Advice

Local Government Advice - Attachment

City of Prospect

February 2023

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A The Commission's approach

In providing the Advice for the City of Prospect (**Council**), the Essential Service Commission (**Commission**) has followed the approach it previously explained in the Framework and Approach – Final Report (**F&A**).[1]

The Commission has considered the Council's strategic management plan (**SMP**) documents (as in the box below), with a particular focus on its performance and outlook against three financial indicators: the operating surplus ratio, the net financial liabilities ratio and the asset renewal funding ratio.[2] Analysis of these three indicators captures financial and service sustainability, in addition to cost control and affordability risk.[3]

- 2022-2023 Annual Business Plan & Budget (adopted 28 June 2022)
- 2021-2022 Annual Business Plan & Budget (adopted (with revision) 14 December 2021)
- Draft Asset Management Plan Summary 2021- 2031 (initiated 24 January 2022 and updated 15 February 2022)
- Draft Buildings Asset Management Plan (initiated 21 August 2021)
- Draft Roads Asset Management Plan (initiated May 2020 and updated August 2021)
- Draft Footpaths Asset Management Plan (initiated May 2020 and updated August 2021)
- Draft Open Spaces Asset Management Plan (initiated July 2021 and updated August 2021)
- Draft Stormwater Asset Management Plan (initiated December 2021).

Given that the Commission must, in providing advice, have regard to the objective of councils maintaining and implementing their infrastructure and asset management plans (**IAMPs**) (usually termed asset management plans (**AMPs**)) and Long-term Financial Plans (**LTFPs**),[4] it has also considered the Council's performance in that context.

The Commission notes that the City of Prospect's LTFP projections are contained in its annual business plan and budget. It has not yet adopted any of its AMPs, which all remain in draft form.[5] The findings regarding the draft AMPs are discussed in section C.3.

The Commission has also reviewed the Council's template data which contains its 2022-23 LTFP forecasts for 2022-23 to 2031-32, as well as its 2021-22 LTFP forecasts, and historical financial data and number of rateable properties and council staff (Full Time Equivalent (**FTE**)) numbers from 2011-12

1 Commission, *Framework and Approach – Final Report*, August 2022, available at www.escosa.sa.gov.au/advice/advice-to-local-government.

2 The indicators are specified in the *Local Government (Financial Management) Regulations 2011* (**Regulations**). Since 2011, each council has been required to refer to these three indicators in its plans, annual budget, mid-year budget review and annual financial statements. The councils can adopt their own target range for each ratio, but the Commission has adopted the previously suggested Local Government Association (**LGA**) target ranges as a basis for its analysis, which were established and agreed during the development of the LGA Financial Sustainability Papers (2006-2011).

3 The F&A listed 29 analytical questions that the Commission has answered in assessing the Council's performance against these indicators to determine affordability, cost control and other sustainability risks.

4 *Local Government Act 1999* (**LG Act**) s122(1g)(a)(i).

5 At the time of drafting this advice.

onwards.[6] [7] All charts and tables in the advice are primarily sourced from these datasets. In addition, the Commission has reviewed the Council's audit committee reports, and other public information, as appropriate.

The Commission has reported estimates in nominal terms, for consistency with the Council's plans and actual rate levels, but it has compared estimated inflation impacts to these trends as a guide to identify 'real' rather than 'inflationary' effects. In the charts, the CPI line shows the cumulative growth in the CPI (Adelaide) series from 2011-12, and then projections of this series from 2022-23 based on RBA (Australia-wide) inflation forecasts (to the June quarter 2025), and the midpoint of the RBA target range (2.5 percent) thereafter.

Finally, in formulating this Advice, the Commission has had regard to the circumstances of the City of Prospect, including its location as a metropolitan council, its established residential base, its income level ($27.4 million) and the size of its rates base (more than 10,300 ratepayers[8]).

6 Sourced from the Local Government Grants Commission (including data reported by the Office of the Valuer-General) and Council's data.

7 The Council's estimates for the 2021-22 financial year, relied on at the time of preparing this advice, were unaudited.

8 Based on the estimated number of property assessments in 2022-23.

B Material plan amendments in 2022-23

The City of Prospect has made various amendments to its 2022-23 budget and forward projections, partly for inflation and partly for other revenue and spending initiatives. The material amendments to some of its main financial forecasts are listed in the table below (in nominal terms).[9] To ensure a comparable analysis of estimates between the 2021-22 and 2022-23 LTFPs, the Commission has reviewed the nine overlapping years' statistics: 2022-23 to 2030-31 and identified material amendments accordingly.

Selected Financial Item	Sum of 2022-23 to 2030-31 estimates in 2021-22 LTFP ($ million)	Sum of 2022-23 to 2030-31 estimates in 2022-23 LTFP ($ million)	Change in 2022-23 estimates ($ million)	Change in 2022-23 estimates (percent)
Rates income	252.7	258.2	+5.4	+2
Total operating income	279.4	285.9	+6.5	+2
Employee expenses	95.7	100.3	+4.6	+5
Depreciation, amortisation and other expenses	53.5	65.6	+12.1	+23
Total operating expenses	263.7	282.9	+19.2	+7
Capital expenditure on renewal of assets	56.1	72.8	+16.7	+30
Capital expenditure on new and upgraded assets	13.1	9.4	-3.7	-29
Infrastructure, property, plant and equipment value	2,071.5	2,292.5	+221.0	+11
Total liabilities	215.6	243.4	+27.9	+13

B.1 Indexation adjustments

The Council indicated that it used a 'zero-budgeting based' approach[10] in 2021-22 and carried this over to its 2022-23 budget with indexation only, in addition to the inclusion of some recurrent savings.[11]

Based on the Council's assumptions in its 2022-23 LTFP, an increase in its cost and revenue estimates by around 2 to 6 percent over the 2022-23 to 2030-31 forecast period[12] would be appropriate for higher inflation, compared with the same estimates (aggregated) in its 2021-22 LTFP.

[9] This table shows only selected financial items to demonstrate the material amendments made by the Council in its 2022-23 estimates. It excludes various financial items and individual items do not sum to totals.

[10] Zero-based budgeting is a method of budgeting whereby all expenses must be reviewed and justified for each new period.

[11] City of Prospect, *2022-2023 Annual Business Plan & Budget*, June 2022, p. 28, available at https://www.prospect.sa.gov.au/__data/assets/pdf_file/0040/1187788/Annual-Business-Plan-2022-2023_web-ready.pdf.

[12] The set of nine years forecast in both the 2021-22 and 2022-23 LTFP projections.

Whether it is up to 2 or 6 percent depends on which index the Council has applied since it has used different indices for different cost and revenue series.

