Revised Merger Business Case

Maitland and Dungog Councils

November 2015

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Background and scope

Maitland and Dungog Councils have commissioned Morrison Low to undertake a revised high level merger business case to combine the councils improvement plans, review the benefits and costs of a potential merger and consider the funding requirement the has merged Council to meet the key benchmarks that must be achieved by 2020 and demonstrate a favourable trend in the others.

The limited timeframe within which Maitland and Dungog, like all NSW councils, have to make a decision and respond to the Government means that the analysis and this report is a limited study which concentrates on

- revisiting the previous merger model to check and update this where necessary. For example adjusting this to include an improvement modelling by the councils
- reviewing the asset based ratio requirements. Standardised asset approaches were adopted in both improvement models that included savings from a different approach to the way the asset costs were calculated. To be consistent these changes have been applied to the merger model.
- reviewing and improve the cost and benefit calculations in the merger model; in particular the transition costs
- conducting a workshop on the 10th of November to identify any possible further savings a merger could reasonable generate and confirm the assessed costs and benefits.
- incorporating any savings/costs and identify the funding requirement to meet the seven benchmarks within the require periods
- modelling the potential rating implication to fund any remaining shortfall via rates. Given the Maitland residents are funding a second Special Rate Variations approved to address their own financial sustainability, two rating scenarios are used to meet the benchmarks
  - Merging Dungog rates into the Maitland categories
  - Creating a model where Maitland rates remain the same and Dungog ratepayers fund the cost to meet the benchmarks. This option is on the basis that Maitland will meet the benchmarks so residents should not necessarily pay more but by the same token should not have a reduction in rates through a redistribution to Dungog residents. This will also help identify if the merger is a better option for Dungog resident as opposed to the standalone case.
- identifying the risks that remain if the merger is to proceed i.e. both councils merger with having low staff numbers compared to benchmarks, the small communities job protection requirement etc.

In October 2013 the Independent Local Government Review Panel (ILGRP) identified a merger of Maitland and Dungog as an option that should be investigated. In our opinion the ILGRP did not indicate this was a preferred option for the Councils however IPART has subsequently determined that this was the preferred option for both Councils.

For this reason IPARTs report, Assessment of Council Fit for the Future Proposals[1], found that Maitland City Council was not fit as a stand-alone Council as it failed to satisfy the scale and capacity criterion. The same report also found that Dungog Shire Council was unfit as it failed the scale and capacity, sustainability and efficiency criteria.

Maitland and Dungog Councils have until 18 November to respond to these findings.

Merger impacts

This report finds that the merger of **Maitland and Dungog** would not result in financial savings, and produce a range of impacts on the Councils and their communities.

- The overall NPV identifies a net cost of $9.3M from the merger. If an infrastructure grant of $5M is received and is applied to infrastructure renewals then the NPV of the cost will reduce to $4.95m however we understand that any infrastructure grant is more likely to be used to fund a capital project in Dungog which is not in a current LTFP.
- Six of the financial benchmarks are met by 2020[2] under the improved merger scenario when additional rates revenue has been added.
- Dungog ratepayers will face significant rate increases which will see their rates double over the first 4 years (2017-2020).
- The proposed merger fails to deliver a financial benefit for the following reasons:
  - When compared to other similar sized councils both Maitland and Dungog have low staffing levels and savings from a reduction in back office and other staff that would normally be expected during a merger process are unlikely to occur.
  - Given the low staffing base an allowance has been included for staff increases, rather than reductions, at 2% per annum from year 4. Discussions with the councils indicated that increases may be required from year one however we have only made allowance from year 4 onwards.

Key risks

The merger of the two 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 renewal needs of the combined council and managing service level expectations[3]. Both councils have many different service levels and delivery methodologies
3. Addressing the needs of different communities of interest within a merged council area.
4. Having too few staff

1 Assessment of Council Fit for the Future Proposals, Local Government – Final Report, October 2015
2 Methodology for Assessment of Council Fit for the Future Proposals, IPART, June 2015
3 We note that both the Councils report much higher infrastructure backlog in 2015

5. Limitations on creating workforce efficiencies. As the legislation currently stands, staff employed in Maitland will be impacted more than those in Dungog's villages.
6. Additional risks to a new merged council relate to costs not currently provided for in the council's LTFPs including
    1. Potential cost claims arising out of Councils current legal action against the operators of Martins Creek Quarry (Dungog)
    2. Funding commitments for current S94 plan (Dungog)
    3. Potential loss of FAG when equalised for a larger council.

The alternative risk is that in doing nothing the Government undertakes large scale forced mergers across NSW, including Maitland and Dungog as suggested by the ILGRP, and this does not provide the two councils with the funding currently available to voluntary mergers of $5 million[4]. Councils in regional NSW who merge will also have access to the Stronger Communities Fund for grants of $5 million for community infrastructure[5].

4 http://www.fitforthefuture.nsw.gov.au/whats-on-offer-for-councils
5 http://www.fitforthefuture.nsw.gov.au/whats-on-offer-for-councils

Introduction

Modelling the proposed merger

Maitland and Dungog councils have commissioned Morrison Low to undertake further modelling to enable the Councils to have a considered response to the office of local government on a possible merger between Maitland and Dungog.

The previous merger model was reviewed and updated with the latest available information for 2014/15 Annual reports and data from each council's improvement model. The merger assumptions and the costs and benefits were reviewed and updated following a workshop with executive officers from the two councils. A number of merger costs and benefits were revised and the updated costs and benefits are explained in Appendix A.

The improvement model has been used to calculate the amount of additional rates revenue that will be required to enable the new merged council to meet the financial sustainability benchmarks.

The following adjustments were made in the improvement model:

- The additional revenue from the proposed Dungog SRV (6 years at 13% p.a.) has been removed.
- Additional depreciation has been included for Dungog to allow for the fact that the depreciation expense was not inflated in the Dungog LTFP.
- The councils' infrastructure backlog has been adjusted to match the calculation used in the improvement model submitted to IPART.
- Additional asset renewals were added in 2018 ($1m) and 2019 ($1.5m). In later years the renewals have been reduced based on available funds and a reduction associated with the backlog meets the benchmark.
- Sufficient rates revenue to make the new merged council achieve the financial sustainability benchmark in 2020 was modelled. This additional requirement has been attributed to Dungog ratepayers in the rates modelling that has been prepared as part of this report. The additional rates revenue requirement was phased in over 3 years as follows:
  - 2017 additional $1.4m
  - 2018 additional $2.9m (2017 increase plus a further $1.5m)
  - 2019 additional $4.4m (2018 plus a further $1.5m)

The modelling is intended to allow the councils to understand what the benefits and dis-benefits of the potential merger are.

In addition rates modelling has been prepared to show the comparative impacts on Dungog properties through a merger. In the modelling Maitland property rates remain the same as proposed under the approved SRV. The approach taken, has been to calculate what additional rates revenue is required to make the new merged council sustainable. The entire additional revenue requirement has been attributed to Dungog on the basis that Maitland was assessed as financially sustainable so Maitland ratepayers should not be impacted by any additional funding requirements through a merger with Dungog.

Reporting

This report has been prepared to provide the key information required for Maitland and Dungog councils 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. The report focuses on performance against the seven benchmarks and on a short summary of some key potential advantages and disadvantages. However, the relative weighting on each factor that Council then applies will be based on what the Council and its community consider most important.

Limitations

The timeframes for this project have been challenging with a timeframe of two weeks for the work to be undertaken.

Notwithstanding that we fully understand the need for those tight timeframes, that understanding is tempered with recognition that the data available for modelling has some limitations as a result. Data has been standardised across the two Councils involved. Data or issues that fall outside this range or are considered by Morrison Low to raise a risk have been identified within this report.

