Advice

Local Government Advice

Adelaide Hills Council

February 2023

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Glossary of terms

ABS	Australian Bureau of Statistics
AMP	Asset management plan
Commission	Essential Services Commission, established under the *Essential Services Commission Act 2002*
CPI	Consumer Price Index (Adelaide, All Groups)
Council	Adelaide Hills Council
CWMS	Community Wastewater Management System
ESC Act	*Essential Services Commission Act 2002*
F&A	Local Government Advice: Framework and Approach – Final Report
FTE	Full Time Equivalent
IAMP	Infrastructure and asset management plan (also called an AMP)
LG Act	*Local Government Act 1999*
LGA SA Financial Indicators Paper	Local Government Association of South Australia, Financial Sustainability Information Paper 9 - Financial Indicators Revised May 2019
LGGC	Local Government Grants Commission
LTFP	Long-term financial plan
Regulations	*Local Government (Financial Management) Regulations 2011*
RBA	Reserve Bank of Australia
SACES	The South Australian Centre for Economic Studies
SMP	Strategic management plan
SG	Superannuation Guarantee
The scheme or advice	Local Government Advice Scheme

1 The Commission's key advice findings for the Adelaide Hills Council

The Essential Services Commission (**Commission**) considers the Adelaide Hills Council (**Council**) to be in a sustainable financial position with historical and projected operating surpluses and the forecast renewal of its infrastructure assets to continue to underpin its strong financial performance, without the need for further significant rate increases.

The Commission suggests the following steps to ensure that the Adelaide Hills Council budgets prudently, reports its cost savings and efficiencies, plans its asset needs appropriately and continues to limit the extent of further rate increases.

Budgeting considerations

1. **Continue** to review its inflation forecasts in its budget each year.
2. **Focus** on constraining cost growth in its budgeting, where possible, particularly related to employee expenses.

Ensuring the right asset management plans are in place

3. **Complete** the asset management plan for building assets and consider potentially other assets not currently covered by a plan (such as sport and recreation facilities), with consideration of desired service levels, as appropriate.
4. **Complete** its planned Stormwater Asset Management Plan, with consideration of desired service levels, as appropriate.
5. **Finalise** its Community Wastewater Management System Asset Management Plan and reflect related cost changes in the 2023-24 Long-term Financial Plan, to include input from the community, including desired service levels.

Providing evidence of ongoing cost efficiencies

6. **Report** its actual and projected cost savings in its annual budget, to provide evidence of constraining cost growth and achieving efficiency across its operations and service delivery.

Refinements to asset management planning

7. **Review** the estimates of asset lives and valuations feeding into the forecast rate of asset consumption in its long-term financial plan and asset management plans.

Containing rate levels

8. **Review** and consider limiting future increases above inflation on its residential rates to help reduce any emerging affordability risk in the community.
9. **Review** the rationale for the quantum of any maximum rate increase (or cap) it seeks to impose (currently at 15 percent) in its next annual business plan, with consideration of the community's capacity to pay for higher increases.

2 About the advice

The Essential Services Commission (**Commission**), South Australia's independent economic regulator and advisory body, has been given a role by the State Government to provide advice on material changes proposed by local councils in relation to elements of their strategic management plans (**SMPs**) and on the proposed revenue sources, including rates, which underpin those plans.[1]

One of the main purposes of the Local Government Advice Scheme (**advice** or **the scheme**) is to support councils to make 'financially sustainable' decisions relating to their annual business plans and budgets in the context of their long-term financial plans (**LTFPs**) and infrastructure and asset management plans (**IAMPs**)[2] – both required as part of a council's SMP.[3] Financial sustainability is considered to encompass intergenerational equity,[4] as well as program (service level) and rates stability in this context.[5] The other main purpose is for the Commission to consider ratepayer contributions in the context of revenue sources, outlined in the LTFP.[6] In addition, the Commission has discretion to provide advice on any other aspect of a council's LTFP or IAMP it considers appropriate, having regard to the circumstances of that council.[7]

The first cycle of the scheme extends over four years from 2022-23 to 2025-26, and the Commission has selected 15 councils for advice in the first scheme year (2022-23), including the Adelaide Hills Council (**Council**).

This report provides the Local Government Advice for the Adelaide Hills Council in 2022-23.