The Council's Consumer Price Index (**CPI**) assumptions[13] generally result in an increase of up to 3 percent to relevant 2022-23 estimates (aggregated from 2022-23 to 2030-31),[14] and around 4 to 6 percent for its Local Government Price Index (**LGPI**)[15] assumptions,[16] depending on which series it is applied to.

The Council applied the largest indexation increases to its capital expenditure and depreciation expense forecasts with adjusted LGPI forecasts of 5.6 percent in 2022-23, 3.5 percent in 2023-24 and 2.5 percent thereafter. This results in an aggregated increase of 6 percent to these items on the 2021-22 estimates (over the period 2022-23 to 2030-31).

At the lower end of the spectrum, the Council applied a CPI-adjusted increase of 2.5 percent per annum from 2022-23 to grants and other non-rates income, which results in an aggregate increase of 2 percent on the 2021-22 estimates.[17] Employee expenses increased by an aggregate 3 percent in the 2022-23 LTFP estimates for the additional CPI inflation.

The Reserve Bank of Australia (**RBA**) revised its inflation forecasts for CPI to increase by 6.7 percent in the year to the June 2023 quarter, by 3.6 percent in the year to the June 2024 quarter and 3.0 percent in the year to the June 2025 quarter.[18] Beyond June 2025, the RBA has not published inflation forecasts, but a return to the long-term average (of 2.5 percent based on the midpoint of the RBA's target range of 2 and 3 percent) is a reasonable assumption.

The Commission notes that the Council's stated assumptions for indexation in its 2022-23 LTFP are well tailored and reasonable in the current inflationary environment, but there remains uncertainty around the forecasts. Notwithstanding the need for the Council to endeavour to find savings and reduce any inflationary impact on its community, it would still be appropriate for it to:

1. **Continue** to review its inflation forecasts in its budget and forward projections each year.

B.2 Increase to income estimates

The City of Prospect has increased its forecast operating income in total by 2 percent, which appears to be reasonable for inflation impacts alone, although it is the result of a combination of different revenue impacts. Additional rates, statutory charges and user charges income has been offset by reduced grants income over this period (noting, not all series are shown in the table on the previous page).

The additional rates income ($5.4 million or 2 percent) reflects the indexation adjustment, and the specific impacts on current and projected rate levels are discussed more in section D. The additional statutory charges income ($1.3 million or 25 percent) appears to reflect a reasonable budgeting adjustment in the 2022-23 financial year for a spike in growth over the preceding two years. Similarly, the additional user charges income ($0.7 million or 32 percent) reflects a similar budgeting adjustment with a lower estimate in 2022-23. The Council stated that its target for user charges growth is CPI plus

13 3.3 percent in 2022-23, 2.75 percent in 2023-24 to 2025-26 and 2.5 percent thereafter.
14 Compared with the 2021-22 LTFP estimates over the same period.
15 The LGPI is published by the South Australian Centre for Economic Studies (**SACES**).
16 3.5, 4.0, 2.9 and 2.8 percent in the first four years from 2022-23 respectively, and then 2.5 percent from 2026-27.
17 In the 2022-23 LTFP estimates, compared with the 2021-22 estimates, for the period 2022-23 to 2030-31.
18 RBA, Forecast Table - February 2023, available at https://www.rba.gov.au/publications/smp/2023/feb/forecasts.html. The CPI (Australia-wide). The 'through the year' forecasts in any one quarter are different to the average annual inflation assumptions usually applied to Council's financial estimates.

1 percent (for each classification of user charges).[19] The 'grants, subsidies and contributions' income reduced by $0.9 million (or 5 percent), largely due to the timing of grant payments.

B.3 Increase to expense and expenditure estimates

The Council has significantly increased its forecast for operating expenses to 2030-31 by $19.2 million or 7 percent in its 2022-23 LTFP estimates.[20] This incorporates indexation adjustments and recurrent savings of $550,000 in 2022-23, and $100,000 in each of the next two years.[21]

Much of the increase to operating expense projections is due to the increase of $12.1 million or 23 percent to the depreciation expenses (including an 11 percent increase in 2026-27) over this period. The value of assets (shown by the 'infrastructure, property, plant and equipment' value) is also 11 percent higher, which explains part of the increase (and incorporates an inflation adjustment). However, the projected estimates for capital expenditure on new and upgraded assets have declined by an aggregate of $3.7 million or 29 percent.[22] Therefore, it is unclear why the estimates for depreciation expenses have increased to the extent that they have since the Council stated that the depreciation methodology has remained consistent with its 2021-22 budgeted financial statements.[23]

The Audit Committee noted the significant increase followed "finalisation of Council's AMPs and their associated asset class revaluations."[24] However, the Council's AMPs remain in draft form at the time of preparing this Advice.

In terms of capital expenditure on renewal works, the Council's latest (2022-23) LTFP has factored in a total of $16.7 million or 30 percent additional works over 2022-23 to 2030-31, compared with its 2021-22 LTFP forecasts, and additional liabilities (for example, borrowings) which help fund its programs. It noted that it is implementing capital projects 'brought forward' by matched stimulus grants.[25] The Council's projected capital expenditure in the context of its asset renewal funding ratio and other considerations (such as its net liabilities and rate levels), is discussed further from section C.2.

[19] City of Prospect, *2022-2023 Annual Business Plan & Budget*, June 2022, p. 27.
[20] Compared with the 2021-22 LTFP estimates aggregated over 2022-23 to 2030-31.
[21] City of Prospect, *2022-2023 Annual Business Plan & Budget*, June 2022, p. 28.
[22] Over the period 2022-23 to 2030-31, comparing the 2022-23 LTFP estimates with the 2021-22 LTFP's.
[23] City of Prospect, *2022-2023 Annual Business Plan & Budget*, June 2022, p. 41.
[24] City of Prospect, *Audit Committee Meeting Agenda - 20 April 2022*, p. 17, available at https://lgasa-web.squiz.cloud/?a=1136325.
[25] City of Prospect, *Audit Committee Meeting Agenda - 20 April 2022*, p. 20.

