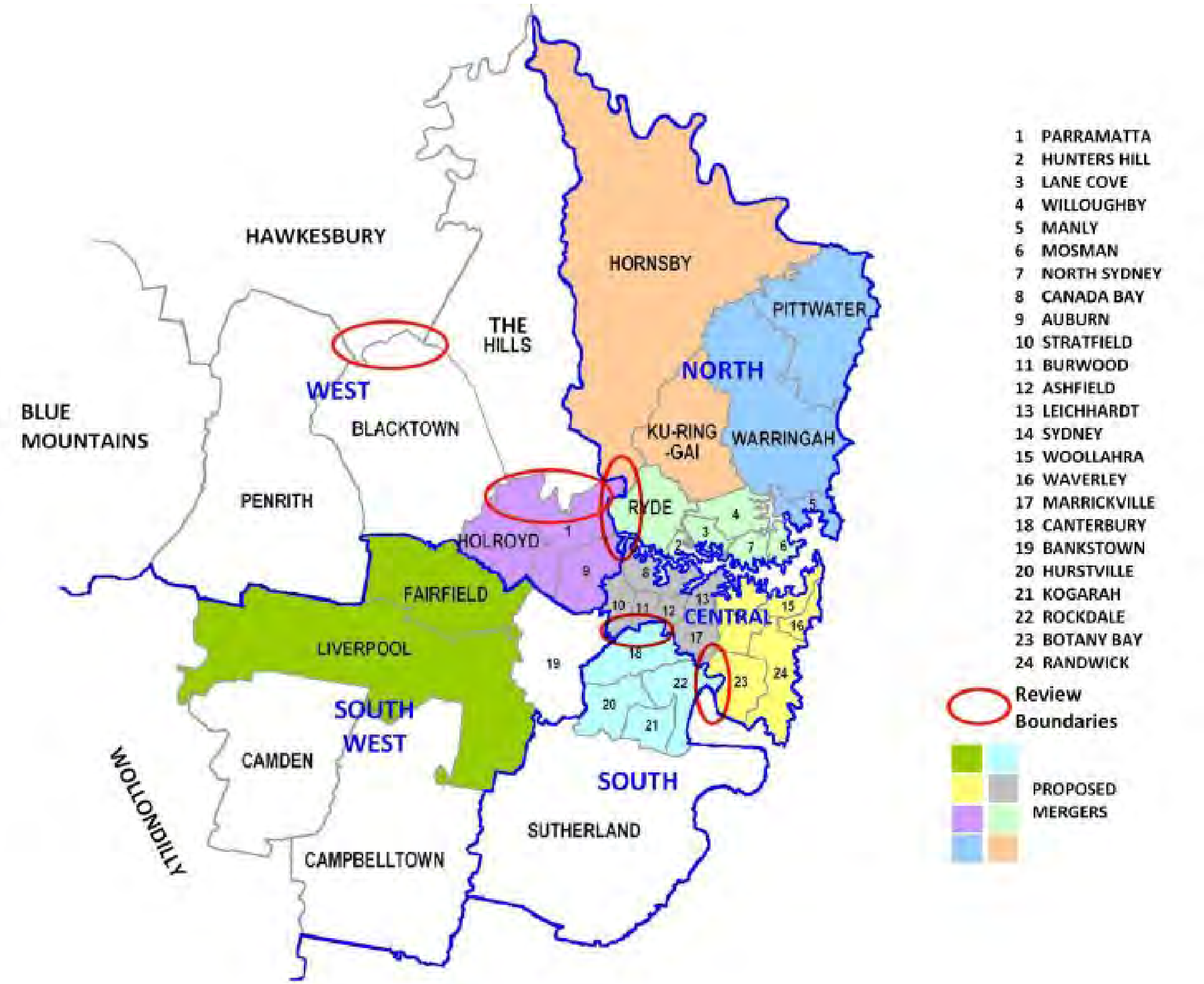
The merger options for Sydney metropolitan councils identified as preferred merger options by the ILGRP are summarised in Table 12 below.

Table 12: ILGRP's preferred metropolitan local council merger options

Group	Councils	Options (preferred in bold)
1	Ashfield, Burwood, Canada Bay, Leichardt, Marrickville, Strathfield	• Amalgamate or • Combine as strong Joint Organisation
2	Auburn, Holroyd, Parramatta, Ryde (part), The Hills (part)	• Amalgamate (eastern two thirds of Ryde to be included with North Shore group) and • Move northern boundary of Parramatta to M2 (balance of The Hills to remain an individual council) or • Adjust Parramatta's boundaries to include parts of Ryde and The Hills and combine Auburn, Holroyd and Parramatta as a strong Joint Organisation
3	Botany Bay, Randwick, Sydney, Waverley, Woollahra	• Amalgamate or • Combine as a strong Joint Organisation
4	Fairfield, Liverpool	• Amalgamate or • Combine as a strong Joint Organisation with Bankstown, Camden, Campbelltown and Wollondilly
5	Hornsby, Ku-Ring-Gai	• Amalgamate or • Combine as strong Joint Organisation and • Boundary with Parramatta shifted to M2
6	Hunters Hill, Lane Cove, Mosman, North Sydney, Ryde (part), Willoughby	• Amalgamate or • Combine as strong Joint Organisation
7	Canterbury, Hurstville, Kogarah, Rockdale	• Amalgamate or • Combine as a strong Joint Organisation, also including Sutherland and • Adjust Rockdale boundary at airport
8	Manly, Pittwater, Warringah	• Amalgamate or • Combine as strong Joint Organisation

These preferred merger options are illustrated in the map below.

Figure 2: Preferred Merger Options for Sydney Metropolitan Councils



We note that the ILGRP Report did not provide an assessment of the costs and benefits associated with the preferred merger options.

4.2 The merger options explored by the councils

4.2.1 Summary of the council merger options

The merger options that have been explored by the local councils in their submissions are presented in Table 13 below. Several of the submissions explored merger options that were different to the ILGRP preferred options, even though most of the local councils did not support amalgamation. The options shown in blue text are those which do not reflect ILGRP preferences.

The majority of the submissions included cost-benefit analysis reports that were prepared by Morrison Low, SGS Consulting and KPMG, with a handful either self-assessed or prepared by other consultants.

Table 13: Summary of council merger options explored in submissions

Morrison Low	SGS Consulting[17]	KPMG	Other[18]
Kogarah + Rockdale + Hurstville	Manly + Pittwater + Warringah	Hornsby + The Hills	Fairfield + Liverpool [assessed by Fairfield]
Canterbury + Kogarah + Rockdale + Hurstville	Manly + Warringah	Hornsby + Ku-Ring Gai	Bankstown + Canterbury [assessed by Bankstown]
Kogarah + Hurstville	Manly + Pittwater	Hornsby + The Hills + Ku-Ring Gai	Gosford + Wyong [assessed by Third Horizon]
Botany + Marrickville + Rockdale	Manly + Part Warringah + Pittwater + Part Warringah	Manly + Warringah + Pittwater	Randwick + Waverley [Randwick Council]
Ashfield + Burwood + Canada Bay + Leichardt + Marrickville + Strathfield		Manly + Part Warringah + Pittwater + Part Warringah	Randwick + Waverley + Woollahra + Botany Bay [Randwick Council]
Ashfield + Leichardt + Marrickville		Manly + Warringah	Randwick + Waverley + Woollahra + Botany Bay + Sydney [Randwick Council]
Hunters Hill + Lane Cove + Mosman + North Sydney + Ryde + Willoughby			
Willoughby + Lane + Cove + North Sydney			
Willoughby + North Sydney			
Auburn + Burwood + Canada Bay			
Auburn + Holroyd + Parramatta + The Hills + Ryde			

[17] We note that SGS also prepared business cases for Randwick Council involving various options (e.g. Randwick + Woollahra + Waverley, Randwick + Woollahra + Waverley + Botany Bay (with and without the airport) however insufficient information has been included in these reports for EY to assess the merger analysis.
[18] Reports prepared by Grant Thornton do not contain sufficient information to enable an assessment of the merger scenarios.

4.2.2 Methodology for assessing merger impacts

Morrison Low

In the reports prepared by Morrison Low ("ML"), the methodology for assessing merger impacts has been to:

- Construct the base case for the merged council using the current long term financial plans of the individual councils
- Model merger impacts across short (1-3 years), medium (4-5 years) and long (6-10 years) terms. This analysis typically examines costs and benefits associated with staffing changes, IT consolidation, material and contracts procurement, and asset rationalisation. All transitional costs are typically modelled as taking place within the first three years.

Table 14 below contains an example of how ML models the time profile associated with costs and benefits from various sources.

Table 14: Example of ML cost-benefit analysis methodology.

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	Reduction in total costs of Senior Staff Reduction through natural attrition	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	
IT	Significant costs to move to single IT system across entire council					Benefits arise from single IT system and decrease in staff
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
Assets			Rationalisation of plant and fleet			
Transitional Body	Establish council and structure, policies, procedures Branding and signage	Government grant				

Key assumptions employed to estimate costs and benefits are generally based on one of the following:

- Estimated impacts based on discussion with management of the relevant councils
- Estimated impacts based on ML's previous experience (e.g. savings from rationalisation of works units and waste collection)
- Estimated impacts based on the experience in the Auckland and Wellington local council amalgamations, or previous local council amalgamations in NSW.

Some of the assumptions that typically appear in the ML reports are:

- For non-management positions, that the merged council adopts a natural attribution policy to not fill positions in the short term (except for staff in core and front line positions which would have to be replaced), leading to short term savings on staff remuneration
- Over longer term, FTE numbers will rise as the merged council increases service levels post-merger. To support this, ML cites research conducted for the ILGRP which noted that each of the councils involved in the 2004 NSW mergers had more staff after the merger than the combined councils together.
- Transition costs comprise transition management unit costs (based on Auckland experience but sized for the number of local councils in the case being examined), ICT costs (based on Wellington local council amalgamation estimates, but scaled for the number of local councils in the case being examined), branding, initial redundancy costs and remuneration harmonisation.

SGS

SGS has adopted a reference council approach to estimate merger costs and benefits. This is described as the council which achieves the best economies of scale currently (i.e. pre-merger). This effectively assumes that the lowest cost council (the reference council) reflects "best practice" and that the merged council's costs will converge around this target.[19]

Key aspects of SGS' approach are:

- Merger costs are estimated based on past amalgamation experience, both domestically and offshore
- Merger savings are applied to cost categories that are likely to be subject to economies of scale. For the merger scenarios involving Warringah, for example, SGS conducted simple linear regression to test the relationship between per capital service costs and population for 11 cost categories. This analysis indicated that six categories were affected by economies of scale – governance, administration, public order & safety, environment, recreation & culture, and transport & communications

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[19] Although a Warringah is identified as the reference council in the merger involving Warringah, Manly and Pittwater Councils, this is no longer the case in the merger scenario involving a split of Warringah Council.

- Expenditure savings are assumed to grow in line with average projected long term financial plan growth rates for the councils involved in the relevant merger scenario
- Merger costs (excluding redundancies) are estimated as a percentage of current operating expenses and assumed to be spread over the first 2 years.

SGS also used an “average efficiencies” model in the Northern Beaches report which was an econometric model used to estimate efficiency gains.

KPMG

KPMG’s methodology is similar to Morrison Low’s approach in the sense that it considers individual groups of expenditures. Analysis is therefore undertaken on the potential for FTE reductions, savings in materials and contracts and expenses classified as “other” in the financial accounts of the councils, which often includes expenditure which may be amenable to scale economies.

Merger implementation costs were considered to relate principally to IT and facility consolidation, redundancies, staff retraining and costs of funding the merger implementation. Redundancies for staff (except for senior staff) are assumed to occur from year 4 onwards, reflecting a 3 year no forced redundancy period. With respect to costs of funding the merger implementation, KPMG’s analysis for Warringah for example, assumed costs would be funded by cash / cash equivalents where upfront costs were less than 10% of cash and cash equivalents. Otherwise, they would be debt funded. Interest rate assumptions were adopted to enable estimation of interest forgone on cash assets and debt funding.

Benchmarks on merger costs and benefits were based on analysis of local council mergers in Toronto and Auckland. Benchmarks are scaled to the size of the relevant merger.

