Environment Southland and Related Councils

Structural Options

environment SOUTHLAND REGIONAL COUNCIL
Te Taiao Tonga

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Table of contents

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1 Executive summary

Introduction

TDB Advisory Ltd (TDB) has been commissioned by Environment Southland (ES) to undertake a high-level review of options for integrating activities and services with other councils in order to deliver best value to the Southland region. This is in the context of councils facing financial pressure leading to large rates increases. In some cases, councils' future funding needs are approaching the upper limit of their borrowing capacity.

This review is undertaken in an environment where government has an increased focus on regionalism. A cohesive regional voice is necessary to be in a strong position to negotiate favourable government investment. New legislation relating to water services leaves structural choice with councils, but provides incentives to establish combined water services entities for reasons such as access to increased financing. This also raises the question as to whether other infrastructure-related services could be more efficiently delivered via a similar combined entity.

Current structural arrangements

The Southland region has the second largest geographical area and the longest coastline of any region in New Zealand. The region is currently governed by one regional council, one city council and two district councils. That could be considered an excessive and potentially inefficient governance structure considering the relatively low population of just over 100,000. However, by OECD standards the number of councils per capita in Southland is comparatively low.

The four councils have shown they can work well together to improve services within the current structure. The region's Shared Services Committee has delivered on many joint initiatives. The Southland Water & Land Plan, which became largely operative in May 2024, is a recent success. However, at times progress on regional collaboration has been slow and impacted by differing political, community and economic interests.

In 2024, the Otago-Southland Mayoral Forum directed chief executives to look at further collaboration and shared services. Subsequently management consulting firm Morrison Low was engaged to explore regional delivery models and has released its report recommending a joint asset-owning entity as the best solution for the future of water services in the two regions.[1] However, since that time Southland's Councils have not found common ground on the best way forward together. SDC and ICC are in favour retaining separate water service functions and Gore is looking at the potential of combining their water services with several councils in the Otago region.

Concurrently Southland District Council (SDC) commissioned a report that concluded the current structure of local government in Southland is no longer adequate. The report recommends two unitary authorities for the Southland region, one based around current Invercargill City Council (ICC) boundaries, and the other comprising the remaining Southland and Gore districts. TDB disagrees with the analysis and conclusions reached in that report and details the reasons why in Appendix 1.

SDC subsequently used the above-mentioned report as the basis of a document titled "Southland Local Government: Together, Our Future". They submitted this to the Local Government Commission (LGC) in February 2025 and requested LGC investigate reorganising local government in the region into two unitary authorities.

Analysis of the financial benefits from scale

This report draws on extensive analysis by TDB and earlier work by the New Zealand Institute of Economic Research (NZIER)[2] on the relationship between scale and financial efficiency in local government. This is to draw conclusions relevant to Southland. It also assesses examples of the cost of amalgamation and transitioning to new

[1] Morrison Low (2024).

[2] NZIER (2012).

local government structures. Wellington Water Limited (WWL) is used as a case study of a functional merger to highlight certain lessons to keep in mind when considering potential changes in Southland.

1. Economies of scale in local government

Larger entities can achieve scale benefits from things like bulk-purchase pricing, automation of activities and spreading of fixed costs across more outputs. These benefits however can be offset if bureaucracy grows disproportionately in terms of processes and hierarchies, operations become more complex, and reduced competition lowers motivation to improve.

In a local-government context, earlier studies show evidence of financial benefits in amalgamating councils up to about 50,000 to 100,000 population,[3] but little evidence of further benefits for councils with larger populations. Our analysis of more recent data from Stats NZ indicates marginal cost efficiencies may continue up to around 200,000, after which costs per capita appear to rise – forming a U-shaped cost curve. Economies of scale are more apparent in relation to the capital-intensive network activities of water and roading services, and less apparent in more local, community-based services. However, even with the network services the true benefits are often exaggerated.

This evidence points to the merits of investigating options for merging these network functions across a region (or wider), especially if the adverse effects of full council amalgamations (such as negative impacts on local democracy) are considered prohibitive.

2. Scale benefits from amalgamating water services

Given the evidence mentioned above, the focus on amalgamating water services is sensible. It is unfortunate this has been in the context of sometimes wildly exaggerated predictions of up to 80% cost savings. In recommending a joint asset-owning entity for Otago/Southland, Morrison Low has wisely scaled back previous savings predictions by 75%. Morrison Low predicts savings of between 15% and 16% being achieved some 12 years after commencement. TDB agrees that that level of savings is possible, but considers it at the upper end of likely outcomes given the challenges involved in the sector and the transition process.

3. Transition and other costs of amalgamating councils

This report presents examples of transition costs which highlight the magnitude of the costs that can be incurred. Morrison Low has estimated the costs of establishing a joint asset-owning water services entity for Otago/Southland at $50.6 million. The potential costs of each option for various Southland reorganisation options haven't been estimated, as that would be speculative without detailed analysis. However, the options have been ranked relative to each other in terms of likely costs.

Despite these potentially high costs of transition, investing adequately in the establishment of and transition to any merged entity is essential. The history of water services in the Wellington region provides an example where underinvestment in systems and processes upfront have almost certainly cost more in the long run in terms of lost potential efficiencies and savings.

Assessment of the alternative structural options

While considering the research referenced above, five structural options have been assessed against the status quo using four criteria on a -5 to +5 scale.

The results are shown on Table 1, ranked from highest to lowest scoring option.

[3] TDB Advisory (2013).

Table 1: Assessment of alternative structural options for Southland governance

Option	Effective services	Financial efficiency	Transition costs	Enabling democracy	Total score
One unitary council	4	5	−3	−3	3
Merged water services entity and other combined services	2	3	−2	0	3
ES plus one TA	3	4	−2	−3	2
ES, ICC plus merged SDC & GDC	1	2	−1	−1	1
Two unitary councils	1	3	−2	−2	0

Our conclusion is that the option of one unitary council for the Southland region is likely to yield the largest net benefits. A single council would produce scale benefits such as an enhanced capability to attract and retain staff and contractors and align services effectively across the region. It also provides the best opportunity to deliver financial savings by consolidating functions and reducing overheads. Transition costs would be significant, but with effective leadership these should be recovered through savings over future years. The reduction in elected members across the region could have a negative effect on local democracy, so care would need to be taken in designing representation arrangements through mechanisms such as local boards to ensure communities remained empowered appropriately.

The option of merging water services and potentially other network infrastructure services also ranks highly as these are the functions most likely to deliver economies of scale. We recommend the Southland region's councils continue investigating this option together with the Otago region, even though this approach now appears less likely to progress. It remains a model that is likely to yield net benefits even if combined with a merger of council entities.

The two options that involve merging local councils, but not ES, have some potential to deliver net benefits. However, not to the same extent as a single unitary authority.

The two unitary council option is ranked the lowest. The scale benefits would be limited as all functions, including ES's activities, would be split across two entities. Splitting ES's functions would increase transition cost and catchment management complexity. It is difficult to see this option proceeding through the Local Government Commission's (LGC) process given the LGC must ensure where practicable the boundaries of regions conform with catchment boundaries.

Progressing a local government reorganisation

Necessary steps in progressing a local government reorganisation include preparing a reorganisation initiative or investigation request and submitting it to the LGC; the LGC assessing the request through to final decision; and the transition process. From beginning to end this is likely to be a three to five-year project. The LGC's work alone has typically taken several years.

We emphasise the importance of developing a quality proposal to maximise the chance of success. This requires addressing the matters that will be critical to the LGC's work. Helpfully these matters are defined in the Local Government Act (LGA) and also in the LGC's guidelines. In particular, we consider enlisting and providing evidence of community support from residents, iwi and other councils is essential for the reorganisation initiative to be progressed.

A further important step is to carefully define the representation arrangements for all the proposed councils, community boards, local boards, and joint committees. Effective representation is essential to the purpose of local government to enable democratic local decision-making and action by, and on behalf of, communities. The proposal should demonstrate how that would occur. Intended arrangements for the involvement of iwi and Māori in the region's local government should also be described, together with the application of existing co-governance arrangements, and other mutual agreements.

As SDC has lodged an investigation request with the LGC in February 2025 the LGC will now be obliged to consult with affected local authorities including ES. It's now important for ES to determine its response to the LGC, including whether it wants an investigation to proceed and how it might best influence the outcome for the benefit of Southland. If a LGC investigation does proceed, ES should consider the benefits of being proactive rather than passive and prepare a well-researched alternative proposal to the one being promulgated by SDC.

2 Introduction and background

2.1 Purpose

Environment Southland (ES) has a strategy to achieve a solid and sustainable financial position and deliver improved services to its population. TDB Advisory Ltd (TDB) has been commissioned by ES to undertake a high-level review of options for integrating activities and services with other councils in order to deliver best value to the Southland Region. Integration could involve vertical integration with one or more of the territorial authorities (TAs) in its region or horizontal integration of certain services with neighbouring councils.

This review assesses the scope for achieving enhanced efficiency in the delivery of services through amalgamation or integration. It considers potential trade-offs that may result and associated issues.

2.2 The Southland region

Murihiku Southland is the second largest region in New Zealand, covering an area of 34,000 km^2. Population density is relatively low, with just over 100,000 people residing in the region.

Southland has the largest coastal boundary of any New Zealand region, extending 3,400 kilometres from Awarua Point on the West Coast to Waiparau Head on the fringe of the east coast and includes Rakiura Stewart Island. The region also contains tens of thousands of kilometres of rivers and streams and their catchments.

Over half of Southland's land area is public conservation land, with Fiordland being the largest national park in New Zealand covering 1,257,000 hectares. Farms occupy 85% of the remaining land. This gives Southland two distinct landscapes - expansive plains of fertile farmland crossed by rivers and Fiordland's rugged, isolated coastline, inlets, lakes and mountains.

Invercargill is the largest city in the region with a population of approximately 58,000 within the wider area including Bluff.

2.3 Environment Southland

Environment Southland is the brand name of the Southland Regional Council. ES is responsible for the sustainable management of Southland's natural resources – land, water, air and the coast. The Council's mission is "Working with the community to enhance Murihiku Southland's environment" and achieving the following outcomes: managed access to quality natural resources; diverse opportunities to make a living; communities empowered and resilient; and communities expressing their diversity.

ES's activity groups are: air quality; water & land; biodiversity & biosecurity; climate change & community resilience; coast & marine; and regional leadership. Its business across these groups involves: regulation & planning; science, research & monitoring; community engagement & education; partnerships; and council operations.

The nature of Southland's landscape, such as its large area, long coastline and extensive river catchments are major challenges. This is particularly so at a time when climate change, water quality standards and service expectations are driving large infrastructure investment needs. These issues are putting huge pressure on council budgets across the country.

Given these pressures, ES's financial performance has been strong in comparison to other councils. For example, unlike many other councils, ES has no net debt and are meeting balanced budget targets. Despite these good results, constraining rates increases to an affordable level remains a challenge.

2.4 Mana whenua

Ngāi Tahu are recognised mana whenua for Murihiku. ES acknowledges the importance of tikanga Māori and highly values its relationship with both Ngāi Tahu (through the four Murihiku Southland papatipu rūnanga, Te Ao Mārama Inc and Te Rūnanga o Ngāi Tahu) and ngā mātāwaka (those of differing tribal descent to mana whenua living within Murihiku Southland. Figure 1 below shows the South Island of New Zealand, outlining regional, district and city boundaries.Figure 1: South Island of New Zealand map

Source: Local Government New Zealand (2024).

