Advice

Local Government Advice

Mid Murray Council

February 2023

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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 *Essential Services Commission Act 2002*
CPI	Consumer Price Index (Adelaide, All Groups)
Council	Mid Murray 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
LGPI	Local Government Price Index
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
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 Mid Murray Council

The Essential Services Commission (**Commission**) finds the Mid Murray Council's (**Council's**) current financial position potentially unsustainable with recurring operating deficits resulting from its revenue base, including rates revenue, being unable to meet the ongoing service level requirements of its infrastructure base. The Council's projected improvement to its financial performance is reliant on a period of service consolidation, and continued rate increases.

Acknowledging this outlook, the Commission considers that would be appropriate for the Council to undertake the following steps to ensure that it budgets prudently, manages its cost base more efficiently, renews its asset base to meet sustainable service levels, plans its asset needs appropriately and ultimately, constrains the extent of further rate increases:

Budgeting considerations

1. **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. **Focus** on constraining cost growth more generally in its budgeting, including related to employee costs.

Providing evidence of ongoing cost efficiencies

3. **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.

Meeting asset renewal needs

4. **Adhere** to the principles underpinning its long-term financial plan projections to provide more funding to the renewal of its assets, rather than prioritising initiatives which involve new or upgraded infrastructure.

Considering asset sale or disposal options

5. **Consider** actioning asset sale or disposal options, where reasonable, in consultation with its community, as necessary.

Refinements to asset management planning

6. **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, including:
   - the estimate for asset lives and valuations feeding into the forecast rates of asset consumption and depreciation expenses, and
   - the asset renewal expenditure requirements for buildings (and other relevant assets), with consideration of the service levels desired by the community.
7. **Complete** its asset management plan for footpaths and kerbs, as well as its other proposed new plans, to support and align with the associated asset expenditure requirements included in its long-term financial plan.

Containing rate levels

8. **Review** and **consider** limiting future increases on its minimum rates and residential rates (for which average rate levels are high) to help reduce affordability risk in the community.
9. **Focus** on constraining cost growth to reduce the pressure on all rate levels (as per **Finding 2**), including consideration of the community's desired service levels, any proposed new capital expenditure and associated costs.

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 Mid Murray Council (**Council**).

This report provides the Local Government Advice for the Mid Murray Council in 2022-23. While the advice is based on the Council's 2022-23 projections, the Commission notes the impact of recent flooding on the Mid Murray area and the potential need for the Council to reprioritise some of its spending plans to respond to the high river event.

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 Mid Murray Council for providing relevant information to assist the Commission in preparing this advice.

2.1 Summary of advice

In general, the Commission finds the Mid Murray Council's current financial position potentially unsustainable with recurring operating deficits resulting from its revenue base, including rates revenue, being unable to meet the ongoing service level requirements of the assets it has accumulated.

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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).