The data provided within the model is drawn from a variety of sources however it is acknowledged that the timeframe limits our capacity to refine both the available data and the model itself to a fine level of detail. For consistency across the Councils, publicly available information and each council's improvement model used to prepare the submissions to IPART 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

Maitland City Council

IPART believed the ILGRPs preferred option was that Maitland merge with the Dungog Shire Council.

IPARTs report, Assessment of Council Fit for the Future Proposals[6], found that Maitland was not fit as a stand-alone council.

IPARTs assessment concluded that Maitland satisfied the financial criteria but it failed to satisfy the scale and capacity criteria[7]. IPART found Maitland unfit because:

- it did not demonstrate that it could achieve the scale and capacity objectives for the region
- Council did not demonstrate a stand-alone proposal that was as good as the ILGRP's preferred option a merger with Dungog.
- IPART's analysis of the merger business case submitted indicated that a merger would generate net merger benefits over a 20 year horizon.

Dungog Shire Council

The ILGRP stated that Dungog Shire Council should complete an undated financial sustainability assessment and consider a merger with Maitland.

The Council submitted a Council Improvement Proposal (CIP). IPART's report, Assessment of Council Fit for the Future Proposals[8], found that Dungog Shire Council was not fit as a stand-alone council because:

- The Council did not satisfy the scale and capacity criterion
- The Council's did satisfy the sustainability criterion as a proposed 6 year SRV option had not been consulted on with the community.
- The Council did not satisfy the efficiency criterion
- IPART's analysis of the merger business case submitted indicated that a merger would generate net merger benefits over a 20 year horizon.

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, pgs. 279-280.
8 Assessment of Council Fit for the Future Proposals, Local Government – Final Report, October 2015 pgs. 193-194.

The Merger

Issues and Challenges

The largest portion of benefits in a merger arising from the rationalisation of staff and workforces. Both Dungog and Maitland councils have smaller workforces per capita[9] than peer group councils as shown in the table below

Council	OLG group	Number of councils in Group	Group average population per FTE	Dungog/Maitland average population per FTE	Group Rank (highest number of residents per FTE)
Dungog	10	27	72	137	1
Maitland	4	31	125	207	1

While neither council has a water or sewerage function, Dungog and Maitland staff each serve the highest number of residents per FTE amongst their peer groups.

Maitland's Workforce Plan acknowledges this gap and the LTFP makes a small provision for staff increases. Dungog makes no provision in its LTFP for staff growth. After reviewing both councils services and programs, in our view both Councils current LTFPs are not making provision for sufficient staff resources for business as usual or population growth by between $500,000 and $1million per annum. Both Councils should review their current Workforce Plans and LTFPs accordingly.

For this reason, as well the small centre employment protection (discussed under risks), and the limited service/service level offerings of both councils[10] we do not consider a merger of Dungog and Maitland offers any staff saving other than the reduction in one general manager and this is reflected in our cost and benefit analysis. It is likely that staff will need to increase through the merger to manage growth and business as usual.

Given the workforce challenges above we do not consider the merger of the two council would increase the scale and capacity of the new organisation.

Infrastructure Improvement Grant

The councils are aware that a merger will entitle the councils to an infrastructure improvement grant of $5M from the Stronger Communities Fund. Both councils consider that in the event of a merger this grant will be required for new capital expenditure in Dungog and as such this business case makes provision for additional depreciation and operational costs.

9 OLG Comparative Data 2013/14
10 Merger Business Case, June 2015

Fit for the Future benchmarks

The merger of the 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.

There are significant transitional costs identified in this report which mean the operating performance ratio of the merged council is adversely affected in the first few years. Under a merged council scenario (prior to improvements to add additional rates revenue) the merged council is unable to meet the operating surplus benchmark and it also fails to meet the asset maintenance and backlog benchmarks.

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.

In the merger scenario before improvement 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. Based in the reported maintenance levels the merged council fails the asset maintenance ratio however in the improved merger scenario where the maintenance requirements have been reassessed the merged council meets the benchmark.

Infrastructure Backlog Ratio

For the purposes of the merger scenario before improvement each council's assessment of the Infrastructure Backlog as at 30 June 2015 has been assumed to represent the actual amount and this has been combined to represent the backlog of the merged council.

For the merger scenario after improvement the revised calculation in each council's improvement model has been used and this sees the merged council meet the benchmark by 2020.

Merged Council Performance against FFTF Ratios

The table below summarises the merged council performance against the benchmarks with actual performance year on year set out below. IPART has set 2020 as the year by which some benchmarks for regional councils 'must be met' and others 'must show improvement' and the merged council is shown to meet all benchmarks by this date.

The benchmarks which must be met by 2020 are the first three measures shown in the table, which are italicised. We note that merging councils may be given an extended period to meet the benchmarks however for the purposes of this report we have assumed these targets are likely to be applied to the merged council.

Table 1 Merged council options performance against Fit for the Future benchmarks

Indicator	2020 Merged Councils	2020 Merged Councils with Improvements
Operating Performance	*Does not meet the benchmark*	*Meets the benchmark*
Own Source Revenue	*Meets the benchmark*	*Meets the benchmark*
Debt Service Cover	*Meets the benchmark*	*Meets the benchmark*
Asset Maintenance	Does not meet the benchmark	Meets the benchmark
Asset Renewal	Meets the benchmark	Meets the benchmark
Infrastructure Backlog	Does not meet the benchmark	Meets the benchmark
Real Operating Expenditure	Does not meets the benchmark	Does not meet the benchmark

The merged council after improvement includes an increase in revenue required to meet the benchmark Operating Performance Ratio by 2020. A decline in Real Operating Expenditure per capita is not achieved under this scenario largely because there are few benefits and increasing staff numbers are modelled from year four.

A merger without improvements will not meet the Operating Performance, Asset Maintenance, Infrastructure Backlog and Real Operating Expenditure per Capita benchmarks.

The merged council's performance against the benchmarks is shown in the charts below.

