Advice

Local Government Advice

The Corporation of the City of Whyalla

February 2024

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The Essential Services Commission is an independent statutory authority with functions in a range of essential services including water, sewerage, electricity, gas, rail and maritime services, and also has a general advisory function on economic matters. For more information, please visit www.escosa.sa.gov.au.

City of Whyalla

AT A GLANCE

OVERVIEW

The Essential Services Commission finds the City of Whyalla's current and projected financial performance **potentially unsustainable** taking into account Whyalla airport's high historical and forecast operating expenses over the next 10 years, and the planned average rate increases of 4.1% p.a. per property over this period

RISKS IMPACTING SUSTAINABILITY

- ⚠ Whyalla airport's costs are not recovered (to be cost neutral) or are not reduced in the short-medium term
- ⚠ Costs in all areas are not controlled and constrained
- ⚠ The asset renewal needs of the existing infrastructure base are not met
- ⚠ Retaining assets that do not provide benefit to the greater community, rather than disposing of them

CONTINUE

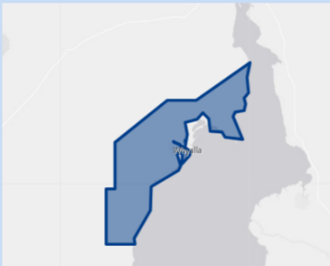
- ✔ Reviewing estimates of asset lives valuations
- ✔ Consulting with the community on strategic management plans
- ✔ Reviewing and considering options to limit further average rate increases above inflation

COMMISSION'S RECOMMENDATIONS

- Improve the transparency of changes to key planning assumptions in the long-term financial plan and annual business plan
- Complete a comprehensive review of the long-term financial plan and infrastructure and asset management plans with consideration of desired service levels
- Publish the long-term financial plan each year
- Report actual and projected cost savings in the annual business plan and long-term financial plan
- Implement the planned long-term funding model for the airport to ensure appropriate recovery of its costs
- Improve the transparency of the Council's budgeting and forecasts to remove the budget distortion linked to the airport
- Improve the transparency of borrowing assumptions in the long-term financial plan and annual business plans
- Provide more funding to the renewal of its assets, rather than prioritising initiatives involving new or upgraded infrastructure

KEY FACTS

- Population in 2021 was **21,244**
- Council covers **399 square kilometres**
- **11,512** rateable properties in 2022-23
- **$23.7 million of rate income** in 2022-23
- Value of assets held in 2022-23 equals **$358.6 million**



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Glossary of terms

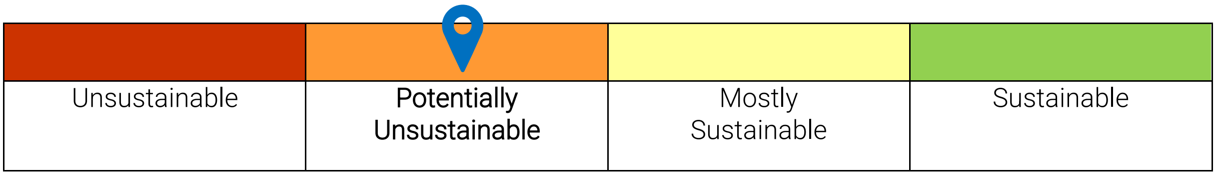
ABS	Australian Bureau of Statistics
AMP	Asset management plan (also called an IAMP)
Commission	Essential Services Commission, established under the *Essential Services Commission Act 2002*
CPI	Consumer Price Index (Adelaide, All Groups)
Council	The Corporation of the City of Whyalla
CWMS	Community Wastewater 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

