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Advice

# Local Government Advice

City of Burnside

February 2023

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**Enquiries concerning this advice should be addressed to:**

Essential Services Commission  
GPO Box 2605  
Adelaide SA 5001

Telephone: (08) 8463 4444  
Freecall: 1800 633 592 (SA and mobiles only)  
E-mail: [advice@escosa.sa.gov.au](mailto:advice@escosa.sa.gov.au)  
Web: [www.escosa.sa.gov.au](http://www.escosa.sa.gov.au)

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## Glossary of terms

ABS	Australian Bureau of Statistics
AMP	Asset management plan (also called an IAMP)
Commission	Essential Services Commission, established under the <i>Essential Services Commission Act 2002</i>
CPI	Consumer Price Index (Adelaide, All Groups)
Council	Council of the City of Burnside
ESC Act	<i>Essential Services Commission Act 2002</i>
F&A	<a href="#">Local Government Advice: Framework and Approach – Final Report</a>
FTE	Full Time Equivalent
IAMP	Infrastructure and asset management plan (also called an AMP)
LG Act	<i>Local Government Act 1999</i>
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
LGPI	Local Government Price Index
LTFP	Long-term financial plan
Regulations	<i>Local Government (Financial Management) Regulations 2011</i>
RBA	Reserve Bank of Australia
SACES	The South Australian Centre for Economic Studies
SEIFA	Socio-Economic Indexes for Areas
SMP	Strategic management plan
SG	Superannuation Guarantee
The scheme or advice	Local Government Advice Scheme

# 1 The Commission's key advice findings for the City of Burnside

The Essential Services Commission (**Commission**) considers the City of Burnside (**Council**) to be in a sustainable financial position but is reliant on further growth in rate revenue and assumptions of lower expense growth than it has achieved in the past. The Council has consistently prioritised the renewal of its asset base, consistent with the requirements it has identified through its asset management planning and demonstrates a commitment to reviewing desired service levels for the community.

Looking ahead, the Commission suggests the following steps to help ensure that it budgets transparently, continues to report its cost savings and efficiencies, ensures the assumptions underpinning its financial and asset management planning are reasonable and looks for opportunities to limit the extent of further residential rate increases.

## Budgeting considerations

1. **Consider** better clarity in its forward estimates in its long-term financial plan concerning the inflation assumptions feeding into its projected revenue (including rates) and expenses, distinct from 'real' impacts.
2. **Review** its inflation assumptions in its forward projections from 2023-24, given the potential for higher short-term inflation outcomes, followed by a return to long-term averages.

## Providing evidence of ongoing cost efficiencies

3. **Continue** the recent focus on constraining cost growth in its budgeting, where possible.
4. **Continue** the good practice of reporting 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

5. **Continue** the good practice of reviewing the capital expenditure program annually in its asset management plans and consider options to better align the assumptions underpinning the expenditure allocations with its long-term financial plan, including the estimate for asset lives and valuations feeding into the forecast rates of asset consumption and depreciation expenses.

## Containing residential rate levels

6. **Review** and **consider** limiting future increases in its average residential rates to help reduce any emerging affordability risk in the community.

## 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.<sup>1</sup>

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**)<sup>2</sup> – both required as part of a council's SMP.<sup>3</sup> Financial sustainability is considered to encompass intergenerational equity,<sup>4</sup> as well as program (service level) and rates stability in this context.<sup>5</sup> The other main purpose is for the Commission to consider ratepayer contributions in the context of revenue sources, outlined in the LTFP.<sup>6</sup> 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.<sup>7</sup>

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 City of Burnside (**Council**).

This report provides the Local Government Advice for the City of Burnside 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.<sup>8</sup> It does not need to publish the attachment to the advice (these will be available with the advice on the Commission's website<sup>9</sup>), nor is it compelled under the LG Act to follow the advice. The Commission thanks the City of Burnside for providing relevant information to assist the Commission in preparing this advice.

### 2.1 Summary of advice

In general, the Commission finds the City of Burnside's current financial performance and position sustainable. Over the last 10 years, the Council has consistently run relatively small operating surpluses, indicating that the operating income it collects is generally exceeding its operating expenses by a conservative margin. The Commission notes that this demonstrates financial prudence since the Council is not accumulating excessive surpluses. At the same time, the Council has increased its rate levels consistently above inflation, and its residential rates are high, noting the socio-economic ranking

<sup>1</sup> 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).