5. Assessment of the merger options

5.1 The ILGRP preferred merger options

EY has been requested by IPART to undertake an analysis of the costs and benefits associated with the 8 sets of amalgamations involving the Sydney metropolitan local councils. In addition, IPART has requested EY to undertake similar analysis for other sets of mergers:

- Botany Bay, Randwick, Waverley and Woollahra Councils (without the City of Sydney Council)
- Gosford and Wyong Councils, Bankstown and Canterbury Councils, Hawkesbury and the Hills Councils – these three merger scenarios did not form part of the ILGRP's preferred options but the Panel recommended they be further explored.
- Randwick and Waverley Councils, and Auburn, Burwood and Canada Bay Councils – these are not part of the ILGRP's preferred options but these councils have put forward a voluntary merger business case that IPART would further explore

We note whilst the ILGRP Report considered that amalgamations were an effective way of achieving efficiency and economies of scale as well as service improvements and strategic capacity, the panel did not provide an assessment of the costs and benefits associated with the preferred merger options.

5.1.1 Expected costs and financial benefits from merger

The types of financial benefits we would expect from a merger include synergies in the following areas:

- Governance functions – for example Mayoral/Councilor salaries/on-costs, executive management
- Back office support functions – for example, payroll, IT, HR, finance, legal and administration
- Procurement savings – for example utilities, outsourced IT contracts
- Direct service delivery e.g. waste management, road maintenance

The degree to which financial synergies can be typically realised for different types of costs will vary, as will the time taken to realise these savings.

5.1.2 Assumptions underpinning potential merger cost-benefit estimates

EY has estimated the potential costs and benefits associated with the ILGRP's preferred merger options using a "top-down" approach, over a 20 year timeframe. Given the approach that has been taken for this exercise, as outlined in Section 2.3, and the limitations that this implies for our analysis, we consider that a top-down approach is the only feasible approach to take. Furthermore, our approach focuses only on operating expenditure and not capital expenditure, as estimating impacts on the latter is generally best undertaken in consultation with management of each local council and this has not been possible in this exercise.

Operating expenditure figures are those publicly reported for each council for 2013-14.

Our model requires us to adopt a number of high level assumptions in estimating the potential costs and benefits of the ILGRP preferred merger options. As discussed in Section 3.6, our model inputs have been informed by a literature review, our experience with synergies that are achievable in corporate transactions, and our consideration of the extent to which those savings are achievable for public sector organisations.

- We have conservatively estimated that potential opex savings of 10% to 15% p.a. of a cost base which comprises the total opex of the entities merging, less the opex of the entity with the largest cost base. This rate of efficiency gain is below the 15-25% rate usually targeted in corporate transactions. We have assumed a lower rate of savings in view of the mixed evidence around the achievement of efficiency gains in local council amalgamations. Whilst we expect that a large proportion of the potential opex savings will relate to rationalisation of back-office functions, we have applied the rate of savings to the total opex line. An alternative approach is to apply varying rates of cost savings to different categories of costs. For example, our experience with corporate transactions indicates that in the executive and corporate governance function, reduction in council members and consolidation of the executive team could potentially generate savings of 60-80%, supplier rationalisation could potentially generate savings of 15-25% in procurement costs and consolidation of IT functions and applications could potentially generate savings of 20-30%. It has not been possible to take a more disaggregated approach to identifying cost savings in this instance as we do not have access to cost data that have been appropriately deconstructed.

- Potential opex savings are assumed to be realised in full over a period of 5 years. The ramp-up rate we have assumed over the 5 year period is 30% by year 1, 60% by year 2, 80% by year 3, 90% by year 4 and 100% by year 5.

- Once-off merger integration costs have been estimated to be incurred at the rate of 3.0 times the annualised expenditure saving. The exception to this are the mergers involving Marrickville, Ashfield, Burwood, Canada Bay, Leichardt and Strathfield Councils, Auburn, Holroyd and Parramatta Councils together with parts of the Hills and Ryde Councils, Botany Bay, Sydney, Waverley, Randwick and Woollahra Councils and Hunters Hill, Lane Cove, Mosman, North Sydney, Willoughby and part Ryde. We understand that these four merger options were regarded by the NSW Parliamentary Budget Office, based on advice from the Office of Local Government, as being of "very high" complexity in their costing of council mergers. For these four merger options, we have therefore assumed merger integration costs at the rate of 4.0 times the annualized expenditure saving.[20]

- Our assumption with respect to merger integration costs reflects a more conservative view of merger integration costs than typically incurred in corporate transactions. In other words, we have assumed higher costs will be incurred. As previously shown in Table 11, integration costs in corporate transactions are on average 0.9 to 1.1x

[20] NSW Parliamentary Budget Office (PBO) costing of council mergers, Briefing Note - 2015.

estimated annualized synergy value. We have adopted a more conservative assumption to reflect our expectation that there are likely to be more complex stakeholder management costs and more variances in systems and processes between local councils as compared with corporations. As noted above, the evidence from the Queensland local council amalgamations indicate a 3-4x annualized merger savings assumption to be reasonable.

- Merger integration costs are assumed to be incurred over 5 years, and front end loaded over this period. Specifically, we have assumed 60% of these costs will be incurred in year 1, 20% in year 2, 10% in year 3, 7% in year 4 and 3% in year 5. This expenditure profile reflects our experience that the majority of the costs will be incurred in the first two years and will relate to initial setting up of the merger implementation program, staffing changes, integration of back office functions, initial business process redesign and consolidation of IT functions and applications. Costs incurred in years 3 to 5 will likely reflect residual costs associated with ongoing IT integration.

An example of our methodology is illustrated diagram below.

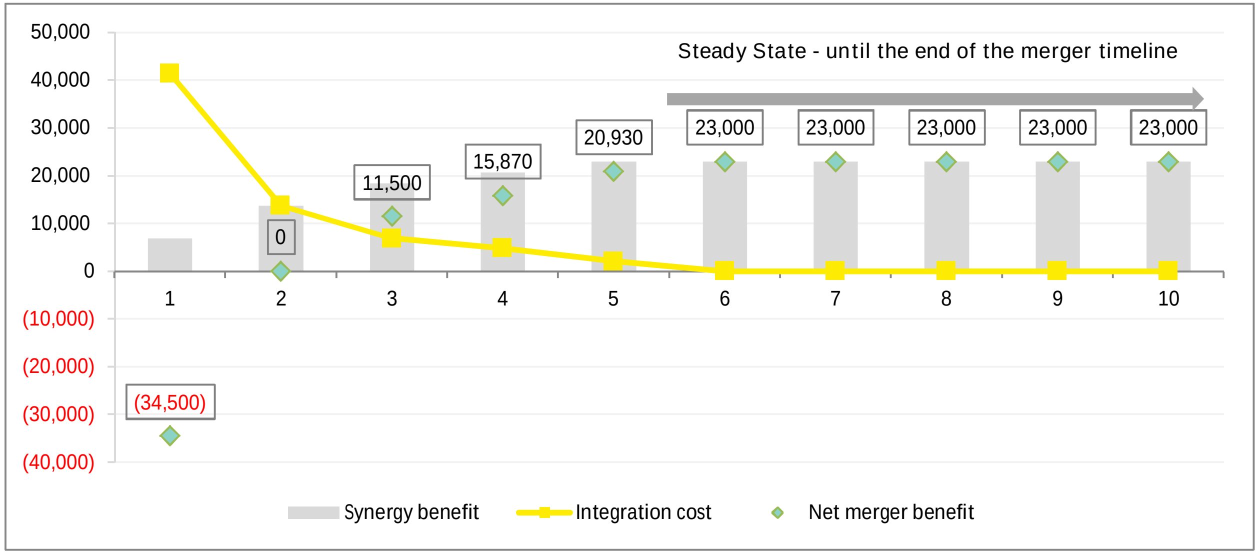
Figure 3: Stylised 4 into 1 merger example of EY's methodology

Assumed cost base of entities:

- Entity #1 $130m
- Entity #2 $50m
- Entity #3 $100m
- Entity #4 $80m

Cost base subject to merger synergies: $230m

Assumed efficiency saving rate of 10% and integration costs of 3x annualised efficiency savings.



5.1.3 Results of top-down analysis

The potential net merger benefit / (cost) outcomes for each ILGRP preferred merger scenario based on the methodology described above is summarised in the table below.

Table 15: Top down analysis of ILGRP metropolitan local council preferred merger options (Base Case) (over 20 years)

	Merger option	NPV range 4% @ 2016 $'000	NPV range 7% @ 2016 $'000	NPV range 10% @ 2016 $'000
	ILGRP preferred merger options			
1	Manly + Warringah +Pittwater	131,470 - 197,204	92,589 - 138,883	66,177 - 99,266
2	Hornsby + Ku-ring-gai	100,408 - 150,611	70,713 - 106,070	50,542 - 75,812
3	Fairfield + Liverpool	148,921 - 223,381	104,879 - 157,318	74,961 - 112,442
4	Canterbury + Kogarah + Rockdale + Hurstville	195,898 - 293,847	137,963 - 206,945	98,608 - 147,912
5	Hunters Hill + Lane Cove + Mosman + North Sydney + Ryde (2/3) + Willoughby	221,023 - 331,535	149,624 - 224,437	101,384 - 152,076
6	Randwick + Waverley + Woollahra + Botany Bay + Sydney	335,015 - 502,522	226,793 - 340,189	153,672 - 230,508
7	Ashfield + Burwood + Canada Bay + Leichhardt + Marrickville + Strathfield	229,663 - 344,495	155,473 - 233,210	105,347 - 158,020
8	Auburn + Holroyd + Parramatta + The Hills (15%) + Ryde (1/3)	177,434 - 266,151	120,116 - 180,174	81,389 - 122,084
	Additional merger options identified by ILGRP and Councils and requested by IPART			
9	Randwick + Waverley + Woollahra + Botany Bay	247,159 - 370,739	174,065 - 261,097	124,411 - 186,617
10	Bankstown + Canterbury	97,170 - 145,755	68,433 - 102,650	48,912 - 73,368
11	Gosford + Wyong	222,831 - 334,247	156,931 - 235,397	112,165 - 168,248
12	Randwick + Waverley	112,555 - 168,832	79,268 - 118,902	56,656 - 84,984
13	Auburn + Burwood + Canada Bay	100,262 - 150,393	70,611 - 105,916	50,468 - 75,703
14	Hawkesbury + The Hills	68,069 - 102,104	47,938 - 71,908	34,263 - 51,395

The base case analysis indicates all of the ILGRP preferred merger options are NPV positive and will produce net merger benefits, lending support to the business case for the preferred merger options. Our NPV range for each merger scenario is reasonably wide and reflects the combination of assumptions we have adopted on potential merger benefits and costs. The degree to which net merger benefits will be achievable in each scenario will likely depend on the specific circumstances of the relevant councils in each merger scenario. In some cases, it could be that potential net merger benefits would be closer to the low end of the range, whilst in other cases, net merger benefits may be higher.

Where certain services are already outsourced by the councils that are the subject of the merger, it is likely a lower level of synergy would be achieved through the merger than would otherwise be the case. For example:

- In the Ashfield + Burwood + Canada Bay + Leichardt + Marrickville + Strathfield merger, we understand three of the councils – Canada Bay, Burwood and Ashfield – already outsource their collection of waste. As such, cost savings will arise only through outsourcing waste collection of the remaining councils and integration into a single contract.

- Similarly, opportunities for procurement cost savings may also be limited in the Auburn + Holroyd + Parramatta + The Hills + Ryde (part) merger scenario as we understand these councils currently engage in collective procurement through shared panel contracts. The size and timing of cost savings will therefore depend not only on the merged council's ability to leverage its buying power but also on the timing for existing contracts to unwind.

We also consider the two merger options which involve the splitting of a council (i.e. Ryde and The Hills) will likely be more complex to implement and as a result, this may impact the potential level of net merger benefits achievable. As noted, we have adopted a higher level of merger integration costs for these merger options.

EY has been asked to specifically comment on the ILGRP's preferred option to merge the City of Sydney with Randwick, Waverley, Woollahra and Botany Bay. It should be noted that the methodology that we have employed to assess net merger benefits / (costs) does not of itself provide us with a sufficient basis to conclude whether the City of Sydney should be merged with these other councils or whether it should stand-alone. As shown in the table above, the option involving a merger of Randwick, Waverley, Woollahra, Botany Bay and the City of Sydney has a higher net benefit than the merger option which excludes the City of Sydney. This result arises because:

- The entity with the largest cost base is different in each case so the calculation of potential opex savings will differ

- The total operating expenditure of the councils excluding the largest council is significantly larger in the merger option which includes the City of Sydney ($373m) than in the merger option which excludes the City of Sydney ($248m).

We reiterate the methodology we have employed is a top-down approach which is limited in its ability to consider individual council circumstances. To this extent, the question of whether the City of Sydney should be merged or remain a stand-alone council is one that would particularly benefit from detailed bottom-up analysis.

