Local Government
Boundaries Commission

PROPOSAL TO DE-AMALGAMATE INNER WEST LOCAL GOVERNMENT AREA

Boundaries Commission Summary of the Key Findings from Deloitte's Analysis of the Financial Implications

December 2023

Local Government

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1. Background

On 19 December 2022 Inner West Council (**IWC** or **Council**) submitted to the Minister for Local Government a business case proposing the de-amalgamation of Council. That business case was referred to the Local Government Boundaries Commission (Boundaries Commission) for review and report on 16 January 2023.

The effect of the proposal in the business case, if implemented by the NSW Government, would be to “demerge” the Inner West local government area into the three local government areas that existed prior to the 2016 merger – Leichhardt, Marrickville, and Ashfield local government areas.

The business case submitted by Council was prepared by Morrison Low (ML) and included modelled financial implications of de-amalgamation under two scenarios that were informed by Council and community consultation.

The IWC business case was made under section 218CC of the *Local Government Act 1993* (the Act). This section was inserted in the Act in May 2021 and allows any council formed by amalgamation, within 10 years of that amalgamation, to submit a proposal for the de-amalgamation of the new area, whether by reconstituting the former areas or constituting different areas.

In examining any proposal for a change in local government boundaries, the Act requires the Boundaries Commission to have regard to a number of specified “factors”. One of those factors (section 263(3)(a) of the Act) is –

> *“the financial advantages or disadvantages (including economies or diseconomies of scale) of any relevant proposal to the residents and ratepayers of the areas concerned”.*

To assist in its consideration of this factor, the Commission engaged Deloitte Touche Tohmatsu to provide advice on the financial implications of the proposal. In doing so, the analysis included both a review of the business case submitted by council and an independent analysis of financial and other information of council. The Commission asked Deloitte to consider a range of aspects regarding the performance and current position of IWC and the financial impact on the community should the proposed demerger be implemented.

2. This Document

The Commission is releasing this summary of what it considers to be the key findings and observations from Deloitte’s work, so that residents and ratepayers might have a better understanding of the financial advantages and disadvantages of the proposal ahead of the close of written submissions on 31 January 2024. The key findings and observations are based on Deloitte’s analysis of information obtained from the business case, information from Council and other sources, discussions with Council staff and Deloitte’s own understanding of the issues involved.

The contents of this summary should not be seen as necessarily having the Commission’s acceptance, nor as representing the Commission’s overall view on the financial advantages or disadvantages of the proposal.

In examining the section 263(3)(a) factor and the demerger proposal in general, the Commission will consider all sources of information, including, but not limited to written submissions from residents and ratepayers, oral presentations at the public inquiry sessions, the Deloitte report and benchmarking data compiled by the Office of local Government.

3. Inner West Council

Current Position

- IWC has operated as a standalone Council for seven years, established on 12 May 2016 following the merger of former Ashfield, Leichhardt, and Marrickville Councils (together, the **former Councils**).
- IWC has 15 Councillors (a decrease of 21 from prior to merger), services a population of 183,105 (up 1,062 since merging), earned $293 million revenue in FY23 and manages $2.4b of infrastructure assets. This is comparable to City of Parramatta (256,729 population, $416 million FY23 revenue and $2.4b infrastructure assets) and Penrith City Council (217,664 population, $363 million FY23 revenue and $2.1b infrastructure assets).
- Council's current operations reflect a series of integration activities and other changes since merger, including:
    - o Increased services, reflecting both (i) harmonised services across the former Council areas, and (ii) delivery of new and expanded services to meet Community demand (for example the recent Ashfield Aquatic Centre Redevelopment);
    - o Reviewed and implemented an updated organisational structure, as well as harmonised salaries and wages across the former Council areas, and enhanced service functions;
    - o Harmonised rates across the former Councils, completed in July 2023 post the five-year rate freeze; resulting in higher rates in the former Marrickville Local Government Area (**LGA**), lower rates in Ashfield and Leichhardt remaining relatively stable, with former special rate variations (**SRV**) absorbed into the rate base; and
    - o Maintained pre-merger physical footprints of three head offices. However, IWC consolidated four depots to three post-merger, resulting in the closure of a depot in Ashfield LGA which was re-purposed into the Inner West Sustainability Hub.
- ML and Council undertook an exercise in August 2021 to explore the merger impacts to Council, separate to the Business Case. They reported a $22 million net benefit to the community of the merger per annum since FY21, made up as follows:
    - o $3.3 million of synergies as a direct result from merging (e.g., from consolidation of functions, in-sourcing services and closure of surplus facilities) reducing Council's cost base offset by costs incurred by Council that have not been passed on to community, Including:
        - ▪ $6.3 million of merger-related cost increases from harmonisation of services, ICT upgrades and consolidation provided at no additional cost to

the community;