The Council is obliged under the *Local Government Act 1999* (**LG Act**) to publish this advice and its response, if applicable, in its 2023-24 Annual Business Plan (including any draft Annual Business Plan) and subsequent plans until the next cycle of the scheme.[8] It does not need to publish the attachment to the advice (these will be available with the advice on the Commission's website[9]), nor is it compelled under the LG Act to follow the advice. The Commission thanks the Adelaide Hills Council for providing relevant information to assist the Commission in preparing this advice.

2.1 Summary of advice

In general, the Commission finds the Adelaide Hills to be in a sustainable financial position with historical and projected operating surpluses and the forecast renewal of its infrastructure assets to continue to underpin its strong financial performance, without the need for further significant rate increases.

The Council has consistently run relatively small average operating surpluses over time, indicating that the operating income it collects is generally exceeding its operating expenses by a conservative margin. This demonstrates financial prudence (for given operating expense growth) since the Council is not

1 Amendments to the *Local Government Act 1999* (s122(1c) to (1k) and (9)) specify the responsibilities for the Commission and local councils for the Local Government Scheme Advice. The Commission must provide advice to each council in accordance with the matters outlined in s122(1e), (1f) and (1g).
2 Commonly referred to as asset management plans.
3 The objectives of the advice with reference to a council's LTFP and IAMPs are presented under LG Act, s122(1g). LG Act s122(1) specifies the requirements of a council's SMP, including the LTFP and IAMPs.
4 'Intergenerational equity' relates to fairly sharing services and the revenue generated to fund the services between current and future ratepayers.
5 Commission, *Framework and Approach – Final Report*, August 2022, pp. 2-3, available at www.escosa.sa.gov.au/advice/advice-to-local-government.
6 LG Act s122(1f)(a) and (1g)(a)(ii).
7 LG Act, s122(1f)(b) and (1g)(b).
8 LG Act, s122(1h).
9 The Commission must publish its advice under LG Act s122(1i)(a).

accumulating excessive surpluses. At the same time, the Council has increased its rate levels consistently above inflation.

Community service levels appear to have been maintained through the Council's focus on renewing its asset base, but it has also added to its asset base in recent years, with an accompanied expansion of service levels. However, its asset management planning is not yet as comprehensive as it should be, with significant asset classes such as stormwater and buildings not yet covered by an adopted plan.

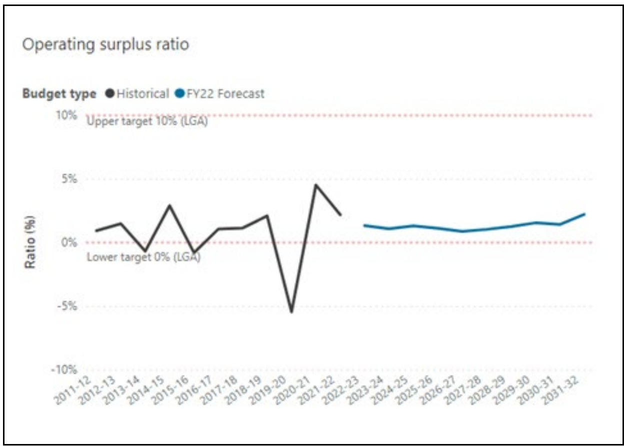
The Council's forward projections from 2022-23 forecast continued financial and service level sustainability through:

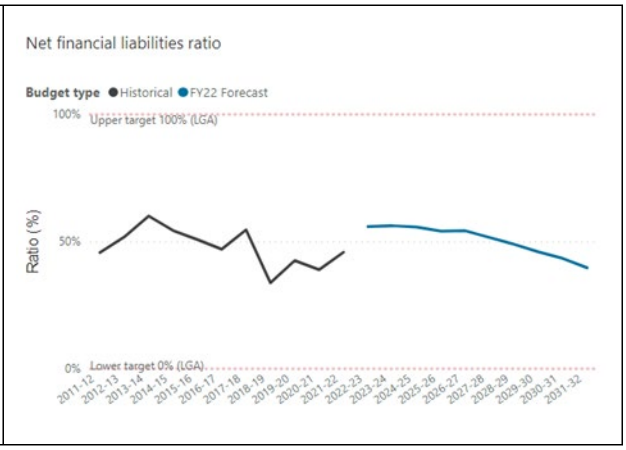
- rate revenues that generally increase in line with the RBA-based inflation forecasts
- total operating expenses estimated to increase generally in line with forecast inflation, and
- the continued prioritisation of its asset expenditure on renewal or replacement needs and lower expenditure on new or upgraded assets.