<sup>2</sup> Commonly referred to as asset management plans.

<sup>3</sup> 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.

<sup>4</sup> 'Intergenerational equity' relates to fairly sharing services and the revenue generated to fund the services between current and future ratepayers.

<sup>5</sup> Commission, *Framework and Approach – Final Report*, August 2022, pp. 2-3, available at [www.escosa.sa.gov.au/advice/advice-to-local-government](http://www.escosa.sa.gov.au/advice/advice-to-local-government).

<sup>6</sup> LG Act s122(1f) (a) and (1g) (a)(ii).

<sup>7</sup> LG Act s122(1f) (b) and (1g) (b).

<sup>8</sup> LG Act s122(1h).

<sup>9</sup> The Commission must publish its advice under LG Act s122(1i) (a).

for the community is also high, suggesting that there is more capacity to pay for higher rates than in other communities.<sup>10 11</sup>

Community service levels appear to have been maintained, largely through the Council's focus on renewing its asset base, consistent with the requirements it has identified through its asset management planning.

The Council's forward projections from 2022-23 continue to forecast a consistent financial sustainability outlook through:

- ▶ lower average cost increases than it has experienced over the past 10 years (but still higher than it had forecast in 2021-22, primarily due to the impact of higher inflation)
- ▶ the continued prioritisation of its asset expenditure on renewal and rehabilitation works, rather than on new and upgraded assets, and
- ▶ continued rate increases on the community above the rate of inflation.

The Commission notes the City of Burnside's current good practice of reporting cost savings and efficiencies in its annual budget and reviewing annually the expenditure requirements in its Asset Management Plans (**AMPs**) and encourages it to continue to do so. It is also suggested that the Council review the asset-related assumptions (e.g., asset lives) feeding into its estimated depreciation expenses in its forward projections to determine whether there are opportunities to reduce these expenses. There are other opportunities for the Council to be more transparent about its price, service level and efficiency-related assumptions in its forward cost projections. In general, a transparent focus on cost constraint should help the Council to identify opportunities to reduce any affordability risk emerging for residential ratepayers, who account for the major share of the rates revenue.

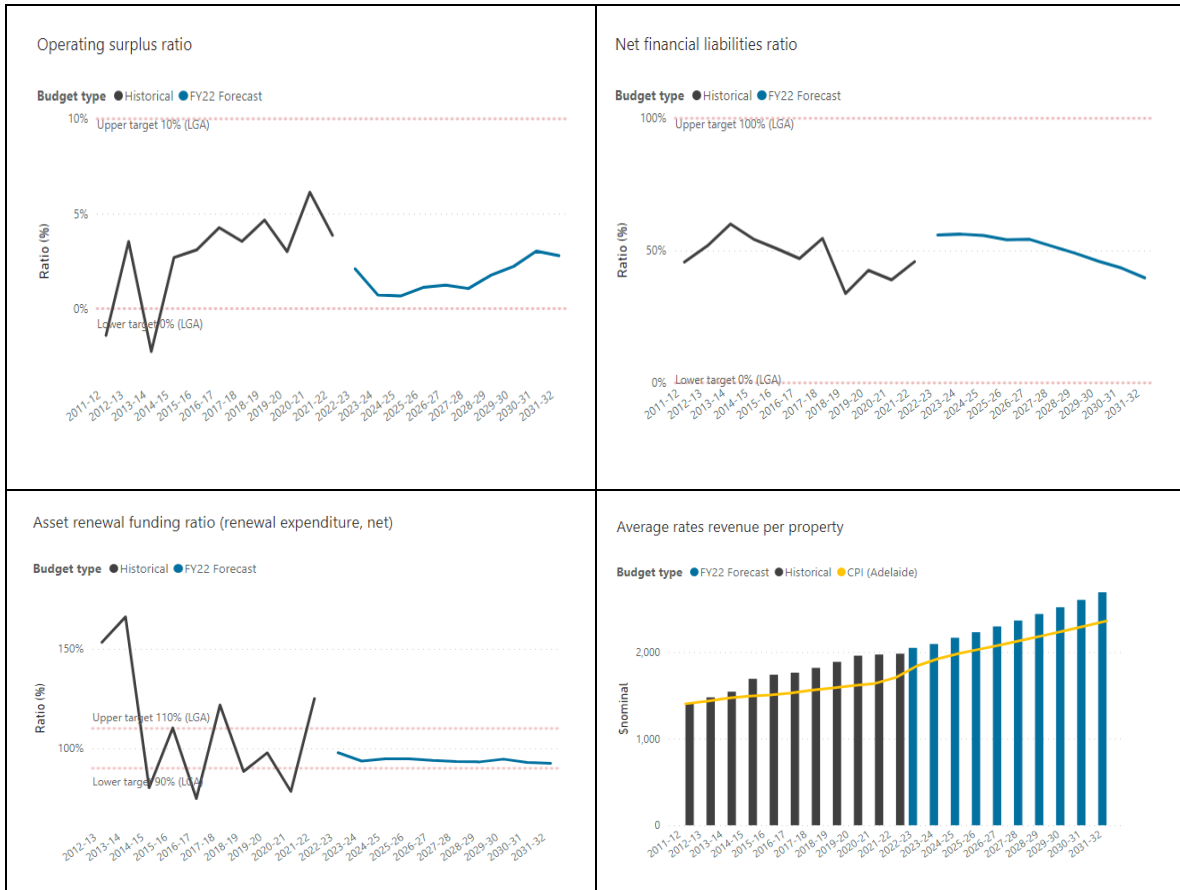
The charts on the next page of the City of Burnside's past and projected operating surplus ratio, net financial liabilities ratio, asset renewal funding ratio and average rate revenue per property, together support these findings.

