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The Chairman
Independent Pricing and Regulatory Tribunal
PO Box K35
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Our Reference:
Your Reference:

Contact: Mr Glenn Handford
Telephone: [redacted]

17 May 2016

Dear Sir

Re: Submission to the Independent Pricing and Regulatory Tribunal on the Review of Local Government Rating System

Introduction

The New South Wales Government has tasked the Independent Pricing and Regulatory Tribunal (IPART) with conducting a review of the local government rating system in New South Wales (NSW). Their aim is to recommend reforms to improve its efficiency and equity to ensure council can implement sustainable fiscal policies over the longer term.

IPART is seeking submissions in response to its Issues Paper (April 2016). It has identified 23 issues about which it seeks comment.

Mid-Coast Council's comments in relation to the issues set out in Section 6 are below:

Freezing Existing Rate Paths for Newly Merged Councils

Issue 13 -We have interpreted the rate path freeze policy to mean that in the four years after a merger, the rating path in each pre-merger council's area will follow the same trajectory as if the merger had not occurred. Do you agree with this interpretation?

Council agrees with the IPART's interpretation of the Government's policy. However Council disagrees with the policy in general. The former Great Lakes Council provided information to the IPART (as part of its special variation application) highlighting the financial impact on a newly merged organisation which did not have the ability to seek a special variation in the four years after the merger.

Issue 14 - Within the rate path freeze period, should merged councils be permitted to apply for new special variations:
- For Crown Land added to the rating base?
- To recover amounts that are 'above the cap' on development contributions set under the Environmental Planning and Assessment Act 1979?
- To fund new infrastructure projects by levying a special rate?

Council is of the opinion that merged councils should be permitted to apply for new special variations for the above purposes. The commentary provided within the Issues Paper adequately covers the reasons why this should occur.

Issue 15 - Are there any other situations where merged councils should be able to apply for new special variations within the rate path freeze period?

Council is of the opinion that merged councils should be able to apply for special variations at the expiry of existing special variations to essentially renew that variation and continue the works program funded by that variation if appropriate.

By way of example, the former Great Lakes Council had an existing special variation within its general income for the purposes of Environmental and Dredging works. This variation was subject to a six year period and expires on 30 June 2020. At that time the value of the variation is removed from Council's general income.

That special variation had been renewed on a number of occasions since its initial approval in approximately 2001 and funds a large program of works that are valued and supported by the community and its removal and non-renewal would have a significant impact on the operations of the council and the environment.

While the potential renewal of this levy will not be an immediate issue for Mid-Coast Council due the expiry date, had the approval been for one year less then it was foreseeable that a program that had run for approximately 20 years and is been widely supported by the community would be dismantled due to the inability of the council to make lodge a special variation application for its renewal.

Secondly Council is of the opinion that merged councils should not be excluded from applying for special variations during the 4 year rate path freeze.

In preparing its submission on the Great Lakes Council, Greater Taree City Council and Gloucester Shire Council merger proposal to the Delegate, the former Great Lakes Council engaged Morrison Low Consultants to undertake a high level merger business case to identify the costs and benefits of a potential merger. Morrison Low carried out financial modelling to understand the financial position of a new merged entity based on the assumption that the proposed special variation applications from both Great Lakes Council and Greater Taree City Council were not approved.

The results of this modelling indicated that a new merged Council (which is now Mid-Coast Council) would meet only three of the seven Fit for the Future benchmarks by 2020 and would not meet the Operating Performance Ratio, Asset Renewal Ratio, Asset Maintenance Ratio or the Infrastructure Backlog Ratio. A copy of the Morrison Low Merger Business Case is attached for your reference.

Further modelling of a scenario whereby both special variation applications (Great Lakes Council and Greater Taree City Council) were successful was completed. This revealed that the new merged council would meet the Operating Performance Ratio in 2021.

Logically the result of this modelling is not surprising. Without the special variations the councils will not meet the benchmarks within the required timeframes as set out in the Fit for the Future process. With the special variations the former Great Lakes Council was a financially sustainable council and the former Greater Taree City Council was making significant inroads in addressing their infrastructure backlog issues and meeting the required benchmarks. As a combined entity (including the former Gloucester Shire Council) the forecast results are similar. A new merged entity was likely to be financially sustainable in the medium term if the special variations for both former councils were approved and the various savings and efficiencies projected in the Business Case were achieved.

As a newly merged Council with this information at hand, the fact that this Council is now excluded from seeking a special variation to its general income for a 4 year period is disappointing. The road ahead becomes extremely difficult in attempting to continue the progress that the former councils had made or planned to make based on additional income from a special variation.

Rather than focussing on addressing the infrastructure backlog and meeting agreed levels of service the new organisations first priority will be to ensure that it is financially sustainable in the long term.

Council would welcome the opportunity to discuss this matter further with the Tribunal.

Yours faithfully

[redacted]

GLENN HANDFORD
Interim General Manager

Merger Business Case

Great Lakes, Greater Taree and Gloucester Councils

April 2016

CONFIDENTIAL

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Ref	Version	Approving director	Date
7150	Final	D Bonifant	April 2016

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Executive Summary

Background and scope

Great Lakes Council has commissioned Morrison Low to undertake a high level merger business case to identify the benefits and costs of a potential merger with Greater Taree and Gloucester Councils.

In 2014 the Independent Local Government Review Panel (ILGRP) as part of the Fit for the Future process considered that an option for reform of Great Lakes Council was as a Council in Mid-North Coast Joint Organisation or merge with Gloucester.[1]

In late 2015 Great lakes Council was deemed to be Fit for the Future, have sufficient scale and capacity and to satisfy the financial criteria set out by the Government.

In March 2016, as a consequence of Gloucester Shire Council indicating that if a merger is to be considered its preference is a three way merger between Great Lakes, Greater Taree and Gloucester Councils, the Minister has made a proposal in accordance with section 218E of the Act to amalgamate the existing areas of Gloucester, Great Lakes and Greater Taree into one new area.

It should be noted that Greater Taree and Gloucester Councils are not a party to this merger option analysis. The Greater Taree and Gloucester data within this report is based on publicly available information.

Councils were given until 15 April 2016 to make a submission on the merger proposal.

The very short timeframe within which Great Lakes has to make a decision and respond to the Government means that the analysis, and this report, is a study which concentrates on:

- estimating the financial costs and savings from a merger
- predicting the financial performance of the merged council against the Fit for the Future benchmarks over the period covered by the councils' LTFPs
- comparing that performance against each individual council
- analysis of the community perspective by reviewing each council's Fit for the Future proposal or other publically available reports
- comparing each council's debt
- considering the impacts on representation
- considering the potential risks of the merger.

[1] Final Report of the NSW Independent Local Government Review Panel - October 2013 page 116

Merger impacts

This report finds that the merger of Great Lakes, Taree and Gloucester may result in financial savings and produce a range of impacts on the Councils and their communities.

- The financial benefits are estimated as potentially $11.2m[2] over 20 years
- Only four of the seven financial benchmarks are met within the required timeframes[3]
- The Operating Performance Ratio remains negative over the modelling period
- Inability of the merged council to fund required infrastructure renewals expenditure
- The merged council would have an asset base that would continue to deteriorate in condition over time
- Based on nine councillors, each councillor would represent 10,015 residents, meaning that Great Lakes residents will receive far less representation than they are currently accustomed to

This report does not address scale and capacity as it has been assumed, that the combined councils satisfy the scale and capacity criteria.

Great Lakes Council has resolved to support the amalgamation proposal subject to a blueprint being developed that will ensure that the new merged council will be sustainable into the future and therefore successful.

Whilst Council is supportive of the Government's reform agenda there are clear risks that benefits and savings from the merger may not be achieved. Council is conscious that a blueprint must be developed for the new council that will address the organisations sustainability and some of the equity issues that will exist if the three areas are merged.

Key risks

The merger of the three councils also creates a range of risks that would need to be managed. In our view the key priorities for the councils, if this proposed merger proceeds and recognising the risks inherent with any such change to local government, are:

1. Managing the transition from the existing councils into a new merged council
2. Continuing to fund the infrastructure needs of the combined council (and in particular funding the asset renewal shortfall) and apportioning the costs of renewing and upgrading infrastructure in a fair and equitable manner
3. The lack of projected renewal funding would result in the overall condition of assets deteriorating over time and as such an increase in the backlog ratio
4. Addressing the needs of different communities of interest within a merged council area

[2] NPV at 9.5%nominal discount rate
[3] Methodology for Assessment of Council Fit for the Future Proposals, IPART, June 2015

5 Realising the benefits from the merger. Should the benefits not be achieved, there will be a significant cost to the communities of Great Lakes, Greater Taree and Gloucester

6 Addressing the significant imbalance in infrastructure condition across the councils

Conclusions

Based on the merger modelling, some conclusions can be drawn.

- Great Lakes Council will meet all of the Fit for the Future benchmarks. The merged council will not
- Great Lakes Council has fully addressed its infrastructure expenditure requirements
- As a result of insufficient projected infrastructure expenditure, it is likely that the infrastructure condition will continue to deteriorate over time
- The merged organisation has a significant infrastructure gap. This has been estimated at $136.5 million or $27.3 million per year for five years and $3.4 million per year thereafter. The organisation will have to fund the additional expenditure during a time when rates cannot increase and significant merger costs are incurred
- There is a significant risk that the benefits from the merger will not be realised and as such there will be an additional costs to the community as a result of the merger

Introduction

Fit for the Future

In 2011, local councils from throughout NSW gathered for a summit, Destination 2036, to plan how local government could meet the challenges of the future. As a result, councils agreed that change was needed and that they wanted to be strong and sustainable and to make a positive difference in their respective communities. However, there were various views as to how this could be achieved, and in April 2012 the State Government appointed an independent expert panel to carry out a review of the sector. That Independent Local Government Review Panel consulted widely in developing its final recommendations which were presented to the Government in late 2013.

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

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

All councils were required to submit a proposal to be or become fit by 30 June 2015.

IPART was appointed by the Minister for Local Government as the Expert Advisory Panel to review all local council Fit for the Future proposals. South Australian local government expert John Comrie was appointed to support IPART in the process. IPART published a methodology for the assessment of proposals.[4]

IPART released its report[5] into the review of council proposals finding them either fit or unfit, largely on the scale and capacity assessment of the ILGRP or where the councils failed to demonstrate financial sustainability.

In late December the NSW Government announced that it had considered these responses and was preparing merger proposals for a number of merger options that were not only for those councils that had been proposed for merger.

In December 2015 the Government released merger proposals and appointed delegates who are tasked with supporting the Boundaries Commission process for each merger. Subsequent to this process additional merger options were proposed and referred by the Minister for consideration.

4 Methodology for Assessment of Council Fit for the Future Proposals, Consultation Paper, April 2015
5 Assessment of Council Fit for the Future Proposals, Local Government – Final Report, October 2015

Modelling the proposed merger

Great Lakes have commissioned Morrison Low to undertake a high level merger business case analysis of a proposed merger of Great lakes, Greater Taree and Gloucester Councils.