Notwithstanding this, on the basis of the analysis EY has undertaken, we do not consider there are compelling reasons to conclude the merger of the City of Sydney with Randwick, Waverley, Woollahra and Botany Bay would not generate efficiency gains. The City of Sydney covers an area that has a different range of activities and services as compared with the remaining councils. However, there is no obvious reason why a merger option including the City of Sydney would not yield cost savings at the levels we have assumed. We note that a number of cities in Australia and in New Zealand have councils that cover the whole city, albeit often smaller cities.

5.1.4 Sensitivity analysis

To understand the NPV impact of variations around our key assumptions, we have examined three hypothetical scenarios:

1. A delay in the achievement of merger cost savings – We have modelled a scenario where savings ramp up to full realisation at a constant rate over 5 years.
2. Understatement of merger costs – We have modelled the impact of a 50% increase in merger costs
3. A combination of the above two scenarios.

The results are summarised in the tables below.

Table 16: ILGRP metropolitan local council preferred merger options – Scenario 1: More conservative ramp-up of merger benefits (over 20 years)

	Merger option	EY top-down indicative NPV Range ($'000)		
		4% Discount Rate	7% Discount Rate	10% Discount Rate
ILGRP preferred merger options				
1	Manly Warringah Pittwater	123,919 - 185,879	85,547 - 128,321	59,592 - 89,388
2	Hornsby Ku-ring-gai	94,641 - 141,962	65,335 - 98,003	45,512 - 68,268
3	Fairfield Liverpool	140,368 - 210,552	96,902 - 145,353	67,502 - 101,253
4	Canterbury Kogarah Rockdale Hurstville	184,648 - 276,971	127,470 - 191,206	88,796 - 133,194
5	Hunters Hill Lane Cove Mosman North Sydney Ryde (part) Willoughby	206,940 - 310,410	136,490 - 204,735	89,101 - 133,652
6	Randwick Waverley Woollahra Botany Bay Sydney	313,669 - 470,503	206,884 - 310,326	135,055 - 202,582
7	Ashfield Burwood Canada Bay Leichhardt Marrickville Strathfield	215,030 - 322,545	141,825 - 212,738	92,584 - 138,876
8	Auburn Holroyd Parramatta The Hills Ryde (part)	166,129 - 249,193	109,572 - 164,358	71,529 - 107,294
Additional merger options identified by ILGRP and Councils and requested by IPART				
9	Randwick Waverley Woollahra Botany Bay	232,965 - 349,448	160,826 - 241,239	112,031 - 168,047
10	Bankstown Canterbury	91,590 - 137,385	63,228 - 94,843	44,045 - 66,067
11	Gosford Wyong	210,034 - 315,051	144,996 - 217,494	101,004 - 151,506
12	Randwick Waverley	106,091 - 159,136	73,239 - 109,859	51,018 - 76,527
13	Auburn Burwood Canada Bay	94,504 - 141,756	65,240 - 97,861	45,446 - 68,170
14	Hawkesbury The Hills	64,160 - 96,240	44,292 - 66,439	30,854 - 46,281

Table 17: ILGRP metropolitan local council preferred merger options – Scenario 2: 50% increase in merger costs (over 20 years)

	Merger options	EY top-down indicative NPV Range ($'000)		
		4% Discount Rate	7% Discount Rate	10% Discount Rate
ILGRP preferred merger options				
1	Manly Warringah Pittwater	112,012 - 168,018	74,033 - 111,050	59,592 - 89,388
2	Hornsby Ku-ring-gai	85,547 - 128,321	56,542 - 84,813	45,512 - 68,268
3	Fairfield Liverpool	126,880 - 190,320	83,860 - 125,791	67,502 - 101,253
4	Canterbury Kogarah Rockdale Hurstville	166,904 - 250,357	110,314 - 165,471	88,796 - 133,194
5	Hunters Hill Lane Cove Mosman North Sydney Ryde (part) Willoughby	172,632 - 258,948	103,478 - 155,217	89,101 - 133,652
6	Randwick Waverley Woollahra Botany Bay Sydney	261,667 - 392,500	156,846 - 235,269	135,055 - 202,582
7	Ashfield Burwood Canada Bay Leichhardt Marrickville Strathfield	179,381 - 269,071	107,523 - 161,284	92,584 - 138,876
8	Auburn Holroyd Parramatta The Hills Ryde (part)	138,587 - 207,880	83,070 - 124,606	71,529 - 107,294
Additional merger options identified by ILGRP and Councils and requested by IPART				
9	Randwick Waverley Woollahra Botany Bay	210,579 - 315,868	139,181 - 208,771	112,031 - 168,047
10	Bankstown Canterbury	82,789 - 124,183	54,719 - 82,078	44,045 - 66,067
11	Gosford Wyong	189,851 - 284,777	125,481 - 188,221	101,004 - 151,506
12	Randwick Waverley	95,896 - 143,845	63,382 - 95,073	51,018 - 76,527
13	Auburn Burwood Canada Bay	85,423 - 128,135	56,460 - 84,690	45,446 - 68,170
14	Hawkesbury The Hills	57,995 - 86,992	38,331 - 57,497	30,854 - 46,281

Table 18: ILGRP metropolitan local council preferred merger options – Scenario 3: Delay in potential merger benefit delay + 50% increase in merger costs (over 20 years)

	Merger options	EY top-down NPV Range ($'000)		
		4% Discount Rate	7% Discount Rate	10% Discount Rate
ILGRP preferred merger options				
1	Manly Warringah Pittwater	60,887 - 121,773	42,097 - 84,194	29,448 - 58,897
2	Hornsby Ku-ring-gai	46,501 - 93,002	32,151 - 64,302	22,491 - 44,981
3	Fairfield Liverpool	68,969 - 137,937	47,685 - 95,370	33,357 - 66,714
4	Canterbury Kogarah Rockdale Hurstville	90,725 - 181,450	62,727 - 125,454	43,880 - 87,760
5	Hunters Hill Lane Cove Mosman North Sydney Ryde (part) Willoughby	113,567 - 227,133	78,520 - 157,039	54,927 - 109,855
6	Randwick Waverley Woollahra Botany Bay Sydney	172,138 - 344,276	119,016 - 238,032	83,256 - 166,512
7	Ashfield Burwood Canada Bay Leichhardt Marrickville Strathfield	118,006 - 236,012	81,589 - 163,178	57,075 - 114,149
8	Auburn Holroyd Parramatta The Hills Ryde (part)	91,170 - 182,339	63,034 - 126,069	44,095 - 88,190
Additional merger options identified by ILGRP and Councils and requested by IPART				
9	Randwick Waverley Woollahra Botany Bay	114,465 - 228,931	79,141 - 158,282	55,362 - 110,724
10	Bankstown Canterbury	45,002 - 90,004	31,114 - 62,228	21,766 - 43,531
11	Gosford Wyong	103,198 - 206,397	71,351 - 142,702	49,913 - 99,825
12	Randwick Waverley	52,127 - 104,254	36,040 - 72,081	25,212 - 50,423
13	Auburn Burwood Canada Bay	46,434 - 92,868	32,104 - 64,209	22,458 - 44,916
14	Hawkesbury The Hills	31,524 - 63,049	21,796 - 43,592	15,247 - 30,494

As can be seen from Table 16 to Table 18 above, the NPV range of net merger outcomes reduces in each case compared with our base case estimates.

As modelled, the delay in achieving potential merger benefits reduces the NPV (@ 7%) of net merger benefits by 8.1%, on average across all merger options, whilst a 50% rise in estimated merger costs reduces NPV outcomes by 24.3%, on average across all merger options.

Nevertheless, in all of the above 3 scenarios, net merger outcomes remain positive for all merger options.

In addition to the above three sensitivity scenarios, we have analysed the extent of the

- Reduction in potential merger benefits that would need to occur such that the NPV outcomes (at 7%) would shift from positive to negative; and
- Increase required in estimated merger costs that would need to be incurred in order to reduce the NPV outcome (at 7%) to shift from positive to negative.

Our calculations indicate that NPV outcomes (at 7%) would shift from positive to negative if:

- Potential opex savings are delayed by 11 years and fully realised over 5 years for low-medium complex merger options and 9 years for very complex merger options. That is, for low-medium complex merger options, there would not be any opex savings from year 1 to year 10 of the merger. Instead, they will begin in year 11 and end in year 20 in the following ramp up profile: 20% of opex savings in year 11, 40% in year 12, 60% in year 13, 80% in year 14, 100% in year 15 to year 20; or
- Estimated merger integration costs increased by 250% from the base case assumptions for low-medium complex merger options and 170% for highly complex merger options.

5.2 The merger options explored by the councils

5.2.1 Summary of local council merger options explored in submissions

Table 19 below sets out the local council merger options we have been asked to analyse. The NPV figures shown below reflect those calculated in the cost-benefit analysis ("CBA") in the relevant submission (or implied by the figures supplied in the submission). That is, the NPV figures do not incorporate any re-calculation based on adjusted assumptions or inputs by EY.

In some cases, merger costs and benefits forecast cash flows were provided but no NPV result was calculated. In these cases, where possible, EY has inferred an NPV estimate based on the data provided. Additionally, In some cases, the merger costs and benefits, and hence NPV outcomes, have been revised by the relevant council or its consultant subsequent to the original submission in response to queries from IPART. Where this has occurred, a revised NPV outcome has been noted in Table 19.

Table 19: Local council merger options as presented by local council cost-benefit analysis submitted

Merger options	As reported / EY inferred NPV $'000[21]	Key assumptions & comments
Canterbury + Kogarah + Rockdale + Hurstville	$98,078	• CBA report prepared by Morrison Low for Rockdale • Analysis in report starts in 2016 and finishes in 2023 • Discount rate applied – 7% • IPART has informed us that Morrison Low has advised that all costs and benefits and discount rates are expressed in nominal terms • Tables in the submitted report and the NPV results have been subsequently updated by Morrison Low and EY has relied on the updated data
Kogarah + Rockdale + Hurstville	$37,110	
Kogarah + Hurstville	$20,700	• CBA report prepared by Morrison Low for Hurstville • Analysis in report starts in 2016 and finishes in 2023 • Discount rate applied – 7% • IPART has informed us that Morrison Low has advised that all costs and benefits and discount rates are expressed in nominal terms • IPART has informed us that Morrison Low has advised that the NPV is calculated as at 2014. • Tables in the submitted report have been subsequently updated by Morrison Low and EY has relied on the updated data
Botany Bay + Marrickville + Rockdale	$83,000	• CBA report prepared by Morrison Low for Botany Bay and Rockdale • Analysis in report starts in 2016 and finishes in 2023 • Discount rate applied – 7% • IPART has informed us that Morrison Low has advised that all costs and benefits and discount rates are expressed in nominal terms • Tables in the submitted report have been subsequently updated by Morrison Low and EY has relied on the updated data
Ashfield + Burwood + Canada Bay + Leichardt + Marrickville + Strathfield	$143,000	• CBA report prepared by Morrison Low for Inner West Councils • Analysis in report starts in 2015 and finishes in 2023 • Discount rate applied – 7% • IPART has informed us that Morrison Low has advised that all costs and benefits and discount rates are expressed in nominal terms • Tables in the submitted report have been subsequently updated by Morrison Low and EY has relied on the updated data

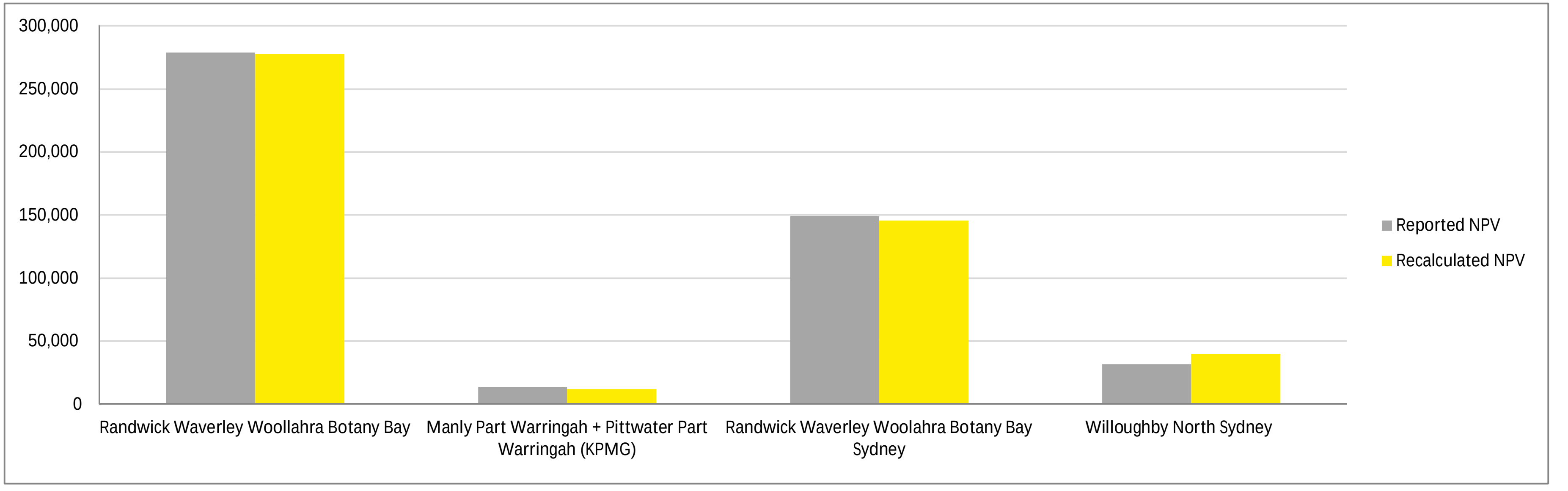
[21] All of the reported NPV's include the grant funding from government except for: Manly + Warringah + Pittwater (SGS), Manly + Warringah (SGS), Manly / Part Warringah + Pittwater / Part Warringah (SGS), Pittwater + Warringah (SGS), Bankstown + Canterbury and Gosford + Wyong.