3 Current structural arrangements

3.1 Regional and local government

The Southland region is currently governed by one regional council, one city council and two district councils. The relative scale of each organisation is shown in Table 2.

Table 2: Key metrics for the Southland councils

2024/25	Environment Southland	Invercargill City	Southland District	Gore District
	$m	$m	$m	$m
Rates revenue	29	79	72	27
Total revenue	50	152	120	53
Operating expenses	51	155	126	40
Total assets	118	1,446	2,439	588
Borrowings	17	182	107	59
Net debt	−16	135	66	55
Peak LTP debt	62	447	301	n/a
Peak LTP net debt	12	347	249	n/a
Rates increase	13%	10%	13%	21%
10 year LTP rates increase	101%	75%	75%	n/a
Population	102,600	57,900	31,833	12,396
Rating units	55,439	25,966	21,092	8,381
Land area (km^2)	34,000	390	29,575	1,250

Source: 2024-2034 Long-Term Plans of ES, ICC and SDC. 2025 Annual Plan of GDC[4]

Four councils could be considered a high number for a region of just over 100,000 people and has been sighted by some as an impediment to financial efficiency.

However, in an international context, New Zealand has a comparatively low number of local governments per capita. Table 3 below shows the small average size of selected European municipalities in 2002: twenty of the twenty five countries shown have average council sizes with less than 30,000 people per council; the UK is the outlier with councils serving on average 123,000 people. Australia currently has 537 councils serving a population of 27.1 million; an average of approximately 50,000 people represented by each council. The United States has an even lower ratio at an average of approximately 9,000 per council (calculated by dividing the US population by the number of municipal and town or township governments in the US. It does not include state governments, county governments or special purpose local governments.).

[4] GDC did not issue a Long-Term Plan in 2024.

Table 3: Average size of local governments in selected European countries

Country	% of municipalities below 1,000 citizens	Average population	Average area
	%	(no. of people)	(sq. km)
England and Wales	0	123,000	533
Lithuania	0	66,000	1,166
Yugoslavia	0	49,500	487
Bulgaria	0	35,000	432
Sweden	0	29,500	1,595
Holland	0.2	20,500	60
Denmark	0	18,000	150
Poland	0	16,000	130
Macedonia	3	15,800	209
Slovenia	3	10,300	106
Albania	0	10,000	77
Finland	5	10,500	730
Norway	4	9,000	710
Croatia	3	8,800	104
Roamnia	2	7,600	81
Italy	24	6,500	38
Estonia	9	5,700	178
Spain	61	5,000	60
Ukraine	n/a	4,600	56
Latvia	32	4,300	115
Hungary	54	3,300	32
Slovakia	68	1,900	17
Czech Republic	80	1,700	13
France	77	1,300	15

Source: P. Swianiewicz (2002).

The international comparatives from Table 3 above indicate that many jurisdictions see benefits in retaining comparatively small local government entities to serve their populations. Perhaps this is due to a better ability to support local engagement and democracy. This is important in the context of New Zealand's Local Government Act 2002 given its emphasis on democratic local decision-making. The Act states (s 10):

> (1) The purpose of local government is—
>
> (a) to enable democratic local decision-making and action by, and on behalf of, communities; and
>
> (b) to promote the social, economic, environmental and cultural well-being of communities in the present and for the future.

3.2 Shared council services in Southland

The Southland region's councils have proven they can work together when it counts. Although, at times progress can be slow and problematic. Examples of joint regional initiatives include:

- The joint Shared Services Committee was established in 2000 and includes the four councils in the Southland region plus Clutha District. It has delivered on over collaborative 50 projects for their member councils including some listed below;
- WasteNet was established as a working group in 2000 and subsequently as a formal joint committee of Invercargill City Council (ICC), Southland District Council (SDC) and Gore District Council (GDC). WasteNet contracts and manages regional solid waste services including the regional landfill contract;
- Emergency Management Southland was established in 2010 by the four Southland councils to provide civil defence and emergency management services to the region;
- Great South was established as the Southland Regional Development Agency in 2019 to provide a unified voice for the region towards its Vision of "Even better lives through sustainable regional development. The organisation is jointly funded by the four councils in the region and also has the Invercargill Licencing Trust, Southland Chamber of Commerce, Southern Institute of Technology and Community Trust South as shareholders; and
- The Southland Water & Land Plan, which became largely operative in May 2024 after many years of work with the community and progressing through the Environment Court. While the Plan was ultimately delivered, there are concerns that the process took far too long.
- The Murihiku Southland Regional Climate Change Strategy was adopted in 2024. This followed the establishment of the Regional Climate Change Working Group in 2022 comprising representatives of councils in the region and Te Ao Mārama

3.3 Looking ahead

In February 2024 the Otago-Southland Mayoral Forum directed their chief executives to form a working group to consider further regional collaboration and shared services. Subsequently, management consulting firm Morrison Low was engaged to explore regional delivery models and has just released its report recommending a joint asset-owning entity as the best solution for the future of water services in the two regions. Individual councils are currently considering their responses and are likely to consult on options in early 2025. It now appears likely that councils will not opt for the joint model recommended by Morrison Low as they are considering other options.

SDC commissioned a report titled Southland Local Government Structural Opportunities: Preliminary Forward Planning (the "SDC Report"). The report concludes that "…the current structure of local government in Southland is no longer adequate to meet the current and future needs of its people" (para. 21). It also finds that "…a structural reform proposal led by Southland District for the benefit of the people it serves along with other communities in Southland is required" (para.27).

The recommended option is for two unitary authorities for the Southland region, one based around current ICC boundaries and the other comprising the remaining Southland and Gore districts.

TDB agrees with some commentary in the SDC Report, but disagrees with several critical arguments put forward and ultimately the conclusions reached. Those areas of disagreement are outlined in Appendix 1.

SDC subsequently used the SDC Report as the basis of a document titled "Southland Local Government: Together, Our Future". They submitted this to the Local Government Commission (LGC) in February 2025 and requested LGC investigate reorganising local government in the region into two unitary authorities.

Prior to this report addressing alternative options for Southland directly, the following section discusses financial considerations relating to scale and amalgamations.

4 Analysis of the financial benefits from scale

A general perception exists that economies of scale provide financial benefits to larger entities and as a result they become more efficient. There is a logical rationale for this as scale provides opportunities for things like bulk purchase pricing, automation of activities and spreading of fixed costs across more outputs. However, these benefits don't always translate into lower costs for consumers. Offsetting diseconomies can arise if bureaucracy grows disproportionately in terms of processes and hierarchies; governors, executives and managers expect increased remuneration; operations become more complex; and reduced competition lowers motivation to improve.

In a local government context, there have been various studies done to assess the financial efficiency of organisations of different sizes. The results of those studies need to be considered with a degree of caution as every council has different circumstances, but the studies do highlight some relevant trends. Our earlier analysis indicates financial benefits in amalgamating councils up to about 50,000 to 100,000 population,[5] and our analysis of more recent data indicates marginal gains may be achieved up to populations of around 200,000 but there is little evidence of further benefits for councils with larger populations (refer Appendix 2).

There is a clear difference however when looking at specific council services. Potential economies of scale are more apparent in relation to the capital-intensive network activities of water and roading services, however even there the true benefits are often exaggerated.[6] This evidence points to the merits of investigating options for merging these functions across a region (or wider), especially if the adverse effects of full council amalgamations (such as negative impacts on local democracy) are considered prohibitive.

4.1 Updating TDB Advisory's 2013 analysis of size and cost-effectiveness

TDB published "Governance options for the Wellington and Wairarapa regions: An economic and financial assessment" in 2013. The report is available via the following link: tdb.co.nz/wp-content/uploads/2016/05/TDB-Advisory-Assessing-regional-governance-options-2013.pdf. The relevance of that report is its detailed analysis of available evidence relating to scale benefits in the local government sector. The analysis draws on, and explores further, analysis undertaken by the NZIER in 2012 as well as other local and international research.

The following is an extract from the executive summary of TDB's 2013 report:

> "Our report focuses primarily on cost-effectiveness. We review the international literature on the relationship between size and cost-effectiveness of local government. We also examine the expenditure data from the approximately 70 territorial authorities in New Zealand over the last five years to assess the relationship between size and cost-effectiveness across the different functions of local governments in New Zealand and for the councils' operations as a whole.
>
> Our review of the extensive international studies on the topic reveals no consensus on the optimal size of local government. Some studies find smaller councils are more efficient, some find larger councils are more efficient and some find a U-shaped cost curve (where per capita costs first decline then level off and then start rising as population increases). In their literature review on the existence of economies of scale in local government, Byrnes and Dollery make a similar observation:

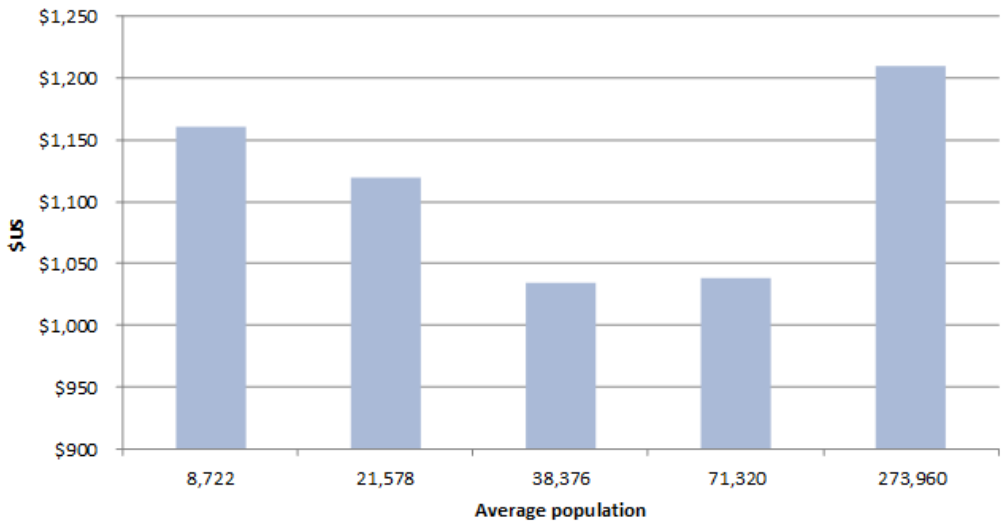
[5] See TDB Advisory (2013).

[6] In a paper published in New Zealand Economic Papers, Phil Barry of TDB Advisory and Dr Tom Stannard of Otago University found that the main driver for lower unit costs in local network activities is increasing population density, not increasing population per se. The paper examined electricity distribution companies but the finding is relevant to other local network monopolies like water and roading. See Barry and Stannard (2024).

'Overall, 29% of the research papers find evidence of U-shaped cost curves, 39% find no statistical relationship between per capita expenditure and size, 8% find evidence of economies of scale and 24% find diseconomies of scale. From this evidence alone we can conclude that there is a great deal of uncertainty about whether economies of scale exist in local government service provision.[7]"

Figure 2 below is an indicative example of the U-shaped cost curves referred to above.

Figure 2: Expenditure per capita for US local governments (USD)



Source: Frontier (2003).