The modelling was undertaken on the basis of using publicly available information such as long term financial plans, annual statements, annual reports, asset management plans and submissions to IPART, in order to ensure consistency across the councils. This was augmented by further information provided by Great Lakes Council.

The modelling is intended to allow the councils to understand what the benefits and dis-benefits of the potential merger options are. It has involved analysing historic, current and forecast performance as well as drawing in information from other jurisdictions in which we have been involved in local government reform (for example, transitional costs).

Only SRV's currently approved by IPART have been included in the modelling. Great Lakes and Greater Taree proposed SRV's are therefore not included whereas Gloucester's recently approved SRV is

Reporting

This report has been prepared to provide the key information required for Council to use in determining what is in the best interests of the Council and community. As such, it does not seek to make a recommendation but will provide comments and observations on the proposed merger modelling. The report focuses on performance against the seven benchmarks and a short summary of some key potential advantages and disadvantages.

Limitations

The timeframes for this project have been challenging, with limited time provided by the Government for councils to prepare submissions on the merger proposals.

The data provided within the model is drawn from a variety of sources. For consistency across the councils, publicly available information has formed the basis of the analysis. Due to time constraints, the financial data sourced from each council has had to be taken at face value and has not been interrogated with each council, unless otherwise stated.

IPART's Assessment of Councils

Great Lakes Council

The ILGRP considered whether a merger or mergers were necessary at this stage. The report considered that Great Lakes should be a council in the Mid-North Coast Joint Organisation or consider a merger with Gloucester Council.

Great Lakes were considered Fit for the Future having satisfying the scale and capacity and the financial criteria.[6] This assessment has been based on the use of an SRV that has been excluded as part of this analysis.

Greater Taree Council

IPART's report, Assessment of Council Fit for the Future Proposals[7], found that Greater Taree Council was unfit as a standalone council. Whilst satisfying the scale and capacity criteria, it did not satisfy the overall financial criteria. In particular, it did not satisfy the sustainability or infrastructure and service management criteria.

Gloucester Shire Council

IPART's report, Assessment of Council Fit for the Future Proposals[8], found that Gloucester Shire Council was Unfit as a standalone council. Council did not satisfy the Scale and capacity criteria and it did not satisfy the overall financial criteria in particularly it did not satisfy the sustainability criteria.

IPART's individual council assessments are attached as Appendix A.

Community views on reforms

We have reviewed the submissions of all three councils to IPART[9] to identify what, if any, preferences were put forward by the communities. There were no public submissions to Gloucester Shire Council whereas Greater Taree had one submission and Great Lakes received five submissions.

Of the proposed merger councils only Great Lakes undertook public meetings, to ascertain the views of its residents for both the IPART submission and the current merger proposal.

6 Assessment of Council Fit for the Future Proposals, Local Government – Final Report, October 2015.
7 Assessment of Council Fit for the Future Proposals, Local Government – Final Report, October 2015.
8 Assessment of Council Fit for the Future Proposals, Local Government – Final Report, October 2015.
9 http://www.ipart.nsw.gov.au/Home/Industries/Local_Govt/Fit_for_the_Future

About the Councils

A comparison of the existing councils and the merged council is set out below.

Table 1 Council comparator data

	Great Lakes Council	Greater Taree Council	Gloucester Shire Council	Merged Council
Full time equivalent staff	292	248	84	624
Geographic area	3,380km^2	3,731km^2	2,996 km2	10,107km^2
Population[10]	36,312	48,846	4,974	90,132
Population projection 2031[11]	38,500	53,100	4,850	96,450
Annual expenditure[12] ($ million)	$69.2	$63.8	$13.5	$136.5
Number of councillors	9	9	7	9

A comparison of Community Strategic Plans provides a starting point in considering the alignment of three communities and communities of interests. Each council's Community Strategic Plan should be reflective of each community's aspirations, interests and desires and as such how alike they are and how similar their priorities may be.

Generally, all communities have similar aspirations although these can be reflected differently in their planning documents.

Great Lakes, Greater Taree and Gloucester rely on a combination of tourism agriculture and commercial endeavours and, as such, we would expect their communities to have similar priorities.

Great lakes Council has adopted a vision: "a unique and sustainably managed environment balanced with quality lifestyle opportunities created through appropriate development, infrastructure and services." This vision is supported by a Council mission, values and principles largely focused on the community, lifestyle and environment.

[10] Actual 2014

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

[12] Excluding water and sewerage

The Council has four key directions to achieve the vision:

- Our environment
- Strong local economies
- Vibrant connected communities
- Local leadership

The Great Lakes Community Strategic Plan also identifies a number of strategies and performance measures.

Greater Taree's key directions include:

- Looking after what we've got
- Respecting our environment
- A strong economy
- A great lifestyle

The Greater Taree City Council's Community Strategic Plan also identifies a number of strategies and projects as well as performance measures.

Gloucester Shire Council has adopted a vision:

"We want to work together to preserve this special place:
To value and protect our environment;
To care and contribute to our community, and
To build a sound and prosperous future."

The Council has four key directions to achieve the vision:

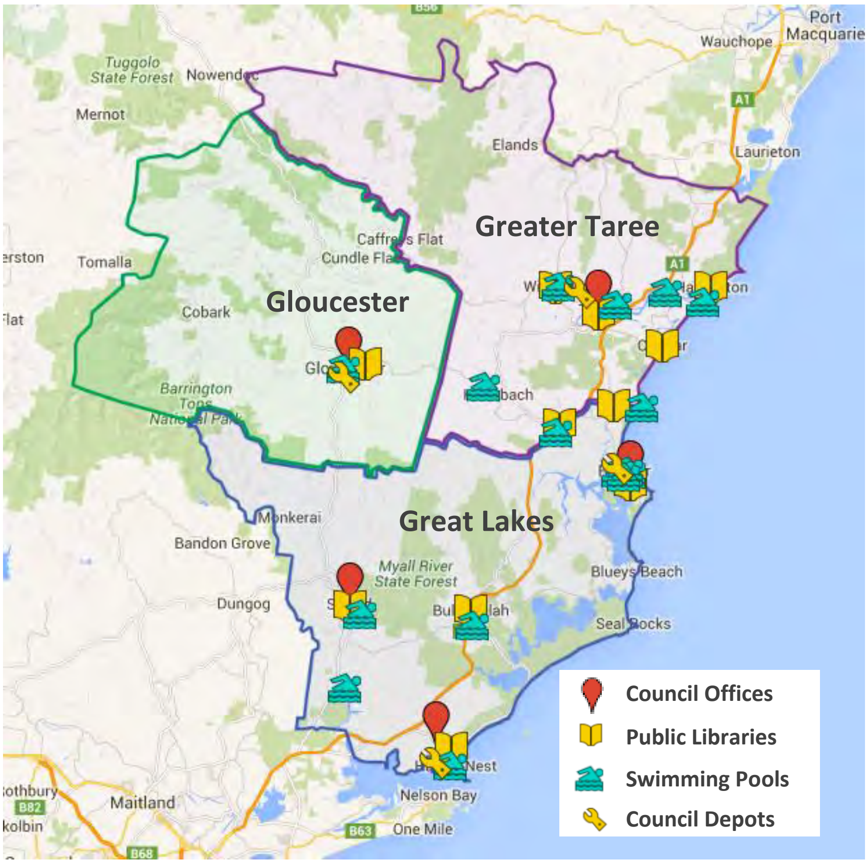
- Maintaining our core infrastructure
- Protecting the environment
- Creating a strong economy
- An engaged and supportive community

The Gloucester Shire Council's Community Strategic Plan also identifies a number of strategies and projects as well as performance measures.

The Merger

The proposed merger would bring together a Mid North Coast council with a combined population of around 90,000 in an area of 10,100km^2. The map below highlights the council areas and indicates key services and facilities across the existing council areas.

Figure 1 Proposed council area



Fit for the Future benchmarks

The merger of the three councils is the sum of the parts. This means that the asset and financial positon of each council directly contributes to the overall asset and financial position of the merged council. The modelling combines the projected expenditure of each council on assets (new capital, renewals and maintenance) as the basis for the merged councils projected expenditure on assets.

While there are significant transitional costs identified in this report which mean the operating performance ratio of the proposed merger is initially negative, the improving financial sustainability of each of the councils and the efficiency benefits modelled as arising through the merger improves the financial performance of the merged council.

The following table shows the results of our modelling for the merged council. The proposed Special Rates Variations for the councils have been taken out in line with the NSW Government's commitment to maintaining rates on their current paths for a four year period.

Table 2 Merged council performance against Fit for the Future benchmarks

Indicator	Great Lakes 2020	Greater Taree 2020	Gloucester 2020	Merged Council 2020
Operating Performance	*Does not meet the benchmark*	*Does not meet the benchmark*	*Does not meet the benchmark*	*Does not meet the benchmark*
Own Source Revenue	*Meets the benchmark*	*Meets the benchmark*	*Meets the benchmark*	*Meets the benchmark*
Debt Service Cover	*Meets the benchmark*	*Meets the benchmark*	*Meets the benchmark*	*Meets the benchmark*
Asset Maintenance	Meets the benchmark	Does not meet the benchmark	Does not meet the benchmark	Does not meet the benchmark
Asset Renewal	Does not meet the benchmark	Does not meet the benchmark	Does not meet the benchmark	Does not meet the benchmark
Infrastructure Backlog	Does not meet the benchmark	Does not meet the benchmark	Does not meet the benchmark	Does not meet the benchmark
Real Operating Expenditure	Meets the benchmark	Meets the benchmark	Meets the benchmark	Meets the benchmark

Asset Maintenance Ratio

The calculation of the maintenance ratio is based on the number each council reports as 'required maintenance'. There are no clear guidelines as to how required maintenance is to be calculated and, as such, the approach varies significantly across NSW.

Each council's assessment of required maintenance is assumed to represent the actual amount required to maintain their assets in an appropriate condition, and the merged council uses the combination of each council's assessment of required maintenance.

Infrastructure Backlog Ratio

For the purposes of this report each council's assessment of the Infrastructure Backlog has been assumed to represent the actual amount and combined to represent the backlog of the merged council. Where a council does not fully fund asset renewals, we have assumed this will result in a decrease in the overall condition of the asset base and, as such, will increase the overall infrastructure backlog.

The merged council meets only three of the indicators during the whole of the modelled period: Own Source Revenue, Debt Service Cover and Real Operating Expenditure.