Merger options	As reported / EY inferred NPV $'000[21]	Key assumptions & comments
Hunters Hill + Lane Cove + Mosman + North Sydney + Ryde (part) + Willoughby	$59,000	• CBA report prepared by Morrison Low for Hunters Hill, Lane Cove and Ryde • Analysis in report starts in 2016 and finishes in 2023 • Discount rate applied – 7% • IPART has informed us that Morrison Low has advised that all costs and benefits and discount rates are expressed in nominal terms • IPART has informed us that Morrison Low has advised that the NPV is calculated as at 2014. • Data shown is for the 'efficiencies realised' scenario
Willoughby + Lane Cove + North Sydney	$33,800	• CBA report prepared by Morrison Low for Willoughby • Analysis in report starts in 2016 and finishes in 2023 • Discount rate applied – 7% • IPART has informed us that Morrison Low has advised that all costs and benefits and discount rates are expressed in nominal terms • IPART has informed us that Morrison Low has advised that the NPV is calculated as at 2014.
Willoughby + North Sydney	$31,600	
Auburn + Burwood + Canada Bay	$32,100	• CBA report prepared by Morrison Low for Auburn • Analysis in report starts in 2016 and finishes in 2023 • Discount rate applied – 7% • IPART has informed us that Morrison Low has advised that all costs and benefits and discount rates are expressed in nominal terms • IPART has informed us that Morrison Low has advised that the NPV is calculated as at 2014. • Tables in the submitted report have been subsequently updated by Morrison Low and EY has relied on the updated data
Auburn + Holroyd + Parramatta + The Hills + Ryde (part)	$41,800	• CBA report prepared by Morrison Low for Holroyd • Analysis in reports starts in 2016 and finishes in 2023 • Discount rate applied – 7% • IPART has informed us that Morrison Low has advised that all costs and benefits and discount rates are expressed in nominal terms • IPART has informed us that Morrison Low has advised that the NPV is calculated as at 2014. • Data shown is for the 'efficiencies realised' scenario
Hornsby + The Hills	$51,509	• CBA reports prepared by KPMG • Analysis in report starts in 2014 and finishes in 2023 • Discount rate applied – 9.5% nominal (inferred from other KPMG reports) • Net merger benefits identified annually but NPV of net merger benefits not stated. The NPV figures stated are inferred based on assumptions employed in the report.
Hornsby + Ku-Ring Gai	$37,751	
Hornsby + Ku-Ring Gai + The Hills	$115,500	
Manly + Warringah + Pittwater (KPMG)	$44,998	• CBA report prepared by KPMG, as originally submitted • Analysis in report starts in 2015 and finishes in 2024, however, merger cash flows begin
Manly / Part Warringah + Pittwater / Part	$13,746	

Merger options	As reported / EY inferred NPV $'000[21]	Key assumptions & comments
Warringah (KPMG)		in 2016. • Discount rate applied – 9.5% nominal • All costs and benefits expressed in nominal terms
Manly + Warringah (KPMG)	$16,815	
Manly + Warringah + Pittwater (SGS)	$233,858	• CBA report prepared by SGS • Analysis in report starts in 2015 and finishes in 2024 • Discount rate applied – 5.5% nominal • NPV figures stated are based on nominal figures. • Data shown is for the reference council model.
Manly / Part Warringah + Pittwater / Part Warringah (SGS)	($179,327)	
Manly + Warringah (SGS)	$123,454	
Pittwater + Warringah (SGS)	$118,285	
Fairfield + Liverpool	($15,443)	• CBA report prepared by Fairfield Council • Analysis in report starts in 2016 and finishes in 2025 • Discount rate applied – 7% real is inferred • Report provided annual data on expected costs and savings, but NPV result was not calculated. Negative NPV of $15.4m is inferred based on EY calculations assuming data is expressed in real terms.
Bankstown + Canterbury	$82,167	• Information prepared by Bankstown Council • Cost savings in report are only estimated for one year. • EY has assumed that the cost savings is in 2014 dollar terms and the savings extend to 10 years. • Report provided data on expected annualised net savings from merger but NPV result was not calculated and no discount rate was assumed. • NPV of $82.2m based on EY calculations and assumes annual savings occur over 10 years, with a real discount rate of 7% • No merger implementation cost estimated
Gosford + Wyong	$42,400	• [Confidential]
Randwick + Waverley	$103,344	• Report originally prepared by SGS but subsequently updated by Randwick • Analysis in report assumed to start in 2017 and finishes in 2026. • Report provided data on expected annualised net savings from merger • Discount rate applied – 4.5% nominal
Randwick + Waverley + Woollahra + Botany Bay	$277,637	
Randwick + Waverley + Woollahra + Botany Bay + Sydney	$145,566	

Based on the information presented in the reports reviewed, EY has tested the mathematical accuracy of the analyses presented. In most cases, the results of our calculations were reasonably close to the NPV figures reported (and as subsequently revised) in the reports. The chart below identifies those merger business cases where variances exceeded $1m.

Figure 4: Reported NPVs versus EY calculations ($'000) – Variances > $1m



The largest mathematical variance based on our checks appears to be in the Willoughby + North Sydney merger business case. We have not had further access to the local councils or their respective consultants to reconcile these differences.

5.2.2 Assumptions underpinning submitted merger business cases

This section of our report provides a high level overview of the key assumptions that have been employed by councils and their consultants in undertaking their merger business case analyses. Appendix B contains a detailed outline of the key assumptions employed.

Merger integration costs

All of the merger business cases we reviewed incorporated assumptions on merger integration costs, with the exception of the information prepared by Bankstown Council for the merger of Bankstown and Canterbury.

Reports prepared by Morrison Low typically apply transition costs principally in the first three years and rely on estimates based on the proposed amalgamation of nine local councils to create a single council for Wellington. As we have discussed earlier, the integration cost estimates for the proposed Wellington reorganization appear to be high, albeit there is limited evidence generally available on the size of these costs. Morrison Low also included estimates for staff redundancy in the transition period although this is limited to Tier 1 and Tier 2 staff. With respect to other staff, Morrison Low assumes that redundancies will occur after a no forced redundancy period (3 years) but in the transition period, it is assumed a natural attrition policy will apply. Other merger transition costs include ICT costs, branding and in some cases, remuneration harmonisation.

In the reports prepared by KPMG, merger integration costs have been estimated based on case study examples. Upfront costs generally were estimated as a proportion of total annual expenditure of the merged entity and apportioned across costs for different types of activities based on a comparative study of the amalgamation experience in Toronto. Effort was made to estimate redundancy costs based on the specific circumstances of individual councils.

SGS estimated merger transition costs as a percentage of operating expenses based on a UK case study. Merger costs were assumed to occur in the first 2 years.

For the remaining merger business cases we reviewed, merger integration costs were generally estimated based on case study examples or on discussions with the relevant councils.

Potential cost savings

Where merger cost savings were identified, key sources of cost savings included staffing where there were duplicated functions and roles, reduction of governance costs due to having a governance structure which was scaled to the size of the merged council, savings in procurement functions through rationalisation of works units and materials, reduced IT costs through ICT consolidation and certain property-related savings due to a reduction in the number of office sites.

Estimates of cost savings were based mainly on case studies of amalgamation experience elsewhere (mainly New Zealand) as well as on discussions with management of the relevant councils. In most cases, cost savings were assumed to commence upon transition, although some staff redundancies were assumed to be delayed due to protections offered under the Local Government Act.

Key risks identified

All of the merger business cases we reviewed identified key risks arising from the merger, particularly around the obvious financial risks such as transitional and implementation costs being more significant than set out in the business cases or that the efficiencies projected are not delivered.

Reports prepared by KPMG also identified other financial and non-financial risks such as the risk of the merged entity not being able to achieve financial sustainability over the longer term, strategic risks, risk to service quality and effectiveness, risk to the effectiveness of local representation and risk to effective implementation and management over time.

Reports prepared by Morrison Low discussed other key risks identified such as the risk that cultural integration of the different councils could negatively impact morale and the staff turnover rate. This could reduce business performance and prolong the time taken to achieve the projected efficiencies. Service levels are also at risk to rise across the merged council, standardizing on the highest level of those services that are being integrated. Meanwhile, should the financial performance of the merged council be less than projected, this could result in the need to reduce services, find further efficiency gains or increase rates to address the operating deficit. In addition, developing a governance model that represents the communities of interest across the proposed merger area could also prove to be challenging.

5.3 EY analysis

We have made two types of adjustments to the business cases submitted by the local councils:

- Standardisation adjustments
- Other adjustments

5.3.1 Standardisation adjustments

Many of the merger business cases were presented in different ways, based on different timelines, using both nominal and real cash flows, and different discount rates. Some included the impact of the grant funding from the State. We have standardised the business cases to facilitate more effective comparison between them and with the NPV results of EY's top-down approach as applied to the ILGRP preferred merger scenarios. The key adjustments were to:

- Extend the analysis to 20 year timeframe, with all costs and benefits commencing FY 2017
- Discount real net merger benefits / (costs) using a 7% real discount rate, or discount nominal net merger benefits / (costs) using 9.675% nominal discount rate (i.e. inflated by 2.5 % inflation assumption)
- Exclude grant funding from merger benefits.

The impact of the standardisation adjustments that we have made are reflected in the figures shown in Table 20.

Table 20: Local council merger options explored by local councils incorporating standardisation adjusted by EY (over 20 years)

Merger scenario	NPV 4% @ 2016 $'000	NPV 7% @ 2016 $'000	NPV 10% @ 2016 $'000
Kogarah Rockdale Hurstville	132,171	90,273	61,711
Canterbury Kogarah Rockdale Hurstville	276,676	196,961	142,441
Kogarah Hurstville	73,944	48,613	31,418
Botany Bay Marrickville Rockdale	193,949	138,221	99,817
Ashfield Burwood Canada Bay Leichhardt Marrickville Strathfield	315,420	229,108	169,546
Hunters Hill Lane Cove Mosman North Sydney Ryde (part) Willoughby	244,461	166,466	113,582
Willoughby Lane Cove North Sydney	127,218	86,403	58,721
Willoughby North Sydney	119,503	83,807	59,407
Auburn Burwood Canada Bay	111,181	76,359	52,741
Auburn Holroyd Parramatta The Hills Ryde (part)	169,629	110,387	70,217
Hornsby The Hills	98,159	74,112	57,539
Hornsby Ku-ring-gai	67,782	50,820	39,143
Hornsby Ku-ring-gai The Hills	216,055	164,369	128,715
Manly Warringah Pittwater (KPMG)	116,046	84,934	63,650
Manly Part Warringah + Pittwater Part Warringah (KPMG)	33,328	21,298	13,177
Manly Warringah (KPMG)	60,855	43,989	32,469

Merger scenario	NPV 4% @ 2016 $'000	NPV 7% @ 2016 $'000	NPV 10% @ 2016 $'000
Manly Warringah Pittwater (SGS)	447,336	328,320	247,180
Manly Warringah (SGS)	237,075	173,812	130,694
Pittwater Warringah [Additional Option] (SGS)	227,595	166,777	125,332
Manly Part Warringah + Pittwater Part Warringah (SGS)	(335,096)	(247,788)	(188,177)
Fairfield Liverpool	(49,456)	(40,823)	(34,407)
Bankstown Canterbury	167,057	130,225	104,651
Gosford Wyong	179,967	126,363	90,527
Randwick Waverley Woollahra Botany Bay Sydney	276,610	191,503	134,444
Randwick Waverley	166,860	119,423	87,066
Randwick Waverley Woollahra Botany Bay	465,025	338,555	252,314

5.3.2 Other adjustments

As discussed in Section 5.2, the merger business cases explored by the local councils are based on a range of assumptions. Most of the assumptions were adequately justified and are considered reasonable given the available evidence, however, a small number were more open to question. These are:

- Assumed increase in service levels and FTE requirements – In most of the merger business cases prepared by Morrison Low, an assumption is made for FTE increases from around year 4 onwards to support an increase in service levels. Morrison Low reports indicate this is based on research conducted for the ILGRP which noted that each of the councils involved in the 2004 NSW mergers had more staff after the merger than the combined councils together. Whilst it may be true that councils may direct initial cost savings towards higher levels of service provision and this may lead to a future increase in FTEs, we consider that for the purpose of modelling the NPV impacts of each merger, the objective should be to capture the first-round direct impacts of the merger. Hence, we consider the merger business cases should include the full benefits of rationalisation, including both cost savings and enhanced service levels. .