The Commission considers that there may be opportunities to achieve greater savings and efficiencies in its recurrent budget and encourages the Council to review and report on this. This includes a review of the asset-related assumptions feeding into its estimated depreciation expenses. In general, a focus on cost constraint should help the Council to identify opportunities to reduce any affordability risk emerging for residential ratepayers, who bear most of the rate burden.

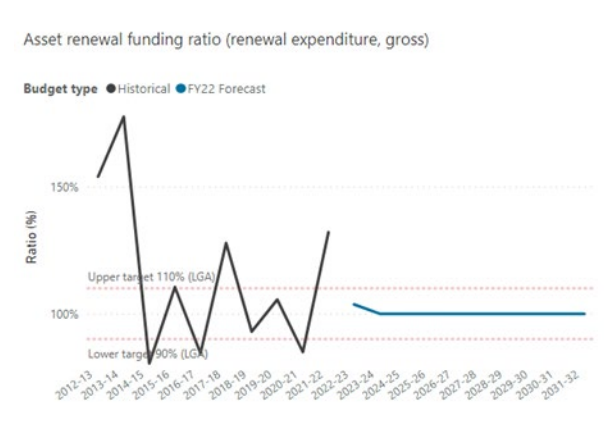
The Commission has also made various recommendations to the Council in relation to the development of its asset management plans (AMPs), and the disclosure of information in its annual business plan. These recommendations, if accepted and acted upon, should improve the transparency of the Council's financial plans and decision-making processes.

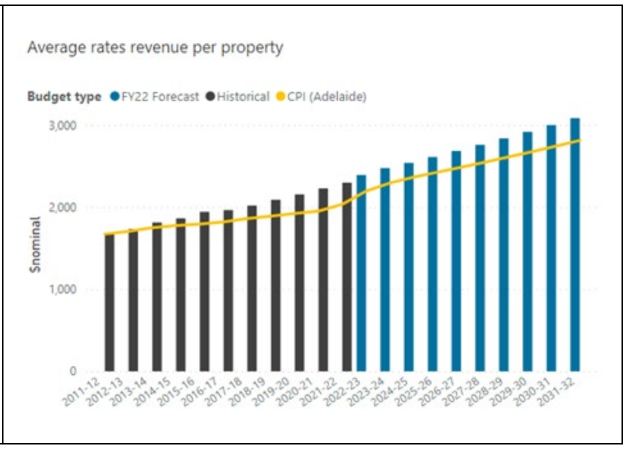
The charts below of the Council's past and projected operating surplus ratio, net financial liabilities ratio, asset renewal funding ratio, and average rate revenue per property, together support the Commission's findings. The 'heat map' diagram on the next page summarises the Commission's findings with reference to whether the Council has met the suggested Local Government Association (LGA) target ranges for the three main financial sustainability indicators[10] and the level of cost control and affordability risk identified for the Council over time.





[10] The suggested LGA target ranges for the ratios are discussed in more detail in the attachment.





Summary of the Adelaide Hills Council's financial sustainability performance and the Commission's risk assessment

Financial sustainability indicators:	Last 10 years from 2011-12 (Actual performance)	2021-22 estimate	Next 10 years from 2022-23 (Council forecasts)
Operating surplus ratio (target 0- 10%)	Ratio within target range, on average, with mostly operating surpluses ——>	Ratio forecast to continue to be met ——>	
Net financial liabilities ratio (target 0-100%)	Ratio met historically and in forecast period ——>		
Asset renewal funding ratio (target 90-110%)	Ratio above target range on average to 2021-22 ——>		Ratio to meet target range in forecast period ——>
Identified Risks:			
Cost control risk	Operating expenses per property average growth 3.2% p.a. to 2020-21 (CPI 1.7%) ——>	Low cost growth (relative to inflation)	Operating expenses per property average growth forecast 2.6% p.a. to 2031-32, below CPI (2.8%)
Affordability risk	Rate revenue per property average growth 3.2% p.a. to 2020-21 and high residential rates but with positive capacity to pay indicators ——>	High rates increase	Projected rate revenue per property average growth 2.9% p.a. on high rate levels to 2031-32 ——>

Ratio outside suggested LGA target range or higher risk

Ratio close to suggested LGA target range or medium risk

Ratio within suggested LGA target range or lower risk

2.2 Detailed advice findings

The next sections summarise the Commission's more detailed observations and advice findings regarding the Adelaide Hills Council's material changes to its 2022-23 plans (compared with the previous year's plans), its financial sustainability (in the context of its long-term operating performance, net financial liabilities, and asset renewals expenditure) and its current and projected rate levels.