The 'heat map' diagram underneath summarises the Commission's findings with reference to whether the Council has met the suggested target ranges for the three main financial sustainability indicators<sup>12</sup> and the level of cost control and affordability risk identified for the Council over time.

<sup>10</sup> Refer to the Councils in Focus website, available at <https://councilsinfocus.sa.gov.au/home> for 2019-20 rates data by council.

<sup>11</sup> The City of Burnside LGA is ranked 68 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 SEIFA Index of Economic Resources (2016), where a lower score (eg, 1) denotes relatively lower access to economic 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>.

<sup>12</sup> The suggested LGA target ranges for the ratios are discussed in more detail in the attachment.



Summary of the City of Burnside’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 met historically and in forecast period →		
Net financial liabilities ratio (target 0-100%)	Ratio met historically and in forecast period →		
Asset renewal funding ratio (target 90-110%)	Spending on renewal works requirements met but with ratio at the lower end of suggested target range →	Ratio within target range	Suggested ratio target range met in projections with forecast higher spending on asset renewal works →
<b>Identified Risks:</b>			
Cost control risk	Operating expenses growth average 3.0% p.a. to 2020-21 (CPI 1.7%) →		Forecast operating expense growth to average 3.3% p.a. to 2031-32 (CPI 2.8%) →
Affordability risk	Low affordability risk with capacity to pay (rates revenue growth average 3.7% p.a. to 2020-21) →	High residential rates	Higher residential rates & successive 'above CPI' rate increases projected (rates revenue growth to average 3.4% p.a.) →

- 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 detailed advice findings regarding the City of Burnside'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 followed the approach it earlier explained in the Framework and Approach – Final Report (F&A). The attachment explores these matters further.<sup>13</sup>

### 2.2.1 Advice on material plan amendments in 2022-23

The City of Burnside's 2022-23 long term financial plan includes increases to its projected income and expenditure to 2030-31, compared with the 2021-22 forecasts,<sup>14</sup> as follows:

- ▶ An additional \$35.1 million or 7 percent in total operating income. This includes an additional \$30.1 million or 7 percent in rates.
- ▶ An additional \$38.1million or 8 percent in total operating expenses (for example, for contracts and employees) and \$10.2 million or 8 percent in total capital expenditure. Also, more than half of the City of Burnside's higher operating expenses are due to an increase of \$20.4 million or 9 percent in 'materials, contracts, and other' expenses. This is due to an increase in the Council's 'Cost Index' applied from 2023-24 to 2031-32.