- Branding costs assumption in Fairfield + Liverpool business case – Fairfield Council's merger business case for the amalgamation of Fairfield and Liverpool Councils has assumed a branding cost assumption of $0.5m per annum from 2016 to 2025. Whilst we do not dispute that costs will be incurred for re-branding, we question whether such costs would amount to $10m over 10 years. This assumption also stands out in comparison with the branding cost assumptions in the other merger business cases explored, particularly given the relative size of the merger. On this basis, we consider a more conservative branding cost assumption of $2m over 2 years should be applied.

- Absence of merger cost savings in Fairfield + Liverpool merger business case – Fairfield Council's merger business case applied a methodology for estimating savings in operating costs from a merger, which results in no merger cost savings. Instead, the analysis predicts a rise in costs post-merger. We do not consider this is a reasonable outcome as some degree of cost savings, however minimal, would be expected from a reduction in the number of mayors and councillors and from FTE numbers in back-office functions. It has also been assumed that any savings that arise would do so in 2022/23. We consider a more reasonable assumption is to assume cost savings from year 1. We have adjusted the merger business case by applying an assumption for cost savings similar to our top-down approach.

- Temporary office relocation costs in Fairfield + Liverpool merger business case - We also note Fairfield Council has assumed there will be relocation costs over five years at the rate of $1.75m per annum as it will be necessary to temporarily lease a building whilst a permanent new building is constructed. Whilst it is not unreasonable to expect the merged council will have its staff relocated to one premise, we question whether Fairfield Council has overlooked cost savings which might arise from moving from the current premises occupied by each council to the new merged office. To the extent these existing office locations are owned or leased, there would be cost savings either in the form of sites which could be sold, or leasing costs forgone.

- Merger assumptions in Bankstown merger business case - Bankstown Council's merger business case identified some cost savings in governance and administration and in certain other areas. These costs however, are assumed to be fully realised in year 1. We consider that it would be more reasonable to assume that cost savings will flow through over time. As such as we have applied a 5 year ramp up similar to that in our top down approach. We also note that the business did not include any consideration of merger costs. We have adjusted the merger business case by applying an assumption for merger integration costs similar to our top-down approach.

- Relocation costs during transition in Randwick & Waverley Council's merger business case – Randwick and Waverley Councils conducted an analysis of a number of merger options. In the merger option involving the City of Sydney, it was assumed that it would be necessary to relocate a number of staff to a single location being Town Hall House. This assumption generates a significant loss of rental revenue as Town Hall House is currently leased out to the commercial tenants. Whilst it is not unreasonable to expect that the merged council would seek to have most of its staff housed in a single premise, no analysis has been presented on whether alternative lower cost options have been explored. In the absence of a better estimate, we have removed the relocation costs in this option and replaced it with relocation costs similar to the Randwick + Waverley + Woollahra option.

- Expenditure made to meet the FFTF ratios in Randwick & Waverley's merger business case – We understand Randwick Council has calculated the net merger benefits of the various merger options by estimating the efficiencies for each option based on a service oriented financial model designed by SGS in 2013. The costs of the amalgamation process were also estimated as part of the analysis. Additional expenditure was also allowed in order to meet the FFTF ratios, eliminate the infrastructure backlog and repay debt for each option. Whilst it may be true that councils could direct initial cost savings towards meeting the FFTF ratios, address infrastructure backlog and debt repayment, these cost savings should nevertheless be recognised as they resulted from the merger. We have therefore made an adjustment to remove this expenditure from all the amalgamation options presented by the Randwick Council.

- Forgone waste reduction levy in various Morrison Low merger business cases – Various merger business cases prepared by Morrison Low have identified cost savings which would arise from a rationalisation of existing arrangements and contracts in waste management. In addition, it has also been assumed the cost savings would then be applied to reduce existing waste collection levies. As such, the business case identifies forgone waste collection levy revenue as a merger cost. We have adjusted the relevant business case to remove the impact of the forgone levy revenue. As noted earlier, we consider that such cost savings should be included in the business case.

- Funding of merger costs in KPMG Pittwater, Manly and Warringah merger business case – The merger business case has identified funding costs of the merger as a merger integration cost. We have adjusted the business case estimates to remove such costs.

The table below presents the NPV results of the merger options incorporating all of the above adjustments.

Table 21: Local council merger options explored by local councils incorporating all EY adjustments (over 20 years)

Merger scenario	NPV 4% @ 2017 $'000	NPV 7% @ 2017 $'000	NPV 10% @ 2017 $'000
Kogarah + Rockdale + Hurstville	183,031	126,201	87,689
Canterbury + Kogarah + Rockdale + Hurstville	355,010	252,298	182,451
Kogarah + Hurstville	106,096	71,325	47,839
Botany Bay + Marrickville + Rockdale	322,114	229,641	166,650
Ashfield + Burwood + Canada Bay + Leichhardt + Marrickville + Strathfield	504,717	364,157	268,277
Hunters Hill + Lane Cove + Mosman + North Sydney + Ryde (part) + Willoughby	368,871	255,199	178,420
Willoughby + Lane Cove+ North Sydney	210,824	146,237	102,597
Willoughby + North Sydney	176,377	123,948	88,403
Auburn + Burwood + Canada Bay	144,009	99,548	69,508
Auburn + Holroyd + Parramatta + The Hills + Ryde (part)	323,578	220,160	150,408
Hornsby + The Hills	98,159	74,112	57,539
Hornsby + Ku-ring-gai	67,782	50,820	39,143
Hornsby + Ku-ring-gai + The Hills	216,055	164,369	128,715
Manly + Warringah + Pittwater (KPMG)	139,188	103,158	78,440
Manly Part Warringah + Pittwater Part Warringah (KPMG)	61,377	43,386	31,103
Manly+ Warringah (KPMG)	76,562	56,357	42,506
Manly + Warringah + Pittwater (SGS)	447,336	328,320	247,180
Manly + Warringah (SGS)	237,075	173,812	130,694
Pittwater + Warringah [Additional Option] (SGS)	227,595	166,777	125,332
Manly Part Warringah + Pittwater Part Warringah (SGS)	(335,096)	(247,788)	(188,177)
Fairfield + Liverpool	167,779	124,462	95,049
Bankstown + Canterbury	116,512	82,055	58,648
Gosford + Wyong	179,967	126,363	90,527
Randwick + Waverley + Woollahra + Botany Bay + Sydney	523,554	389,275	297,062
Randwick + Waverley	176,250	127,308	93,800
Randwick + Waverley + Woollahra + Botany Bay	497,300	365,084	274,499

Following the adjustments we have made, NPV outcomes have improved except for the scenario (prepared by SGS) where Warringah Council is split into two, merging one half with Manly and one half with Pittwater to create two new councils, which remains negative. We note there remain substantial variations between the merger business cases prepared by KPMG and SGS in relation to the various combinations of merger involving Manly, Pittwater and Warringah Councils. For example, based on the adjusted figures reported in the table above, the merger scenario which involves splitting Warringah Council has a negative NPV (at 7%) of $247m as assessed by SGS and a positive NPV of $43m as assessed by KPMG (with EY adjustments).

6. Key findings

The table below compares:

- The NPV outcomes for the ILGRP preferred merger options and the additional Bankstown/Canterbury and Gosford/Wyong options that we have been asked to assess, based on EY's top-down methodology ("EY top-down approach"); with
- The NPV outcomes for the same options where they have been explored in local council submissions, incorporating the adjustments made by EY as outlined in Section 5.3 ("adjusted reported NPV").

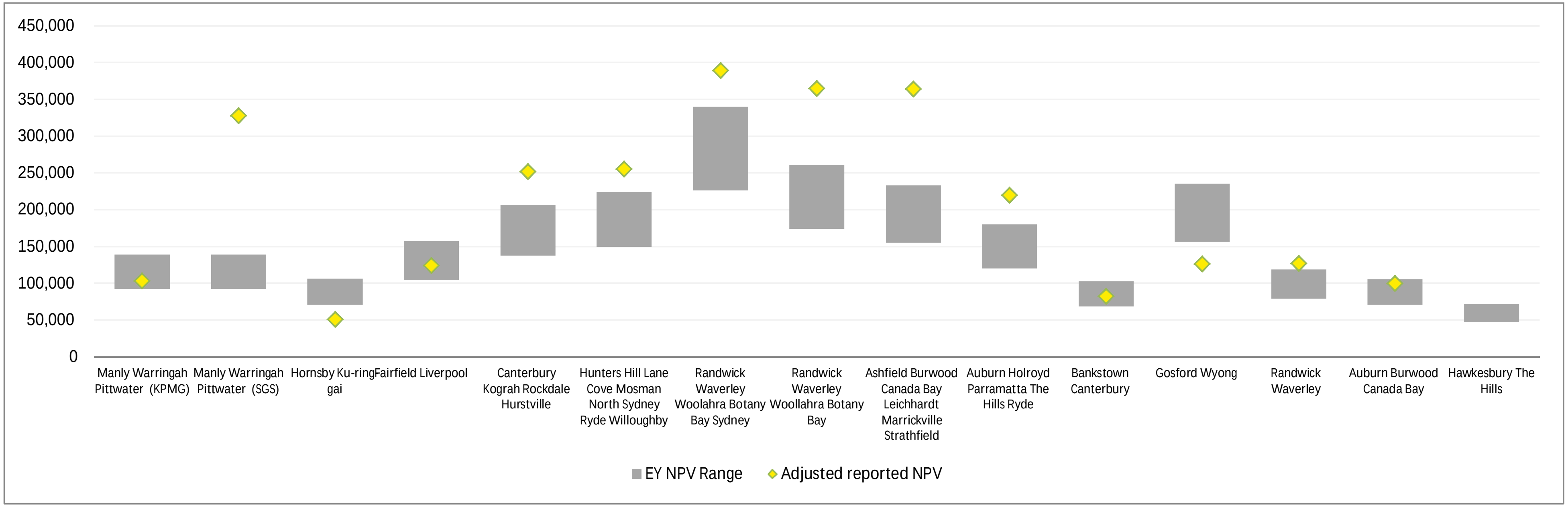
Table 22: ILGRP metropolitan local council preferred merger options (over 20 years)

	Merger scenario	4% Discount Rate		7% Discount Rate		10% Discount Rate	
		EY top-down NPV Range ($'000)	Adjusted Reported NPV ($'000)	EY top-down NPV Range ($'000)	Adjusted Reported NPV ($'000)	EY top-down NPV Range ($'000)	Adjusted Reported NPV ($'000)
ILGRP preferred merger options							
1A	Manly Warringah Pittwater (KPMG)	131,470 - 197,204	139,188	92,589 - 138,883	103,158	66,177 - 99,266	78,440
1B	Manly Warringah Pittwater (SGS)	131,470 - 197,204	447,336	92,589 - 138,883	328,320	66,177 - 99,266	247,180
2	Hornsby Ku-ring-gai	100,408 - 150,611	67,782	70,713 - 106,070	50,820	50,542 - 75,812	39,143
3	Fairfield Liverpool	148,921 - 223,381	167,779	104,879 - 157,318	124,462	74,961 - 112,442	95,049
4	Canterbury Kogarah Rockdale Hurstville	195,898 - 293,847	355,010	137,963 - 206,945	252,298	98,608 - 147,912	182,451
5	Hunters Hill Lane Cove Mosman North Sydney Ryde (part) Willoughby	221,023 - 331,535	368,871	149,624 - 224,437	255,199	101,384 - 152,076	178,420
6	Randwick Waverley Woollahra Botany Bay Sydney	335,015 - 502,522	523,554	226,793 - 340,189	389,275	153,672 - 230,508	297,062
7	Ashfield Burwood Canada Bay Leichhardt Marrickville Strathfield	229,663 - 344,495	504,717	155,473 - 233,210	364,157	105,347 - 158,020	268,277
8	Auburn Holroyd Parramatta The Hills Ryde (part)	177,434 - 266,151	323,578	120,116 - 180,174	220,160	81,389 - 122,084	150,408
Additional merger scenarios identified by ILGRP and Councils and requested by IPART							
9	Randwick Waverley Woollahra Botany Bay	247,159 - 370,739	497,300	174,065 - 261,097	365,084	124,411 - 186,617	274,499
10	Bankstown Canterbury	97,170 - 145,755	116,512	68,433 - 102,650	82,055	48,912 - 73,368	58,648
11	Gosford Wyong	222,831 - 334,247	179,967	156,931 - 235,397	126,363	112,165 - 168,248	90,527

	Merger scenario	4% Discount Rate		7% Discount Rate		10% Discount Rate	
		EY top-down NPV Range ($'000)	Adjusted Reported NPV ($'000)	EY top-down NPV Range ($'000)	Adjusted Reported NPV ($'000)	EY top-down NPV Range ($'000)	Adjusted Reported NPV ($'000)
12	Randwick Waverley	112,555 - 168,832	176,250	79,268 - 118,902	127,308	56,656 - 84,984	93,800
13	Auburn Burwood Canada Bay	100,262 - 150,393	144,009	70,611 - 105,916	99,548	50,468 - 75,703	69,508
14	Hawkesbury The Hills	68,069 - 102,104	N/A	47,938 - 71,908	N/A	34,263 - 51,395	N/A

The adjusted reported NPV of net merger outcomes are all positive. In addition, they are higher than or within the NPV range based on EY's top down approach except for the mergers involving Hornsby+Ku-ring-gai Councils and Gosford+Wyong Councils. This is illustrated in the chart below.