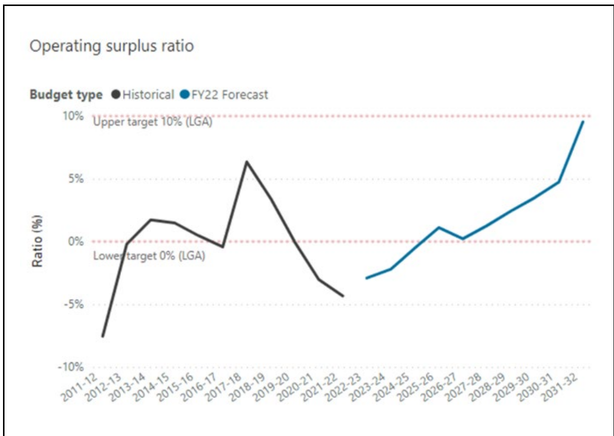
C Financial sustainability

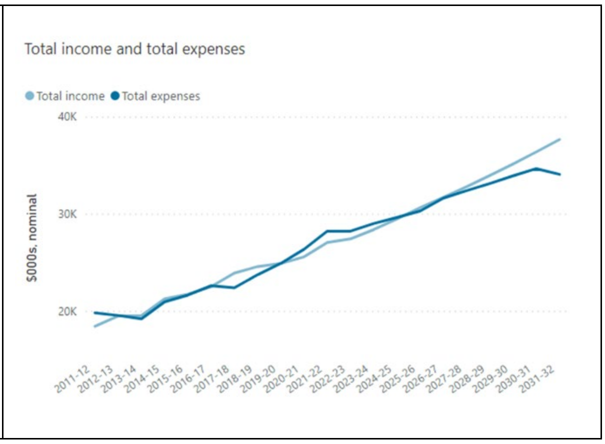
C.1 Operating performance

The City of Prospect achieved operating surpluses between 2014-15 and 2020-21, when measured on a three-year rolling average, indicating a generally sustainable operating position. Its operating surplus ratio[26] was mostly positive and within the sector's suggested LGA target range for these years (see the left chart below).[27]

Since 2021-22, the Council has shifted into an operating deficit position, with operating surplus ratios of negative 3.0 percent in 2020-21 and negative 4.3 percent in 2021-22. Expense growth has averaged 4.9 percent per annum in the three years to 2021-22, compared with operating income growth of 3.4 percent over this period.

The Council is forecast to be in a three-year rolling operating surplus position again from 2026-27 (noting, the operating surplus ratio will be positive again (at 1.1 percent) one year earlier in 2025-26). The forecast return to an operating surplus is due to budgeting for continued rates income increases above the rate of expenses growth (see the right chart below). In the four years to 2025-26, expense growth is forecast to average 1.8 percent, compared with rates income growth of 4.6 percent. With further projected rates increases, the operating surplus ratio is projected to reach 9.5 percent in 2031-32. The extent of the surplus could provide the Council with the opportunity to restrict future rate increases below the levels currently forecast, although it is also dependent on relatively low-cost growth.





The Council has long been reliant on its rate base for its operating sustainability, and increasingly so in recent years. As the chart on the next page shows (to the left), the Council's rates income is forecast to account for 89 percent of budgeted operating income in 2022-23, compared with 81 percent of income in 2011-12.

Rates revenue growth averaged 4.6 percent per annum from 2011-12 to 2020-21 (when rateable property growth averaged just 0.2 percent), compared with average annual CPI growth of 1.7 percent over this period. Rates revenue growth has been partially offset by lower revenue growth from 'grants,

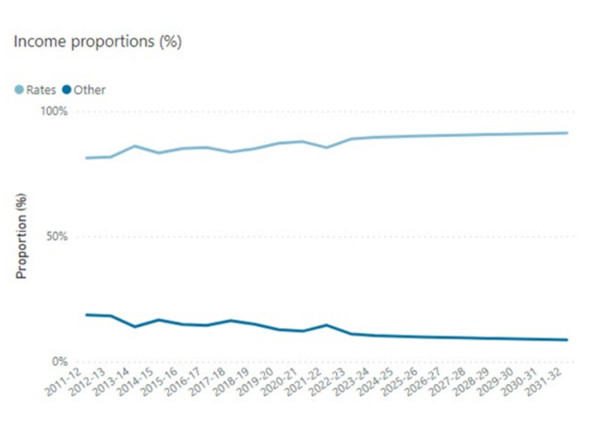
[26] The operating surplus ratio is defined as: Operating Surplus (Deficit) ÷ Total Operating Income. The general target for councils is to achieve, on average over time, an operating surplus ratio of between zero and 10 percent (Local Government Association of South Australia, *Financial Sustainability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

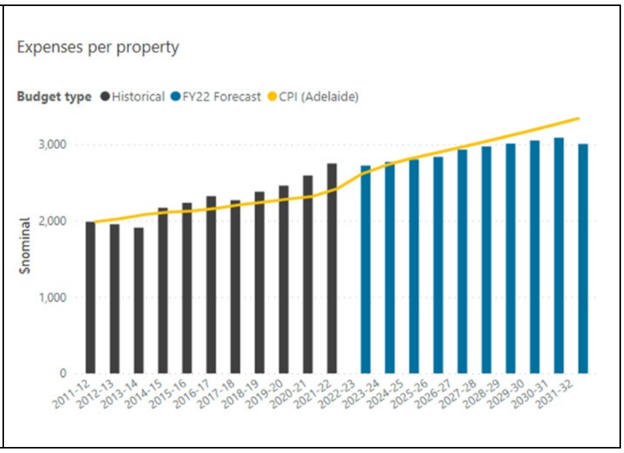
[27] The Council adopted target ranges for the Operating Surplus Ratio of -1 to 3 percent annually and a minimum of 0 percent for the five-year average (City of Prospect, *2022-2023 Annual Business Plan & Budget*, June 2022, p. 42), which is similar to the suggested target range for the sector.

subsidies and contributions'. Grants income has been 'lumpy' from year to year[28] but the three-year average of $173 per ratepayer in 2021-22 compares with the three-year average of $183 in 2013-14.[29]

The Council is projecting continued average rate revenue increases of 3.9 percent from 2022-23 to 2031-32, above the RBA-based projected rate of inflation (2.8 percent)[30] (this is discussed further in section D).

The rates revenue growth is forecast to exceed operating expense growth of 2.1 percent per annum, which incorporates the Council's recurrent savings and minor service changes.[31]





In the past 10 years[32], the Council's average operating expense growth was 3.2 percent (compared with CPI growth of 1.7 percent over this period). Average expense growth per property was 3.0 percent (see the right chart above).

The relatively high operating expense growth was primarily due to an average annual increase of 6.4 percent in 'depreciation, amortisation and impairment' expenses. Depreciation expenses are projected to average much lower growth of 2.7 percent per annum to 2031-32 (virtually on par with RBA-based projected CPI growth of around 2.8 percent[33]), following the significant revision to these estimates in the 2022-23 LTFP (as was noted in section B.1).

