

7 February 2015

Senior Advisor
Local Government Commission
Wellington

Dear

Revision of Stimpson & Co "Report to Local Government Commission on Wellington reorganisation transition costs" dated 28 November 2014

Further to your email of 30 January 2015 identifying three issues with tables in the LGC report: *Draft Proposal for Reorganisation of Local Government in Wellington, Volume 2, Technical Report: Evaluation of the options and draft proposal, December 2014*. I advise as follows.

Issues identified with tables in LGC report	Stimpson response
1. Volume 2, Table 37 (p.216) presents estimates of the costs of transition and potential savings for eight options. The estimated net present value of two of the options ("One Wairarapa & One Hutt Valley TA, plus WCC, PDC and KCDC" and "Three Territorial Authorities" are not provided in the table. Could you please provide these numbers.	Stimpson & Co conducted no analysis (including NPV analysis) of the "One Wairarapa & One Hutt Valley Territorial Authority plus WCC, PCC & KCDC" option, nor the "Three Territorial Authorities" option in our report of 28 November 2014. We propose to analyse these options this week.
2. Volume 2, Table 37 (p.216): could you please advise the discount rate used for the net present value calculations.	The discount rate used in the NPV analysis in our report was 7%.
3. Volume 2, Table 38 (p.219) presents low and high estimates of the costs of ICT system design and delivery for the eight options. It appears that the midpoint of the low and high estimates of the ICT costs have been used for the estimates of the total transition costs in Table 37 for all options except the two "One Wellington Council" option. In the case of the two "One Wellington Council" options it appears the low estimate has been used. Could you please confirm our understanding is correct.	The Stimpson analysis of 28 November 2014 and previous versions uses an incorrect treatment of IT systems and costs. The low-end IT systems cost of \$105 million was used for the one Wellington options rather than the mid point of \$127.5 million. I discuss below the details of this error and proposed revisions to both our report and Table 37 of Volume 2 of the LGC draft proposal of December 2014.

Correction of errors with respect to IT costs for the One Wellington options

The low range rather than the correct mid point estimates of "IT system delivery costs" has been used in error for the One Wellington options only.

This error has a flow on impact upon a further four line items for the One Wellington Options in Table 37 of Volume 2 of the LGC draft proposal of December 2014. These are noted as follows. Appendix One to this letter contains spreadsheet details of the errors in Table 37 as at December 2014 and proposed revisions.

1. "IT system delivery costs"

These costs for the One Wellington options should read \$127.5 million rather than \$105 million.

2. "Business process change" costs

These costs are calculated as a percentage of IT system delivery costs and for the One Wellington options should read \$48.2 million rather than \$45.2 million.

3. "Total estimated cost of transition" for the One Wellington options without and with local boards should read \$209 million and \$210 million respectively.

4. "Net present value" for the One Wellington options therefore have an incorrect more favourable costing. This makes the NPV less attractive for the one Wellington options. With correction of the errors they change as follows:

- One Wellington without local boards. \$175m NPV falls to \$154 million.
- One Wellington with local boards \$79m NPV falls to \$58 million.

5. "Payback period"

- One Wellington without local boards. Payback period rises from 6 to 7 years.
- One Wellington with local boards. Payback period rises from 8 to 9 years

I apologise for these errors in our analysis.

I will issue a revision of the Stimpson & Co report of 28 November 2014 later this week to incorporate correction of the errors and the further analysis of options noted above.

Other considerations for Table 37

The attached table revision also notes three further changes to the table for your consideration including:

- a) Addition of 7% discount rate as a matter of further information.
- b) Correction of \$148 million NPV for the One Western Territorial Authority, which should read \$143 million. I assume this is a typographical error.
- c) Possible error in annual savings for the "Three Territorial Authorities" option. This option was not assessed by Stimpson and Co, but I believe it should probably read \$31.6 million rather than \$28.6 million.