We have updated the 2013 TDB analysis using the Statistics NZ (Local authority financial statistics: Year ended June 2023) data which is available to 2023 on an annual basis.[8] Our update finds a similar lack of a simple unequivocal relationship between size and efficiency in local government. Our earlier study indicated that there are likely to be efficiency gains from combining councils of up to around 50,000 to 100,000 people but beyond that found little or no evidence that further efficiency gains are available from amalgamation in respect of the majority of local public services provided by councils. Our analysis of the updated data from Stats NZ confirms that the bulk of the financial benefits from amalgamation occur in mergers involving populations up to the around 50,000 to 100,000 population threshold and marginal efficiency gains may continue up to a population of around 200,000, after which per capita costs begin to rise – forming a U-shaped cost curve, a pattern also observed in Figure 2 above.

The evidence also suggests that, when considering the optimal structure of local government, it is necessary to differentiate between the different functions of local government: i.e. to follow the principle that "form should follow function". Our and the earlier NZIER's analyses of expenditure data from the approximately 70 territorial authorities (TAs) in New Zealand over the last twenty years indicates:

- for the capital and expertise-intensive network operations like land transport and the three waters (potable water, storm water and waste water), there are economies of scale that merit a region-wide perspective regardless of the structure of other local government functions. In the case of water, for example,

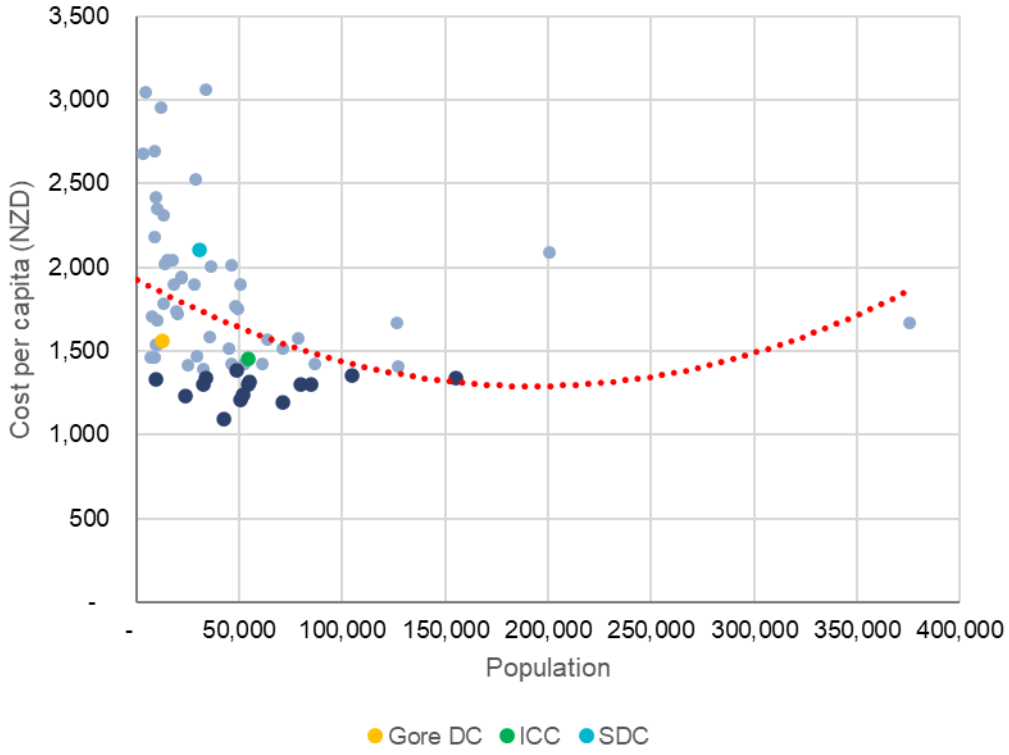
[7] Byrnes and Dollery (2002).

[8] Stats NZ (2023). The Stats NZ data covers expenditure by all local authorities – ie, both territorial authorities (city councils, district councils and unitary authorities) and regional councils. Expenditure by regional councils is excluded from our analysis.

PricewaterhouseCoopers (PwC)[9] found benefits of up to around $5m annually could be expected if the three waters were managed by a single organisation (e.g. Capacity Infrastructure Services (Capacity)) across the Wellington region. These capital-intensive functions where our analysis suggests there is also a good case for network-wide amalgamation account for around 34% of local government expenditure in the Wellington and Wairarapa regions; and

- in regard to the other, more labour-intensive activities, of local councils like environmental protection, recreation and sport, and noise and dog control the case for amalgamation is weak. The evidence suggests councils are likely to gain more from moving to best-practice management and operational techniques than from increasing their scale through amalgamation with other councils. The Productivity Commission in its 2013 review of local government regulation[10] reached a similar conclusion. The Commission found that "the size of the local authority did not seem to be a factor in the extent councils followed adequate regulatory decision-making processes. Rather, leadership, culture and organisational management are the key driving factors."

Figure 3 below presents our updated analysis, based on the TAs' average annual total expenditure between 2003 and 2023.Figure 3: Average annual total operating expenditure and average population for NZ TAs, 2003 to 2023



In line with the findings discussed above, Figure 3 shows that most efficiency gains from amalgamating small councils occur when increasing the population size of TAs up to about 50,000 to 100,000, with further marginal gains up to around 200,000. Beyond this point, diseconomies of scale begin to emerge – forming a U-shaped cost

[9] PwC (2012).

[10] New Zealand Productivity Commission (2013).

curve, where per capita costs initially decline with increasing population but rise again as councils become too large. This analysis is based on the average total expenditure of TAs in NZ from 2003 to 2023.

The figure also highlights the lowest cost councils (the bottom 25th percentile as shown in dark blue) and the relative positions of GDC, IC and SDC. GDC and ICC are near the lower end of the dataset, close to the 25th percentile of councils with the lowest per capital expenditure, while SDC has a higher cost per capita than the other two Southland TAs quite possibly reflecting its more dispersed population and its need to deliver services across a larger geographic area. Further information on our analysis is provided in Appendix 2.

4.2 Recent international research

Since TDB's 2013 report there have been some notable examples of studies exploring the relationship between the size of local governments and their efficiency. The nuanced relationship between local government size and efficiency continues to be apparent. While larger municipalities may benefit from economies of scale, they also face challenges related to accountability, local responsiveness and service quality. Medium-sized local governments often strike a balance that allows for both efficiency and a more personalised approach to service delivery.

A brief summary of the findings of these reports is provided below:

- Bel (2012) found that there is a non-linear relationship between council size and efficiency. While smaller councils often face inefficiencies due to underutilisation of resources, very large councils may also become inefficient due to governance and management issues. The optimal size for efficiency varies depending on the service, population density and organisational structure. The study recommended solutions such as inter-municipal cooperation and service fragmentation in large councils. For smaller municipalities, cooperation in service delivery resulted in lower costs, while service fragmentation in larger cities produced mixed results depending on scale and competition;[11]

- Joseph, Miyazaki and McQuestin (2024) found that larger local governments are less financially sustainable, opposing general norms. The authors used a five-year panel of data to test the association between size and financial sustainability, concluding that the assumption that larger governments are more sustainable is not supported by empirical evidence;[12]

- Research by the New Zealand Infrastructure Commission (2022) explored the impact of local government structure on cost efficiency. The report indicates that council size is neutral for cost efficiency in three key areas: road maintenance; building consent processing; and overhead costs for governance and support services. The study also found no evidence that larger councils are more cost-efficient than smaller councils. Other factors, such as population density and road surface quality, have a more significant impact on costs than council size, challenging the assumption that larger local governments are inherently more efficient and sustainable;[13] and

- The Office of the Auditor-General (2023) in New Zealand briefly touched on the issue of council size, highlighting its impact on resourcing and engagement with reform processes. Smaller councils often struggle due to limited resources, whereas larger councils tend to have greater capacity to participate in reforms due to better access to resources.[14]

[11] Bel (2012).

[12] Drew, Miyazaki and McQuestin (2024).

[13] New Zealand Infrastructure Commission (2022).

[14] Office of the Auditor-General (2023).

4.3 Scale benefits from water services amalgamation

As noted above, analysis by TDB has identified that certain council services show stronger evidence of scale benefits, most significantly roading and water services. Water services mergers are being considered across the country at present, so it's worth exploring the potential benefits in this area more closely.

Unfortunately, the predicted savings from various iterations of water service amalgamations in New Zealand have varied so wildly that they give the appearance of being speculative. Promised savings under the previous government's Three Waters proposals were based on work by the Water Industry Commission for Scotland (WICS). The Department of Internal Affairs FAQ promoted the reforms as delivering savings between 58% and 82% with this statement on its FAQ page:

> ***What will be the costs to households / ratepayers?***
>
> *"The analysis shows that without reform the cost per household could be between $1,900 and $9,000 per year over the next 30 years, depending on location. With reform, costs are projected to range between $800 and $1,640."*

In early 2023, the then government announced a reset of the Three Waters Plan. The now "Affordable Water" model was for more entities, with massive savings forecasts still based on the work by WICS. The headline statement was now:

> ***What will be the costs to households / ratepayers?***
>
> *"Without reform, average costs per household in 2054 are estimated to range from $3,900 to more than $10,000 per year in some districts over the next 30 years. After reform, costs per average household are projected to range between $1,460 and $4,430."*

Even in the Wellington region where the final proposed entity was only slightly larger than the existing Wellington Water Limited company, savings were predicted to be between 56% and 83%. Table 4 shows individual council savings predictions from WICS for Otago/Southland and Wellington.

Table 4: Affordable water savings forecasts by council in 2054

Council	Status Quo ($)	Three Waters ($)	Savings ($)	Savings (%)
Otago/Southland Entity				
Southland District Council	15,450	4,430	11,020	71%
Invercargill City Council	6,660	4,430	2,230	33%
Gore District Council	8,390	4,430	3,960	47%
Dunedin City Council	8,020	4,430	3,590	45%
Clutha District Council	22,080	4,430	17,650	80%
Central Otago District Council	10,490	4,430	6,060	58%
Queenstown Lakes District Council	13,320	4,430	8,890	67%
Wellington Entity				
Porirua City Council	5,130	2,280	2,850	56%
Hutt City Council	5,280	2,280	3,000	57%
Upper Hutt City Council	5,540	2,280	3,260	59%
Wellington City Council	5,380	2,280	3,100	58%
Kapiti Coast District Council	5,620	2,280	3,350	60%
South Wairarapa District Council	13,750	2,280	11,470	83%
Masterton District Council	8,890	2,280	6,610	74%
Carterton District Council	9,120	2,280	6,840	75%

Source: Water Industry Commission for Scotland (2021).

According to Table 4, savings for the Otago/Southland entity range between 33% and 80% while the Wellington entity achieves higher savings, ranging from 56% to 83%.

It is worth noting that at least two peer reviews were conducted on the WICS forecasts:

- Castalia – Flaws in Water Service Entities Bill. This report was commissioned by Communities 4 Local Democracy (a group of councils against the Three Waters reforms). Castalia also prepared reports for some individual councils. Castalia states the savings predicted by WICS are highly implausible and based on faulty modelling; and

- Farrierswier – a critique of Castalia's reports. This response was commissioned by the Department of Internal Affairs. Farrierswier challenged some of Castalia's claims and supported the existence of amalgamation savings, but didn't validate the large scale predicted by WICS.