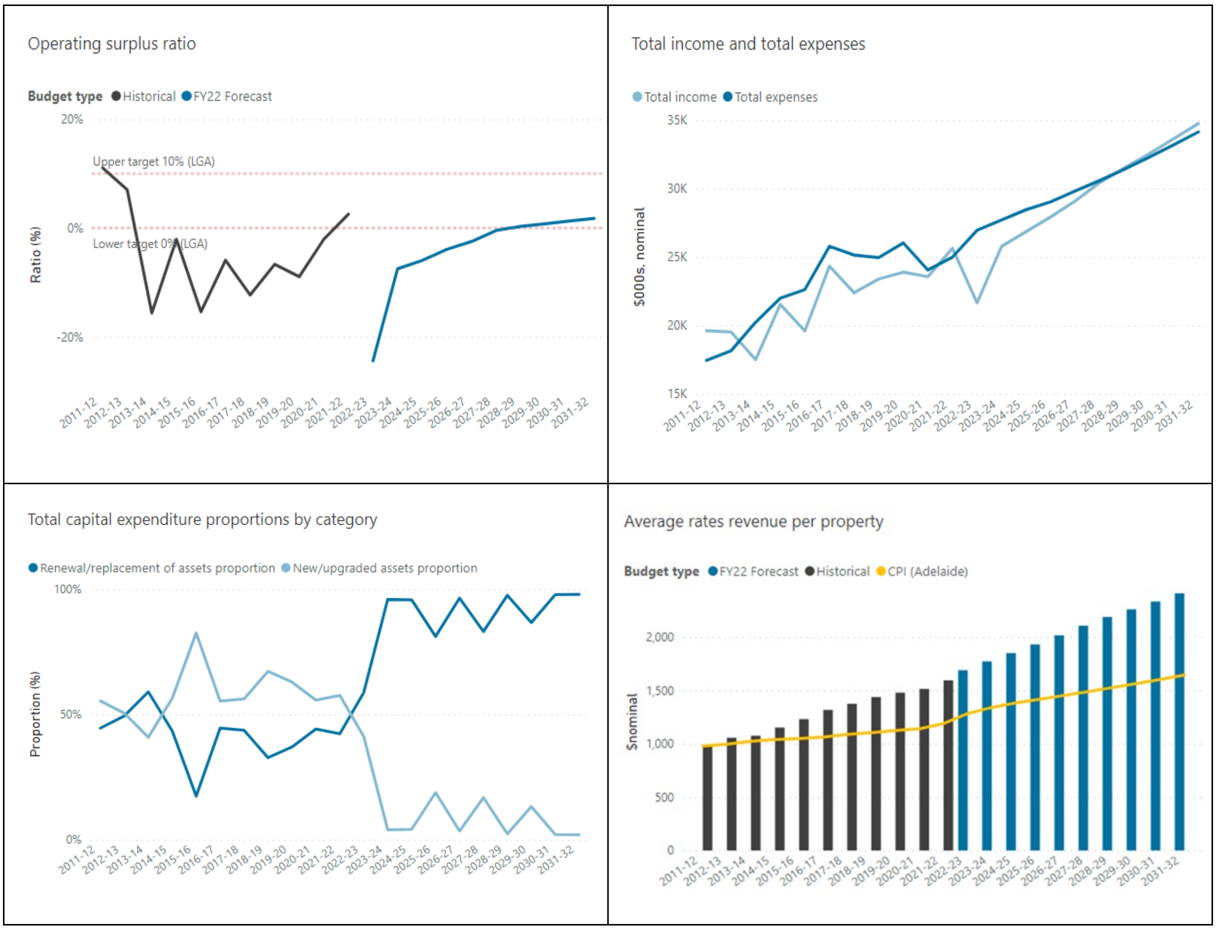
The Council has spent a large portion of its revenue on new and upgraded assets over the past 10 years with various infrastructure projects, but it has not been renewing its existing assets at the required levels for financial and service level sustainability.[10] At the same time, it has consistently raised its rates above the rate of inflation.

Its forward projections from 2022-23 (in its LTFP) forecast an improved financial sustainability outlook for the Council with the rate of operating revenue growth set to outpace expense growth and:

- continued rate increases on the community, above the rate of forecast inflation growth
- lower average cost growth 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), and
- the reprioritisation of its asset spending away from new and upgraded assets and more towards renewal and rehabilitation capital works projects.

The charts below of the Mid Murray Council's past and projected operating surplus ratio, income and expenses, capital expenditure and average rate revenue per property, together support these findings.

The 'heat map' diagram over the page summarises the Commission's findings with reference to whether the Council has met the suggested LGA target ranges for the three main financial sustainability indicators[11] and the level of cost control and affordability risk identified for the Council over time.



10 As recommended by its AMPs.

11 The suggested target range for the ratios are discussed in more detail in the attachment.

Summary of the Mid Murray 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%)	Operating deficits & ratio target range not met ——>		Surpluses forecast from 2028-29
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 below requirements with ratio below target range ——>	Ratio exceeds target range	Ratio target range met in projections with higher projected spending on asset renewal works ——>
Identified Risks:			
Cost control risk	Operating expenses per property average growth 3.2% p.a. to 2020-21 (CPI 1.7%) ——>	Lower cost growth forecast ex. wages ——>	Further lower expense growth forecast (average per property 2.2% p.a. 2022-23 to 2031-32) ——>
Affordability risk	Low but emerging risk for some ratepayers (5.0% p.a. rates revenue per property average growth to 2020-21)	Higher residential rates	Higher forecast rates revenue per property average growth (4.0% p.a. to 2031-32) (CPI 2.8%) and new rates introduced ——>

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

The higher rate levels for the Council's community from 2022-23 present an affordability risk, which could be addressed:

- in part, by sharing the rate burden more equitably and charging larger increases on rates categories where the affordability risk is lower (based on lower comparative rate levels and the Council's own assessment)
- but, more comprehensively, through a greater focus on constraining cost growth and achieving tangible savings – this could then reduce the pressure on all rate levels.