- $15.9 million unrelated to the merger consisting of discounts and subsidies on rates and reduction in income from finalisation of SRVs; and
- $3.3 million loss related to COVID-19.

- Since the merger, IWC operating performance has been supported by capital funding. Council has also successfully undertaken initiatives to generate cash and expand services without seeking additional rates from the community.

Change in Financial Position Post-Merger

Figure 1: IWC Pre-merger versus FY23 Summary

$'m Actuals	FY16 (pre-merger) Ashfield	Leichhardt	Marrickville	FY16 Total	FY23
Revenue	41.6	93.5	116.5	251.6	293.4
Revenue (excluding Capital Grants)	36.1	80.2	102.7	218.9	264.2
Expenditure	(33.6)	(69.6)	(83.8)	(187.0)	(270.7)
Net operating result	**8.0**	**23.8**	**32.7**	**64.6**	**22.7**
Net operating result (excluding Capital Grants)	**2.5**	**10.6**	**18.9**	**32.0**	**(6.5)**
Operating performance ratio (%)	*6.7%*	*13.2%*	*18.4%*	*14.5%*	*(2.4%)*
Own source revenue (%)	*81.7%*	*81.3%*	*82.8%*	*82.0%*	*85.6%*
Total cash and cash investments	24.3	75.6	68.7	168.6	300.4
Unrestricted cash and cash investments	9.7	46.0	37.2	92.9	142.8
Net assets	299.7	582.3	1,021.8	1,903.5	3,033.6
Infrastructure backlog	23.5	3.5	4.4	31.3	25.3

- IWC's combined net asset position has increased by 60% or $1.1 billion at June 2023, largely due to the revaluation of Council assets. IWC has also undertaken investment activities since 2016 which have contributed to the net increase in IPPE, funded by grants, cash reserves and borrowings, including:
  - $85 million in funding secured from FY18 – FY22 for roads, footpaths and stormwater drains;
  - $65 million invested in parks and recreation facilities from FY18 – FY21;
  - $46 million Ashfield Aquatic Centre Redevelopment (funded via TCorp financing of $40 million);
  - $7 million contribution to commencing the GreenWay central links, and $7.5 million to deliver the Urban Amenity Improvement Program (Parramatta Road and surrounds);
  - $40 million Marrickville Library upgrade; and
  - $76 million invested in properties ($55 million in FY23) which utilised funds from the sale of Tempe Lands in FY20 (previously within Marrickville LGA).

- At June 2023, IWC held $300 million in cash and investments, of which $158 million or 53% is restricted. Higher cash holdings (up from $168.6 million at merger) is attributable to the Tempe Land sale (contributing $78.8 million cash and a $49.4 million gain on sale), $40 million in funding for the Ashfield Aquatic Centre Redevelopment and capital grants ($211.4 million). Restricted funds as at June 2023 largely related to developer contributions, domestic waste management reserve and specific purpose grants.

Overview of IWC's Financial Performance (FY17 to FY23)