- Own Source Revenue increases from 66% to 76% while the Debt Services Ratio remains well within the benchmark, giving the merged council a good level of borrowing capacity if required
- The Debt service ratio meets the benchmark over the modelling period
- The Real Operating Expenditure over the modelling period demonstrates an overall decline, as the benchmark requires, however does trend upwards in the first two years as a result of the costs of merging

Of the measures not met throughout the entire period:

- The Operating Performance Ratio commences at -10 % in 2016 then decreasing before stabilising at approximately -4%. It does not meet the benchmark requirement of being greater than break-even in 2020. This reflects the impact of the transitional costs and in later years the impact of some efficiencies generated from the merger. The merged council may be considered unfit on IPART's assessment criteria as the benchmark should be met by 2020, although we note, merging councils may be granted an extension of time
- The Asset Renewal Ratio increases over time and remains just below the benchmark until 2023. This will directly impact on the infrastructure backlog ratio
- The Asset Maintenance Ratio remains around benchmark at 85% but does not meet the benchmark
- The Infrastructure Backlog Ratio is 11% in 2016 and remains steady before slightly decreasing to 8% in 2022

The performance against the benchmarks overtime is set out in the graphs below with the results in each case compared to the performance of Council over the same time period.

Figure 2 Operating performance ratio

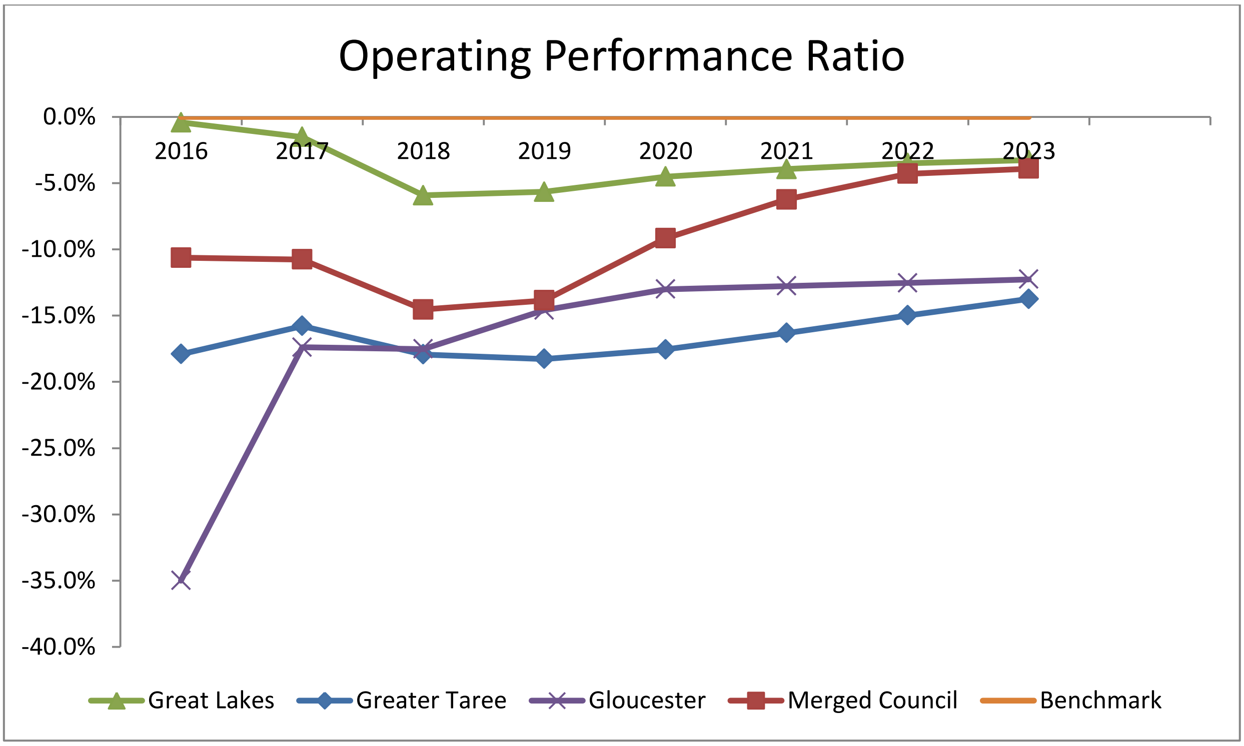


Figure 3 Own source revenue

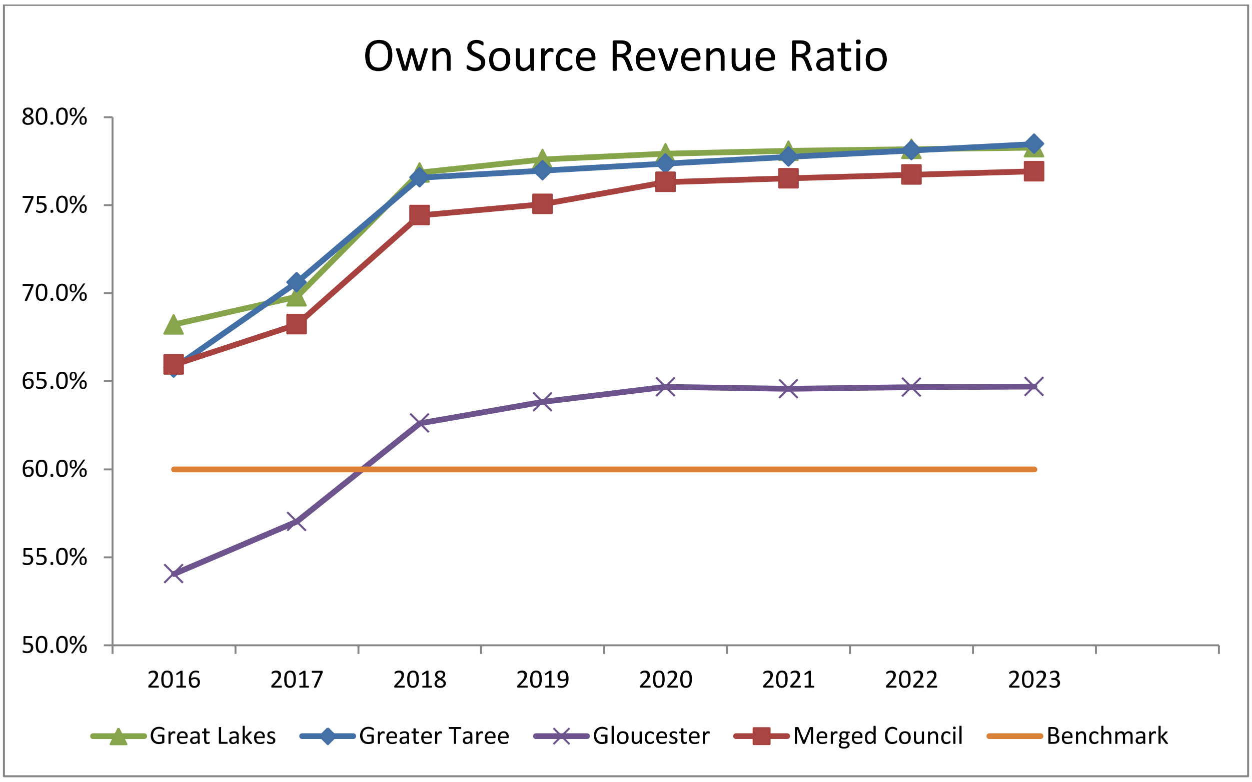


Figure 4 Debt service ratio

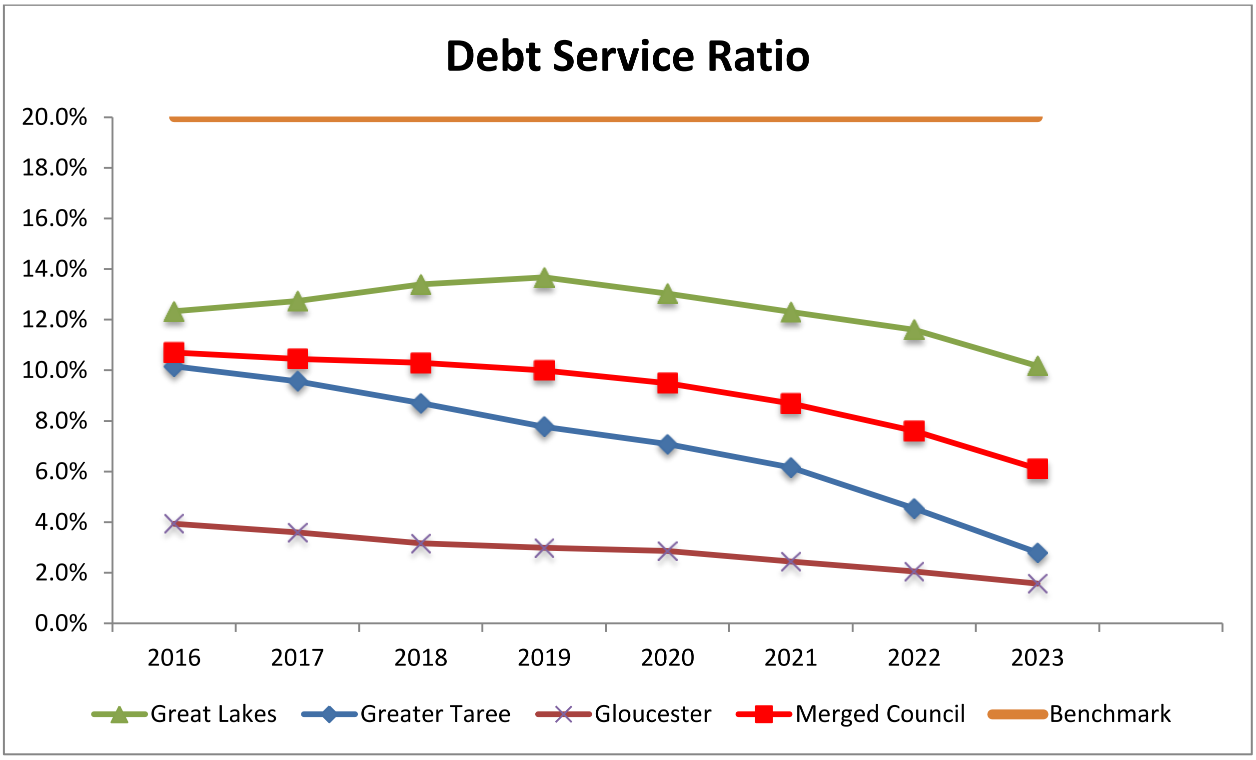


Figure 5 Asset renewal ratio

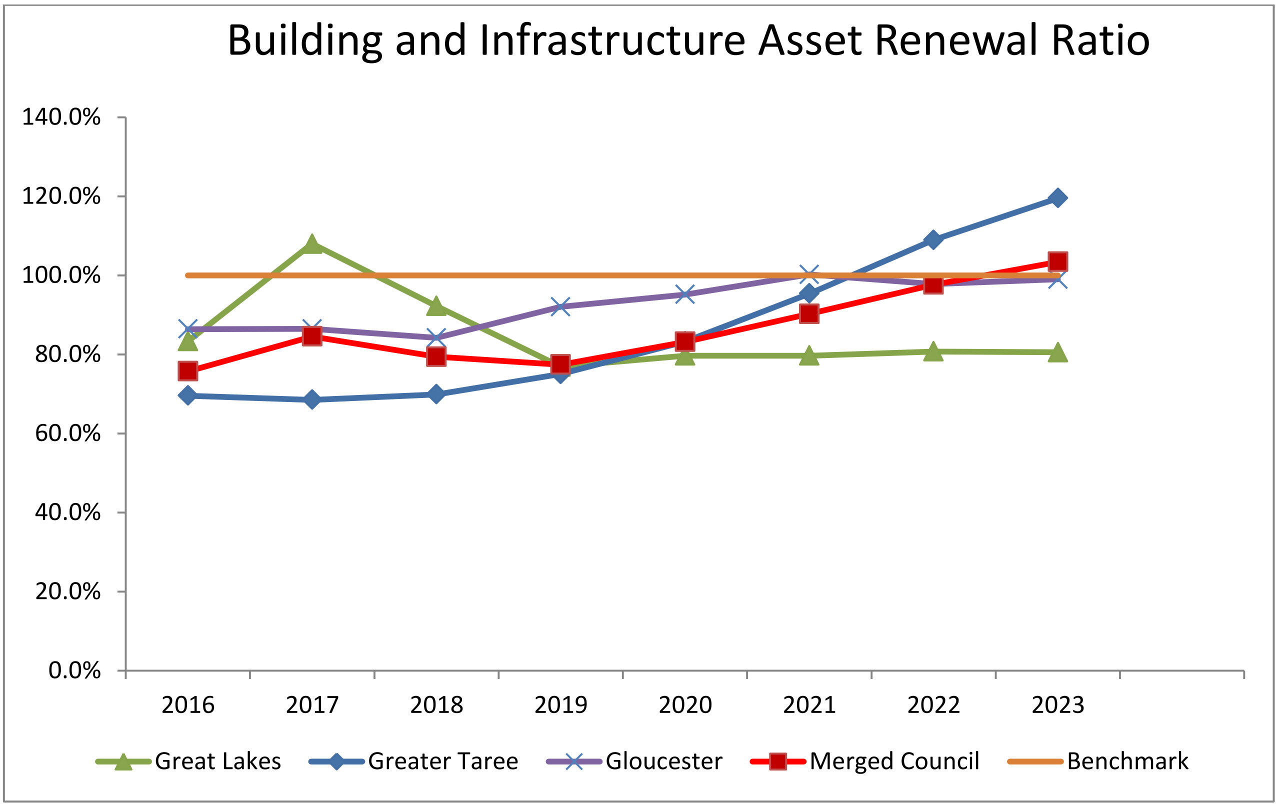


Figure 6 Infrastructure backlog ratio

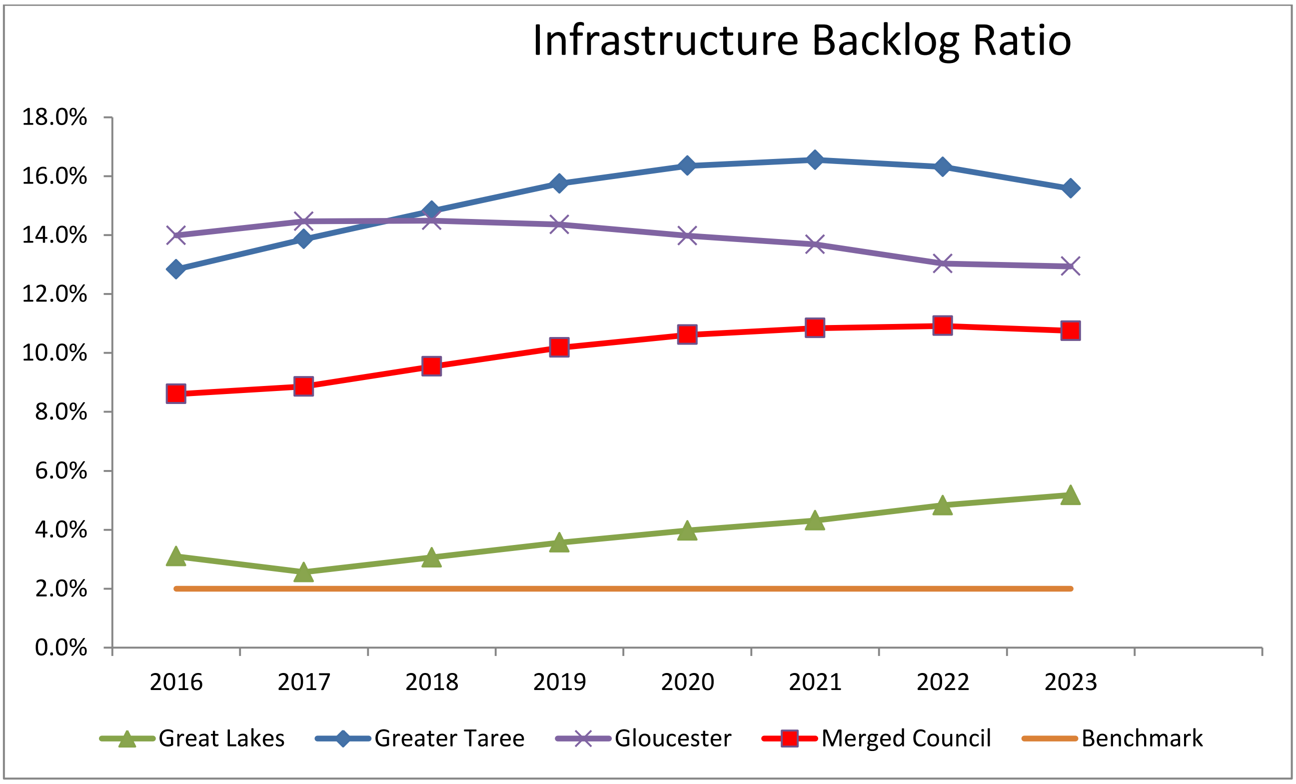


Figure 7 Asset maintenance ratio

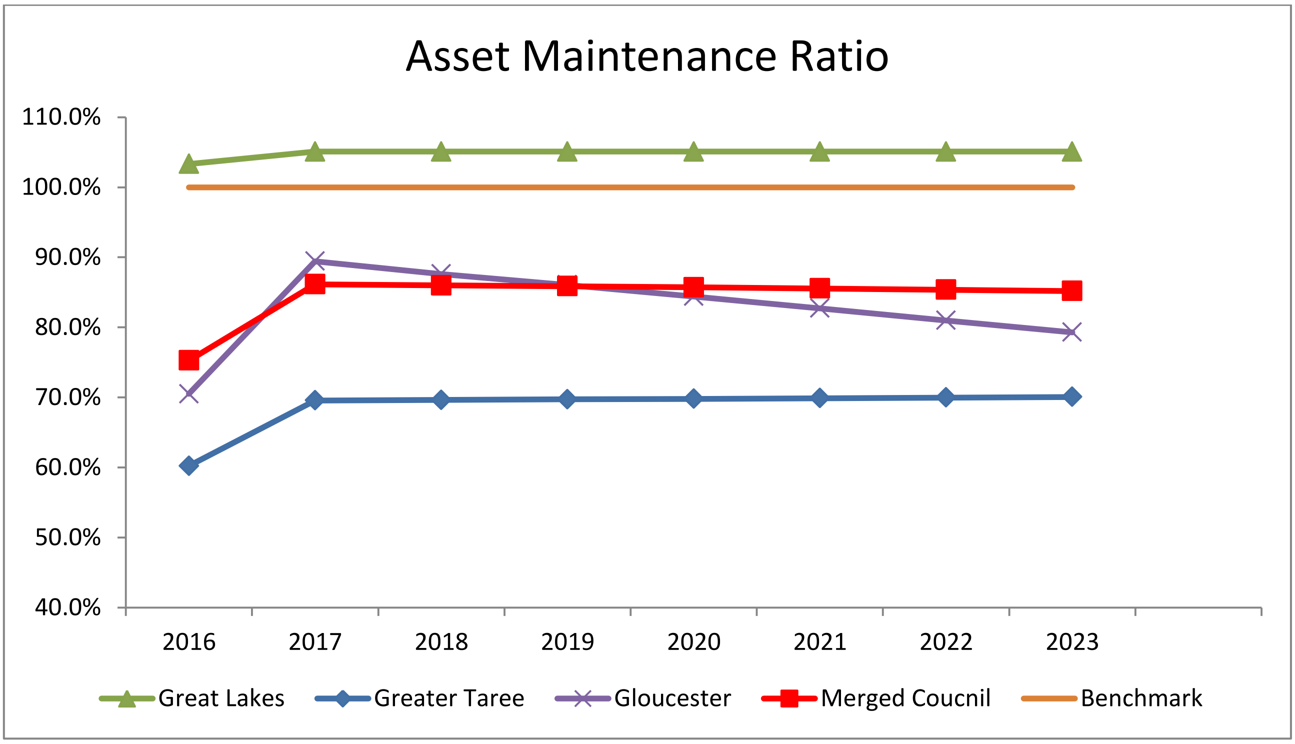
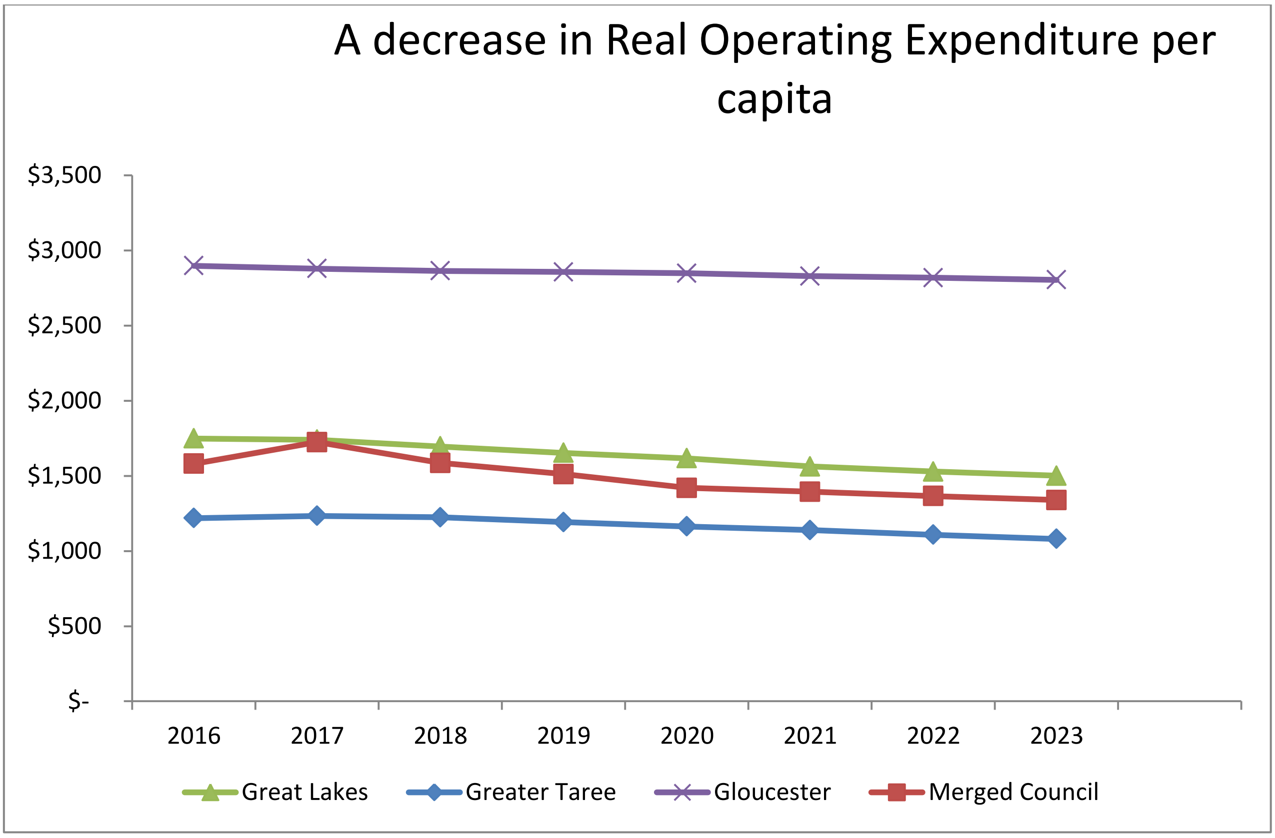


Figure 8 Real operating expenditure per capita



Debt

The councils carry different levels of debt but the debt levels are reasonably consistent with the size of the organisations. While all three councils meet the Debt Service Ratio, taking on the debt of other communities can often be a significant issue to manage in a transition to a merged council. The table below highlights the differences in debt levels between the councils.