Employee expenses increased by 3.9 percent per annum from 2011-12 to 2020-21 with FTE staff numbering 88 in 2020-21, compared with 74 in 2014-15. With the number of staff reduced (to 83.5 FTEs) in the 2022-23 budget,[34] employee expenses are forecast to increase by an average of 2.6 percent per annum (to 2031-32), mainly for indexation and superannuation[35] adjustments.

'Materials, contracts and other' expense growth for the Council has been low; just 1.3 percent in the 10 years to 2020-21. These expenses are projected to continue to grow relatively conservatively in the

[28] Due to the timing of different grants and sometimes advance grant payments (as for the 2022-23 grant allocation).

[29] This is a reduction of 5.5 percent in nominal terms compared with a CPI increase of 1.9 percent over these years.

[30] Based on RBA forecasts for CPI (Australia wide) to June 2025, calculated as average annual increases by the Commission and with an assumed return to long run averages (2.5 percent per annum) from 2025-26.

[31] City of Prospect, *2022-2023 Annual Business Plan & Budget*, June 2022, p. 28.

[32] 2011-12 to 2020-21.

[33] See footnote 30.

[34] City of Prospect, *Audit Committee Meeting Agenda - 20 April 2022,* p. 17.

[35] From 1 July 2021, the Superannuation Guarantee was legislated to rise in half percent increments from 9.5 percent each year until it reaches 12 percent of wages in 2025.

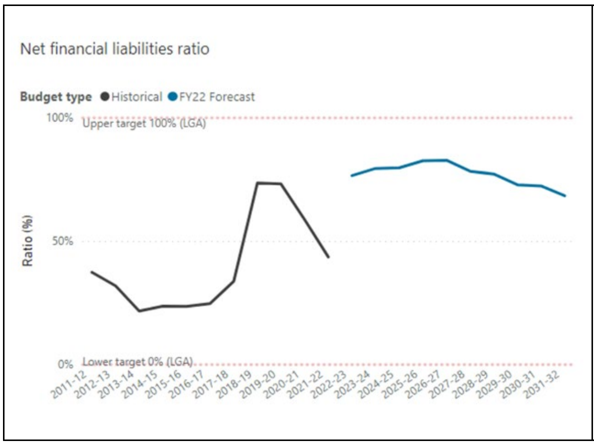
current inflation environment, by an annual average of 2.1 percent to 2030-31, and then to fall by 6.0 percent in 2031-32.[36]

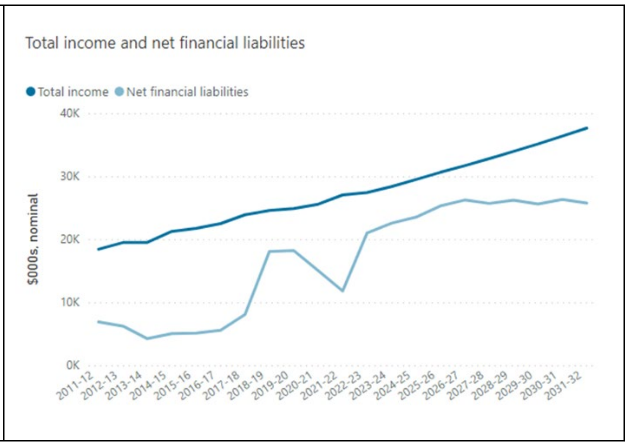
The Council's LTFP now forecasts average operating expense growth of just 1.1 percent per property in the 10 years to 2031-32. In general, the Council's focus on 'zero-cost budgeting' and achieving recurrent savings is a positive step, noting its improved financial sustainability outlook identified in the medium to long term does rely on it achieving 'cost control'. Given the savings noted by the Council in its 2022-23 budget, the Commission considers that it would be appropriate for it to:

2. Continue to report its cost savings and efficiencies in its future budgets, to demonstrate its commitment to achieving cost control and efficiency across its operations and service delivery.

C.2 Net financial liabilities

In its annual business plan, the Council stated that it has maintained a prudent approach to using debt funding for infrastructure and intergenerational projects.[37] The Council's net financial liabilities ratio[38] has comfortably met the sector benchmark (between zero and 100 percent) [39] over the past 10 years with an average of 40 percent between 2011-12 and 2020-21 (see left chart below).[40] This demonstrates that the Council is only increasing borrowings and other liabilities that its operating income can reasonably service in the medium term (see right chart below).[41]





In 2022-23, the ratio is estimated to increase to 77 percent from 46 percent in 2021-22, with an increase in net financial liabilities of $4.5 million or 23 percent.[42] With continued growth in liabilities, the ratio is forecast to peak at 83 percent in 2026-27, before trending down to 68 percent by 2031-32.

The additional liabilities are mainly for the use of 'cash advance debenture loans', which the Council will use to fund any short to medium term financing needs. In total, it has an approved facility of up to

36 The reason for this decrease is not clear in the estimates.

37 City of Prospect, *2022-2023 Annual Business Plan & Budget*, June 2022, p. 27.

38 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.

39 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).

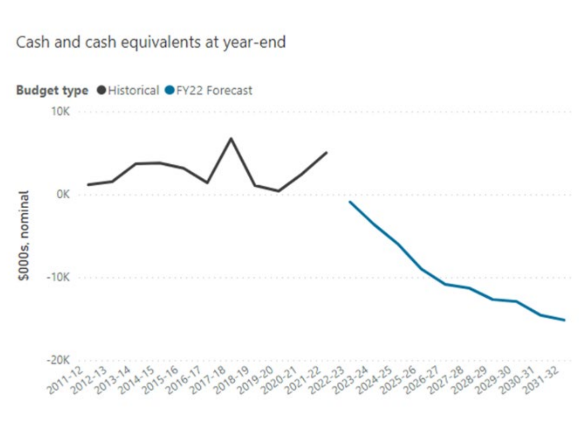
40 The Council's target range for the ratio of below 90 percent is similar to the suggested LGA target range (zero and 100 percent).

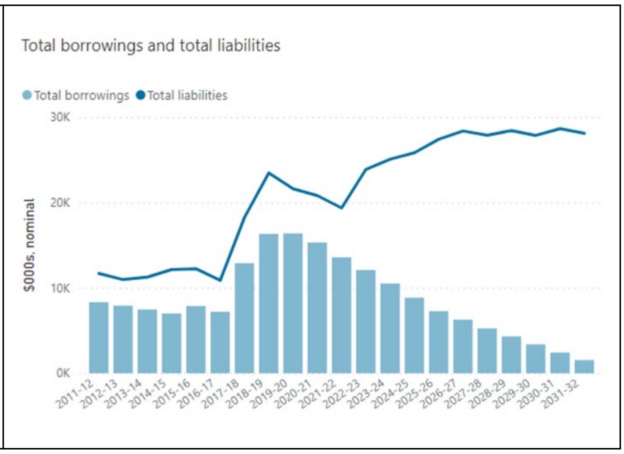
41 For example, it undertook borrowings for the North Adelaide Football Club facilities redevelopment (City of Prospect, *2022-2023 Annual Business Plan & Budget,* June 2022, p. 43).