It is also appropriate for the Council to review and report upon desired service levels (in its asset management plans (AMPs)), in consultation with its community, to better identify the level of service that the community is willing to pay for, and where there are opportunities for cost savings through reduced service levels.

2.2 Detailed advice findings

The next sections summarise the Commission's more detailed observations and advice findings regarding the Mid Murray 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.[12]

2.2.1 Advice on material plan amendments in 2022-23

The Mid Murray Council's 2022-23 budget includes increases to both its projected income and expenditure items to 2030-31, compared with the 2021-22 forecasts,[13] as follows:

- An additional $15.9 million or 7 percent in total operating income. This includes an additional $17.0 million or 9 percent in rates and statutory charges revenue (offset by other smaller reductions). This accounts for higher inflation, but also reflects the introduction of some new services and a new separate rate for 'Mannum Waters' properties.
- An additional $21.1 million or 8 percent in total operating expenses (for example, for contracts or employees) and $15.7 million or 28 percent in total capital expenditure.[14] Much of these increases also account for higher inflation, although the higher capital expenditure estimates reflect a significant new allocation for previously unfunded building renewal works in the latter years of the forecast period. Also, more than half of the Council's higher operating expenses are due to an increase of $11.3 million or 13 percent in employee costs, reflecting in part, a reversal of its temporary strategy to reduce casual employee hours and maintain some unfilled positions for reduced services during Covid.[15]

Based on the Council's inflation assumptions,[16] an increase in total revenue and expenditure estimates by up to around 7 percent over the nine years to 2030-31, compared with its 2021-22 estimates, would be appropriate 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.

In examining the Council's changes to its 2022-23 plans, the Commission has found that it would be appropriate for it to:

1. **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. **Focus** on constraining cost growth more generally in its budgeting, including related to employee costs.

12 The attachment will be available on the Commission's website with the main body of the advice.
13 The overlapping forecast period in both LTFPs (2021-22 to 2030-31 and 2022-23 to 2031-32).
14 This excludes the Murraylands Road works of $3.3 million deferred to 2022-23.
15 Mid Murray Council, *Long Term Financial Plan for the period 2021-22 to 2030-31*, July 2021, p. 5, available at https://www.mid-murray.sa.gov.au/__data/assets/pdf_file/0030/934680/Adopted-Long-Term-Financial-Plan-2021-22-to-2030-31.pdf and Mid Murray Council, email to the Commission dated 27 February 2023.
16 The Council has increased its CPI growth forecast for 2022-23 from 1.5 percent to 3 percent (which is lower than current Reserve Bank of Australia (**RBA**) CPI forecasts in February 2023) and from 2023-24 and thereafter, from 1.5 to 2.75 percent (which is higher than the midpoint of the RBA's target band of 2 and 3 percent). It has also assumed Local Government Price Index (**LGPI**) growth 0.4 percent higher than CPI growth, but it is unclear if it has applied the LGPI to any of its estimates.

2.2.2 Advice on financial sustainability

Operating performance

The Mid Murray Council has run recurring operating deficits[17] from 2013-14 to 2020-21 and the operating surplus ratio is not forecast to meet the suggested LGA target range (with a surplus) until 2028-29 (when it will be 0.3 percent).[18]

One of the reasons for the recurring deficits is that the Council has spent more in real terms on asset and service growth. The Council's 'materials, contracts and other' expenses increased by an average of 5.4 percent per annum each year from 2011-12 to 2020-21, compared with average Consumer Price Index (CPI) growth of 1.7 percent.[19] The Commission notes that the Council phased in a new roadside residential waste bin collection service to many rural residents over the past 3 to 5 years,[20] as well as the impact of the increase in the solid waste levy on councils' waste management costs over this period. Depreciation expenses also increased by an average of 5.0 percent per annum to 2020-21. The estimated reduction in the rate of growth in operating expenses projected over the next 10 years (to an average of 2.6 percent per annum, which aligns with forecast inflation[21]), combined with higher rates increases, is expected to slowly improve the Council's operating performance.