In our opinion, savings promised for the Three Waters and Affordable Water models were not credible. They did not stand up to a common-sense review. This was readily apparent in the Wellington context as the primary rationale given for savings was economies of scale. Given the entity proposed for the Wellington region was only marginally larger than the existing Wellington Water Limited, further economies of scale cannot be so significant and may in fact be negative given the proposed expanded entity extended across multiple catchments.

Future water service costs are overwhelmingly driven by the cost of infrastructure construction; its funding and depreciation charges. Savings of the magnitude promised could only be achieved if infrastructure construction costs were cut in half, if not more. This is not an achievable benefit from changing organisation structures.

Helpfully, savings predictions now being applied during modelling for the Wellington region's water services entity discussions are much lower albeit still a work-in-progress at this stage.

Turning the focus to the Otago/Southland region specifically, the recent Morrison Low report analyses the potential for savings through amalgamating water services across the two regions. It is notable that Morrison Low have scaled back the WICS savings predictions by 75% and that this is supported by a bottom-up analysis. Morrison Low comments (Appendix 3, page 68, Otago Southland water services entity assumptions):

> ***Operating and capital efficiencies***
>
> *Efficiencies have been modelled using the efficiency data produced by the Water Industries Institute of Scotland (WICS) for the Department of Internal Affairs (DIA) as a base case, noting the following adjustments:*
>
> - *The total achievable efficiency identified by WICS have been scaled back by 75%. These total achievable efficiencies have been compared to our bottom-up estimates to confirm that scaling is appropriate. This has reduced the total achievable efficiencies from 50% capital and 53% operating efficiencies to 13% capital and operating efficiencies.*
> - *Efficiencies have then been scaled according to data produced by WICS in reports produced for DIA. This has resulted in modelled scale efficiencies of 15% capital and 16% operating efficiencies.*
> - *We have assumed that these efficiencies are achievable over a ten-year period commencing two years after the establishment of the entity. Efficiencies are modelled as being achieved evenly over that period.*

Intuitively savings of 15% to 16% being achieved some 12 years after commencement may be possible given the size of the water services entity proposed for Southland/Otago in comparison to current delivery arrangements. However, achieving this level of savings would require sustained determined governance and leadership focus, and sufficient upfront investment to establish efficient systems and processes. Therefore, it is TDB Advisory's view that this level of savings is at the upper end of the likely outcomes. It is also worth noting that these savings may not result in an overall reduction in expenditure, as the impact of climate change and demands for service level improvements are likely to continue and offset the savings achieved under any delivery model.

An important factor apparent in Morrison Low's modelling is that savings don't fall evenly across councils. Accordingly, the benefits of participating in their recommended single water services entity for the two regions differ significantly by council. Importantly however, benefits are still possible if one or two of the larger councils opt out.

It is evident that assessing financial savings from water services amalgamations involves many judgement calls and every set of eyes will produce a different answer. Overall, our considered view is that the current savings estimates being applied in the Otago and Southland regions are far more reasonable and reliable than those previously promulgated to promote water reforms in New Zealand.

4.4 Transition and other costs of amalgamating councils

As indicated above the financial outcomes from amalgamating entities and services can be difficult to predict and vary widely. In many instances there are unexpected costs and challenges.

Direct costs of amalgamations include consultation and planning; transition arrangements such as legal advice, administration and meeting contractual obligations to staff; and infrastructure upgrades which are often needed to standardise services and ensure consistent quality. Information technology investment can be substantial.

There are also indirect costs of amalgamations which can be even more difficult to quantify. Risks such as disruption to services and reductions in employee morale and productivity during the transition are considerations that require focus and some investment to mitigate.

Before considering the costs of amalgamation scenarios in Southland, it's worth considering the reported costs of other council mergers. Some examples are:

- Morrison Low have estimated transitional costs to establish an Otago/Southland water services entity would be $50.6 million;[15]
- In 2015 the Local Government Commission estimated the costs of amalgamating the nine councils in the Wellington region to be $210 million;
- In 2013 Peter Winder's report to Hawkes Bay Regional Council on the potential merger of councils in the region estimated costs of $13.6 million to $18.4 million;
- In 2010 Local Govt Minister Rodney Hide announced transition and IT system establishment costs were forecast to be $160 million for the new Auckland Council (this in the context of an annual $2 billion council spend). It's hard to gauge what the eventual costs were. IT cost overruns were regularly reported, but it is unclear to what extent they could be considered costs of amalgamation as opposed to costs the previous councils would have incurred anyway. The most substantial figure quoted was in a NZ Herald article on 29 February 2016 "Council's $1b in IT costs wasted". The total spend referred to was $1.2 billion which included costs incurred by their infrastructure council-controlled organisations (CCOs); and
- Turning to Australia, in 2008 157 councils in Queensland were amalgamated into 73. The reported costs of the amalgamation were $184 million. In 2015 the New South Wales Parliamentary Budget Office estimated the gross cost of amalgamating 152 councils into 38 was A$445 million or an average of $12 million per new council. Many forced amalgamations did occur, but they have been controversial with claims of savings not being realised and steps taken to facilitate demergers which have occurred in some instances.

It is worth emphasising the importance of investing adequately in the establishment of and transition to any merged entity. The history of water services in the Wellington region is summarised and commented on in Appendix 3. The Wellington experience provides a clear example of where underinvestment in systems and processes upfront have cost far more in the long run in terms of lost potential efficiencies and savings.

At this early stage of considering options for Southland, estimating amalgamation costs would be difficult. To assist in comparing high-level options we have ranked the likely implementation costs from as follows:

Moderately high	– Single unitary council
Moderate	– Two unitary councils
Moderate	– Regional council and single local council
Moderately low	– Regional council and two local councils
Moderate	– Merged water services entity

[15] Morrison Low (2024), p. 69.

5 Alternative structural arrangements

5.1 Why consider change?

The desire to achieve a solid and sustainable financial position and better services for the region are behind the call to consider alternative structural options for Southland. All councils are facing financial pressure leading to large rates increases (refer Table 2 in Section 3.1 above). In some cases, councils' future funding needs will approach the upper limit of their borrowing capacity.

Since the change in government, Environment Southland has noticed an increased focus on regionalism. This change has been evident in several ways:

- The government's language has changed and it has been using the term "regional deals" in place of "city deals".
- At a recent Local Government New Zealand Conference, government ministers emphasised they wanted to be dealing more with united regions rather than individual councils. Similar comments have been made by ministers in other settings.

To be in a strong position to negotiate favourable government investment in the Southland region a cohesive regional voice is necessary. While there are joint council forums that help towards that purpose, when multiple organisations are required to work together with sometimes competing interests achieving agreement and optimal outcomes is more difficult and time consuming.

New legislation relating to water services leaves structural choice with councils, but provides incentives to establish water services entities for reasons such as access to increased financing. Reestablishing water service operations into a new entity lends itself to cooperating with neighbouring councils to generate efficient scale. If a water services entity is set up for the region, or jointly with Otago, the district and city councils will reduce in scope and scale of their operations, potentially adding further weight to calls for TAs' amalgamation. It also raises the question as to whether other infrastructure related services could be more efficiently delivered via a similar combined entity.

The lodging of a request for LGC to investigate reorganising local government in the Southland region creates further incentive for informed debate on this issue. This is especially the case given the request promulgates an option that TDB Advisory considers to be sub-optimal.

5.2 What are the options?

There is a large number of possible alternative structures for regional and local government services in Southland. We have necessarily focused on those we consider to have the greatest potential merit:

1. **One unitary council**. This option combines ES, ICC, SDC and GDC into a single unitary council. An indication of the scale of the entity is provided in Table 5 below;

Table 5: One unitary council

2024/25	Southland Council
	$m
Rates revenue	207
Total revenue	375
Operating expenses	372
Total assets	4,591
Borrowings	365
Net debt	240
Population	102,600
Rating units	55,439
Land area (km2)	34,000

Source: TDB analysis.

2. **Two unitary councils**. This option has one unitary council for the Invercargill area and another unitary council for the remainder of the region. The indicative scale of the two entities is provided in Table 6 below;

Table 6: Two unitary councils

2024/25	Invercargill Council	Southland Council
	$m	$m
Rates revenue	93	114
Total revenue	175	200
Operating expenses	179	193
Total assets	1,501	3,090
Borrowings	190	175
Net debt	128	112
Population	57,900	44,700
Rating units	25,966	29,473
Land area (km2)	390	33,610

Source: TDB analysis.

3. **Regional council and merged local councils**. This option retains Environment Southland as the regional council and has one local council covering the entire region. The indicative scale of the two councils is provided in Table 7 below;

Table 7: Regional council and merged local councils

2024/25	Environment Southland	Southland Council
	$m	$m
Rates revenue	29	178
Total revenue	50	325
Operating expenses	51	321
Total assets	118	4,473
Borrowings	17	348
Net debt	−16	256
Population	102,600	102,129
Rating units	55,439	55,439
Land area (km2)	34,000	31,215

Source: TDB analysis.

4. **Regional council, ICC and merged SDC and GDC**. This option retains ES as the regional council, with ICC and another local council (a merged SDC and GDC) serving the rest of the region as per the indicative Table 8 below; and

Table 8: Regional council, ICC and merged SDC and GDC

2024/25	Environment Southland	Invercargill City	Southland + Gore DC
	$m	$m	$m
Rates revenue	29	79	99
Total revenue	50	152	173
Operating expenses	51	155	166
Total assets	118	1,446	3,027
Borrowings	17	182	166
Net debt	−16	135	121
Population	102,600	57,900	44,229
Rating units	55,439	25,966	29,473
Land area (km2)	34,000	390	30,825

Source: TDB analysis.

5. **Merged water services entity and other combined services**. This option includes establishing a combined water services entity and other shared services. It differs from the other options above in that analysis is already underway and the scope extends beyond Southland's boundaries to include the Otago region. The

current emphasis is on water services, but other capital-intensive network services have the potential to provide benefits. Roading is an obvious candidate, but flood protection works could also be considered.

6 Assessment of the alternative structural options

6.1 Assessment methodology

This section provides a high-level evaluation of the five options described above. These high-level evaluations compare each option to the status quo, which is of course a valid option itself.

Each option has been assessed against four key factors:

1) **Effective services**. Supporting effective service delivery across the region. Includes the ability to attract and retain staff and contractors and align services and processes where beneficial for residents and businesses. It also reflects the need to comply with LGA Schedule 3, 17 such that if practicable, the region's boundaries comply with catchment boundaries;
2) **Financial efficiency**. Potentially reducing average costs for the region through economies of scale and reduction of duplication and increasing funding capacity for infrastructure investment;
3) **Transition costs**. The cost of change (e.g. financial, service disruption); and
4) **Enabling local democracy**. Enabling democratic local decision-making by, and on behalf of, local communities.

Should ES decide to investigate any of these options further, other important criteria will need to be considered early in the process. These criteria include the likelihood of support for the favoured options from the community in general, iwi, Māori and other organisations specifically, and the views of other councils. These matters are discussed further under Section 8: Progressing a local government reorganisation.

For comparability purposes, the assessment of Option 5: Merged water services entity and other combined services, has been based on a combined water services entity for Otago and Southland only. Potential benefits and costs of merging other services have not been reflected below as it would become too subjective and require further analysis.

Scores against each of the five criteria have been allocated on a scale of -5 to +5. A score of zero indicates a level similar to the status quo.