Figure 1 Operating performance ratio

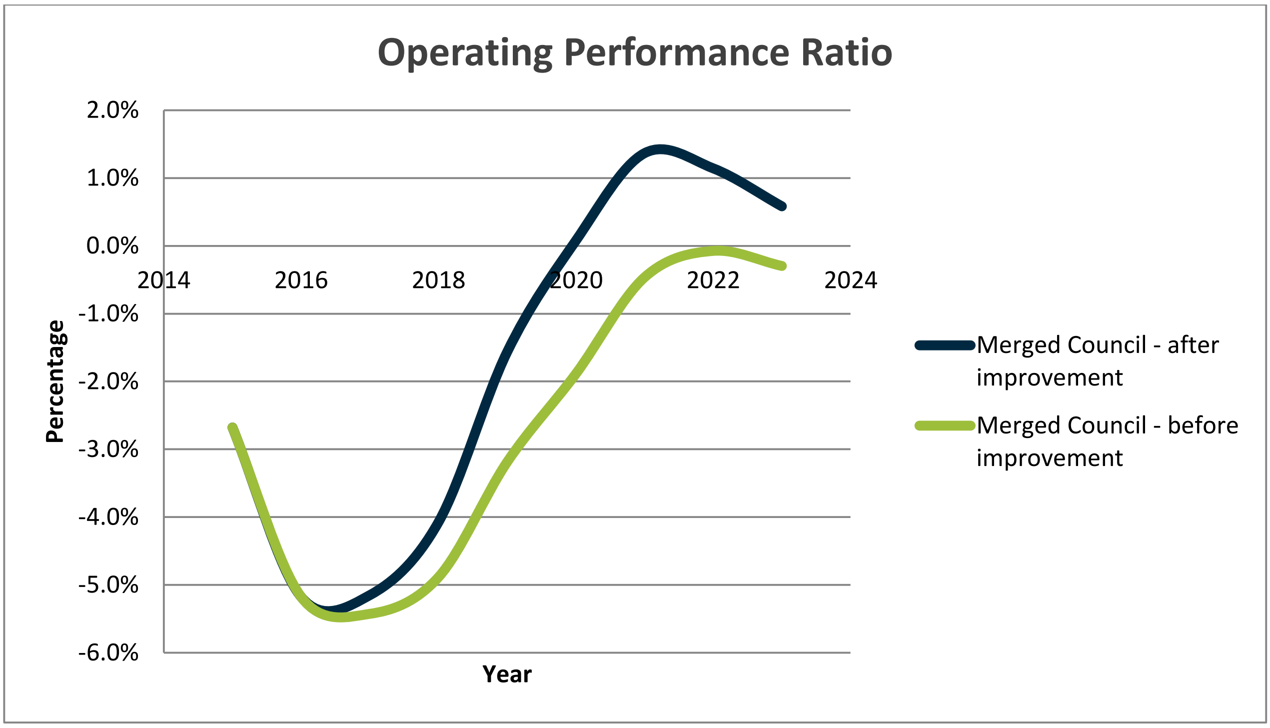


Figure 2 Own source revenue

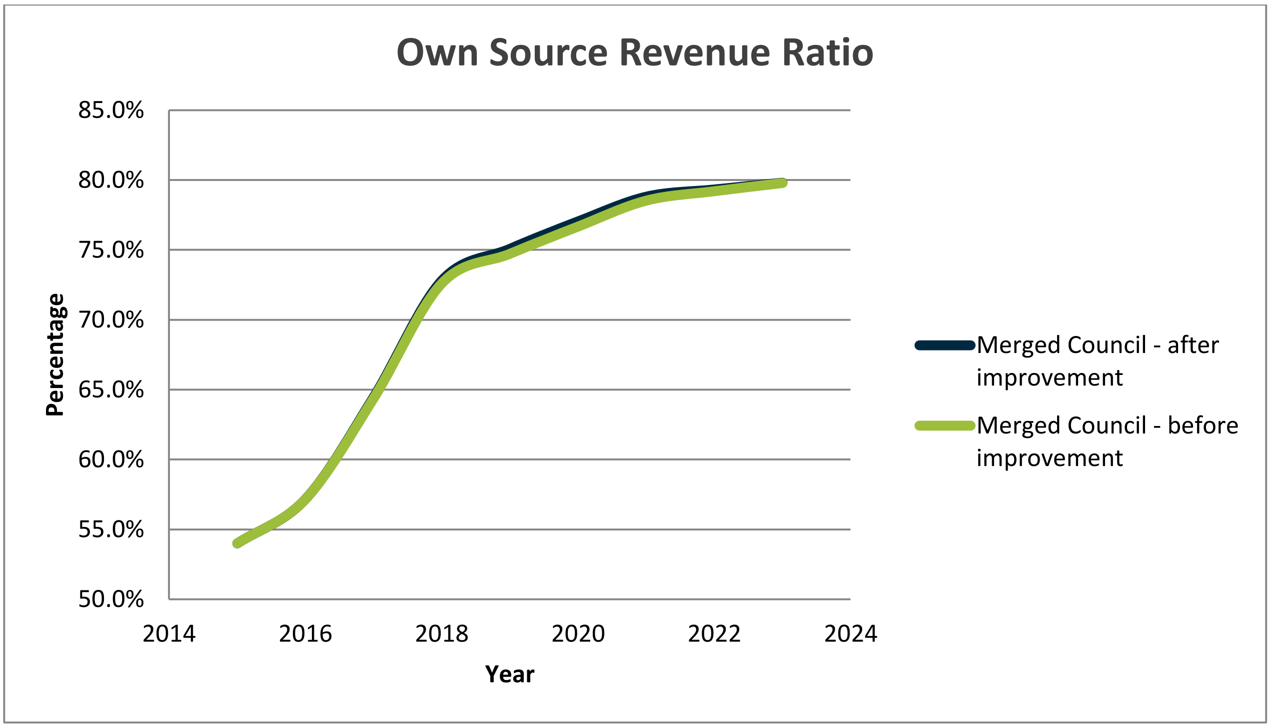


Figure 3 Debt service ratio

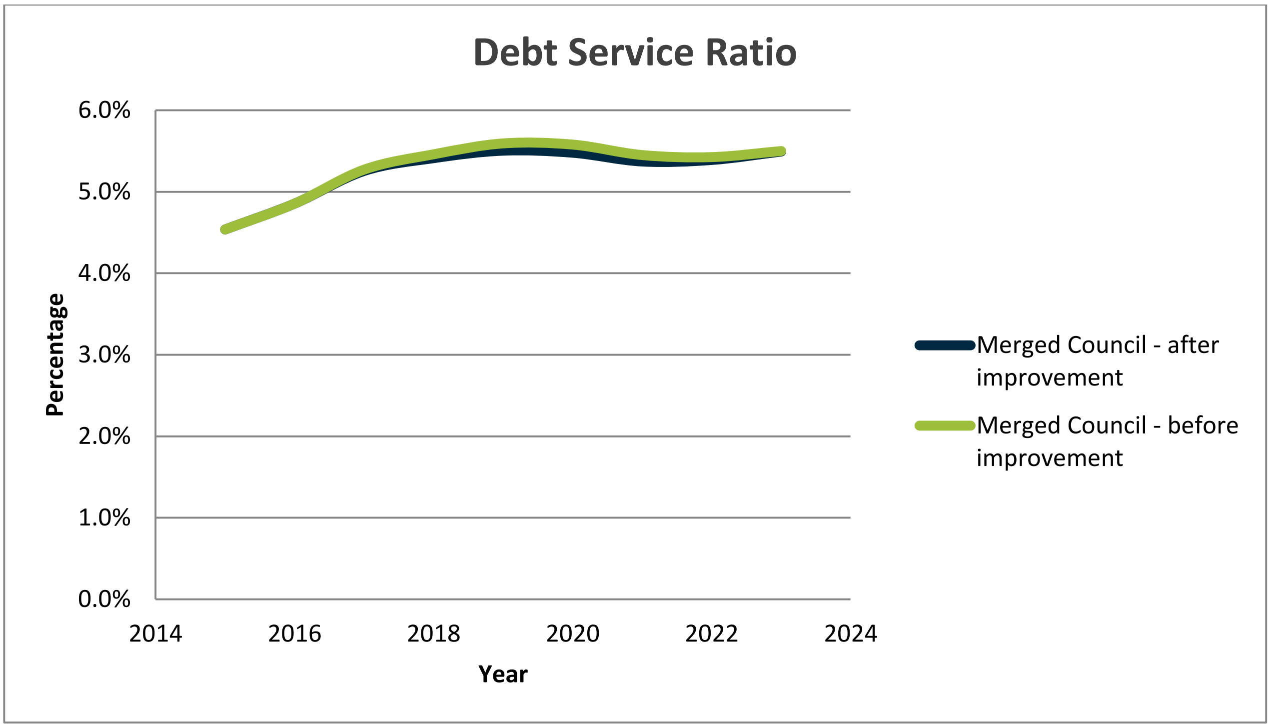


Figure 4 Asset renewal ratio

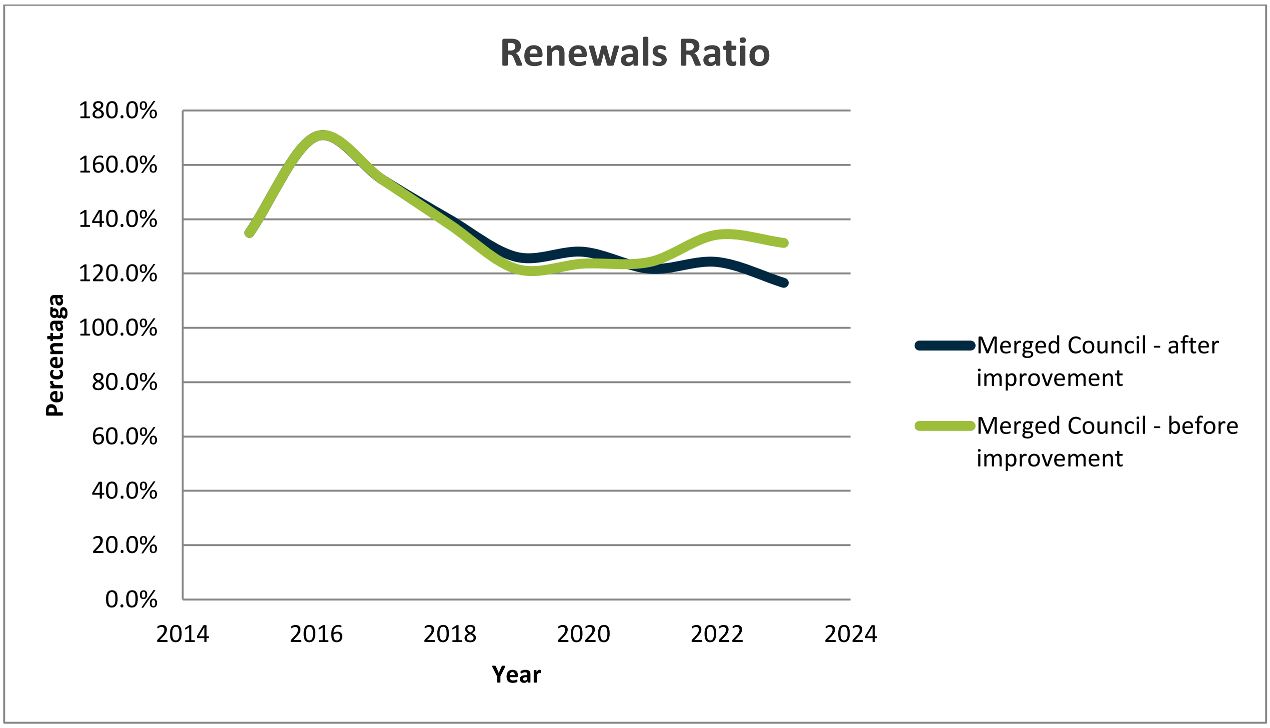


Figure 5 Infrastructure backlog ratio

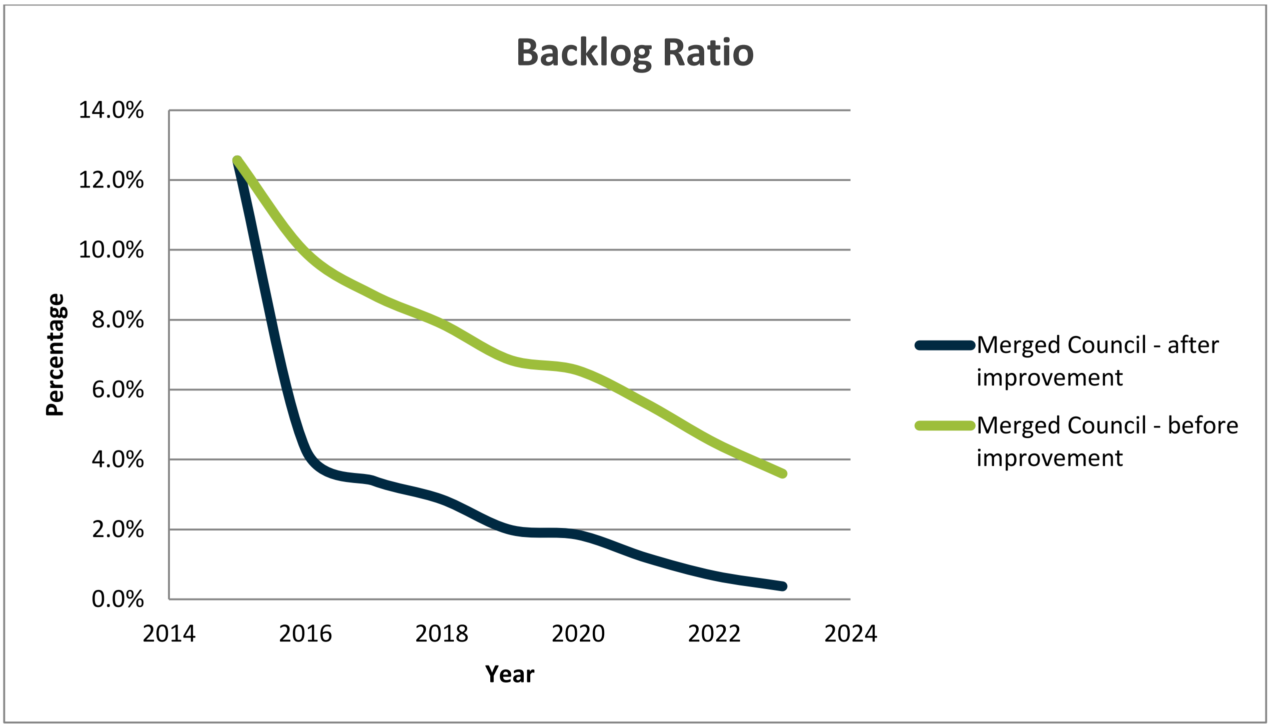


Figure 6 Asset maintenance ratio

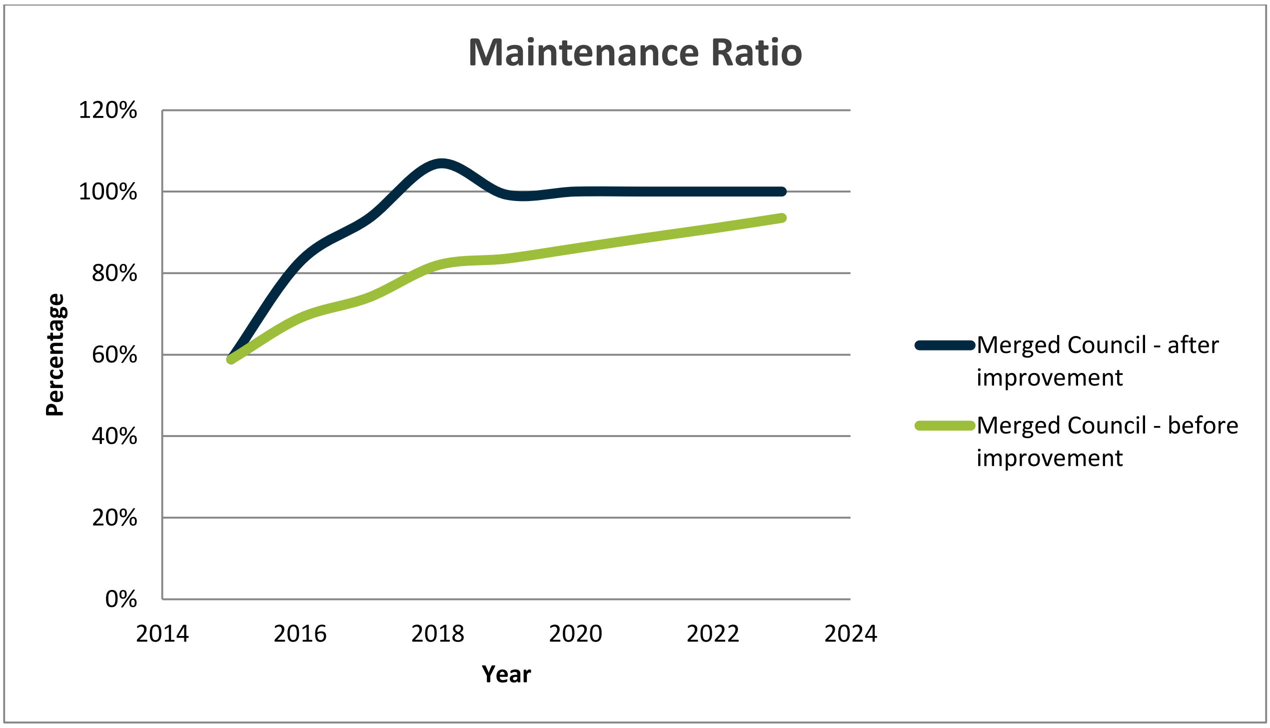
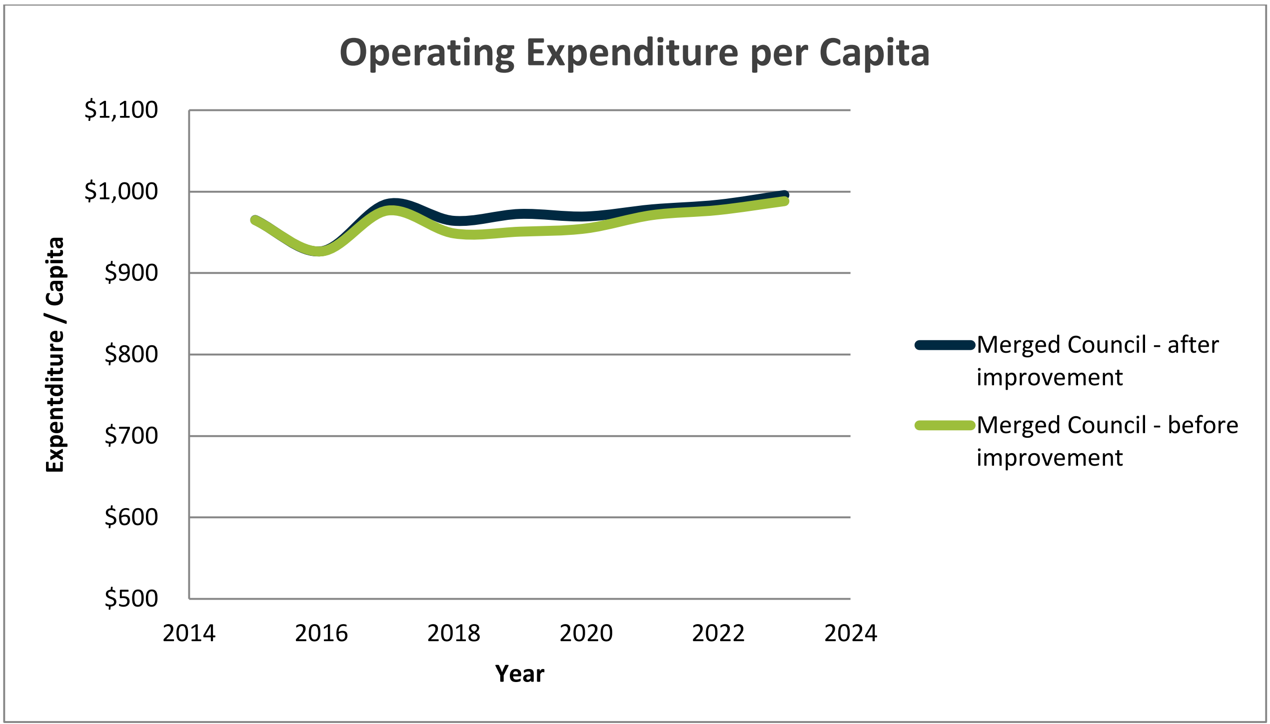


Figure 7 Real operating expenditure per capita



Rates

Different rates scenarios have been modelled to inform both Maitland and Dungog councils on the potential impacts on ratepayers from a merger. The modelling reflects the fact that Maitland was assessed as financially sustainable based on the SRV which has already been approved and was included in the Maitland LTFP. The assumption has been made, for the purpose of the rates options