- IWC has generated a cumulative operating surplus totalling $217 million, which reduces to a normalised loss of $42.9 million after excluding $211 million capital grants and $49.4 million from the Tempe Land sale (relating to the former Marrickville council) in FY20.
- The majority of the loss (excluding capital grants and land sale) was incurred in the initial years post-merger (FY17 to FY20 aggregate net loss of $22.3 million), due to (i) $26.3 million in merger costs, partially funded by grants ($10 million), and (ii) the rate freeze, where IWC could not pass on these higher costs.
- Over this period IWC invested in establishing an integrated and cohesive Council increasing the cost base by 27% relative to the former Councils since merger (equivalent to 12% when adjusting for inflation). This is driven by the following:
  - COVID-19 restrictions which initially appeared to improve performance as services running at a deficit were shutdown, however, has since been quantified by Management as having a $3.3 million net cost;
  - Delivery of new / expanded services which contributed c.$3.3 million net cost p.a. to IWC (majority relating to Ashfield Aquatic Centre at c.$1.2 million and Marrickville Library at $2.2 million in addition to three other smaller sites);
  - Service uplift within certain council areas (e.g. verge mowing, provision of small bins and animal companion services) to provide consistently across the three former Councils;
  - Rate revenue increases totalling 10% since merging (from both annual rate pegs and changes to general income factors) that were lower than the rising cost base;
  - Decision to absorb costs relating to the Emergency Services Levy (**ESL**) of $4.3 million annually from FY18 and Domestic Waste Management (**DWM**) charges of $829k annually over seven years from FY22 to FY28, rather than to pass on these costs to the community; and
  - Higher employment costs (discussed below).

The Council has also delivered a range of community projects as well as c.$388 million of capital expenditure (FY17-FY23), funded by both grants and cash reserves. This investment in the asset base has resulted in higher depreciation expenses (increased by $9.2 million from FY16 to FY23) and a reduction in infrastructure backlog from $31.3 million at merge to $25.3 million as at 30 June 2023.

Local Government

Boundaries Commission

Figure 2: IWC Operating Result (FY17 to FY23)

$m	FY17 Act.	FY18 Act.	FY19 Act.	FY20 Act.	FY21 Act.	FY22 Act.	FY23 Act.	7 Yr Total
Rates and annual charges	152.9	153.5	159.3	162.6	164.7	162.2	166.3	**1,121.4**
User fees and charges	46.3	41.7	42.9	32.7	43.1	41.4	55.9	**303.9**
Interest and investment income	7.4	6.1	6.5	5.2	3.2	3.0	11.0	**42.4**
Other Revenue	29.0	24.5	27.6	25.2	22.7	15.4	22.1	**166.5**
Operating grants	30.9	11.5	11.7	17.1	14.3	15.4	13.8	**114.7**
Capital grants	49.0	16.8	23.4	35.5	26.7	30.8	29.2	**211.4**
Net gains/(losses) from the disposal of assets	(3.6)	(1.2)	(8.3)	45.2	(5.1)	(2.5)	(4.9)	**19.8**
Revenue	**311.9**	**252.8**	**263.2**	**323.5**	**269.8**	**265.5**	**293.4**	**1,980.1**
Merger grants (operating)	10.0							**10.0**
Merger grants (capital)	10.0							**10.0**
Revenue excluding merger grants	**291.9**	**252.8**	**263.2**	**323.5**	**269.8**	**265.5**	**293.4**	**1,955.1**
Employees	(119.6)	(109.3)	(119.5)	(115.7)	(113.1)	(112.1)	(124.9)	**(814.1)**
Materials & services and other	(74.0)	(62.2)	(65.1)	(63.9)	(76.5)	(86.2)	(100.0)	**(527.9)**
Borrowing costs	(1.3)	(0.9)	(0.6)	(0.4)	(0.8)	(1.0)	(0.9)	**(5.9)**
Depreciation	(30.8)	(28.3)	(26.6)	(29.3)	(36.8)	(34.1)	(33.2)	**(219.1)**
Other	(50.8)	(37.4)	(34.4)	(32.3)	(16.3)	(12.2)	(11.8)	**(195.2)**
Expenses	**(276.6)**	**(238.1)**	**(246.3)**	**(241.6)**	**(243.6)**	**(245.5)**	**(270.7)**	**(1,762.3)**
Net operating result	**35.4**	**14.8**	**16.9**	**82.0**	**26.1**	**20.0**	**22.7**	**217.9**
Net operating result excluding capital grants	**(13.6)**	**(2.1)**	**(6.6)**	**46.5**	**(0.5)**	**(10.7)**	**(6.5)**	**6.4**
Net operating result excluding capital grants & Tempe Land Sale	**(13.6)**	**(2.1)**	**(6.6)**	**(2.9)**	**(0.5)**	**(10.7)**	**(6.5)**	**(42.9)**

Operating performance ratio (%)	**(5.1%)**	**(0.9%)**	**(2.6%)**	**19.1%**	**(0.2%)**	**(4.5%)**	**(2.4%)**	**(0.4%)**
Own source revenue (%)	**74.7%**	**88.9%**	**87.0%**	**81.1%**	**85.1%**	**82.8%**	**85.6%**	**95.6%**