Table 3 Comparison of debt[13]

Council	Debt ($000)	Debt Service Ratio	Debt per Capita ($)
Great Lakes	$47,293	11.9%	$1,300.16
Greater Taree	$22,284	10.1%	$455.59
Gloucester	$3,446	4.3%	$689.20
Merged Council	**$73,023**	**10.6%**	**$808.79**

Rates

Modelling the changes in rates in a merger is very difficult to do with any degree of accuracy as there are a number of significant differences in the rating systems of the three councils which impact on the rates charged to an individual property. In the time available, it has not been possible to analyse the changes in rates that may arise.

Any of the merger options would need to align the rates over time across the communities that would now be contained within a single council area.

Representation

One of the biggest negative impacts from a merger of the councils is on representation. The number of people represented by each councillor will increase significantly under a merger making it more difficult for residents to access their councillors and the council.

Based on a merged council with nine councillors, each councillor would represent 10,015 residents. Great Lakes residents will receive significantly less representation than they are accustomed to (one councillor per 4,035 residents), while Gloucester residents will also receive significantly less representation than currently (one councillor per 711 residents).

[13] Based on 2014 Actual

Table 4 Comparison of representation

Council	Councillors	Representation (population / Councillor)
Great Lakes	9	4,035
Greater Taree	9	5,427
Gloucester	7	711
Merged Council	9	10,015

While measures can be put in place to address a loss of representation through local or community boards, at present the Government has not set out in detail any proposal that the community could consider.

Financial costs and savings of the merger

The costs and savings of the mergers arise throughout the period being modelled. The costs and savings should not be considered in isolation. They only form part of the information on which a decision should be made and, in particular, the overall financial performance of the merged council and projected asset expenditure.

In the initial transition period, for any of the options, there are costs associated with creating the single entity (structure, process, policies, systems and branding). Costs continue to arise through redundancies of senior staff and the implementation of a single IT system across the new council, which has significant cost implications. Further costs arise in the medium and longer term largely from redundancy costs (one off) but increasingly from an overall increase in staff numbers which is typical of merged councils and considered to arise as a result of increased services and service levels.

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

Tables 5 - 7 provide a summary, narrative and financials of the costs and savings of the merger. The detailed assumptions are set out in Appendix B. All costs and savings arising from the merger are in comparison to the current operating costs of the combined councils.

The merged council is modelled on the basis of a combined LTFP where all council costs and revenues set out in the LTFP are brought together. Actual data from the latest financial year (2014/15) has been inserted into that year and this has been compared to the LTFP projections. When loading data for each individual council, every effort has been made to ensure the best available data has been used and any specific assumptions and adjustments for individual councils are noted in Appendix C.

The combined councils' LTFPs have then been adjusted by the costs and savings of the merger with Short (1 - 3 years), Medium (4 - 5 years) and Long Term (6 - 10 years) time horizons. For simplicity, all transitional costs are modelled as taking place within the first three years.

The NPV of the costs and savings over the period being modelled has been calculated, and overall the modelling projects a financial benefit to the three communities arising from the merger of an estimated \$11.2[14] million over 20 years including the government grant.

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

[14] NPV over 20 years using a 9.5%nominal discount rate

Table 5 High level description of financial costs and savings arising from merger

Item	Short Term (1 – 3 years)		Medium term (4 – 5 years)		Long Term (6-10 years)	
	Cost	Benefit	Cost	Benefit	Cost	Benefit
Governance		Reduction in total cost of councillors				
Staff	Redundancy costs associated with senior staff Harmonisation of wages	Reduction in total costs of senior staff	Redundancy costs associated with any reduction in staff numbers Increase in staff costs associated with typical increase in services and service levels from merger. Harmonisation of wages	Reduction in staff numbers in areas of greatest duplication	Increase in staff costs associated with typical increase in services and service levels from merger. Harmonisation of wages	
Materials and Contracts		Limited or no savings in the short term as each of the Councils forms part of the Joint organisation and there are already bulk supply contracts in place		Savings from procurement and network level decisions over asset expenditure		Savings from procurement and network level decisions over asset expenditure
IT	Significant costs to move to combined IT system across entire council					Benefits arise from single IT system and decrease in staff
Assets				Rationalisation of buildings, plant and fleet		
Transitional Body	Establish council and structure, policies, procedures Branding and signage	Government grant				

Table 6 Summary of financial costs and savings for the merger[15][16]

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8
Governance	-311	-320	-330	-339	-349	-360	-370	-381
Staff								
- Redundancies	861	0	0	-952	0	0	0	0
- Harmonisation	1,256	1,293	1,331	1,369	1,409	1,450	1,493	1,536
- Staff cost changes	-1,458	-2,468	-3,483	-6,529	-5,604	-4,627	-3,595	-2,506
IT								
- Transition costs	9,000	4,500	1,500	0	0	0	0	0
- Long term benefits	0	0	0	0	0	917	944	971
Materials and Contracts	-645	-663	-683	-1,314	-1,352	-2,039	-2,099	-2,160
Assets								
- Plant and fleet	0	0	0	-935	0	0	0	0
- Buildings	0	0	0	-462	0	0	0	0
Grants and Government Contributions	-5,000	0	0	0	0	0	0	0
Transitional Costs								
- Transitional body	3,862	0	0	0	0	0	0	0
- Rebranding	750	0	0	0	0	0	0	0
Total	8,316	2,341	-1,664	-9,163	-5,897	-4,658	-3,627	-2,539

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

Table 7 Summary of financial impacts of the merger

Great Lakes, Greater Taree, Gloucester, Councils											
Morrison Low Fit For Future Analysis											
	Actual	Actual	LTFP								
Selected Councils Combined LTFP - 2014/15 Extrapolated	**2014 (000s)**	**2015 (000s)**	**2016 (000s)**	**2017 (000s)**	**2018 (000s)**	**2019 (000s)**	**2020 (000s)**	**2021 (000s)**	**2022 (000s)**	**2023 (000s)**	**2024 (000s)**
Operating Results											
Income Statement	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**
Source: Council Financial Statements and Long Term Financial Plan	**(000s)**	**(000s)**	**(000s)**	**(000s)**	**(000s)**	**(000s)**	**(000s)**	**(000s)**	**(000s)**	**(000s)**	**(000s)**
Rates & Annual Charges	77,168	81,606	84,582	87,227	90,199	93,228	96,276	97,441	100,553	103,771	107,116
User Fees & Charges	12,142	13,553	12,775	13,198	13,680	14,132	14,612	15,099	15,605	16,131	16,676
Grants & Contributions - Operations	28,023	35,900	28,126	33,206	28,565	28,821	29,194	29,567	29,988	30,386	30,885
Grants & Contributions for Capital	23,326	36,193	7,704	6,823	6,661	6,852	6,947	7,195	7,248	7,404	7,532
Interest and Investment Income	4,048	3,512	3,310	3,444	3,543	3,633	3,705	3,758	3,788	3,847	3,904
Gains from disposal assets	2,654	477	50	-	50	-	354	-	50	-	-
Other Income	4,977	7,031	3,680	3,753	3,820	3,898	4,004	4,112	4,224	4,296	4,370
Total Income	**152,338**	**178,272**	**140,228**	**147,651**	**146,517**	**150,565**	**155,093**	**157,172**	**161,457**	**165,835**	**170,483**
Income excl Gains\losses	149,684	177,795	140,178	147,651	146,467	150,565	154,739	157,172	161,407	165,835	170,483
Income excl Gains\losses & Capital Grants	126,358	141,602	132,474	140,828	139,806	143,713	147,792	149,977	154,159	158,431	162,951
Expenses											
Borrowing Costs	5,243	5,083	4,369	4,199	3,695	3,187	2,680	2,175	1,766	1,433	1,277
Employee Benefits	45,413	46,067	48,116	50,079	49,669	49,918	47,181	49,204	50,800	52,473	54,154
Gains & losses on disposal	-	921	-	-	-	-	-	-	-	-	-
Depreciation & Amortisation	45,277	42,432	42,301	43,260	43,478	43,706	43,938	44,190	44,433	44,658	44,875
All other Expenses	53,845	51,913	52,951	68,804	62,253	60,895	60,277	61,660	63,025	64,846	66,579
Total Expenses	**149,778**	**146,416**	**147,737**	**166,342**	**159,095**	**157,706**	**154,075**	**157,230**	**160,023**	**163,410**	**166,885**
Operating Result	**2,560**	**31,856**	**-7,509**	**-18,690**	**-12,578**	**-7,142**	**1,017**	**-58**	**1,434**	**2,425**	**3,598**
Operating Result before grants & contributions for capital purposes	**-20,766**	**-4,337**	**-15,213**	**-25,513**	**-19,239**	**-13,994**	**-5,930**	**-7,253**	**-5,814**	**-4,979**	**-3,934**

Risks arising from merger

There are a number of significant potential financial and non-financial risks arising from this particular merger that will need to be considered, including the following:

- Transitional costs may be more significant than set out in the business case
- The efficiencies projected in the business case may not be delivered
- Savings through any reduction in staff is likely to only impact the smallest community as stated earlier
- The implementation costs may be higher and the anticipated savings may not be achieved
- Decisions, subsequent to the merger about the rationalisation of facilities and services, may not reduce the cost base of the merged organisation as originally planned
- The cultural integration of the council organisations may not go well resulting in low morale, increased staff turnover rate etc. This would reduce business performance and prolong the time it takes for the predicted efficiencies to be achieved
- Service levels rise across the merged council, standardising on the highest level of those services that are being integrated
- New services are introduced that are not currently delivered in one or more of the former council areas
- The financial performance of the merged council is less than that modelled, resulting in the need to either reduce services, find further efficiency gains and/or increase rates to address the operating deficit
- Developing a governance model that represents the communities of interest across the proposed merger area

If the new council chooses not to follow through with the reduced staffing as projected, this will affect the financial viability of the merged council.