42 This is 'other liabilities' not previously reported as such by the Council for debenture facility funds.

$11 million in place for this purpose and has indicated that it will likely need an extension of the facility from 2025-26.[43]

Overall, the net financial liabilities ratio is expected to be comfortably within the benchmark range across the forward projections in the LTFP.





With operating deficits and high capital spending on renewal works by the Council in the short to medium term[44] it is still relying on further rates income growth and achieving recurrent savings to ensure that it has sufficient funding to improve its overall financial sustainability.

However, the Council's projected debt in 2022-23 is approximately 9.2 percent of its equity (as of 30 June 2023) and the Council's Chief Executive Officer noted how this is *"equivalent to a $46,000 mortgage or so on a $500,000 house."*[45] Therefore, it might still be prudent to consider additional borrowings in later years, relative to its forecasts, but this will depend on its future income capacity.

C.3 Asset renewals expenditure

The Commission's review of the Council's performance regarding its asset renewals expenditure relies on information provided from draft AMPs only, since these have not yet been adopted by the Council. The status of the AMPs means that the estimates might be less reliable than they otherwise should be.

The Council 's performance against its asset renewal funding ratio[46] has been relatively volatile over the past 10 years. It was within the sector's suggested LGA target range of 90 to 110 percent in just one year (2015-16) with a ratio of 109 percent; otherwise, it was either below 90 percent (for example, 45 and 79 percent in 2013-14 and 2016-17 respectively) or above 110 percent, sometimes significantly above (for example, 216, 281 and 162 in 2017-18, 2018-19 and 2020-21 respectively) (see the charts

[43] City of Prospect, *2022-2023 Annual Business Plan & Budget*, June 2022, p. 43.

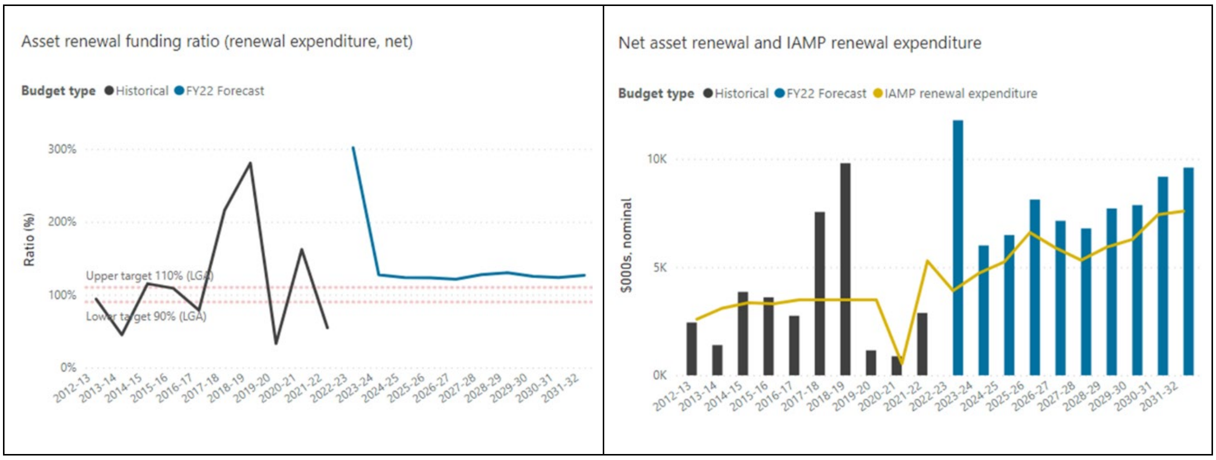
[44] Based on the required renewal and rehabilitation works expenditure in its draft AMPs.

[45] City of Prospect, *Ordinary Council Meeting Agenda – 28 June 2022, Item 12.3 – Chief Executive Officer's Statement on Financial Sustainability – Annual Business Plan 2022-2023*, p. 264, available at https://www.prospect.sa.gov.au/__data/assets/pdf_file/0022/1168015/Council-Agenda-28062022.pdf.

[46] The IAMP-based method is the current industry standard whereby net asset renewal/replacement expenditure is divided by the recommended expenditure in the IAMP (or AMP). The suggested LGA target range for local councils is between 90 and 110 percent (LGA SA Financial Indicators Paper, p. 9). The City of Prospect has adopted a broader range (between 90 and 120 percent) but there is no clear need for a higher level. Prior to 2013, the calculation of the ratio in the sector was based on the 'depreciation method'.

below). The ratio average from 2012-13 to 2020-21 was 119 percent, above the suggested LGA target range.[47]

Spending on the renewal of assets averaged $4.4 million between 2011-12 and 2020-21. However, the Council's annual spending varied quite significantly each year, consistent with its ratio performance, peaking in 2017-18 and 2018-19 ($7.7 million and $9.9 million respectively) and as low as $1.6 million in 2013-14.



In the 2022-23 LTFP, the asset renewal ratio is forecast to continue to exceed the suggested LGA target range over the forecast period – as high as 301 percent in 2022-23, with significant grant funding for the Broadview Oval Community and Sports Hub, and Churchill Road and Livingstone Avenue reconstruction and drainage upgrades. The ratio is then forecast to track between 120 and 130 percent to 2031-32.

Should the estimate for required renewal and rehabilitation expenditure in the draft AMPs be accurate, it would suggest a continued projected overspend on asset renewal and rehabilitation works by the Council over the forecast period. The Council's LTFP forecasts average annual renewal works expenditure of $8.2 million from 2022-23 to 2031-32, almost double the average of the preceding 10 years[48] (noting CPI growth would account for around 38 percent of the increase over this time).

In its Annual Business Plan, the City of Prospect states that the renewal and replacement capital projects will be based on long-term AMPs, which consider the optimal timeframe for a set replacement based on whole of life costing.[49]

However, the Council's projected spending on renewal works is still $93 per ratepayer per annum above an average ratio of 120 percent as recommended in its draft AMPs[50] (the Council's own upper limit for the asset renewal funding ratio, which is higher than the sector's upper limit of 110 percent).