Yours faithfully



Director

Appendix One
LGC Table 37 as at December 2014 and proposed revisions in February 2015

Table 37 as at Dec 2014

Enhanced local efficiency					One Wellington Council							
	One Wairarapa Territorial Authority	One Hutt Valley Territorial Authority	One Western Territorial Authority	One Wairarapa & One Hutt Valley Territorial, plus WCC, PCC & KCDC	Three Territorial Authorities	Stronger Regional Delivery - transfer obligations to GWRC	without local boards	with local boards				
Annual savings by year 4 (\$m)	1.3	5.5	24.8	6.9	28.6	36.3	40.4	30.4				
Transition costs												
Transition board (\$m)	1.0	2.0	5.0	3.0	8.0	7.6	10.1	10.3				
New council start-up (\$m)	1.0	2.0	5.0	3.0	8.0	7.6	10.1	10.3				
IT system delivery costs (\$m)	25.5	40.0	67.5	65.5	133.0	79.0	105.9	105.0				
Business process change (\$m)	4.2	6.0	9.8	10.2	20.0	23.7	45.2	45.2				
Other (\$M)	0.2	0.4	1.0	0.6	1.6	1.5	2.0	2.0				
HR costs (\$m)	0.1	1.6	6.6	1.7	8.3	10.2	11.3	11.3				
Total estimated cost of transition (\$m)	32	52	95	84	179	129	184	184				
Net present value (\$m)	-13.7	8	148	148	199	199	175	79				
Payback period (years)	25	10	5	12	6	5	6	8				

David Stimpson:
If this option is the summation of the first three options, then total should be \$31.6 m??

David Stimpson:

Table 37 in Dec14 version listed \$148m. Assume this is a typo as Stimpson

Stimpson comments on Table 37 as is

Payback check calc based on total estimated cost of transition divided by annual savings

24.6 9.5 3.8 12.2 6.3 3.6 4.6 6.1

Option not evaluated by BS or Stimpson. Understood to be summation of options 1 & 2

Option not evaluated by BS or Stimpson. Understood to be summation of options 1, 2 & 3

Payback period as calculated immediately above from table data varies from payback period in table because savings used in Stimpson analysis are not secured until Year 5

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Revision of Stimpson & Co "Report on Wellington reorganisation

Table 37 proposed in Feb 2015

	Enhanced local efficiency					One Wellington Council				
	One Wairarapa Territorial Authority	One Hutt Valley Territorial Authority	One Western Territorial Authority	One Wairarapa & One Hutt Valley Territorial, plus WCC, PCC & KCDC	Three Territorial Authorities	Stronger Regional Delivery - transfer obligations to GWRC	Without local boards	With local boards		
Annual savings by year 4/5 (\$m)	1.3	5.5	24.8	6.9	28.6	36.3	40.4	30.4		
Transition costs										
Transition board (\$m)	1.0	2.0	5.0	3.0	8.0	7.6	10.1	10.3		
New council start-up (\$m)	1.0	2.0	5.0	3.0	8.0	7.6	10.1	10.3		
IT system delivery costs (\$m)	25.5	40.0	67.5	65.5	133.0	79.0	127.5	127.5		
Business process change (\$m)	4.2	6.0	9.8	10.2	20.0	23.7	48.2	48.2		
Other (\$M)	0.2	0.4	1.0	0.6	1.6	1.5	2.0	2.0		
HR costs (\$m)	0.1	1.6	6.6	1.7	8.3	10.2	11.3	11.3		
Total estimated cost of transition (\$m)	32	52	95	84	179	129	209	210		
Net present value (\$m) at 7%	-13.7	8	143			199	154	58		
Payback period (years)	25	10	5	12	6	5	7	9		

David Stimpson:
Brian Smith analysis of 30/8/14 showed savings peaking in year 3 for the first three options and year 4 for the final three options. This assumption was used for the first analysis delivered by Stimpson in Sept 2014. The LGC subsequently asked for a shorter transition period to be modelled. The subsequent Stimpson updates therefore assumed a delay in the timing of Brian Smith's assessment of savings by one year to start in year 2 and complete in years 4 and 5.

David Stimpson:
This option was not assessed by Stimpson. However - if this option is the summation of the first three options, then should total be \$31.6 m?

David Stimpson:
Use of mid point IT costs from Deloitte \$105m Low - \$150m High range. Low point estimate was previously used by Stimpson in error.

David Stimpson:
Business process change costs increase slightly because they are modelled as a percentage of IT system delivery costs which have increased as noted in line above.

David Stimpson:
Insert 7% discount rate as additional information

David Stimpson:
Table 37 in Dec14 version listed \$148m. Assume this is a typo as Stimpson analysis shows \$143m