Figure 5: NPV of net merger benefits – EY NPV range against adjusted reported NPVs ($'000)



We have undertaken further analysis on the above comparison by separating merger benefits. The results of this analysis is summarised in the charts below. We note the reports prepared by Hornsby + Ku-Ring-Gai do not provide sufficient data for us to separately analyse the merger benefits and merger costs.

Figure 6: NPV of merger benefits - EY NPV range versus adjusted reported NPVs (7%) ($'000)

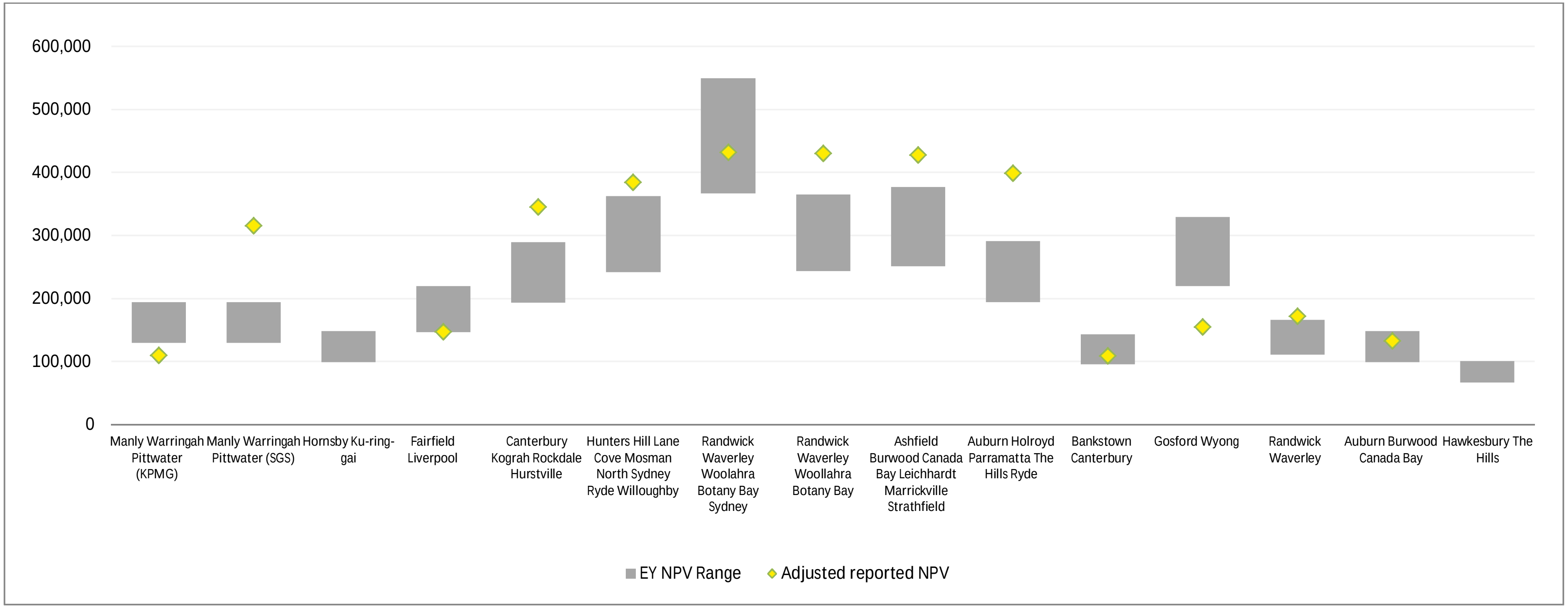
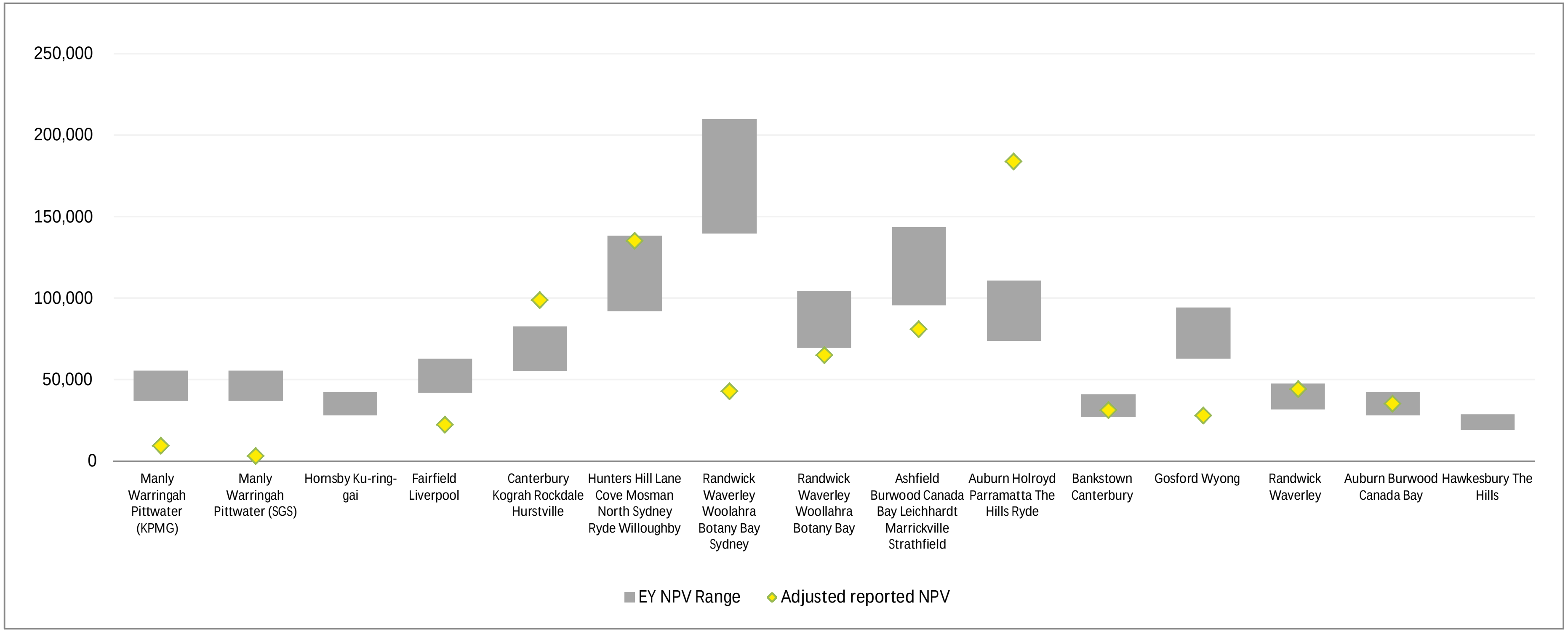


Table 23: NPV of merger integration costs - EY NPV range versus adjusted reported NPVs (7%) ($'000)



It is evident there is substantially more variations around views on merger costs and merger benefits. In most cases, local councils' estimates of merger costs are lower than EY's, but there appears to be a reasonable level of alignment in views on merger benefits with a few exceptions. Overall, EY's top-down analysis yields net merger outcomes that are more conservative than many of the analysis undertaken.

We are of the view that our analysis is conservative but prudently so in light of the work that has been undertaken.

Irrespective of differing views on the size of potential merger benefits and merger costs, there would be appear to be consensus that net merger outcomes are positive in all of the listed scenarios above. They also appear to be reasonably robust based on the sensitivity analysis.

EY acknowledges that there are a range of non-financial costs and benefits that will impact any merger. Some of the benefits include:

- Additional capacity for improved and consistent planning decisions
- Improved scale to better partner with government
- Greater resource bases for amalgamated councils
- Additional capacity for local government to improve the range and quality of its services
- Improved ability to attract skilled staff and capacity to offer better staff career development options

Offsetting these non-financial benefits are the challenges noted earlier in this report associated with managing the disruption that inevitably accompanies most mergers, managing cultural differences and addressing staff morale.

These non-financial costs and benefits have not been quantified in our analysis due to the inherent difficulties of valuing such impacts. Nevertheless, the impact of these costs and benefits is a relevant consideration in any merger.

Appendix A Merger business cases reviewed

Merger business cases reviewed			
Consultant's name	Title of report	Date	Options analysed
Morrison Low	Rockdale Council Fit for the Future – Merger Business Case Modelling	March 2015	Kogarah Rockdale Hurstville Canterbury Kogarah Rockdale Hurstville
Morrison Low	Kogarah Council Fit for the Future Merger Business Case Modelling	March 2015	Kogarah Hurstville
Morrison Low	Airport Councils Fit for the Future – Shared Modelling	March 2015	Botany Bay Marrickville Rockdale
Morrison Low	Inner West Councils Fit for the Future – Shared Modelling	February 2015	Ashfield Burwood Canada Bay Leichhardt Marrickville Strathfield
Morrison Low	Review of ILGRP recommendations relating to a proposed merger of the whole of Hunters Hill, Lane Cove, Mosman, North Sydney, Willoughby and two thirds of Ryde Council.	19 June 2015	Hunters Hill Lane Cove Mosman North Sydney Ryde Willoughby
Morrison Low	Willoughby City Council Fit for the Future Assessment of Options	June 2015	Willoughby Lane Cove North Sydney Willoughby North Sydney
Morrison Low	Sydney Olympic Park City Council Merger Business Case	June 2015	Auburn Burwood Canada Bay
Morrison Low	Holroyd City Council Merger vs Stand-Alone Business Case	June 2015	Auburn Holroyd Parramatta The Hills Ryde
KPMG	Analysis of local government reform options in the Northern Sydney area	22 May 2014	Hornsby The Hills Hornsby Ku-ring-gai Hornsby Ku-ring-gai The Hills
KPMG	Independent review of structural options for Manly Council & Pittwater Council	1 April 2015	Manly Warringah Pittwater Manly Part Warringah + Pittwater Part Warringah Manly Warringah
SGS Consulting	Local Government Structural Change – Supplementary Study	February 2015	Manly Warringah Pittwater Manly Part Warringah + Pittwater Part Warringah Pittwater Warringah Manly Warringah
Fairfield Council	Chapter 2 Fit for the Future Financial criteria and measures	June 2015	Fairfield Liverpool
Bankstown Council	Bankstown City Council: fit for the future (information prepared by Bankstown Council)	30 July 2015	Bankstown Canterbury

Merger business cases reviewed			
Third Horizon	Wyong Shire Council Fit for the Future Cost-Benefit Analysis of Local Government reform options	12 June 2015	Gosford Wyong
Randwick Council (using an updated report from SGS Consulting)	Randwick City Council Fit for the Future Options Analysis	May 2015	Randwick Waverley Woollahra Botany Bay Sydney Randwick Waverley Randwick Waverley Woollahra Botany Bay

It should be noted that in some cases, the data in the merger business cases submitted to IPART were amended following inquiries made by IPART. We have applied the amended data where this has been provided to us.