To improve its operating position without the need for continued rate increases above inflation, the Council would need to find more savings and efficiencies in its budgets, as it has stated it would seek to do.[22] To this end, the Commission has found that it would be appropriate for the Council to:

3. 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

With the Council's recurring operating deficits from 2013-14 (including depreciation expenses), its net cash shortfall after its operating and investing (i.e., capital-related) activities has averaged $447,000 between 2011-12 and 2020-21.

The Council has consistently used borrowing and other financing options to supplement any annual shortfall of funds, and over time, this has been within the suggested LGA target range for the net financial liabilities ratio.[23]

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17 This means the Council's operating expenses (including depreciation) have exceeded operating income (including rates and other revenue sources but excluding capital grants, subsidies, and contributions).

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 Mid Murray Council, email to the Commission dated 27 February 2023.

21 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.

22 Mid Murray Council, *Long Term Financial Plan for the period 2022-23 to 2031-32*, September 2022, p. 8, available at https://www.mid-murray.sa.gov.au/__data/assets/pdf_file/0024/1204980/Final-Long-Term-Financial-Plan-2022-23-to-2031-32.pdf.

23 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).

It will continue to meet the suggested LGA target range under its 2022-23 forecasts and has projected a reduction in the ratio from a peak of 90 percent in 2022-23 to an average of 50 percent in the five years to 2031-32. The reduction is projected to come from a marginally lower trend in borrowings and liabilities and higher operating income growth. The projected rates revenue growth will continue to provide the Council with the capacity to take on more debt, as it requires, to support intergenerational equity between its current and future ratepayers.

Asset renewals expenditure

In recent years, the Mid Murray Council has spent more on new and upgraded assets than the renewal and rehabilitation of its existing stock. Between 2011-12 and 2020-21, its spending on new or upgraded assets averaged $4.3 million per annum, compared with $3.0 million on the renewal of its asset base. As a result, the amount of spending on asset renewals has fallen well short of the requirements the Council identified in its AMPs. For this reason, the Council's asset renewal funding ratio (IAMP-based) was well below the suggested LGA target range of (90 percent to 110 percent) across years,[24] including an average of 59 percent between 2012-13 and 2018-19.

From 2019-20, the Council has increased its asset renewals spending considerably and its asset renewal funding ratio (IAMP-based) moved into the suggested target range. It is forecast to return to the target range consistently (with an average of 100 percent) from 2022-23 with the Council's spending on renewal assets projected to average $7.5 million to 2031-32 (in nominal terms). This coincides with much lower forecast spending by the Council on new or upgraded assets (estimated to average $0.6 million per annum to 2031-32).

Acknowledging this significant shift in asset spending priorities by the Council, which is reflected in its LTFP projections and to reduce any further accumulation of asset backlogs, the Commission considers that it would be appropriate for it to:

4. Adhere to the principles underpinning its long-term financial plan projections to provide more funding to the renewal of its assets, rather than prioritising initiatives which involve new or upgraded infrastructure.

It has also identified potential asset disposal options in its Buildings, Land & Structures AMP[25] as part of its disposal plan, and it might have other feasible asset sale options to generate funding and reduce recurrent expenses. For this reason, the Commission considers that it would be appropriate for the Council to:

5. Consider actioning asset sale or disposal options, where reasonable, in consultation with its community, as necessary.

Even with higher forecast spending on asset renewals, the Council's depreciation expenses, which should represent the rate of asset consumption, are projected to continue to exceed its renewal spending in forward projections (until 2028-29).[26]

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24 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 LGA target range for the ratio is 90 to 110 percent (LGA SA Financial Indicators Paper, p. 9).

25 Mid Murray Council, *Building, Land & Structures Asset Management Plan*, April 2022, p. 15, available at https://www.mid-murray.sa.gov.au/__data/assets/pdf_file/0023/1184441/BLSI-AMP-112042022.pdf.