modelled, that any additional rates revenue required to make the merged council financially sustainable is met by Dungog ratepayers, and rates for Maitland will remain as proposed in the Maitland LTFP (and approved SRV application).

The following tables and charts show the results of the modelling for the period from 2015/16 to 2020/21. Four different data sets are considered.

Dungog Base	This shows the profile of the base LTFP (rates increase at 2.6% p.a.)
Maitland	This represents the proposed increases in Maitland rates are shown in the approved SRV application and LTFP.
Dungog Option 1	This increases the Dungog rate in the dollar per category to that of Maitland in 2016/17 and future Maitland SRV rate increases are also applied to Dungog.
Dungog Option 2	This models the impact of increasing Dungog rates progressively over 3 years (2017-2019) to generate sufficient revenue to achieve a positive 3 year average Operating Surplus Ratio by 2020. This requires additional rates of $4.4m by 2019.

Both Dungog Option 1 and 2 (shown in figure 1) will bring the merged council into operating surplus by 2020. The impact of these options are shown in the table below

Dungog Rates - Annual % movement (excluding growth)	2016/17	2017/18	2018/19	2019/20	2020/21
Base LTFP at 2.6% p.a.	2.6%	2.6%	2.6%	2.6%	2.6%
Option 1 = Move to Maitland rate in $	66.4%	7.2%	7.2%	7.3%	7.2%
Option 2 = Fund to meet Benchmark	29.6%	23.0%	18.3%	2.6%	2.6%

The options will generate additional rating income as shown below

Comparison Of Total Dungog Rates	2016/17	2017/18	2018/19	2019/20	2020/21
	$m	**$m**	**$m**	**$m**	**$m**
Base LTFP at 2.6% p.a.	5,519	5,745	5,981	6,226	6,482
Option 1 = Move to Maitland rate in $	8,901	9,680	10,527	11,448	12,450
Option 2 = Fund to meet Benchmark	6,952	8,654	10,366	10,791	11,233

The impact on average rates is shown in the following charts.