Assuming the maximum for the ratio should instead be 110 percent (as the suggested LGA target upper limit), the Council's potential spend above the average ratio is instead estimated to be as high as

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47 The performance of the ratio depends on whether the calculation is based on the net asset renewal expenditure (excluding asset sales) or gross capital renewal expenditure. In some years, significant asset sales have reduced the ratio if based on net asset renewal expenditure (for example, in 2019-20), but the volatility across years for the City of Prospect is evident under both methods.

48 Based on the period 2011-12 to 2019-20, thus excluding 2021-22.

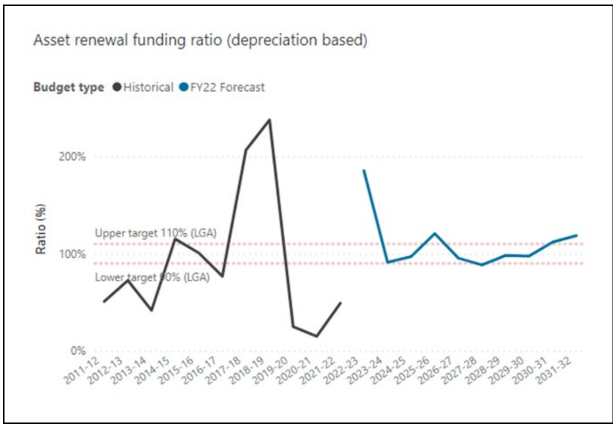
49 City of Prospect, *2022-2023 Annual Business Plan & Budget*, p. 27.

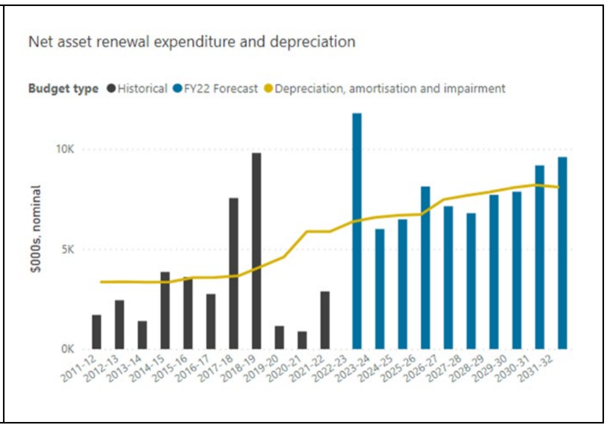
50 And indicated in the Excel template (with 2022-23 LTFP projections) provided by the Council to the Commission.

$1.5 million per annum, on average, which equates to an average of $147 per ratepayer each year over this period.

From 2023-24, the City of Prospect's depreciation-based asset renewal funding ratio[51] is projected to track more closely to the IAMP-based target range,[52] between 88 and 121 percent (see the charts below). Under the depreciation-based method, there is no projected spend above the average ratio over the period on asset renewals (based on an upper limit for the IAMP-based ratio of 110 percent).

As was discussed in section B.3, the Council has significantly increased its depreciation expenses in its 2022-23 forward estimates (by $12.1 million), based on the same methodology it applied in the previous year. These additional expenses have improved the performance of the projected asset renewal funding ratio (if depreciation-based) with the Council's higher asset renewal spending aligning with the revised depreciation expense estimates.





It is important for the City of Prospect to adopt its AMPs, which remain in draft form,[53] to ensure that its assets are maintained and renewed for the benefit of the community over time.[54]

The draft AMPs (such as the Roads and Footpaths AMPs) have reported condition assessments and reviews of any "service level concerns" to help justify the proposed renewal budgets.

However, based on the draft AMPs, there are currently certain anomalies between the asset renewal budgets and the budgets in its 2022-23 LTFP,[55] as follows:

- The Draft AMP Summary states that asset renewal needs from 2022-23 average $5.2 million per annum whereas the LTFP has budgeted for an average of $8.1 million per annum (to 2030-31).[56] The higher LTFP estimate is not due entirely to the impact of inflation between the two estimate periods. There are similar (but lesser) anomalies in individual asset draft AMPs.

51 The Council's asset renewal funding ratio by the depreciation-based method (where asset renewal/replacement expenditure is divided by depreciation expenses).

52 There is currently no suggested target range for the depreciation-based ratio (just the IAMP-based ratio).

53 City of Prospect, *2022-2023 Annual Business Plan & Budget*, June 2022, p. 39.

54 It is also a requirement under s122(1a)(b) of the LG Act.

55 The financial projections in a LTFP adopted by a council must be consistent with those in the adopted IAMP (s122(1b) of the LGA Act).

56 City of Prospect, Draft Asset Management Plan Summary 2021- 2031, February 2022, p. 9, available at https://cityofprospect.engagementhub.com.au/projects/download/12816/ProjectDocument.

- The Barker Inlet Catchment upgrade needs amounting to $9 million over 10 years appear to be factored into the extent of stormwater works projected in its LTFP but are not included in the asset renewals identified for the budget in the Draft Stormwater AMP.[57]

The valuations used in the draft AMPs also need to be updated. The Draft Roads, Buildings, Open Space and Stormwater AMPs includes June 2020 valuations.[58] The Draft Roads AMP also acknowledges the disparity between the asset lives used for valuation (and presumably depreciation) purposes (which are based on a survey in 2015) and lives used for renewal, which is proposed to be addressed in future valuations.[59]

Given the significant change in depreciation estimates in its LTFP, the difference between the draft AMP and LTFP projections, and the pressure on rate levels from higher spending on renewal works, it would be appropriate for the City of Prospect to:

3. Review the assumptions underpinning its asset management plans to ensure those plans incorporate a more accurate picture of required asset expenditure and better alignment with the allocations in its long-term financial plan as necessary, including the estimate for asset lives and valuations feeding into the forecast rates of asset consumption and depreciation expenses.

4. Finalise and adopt its asset management plans across different asset categories and make them accessible from its website.

The City of Prospect has grown its asset base considerably with the average growth in the value of the asset stock per property of $882 or 5.1 percent per annum in the 10 years to 2020-21 (see the left chart below). The average growth in property numbers was 0.2 percent per annum over this period.

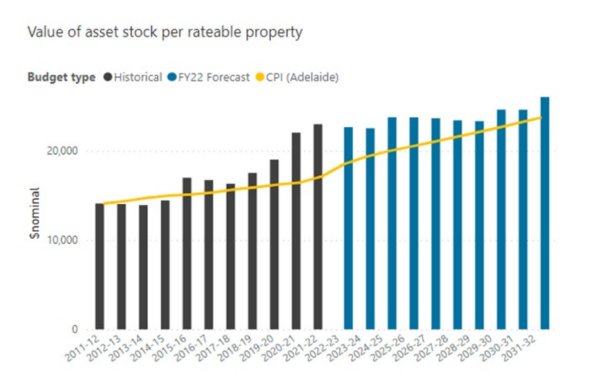
Its expenditure on new or upgraded assets averaged $1.7 million per annum, which is lower than its spending on renewal and rehabilitation works ($4.4 million per annum). While service levels will have also increased, the extent of capital expenditure by the Council has contributed to successive rate increases above inflation, as discussed more in the next section (see the right chart over the page).