Appendix B Local council submitted merger business cases – key assumptions

Source Document & Merger Options	Valuation assumptions	Key merger assumptions	
		Merger costs	Merger cost savings
SGS (Warringah) Options: 1. Status quo – three separate councils 2. Manly + Warringah + Pittwater 3. Manly + Warringah 4. Pittwater + Warringah 5. Form 2 new councils by splitting Warringah – i.e. Manly + Part Warringah; Pittwater + Part Warringah	• Discount rate of 5.5% nominal • Base year 2015 • Nominal cash flows to 2024 • Concludes that Option 2 has the preferred outcome • Uses the reference council model	• Captures transitions costs associated with systems and processes as these can be objectively measured. • Redundancy costs are excluded as assumed to be offset by savings from staff natural attrition policy in the first 3 years • Estimates based on a UK case study which assumed 1.4% of current operating expenses • Merger costs of $3m to $5.5m (measured as present value over 10 years) but assumed to be incurred in first 2 years • Merger costs are higher in option 5 due to the formation of 2 councils	• SGS has identified the following services as those which are subject to economies of scale - governance, administration, public order and safety, environment, recreation & culture, and transport & communications. Per capita service costs used as a measure of cost. • Other than governance costs, cost savings in the remaining categories modelled on the basis of achieving the per capita cost achieved by the most efficient council in the merger scenario • Governance costs are dependent on the number of councilors so modelled separately. Option 2 assumes 13 councillors whilst options 3 through 5 assume 10 councillors per council (same as current number in Warringah). Therefore Option 5 has double the governance costs of options 3 and 4. • Cost savings are assumed to commence 3 years from current time (i.e. in FY18) to reflect a transition period for moving to the new structure. • Cost savings are assumed to grow in line with growth in operating expenditure (excluding depreciation) which is based on projected long term financial plan growth rates.
KPMG (Pittwater & Manly) Options: 1. Status quo – three separate councils 2. Form 2 new councils by splitting Warringah – i.e. Manly + Part Warringah; Pittwater + Part Warringah 3. Manly + Warringah + Pittwater 4. Manly + Warringah (Alternative option)	• Discount rate: 9.5% nominal, 7% real • Nominal cash flows • Inflation of 2.5% p.a. • Merger cash flows from 2016 to 2024	• Captures estimated redundancy costs as well as implementation costs comprising IT and facility consolidation, staff retraining and cost of financing transition costs • Total upfront costs estimated at 4.7% of total annual expenditure and apportioned across cost types based on Toronto case study • Total upfront costs assumed to be funded by cash or cash equivalents where upfront costs were less than 10% of cash and cash equivalent. Interest forgone estimated based on RBA's interbank overnight cash rate of 2.3% p.a. Otherwise funded by debt at a cost equal to weighted average small business lending rate (6.6% p.a.) • Redundancy costs varied from the 4.7% average due to assumptions underpinning the	• Staffing reductions estimated based on experience in Toronto and Auckland. Option 2 assumes 3.3% reduction, Option 3 assumes 8% and Option 4 assumes 5.6%. • Salary and wages costs assumed to grow at 3.1% p.a. consistent with the average level used by the Northern Beaches Council in long term financial plans • Assumes that there are no forced redundancies in first year of implementation. Combined with natural attrition of approximately 11 per cent, 25% of redundancies were assumed to occur each year over the four year period from 2015 – 2019. • 2% savings assumed in materials and contracts based on scaling of the 3% saving achieved in the Auckland case study. Reduction only applied to those cost items within materials & contracts which were regarded as variable.

Source Document & Merger Options	Valuation assumptions	Key merger assumptions	
		Merger costs	Merger cost savings
		efficiency package e.g. 4-12 weeks' pay assumption depending on staff tenure. Staff tenure was estimated with respect to the average employee turnover rate of 10.9 per cent across each of the councils. Consideration was given to staffing efficiencies achievable by branch and average salaries and on-costs accruals from Manly and Pittwater.	• 2% savings in other expenses after considering make-up of other expenditure and excluding costs that are not scalable. • No quantification of avoided annual facilities expenditure although KPMG considered that there may be additional financial benefits from merging councils should opportunities for asset rationalisation be pursued.

KPMG (Hornsby)
 	
Options:
Hornsby + The Hills
Hornsby + Ku-Ring Gai
Hornsby + Ku-Ring Gai + The Hills
	• Data was not discounted
	• 10 year nominal cash flows from 2014 to 2023
		• Costs associated with the merger included estimated redundancy costs as well as implementation costs comprising IT and facility consolidation, staff retraining and costs of debt financing (or foregone interest on cash or cash equivalents). Estimates were based on case study examples.
		• Total upfront costs were estimated at 4.7 per cent of total annual expenditure and apportioned across cost types based on Toronto's comparative study
		• For Hornsby, redundancy costs were estimated based on:
		  • The estimated staffing efficiencies by division
		  • Average salaries and accruals (annual leave and long service leave) by division
		  • An assumption about the average tenure of employees (based on turnover rates) to determine the redundancy liability as a function of annual salaries.
		• For neighbouring councils, the estimated redundancy costs were based on the ratio for Hornsby of redundancy costs as a proportion of total upfront costs.
		• Total upfront costs assumed to be funded by cash or cash equivalents where upfront costs were less than 10% of cash and cash equivalent. Interest forgone estimated based on assumptions consistent with Hornsby Shire Council's long term financial projections. Otherwise funded by debt at a cost equal to weighted average small business lending rate (6.8% p.a.)
			• Data was based on detailed assumptions for Hornsby council but publicly available data for other neighbouring councils.
			• For Hornsby, staffing efficiencies were estimated at between 4 per cent and 7 per cent of the establishment.
			• It was estimated that there would be an efficiency saving of 3% of applicable expenses in materials and contracts, informed by the comparative study of Auckland. A similar approach was adopted for the neighbouring councils.
			• 3% savings in other expenses after considering make-up of other expenditure and excluding bad and doubtful debts; bank charges and cash collection expenses; contributions/levies to other levels of government; councillor expenses (mayoral and councillors' fees and other expenses); and • donations, contributions and assistance.

Source Document & Merger Options	Valuation assumptions	Key merger assumptions	
		Merger costs	Merger cost savings

Morrison Low (Kogarah)
 	
Options:
Kogarah + Hurstville
Kogarah + Hurstville + Rockdale (“St George”)
Kogarah + Hurstville + Rockdale + Canterbury (St George and Canterbury)
	• Discount rate 7%
	• 8 year cash flows from 2016 to 2023
	• ML has advised that all cash flows and discount rate are expressed in nominal terms
	• ML has advised that the base year for Kogarah + Hurstville is 2014.
		• Costs associated with the merger options that were quantified include the cost of a transition body, ICT costs, rebranding, remuneration and harmonisation. The costs for the transition body were estimated based on the experience of Auckland and Wellington.
		• Costs incurred by the transition body are assumed to relate to pre-day 1 costs, which relate principally to a range of strategy, planning and change management activities.
		• The costs for ICT were based on analysis undertaken by Deloitte for Wellington and have been scaled. The estimated cost for branding is "based on other amalgamation experience."
		• The estimate for redundancy costs was based on assumed redundancy in Tier 1 and Tier 2 positions with the cost calculated using information from the Council's annual reports. Costs are assumed to be incurred in 2016 and 2019. Whilst not stated, the latter costs are presumed to reflect protections in the Local Government Act.
		• The estimate for remuneration harmonisation is founded on average employee costs for similar sized councils as well as between the councils
		• Bulk of transition costs assumed to take place within the first 3 years of the merger.
			• Some savings related to governance costs due to fewer number of Mayors and councilors. Governance savings commence in 2016.
			• The estimates for staffing reductions were calculated based on the strata of staff.
			• Assumed FTE reduction in:
			  • Executive management
			  • Corporate support personnel of around 5-15%. The starting point assumption was a reduction of 35%, but this was moderated following a review of organizational structures.
			  • Number of staff in works units of 20%, based on ML experience.
			  • Assumed rationalisation of plant and fleet of around 30%, based on ML experience.
			• Savings from ICT benefits due to reduced IT costs and costs of staff required to support it will arise in the long term at the rate of $4.8 - $7.9m p.a.
			• Staff costs are assumed to increase in the long term (6-10 years) following earlier falls. ML believes that longer run there will be an increase in service levels following the merger based on evidence considered by the ILGRP.

Morrison Low (Rockdale)
 	
Options:
Botany + Rockdale + Marrickville
	• Discount rate 7% (Nominal)
	• 9 year cash flows from 2015 to 2023 advised to be in nominal terms
		• Costs associated with the merger options that were quantified include the cost of a transition body, ICT costs, rebranding, remuneration and harmonisation. The costs for the transition body were estimated based on the experience of Auckland and proposed reorganization in Wellington.
		• The costs for ICT were based on analysis undertaken by Deloitte for Wellington and have been scaled. The estimated cost for branding is "based on other amalgamation experience."
		• The estimate for redundancy costs was based on assumed redundancy in Tier 1 and Tier 2 positions with the cost calculated using information from the Council's annual reports.
			• Some savings related to governance costs due to fewer number of Mayors and councilors. Governance savings commence in 2016.
			• Assumed FTE reduction in:
			  • Executive management
			  • Corporate support personnel of around 15-20%. The starting point assumption was a reduction of 35%, but this was moderated following a review of organizational structures.
			  • Number of staff in works units of 20%, based on ML experience
			  • Assumed rationalisation of plant and fleet of around 20%, based on ML experience.
			• Materials and contracts savings are estimated at 3% rising to 5%. This estimate is based on ML experience

Source Document & Merger Options	Valuation assumptions	Key merger assumptions	
		Merger costs	Merger cost savings
		Costs are assumed to be incurred in year 1 (2015) and year 4 (2018). Whilst not stated, the latter costs are presumed to reflect protections in the Local Government Act. • The estimate for remuneration harmonisation is founded on average employee costs for Sutherland Shire Council have been compared with that of the Airport councils combined and individually. • Bulk of transition costs assumed to take place within the first 3 years of the merger.	and analysis. • Savings from ICT benefits due to reduced IT costs and costs of staff required to support it will arise in the long term at the rate of $7.8m p.a. • Assumed reduction of property assets of 5% • Staff costs are assumed to increase in the long term (6-10 years) following earlier falls. ML believes that longer run there will be an increase in service levels following the merger based on evidence considered by the ILGRP.

Morrison Low (Holroyd)
 	
Options:
Holroyd + Parramatta + Auburn + The Hills (part) + Ryde (part)
 	
Note: Based on efficiencies realised scenario (Scenario 1 or base case). Alternative scenarios were also presented including efficiencies not realized and a scenario based on Holroyd Council assumptions.
	• Discount rate 7% (Nominal)
	• Base year 2014, as advised by ML
	• 8 year cash flows starting from 2016 advised to be in nominal terms
		• Costs associated with the merger options that were quantified include the cost of a transition body, ICT costs, rebranding, remuneration harmonisation. The costs for the transition body were estimated based on the experience of Auckland and proposed reorganization in Wellington. Additional costs ($2m) over and above these costs were allowed to address the splitting of The Hills and Ryde.
		• The costs for ICT were informed by analysis undertaken by Deloitte for Wellington. The high end of the range has been assumed due to complexity associated with splitting The Hills and Ryde.
		• The estimated cost for branding ($6m) is "based on other amalgamation experience."
		• The estimate for redundancy costs was based on assumed redundancy in Tier 1 and Tier 2 positions with the cost calculated using information from the Council's annual reports. Redundancy costs modelled on 38 weeks for Tier 1 and 2 management and 26 weeks for corporate services personnel. Costs are assumed to be incurred in 2016 and 2019. Whilst not stated, the latter costs are presumed to reflect protections in the Local Government Act.
		• The remuneration harmonisation costs are estimated by comparing the average employee costs for similar councils to that of the combined councils as well as between the five
			• Some savings related to governance costs due to fewer Mayors and councilors. 15 Councillors and a Mayor are assumed. Governance savings commence in 2016.
			• Assumed FTE reduction in:
			  • Executive management of positions across Tiers 1 through 4 levels. Assumes reduction to one General Manager and from 13 directors to 4 in the short term. Also assumes a 30% reduction across the existing Tier 3 and Tier 4 managerial positions over the medium term.
			  • Corporate support personnel of around 35% informed by the Auckland experience. The starting point assumption was a reduction of 35%.
			  • Number of staff in works units of 20%, based on ML experience
			  • Assumed rationalisation of plant and fleet of around 20%, based on ML experience
			• Further savings in staff costs based on a natural attrition policy
			• Materials and contracts savings are estimated at 2% rising to 4%. This estimate is based on ML experience and analysis.
			• Savings from ICT benefits due to reduced IT costs and costs of staff required to support it will arise in the long term at the rate of $7m p.a.
			• Assumed reduction of property assets of 5%
			• Staff costs are assumed to increase by 2% from year 4 onwards following earlier natural attrition period. ML believes that longer run there will be an increase in service levels following the merger based on evidence considered by the ILGRP.