Notes:

- FY17 reflects a 13.5-month period from 13 May 2016 to 30 June 2017.
- Operating Performance Ratio measures how well local councils contain expenses within revenue. The benchmark set by the Office of Local Government (**OLG**) for the ratio is greater than 0%.
- Own Source Revenue measures a council's fiscal flexibility and the degree to which it relies on external funding sources such as operating grants and contributions. The benchmark set by OLG for the ratio is greater than 60%.
- As indicated by Management, merger grants of $25 million ($10 million Merger Implementation Grant (operating grant) and Stronger Communities Fund of $15 million (capital grant)) have been received in FY17. Upon review of the audited financial statements $20.0 million has been reported as revenue, with $5.0 million reported as restricted reserves. We have been unable to reconcile.
- Management have confirmed that a portion of other costs has been reallocated to be captured within Materials and Services from FY21 onwards. For the purposes of trend analysis, these items have been consolidated.

Figure 3: IWC Asset Summary (FY17 to FY23)

$m	FY17 Act.	FY18 Act.	FY19 Act.	FY20 Act.	FY21 Act.	FY22 Act.	FY23 Act.
Total cash and investments	204.8	217.3	221.8	324.2	325.5	354.2	300.4
Net assets	2,229.4	2,347.4	2,379.1	2,532.7	2,546.3	2,689.0	3,033.6
Infrastructure backlog	135.4	146.2	142.2	140.4	36.8	20.7	25.3

IWC Cost Base

- IWC's cost base has increased by 27% relative to the former councils since merger. Despite c. three years of operating at a new baseline of harmonised service delivery (FY21 to FY23), it appears that IWC has not yet realised significant levels of economies of scale or net cost savings as a result of the merger.
- After incurring higher costs in FY17 to FY19 due to the merger process, IWC cost base in FY20 (excluding depreciation) has grown to be approximately 18% higher than the aggregate cost base of the former three Councils in FY16 (equivalent to 12% when adjusting for inflation). Factors contributing to this cost growth include:
  - The implementation of integration activities which were largely completed by FY21, and the delivery of new services/functions, outlined in the previous section, increasing Materials and Services and other costs by 32% (based on normalised FY16 values);
  - A 23% increase in employee costs (based on normalised FY16 values) which reflects higher wage per full-time equivalent (FTE) employee from the harmonisation of salary structures to further integrate, promote equity and streamline back-office processing. Also, any executive-level consolidation savings realised on merger were reinvested into other new roles or offset by other employee cost increases (e.g. award rates and progression of salary structures).
- In relation to IWC's organisation structure:
  - IWC employed 1,128 FTE as at November 2023 which is a 28 FTE (net) decrease (-2.4%) on pre-merger staffing levels. However, this excludes 120 FTE vacant positions looking to be filled (6% higher than pre-merger) for roles relating largely to service transformation and community service.
  - IWC effectively operates teams in each former Council for logistic purposes, however the operating structure has significantly changed since merging, resulting in:
    - Consolidation of the three organisation structures, which reduced FTE by 156 FTE from June 2016 to June 2023, primarily due to consolidation of back-office functions and implementation of shared services (e.g. reduction of depots from three to two);
    - Voluntary redundancy program, of which c.3.4% of employees partook resulting in $14.2 million of payouts across FY17 to FY24;
    - Temporary high vacancies due to COVID-19, requiring temporary backfill

from consultants or contractors at a higher price point; and

    - Uplift in new service functions and heightened service levels requiring additional staffing (e.g. service transformation function, additional staff for aquatic centres, childcare and operational services).

  - The average cost per FTE has increased since merger from $105k to $122k per FTE, due to:

    - Annual award increases under the Act; and

    - Progression of in salary and harmonisation of wages across the three former Councils, increasing cost per FTE by 5% (excluding award / CPI increases).

4. IWC's Long Term Financial Plan

- IWC adopted the most recent LTFP in June 2023, which forecasts financial performance from FY23 to FY33 (**LTFP**), largely based on the FY23 service levels.

- For the purposes of comparing the demerger modelling performed by Deloitte, they have focused on the FY24 to FY28 period.