6.2 Effective services

Table 9: Options assessed against effective services

Option	Score	Comment
One unitary council	4	A large entity providing all Southland's regional and local government functions would have increased capability to attract and retain staff and contractors, and align services effectively across the region. There is risk of an expanded bureaucracy and services being less tailored to local requirements.

Two unitary councils	1	Amalgamating councils into just two entities would increase scale and ability to attract and retain staff to a moderate extent. However, splitting ES activities into two separate organisations could compromise catchment management effectiveness and offset other benefits.
ES plus one TA	3	The merging of Southland's local council functions into one entity would increase scale and capability to attract and retain staff and contractors, and align services effectively across the region. Resourcing challenges within ES would not be resolved.
ES, ICC plus merged SDC & GDC	1	The merging of TDC and GDC functions would slightly increase scale and capability to attract and retain staff and contractors for services across those districts. Any other resourcing challenges within ES and ICC would not be resolved.
Merged water services entity and other combined services	2	A combined water services entity for Otago and Southland would have significant scale and enhance capacity to attract and retain staff and contractors for water services. There would be no benefit in relation to other services unless they were similarly amalgamated.

6.3 Financial efficiency

Table 10: Options assessed against financial efficiency

Option	Score	Comment
One unitary council	5	This option provides the greatest reduction in entities. It is the one most likely to reduce overheads and generate economies of scale.
Two unitary councils	4	Potential economies of scale from amalgamating councils will be somewhat offset as result of splitting regional council activities and establishing them in two separate entities.
ES plus one TA	4	This option is likely to generate greater financial efficiencies than a two unitary model, because it results in less duplication of functions.
ES, ICC plus merged SDC & GDC	2	Some financial efficiencies would be possible from amalgamating SDC and GDC.
Merged water services entity and other combined services	3	Capital intensive infrastructure activities are most likely to generate economies of scale. A combined water services entity has the added benefit of being to access increased borrowings levels from the Local Government Financing Agency, should that become necessary. Savings will be somewhat offset due to the overheads created by having an additional local government entity in the region.

6.4 Transition costs

Table 11: Options assessed against transition costs

Option	Score	Comment
One unitary council	-5	Costs would be high due to the extensive change needed to merge the four current entities, align processes and increase systems capacity within one organisation.
Two unitary councils	-4	While not as costly as the one unitary option, costs would be still be moderately high in part due to the added complication of splitting ES's activities across two organisations.
ES plus one TA	-3	Costs for this option would be lower than for the unitary options as ES's activities would not change.
ES, ICC plus merged SDC & GDC	-2	The cost of amalgamating just SDC and GDC would be low in comparison to the other change options.
Merged water services entity and other combined services	-3	The cost of amalgamating selected services would be lower than the costs of amalgamating entire organisations. However, extra expenditure would be needed to establish a new entity of sufficient scale to service Otago and Southland regions.

6.5 Enabling local democracy

Table 12: Options assessed against enabling local democracy

Option	Score	Comment
One unitary council	-4	The reduction in elected members across the region potentially reduces local involvement in decision making. This could be offset to some degree by the use of local boards or other bodies with decision making powers. On the other hand, some groups may actually prefer engaging with a single local government entity across the region rather than requiring multiple relationships and processes.
Two unitary councils	-2	The reduction in elected members across the region potentially reduces local involvement in decision making, but to a lesser extent than for the one unitary option. This could be offset to some degree by the use of local boards or other bodies with decision making powers.

ES plus one TA	-3	The reduction in elected members across the region potentially reduces local involvement in decision making, but to a similar degree as the two unitary option. This could be offset to some degree by the use of local boards or other bodies with decision making powers.
ES, ICC plus merged SDC & GDC	-1	The reduction in elected members across the region potentially reduces local involvement in decision making, but to a lesser extent than any of the options above. This could be offset to some degree by the use of local boards or other bodies with decision making powers.
Merged water services entity and other combined services	-1	There would be a reduction in local influence over merged services due to decision-makers being more remote from the user.

7 Recommended structure

7.1 Assessment summary

Table 13: Scoring of alternative structural options for Southland governance

Option	Effective services	Financial efficiency	Transition costs	Enabling democracy	Total score
One unitary council	4	5	−3	−3	3
Merged water services entity and other combined services	2	3	−2	0	3
ES plus one TA	3	4	−2	−3	2
ES, ICC plus merged SDC & GDC	1	2	−1	−1	1
Two unitary councils	1	3	−2	−2	0

While subjective judgement is involved in scoring structural options, we are satisfied that the order above fairly reflects the relative merits of each option based on the criteria chosen.

7.2 Recommendations

The two lowest ranking options (ES, ICC plus merged SDC & GDC which scored 1, and two unitary councils which scored 0) haven't been considered further as we believe they will not provide optimal outcomes for the region. Significant benefits should be available to justify taking on the substantial risks inherent a major restructuring of organisations and services. That is not the case with these options.

In considering the remaining options, note that merging councils does not prevent pursuing further benefits from merging water services and/or other activities across wider geographical boundaries. However, the marginal gains will be lower due to already having captured some economies of scale by merging councils.

The option of retaining a separate regional council and amalgamating the TAs scored reasonably well at 2. This option might be further enhanced by selected functional changes to centralise resources and capabilities. For example, environmental planning responsibilities could be transferred from the TAs to ES. A precedent for changes along these lines was set when the Local Government Reorganisation Scheme (West Coast Region) Order 2019 transferred certain district planning obligations to the West Coast Regional Council. Although, we do not currently have information to gauge the effectiveness of this change in the West Coast.

Even if refinements like this were made to the option of retaining a separate regional council, we do not believe this form of restructure would surpass the potential of a single unitary council.

Our conclusion is that the option for one unitary council for the Southland region is likely to yield the largest net benefits and that those benefits may be further enhanced by merging water services across Otago and Southland regions.

8 Progressing a local government reorganisation

8.1 The process

Reorganising selected local councils in New Zealand takes a long time. The major parts of the process are: preparing and submitting a reorganisation initiative or investigation request to the LGC; the LGC's process to assess the reorganisation initiative or investigation request through to final decision; and the transition process.

8.1.1 Preparing a reorganisation initiative or investigation request

The LGA uses the term "reorganisation initiative" when referring to specific proposals for change and the term "investigation request" when referring to more general requests relating to local government problems and opportunities in an area. Preparing documentation for an investigation request or even a reorganisation initiative could be done quite quickly, but to improve chances of success it is advisable to invest time up front on matters such as analysing financial impacts in each affected district and their ratepayers, engaging with the community to incorporate their views and establish support (refer Section 8.2 below), and documenting a preferred system of electoral representation (refer Section 8.3 below). The submission to the LGC should address the matters that the LGC will be referring to during their deliberations. In particular those specified in the LGA including:

- Section 24AA Purpose of local government reorganisation provisions;
- Schedule 3 clause 6 Factors Commission must have regard to when deciding whether to undertake reorganisation investigation;
- Schedule 3 clause 10 Objectives that Commission must consider in reorganisation investigation; and
- Schedule 3 clause 14 Contents of reorganisation plan.

8.1.2 The LGC's process

Schedule 3 of the LGA specifies the steps the LGC must follow after receipt of a reorganisation initiative or investigation request. We haven't replicated those steps in this report as there is good guidance available on the LGC's website: https://www.lgc.govt.nz/our-work/local-government-reorganisation/about-local-government-reorganisation/.

In seeking to understand the length of time their processes could take, it's worth reviewing past investigations documented on the LGC's website. Here are some examples:

- in June 2015 the LGC received an application asking it to look at local government arrangements on the West Coast, with a view to making changes. In June 2019, the second Order in Council giving effect to the combined West Coast District Plan proposal was signed. This marked the end of the reorganisation process for the LGC, but only the beginning of the work to implement the changes;
- a proposal to establish a local board in Tasman took two years to reach final decision not to proceed; and
- on 22 May 2013, the LGC received a reorganisation application from Masterton, Carterton and South Wairarapa district councils. The application was for the union of the three Wairarapa districts and the constitution of a unitary authority for the united area. Towards the end of the LGC's work in late 2017, a postal ballot held and a majority of votes opposed the proposal. The result was binding and ended the LGC's process.

The Local Government Act 2002 Amendment Act 2019 simplified the process somewhat, but there's a lack of recent examples available to gauge the extent to which this has reduced timeframes. It seems probable that a period of at least two-years would be taken between the LGC receiving a reorganisation initiative or

investigation request and a final decision to proceed in some form. The process could reach a conclusion sooner if the LGC decides not to proceed with an investigation.

8.1.3 The transition

When it comes to the transition process, Auckland Council provides a useful example even though its establishment was subject to separate legislation. A summary of the timetable to establish Auckland Council is available on https://oag.parliament.nz/2012/auckland-council/appendix.htm. It shows that after enacting the Local Government (Tamaki Makaurau Reorganisation) Act 2009, it took a period of 18 months for the Auckland Council to be formed, including elections. About twenty months after that, key documents (a spatial plan and long term plan) were completed and a unified rating system adopted.

As a rough guide, we consider a period of five years should be assumed for this full process. While there is potential for it to be completed more quickly with strong support from all affected parties, there are also risks that could result in the process taking even longer.

8.2 The importance of community support

Communities in the region will have views as to how their interests are best served as well as the interests of the wider region. Their views of local communities are very important and they can be the deciding factor as to whether a proposed reorganisation proceeds. Accordingly, these views should be assessed and reflected in decision making early in the process.

While community support can be considered under many categories, there are three that are particularly important:

- **Resident support**. The LGA process for reorganisations leads to an eventual poll of residents where support from at least 50% of voters is required for the reorganisation to proceed. So, engagement with communities is essential early in the process to assess the chances of success of any option under consideration. In our view, the LGC is unlikely to progress a reorganisation initiative without evidence of resident support. The degree of support within each affected district is also important given it may vary significantly and be an important factor in the LGC's deliberations;
- **Southland councils' support**. The government has made it clear that it wants to work on a regional basis with aligned councils, rather than fragmented councils. A reorganisation initiative's chances of progressing would be greatly enhanced if it had strong support from most, if not all, Southland councils; and
- **Iwi and Māori organisation support**. The LGA contains principles and requirements for involving Māori in decision making processes. In addition, ES has established a productive partnership with mana whenua and is signatory to the Charter of Understanding *He Huarahi mō Ngā Uri Whakatapu - A Pathway for the Generations Coming Through,* together with the six other local authorities in Southland/Otago and Te Ao Mārama Inc. For these, and other reasons, ES is committed to engagement with, and involvement of, Māori when facing decisions such as a potential local government reorganisation.

8.3 Representation arrangements including community boards, local boards and joint committees

While a reorganisation initiative could be submitted without specifying the representation arrangements that would apply should it be implemented, we think that would be unwise. Effective representation is essential to the purpose of local government to enable democratic local decision-making and action by, and on behalf of, communities. In addition, section 24AA of the LGA states: The purpose of the local government reorganisation provisions of this Act is to promote good local government by enabling and facilitating improvements to local governance.

Demonstrating how those purposes are enhanced by the proposed reorganisation requires defining how distinct communities will be supported through representation arrangements. If those arrangements are not specified, communities will have difficulty deciding whether to support a proposed reorganisation and are more likely to prefer the relative security of the known status quo.