In providing this advice, the Commission has followed the approach it previously explained in the Framework and Approach – Final Report (F&A). The attachment explores these matters further.[11]

2.2.1 Advice on material plan amendments in 2022-23

The Adelaide Hills Council's 2022-23 LTFP includes increases to the following financial items to 2030-31, compared with the 2021-22 LTFP forecasts:[12]

- Employee costs are forecast to increase by 5.1 percent in total over the projected years, due to higher inflation and increases to superannuation.
- Capital expenditure on new and upgraded assets are forecast to increase by $14.5 million, driven by increases in expenditure on buildings, roads, and stormwater assets.
- Revenue for new and upgraded assets has increased by $2.1 million due to an increase in grants revenue of $2 million for 2022-23 only.

The Commission notes that the Adelaide Hills Council's revisions to its operating income and operating expense forecasts, and other expenditure and revenues, are consistent with its revised forecasts for higher inflation.

In the current inflationary environment, the assumptions concerning price rises over the next 10 years will require annual review, particularly given the potential for higher short-term inflation before a return to long run averages. However, the Commission notes that the Council should still endeavour to find savings in real terms to reduce any inflationary impact on its community. To these ends, the Commission has found that it would be appropriate for the Council to:

1. Continue to review its inflation forecasts in its budget each year.
2. Focus on constraining cost growth in its budgeting, where possible, particularly related to employee expenses.

Concerning the significant revisions to its planned capital expenditure, the Commission notes that the Council has not yet adopted AMPs for buildings[13] and stormwater infrastructure. In total, the Council had around $66 million in building assets and $44 million in stormwater assets on 30 August 2021, representing around 11 and 7 percent of its total asset value respectively.[14]

The Council's Annual Business Plan 2022-23 states that the Council will conduct ongoing management, maintenance and replacement planning of public infrastructure including stormwater.[15] The Council is scheduled to complete the Stormwater Management Plan by April 2023 after completing three

11 The attachment will be available on the Commission's website with the advice.
12 The overlapping forecast period in both LTFPs.
13 Adelaide Hills Council, *Annual Business Plan 2021-22*, July 2021, p. 12, available at https://www.ahc.sa.gov.au/assets/downloads/council/Plans/Annual-Business-Plan/Annual-Business-Plan-2021-22.pdf.
14 Adelaide Hills Council, *2020-21 Financial Statements*, p. 22, available at https://www.ahc.sa.gov.au/assets/downloads/council/Reports/Annual-Reports/Annual-Report-2020-21-Final.pdf.
15 Adelaide Hills Council, *Annual Business Plan 2022-23*, July 2022, p. 9, available at https://www.ahc.sa.gov.au/assets/downloads/council/Plans/Annual-Business-Plan/Annual-Business-Plan-2022-23.pdf.

consultation stages.[16] It is also undertaking community consultation on its draft AMP for Community Wastewater Management Systems (**CWMS**).

Noting the legislative requirement to develop and adopt an IAMP relating to the management and development of its infrastructure and major assets for at least 10 years,[17] the Commission has found that it would be appropriate for the Adelaide Hills Council to:

3. **Complete** the asset management plan for building assets and consider potentially other assets not currently covered by a plan (such as sport and recreation facilities), with consideration of desired service levels, as appropriate.
4. **Complete** its planned Stormwater Asset Management Plan, with consideration of desired service levels, as appropriate.
5. **Finalise** its Community Wastewater Management System Asset Management Plan and reflect related cost changes in the 2023-24 Long-term Financial Plan, to include input from the community, including desired service levels.

2.2.2 Advice on financial sustainability

Operating performance

The Council's operating surplus ratio[18] averaged 0.7 percent over the 10 years to 2020-21 and is forecast to continue to remain at a modest surplus level. The Council has estimated an average ratio of 1.3 percent to 2031-32 in its 2022-23 LTFP, with total income projected to continue to be marginally higher than total expenses. The Commission notes that the Council has sought to avoid running excessive operating surpluses, which demonstrates prudent financial management, in the context of the growth in expenses experienced.

In the 10 years to 2020-21, the Council's average annual increase in expenses per property was 3.2 percent, with 0.5 percent average annual growth in property assessments.[19] This compares with average annual inflation of 1.7 percent. Operating income per property grew by an average of 3.6 percent per annum.