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

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

The restructuring of any business activity is always a source of potential risk and the merging of council organisations is no exception. A proper risk assessment and mitigation process is an essential component of any structured merger activity.

Notwithstanding the above, this report is not intended to incorporate or deliver a detailed risk management strategy for any merger of the councils. However, it is possible to at least identify the major risks involved in the process from a strategic perspective.

Infrastructure expenditure

The merger analysis shows a large expenditure gap in relation to required asset expenditure. Additional asset expenditure is required to fully fund the gap in

- Infrastructure renewals
- Infrastructure backlog
- Infrastructure maintenance.

Renewals

Using each council's projections as a base, the new council will meet the necessary funding for asset renewals in 2023. Prior to that the Council will have a funding deficit as shown below.

Council	Average predicted annual renewals $,000	Average required annual renewals $,000	Gap $,000
Merged Council	32,886	36,312	-3,425

Backlog:

We have assumed that, if the merged council is not fully funding infrastructure renewals the condition of assets will deteriorate and the backlog increase. In our view to reduce the backlog a council must allocate renewal expenditure to maintain and improve the overall condition of the network. This will require renewal expenditure of greater than 100% until asset condition improves and a backlog ratio of less than 2% is achieved.

We have calculated the additional renewal expenditure required to reduce the backlog ratio to below the benchmark in five years. Once the benchmark is achieved then renewal expenditure can be maintained at 100% so that the overall asset condition is maintained.

The additional renewal expenditure required to reduce the backlog to the benchmark in five years is indicated in the table below

Council	Cost to satisfactory $,000	Target Backlog $,000	Reduction Required $,000	Per year (5 years) $,000
Merged Council	132,613	29,939	-102,674	-20,535

Asset Maintenance:

The merged council is not sufficiently funding asset maintenance and does not meet the benchmark. The table below highlights the gap in maintenance expenditure for the merged council.

Council	Actual Annual Maintenance $,000	Estimated Required Maintenance $,000	Gap $,000
Merged Council	19,917	23,285	-3,368

Overall:

The table below highlights the overall asset expenditure gap for the merged organisation.

Council	Asset Maintenance $,000	Renewals $,000	Infrastructure Backlog $,000	Average funding required per annum (1 -5 years) $,000	Average funding required per annum (>5 years+) $,000
Merged Council	-3,368	-3,425	-20,535	-27,328	-3,368[17]

The table highlights a significant infrastructure expenditure gap for the merged organisation. The new organisation would need to spend an additional $27.3 million per years for five years and beyond 2023 an ongoing additional $3.4 million per year after to fully fund its infrastructure needs. This poses a significant ongoing risk to the merged organisation.

Subsequent events and policy decisions

The primary risk is that the efficiencies projected in the business case are not delivered. This can occur for a variety of reasons; however, the highest risk is that subsequent events are inconsistent with the assumptions or recommendations made during the process.

Those events may arise from regulatory changes between analysis and delivery or subsequent policy decisions about service levels or priorities. As an example, a policy decision to adopt a “no forced redundancies” position after the statutory moratorium expires is unlikely to deliver on the financial savings proposed.

Similarly, decisions made subsequent to the merger about the rationalisation of facilities and services may not reduce the cost base of the merged organisation as originally planned.

This clearly highlights the significant risk that the benefits of the merger may not be achieved.

Conclusions

Whilst this report does not seek to make any recommendation, either for or against the merger, based on the

17 Beyond 2023 the merged Council fully funds renewals and this has already been taken into account.

merger modelling some conclusion can be clearly drawn.

- Great Lakes Council was deemed Fit for The Future by IPART
- The merged organisation has a significant infrastructure gap of $27.3 million per year for five years and $3.4 million per year thereafter. The organisation will have to fund the additional expenditure during a time when rates cannot increase and significant merger costs are incurred
- As a result of insufficient infrastructure expenditure, it is likely that the infrastructure condition will not significantly improve
- There is a significant risk that the benefits from the merger will not be realised and as such there will be an additional cost to the community as a result of the merger

Appendix A IPART Individual Council Assessments

GREAT LAKES COUNCIL – CIP

FIT

Area (km^2)	3,380	Population	2011	35,750
OLG Group	4		(2031)	38,500
ILGRP Group	G	Merger	2011	40,750
			(2031)	43,350
Operating revenue (2013-14)	$63.5m	TCorp assessment		Moderate FSR Neutral Outlook
ILGRP options (no preference)	Council in Mid-North Coast JO (all shaded) or merge with Gloucester (yellow).			

Assessment summary

Scale and capacity	**Satisfies**
Financial criteria	**Satisfies overall**
• Sustainability	Satisfies
• Infrastructure and service management	Satisfies
• Efficiency	Satisfies

Fit for the Future – FIT

- The council satisfies the scale and capacity criterion.
- The council satisfies the financial criteria overall. It satisfies the sustainability, infrastructure and service management and efficiency criteria.

Scale and capacity – satisfies

- The council's proposal is consistent with the ILGRP's option to stand alone.
- We consider the council currently meets or partially meets most of the elements of scale and capacity.
- We note that the council is currently participating in the Hunter pilot JO and the OLG has allowed it to join the Hunter JO rather than the Mid-North Coast JO.
- The council engaged Morrison Low to undertake a business case for the ILGRP option to merge with Gloucester, which resulted in a negative NPV of -$1m over 8 years. On this basis, both councils decided not to pursue the merger.
- Our analysis of this business case suggests the merger would generate benefits of $11m over 20 years (including the Government grant). While this evidence suggests a merger may be a better alternative to the council's proposal to stand alone, our finding is based on the proposal being consistent with the ILGRP option to stand alone.

Sustainability – satisfies

- The council satisfies the criterion for sustainability based on its forecast to meet the benchmarks for the operating performance ratio and the own source revenue ratio by 2019-20.
- Although the council's forecast to meet the operating performance ratio benchmark in 2019-20 is marginal, further improvement in the ratio is forecast to 2024-25.
- While the building and infrastructure asset renewal ratio is slightly below the benchmark in 2019-20, it peaks at around 128% in 2015-16.
- In its proposal, the council relies on the successful application for and adoption of a special variation from 2016-17 of 20.7% cumulative over 4 years (10.3% above the rate peg).

Infrastructure and service management – satisfies

- The council satisfies the criterion for infrastructure and service management based on maintaining its asset maintenance ratio at the benchmark level and having an asset backlog ratio which meets the benchmark.
- The council undertook community consultation in 2014 to determine the community's preferences regarding asset quality, cost and service levels. Feedback from this consultation resulted in a reduction in asset service levels and the required cost to bring assets to a satisfactory condition, thereby improving the infrastructure asset backlog ratio.
- The debt service ratio is forecast to meet the benchmark in 2019-20.
- The council states it historically received $3m-$5m in grants and contributions for capital purposes, but given the variability and uncertainty of approval surrounding these, it has conservatively included $1.17m of grants and contributions annually from 2016-17.

Efficiency - satisfies

- The council satisfies the criterion for efficiency based on forecast decreases in real operating expenditure per capita over time.

Other relevant factors	
Social and community context	Morrison Low compared Great Lakes and Gloucester communities, noting similar features such as demographics, a well-developed focus on environmental protection and many aligned policies. Differences include the councils' approaches to infrastructure: Gloucester focuses on maintaining the core elements and Great Lakes refers to managing its environment with quality lifestyle opportunities.
Community consultation	Great Lakes Council's proposal has not outlined details of any community consultation undertaken on Fit for the Future. In 2014, it consulted its community on asset service levels to inform its Asset Management Plans.
Water and/or sewer	The council does not have water/sewer businesses.
Submissions	We received 5 submissions regarding Great Lakes Council's proposal. All support amalgamation stating discontent with the current council and believing there would be benefits from a merger. Two of these submissions supported a merge with Port Stephens Councils. One late submission was received which raised concerns about council management.

GREATER TAREE CITY COUNCIL – CIP

NOT FIT

Area (km^2)	3,731	Population 2011	48,100
OLG Group	4	(2031)	51,900
ILGRP Group	G	Merger 2011	53,100
		(2031)	56,750
Operating revenue (2013-14)	$52.3m	TCorp assessment	Very weak FSR Negative Outlook
ILGRP options (no preference)	Council in Mid-North Coast JO (all shaded) or merge with Gloucester (yellow).		

Assessment summary

Scale and capacity	**Satisfies**
Financial criteria:	**Does not satisfy overall**
• Sustainability	Does not satisfy
• Infrastructure and service management	Does not satisfy
• Efficiency	Satisfies

Fit for the Future – NOT FIT

- The council satisfies the scale and capacity criterion.
- The council does not satisfy the financial criteria overall. Although it satisfies the efficiency criterion, the council does not satisfy the infrastructure and service management criterion.
- It also does not satisfy the sustainability criterion as a result of its forecast for a negative operating performance ratio by 2019-20.
- We consider a council's operating performance ratio is a key measure of financial sustainability that all Fit for the Future (FTFF) councils should meet, therefore the council is not fit.

Scale and capacity – satisfies

- The council's proposal is consistent with the ILGRP's option to stand alone.
- The council currently meets or partially meets most of the elements of scale and capacity.
- The council's 2031 forecast population represents 91% of the suggested merged entity's forecast population. The suggested merged entity would not greatly increase scale and capacity compared with Greater Taree as a stand-alone council.

Sustainability – does not satisfy

- The council does not satisfy the criterion for sustainability because it does not meet the operating performance ratio benchmark by 2019-20. The operating performance ratio was -24.2% in 2014-15 and will improve to -2.3% by 2019-20.
- The council meets the benchmark for own source revenue by 2019-20.
- The building and infrastructure asset renewal ratio is forecast to be 75.9% by 2019-20, which is below the benchmark.
- In its financial planning, the council assumes the successful application for and adoption of a special variation from 2016-17 of 63.2% cumulative over 6 years (47.2% above the rate peg).

Infrastructure and service management – does not satisfy

- The council does not satisfy the criterion for infrastructure and service management based on its forecasts of a high infrastructure backlog ratio.
- The infrastructure backlog ratio was 24.1% in 2014-15 and is forecast to improve to 11.8% by 2019-20, which remains above the benchmark. According to the Long Term Financial Plan, it would not meet the benchmark by 2024-25.
- The council meets the benchmark for the asset maintenance and debt service ratios.
- The council intends to change its approach to asset service levels. It will consult the community in the coming months proposing the 'satisfactory condition' of a road is less than condition 1 or 2.