Therefore, the reorganisation initiative should describe the number of councillors to be elected to each proposed council and the ward system/s that will apply. It should outline any local boards and community boards that will be retained or established and give an indication of their delegations. As joint committees can also have important governance roles, they should also be described alongside their membership and delegations.

Intended arrangements for the involvement of iwi and Māori in the region's local government should be described, together with the application of existing co-governance arrangements and other mutual agreements.

8.4 Additional considerations now that SDC has lodged an investigation request

LGC will decide whether to proceed with an investigation after considering matters specified in clause 6 of schedule 3 in the LGA. The LGC is obliged to consult with affected local authorities as part of this process.

This presents an opportunity for ES to influence LGC's response. Accordingly, ES should be prepared with a view on whether they consider an LGC investigation to be in the best interests of Southland and have supporting evidence to support that view. ES could:

- Adopt a defensive approach focusing primarily on challenging the option promoted by SDC and endeavouring to ensure a LGC investigation does not proceed. The critique of the SDC Report contained in Appendix 3 of this report TDB Advisory provides evidence for that, with some modification to directly reference the "Southland Local Government: Together, Our Future" document SDC have lodged with the LGC; or

- Adopt a proactive approach taking the opportunity to promote an alternative option (for example, a single unitary council for the region) at this preliminary stage. This could extend to preparing a reorganisation initiative as outlined in section 8.1.1 and advising the LGC that this work is underway.

If LGC subsequently determines an investigation will proceed, it becomes even more important to be proactive in influencing the outcome in the best interests of Southland. At this stage, TDB Advisory considers a well-researched alternative option to the two unitary model promoted in SDC's investigation request to be essential unless ES wishes to advocate for the status quo. Ideally, this alternative option and supporting business case could be documented and promoted with support from other like-minded councils in the region.

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Appendix 1: Comments on the SDC Report

The Southland Local Government Structural Opportunities: Preliminary Forward Planning report prepared in 2024.

TDB has recommended a different option to the one promoted in the SDC Report, so we have added this commentary to explain why we disagree with the analysis in the SDC Report in key areas. The SDC Report also provides some useful commentary and ideas in relation to other matters, but we have not repeated those here.

1. The SDC Report presents a series of arguments around communities of interest that are flawed in our opinion:

    1.1. Paragraphs 33 to 40 discuss communities of interest. The discussion centres around the Local Government Commission's "Guidelines for Undertaking Representation Reviews". These guidelines are useful when considering the boundaries of wards, community boards or local boards. It does not follow that they are appropriate for considering the boundaries of entire districts or regions.

    1.2. Paragraph 42 contains the following statement: "A single council for Southland would fail abysmally when viewed through the lens of communities of interest". This appears to be based on an assumption that the LGC will reject any reorganisation proposal that creates a district or region that contains more than one community of interest. This assumption is clearly incorrect:

        (a) The commentary leading towards this statement is relevant to representation reviews, not reorganisations.

        (b) The LGA assumes that districts and regions will contain more than one community of interest. This is evident by consistently using the plural "communities" in the sections relating to reorganisations.

        (c) The LGC has previously rejected multiple unitary council reorganisation options in favour of single unitary councils. The LGC promoted a single unitary council for the entire Wellington region including Wairarapa, despite the existence of many clearly distinct communities of interest.

    1.3. The SDC Report raises valid considerations about different rural and urban interests and how representation arrangements may fail to give adequate voice and voting power to rural residents and ratepayers. However, these are concerns best addressed in representation arrangements through mechanisms such as wards, community boards, local boards and their delegations, not changing council boundaries. These considerations would arise under a single unitary council option AND a two unitary option. Residents of Gore may be equally concerned about dilution of their voice and voting power in comparison to rural interests under a combined Southland District/Gore District unitary.

2. The SDC Report fails to address the costs and complications arising from splitting ES's responsibilities and activities across the proposed unitary Councils. Importantly, it doesn't address clause 17 of Schedule 3 to the LGA which requires that boundaries of regions conform to catchment boundaries where practicable. TDB considers it unlikely that the LGC would progress an option that effectively split the regulation and management of the Oreti river catchment across two unitary councils.

    LGA Schedule 3, Subpart 1A—Content of reorganisation plans

    17 Appropriate boundaries

    In determining boundaries for a reorganisation plan, the Commission must ensure that, —

    (a) if practicable, the boundaries of regions conform with catchment boundaries; and

    (b) if practicable, the boundaries of districts conform with the boundaries of regions; and

(c) the boundaries of regions and the boundaries of districts conform with the boundaries of statistical meshblock areas determined by Statistics New Zealand and used for parliamentary electoral purposes.

3. The SDC Report reads as a critique of ES and GDC in paragraphs 49 through to 67. A similar lens has not been applied in respect of SDC (or ICC), so the report gives the impression of not being balanced in the matters it has considered.

4. The SDC Report comments on finance and rating in paragraphs 85 to 104. There are some comments about areas where potential savings could arise under a two unitary model that are reasonable (e.g. a reduction in elected members and executives). However, using the rating levels of existing unitary authorities (excluding Auckland and assuming a Southland/Gore unitary authority would require similar funding is not a reliable methodology. While population levels are somewhat similar across those unitary councils, Southland's land area, coastline, river network and catchments are all vastly larger and potential costly to service. As a result, the potential savings in excess of $10 million per annum calculated using this methodology are purely speculative.

5. The SDC Report notes advantages and disadvantages of alternative structures in paragraphs 108 and 109. Apart from the underlying and fundamental concerns noted above, TDB agrees with many of the matters covered in these paragraphs. Unfortunately, the report dismissed consideration of a single unitary authority, as many of the advantages listed apply more strongly to that option than for two unitary councils.

6. The SDC Report concludes in paragraph 124 that the Southland Region is over-governed and has a high local government cost structure. That hasn't been proven in the report through analysis, so presents as a matter of opinion only. As noted in section 3 above, on average, local government organisations in New Zealand support relatively large populations by international standards.

7. In summary, TDB disagrees with several fundamental arguments presented in the SDC Report and the conclusions it contains.

Appendix 2: Update of TDB Advisory's 2013 report

In this section we report our analysis of the relationship between size and cost-effectiveness in local councils in New Zealand, updating the analysis done in our 2013 report for Hutt City.

Our approach

Based on historical spending by territorial authorities (TAs) in New Zealand we estimate cost-curves for individual local government functions. We use Stats NZ's data on annual per capita spending separated by TA and by function for the twenty year period 2003 to 2023. In modelling the relationship between spending per capita and population we seek to estimate the savings that may result from council amalgamations.

Figure 4 below is an indication of how we arrive at our results. In the example below, the blue line can be considered the estimated cost curve for a particular local government function. We can compare the combined total spending of local authority A and local authority B with the total spending of Unitary A+B to estimate the savings we might expect from an amalgamation of local authorities A and B. The blue line can be considered an estimate of the per capita spend by an average-performing local authority in terms of cost-effectiveness for a given population.

Figure 4: Where size and efficiency merger gains come from

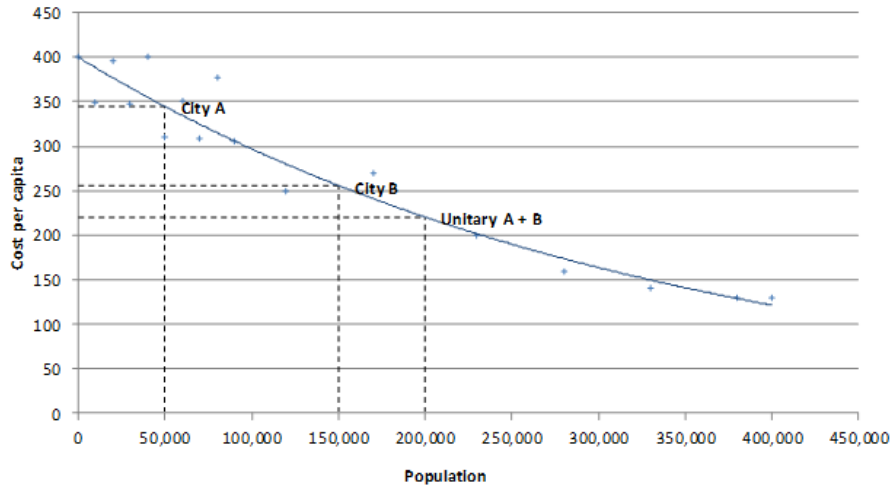


Figure 4 above demonstrates that:

- an average local authority the size of A delivers the example service to a population of 50,000 people at a cost of approximately $350 per capita;
- an average local authority the size of B delivers the example service to a population of 150,000 people at a cost of approximately $250 per capita;
- an average local authority the size of Unitary A+B delivers the example service to a population of 200,000 people at a cost of approximately $220 per capita; and

- when we compare the spending of Unitary A+B with the combined spending of A and B we estimate the measurable efficiency gains we might expect from council amalgamations.

Estimates of the size of the prize

We have extended the analysis undertaken by NZIER in 2012 by fitting 'cost function' curves to the available data on per capita service delivery spending, using regression techniques to estimate the relationship between population size and cost per capita.[16] The purpose is to provide a basis for making estimates of the potential synergy gains from amalgamating service functions or councils.

We estimate cost-curves for sixteen separate functions and overall spending by local councils.

The figures below (Figures 5 to 10) show the functions and overall spending where the relationship between spending and population suggests that "efficiency gains" may be achievable through amalgamation.[17] When interpreting the figures:

- the light blue and dark blue points represent actual spending by local councils in New Zealand over the period 2003 to 2023;
- the red line is the estimated cost-curve and indicates the relationship between spending per capita and population for an average performing council of a given size; and
- the twenty five percent top-performing councils (ie, lowest cost) are coloured dark blue. Our proxy measure of 'top-performing' is the lowest per capita spend.

We find water supply, solid waste, roading, governance and emergency management are the council functions where improved cost-effectiveness may be achievable through amalgamation.

The steeper the downward sloping portion of the red curve the greater the expected efficiency gain for councils over that population. In all cases the great bulk of the efficiency gains from amalgamation are only evident for relatively small local authorities. Observation of the figures below suggests:

- amalgamations up to around 50,000 to 100,000 people will likely lead to reasonable cost-savings for specific council functions (eg, water supply, solid waste, roading, governance and emergency management);
- even for those five functions illustrated below where there are economies of scale initially, the per capita spend is unlikely to change materially after an amalgamation of entities serving in aggregate a population of 100,000 or more, although with water supply, solid waste and roading there are signs of some efficiency gains from larger-scale amalgamations; and
- at the total expenditure per capita level (Figure 10), most of the efficiency gains from amalgamating small councils occur between 50,000 to 100,000, with marginal efficiency gains continuing up to 200,000. Beyond this point, there may be diseconomies of scale, leading to rising costs per capita – forming a U-shaped cost curve as seen in Figure 10.

[16] We selected the 'cost function' curve with the highest R-squared value for each dataset on per capita service delivery spending, ensuring the best fit to the observed relationship between population size and cost per capita.

[17] Auckland Council was removed from Figures 5 to 10 to prevent it from skewing the analysis with its large population and distinct governance when compared to the other TAs. As the only council over 500,000 people, its inclusion distorts trendlines and obscures cost patterns in small to mid-sized councils.