In the current inflationary environment, most of the revisions to the forward estimates appear to be for additional inflation impacts. The Council's annual business plan identifies inflation assumptions distinct from other cost impacts for 2022-23, however the LTFP is less clear from 2023-24, with the Council not stating its annual inflation assumptions.

The Commission considers that it would be appropriate for it to:

1. **Consider** better clarity in its forward estimates in its long-term financial plan concerning the inflation assumptions feeding into its projected revenue (including rates) and expenses, distinct from 'real' impacts.

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 always endeavour to find savings in real terms to reduce any inflationary impact on its community. To these ends, the Commission suggests that the Council:

2. **Review** its inflation assumptions in its forward projections from 2023-24, given the potential for higher short-term inflation outcomes, followed by a return to long-term averages.

### 2.2.2 Advice on financial sustainability

#### Operating performance

Historically, the City of Burnside has ensured that its income growth exceeds its expense growth, thereby providing for recurring operating surpluses. From 2011-12 to 2020-21, operating expenses increased by an average of 3.0 percent per annum, which compares with average operating income

<sup>13</sup> The attachment will be available on the Commission's website with the advice.

<sup>14</sup> The overlapping forecast period in both LTFPs (2021-22 to 2030-31 and 2022-23 to 2031-32).

growth of 3.9 percent and average annual inflation growth of 1.7 percent over this period.<sup>15</sup> Accordingly, the operating surplus ratio<sup>16</sup> averaged 2.7 percent which demonstrates prudent financial management without excessive surplus levels, in the context of the growth in expenses experienced.

'Materials, contracts, and other' expenses increased by an average of 3.8 percent per annum in the 10 years to 2020-21, while 'employee' expenses increased by 3.0 percent per annum over this period.<sup>17</sup>

<sup>18</sup> The estimated annual average rate of growth in these expenses projected over the next 10 years (3.1 percent and 3.4 percent respectively), combined with higher rates increases, will ensure the Council's operating performance remains in surplus.

The Commission further notes that on a per property basis, operating expense growth is forecast to average 2.6 percent per annum and operating income growth 2.7 percent annum. These projections are below RBA-based forecast average inflation of 2.8 percent and represent a shift from the Council's historical performance of cost growth exceeding the rate of inflation.<sup>19</sup>

To continue to achieve its sound operating position without the need for additional or unplanned rate increases, the Council will need to continue to find savings and efficiencies in its budgets, as it stated it is committed to doing. It achieved savings and efficiencies of more than \$3.7 million over the past five years, and it stated that it would continue to review its services, processes and systems.<sup>20</sup> To this end, it would be appropriate for the Council to:

3. **Continue** the recent focus on constraining cost growth in its budgeting, where possible.
4. **Continue** the good practice of reporting 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

Over the past 10 years, the City of Burnside has consistently used borrowing and other financing options within the suggested target range for the net financial liabilities ratio.<sup>21</sup> It will continue to meet the suggested target range in its 2022-23 forecast and has projected a reduction in the ratio from 65 percent in 2022-23 to 44 percent by the end of 2031-32. This will be achieved by the City of Burnside

<sup>15</sup> CPI (All groups). Average annual growth in the LGPI published by the South Australian Centre for Economic Studies was similar (at 1.9 percent), available at <https://www.adelaide.edu.au/saces/economic-and-social-indicators/local-government-price-index>.

<sup>16</sup> The operating surplus ratio is defined as: Operating Surplus (Deficit) ÷ Total Operating Income. The general target for councils 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).

<sup>17</sup> The Commission notes the increase in the solid waste levy over the last 10 years, which has impacted waste management costs in the local government sector.

<sup>18</sup> Based on the compound average annual growth rate formula throughout the Commission's Advice.

<sup>19</sup> The forecast average annual growth in the CPI from 2022-23 to 2031-32 is estimated to be 2.8 percent based on Reserve Bank of Australia (RBA) forecasts for the Consumer Price Index (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

<sup>20</sup> City of Burnside, *2022 -23 Annual Business Plan and Budget*, July 2022, p. 29, available at <https://www.burnside.sa.gov.au/files/assets/public/about-council/policies-plans-amp-reports/annual-business-plan-amp-budget/adopted-annual-business-plan-amp-budgets/annual-business-plan-and-budget-2022-23.pdf>.