Legend: ✅ Low-risk ⚠ Moderate-risk 🔴 High-risk

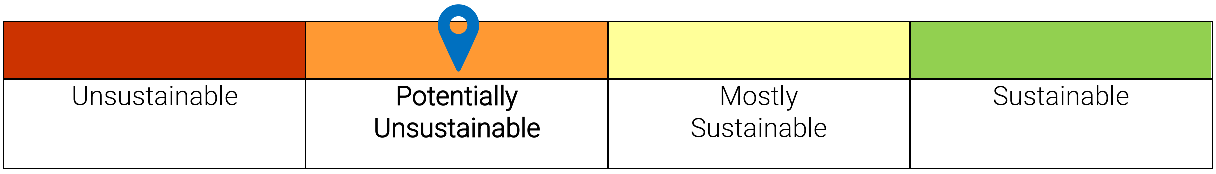
1 The Commission's key advice findings for the Corporation of the City of Whyalla

The Essential Services Commission (**Commission**) finds the Corporation for the City of Whyalla's (**Council** or **City of Whyalla**) current and projected financial performance potentially unsustainable, driven by continued operating deficits, growth in its cost base, and higher financial risks emerging through increased borrowings. The Council's projected improvement to its financial performance is reliant on cost control, a reassessment of its service levels and asset needs, and further rates increases above forecast Consumer Price Index (**CPI**).[1]

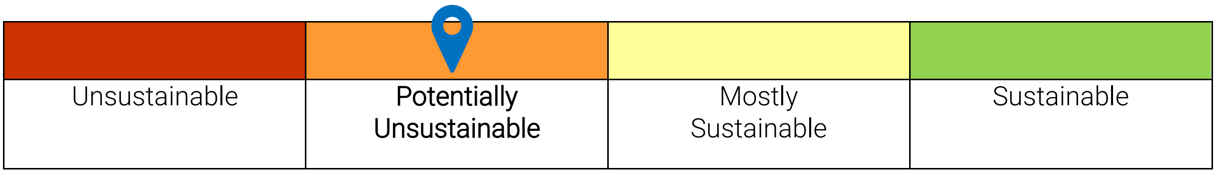
Current financial performance:



Projected financial performance (future):



Previous financial performance (past ten years):



Looking ahead, the Commission suggests the following steps, so the Council continues to budget appropriately, reports its cost savings and efficiencies, maintain the reasonableness of the assumptions underpinning its financial and asset management planning and looks for opportunities to limit the extent of further residential rate increases.

Budgeting considerations

1. **Improve** the transparency of changes to its key planning assumptions in its long-term financial plan and annual business plan each year.
2. **Complete** its planned comprehensive review of its long-term financial plan and infrastructure and asset management plan, as it is required to do under the LG Act; and consider publishing its long-term financial plan each year.

1 The forecast average annual growth in the CPI from 2023-24 to 2032-33 is estimated to be 2.6 percent based on the RBA forecasts for the CPI (Australia-wide) to December 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.

Continuing to provide evidence of ongoing cost efficiencies

3. Complete its planned Service Review Framework and report its actual and projected cost savings in its annual business plan and long-term financial plan, to provide evidence of constraining cost growth and achieving efficiency across its operations and service delivery.
4. Implement its planned long-term funding model for the Whyalla airport to ensure appropriate recovery of the airport's costs, to reduce the burden on the Council's budgets and the potential for cross-subsidies by ratepayers.
5. Improve the transparency of the Council's budgeting and forecasts to remove any budget distortion associated with the airport.

Managing financial risk

6. Improve the transparency of borrowings assumptions in its long-term financial plan and annual business plan, as appropriate.

Refinements to asset management planning

7. 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 (particularly without funding commitments such as grants (on appropriate terms), contributions, or subsidies).
8. Continue to review the estimates of asset lives (and valuations) informing its forecast rate of asset consumption (and depreciation expenses) and asset renewal needs in its long-term financial plan and asset management plans.
9. Complete the planned reviews of its asset management plans, with consideration of desired service levels, the level of the asset stock, and financial sustainability objectives, as appropriate.

Containing rate levels

10. Continue the good practice of consulting with the community on its strategic management plans, with a focus on understanding the community's preferences on service levels and managing emerging affordability risk.
11. Continue to review and consider options in limiting any further average rate increases above inflation, including through considering alternative funding models with the support of State and Federal Governments, as appropriate.