Figure 5: Water supply

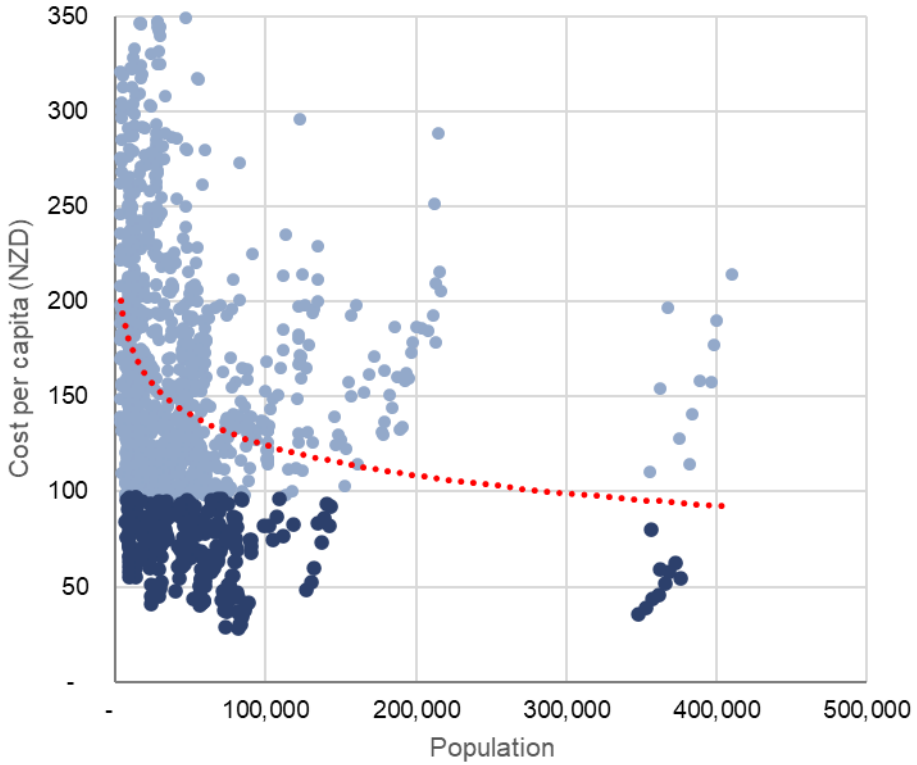


Figure 6: Solid waste

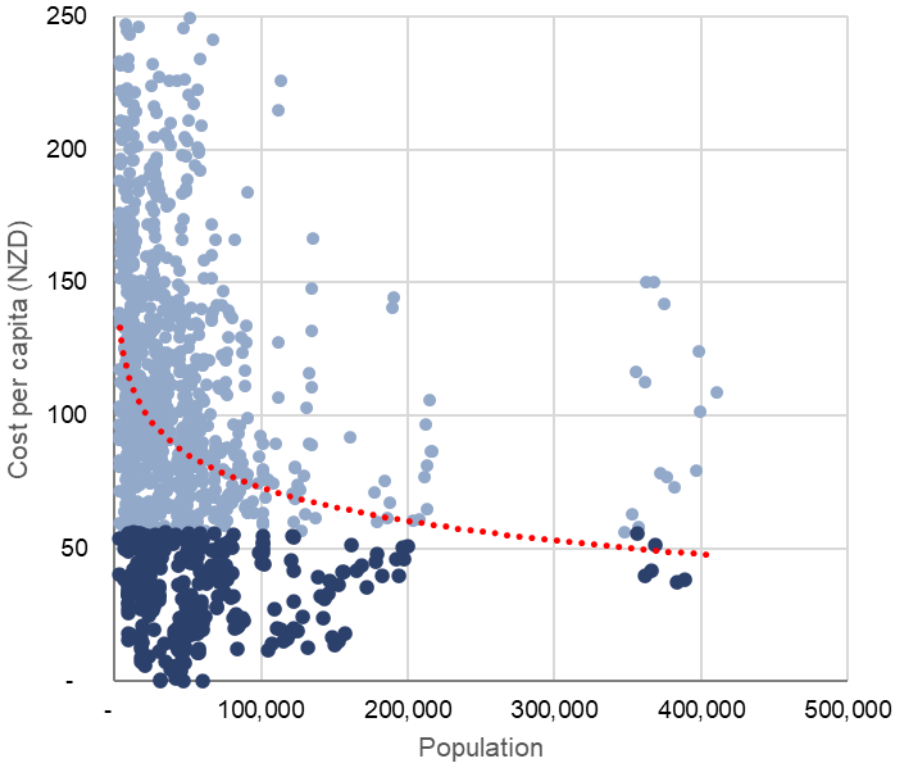


Figure 7: Roading

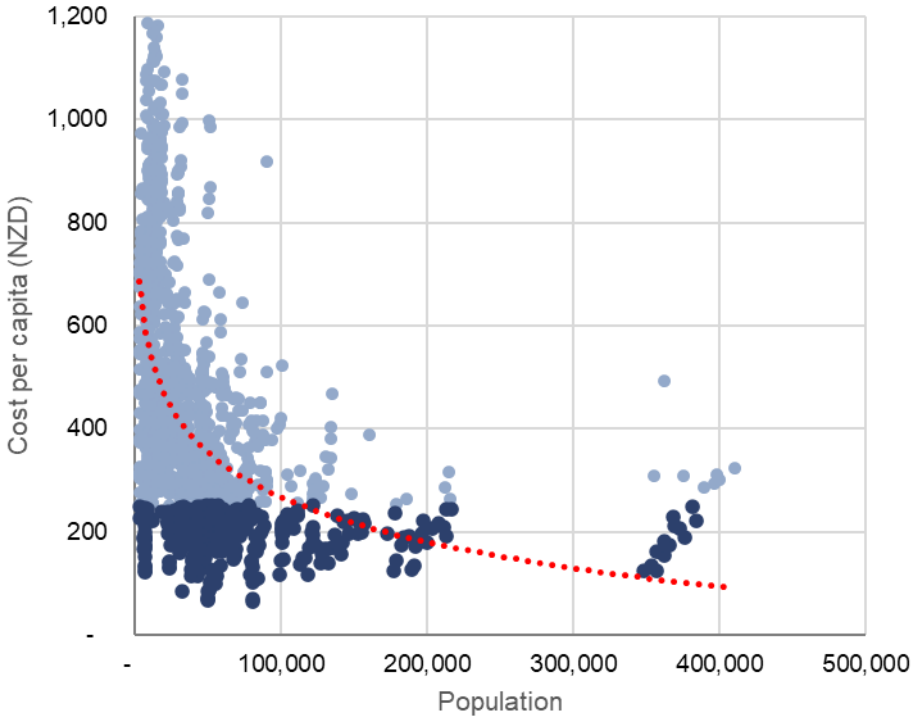


Figure 8: Governance

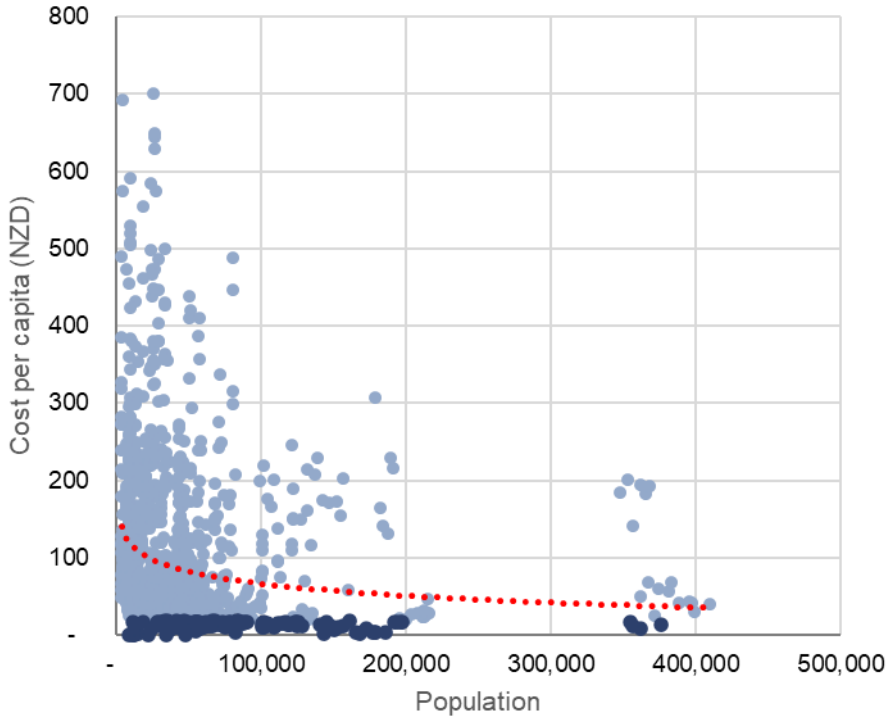


Figure 9: Emergency management

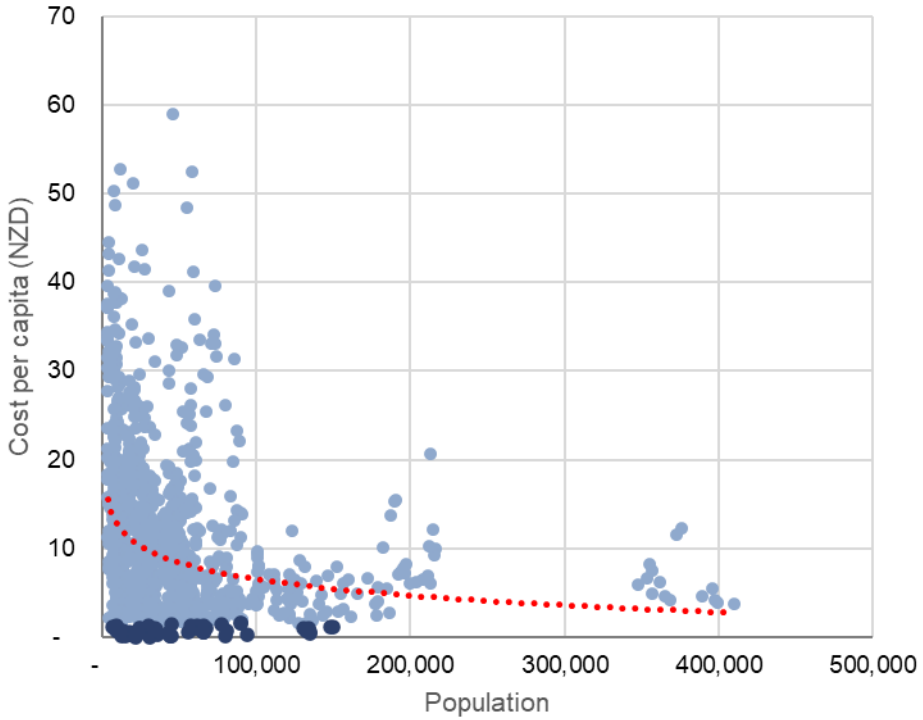
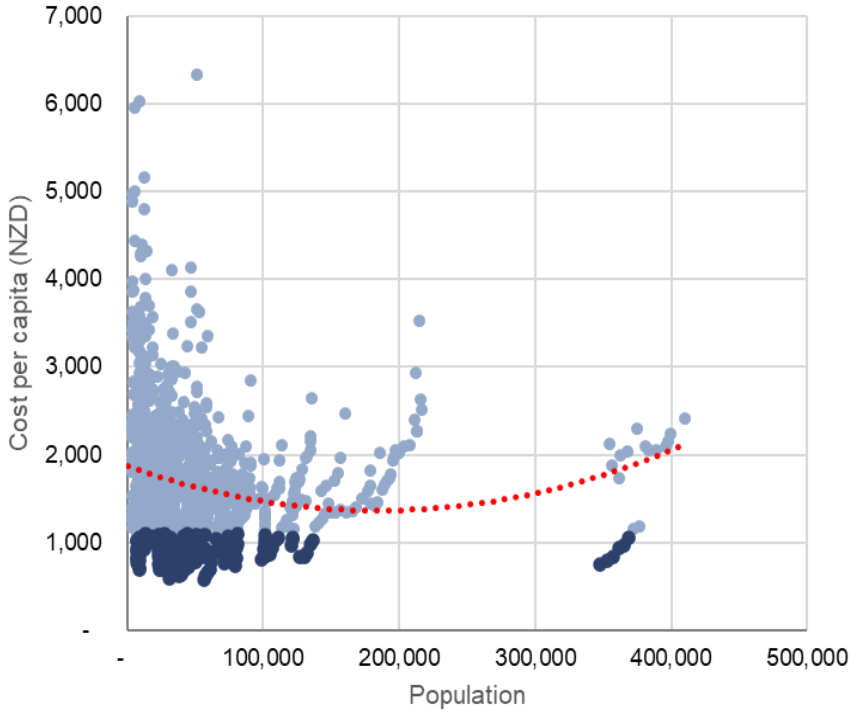