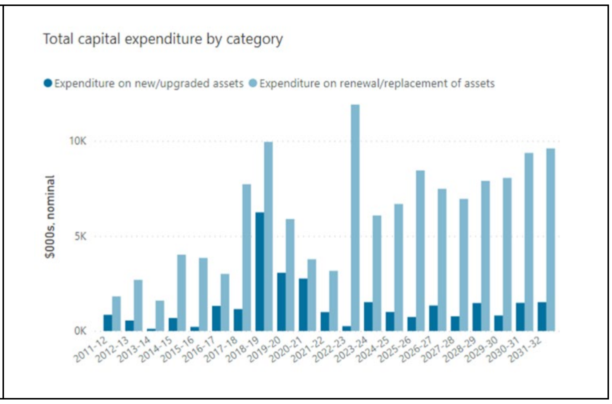
Appropriately, growth (asset value per property) over next 10 years from 2022-23 is forecast at a much lower rate; an average of $375 per property or 1.6 percent per annum.

57 City of Prospect, *2022-2023 Annual Business Plan & Budget*, June 2022, p. 53.

58 City of Prospect, *Draft Buildings Asset Management Plan*, August 2021, p. 25; available at https://cityofprospect.engagementhub.com.au/projects/download/12978/ProjectDocument, *Draft Open Spaces Asset Management Plan*, August 2021, p. 26 available at https://cityofprospect.engagementhub.com.au/projects/download/12980/ProjectDocument; *Draft Stormwater Asset Management Plan*, December 2021, p. 25; available at https://cityofprospect.engagementhub.com.au/projects/download/12982/ProjectDocument, *Draft Roads Asset Management Plan*, August 2021, p. 27, available at https://cityofprospect.engagementhub.com.au/projects/download/12981/ProjectDocument.

59 City of Prospect, *Draft Roads Asset Management Plan*, August 2021, p. 15.

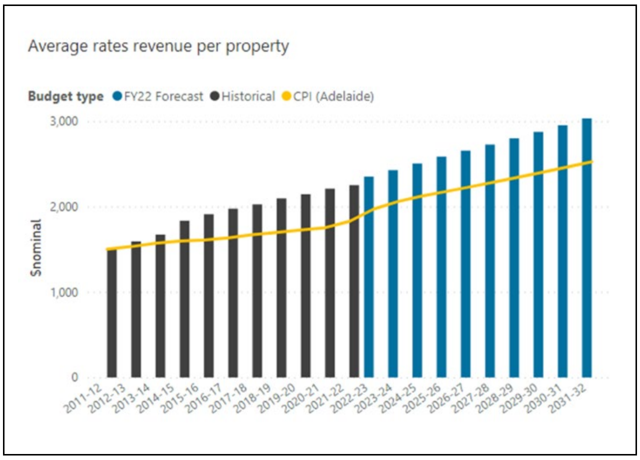

Value of asset stock per rateable property
Budget type ● Historical ● FY22 Forecast ● CPI (Adelaide)
$nominal
20,000
10,000
0
2011-12
2012-13
2013-14
2014-15
2015-16
2016-17
2017-18
2018-19
2019-20
2020-21
2021-22
2022-23
2023-24
2024-25
2025-26
2026-27
2027-28
2028-29
2029-30
2030-31
2031-32


Total capital expenditure by category
● Expenditure on new/upgraded assets ● Expenditure on renewal/replacement of assets
$000s, nominal
10K
5K
0K
2011-12
2012-13
2013-14
2014-15
2015-16
2016-17
2017-18
2018-19
2019-20
2020-21
2021-22
2022-23
2023-24
2024-25
2025-26
2026-27
2027-28
2028-29
2029-30
2030-31
2031-32

D Current and projected rate levels

D.1 Historical rates growth

The City of Prospect's rate revenue growth has averaged 5.5 percent or $83 per annum for each property over the past 10 years[60] to reach an estimated $2,210 per property in 2020-21 (see the left chart below). This has exceeded CPI growth of an average of 1.7 percent per annum, over this period and encompasses relatively modest average annual growth of 0.2 percent in rateable property numbers.[61]



The Council indicated that residential rate contributions were projected to account for 82 percent of the Council's total general rates revenue in 2022-23.[62]

In contrast, its average commercial rates are relatively low and contributions from commercial ratepayers were estimated to make up only 14 percent of total rates revenue in 2022-23.[63]

D.2 Proposed 2022-23 rate increases

The City of Prospect budgeted for an average rate increase of 4.9 percent or $109 for its existing ratepayers in 2022-23[64], which is 1.4 percentage points more than it had anticipated charging for this year in its 2021-22 LTFP projections (3.5 percent).[65]

The rates increase partly reflects higher short-term inflation (CPI inflation is anticipated to be up to 1.25 percent higher by the Council in 2022-23, compared with its previous year's assumption), and a

[60] From 2011-12 to 2020-21.
[61] CPI (All groups). Average annual growth in the LGPI published by SACES was 1.9 percent over this period. https://www.adelaide.edu.au/saces/economic-and-social-indicators/local-government-price-index.
[62] City of Prospect, *2022-2023 Annual Business Plan & Budget*, June 2022, pp. 60 and 73.
[63] City of Prospect, *2022-2023 Annual Business Plan & Budget*, June 2022, pp. 60 and 73.
[64] Individual rate level changes may be higher or lower depending on the rates category and property value.
[65] City of Prospect, *2022-2023 Annual Business Plan & Budget*, June 2022, p. 73 and the Commission's calculations. The Council stated that it expected the average residential ratepayer to experience an increase of 4.7 percent, with some rate distribution and valuation movements (p. 72).

further 'real' increase.[66] Its projected total 'general rates' revenue growth is higher (5.5 percent) due to assumed growth of 1.0 percent in rateable property numbers.[67]

Different rate categories were subject to varying changes, with residential ratepayers levied an increase of 4.8 percent or $94 per property on 2021-22 average rate levels. Minimum rate ratepayers (97 percent of whom are residential ratepayers) were levied a similar increase of 4.7 percent or $60 (to $1,347) in 2022-23.[68]

Commercial ratepayers, who are subject to relatively lower average rate levels (and lower differential rates in the City of Prospect compared with residential ratepayers), were levied an average of between 5.5 to 10.8 percent more (or $236 to $673 more) in 2022-23, depending on the sub-category of rates.