Figure 8 Comparison of average rates per property

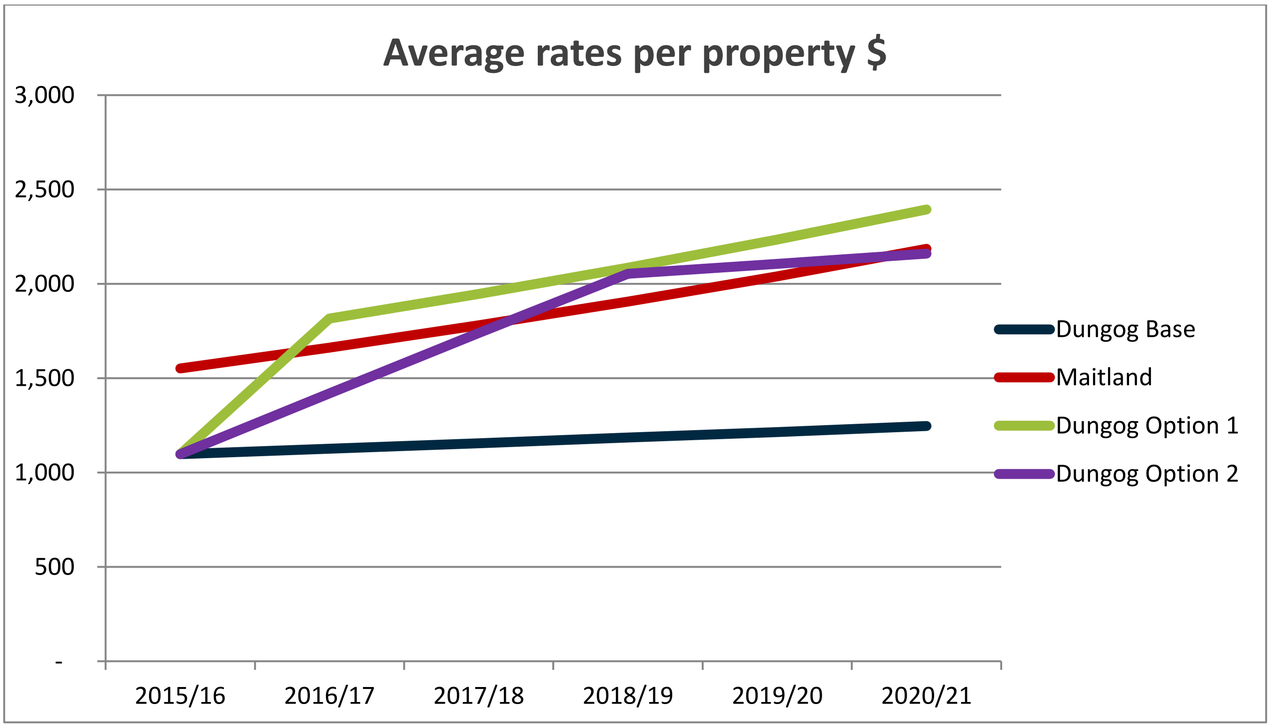
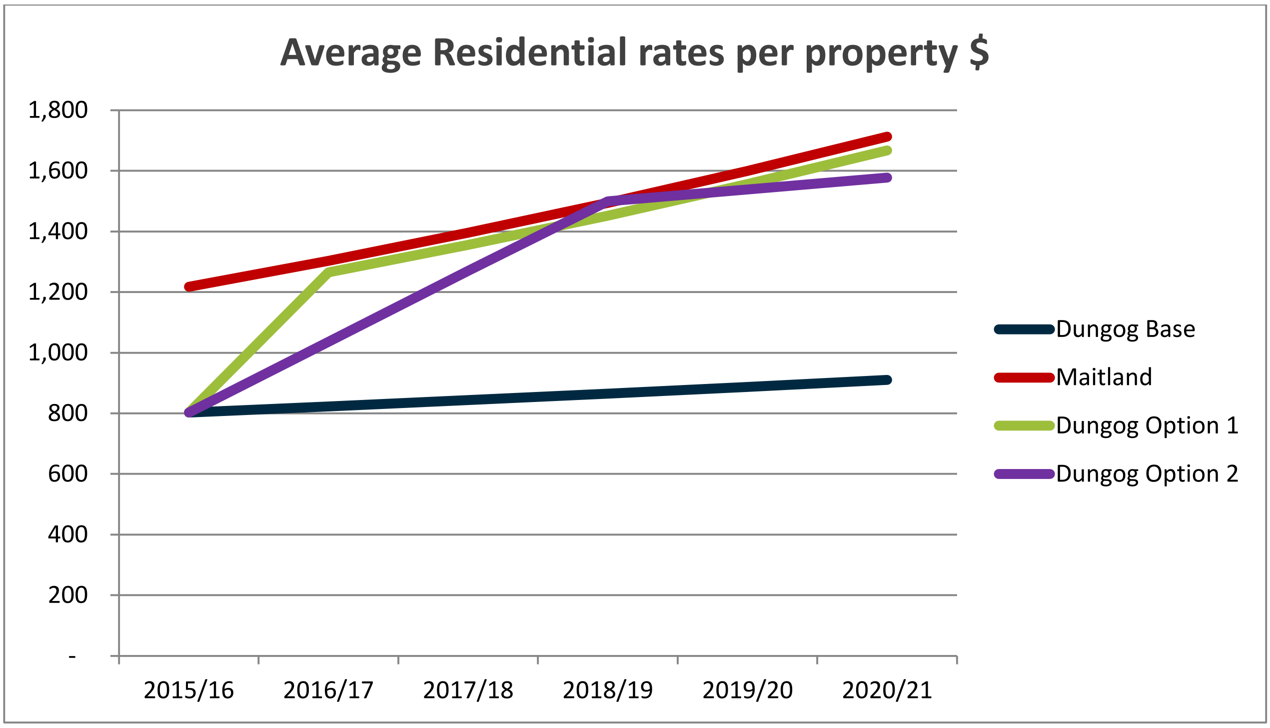


Figure 9 Comparison of average residential rates



Note: Dungog residential and rural residential combined.

Figure 10 Comparison of average farming rates

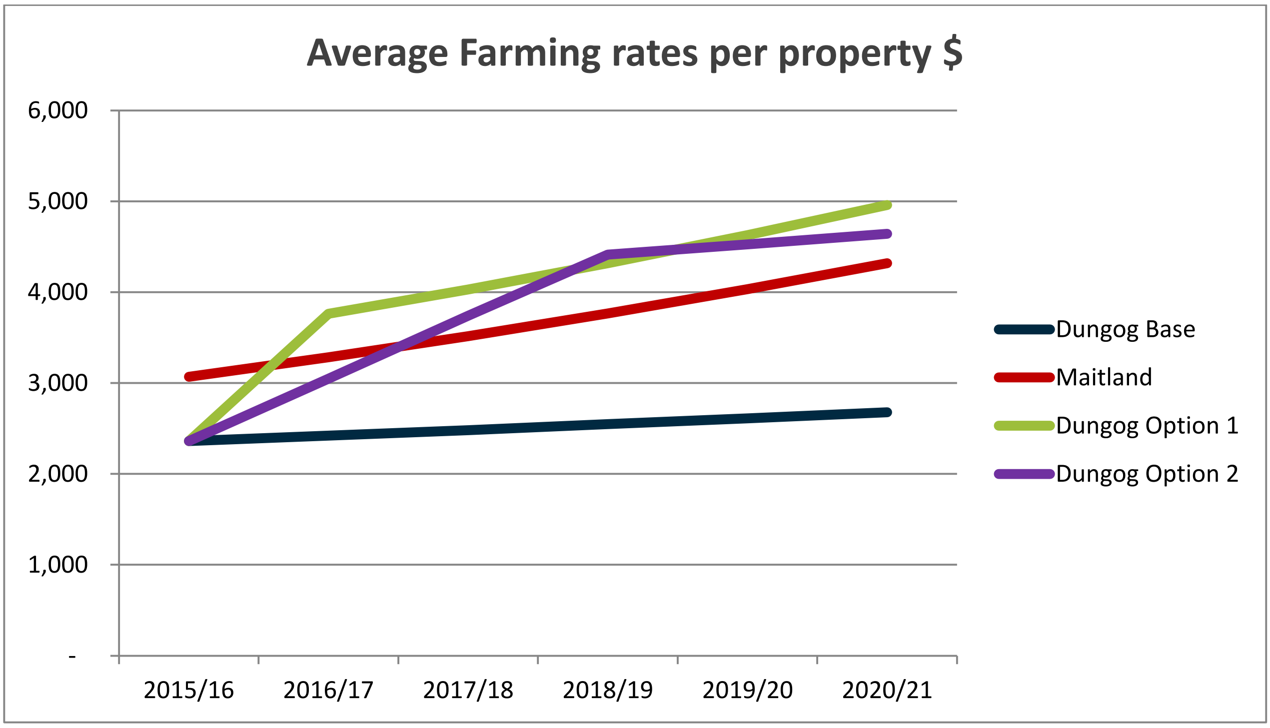
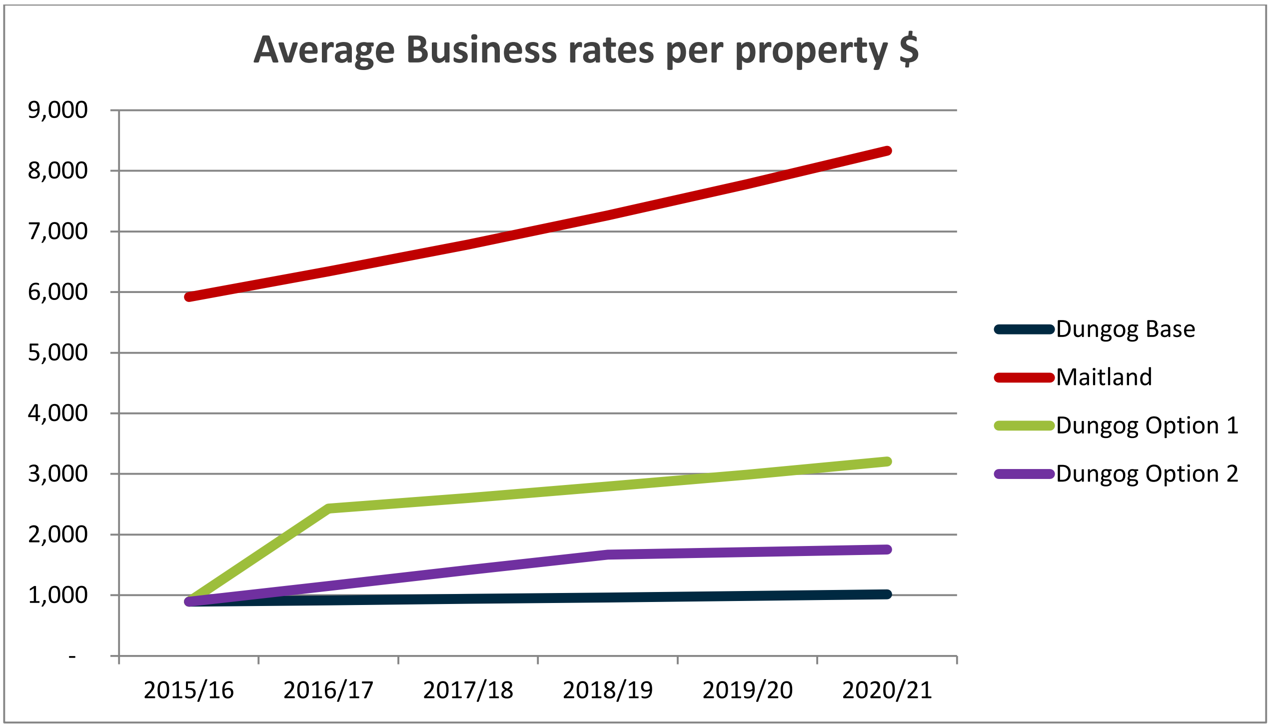