Efficiency - satisfies

- The council satisfies the criterion for efficiency based on a forecast decline in real operating expenditure per capita over the outlook period.

Other relevant factors	
Social and community context	The council has not included much information on the social and community context in regards to this proposal other than stating it is in the growth corridor of NSW. It has suggested border changes such that Greater Taree would include the communities currently to the north of the Great Lakes LGA which it considers are strongly connected with the Mid-North coast
Community consultation	The council has not indicated it undertook community consultation regarding its Fit for the Future application.
Water and/or sewer	The council does not supply water/sewerage services.
Submissions	We received one submission regarding Greater Taree's submission, stating the council is not Fit for the Future.

GLOUCESTER SHIRE COUNCIL – CIP

NOT FIT

Area (km^2)	2,996	Population: 2011	5,000
OLG Group	10	2031	4,850
ILGRP Group	F	Mergers: 2031	43,350 with Great Lakes 56,750 with Greater Taree 95,250 all three councils
Operating revenue (2013-14)	$10.2m	TCorp assessment	Very weak FSR Negative Outlook
ILGRP options (no preference)	Council in Mid-North Coast JO (all shaded) or merge with Great Lakes and/or Greater Taree (both yellow).		

Assessment summary

Scale and capacity	**Does not satisfy**
Financial criteria	**Does not satisfy overall**
• Sustainability	Does not satisfy
• Infrastructure and service management	Satisfies
• Efficiency	Satisfies

Fit for the Future – NOT FIT

- The council does not satisfy the scale and capacity criterion.
- Scale and capacity is a threshold criterion which councils must satisfy to be Fit for the Future (FFTF), therefore the council is not fit.
- The council does not satisfy the financial criteria overall. Although it satisfies the infrastructure and service management and efficiency criteria, it does not satisfy the sustainability criterion.
- The council does not satisfy the sustainability criterion because its forecast to meet the operating performance ratio benchmark includes the assumed approval of a large proposed special variation which may be unreasonable.
- We consider the operating performance ratio benchmark is a key measure of financial sustainability that all Fit for the Future (FTFF) councils should meet, therefore the council is not fit.

Scale and capacity - does not satisfy

- The council's population is forecast to decline 4,850 by 2031 based on DP&E data. While the council forecasts population growth of 1.8% over the next 10 years, the population is likely to remain below 10,000, which the ILGRP considers may place a council at risk of becoming unsustainable. Our analysis suggests the council has insufficient scale to deliver services cost-effectively for its community and to partner effectively with governments compared to the merged entity. Therefore the council's proposal to stand alone does not satisfy scale and capacity.
- The council's current financial position also restricts its regional capacity, and a merged council would have a more robust revenue base.
- A merged council is likely to have improved capabilities and a more robust revenue base, greater scope to undertake new functions and projects, improved integrated planning and regional collaboration.
- The council engaged Morrison Low to undertake a business case for the suggested merger with Great Lakes Council, which showed a negative NPV from the merger. Based on this model, our analysis suggests the merger could produce net benefits of $11m over 20 years (including the Government grant).

Sustainability - does not satisfy

- The council does not satisfy the criterion for sustainability. Its forecast for a positive operating performance ratio by 2024-25, which is largely dependent on a successful application and adoption of a large special variation which we consider may not be a reasonable assumption because it could have a high impact on ratepayers.
- We approved a special variation of 44.3% over 3 years to begin in 2015-16 (33.6% above the rate peg). The council relies on the successful application for and adoption of a special variation from 2018-19 of 44.3% cumulative over 3 years (36.6% above the rate peg). Together, these special variations result in a cumulative increase in rates of 108% over 6 years (92% above the rate peg).

	• The council meets the benchmarks for the own source revenue and the building and infrastructure asset renewal ratios by 2019-20. **Infrastructure and service management – satisfies** • The council satisfies the benchmarks for the infrastructure backlog and the debt service ratios. It shows considerable improvement in the asset maintenance ratio but does not meet the benchmark. • The council changed its asset condition assessment methodology to a risk-based approach. This led to a significant improvement in the backlog ratio from 2013-14 to 2014-15 and has contributed to the operating performance ratio improvement through lower depreciation costs. **Efficiency - satisfies** • The council meets the criterion for efficiency based on forecast decreases in real operating expenditure per capita over time.
Other relevant factors	
Social and community context	Gloucester Shire is a small rural area with its economy mainly based on retail and services (43%), farming (20%) and manufacturing (14%) as well as tourism industries. It includes the World Heritage listed Barrington Tops NP. It has an older demographic than the State average. Morrison Low compared Gloucester and Great Lakes communities, noting similar features such as demographics, a well-developed focus on environmental protection, and many aligned policies. Differences include the councils' approach to infrastructure: Gloucester focuses on maintaining the core elements, whilst Great Lakes aims to manage its environment to produce quality lifestyle opportunities through appropriate development. Morrison Low suggests merging unequal sized councils presents a risk of a perceived takeover by the larger council, in this case Great Lakes.
Community consultation	The council consulted its community via: • an information brochure included in the rate notices and handed out at local events • its website • local radio and newspaper • staff information and workshops with councillors. It undertook a survey which showed: • 81% of respondents preferred the council to remain independent (with 11% unsure), • 55% of respondents disagreed that Gloucester should merge with Great Lakes Council (with 25% unsure). Comments related to retaining a local focus and losing representation in a merger, needing to be realistic about the financial situation and potential benefits, and that rural councils require different treatment to Sydney councils.
Water and/or sewer	The council does not have a water/ sewer business.
Submissions	There were no submissions received in relation to Gloucester's proposal.

Appendix B Costs and Benefits Arising from Merger of Great Lakes Council, Greater Taree Council and Gloucester Shire Council

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

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

Queensland Treasury Corporation August 2009 Report

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

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

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

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

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

reflected in a local government's bottom line. This is because local governments, unlike the private sector, are not in the business of making profits. Therefore, it is more difficult to measure the cost savings resulting from amalgamation of local governments than it is for corporations as the benefits will generally be utilised by the amalgamated local government in the provision of services.

The costs and benefits that Morrison Low has modelled for a possible merger of the three councils are described below.

1 Governance and executive team

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

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

	Staff	Duplicated Services	Elected Members	On Costs
Transition Period	Nil	Nil	Nil	Nil
Short Term (1 to 3 years)	Streamlined Management (General Managers and Directors) Natural attrition (voluntary)	General managers, directors, Mayoral/GM support council/committee secretarial support	Reduced councillors and remuneration	Staff associated costs e.g. HR, accommodation, computers, vehicles
Medium Term (3 to 5 years)	Streamlined Management and staff Natural attrition (voluntary)			Staff associated costs e.g. HR, accommodation, computers, vehicles
Long Term (5 years plus)				

1.1 Governance

The formation of a new entity is expected to result in efficiencies resulting from a new governance model and a reduction in the number of existing mayors and councillors. However, this will depend directly on the adopted governance structure including the number of councillors. Estimated governance costs for the new entity have been based on the councillor fees and expenses of Port Macquarie Hastings Council as reported in the Annual Report 2014. It is assumed that there would be thirteen elected members.

1.2 Executive management

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

The general managers' total remuneration for the councils was based on the councils' respective Annual Reports 2014/15, and the amalgamation to a single entity with a single general manager has the potential saving of approximately $252k.

In addition, there would be a rationalisation of the existing director positions. Based on the Annual Reports there are six such positions across the councils with the combined remuneration based on the Annual Reports 2014/15. Assuming that the new entity would retain four director positions, but with changes to responsibilities, this is likely to have a saving in the order of $401k.

It is important to note that while ongoing efficiencies have been identified as effective from the short term, there is the one off cost of redundancies of approximately $1.4m that in our experience is a cost incurred during the transition period. This redundancy cost is based on 38 weeks.

1.3 Rationalisation of services

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

As an example, the councils currently have the resources necessary to support the democratic services and processes including council and committee agendas and minutes. Under a new entity, there is likely to be a duplication of democratic resources and the new entity would need to determine the number of resources required to deliver this service. The expected efficiencies relative to this area are realised in the Corporate Services Section.

Based on our previous experience, one would expect resource efficiencies in a council of this size of between 30 and 40%. The reduction in resources is only likely to occur in the medium term due to the form of employment contracts. However, having said that, there is the potential not to replace positions vacated in the short term, if they are considered to be duplicate positions under the new entity (natural attrition policy). The expected efficiencies relative to this area are realised in the Corporate Services Section.

2 Corporate services

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

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

	Staff	Duplicated Services	Contract/ Procurement	Information Technology	On Costs
Transition Period	Natural attrition (voluntary)	Finance ICT Communications Human Resources Records Customer Services Risk Management			
Short Term (1 to 3 years)	Natural attrition (voluntary)				Staff associated costs e.g. HR, accommodation computers, vehicles
Medium Term (3 to 5 years)	Streamlined management (Tier 3) Natural attrition (voluntary)				Staff associated costs e.g. HR, accommodation computers, vehicles
Long Term (6 years plus)					

2.1 Rationalisation of duplicate services

Consistent with the dis-establishment of three councils and the creation of a single entity, there are a number of back office duplicated services that would be replaced, standardised and simplified. The rationalisation and streamlining of back office services means that there would be an opportunity to rationalise financial reporting, business systems, administrative processes and staff numbers. Examples for the rationalisation of corporate services include:

- Finance - A reduction in finance service costs with the rationalisation of financial reporting and financial planning with a single, rather than three resourcing strategies, long term financial plans, asset management strategies, workforce management plans , annual plans and annual reports needing to be prepared, consulted on and printed. In addition, the centralisation of rates, accounts receivable, accounts payable and payroll, including finance systems will reduce resourcing requirements and costs.
- Human Resources (HR) – The size of the HR resource would be commensurate with the number of FTEs in the new entity based on industry benchmarks. The number of HR resources would be expected to reduce proportionately to the reduction in organisational staff numbers.
- Communications – The resourcing would be expected to reduce since there would be a single website and a more integrated approach to communication with fewer external reporting requirements.
- Customer Services – No reduction in the 'front of house' customer services has been assumed on the basis that all existing customer service centres would remain operative under a single entity and the existing levels of service would be retained. However, there is potential to reduce the number of resources in the 'back office' such as the staffing of the call centre.

The potential efficiency in the corporate services category is difficult to determine largely due to the fact that ICT accounts for a large cost through the transition into the new entity, both in terms of resources and actual cost. However, it is expected that ICT would be implemented in the medium term and due to existing employment contracts, the corporate service efficiencies would therefore only be realised in the medium term. The assumption underpinning the efficiency for corporate services is a 35%[19] reduction in corporate support personnel that has an estimated saving of $4.1 million. On costs are considered to be included as the figures used are based on total employee costs as reported by the councils.