Industry ratepayers were levied 5.9 to 13.9 percent (or $204 to $628 more) in average rates, 'other' ratepayers were levied 6.9 percent (or $736) more and owners of vacant residential land were levied an average of 9.1 percent (or $178) less per property. Owners of non-residential vacant land were levied the largest increase – 15.7 percent (or $2,292) per property more on 2021-22 average rates.[69] The Council has intended to provide a disincentive to withhold land from development with the vacant land rate.[70]

Other than 'general rates' income, the City of Prospect also collects the Regional Landscape Levy (previously called the NRM levy), which is a levy collected on all rateable properties on behalf of Green Adelaide, to fund projects for catchment water management and/or animal and plant control.[71] The amount of the levy for ratepayers (as an average) is not stated in the Council's Annual Business Plan. The Council also collects revenue for the continuing Village Heart Marketing Fund, which is a levy of $150 on beneficiary non-residential properties to fund the marketing and promotion of the Prospect Road Village Heart. [72]

D.3 Projected further rate increases

Over the forward years of its LTFP, the Council is projecting average annual rates increases for its ratepayers of 3.3 percent from 2023-24 to 2025-26, then 2.75 percent from 2026-27. In total, the LTFP effectively projects a cumulative increase of $781 per existing ratepayer (to $3,032) by 2031-32, potentially an increase of $111 above the Council's assumed CPI inflation growth over this period.[73]

The City of Prospect's rates revenue forecasts (averaging 3.9 percent per annum to 2031-32) also factor in average annual growth of 1.0 percent in property numbers. This assumption is consistent with the Council's expectation for high growth in certain areas.[74] It is different to the level of growth reported

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66 City of Prospect, *2022-2023 Annual Business Plan & Budget*, June 2022, p. 41, City of Prospect, *2021-2022 Annual Business Plan & Budget*, December 2021, p. 40 and the Commission's calculations.

67 Based on the Excel template with the Council's LTFP 2022-23 estimates provided to the Commission (noting the Council's Annual Business Plan reported a rate revenue increase of 5.4 percent and only 0.5 percent growth in property assessments (pp. 72 and 73)).

68 City of Prospect, *2022-2023 Annual Business Plan & Budget,* June 2022, pp. 72 and 73.

69 City of Prospect, *2022-2023 Annual Business Plan & Budget*, June 2022, pp. 72 and 73.

70 City of Prospect, *2022-2023 Annual Business Plan & Budget*, June 2022, p. 60.

71 In the Green Adelaide region (17 metropolitan councils), the share of the total landscape levy that each local council collects is based on the proportion of the total capital value of the region in that council area. Green Adelaide, *Annual Business Plan 2022-23*, p. 15, available at https://cdn.environment.sa.gov.au/greenadelaide/images/Green-Adelaide-Business-Plan-2022-2023.pdf.

72 City of Prospect, *2022-2023 Annual Business Plan & Budget,* June 2022, p. 71.

73 Based on the City of Prospect's financial template data provided to the Commission, City of Prospect, *2022-2023 Annual Business Plan & Budget,* June 2022, p. 41 and the Commission's calculations.

74 250 Churchill Road sites (City of Prospect*, Ordinary Council Meeting Agenda – 28 June 2022*, Item 12.3 – Chief Executive Officer's Statement on Financial Sustainability – Annual Business Plan 2022-2023, p. 259) and Urban Corridor Zones (City of Prospect, *2022-2023 Annual Business Plan & Budget*, June 2022, p. 16).

in the Annual Business Plan for 2022-23 (0.5 percent)[75] and compares with average annual growth of 0.2 percent from 2011-12 to 2020-21.

The Commission notes that the Council's projected operating sustainability is reliant on the additional rates revenue that has been forecast (in the absence of further expenditure reductions), and any growth below the average of 1.0 percent, might be a catalyst for the Council to increase average rates further than it has forecast, in order to generate the same level of income. For this reason, it would be appropriate for the Council to:

5. Review the rateable property growth forecasts in its budget projections each year to ensure that they remain current and do not create a need for additional rate increases to generate the same level of projected revenue.

D.4 Affordability risk

One of the Council's budget principles is for rates to be

> *'set at an affordable level, having regard to the City's Strategic Plan and its social, environmental, economic, and financial objectives, balanced against the community's ability to pay.'*[76]

The Council considers that it has limited opportunity to gain revenue other than from rate income from residents, because of low grants income, and geographical limits to industrial developments and larger commercial activities.[77]

The Commission notes that the Council has considered the affordability of rate rises and that there is evidence of capacity to pay for higher rate levels in the community based on:

- the relatively high socio-economic indexes for areas (SEIFA) economic resources ranking for the City of Prospect area,[78] and
- results from the Council's community consultation survey of June 2022, which indicated that ratepayers were comfortable with a 3.5 percent rates increase in 2022-23 to maintain desired service levels (eg, concerning parks and reserves).[79]

Nonetheless, residential rates are already relatively high[80], and with a 4.9 percent increase in 2022-23 and further rate increases on the horizon, affordability risks for the City of Prospect appear to be emerging.

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[75] City of Prospect, *2022-2023 Annual Business Plan & Budget*, June 2022, p. 72.
[76] City of Prospect, *2022-2023 Annual Business Plan & Budget*, June 2022, p. 25.
[77] City of Prospect, *2022-2023 Annual Business Plan & Budget*, June 2022, p. 57.
[78] The City of Prospect area is ranked 49 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 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.
[79] City of Prospect, *Ordinary Council Meeting Agenda – 28 June 2022,* Item 12.2 – Attachment 1, Draft Annual Business Plan 2022-2023 – Summary of Engagement Process, p. 9.
[80] Refer to the Councils in Focus website available at https://councilsinfocus.sa.gov.au/councils/city_of_prospect for 2019-20 rates data by council, noting the history of rate increases by the Council and the SEIFA indicator has already guided the Commission in its advice (the Councils in Focus data just provides more detail about average rate levels by rates category).

Its community survey indicated low support among the community for a rate increase as high as 4.7 percent in 2022-23.[81] Some respondents also commented that the Council should restrict rate increases to inflation only and reduce spending on the renewal of assets.

To reduce affordability risk for its ratepayers, and considering where there could still be genuine opportunities for cost reduction in its LTFP, it would be appropriate for the Council to:

6.	Consider reducing future rate increases and proposed capital expenditure, in consultation with its community and in the context of desired service levels, to minimise any affordability risk.

[81] See footnote 79.

ESSENTIAL SERVICES COMMISSION OF SOUTH AUSTRALIA