<sup>21</sup> 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 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.

reducing its borrowings from \$28.9 million in 2022-23 to \$24.1 million in 2031-32 and demonstrates that the Council will continue to have sufficient operating capacity for its borrowing needs.

### Asset renewals expenditure

The City of Burnside has consistently invested enough on renewing its assets to maintain service levels and avoid a backlog of renewal expenditure. The Council's asset renewal funding ratio (IAMP-based) has been within the suggested target range of 90 percent to 110 percent,<sup>22</sup> in seven of the previous eight years, at an average of 92 percent between 2015-16 and 2021-22.

Looking forward, the City of Burnside is forecasting to continue to spend close to the amount it recommends from its IAMP on the renewal and rehabilitation of its existing asset stock.<sup>23</sup> Accordingly, the ratio is forecast to remain within the suggested target range in each year to 2031-32.

The City of Burnside updates its capital program allocation for new and upgraded expenditure and for asset renewal and rehabilitation on an annual basis through its AMPs. These AMPs provide a list of expected renewal expenditure based on the expired useful life or intervention points on assets that the Council manages. The plans also include consideration of the desired levels of service for different assets by the community.

One potential area for improvement regarding the City of Burnside's asset management planning relates to the LTFP projections better aligning with the expenditure needs identified in the AMPs. For example, in the 2022-23 to 2031-32 LTFP, estimated renewal and rehabilitation expenditure is \$16.9 million for 2022-23<sup>24</sup> while the AMPs' identified aggregate expenditure on renewal and rehabilitation is \$8.4 million for the same year. Similarly, estimated new and upgraded asset expenditure in the LTFP is \$7.6 million<sup>25</sup> while in the four AMPs it is altogether \$1.07 million. The Commission notes that there can be legitimate budgeting reasons for adjusting capital expenditure from year to year, as well as additional inflation impacts, but encourages the Council to review this area to determine if there can be better alignment.

In addition, the City of Burnside's annual depreciation expenses, which should represent the estimated average rate of asset consumption over time, are forecast to continue to exceed its renewal spending in forward projections. This might indicate that the assumptions underpinning the depreciation expenses, such as the extent of asset lives assumed (in the depreciation calculation), warrant further review and revision by the Council. The Commission notes that lower depreciation expenses would reduce operating expenses and improve the Council's operating position, which would help to relieve further pressure on rate levels.

For the reasons discussed above, the Commission suggests that the Council:

5. **Continue** the good practice of reviewing the capital expenditure program annually in its asset management plans and consider options to better align the assumptions underpinning the expenditure allocations with its long-term financial plan, including the estimate for asset lives and valuations feeding into the forecast rates of asset consumption and depreciation expenses.

<sup>22</sup> The IAMP-based method is the current industry standard whereby asset renewal/replacement expenditure is divided by the recommended expenditure in the IAMP (or AMP). Ideally, this will show the extent to which a council's renewal or replacement expenditure matches the need for this expenditure, as recommended by the plan. The suggested target range for the ratio is 90 to 110 percent (LGA SA Financial Indicators Paper, p. 9).

<sup>23</sup> City of Burnside, *Long Term Financial Plan 2022-23 to 2031-32*, July 2022, p. 30, available at <https://www.burnside.sa.gov.au/files/assets/public/about-council/policies-plans-amp-reports/long-term-financial-plan/ltfp-2022-23-2031-32-finalweb.pdf>.

<sup>24</sup> City of Burnside, *Long Term Financial Plan 2022-23 to 2031-32*, July 2022, p. 5.

<sup>25</sup> City of Burnside, *Long Term Financial Plan 2022-23 to 2031-32*, July 2022, p. 5.