Source Document & Merger Options	Valuation assumptions	Key merger assumptions	
		Merger costs	Merger cost savings
		councils. • Bulk of transition costs assumed to take place within the first 3 years of the merger.	

Morrison Low (Auburn)
 	
Options:
Auburn + Burwood + Canada Bay
	• Discount rate 7% (Nominal)
	• 8 year cash flows starting from 2016 advised to be in nominal terms
		• Costs associated with the merger options that were quantified include the cost of a transition body, ICT costs, rebranding and remuneration harmonisation. The costs for the transition body were estimated based on the experience of Auckland and proposed reorganization in Wellington.
		• The costs for ICT were based on analysis undertaken by Deloitte for Wellington ($30m)
		• The estimated cost for branding is "based on other amalgamation experience."
		• The estimate for redundancy costs during the transition period was based on assumed redundancy in Tier 1 and Tier 2 positions with the cost calculated using information from the Council's annual reports. Redundancy costs modelled on 38 weeks for Tier 1 and 2 management and 26 weeks for corporate services personnel.
		• The remuneration harmonisation costs are estimated by comparing the average employee costs for similar councils to that of the combined councils as well as between the three councils.
		• Bulk of transition costs assumed to take place within the first 3 years of the merger.
			• Some savings related to governance costs due to fewer Mayors and councilors. 15 Councillors and a Mayor are assumed. Governance savings commence in 2016.
			• Assumed FTE reduction in:
			  ◦ Executive management of positions across Tiers 1 through 4 levels. Assumes reduction to one General Manager and from 8 directors to 4 in the short term. Also assumes a 40% reduction across the existing Tier 3 and Tier 4 managerial positions over the medium term.
			  ◦ Corporate support personnel of around 35% informed by the Auckland experience.
			  ◦ Number of staff in works units of 20%, based on ML experience
			  ◦ Assumed rationalisation of plant and fleet of around 20%, based on ML experience
			• Materials and contracts savings are estimated at 2% rising to 3% then to 4% in the medium and longer term. This estimate is based on ML experience and analysis.
			• Savings from ICT benefits due to reduced IT costs and costs of staff required to support it will arise in the long term at the rate of $3m p.a.
			• Assumed reduction of property assets of 5%
			• Staff costs are assumed to increase by 2% from year 4 onwards following earlier natural attrition period. ML believes that longer run there will be an increase in service levels following the merger based on evidence considered by the ILGRP.

Morrison Low (Inner West Councils) Options: Ashfield + Burwood + Canada Bay + Leichhardt + Marrickville + Strathfield	• Discount rate 7% (Nominal) • 9 year cash flows from 2015 to 2023 advised to be in nominal terms	• Costs associated with the merger options that were quantified include the cost of a transition body, ICT costs, rebranding and remuneration harmonisation. The costs for the transition body were estimated based on the experience of Auckland and proposed reorganization in Wellington. • The costs for ICT were based on analysis undertaken by Deloitte for Wellington.	• Some savings related to governance costs due to fewer number of Mayors and councilors. 14 Councillors and a Mayor are assumed. Governance savings commence in 2016. • Assumed FTE reduction in: ◦ Executive management of positions across Tiers 1 through 4 levels. Assumes reduction to one General Manager and from 17 directors to 5 in the short term. Also assumes a 15% reduction across

Source Document & Merger Options	Valuation assumptions	Key merger assumptions: Merger costs	Key merger assumptions: Merger cost savings
		Estimated cost is \$55m - \$80m, of which \$10m - \$20m is in the transition period and \$45m - \$60m is incurred post Day 1. • The estimated cost for branding (\$2m) is "based on other amalgamation experience." • The estimate for redundancy costs for senior management during the transition period was based on assumed redundancy in Tier 1 and Tier 2 positions with the cost calculated using information from the Council's annual reports. Redundancy costs modelled on 38 weeks for Tier 1 and 2 management and 26 weeks for other personnel. • The remuneration harmonisation costs are estimated by comparing the average employee costs for similar councils to that of the combined councils as well as between the six councils. • Bulk of transition costs assumed to take place within the first 3 years of the merger.	the existing Tier 3 and Tier 4 managerial positions over the medium term • Corporate support personnel of around 35% informed by the Auckland experience • number of staff in works units of 20%, based on ML experience • Assumed rationalisation of plant and fleet of around 20%, based on ML experience • Further savings in staff costs based on a natural attrition policy • Materials and contracts savings are estimated at 3% in the short term rising to 5% in the medium and longer term. This estimate is based on ML experience and analysis. • Assumed reduction of property assets of 5% • Move to outsourced waste collection contract will generate cost savings in the short term, with further cost savings expected from moving to a single contract over the longer term. • Staff costs are assumed to increase by 2% from year 4 onwards following earlier natural attrition period. ML believes that longer run there will be an increase in service levels following the merger based on evidence considered by the ILGRP.
Morrison Low Options: Willoughby + North Sydney Willoughby + Lane Cove + North Sydney Hunters Hill + Lane Cove + North Sydney + Mosman + Willoughby + Ryde (part)	• Discount rate 7% (Nominal) • Base year 2014, as advised by ML • 8 year cash flows starting from 2016 advised to be in nominal terms	• Costs associated with the merger options that were quantified include the cost of a transition body, ICT costs, rebranding and remuneration harmonisation. The costs for the transition body (\$11m) were estimated based on the experience of Auckland and proposed reorganization in Wellington. Additional costs (\$2m) over and above these costs were allowed to address the splitting of Ryde council. • The costs for ICT were based on analysis undertaken by Deloitte for Wellington which suggests costs in the range of \$55m - \$80m, of which \$10m - \$20m is in the transition period and \$45m - \$60m is incurred post Day 1. Estimate for this merger is approx. \$75m due to splitting of Ryde. • The estimated cost for branding (\$2m) is "based on other amalgamation experience."	• Some savings related to governance costs due to fewer Mayors and councilors. 14 Councillors and a Mayor are assumed. Governance savings commence in 2016. • Assumed FTE reduction in: • Executive management of positions across Tiers 1 through 4 levels. Assumes reduction to one General Manager and from 17 directors to 5 in the short term. Also assumes at least a 30% reduction across the existing Tier 3 and Tier 4 managerial positions over the medium term. • Corporate support personnel of around 35% informed by the Auckland experience. • Number of staff in works units of 20%, based on ML experience • Assumed rationalisation of plant and fleet of around 20%, based on ML experience • Further savings in staff costs based on a natural

Source Document & Merger Options	Valuation assumptions	Key merger assumptions: Merger costs	Key merger assumptions: Merger cost savings
		• The estimate for redundancy costs during the transition period was based on assumed redundancy in Tier 1 and Tier 2 positions with the cost calculated using information from the Council's annual reports. Redundancy costs modelled on 38 weeks for Tier 1 and 2 management and 26 weeks for other personnel. • The remuneration harmonisation costs ($4m) are estimated by comparing the average employee costs for similar councils to that of the combined councils as well as between the six councils. • Bulk of transition costs assumed to take place within the first 3 years of the merger.	attrition policy • Materials and contracts savings are estimated at 1% rising to 2% in the short term, then to rising to 3% in the medium and longer term. This estimate is based on ML experience and analysis. • Savings from ICT benefits due to reduced IT costs and costs of staff required to support it will arise in the long term. • Assumed reduction of property assets of 5% (for Northern Sydney option) • Move to outsourced waste collection contract will generate cost savings in the short term, with further cost savings expected from moving to a single contract over the longer term. • Staff costs are assumed to increase by 2% from year 4 onwards following earlier natural attrition period. ML believes that longer run there will be an increase in service levels following the merger based on evidence considered by the ILGRP. • Data shown is for the 'efficiencies realised' scenario.
Randwick Council Options: Randwick + Waverley Randwick + Waverley + Woollahra + Botany Bay Randwick + Waverley + Woollahra + Botany Bay + Sydney	• Discount rate of 4.5 % (10 Years) • 10 year nominal cash flows • Base year 2017 • All income projections based on current LTFPs. • Note that original merger business case was undertaken by SGS in 2013 and has been updated by Randwick Council	• Amalgamation is assumed to take 3 years, with 2015-16 being the transition year and the first two years of the new merged entity being 2016-17 and 2017-18. • Amalgamation costs are assumed to relate to ICT costs, recruitment of senior staff, redundancy costs, staff training, transition committee and general reform costs, community and staff consultation, new buildings / renovations, legal and audit services during transition, statutory planning integration, branding / visual identity. Of these it is assumed that the costs incurred during transition would relate to ICT, recruitment, senior staff redundancy, community and staff consultation, legal and audit fees and branding. • It is assumed that there will be relocation costs under all options due to having to accommodate additional staff. Some of loss of rental income would be incurred as staff will be required to move into council owned properties that are currently leased out to tenants. The	• No change in the service costs for the first year • In the second year 50% of service costs are based on existing pre-merger cost structures and the remaining 50% based on the new service cost model • Modelling of cost profile of the merged council is based on Randwick' s current per dwelling service costs for governance, administration, public order and safety, community services and education, housing and community amenities, mining, manufacturing and construction, transport and communication. Each council's current per dwelling service costs were used for expenditure on health, environment, street cleaning, solid waste management, recreation and culture, parking and economic affairs. • Governance costs assumed to change 18 months after amalgamation at Randwick's per dwelling rates. Parking and economic affairs expenditure inflated by the LGCI as these costs do not grow with number of dwellings • The City of Sydney's operating costs are as per the LTFP. • Some cost savings expected to accrue from sale of

Source Document & Merger Options	Valuation assumptions	Key merger assumptions	
		Merger costs	Merger cost savings
		forgone rental is largest in the option involving a merger with the City of Sydney as it is assumed that staff would relocate to Town Hall House.	excess depot sites.
Fairfield Council Options: Fairfield + Liverpool	• No discount rate applied – only total amounts included and not based on NPV • 9 year cash flows provided to 2025 • Cash flows assumed to be stated in real terms	• Relies on experience with amalgamations in Queensland, in particular, Toowoomba, to estimate amalgamation costs. Broadly estimated by applying a ratio of 86.9% to the $19m of amalgamation costs over 4 years which was incurred by Toowoomba. It is noted that this amounts to $16.5m for systems, processes and redundancies. • Costs related to systems integration estimated at $7.2m in total, based on 43.8% of $16.5m. Initial costs of $1m incurred in 2018/19 followed by a 3 year implementation period. • Redundancy costs estimated at $4.6m incurred in 2019/20 due to award guarantee of no redundancies in the first 3 years of amalgamation. Estimated based on 28% of $16.5m. • Branding costs of $0.5m p.a. from 2015-16 to 2024-25 (period of long term financial plan) • Salary equalization costs assumed to amount to $15.8m (i.e. $3.96m p.a. over four years to 2019/20). Based on experience in Toowoomba where salaries increased by 6.65% due to salary equalization. Estimate for Fairfield/Liverpool merger based on half of this. • Relocation costs assumed based on lease costs of $1.75m p.a. from 2016/17 to 2022/23. It is assumed that it will be necessary to temporarily lease a building whilst a permanent new building is constructed.	• It is assumed that cost savings will only commence seven years from the base year identified, that is, in the 2022/23 year. This is the period of time it will take for council cost structures to gradually move to merged structures where economies of scale will apply. • To estimate future cost savings, it is assumed that the post-merger operating services per capita will be at the average of the pre-merger operating services per capital for the individual councils. This is then applied to the combined population estimate for the merged council to estimate the post-merger annual operating costs. The difference between the post-merger operating cost estimate and the sum of the operating costs of the individual councils based on the relevant year of the LTFP is the cost savings. Using this methodology, there are effectively no cost savings which arise as of 2022/23. However, costs will rise instead.
Third Horizon Options: Gosford + Wyong	• [Confidential]	• [Confidential]	• [Confidential]
Bankstown Council	• No discount rate applied – only total amounts included	• No information provided on merger costs.	• Savings in governance and administration estimated by aligning the ratio of Governance and Administration expense to operating expense of Canterbury Council

Source Document & Merger Options	Valuation assumptions	Key merger assumptions	
		Merger costs	Merger cost savings
Options: Bankstown + Canterbury	and not based on NPV		with that of Bankstown Council. • Assumed savings in workers compensation insurance from moving to self-insurance. • Savings in senior staff remuneration based on removing duplication. • Assumed savings in systems from reducing duplication of systems and contracts.

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