- The LTFP forecasts an operating surplus (excluding capital grants) of $3.3 million in FY28, representing an improvement from the $6.5 million operating deficit (excluding capital grants) achieved in FY23, driven by:

  - An improved FY24 result attributable to:

    - A reduction of 15% in Materials and Services costs through reduction of reliance on agency staff to be filled by full time employees, resulting in employee costs increasing by 11% in the same year. Further, optimisation of spend across Council is forecast to decrease overall costs; and

    - An increase in rates and annual charges of 4%;

    - IPART has recently updated the rate peg for FY25 to 4.9%, which if instituted by Council could mitigate the required cost reduction and improve IWC financial sustainability by c.$9.5 million across FY25 to FY28.

  - Steady improvement from FY24 to FY28 expected to be achieved via:

    - An increase in rates and annual charges of 12%, primarily related to increases to the rate peg;

    - An increase in user fees and annual charges of 14%, resulting from CPI increases;

    - A comparatively smaller increase in Materials & Services costs of 1%, relying on optimisation of budget spend; and

    - A partial offset by a 13% increase in employee expenses, in accordance with forecast award increases.

- Council is forecasting a decline in net cash and investments over the forecast related to purchase of an additional investment property in Warrawong for $21.2 million in July 2023 (already secured), amortisation of the $40 million Ashfield Aquatic Centre Redevelopment loan facility and investment in asset renewals ($392 million). A portion of this asset expenditure is connected with externally funded projects where cash is currently held in Council's restricted funds (c.$64 million developer contributions)
- Since the LTFP was developed in June 2023, FY24 Q1 actuals have been finalised. Council performed above budget, largely driven by a) increased investment income related to increased interest rates, and b) continuing vacant staff positions reducing salaries and wages costs partially backfilled by agency costs. Management notes this will have minimal impact to the remaining FY24 forecast.

5. Demerger Considerations

Demerger Costs

- A demerger will result in additional costs being incurred for which, under s218CC of the Act provides that the Minister is to fund one-off costs of any de-amalgamation. Deloitte's work assumes that one-off costs will be borne by the Minister, while ongoing incremental ongoing costs are assumed to incurred by the respective Councils.

One-off costs:

- Based on analysis of available benchmarks, Deloitte estimated that one-off demerger costs could be in the range of **$31.3 million to $39.1 million** (combined for all three proposed de-amalgamated councils). These include:
    - Establishment costs (e.g. rebranding);
    - IT system implementation costs;
    - Transition costs including financial and legal adviser costs; and
    - Provisions for each of employee benefits and recruitment have been assumed based on the 13.4% rate of redundancy observed post-merger, and the increase in services compared to pre-merger levels.

Incremental costs:

- Total ongoing costs equate to **$114.1 million** over the four-year forecast period (assuming demerger occurs 1 July 2024), including additional costs of:
    - Replicating Councillor structures, estimated at $0.3 million per annum per council;
    - Additional FTE to maintain current services and back office functions. IWC estimated a likely additional requirement of 163 FTE at a total cost of $26.5 million p.a.;
    - Elections scheduled for FY25 (now required across three councils), estimated to be a $0.6 million in FY25 per Council; and
    - Replicating the internal audit function, now required by legislation, estimated to be $0.2 million per annum per Council.

Figure 4: Demerger Cost Estimates and Ratepayer Impacts

		FY25 Fct.	FY26 Fct.	FY27 Fct.	FY28 Fct.	4 Year Total
Ashfield	Incremental costs p.a. per region ($m)	6.1	5.5	5.5	5.5	22.6
	Rateable Assessments (#)	17,233	17,233	17,233	17,233	17,233
	$ / Rateable Assessment ($)	**(354)**	**(318)**	**(318)**	**(318)**	**(1,309)**
Leichhardt	Incremental costs p.a. per region ($m)	11.0	10.3	10.3	10.3	42.0
	Rateable Assessments (#)	25,380	25,280	25,380	25,380	25,380
	$ / Rateable Assessment ($)	**(432)**	**(407)**	**(407)**	**(407)**	**(1,653)**
Marrickville	Incremental costs p.a. per region ($m)	12.9	12.2	12.2	12.2	49.6
	Rateable Assessments (#)	36,849	36,849	36,849	36,849	36,849
	$ / Rateable Assessment ($)	**(349)**	**(332)**	**(332)**	**(332)**	**(1,347)**
Total	Incremental costs p.a. per region ($m)	29.9	28.1	28.1	28.1	114.1
	Rateable Assessments (#)	79,462	79,462	79,462	79,462	79,462
	$ / Rateable Assessment ($)	**(1,136)**	**(1,058)**	**(1,058)**	**(1,058)**	**(4,309)**