### 2.2.3 Advice on current and projected rate levels

Between 2011-12 and 2020-21, the City of Burnside's rate revenue per property increased by an average of 3.9 percent per annum to \$1,973 in 2020-21. This exceeded CPI growth of an average of 1.7 percent per annum.<sup>26</sup>

Between 2022-23 and 2031-32 the average rate across all categories is forecast to increase from \$2,049 to \$2,691<sup>27</sup>, a cumulative increase of \$642 per property. This equates to a 3.1 percent average annual increase (between 2022-23 and 2031-32) which is higher than the forecast average inflation over the next 10 years of 2.8 percent.<sup>28</sup>

The majority of the City of Burnside's revenue comes from residential rates (contributing around 90 percent of total rates revenue in 2021-22).<sup>29</sup> The Council's average residential rates per property are relatively high, while its average commercial rates are relatively low.<sup>30</sup>

The Council increased residential rates by an average of 6.0 percent or \$112 to an average rate of \$1,972 in 2022-23 (which also includes 0.9 percent growth in residential property assessments).<sup>31</sup> The three-year average annual increase (excluding growth) from 2019-20 to 2022-23 was 2.7 percent.<sup>32</sup>

Currently, affordability risk among the community appears relatively low based on the Socio-Economic Indexes for Areas (SEIFA) economic resources ranking, which places the area in the top three councils in South Australia in terms of residents' access to economic resources.<sup>33</sup> The Council's lower commercial rates might also provide it with some leverage to limit residential rate increases.

However, affordability risk could still emerge given the current economic environment affecting the residents more generally. The survey feedback from 485 residents on the Council's Draft 2022-23 Business Plan and Budget and LTFP indicated that only 14 percent or 67 residents supported a rate increase above 3.5 percent.<sup>34</sup> For these reasons, the Commission suggests that the Council:

6. **Review** and consider limiting future increases on its average residential rates to help reduce any emerging affordability risk in the community.

## 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 City of Burnside's:

- ▶ ongoing performance against its LTFP estimates, and transparency of its inflation assumptions in its LTFP
- ▶ achievement of cost savings and efficiencies, and its reporting of these achievements

<sup>26</sup> CPI (All groups). Average annual growth in the LGPI published by the South Australian Centre for Economic Studies was similar (at 1.9 percent), available at <https://www.adelaide.edu.au/saces/economic-and-social-indicators/local-government-price-index>.

<sup>27</sup> This includes rates growth of 1 percent expected each year.

<sup>28</sup> See footnote 19.

<sup>29</sup> City of Burnside, *2022-23 Annual Business Plan and Budget*, July 2022, p. 57.

<sup>30</sup> Refer to the Councils in Focus website, available at [https://councilsinfocus.sa.gov.au/councils/city\\_of\\_burnside](https://councilsinfocus.sa.gov.au/councils/city_of_burnside).

<sup>31</sup> City of Burnside, *2022-23 Annual Business Plan and Budget*, July 2022, p. 57.

<sup>32</sup> City of Burnside, *2022-23 Annual Business Plan and Budget*, July 2022, p. 33.

<sup>33</sup> See footnote 11.

<sup>34</sup> City of Burnside, *Ordinary Council Meeting Agenda -28 June 2022, Engagement Outcomes, 2022/23 Draft Annual Business Plan and Budget and Long-Term Financial Plan 2022/23 to 2031/32*, Item 11.2, p. 110, available at [https://www.burnside.sa.gov.au/files/assets/public/about-council/council-amp-committees/agendas-minutes-amp-workshops/council/2022/agendas/2022-06-28-notice-of-meeting-agenda\\_public.pdf](https://www.burnside.sa.gov.au/files/assets/public/about-council/council-amp-committees/agendas-minutes-amp-workshops/council/2022/agendas/2022-06-28-notice-of-meeting-agenda_public.pdf).

- ▶ actions to address any misalignment between the renewals capital expenditure and depreciation estimates in its LTFP and various AMPs, as appropriate, and
- ▶ how it has sought to address any emerging affordability risks for residential ratepayers.



The Essential Services Commission  
Level 1, 151 Pirie Street Adelaide SA 5000  
GPO Box 2605 Adelaide SA 5001  
T 08 8463 4444

E [escosa@escosa.sa.gov.au](mailto:escosa@escosa.sa.gov.au) | W [www.escosa.sa.gov.au](http://www.escosa.sa.gov.au)