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 Parliament 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.[2]

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**)[3] – both required as part of a council's SMP.[4] Financial sustainability is considered to encompass intergenerational equity,[5] as well as program (service level) and rates stability.[6] The other main purpose is for the Commission to consider ratepayer contributions in the context of revenue sources, as outlined in the LTFP.[7] 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.[8]

The first cycle of the scheme extends over four years from 2022-23 to 2025-26, and the Commission has selected 17 councils for advice in the second scheme year (2023-24), including the City of Whyalla.

This report provides the Local Government Advice for the Council in 2023-24.

The Council is obliged under the *Local Government Act 1999* (**LG Act**) to publish this advice and its response, if applicable, in its 2024-25 Annual Business Plan (including any draft Annual Business Plan) and subsequent plans until the next cycle of the scheme.[9] It does not need to publish the attachment to the advice (these will be available with the advice on the Commission's website[10]), nor is it compelled under the LG Act to follow the advice.

The Commission thanks the Council for meeting with the Commission and for providing relevant information to assist the Commission in preparing this advice.

2.1 Summary of advice

In general, the Commission finds the Council's financial position is potentially unsustainable, driven by an increasing cost base, forecast operating deficits and an increase to its borrowings which will add further pressure on its financial capacity. The Council is projecting to increase rates above CPI to improve its financial situation and allow it to continue to renew its asset base at existing service levels.

The Council is projecting to target an operating surplus position by 2030-31, however its plans don't factor in growth from rateable properties or upside resulting from the development of the Hydrogen industry in the council area. Historically, the Whyalla airport (**airport**) has contributed to the Council's deficits which has been impacted by the COVID-19 pandemic and the associated decline in passenger numbers. The Council has, at times, not been able to meet its ongoing renewal needs of its existing

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2 Amendments to the LG Act (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).

3 Commonly referred to as asset management plans.

4 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.

5 'Intergenerational equity' relates to fairly sharing services and the revenue generated to fund the services between current and future ratepayers.

6 Commission, *Framework and Approach – Final Report*, August 2022, pp. 2-3, available at www.escosa.sa.gov.au/advice/advice-to-local-government.

7 LG Act s122(1f)(a) and (1g)(a)(ii).

8 LG Act s122(1f)(b) and (1g)(b).

9 LG Act s122(1h).

10 The Commission must publish its advice under LG Act s122(1i)(a).

infrastructure base,[11] and it recognises it may not have the capacity to fund the existing infrastructure for a city that was designed for a larger population base (around double the current population).

The past rate increases, from 2012-13 to 2022-23, have been at almost double the rate of historical inflation similar to the rate of growth in operating costs. Based upon the evidence available to the Commission, the Council has not been able to reduce its recent deficits through effective cost constraint.

Its forward projections from 2023-24 in its annual business plan (**ABP**) show a gradual improvement in its financial sustainability outlook (over the longer-term) because the forecast rate of operating income growth outpaces expense growth, through:

- continued average rate increases above the Reserve Bank of Australia (**RBA**)-based forecast inflation rate - this is generally aligned with the Council's own forecast inflation; however, it is forecasting an additional 1.9 percent per annum increase on rate revenues above inflation, and
- lower rate of average cost growth particularly in 'materials, contracts and other' expenses lower than it has experienced over the past 10 years (however this is increasing on a much higher cost base from 2022-23).

Based on the financial projections in its LTFP (included in its ABP), the Commission has identified that the Council could make further improvements to its financial situation and avoid a significant burden being placed on ratepayers through higher rate contributions. This could include a focus on cost control and consideration of whether the Council needs to retain the same asset stock and provide the same level of services. Further, and noting the Council acknowledges the financial sustainability risk it faces, it may need to reassess the timing of new infrastructure spending until growth or funding from Government and private sector investment in the region becomes evident.

2.2 Detailed advice findings

The next sections summarise the Commission's more detailed observations and advice findings regarding the Council's material changes to its 2023-24 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 explained in the Framework and Approach – Final Report (**F&A**).[12] The attachment explores these matters further.[13]

2.2.1 Advice on material plan amendments in 2023-24

Key Points:

The long-term financial plan document was last adopted in March 2020 and is comprehensively updated every four years, potentially being inconsistent with the requirements of the LG Act.