- As mentioned above, the total demerger costs over four years is estimated at **$145 million to $153 million**. The incremental costs have been applied to the three councils as detailed in Figure 4. Modelling indicates that, due to these incremental costs, all councils' financial sustainability in the forecast period is likely to deteriorate in a demerger scenario.
- Demerger costs should be considered a high-level estimate and indicative only. The actual costs could be somewhat higher or lower depending on a range of factors including the ability of the councils to reach consensus on shared services such as IT, legal, financial and commercial separation matters, including the allocation of its cash and investment reserves, allocation of balance sheet items and the financial capacity of the new councils and/or its community to fund such costs.

6. Financial Sustainability of New Councils

- In order to assess the Councils' financial viability under a demerger scenario Deloitte has undertaken high-level modelling to identify the estimated 'gap' to achieving a breakeven operating result (excluding capital grants) (as an indicator of financial sustainability) in FY28.
- Deloitte modelling is based on IWC's FY23 financial statements and LTFP (2022-23) assumptions, adjusted for FY23 closing cash position and demerger cost assumptions.
- The 'gap' to achieving a breakeven result in each scenario is presented on a per rateable assessment basis in the following table in order to illustrate the potential impact on ratepayers in a demerged scenario compared to the IWC LTFP.
- The scenario analysis indicates a demerger could impact Ashfield, Leichhardt and Marrickville ratepayers differently, with Leichhardt's financial capacity less sustainable than the other two Councils. This is predominantly due to service and wage harmonisation

that has increased the cost base without the benefit of new revenue channels implemented in the other Council areas since merger.

Figure 5: Demerged Councils Forecast Operating Performance excluding Capital Grants

$m	FY25	FY26	FY27	FY28	Total
IWC LTFP	(2.1)	0.1	2.3	3.3	3.6
Demerged Ashfield	(7.1)	(5.7)	(5.2)	(4.8)	(22.8)
Demerged Leichhardt	(14.4)	(12.9)	(12.3)	(12.0)	(51.6)
Demerged Marrickville	(10.5)	(9.3)	(8.3)	(7.8)	(36.0)

Figure 6: Gap to FY28 Operating Surplus (excluding capital grants) on a per Rateable Assessment Basis ($)

	Forecast Operating Gap	Rateable Assessments	$/Assessment	$ variance to IWC LTFP
	$m	No.	$	$
IWC LTFP	3.3	79,462	42	N/A
Demerged Ashfield	(4.8)	17,233	(281)	(323)
Demerged Leichhardt	(12.0)	25,380	(474)	(516)
Demerged Marrickville	(7.9)	36,849	(213)	(255)

Notes:

- Forecast Operating Result (excluding capital grants) in FY28 based on high-level de-merger modelling.
- Rateable assessment numbers are per the 'Historical rates information' provided by Management. Management does not forecast rateable assessments, therefore, they are fixed across the period to determine ongoing impact to ratepayers.

- The above analysis does not imply that the 'gap' can only be closed through rate increases – see later discussion.

Demerged Ashfield Scenario Observations

- The high-level demerger analysis indicates that in FY28, Ashfield's forecast operating deficit would be $4.8 million which equates to a $281 deficit per rateable assessment, $323 per rateable assessment above the IWC LTFP ($42 surplus).
- Ashfield has benefited from increased income from the redevelopment of the Aquatic Centre from October 2020, albeit the first years of operations have reported a net loss position. However, through inheriting the Ashfield Aquatic Centre Redevelopment loan received in FY20 for $40.0 million, the council requires additional cash reserves in comparison to the other council to meet the debt servicing. It also requires Ashfield to meet the obligations of the loan e.g. covenants.

Demerged Leichhardt Scenario Observations

- The high-level demerger analysis indicates that in FY28, Leichhardt's forecast operating deficit would be $12.0 million which equates to a $474 deficit per rateable assessment, $516 per rateable assessment above the IWC LTFP ($42 surplus).