Figure 11 Comparison of average business rates



Revised 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). Normally costs continue to arise through redundancies of senior staff (limited in this model) and the implementation of a single IT system across the new council which has significant cost implications. Costs of the mergers continue from an overall increase in staff numbers which is typical of merged councils and considered to arise as a result of growth and service level equalisation.

Savings initially arise in the short term through the reduction in the number of General Managers and Councillors required in comparison to the councils combined. Limited savings are also projected to arise in relation to procurement and operational expenditure due to the size and increased capacity of the larger council. There are no forecast medium and longer term benefits arising through reducing the overall staff numbers or by removing the duplication of roles and creating greater efficiency in operations and the rationalisation of buildings and plant.

A table setting out the impacts of the costs and savings by reference to the merged councils' Long Term Financial Plans are set out in Tables 2 and 3. The costs and savings arising from the mergers are in comparison to the current operating costs of the combined councils.

The merged councils are 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 have 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.

The combined council's 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 cost of $9.3m** for the merger of Maitland and Dungog.

The NPV is of projected costs and savings from the merger projected until 2024 with a discount rate of 7% and 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 councils and in particular the need for the organisation to increase asset expenditure to meet the Fit for the Future benchmarks.

Table 2 **Summary of financial costs and savings for the merger[11][12]**

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8
Governance	-93	-96	-98	-101	-104	-107	-110	-113
Staff								
-Redundancies	127	0	0	0	0	0	0	0
-Natural attrition\growth	0	0	0	828	1,706	2,636	3,618	4,652
-Staff increases\decreases	209	215	221	227	234	240	247	254
IT								
-Transition costs	1,500	1,000	500	0	0	0	0	0
-Long term benefits	0	0	0	0	0	-242	-249	-256
Materials and Contracts	-67	94	97	50	52	1	1	1
Assets								
-Plant and fleet	0	0	0	0	0	0	0	0
-Buildings	0	0	0	0	0	0	0	0
Grants and Government Contributions	-5,000	0	0	0	0	0	0	0
Transitional Costs								
-Transitional body	2,250	0	0	0	0	0	0	0
- Rebranding	750	0	0	0	0	0	0	0
Total	-323	1,214	720	1,005	1,888	2,528	3,507	4,538

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

Table 3 Summary of financial impacts of the merger

Merged Council - after improvement										
Morrison Low Fit For Future Analysis										
Maitland and Dungog										
Operating Results										
Income Statement	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**
Scenario with extra rates to achieve financial sustainability	**(000s)**	**(000s)**	**(000s)**	**(000s)**	**(000s)**	**(000s)**	**(000s)**	**(000s)**	**(000s)**	**(000s)**
Rates & Annual Charges	60,199	65,695	71,282	77,893	85,088	89,267	95,486	99,430	103,519	107,695
User Fees & Charges	7,679	7,682	8,137	8,615	9,120	9,651	10,222	10,817	11,442	12,109
Grants & Contributions - Operations	16,510	12,754	18,515	13,478	14,505	15,145	15,462	15,905	16,509	16,916
Grants & Contributions for Capital	52,319	18,942	13,600	19,098	13,545	13,390	13,570	13,638	13,561	13,692
Interest and Investment Income	4,164	3,740	3,649	3,880	4,058	3,759	3,700	3,634	3,626	3,548
Gains from disposal assets	124	3,000	5,000	7,000	-	-	-	-	-	-
Other Income	3,351	2,414	2,485	2,558	2,632	2,708	2,786	2,868	2,952	3,040
Total Income	144,346	114,227	122,668	132,522	128,948	133,920	141,226	146,293	151,609	157,000
Income excl Gains\losses	144,222	111,227	117,668	125,522	128,948	133,920	141,226	146,293	151,609	157,000
Income excl Gains\losses & Capital Grants	91,903	92,285	104,068	106,424	115,403	120,530	127,656	132,655	138,048	143,308
Expenses										
Borrowing Costs	1,550	1,910	2,195	2,381	2,504	2,306	2,434	2,556	2,624	2,594
Employee Benefits	33,980	34,238	36,678	38,776	41,120	44,417	47,897	51,365	55,010	58,840
Gains & losses on disposal	2,528	55	56	58	59	61	62	64	65	67
Depreciation & Amortisation	23,919	21,763	22,381	23,128	23,786	24,204	24,901	25,615	26,351	27,111
All other Expenses	37,845	40,046	46,602	45,126	47,051	49,011	52,022	54,037	56,843	59,760
Total Expenses	99,822	98,012	107,913	109,469	114,520	119,999	127,315	133,638	140,894	148,372
Operating Result	44,524	16,215	14,755	23,053	14,428	13,921	13,911	12,655	10,716	8,628
Operating Result (excl Gains\losses and capital grants)	-5,391	-5,672	-3,789	-2,987	942	592	403	-919	-2,780	-4,997

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 largest community.
- The implementation costs maybe higher and the anticipated savings may not be achieved
- Decisions subsequent to the merger about the rationalisation of facilities and services may not reduce the cost base of the merged organisation as originally planned
- The cultural integration of the council organisations may not go well resulting in low morale, increased staff turnover rate 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

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

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

Dungog is impacted by section 218CA of the Local Government Act which also creates risks to successfully bringing together the two workforces. This section of the Act relates to the maintenance of staff in rural centres and provides that a council must ensure that the number of regular staff of the council employed at a rural centre of 5,000 people or less is, as far as is reasonably practicable, maintenance at not less than the same level of regular staff as were employed by the previous council at the centre immediately before amalgamation.