The expense growth was underpinned by average annual growth of 4.9 percent in employee expenses (with full time equivalent numbers increasing by 2.3 percent per annum) and 3.5 percent growth in depreciation expenses.

Looking forward, the Council is projecting lower average expense and income per property growth of 2.6 and 2.7 percent per annum respectively (to 2031-32). This is lower than RBA-based forecast Consumer Price Index (**CPI**) inflation growth (2.8 percent) and assumes continued growth in rateable property numbers averaging 0.5 percent each year.[20]

16 Refer: https://engage.ahc.sa.gov.au/draft-stormwater-management-plan-aldgate-bridgewater-crafers-and-stirling.

17 LG Act s122 (1a).

18 The operating surplus ratio is defined as: Operating Surplus (Deficit) ÷ Total Operating Income. The general target is to achieve, on average over time, an operating surplus ratio of between zero and 10 percent (Local Government Association of South Australia, *Financial Sustainability Information Paper 9 - Financial Indicators Revised,* May 2019 (**LGA SA Financial Indicators Paper**), p. 6).

19 Based on the compound average annual growth rate formula (which is the adopted approach to calculating average annual growth rates throughout the Commission's advice).

20 The forecast average annual growth in the CPI from 2022-23 to 2031-32 is estimated to be 2.8 percent based on the RBA forecasts for the CPI (Australia-wide) to June 2025 (and the Commission's calculations of average annual percentage growth) and the midpoint of the RBA's target range (2.5 percent) from 2025-26.

The Council identified that it would undertake a strategy to manage its operating performance efficiently.[21] Therefore, the Commission considers that the Council should be well placed to:

6. **Report** its actual and projected cost savings in its annual budget, to provide evidence of constraining cost growth and achieving efficiency across its operations and service delivery.

Net financial liabilities

The net financial liabilities ratio has ranged between 34 and 60 percent between 2011-12 and 2021-22. This is within the suggested LGA target range of 0 to 100 percent.[22] It will continue to meet the suggested LGA target range under its 2022-23 LTFP forecasts (forecast to average 51 percent to 2031-32). The Council's total borrowings and liabilities are forecast to increase significantly until 2026-27, and then decrease moderately for the remainder of the LTFP period.

Asset renewals expenditure

While showing some volatility from year to year, the Council's asset renewal funding ratio[23] has averaged 113 percent between 2012-13 and 2020-21.[24] This is above the suggested LGA target range (between 90 to 110 percent) suggesting that the Council has spent more on the renewal of its assets than its IAMPs have recommended. Average spending on the renewal of assets averaged $9.1 million per annum over this period.

In 2013-14, the ratio spiked at 178 percent with the Council seeking to address an infrastructure renewal backlog with higher renewal expenditure ($12.3 million in that year in nominal terms).[25] However, in the five years to 2021-22, the ratio averaged 109 percent, which is back within the suggested LGA target range.

The Council is forecasting its asset renewal funding ratio to continue to perform within the suggested LGA target range (and remain at 100 percent) to 2031-32. Average spending on the renewal of assets will be $11.5 million, compared with $3.1 million on new and upgraded assets.

The Council's depreciation expenses, which should represent the rate of asset consumption, are forecast to continue to exceed its renewal spending in forward projections. Higher depreciation forecasts may lead to higher than necessary levels of rates since the Council incorporates the estimates into its expense projections which in turn, impacts its operating balance.

To ensure a closer alignment between depreciation expenses and asset renewals expenditure over the longer term, it would be appropriate for the Council to:

7. **Review** the estimates of asset lives and valuations feeding into the forecast rate of asset consumption in its long-term financial plan and asset management plans.

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21 Adelaide Hills Council, *Annual Business Plan 2022-23*, July 2022, p. 30.

22 The net financial liabilities ratio is defined as: Net financial liabilities ÷ Total operating income. This ratio measures the extent to which a council's total operating income covers, or otherwise, its net financial liabilities. The suggested LGA target range is between zero and 100 percent of total operating income, but possibly higher in some circumstances (LGA SA Financial Indicators Paper, pp. 7-8).

23 Since 2013, the asset renewal funding ratio has been defined as: Asset Renewal Expenditure ÷ IAMP Renewal Expenditure. The suggested LGA target range for the ratio is 90 to 110 percent. Ideally, this ratio will show the extent to which a council's renewal or replacement expenditure matches the need for this expenditure, as recommended by the plan.