- The large amounts of capital expenditure forecast ($125.0 million over the forecast period, c.90% is expected to be unfunded) in comparison to the other councils, relate to upgrades for the Leichhardt Park Aquatic Centre, the Greenway Program and upgrades to park & property buildings.
- Service and wage harmonisation during the IWC merger has increased the cost base for Leichhardt while the council area has not received the benefit of new revenue channels implemented in the other council areas. Therefore, Leichhardt would require a comparatively higher percentage increase in the rate base (or a comparatively higher cost savings) to bridge the sustainability gap in FY28.

Demerged Marrickville Scenario Observations

- The high-level demerger analysis indicates that in FY28, Marrickville's forecast operating deficit would be $7.8 million which equates to a $213 deficit per rateable assessment, $255 per rateable assessment above the IWC LTFP ($42 surplus).
- Marrickville benefits from a larger population and ratepayer base and is therefore able to absorb a higher portion of the impact of the demerger costs comparatively to the other council areas.
- Marrickville benefits from the sale of land in Tempe to the NSW State Government in March 2020 for $78.8 million. The cash generated from this sale has been utilised to purchase two investment properties. Therefore, Marrickville benefits from annual investment income of $4.7 million.
- Harmonisation of rates which, combined with property valuations, resulted in a $0.3 million increase in rate revenue generated in Marrickville, provides greater benefit in a demerged scenario.

7. Pathways to Financial Sustainability

- For clarity, the analysis in Figure 6 does not represent and should not be interpreted as an intention by – or recommendation to – councils to increase rates by these amounts in a demerged scenario. Rather it is a comparative indicator of the demerged councils' capacity to achieve financial sustainability in that year.
- Financial sustainability prospects will typically be higher where Management, Councillors and community stakeholders are aligned on priorities for financial outcomes, service levels and the associated cost to community.
- The demerger costs would initially be buffered by the current strong cash reserves of IWC however, likely to deteriorate in comparison to a continuing IWC scenario due to ongoing demerger costs.
- Further considerations around the level of asset renewals and capital expenditure could be assessed to maintain operating liquidity. However, the council would need to consider whether this has a material impacts on asset renewal.
- Each individual council would assess initiatives available to deliver financial sustainability, including:

- Increasing the FY25 rates to align with the recently updated rate peg of 4.9%
- Securing additional operating grants or other third-party revenue streams
- SRVs
- Cost reductions which may include:
  - Implementing alternative operating or service delivery models such as outsourcing;
  - Headcount reductions or replacing vacancies with lower-level resources that may be more suitable for smaller councils relative to IWC (noting this would take time due to initial staff protections and would be subject to staff turnover rates), with an impact on service levels;
  - Limiting non-critical capital spend and general austerity measures, noting this will impact current service levels; and
  - Exploration of a shared service model, however, Deloitte notes this may be challenging to implement given past experiences of other councils and the requirement for demerged councils to align on future shared service requirements. Further work may be required to assess this option.

- In this regard, a demerged council may have more flexibility to achieve cost savings as a result of:
  - Prioritising services most valued by the local community, which may differ across the three councils; and
  - Ceasing services of lesser value to the local community, noting this would require a high level of community engagement and may require planning and implementation to redeploy resources.
- The following sections illustrate the options available to councils to achieve a breakeven operating result (before account of capital grants).

Ashfield Sustainability Pathway

- The financial sustainability 'gap' of $4.8 million in FY28 is equivalent to an 8.5% reduction of FY28 controllable costs base or a 16.6% increase to rate base.
- Ashfield has a greater level of forecast population growth (9% from FY23 to FY28) in comparison to Leichhardt and may see revenue growth which could assist in bridging the sustainability gap (net of higher population driven costs).
- Also to note, Ashfield would be susceptible to increased interest rates tied to the debt service obligations and related covenants of the loan facility with the NSW Treasury TCorp, and liquidity risks if a change in community needs impacted the Ashfield pool usage.
- Below provides ways in which Ashfield could bridge the sustainability gap, for example, if Ashfield receives additional external funding of $2.0 million it would need to achieve $2.8 million of additional cost savings in order to achieve a breakeven result (excluding capital

grants) in FY28. Ashfield's capacity as a standalone council to achieve incremental income or cost savings over this period has not been tested.