The impact on the merger will be to require the merged council to maintain a workforce in Dungog (and other small centres) at the same size as they are currently unless the council can show that it is not reasonably practicable. The perception may therefore be that the reduction in staff numbers as proposed under this merger business case can only occur in Maitland. While this is not the case as the reduction can and would occur from any location, any reduction in staff numbers at Dungog would have to be offset by moving other staff to these communities to satisfy the requirements of 218CA. The section also embeds into the council's operations inefficiency from having a large proportion of the workforce based in Dungog in perpetuity.

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

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

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

Potential risks

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.

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.

Appendix A Revised Costs and Benefits Arising from Merger of Maitland and Dungog Councils

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 professional opinion of Morrison Low staff based on experience, including with the Auckland Transition Authority.

Queensland Treasury Corporation August 2009 Report

In an August 2009 report[13] from the Queensland Treasury Corporation reporting on costs associated with the amalgamation of the Western Downs Regional Council, the report said:

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

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

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

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

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.

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

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

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

1 Governance and executive team

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

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

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

1.1 Governance ($88k)

The formation on a new entity is expected to produce 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 12 councillors for the new merging council.

1.2 Executive management ($230k)

The formation of a single entity will result savings in executive management costs as it is likely that there will be only one less position in a merged council and a reorganisation of Tier 2 positions. Revised remuneration packages for the new entity have been informed and assumed to be on par with similar sized councils.

It is important to note that while ongoing efficiencies have been identified effective from the short term, there is a potential one off cost of redundancies of an estimated $1.025m 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 (not applicable to this merger business case)

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 but in our view in this merger any opportunities would be minor.

2 Corporate services (not applicable to this merger business case)

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

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

	Staff	Duplicated Services	Contract/ Procurement	Information Technology	On Costs
Transition Period	Natural attrition (voluntary)				
Short Term (1 to 3 years)	Natural attrition (voluntary)	Finance ICT Communications Human Resources Records Customer Services Risk Management			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 ($0 - not applicable to this merger business case)

Consistent with the dis-establishment of the councils and the creation of a single entity, there are a number of back office duplicated services that would be replaced, standardised and simplified. The rationalisation and streamlining of back office services means that there would an opportunity to rationalise financial reporting, business systems, administrative processes and staff numbers. 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 two Resourcing Strategies, Long Term Financial Plans, Asset Management Strategies, Workforce Management Plans , Annual Plans and Annual Reports needing to be prepared, consulted on and printed. In addition the centralisation of rates, accounts receivable, accounts payable and payroll, including finance systems will reduce resourcing requirements and costs.
- Human Resources (HR) – The size of the HR resource would be commensurate with the number of FTEs in the new entity based on industry benchmarks. The number of HR resources would be expected to reduce proportionately to the reduction in organisational staff numbers.
- Communications – The resourcing would be expected to reduce since there would be a single website and a more integrated approach to communication with less external reporting requirements.
- Customer Services – No reduction in the 'front of house' customer services has been assumed on the basis that all existing customer service centres would remain operative under a single entity and the existing levels of service would be retained. However there is potential to reduce the number of resources in the 'back office' such as the staffing of the call centre.

The potential efficiency in the corporate services category is in our view limited. Dungog has a small multi skilled staff and we have already identified both organisations appear under resourced. We have not allowed for a reduction in staff, rather a reorganisation to improve service delivery.

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 tier 3 and 4 ($0 - not applicable to this merger business case)

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

On the basis that two councils are being disestablished and a single entity created there is typically opportunity for a reduction in Tier 3 and 4 positions. However, given the lean nature of the organisations, the council's organisational structures and the geographic distance between them means that in this case there is unlikely to be any reduction in this aspect of the organisation.

3.2 ICT Benefits ($200K)

Without a full investigation into the current state of the council's 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 two 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[14] over time in line with reduced IT applications and systems.

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

Through the work undertaken as part of the Wellington reorganisation, Stimpson and Co have undertaken a sensitivity analysis on the ICT costs for two options and based on an ICT cost of $90 million have estimated the Net Present Value at $200 million and payback period of 5 years. Without a detailed investigation of systems, processes and the future state of the IT system and support it is not considered possible to model the benefits as arising at a similar rate however to retain consistency with the estimated costs and the basis for them benefits have been modelled as arising over the long term and a rate of $200K per annum.

3.3 Materials and contracts ($129k)

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 two councils to one. An estimate needs to take into account that the councils currently engage in some collective procurement and resource sharing through the various Hunter Councils initiatives.

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). The amount provided is modest reflecting the nature of the purchasing currently undertaken. The saving grows from $43k in year 1 to $129k in year 5.

3.4 Properties ($0 - not applicable to this merger business case)

Typically 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.

However the nature of the two councils, the geography and the limited opportunities to reduce staff numbers means that in our view that no allowance should be made for the rationalisation of buildings.

3.5 Works units ($0 - not applicable to this merger business case)

Staff ($0)

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. However, given the nature of the two entities and location of works staff and depots we believe that it is unlikely that savings will be achieved in this instance.

Plant and Fleet ($0)

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 normally 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. In this instance, following discussion with the councils and taking into consideration advice that they each believe that they are under-resourced with plant and fleet we have not allowed for any savings from a reduction in plant and fleet.

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[15] 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 two 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.[16] 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.

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

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

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 ($2.25M)

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

The work undertaken for the reorganisation of Wellington identified the cost of the transition body as $20.6 million[17] and on the assumption of FTEs to transition body costs for Wellington, the estimated cost of the transition body for the merger is $11 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.

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

5.2 ICT ($3M)

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[18] 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 a range of $23 - $37m.

Maitland have invested in a new IT system that has the capacity to also serve Dungog. Most costs will lie in extending the system into Dungog, creating reliable connectivity, telecommunications establishment, data migration and training. As the system is still being implemented it is likely that a merger will incur additional costs as the implementation will need to be accelerated to accommodate the merger.

The estimated cost of using the Maitland as a basis for merger model is spread across the initial years of the councils operations with the majority falling in the first two years.

5.3 Business Process (existing Council budget)

As part of ensuring the entity is functional on Day 1 there 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 ($750K)

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 two 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 $750K based on discussions and other amalgamation experience.

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[18] Wellington Local Government Reorganisation Options – Transition Costs and Benefits for Technology Changes, Deloitte September 2015

5.5 Redundancy Costs ($170k)

This is based on a reduction from two general managers to one for a merged council and is based on employment contracts with a redundancy period of 38 weeks, and on the councils' respective Annual Reports 2013/14.

5.6 Remuneration Harmonisation ($428k)

The remuneration, terms and conditions for staff would need to be reviewed as part of the transition as there is currently variation in pay rates and conditions across the two councils. In order to estimate the cost of wage parity in 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 two councils.

5.7 Audit fees ($20k)

This is based on a reduction from two separate entities to one for a merged council and is based on a comparator council and current costs as stated in the councils' respective Annual Reports 2013/14.

5.8 Elections ($0K)

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