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

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

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

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

3 Areas for further efficiency

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

	Staff	Duplicated Services	Contract/ Procurement	Information Technology	On Costs
Transition Period					
Short Term (1 to 3 years)	Staff turnover	Property/ accommodation, Works Units	Printing, stationary, ICT systems/ licences, legal	ICT Benefits	Staff associated costs e.g. HR, accommodation, computers, vehicles
Medium Term (3 to 5 years)	Streamlined management (Tier 3 & 4)	ICT Resourcing	Waste	ICT Benefits	Staff associated costs e.g. HR, accommodation, computers, vehicles
Long Term (5 years plus)					

3.1 Management

The extent of efficiencies for Tier 3 and Tier 4 is directly dependent on the organisational structure of the new entity, types of services and the manner in which these services are to be delivered in the future, i.e. delivered internally or contracted out.

The Auckland amalgamation resulted in an FTE reduction of almost 60%[2] across the total Tier 1 through to Tier 4 positions. While Section 1 addresses the Tier 1 and Tier 2 efficiencies, there is further opportunity for efficiencies in regard to the Tier 3 and Tier 4 managerial positions although these would only be realised in the medium term. In the case of the Great Lakes / Greater Taree / Gloucester merger the reduction in tier 3 & 4 are included with the 35% reduction in corporate services

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

3.2 Staff Turnover

While the industry average turnover is approximately 9% and on the basis that the new entity adopts a 'natural attrition' policy not to fill positions in the short term, there is an estimated annual efficiency based on applying a modest 4.5% natural attrition.

3.3 ICT Benefits

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

The operational cost savings and reduction of capital expenditure would be as a direct result of rationalising the number of IT systems, business applications, security and end user support from three councils to a single entity. The cost of IT and the number of staff resources required to support it would be expected to decrease over time. FTEs are assumed to reduce over time in line with reduced IT applications and systems. An allowance of 5% of the investment has been applied as a benefit from year 6 onwards.

3.4 Materials and contracts

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

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

Based on the analysis during the project and our experience, the combined savings have been modelled in the short term at 0% and rising to 0.5% over the medium and longer term.

3.5 Properties

There is an opportunity to rationalise and consolidate the property portfolio through assessing the property needs of the new entity and disposing of those properties no longer required for council purposes. The rationalisation of buildings in the first instance is likely to incorporate accommodation associated with the reduction in staff, other obvious areas would include the work depots although the size of the new Council and the distances between centres makes this unlikely.

The councils have a combined buildings portfolio of over $508.5m and for the purposes of modelling the merged council, it is assumed that the council would dispose of 1% of the building assets in the medium term. In the longer term, savings in properties are achievable but should be carried out in a more strategic manner across the combined entity.

3.6 Works units

Staff

Based on our experience of reviewing a large number of works units across NSW, we have found significant savings in all organisations that we have reviewed. As such, it is reasonable to assume that a reduction in staff in the order of 10% across the works areas will be easily achieved in the medium term to reflect the duplication of services across the depots.

Redundancy costs have been modelled for all works staff based on an average of 26 weeks.

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

Plant and Fleet

Based on our experience of reviewing a large number of works units across NSW, most councils have significantly more plant and equipment than reasonably required to undertake their day to day functions. As such, it is reasonable to assume that a reduction in plant and fleet in the order of 5% would be achievable should there be an amalgamation of councils.

4 Services and Service Levels

Typically, merged councils see an increase in staff associated with rises in services and service levels. Research conducted for the Independent Review Panel noted that each of the councils involved in the 2004 NSW mergers had more staff after the merger than the combined councils together[21] and an average over the period of 2002/3 to 2010/11 of 11.7%.

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

5 Transition costs

The formation of the new entity from the current state of the three councils to one will require a transition to ensure that the new entity is able to function on Day 1. This section identifies tasks to be undertaken and estimates transitional costs that are benchmarked against the Auckland Transition Agency (ATA) results and the costs as estimated by Stimpson & Co.[22] for the proposed Wellington reorganisation.

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

[21] Assessing processes and outcomes of the 2004 Local Government Boundary Changes in NSW, Jeff Tate Consulting

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

Governance	• Developing democratic structures (council committees) • Establishing the systems and processes to service and support the democratic structure • Developing the governance procedures and corporate policy and procedures underlying elected member and staff delegations • Developing the organisational structure of the new organisation
Workforce	• Developing the workforce-related change management process including new employment contracts, location and harmonisation of wages • Establishing the Human Resource capacity for the new entity and ensuring all policies, processes and systems are in place for Day 1 • Ensuring that positions required are filled
Finance and Treasury	• Ensuring that the new entity is able to generate the revenue it needs to operate • Ensuring that the new entity is able to satisfy any borrowing requirements • Ensuring the new entity is able to procure goods and services • Developing a methodology for interim rates billing and a strategy for rates harmonisation • Developing a plan for continued statutory and management reporting requirements • Developing a financial framework that complies with legislative requirements
Business Process	• Planning and managing the integration and harmonisation of business processes and systems for Day 1 including customer call centres, financial systems, telephony systems, office infrastructure and software, payroll, consent processing etc. • Developing an initial ICT strategy to support the Day 1 operating environment that includes the identification of those processes and systems that require change • Developing a longer term ICT strategy that provides a roadmap for the future integration and harmonisation of business processes and systems beyond Day 1
Communications	• Ensuring that appropriate communication strategies and processes are in place for the new entity • Developing a communication plan for the transition period that identifies the approach to internal and external communication to ensure that staff and customers are kept informed during the transition period
Legal	• Ensuring any legal risks are identified and managed for the new entity • Ensuring that existing assets, contracts etc. are transferred to the new entity • Ensuring all litigation, claims and liabilities relevant to the new entity are identified and managed
Property and Assets	• Ensuring that all property, assets and facilities are retained by the new entity and are appropriately managed and maintained • Ensuring the ongoing delivery of property related and asset maintenance services are not adversely impacted on by the reorganisation • Facilitating the relocation of staff accommodation requirements as required for Day 1
Planning Services	• Ensuring the new entity is able to meet its statutory planning obligations from Day 1 and beyond • Ensuring that the entity is able to operate efficiently and staff and customers understand the planning environment from Day 1 • Developing a plan to address the statutory planning requirements beyond Day 1
Regulatory Services	• Ensuring that Day 1 regulatory requirements and processes including consenting, licensing and enforcement activities under statute are in place • Ensuring that business as usual is able to continue with minimum impact to customers from Da1 and beyond
Customer Services	• Ensuring no reduction of the customer interaction element – either face to face, by phone, e-mail or in writing from Day 1 and beyond • Ensuring no customer service system failures on Day 1 and beyond • Ensuring that staff and customers are well informed for Day 1 and beyond
Community Services	• Ensuring that the new entity continues to provide community services and facilities • Ensuring that current community service grant and funding recipients have certainty of funding during the short term

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

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

5.1 Transition body

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

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

5.2 ICT

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

Estimating the costs for ICT is inherently difficult due to the complexities associated with integrating systems and applications, and not knowing what the new entity may decide on as a future system. With the limited time to undertake this report, the ICT costs have thus been based on the proposed Wellington reorganisation. A number of ICT scenarios were explored by Deloitte[23] for Wellington. The estimated cost is split between those costs incurred during the transition and the implementation costs post Day 1 that would be the responsibility of the new entity, giving rise to an estimate of ITC transition cost of $25.5m.

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

5.3 Business Process

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

5.4 Branding

The new entity will require its own branding and, as part of this, a new logo will need to be designed. Once agreed, there will be a need to replace some existing signage of the three councils for Day 1 of the new entity on buildings, facilities and vehicles. In addition, it will be necessary to replace the existing website, staff uniforms, letterheads, brochures, forms and other items. The estimated cost for branding is $1.5m based on other amalgamation experience.

5.5 Redundancy Costs

This is based on a reduction from three general managers to one for a merged council and reduction of senior contracted staff is based on employment contracts with a redundancy period of 38 weeks, and based on the councils' respective Annual Reports 2014/15.

5.6 Remuneration Harmonisation

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

5.7 Elections

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

Appendix C Assumptions used in Modelling Council Data

General Assumptions

The latest actual results have been loaded from the 2013/14 and 2014/15 Annual Reports, together with the latest available LTFP. Wherever possible, additional data has been sought to enable the key Fit for the Future ratios to be calculated correctly.

The following specific comments relate to data received from each council.

Great Lakes

Budget data was loaded from the Great Lakes Councils latest LTFP and additional data was supplied by council staff to enable the Buildings and Infrastructure Renewals, Buildings and Infrastructure Backlog and Maintenance Ratios to be calculated.

The base data loaded matches that used for Council's Fit for the Future submission to IPART. The modelling also removed any special rates variations in the first four years of the merger.

There are differences to the IPART submission in the first of three year averages due to the inclusion of actual data for 2014/15.

Greater Taree and Gloucester Councils

Budget data was loaded from an updated LTFP provide to IPART for Council's Fit for the Future submissions. The supplied version matches a revision made following discussions with IPART. The key ratios in the model match those in the LTFP supplied with the exception that the first three years are influenced by the updated actual 2014/15 data.

Employee costs were not disclosed separately in the LTFP so the employee costs per year were calculated based on the stated change in total employee remuneration stated in the supporting data. The Greater Taree proposal included a special rate variation which has been removed from the modelling, similar to the Great Lakes LTFP, and in line with the NSW government guidelines.

As part of the merger model, we have assumed Councils should meet the asset renewal ratio. We have assumed that if assets are not being appropriately renewed then the asset condition will deteriorate and the backlog will increase over time. This is significantly different from the assumptions in Councils IPART proposal. The modelling also removes any special rates variations in the first four years of the merger.

There are differences in the three year averages for the first three years due to the inclusion of actual data for 2014/15.

Appendix D Fit for the Future Benchmarks[24]

Operating Performance Ratio

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

Description and Rationale for Criteria:

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

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

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

Description and Rationale for Benchmark:

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

Own Source Revenue Ratio

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

Description and Rationale for Criteria:

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

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

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

Description and Rationale for Benchmark:

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

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

Debt Service Ratio

Cost of debt service (interest expense & principal repayments)

Total continuing operating revenue (exc. capital grants and contributions)

Description and Rationale for Criteria:

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

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

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

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

Description and Rationale for Benchmark:

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

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

Asset Maintenance Ratio

Actual asset maintenance

Required asset maintenance

Description and Rationale for Criteria:

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

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

Description and Rationale for Benchmark:

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

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

Building and Infrastructure Renewal Ratio

Asset renewals (building and infrastructure)

Depreciation, amortisation and impairment (building and infrastructure)

Description and Rationale for Criteria:

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

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

Description and Rationale for Benchmark:

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

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

Infrastructure Backlog Ratio

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

Description and Rationale for Criteria:

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

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

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

Description and Rationale for Benchmark:

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

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

Reduction in Real Operating Expenditure

Description and Rationale for Criteria:

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

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

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

- can realise natural efficiencies as population increases (through lower average cost of service delivery and representation); and
- can make necessary adjustments to maintain current efficiency if population is declining (e.g. appropriate reductions in staffing or other costs).

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

Description and Rationale for Benchmark:

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

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