26 The Council's asset renewal funding ratio by the depreciation-based method (where asset renewal/replacement expenditure is divided by depreciation expenses) is forecast to average 87 percent to 2031-32. This ratio shows the extent to which capital expenditure on the renewal and replacement of assets matches the estimated rate at which these assets are used or consumed.

Further, the significant increase to the LTFP's projected expenditure on renewal works for buildings and toilet blocks ($15 million or an average of $1,417 per property between 2028-29 and 2031-32), could be better aligned with the needs specified in the AMP and include consideration of desired levels of service.

For these reasons, it would be appropriate for the Mid Murray Council to:

6. **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, including:
   - the estimates for asset lives and valuations feeding into the forecast rates of asset consumption and depreciation expenses, and
   - the asset renewal expenditure requirements for buildings (and other relevant assets), with consideration of the service levels desired by the community.

The Council has stated that it will develop an AMP for footpaths and kerbs, and its LTFP has allocated more spending to renewal works than new or upgrade works (amounting to 4 percent of the total renewal budget to 2031-32). It is also developing new plans for other asset classes (such as marine vessels). The Commission considers that it would be appropriate for the Council to:

7. **Complete** its asset management plan for footpaths and kerbs, as well as its other proposed new plans, to support and align with the associated asset expenditure requirements included in its long-term financial plan.

2.2.3 Advice on current and projected rate levels

The Council has implemented a 6 percent increase to its existing rates in 2022-23, which is higher than previously forecast due to a higher inflation estimate for 2022-23 (3 percent), a retrospective inflation adjustment for 2021-22 (1 percent) and a 2 percent allowance for 'sustainability' (which is the Council's own term).[27] Its 2022-23 LTFP forecasts an average increase of $704 to existing rates in total to 2031-32 (to $2,017), which represents an increase of $337 above the Council's assumed inflation growth.[28] The Council has also increased its waste management charge (by 3.5 percent or $10 for the 2 bin service) and minimum rates levels which can be paid by the more vulnerable members of the community. In addition, it has introduced a new separate rate for 'Mannum Waters'.

Affordability risk among the community for the further rate increases appears high based on a range of factors including the existing residential rate levels (and minimum rates), the cumulative impact of the

[27] The Council noted a 2 percent increase for 'sustainability' (Mid Murray Council, *Long Term Financial Plan for the period 2022-23 to 2031-32*, September 2022, p. 6).

[28] The Council's projected CPI inflation is 3 percent in 2022-23 and then 2.75 percent thereafter (Mid Murray Council, *Long Term Financial Plan for the period 2022-23 to 2031-32, September 2022,* p. 6). This is different to the CPI line in charts throughout this Advice which are based on RBA forecasts and then, a return to long run averages from 2025-26 (with growth of 2.5 percent per annum).

increase in the waste management charges, an assessment of the economic resources available to the community[29] and the community concerns expressed about the increases.[30]

For these reasons, it would be appropriate for the Mid Murray Council to:

8. **Review** and **consider** limiting future increases on its minimum rates and residential rates (for which average rate levels are high) to help reduce affordability risk in the community.

9. **Focus** on constraining cost growth to reduce the pressure on all rate levels (as per **Finding 2**), including consideration of the community's desired service levels, any proposed new capital expenditure and associated costs.

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 Mid Murray Council's:

- ongoing performance against its LTFP estimates
- achievement of cost savings and efficiencies (including operational savings and any asset disposal or rationalisation savings), and its reporting of these achievements
- actions to address any misalignment between the capital expenditure and depreciation estimates in its LTFP and various AMPs
- monitoring and reporting of the desired levels of service by the community for its various service assets in its AMPs, and
- how it has sought to address the affordability risks identified.

[29] The Mid Murray Council area is ranked 24 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 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.

[30] Mid Murray Council, *Ordinary Council Meeting Agenda -14 June 2022, Item 7.1.4 Summary of responses, to Annual Business Plan and draft LTFP*, pp.17-20, available at https://www.mid-murray.sa.gov.au/__data/assets/pdf_file/0019/1160029/20220614-Council-Agenda-Released-20.1.2.pdf.

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