Figure 7: Ashfield's Resulting Operating Surplus excluding capital grants ($m)

		Additional rate revenue or external funding				
	$'m	-	1.0	2.0	3.0	4.0
Additional cost savings	-	(4.8)	(3.8)	(2.8)	(1.8)	(0.8)
	1.0	(3.8)	(2.8)	(1.8)	(0.8)	0.2
	2.0	(2.8)	(1.8)	(0.8)	0.2	1.2
	3.0	(1.8)	(0.8)	0.2	1.2	2.2
	4.0	(0.8)	0.2	1.2	2.2	3.2

Leichhardt Sustainability Pathway

- The financial sustainability 'gap' of $12.0 million in FY28 is equivalent to an 11.8% reduction of FY28 controllable costs base or a 25.8% increase to rate base.
- Leichhardt has a forecast population growth of 6% from FY23 to FY28, indicating the council could see revenue growth which could assist in bridging the sustainability gap (net of higher population driven costs).
- Below provides ways in which Leichhardt could bridge the sustainability gap, for example, if Leichhardt receives additional external funding of $5.0 million it would need to achieve $7.0 million of additional cost savings in order to achieve a breakeven result (excluding capital grants) in FY28. Leichhardt's capacity as a standalone council to achieve incremental income or cost savings over this period has not been tested.

Figure 8: Leichhardt's Resulting Operating Surplus excluding capital grants ($m)

		Additional rate revenue or external funding				
	$'m	-	2.5	5.0	7.5	10.0
Additional cost savings	-	(12.0)	(9.5)	(7.0)	(4.5)	(2.0)
	2.5	(9.5)	(7.0)	(4.5)	(2.0)	0.5
	5.0	(7.0)	(4.5)	(2.0)	0.5	3.0
	7.5	(4.5)	(2.0)	0.5	3.0	5.5
	10.0	(2.0)	0.5	3.0	5.5	8.0

Marrickville Sustainability Pathway

- The financial sustainability 'gap' of $7.9 million in FY28 is equivalent to a 6.2% reduction of FY28 controllable costs base or a 14.9% increase to rate base.
- Marrickville has the greatest levels of forecast population growth (12% from FY23 to FY28) and may see rate revenue grow which could assist in bridging the sustainability gap (net of higher population driven costs).
- Marrickville performance would be sensitive to (i) financial market fluctuations, affecting returns from property and other investments, and (ii) changing community needs, including use of the redeveloped library which is a key contributor to usage charges.
- Below provides ways in which Marrickville could bridge the sustainability gap, for example, if Marrickville receives additional external funding of $3.0 million it would need to achieve

$4.9 million of additional cost savings in order to achieve a breakeven result (excluding CG) in FY28. Marrickville's capacity as a standalone council to achieve incremental income or cost savings over this period has not been tested.

Figure 9: Marrickville's Resulting Operating Surplus excluding capital grants ($m)

		Additional rate revenue or external funding				
	$'m	-	1.5	3.0	4.5	6.0
Additional cost savings	-	(7.9)	(6.4)	(4.9)	(3.4)	(1.9)
	1.5	(6.4)	(4.9)	(3.4)	(1.9)	(0.4)
	3.0	(4.9)	(3.4)	(1.9)	(0.4)	1.1
	4.5	(3.4)	(1.9)	(0.4)	1.1	2.6
	6.0	(1.9)	(0.4)	1.1	2.6	4.1

8. Other Key Risks and Considerations

- Consistent with the demerger modelling presented, any demerger process will add cost and operational disruption that could worsen this financial position in the short-term.
- The IWC LTFP includes FY24 Materials and Services cost reductions that will require budgetary control measures. These are material to the opening position of the demerged councils (albeit at different levels given the different impacts of the merger between the three de-amalgamated councils).
- There is a current labour shortage impacting councils (as evidenced by current vacancy rates) and may further impact the demerged councils, noting the potential 10% increase in FTE to deliver the same services model as IWC. Over time, this labour constraint should normalise.
- The allocation of cash reserves, both to restricted and unrestricted funds, is also a critical consideration in a demerger scenario as it underpins the short-term liquidity position for the new councils. This has not yet been considered.