Figure 10: Total spending

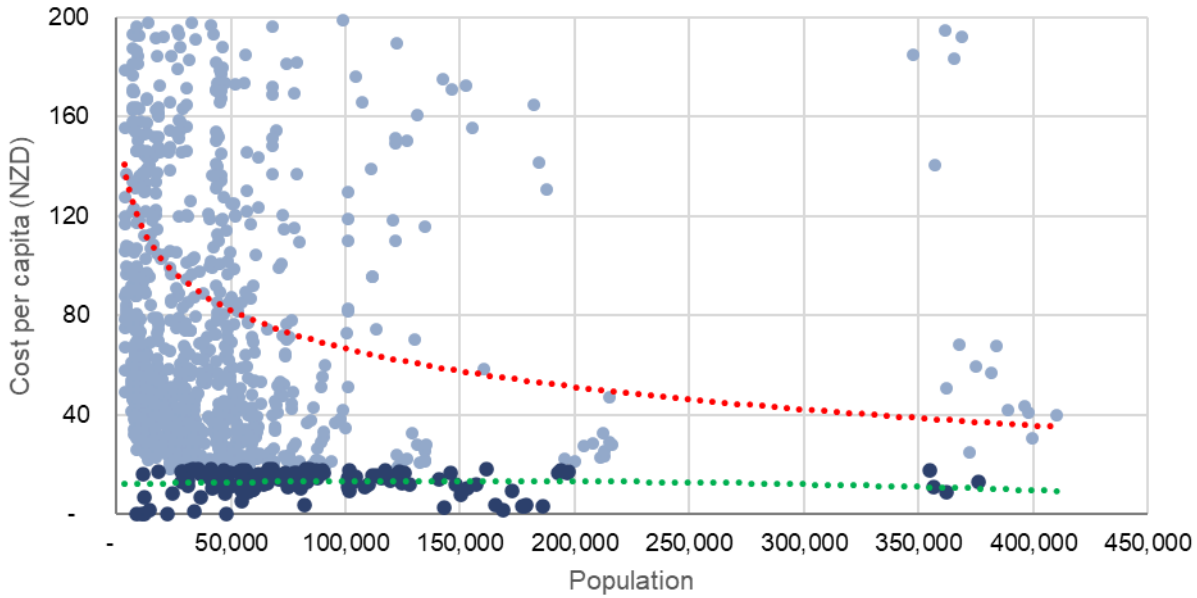


6.3 Best practice

We also estimate a best-practice cost curve for each local council function: this line indicates the point below which 25 percent of territorial authorities have a lower cost per capita for the given function. It is important to note that cost per capita is an imperfect proxy for cost-effectiveness. Not all councils that fall within the lowest 25 percent in cost per capita for a given function will necessarily be cost-effective providers of that function. A low per capita expenditure may be driven by a variety of factors other than population size (further discussion of this issue can be found in Section 6.8 below).

Best practice can be sought by councils of all sizes through efficiency gains, changes in management, new technology, or other means. The green cost-curve in Figure 11 below is the best-practice estimate. The governance example provided in Figure 11 below is indicative of the shape of most other best practice cost-curves for other functions. Surprisingly, almost all the best practice curves are flat or very close to flat. This suggests that councils of any size that have managed to achieve best-practice have very little to gain from amalgamation. The significant gap between the average governance cost-curve and the best practice cost-curve is also telling: the graph suggests the average local authority could gain significant cost-savings by moving towards best-practice.

Figure 11: Best practice estimation: governance



A few local authority functions (as pictured above) exhibit an inverse relationship between per capita cost and population size for average performing councils. However, for almost every local government function it appears at the best practice level there is little to no correlation between per capita spending and size. The implication of this lack of correlation is that if a council can achieve best practice, there is little or nothing more to gain from increasing the scale of operations. Good internal practices are the key to cost savings, not the scale of operations. The New Zealand Productivity Commission echoed this sentiment in its 2013 report on regulatory decision-making in local authorities. The Productivity Commission noted:

"Local authorities generally follow adequate regulatory decision-making processes. This finding is not dependent on the size of the local authority. The review specifically tested the hypothesis that larger local authorities are able to follow better regulatory processes because of their greater financial resources and internal capability. The

analysis revealed that while larger local authorities are able to draw upon a larger body of technical information when making regulatory decisions, smaller local authorities appear better able to incorporate specific community concerns, due to their closer relationship with the community. To some extent this reflects a trade-off between the resources available to a local authority and the level of community responsiveness that can realistically be achieved."

Appendix 3: Case study: Wellington region water amalgamations – lessons learned

The beginnings

Councils in the Wellington region investigated options to combine their water service operations in the early 2000's. The primary driver for this work was to achieve efficiency for ratepayers and water users. Ultimately only Wellington City Council (WCC) and Hutt City Council (HCC) proceeded and formed the water-management company that would later become known as Capacity. Strong community resistance occurred during consultation processes which prompted other councils to pull out of the proposed merger. This resistance also influenced the decision to quell privatisation fears by keeping asset ownership within councils rather than transfer the assets to Capacity.

Savings of $4 million were forecast over the first five years of operations. These were expected to fall $2.5million to the benefit of WCC and $1.5million to HCC. Proving the existence of savings or otherwise was complex due to the variable nature of expenditure demands across the years. Calculations showed HCC's savings were close to target but WCC's fell short. It's worth noting that the period assessed included 2004 and 2005 when significant flooding occurred in the region.

Other councils gradually came together and in 2014 Capacity was reestablished as Wellington Water Limited and also included Upper Hutt City Council, Greater Wellington Regional Council and Porirua City Council as shareholders. South Wairarapa District Council subsequently joined in 2019. The main benefits cited were the ability to achieve a step change in cost efficiency and more effective network service planning and delivery via integrated services.

Reflections on the Wellington Water model to date

The initial focus on costs and efficiency was a key factor in getting buy-in from the founding councils. However, it was to the detriment of long-term success and maximising the benefits from combining services. Upfront investment in establishing the new entity and aligning processes was minimal; about $1million only. As a result, Capacity was not funded to invest in an asset management system of its own. Each shareholding council held on to distinct KPIs, reporting requirements and service level expectations.

Significant non-financial benefits were achieved such as a greater ability to attract and retain skilled employees, enhanced staff capability and a stronger strategic planning focus. The level of advice provided to shareholding councils increased over time. An example of this increased effectiveness was seen in the aftermath of earthquakes affecting the region. WWL took the lessons learned and led the way in planning and delivering substantial improvements to the resilience of water services so the region is better placed to recover should a major earthquake occur in the future.

While there have been many infrastructure upgrades and other achievements by WWL over the years, there are also clear opportunities for further improvements to the Wellington model as highlighted by recent network performance issues.

Ultimately the organisation's Board of appointed expert directors and executive staff have been limited in their ability to manage water services by one major constraint: reliance on negotiated funding from councils each year. Councils were reluctant to fully support requests for increased funding due to rating impacts and this led to an approach described sometimes as "sweating the assets" or pushing the limits of their expected useful lives.

A view among some directors of WWL has also been that the organisation would have been more able to deliver best-practice asset planning and management if asset ownership resided with the company rather than with the shareholding councils.

WWL's shareholding councils now face a situation like many others around the country: ageing assets, large increases in unit rates for asset replacements and rising environmental standards and customer expectations, all of which are compounded by funding limitations and inadequate pricing mechanisms.

Recently Wellington Water has been challenged by negative headlines and issues relating to a large budgeting error, the poor performance of a waste water treatment plant, and procurement processes that lacked the competitive tension needed to ensure councils received good value for their communities. This serves to highlight that effective management is critical to the success of any structural model.

Planning for the future

WWL recently completed independent reviews to identify opportunities to improve its capability further. These are being implemented, albeit some actions are subject to funding. WWL's intention is to be well positioned to support the region's new water services model once this is agreed. The most recent report into procurement processes raises further issues that will need to be addressed in order for the Wellington region's councils to have confidence that Wellington Water should be part of the regional solution in the long-term.

The Wellington region's councils were preparing for transition to the Three Waters model until this was cancelled by the incoming government. They are now working together on plans for a Water Services Delivery Plan and potential new water services entity/entities to best meet their needs within the legislative framework being developed for the coalition government's Local Water Done Well programme.

The recommended option is for a joint council-owned company (i.e. a full-breadth water utility, owning all assets, revenues and liabilities). At the time of writing Greater Wellington Regional Council, Wellington City Council, Porirua City Council, Hutt City Council and Upper Hutt City Council have voted to continue working towards this regional model. Kapiti Coast District Council has decided to look at options with councils to the north and continuing with in-house service delivery. South Wairarapa District Council and Carterton District Council have opted out to pursue a Wairarapa model, and Masterton District Council has decided to consult on both options.

A significant factor in deliberations has been the opportunity under a water services entity model to access increased loan funding to support necessary infrastructure investment with a lower level of rates increases than would be needed under current structural arrangements. Savings through economies of scale have also been predicted and are another important factor in deliberations (refer discussion in Section 4.3).

Summary of lessons learned

- Invest sufficiently in the transition and establishment processes to avoid compromising medium and long-term benefits from an amalgamation or shared entity;
- Be prepared to compromise district autonomy when beneficial to align processes, delivery standards, reporting etc to achieve efficiencies and financial benefits;
- To achieve the full benefits of a regional water entity, transferring asset ownership (within an appropriate framework) is undoubtedly necessary;
- There is real value in having independent expert directors governing large CCOs, but only if they have sufficient freedom to lead the company according to their informed views. Elected member oversight and input is important as shareholders and community representatives, but careful thought needs to be given to get the balance right and not frustrate the potential for best-practice performance;
- Test the promised savings for reasonableness. Don't rely only on high-level comparatives with other organisations due to the risk of comparing "apples with oranges". Question where the savings will come from in practice by also taking a bottom-up view; and
- Don't focus on immediate gains. Initial estimates of savings are less important than setting up the region with the best possible structures to efficiently and effectively deliver services in the long-term.