24 The ratio was reported from 2012-13.

25 Adelaide Hills Council, *2013-14 Annual Report*, p. 3, available at https://www.ahc.sa.gov.au/assets/downloads/council/Reports/Annual-Reports/COUNCIL-Annual-Report-2013-2014.pdf.

2.2.3 Advice on current and projected rate levels

The Council's rate revenue growth has averaged 3.2 percent, or $62 per annum for each property over the past 10 years,[26] compared with average annual CPI growth of 1.7 percent over this period. [27]

The Council budgeted for an average rate increase of 4.9 percent or $110 for its existing ratepayers in 2022-23,[28] in line with its 2022-23 LTFP projections. To 2031-32, the Council's average projected growth in rates revenue per rateable property is 2.9 percent per annum.[29] This is in line with the RBA-based forecast.

Affordability risk among the community for the further rate increases appears relatively low, based on a range of factors, including the existing non-residential rate levels, an assessment of the economic resources available to the community[30] and the community survey results which indicated some support for the rate increases in 2022-23. [31] Based on the Council's survey concerning its 2022-23 operating budget (including the rate contributions), 70 percent of community respondents either supported the budget (25 percent) or were neutral towards it (45 percent). Around one third (30 percent) opposed it.[32] The Commission notes that the number of survey responses were relatively low.

However, one of the respondents did also raise concern about the Council's proposed maximum rate increase of 15 percent (as a cap) being too high, especially relative to the average rate increase (4.9 percent).[33]

The current economic environment is putting more pressure on most communities' capacity to pay for further rate increases. Therefore, despite the strong socioeconomics of the area and the level of neutrality and support for its 2022-23 budget, on balance, the Commission considers that it would be appropriate for the Council to:

8. Review and consider limiting future increases above inflation on its residential rates to help reduce any emerging affordability risk in the community.

9. Review the rationale for the quantum of any maximum rate increase (or cap) it seeks to impose (currently at 15 percent) in its next annual business plan, with consideration of the community's capacity to pay for higher increases.

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26 From 2011-12 to 2020-21.

27 CPI (All groups). Average annual growth in the LGPI published by the South Australian Centre for Economic Studies was similar (at 1.9 percent) to CPI growth over this period. Available at https://www.adelaide.edu.au/saces/economic-and-social-indicators/local-government-price-index.

28 Adelaide Hills Council, *Annual Business Plan 2022-23*, July 2022, p. 35. Individual rate level changes may be higher or lower depending on the rates category and property value.

29 Since the Council does not provide the estimation number of rateable properties, the Commission extrapolated the numbers based on 'rates growth of new development' as shown in the indexation forecasts.

30 The Adelaide Hills Council area is ranked 71 among 71 South Australian '*local government areas*' (including Anangu Pitjantjatjara and Maralinga Tjarutja Aboriginal community areas and 'unincorporated SA') on the Australian Bureau of Statistics Socio-Economic Indexes for Areas Index of Economic Resources (2016), where a lower ranking (eg, 1) denotes relatively lower access to resources in general, compared with other areas, available at: https://www.abs.gov.au/ausstats/subscriber.nsf/log?openagent&2033055001%20-%20lga%20indexes.xls&2033.0.55.001&Data%20Cubes&5604C75C214CD3D0CA25825D000F91AE&0&2016&27.03.2018&Latest.

31 Adelaide Hills Council, *Agenda for Special Council Meeting 14 June 2022: Item 7.1*, p. 27.

32 Adelaide Hills Council, *Agenda for Special Council Meeting 14 June 2022: Item 7.1. Draft Annual Business Plan 2022-23 Community Engagement Outcome Report,* p. 27, available at https://www.ahc.sa.gov.au/assets/meetings/2022/06-June/special-council-meeting-14-jun-2022/agendas/220614-Special-Council-Agenda-PUBLIC.pdf.

33 Adelaide Hills Council, *Agenda for Special Council Meeting 14 June 2022: Item 7.1*, p. 27.

2.3 The Commission's next advice and focus areas

In the next cycle of the scheme, the Commission will review and report upon the Council's:

- ongoing performance against its LTFP estimates and relevant assumptions in its LTFP (including inflation)
- achievement of cost savings and efficiencies, and its reporting of these achievements
- completion and adoption of its AMPs for stormwater, CWMS and buildings and potentially other assets
- actions to address any misalignment between the capital expenditure on renewal/replacement of assets and the level of depreciation expenses in its LTFP and various AMPs, and
- actions to address the emerging affordability risks for residential ratepayers identified, including its policy on maximum rate increases.

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