Rates income increased by 5 percent mainly reflecting the change in CPI between the Council's 2022-23 adopted budget (estimated by the Council at 2.3 percent for 2023-24), and its 2023-24 adopted budget where actual CPI of 7.9 percent was applied.

Operating expenses increased by 3 percent mainly driven by changes in the CPI.

11 As recommended by its AMPs.
12 Available at: www.escosa.sa.gov.au/advice/guidance-on-local-government-advice
13 The attachment (to this advice) will be available on the Commission's website with the advice, available at: www.escosa.sa.gov.au/advice/advice-to-local-government

⚠ 'Materials, contracts and other' expenses, and depreciation increased by approximately 4 percent respectively reflecting the higher anticipated costs associated with electricity contract renewal, and higher asset indexation.

The Council updates its LTFP projections each time a budget is amended (as part of its annual business planning process, typically in June) and then again in October for the audited (or actual) financial information. Its main LTFP document was last adopted in March 2020 and is comprehensively updated every 4 years.[14] The Commission notes this contrasts with the approach of other councils which republish their LTFP each year, therefore potentially being inconsistent with the requirements of the LG Act.[15]

Since the Council adopted its LTFP several of its long-term planning assumptions would have changed, including macro-economic variables such as CPI, asset indexation, interest rates, and commodity prices (among other things).[16] While the Council regularly updates its forecast numbers in its ABP, it is not clear how its assumptions have changed over its forecast period, and the implications being that ratepayers (or stakeholders) may not be fully informed on these matters. More recently, in its 2023-24 ABP, the Council has been disclosing its long-term planning assumptions.

Regarding the Council's IAMP, it was comprehensively reviewed in 2019-20, however it is preparing to undertake this review again within the next 12 months. It is positive that the Council incorporates annual updates to its asset valuations, and also undertakes a detailed valuation process and asset condition assessment for each asset class every 5 years.[17] The Council states it has observed increases in asset value of 8 percent at 30 June 2022, approximately 3.5 percent higher than it had anticipated in financial projections.

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

1. **Improve** the transparency of changes to its key planning assumptions in its long-term financial plan and annual business plans each year.
2. **Complete** its planned comprehensive review of its long-term financial plan and infrastructure and asset management plan, as it is required to do under the LG Act; and consider publishing its long-term financial plan each year.

The Council's 2023-24 LTFP projections shows notable increases in total operating income and total operating expenses, compared with the 2022-23 projections,[18] as follows:

- A 5 percent increase in rates income mainly reflecting the change in CPI between the Council's 2022-23 adopted budget (estimated by the Council at 2.3 percent for 2023-24), and its 2023-24 adopted budget where actual CPI of 7.9 percent was applied.[19]
- A 43 percent increase in user charges being offset by a 24 percent decrease in 'grants, subsidies and contributions', reflecting the shift in funding assumptions for security screening at the airport which will be levied on airlines using the airport.

14 City of Whyalla, *Long Term Financial Plan 2021 – 2030*, March 2020
15 Under s.122(4)(a)(i) of the LG Act the Council must undertake a review of its long-term financial plan on an annual basis.
16 Including numerous COVID and post-COVID impacts.
17 The Council's statement on material amendments to its IAMP provided to the Commission in September 2023.
18 The overlapping nine years forecast in both the 2022-23 and 2023-24 LTFPs (included in its ABP).
19 CPI Adelaide (All groups) increased by 7.9 percent in the year to March 2023 quarter. Available at https://www.abs.gov.au/statistics/economy/price-indexes-and-inflation/consumer-price-index-australia/sep-quarter-2023.

- An increase in operating expenses by 3 percent driven by changes in CPI (as noted above), however some offsetting factors include the Council resolving to reduce the size of the management team by three FTEs from 2025-26 if growth expected from the development of Hydrogen (and related) industries don't eventuate. Other changes include increases in 'materials, contracts and other' expenses and depreciation by approximately 4 percent respectively reflecting the higher anticipated costs associated with electricity contract renewal, and higher asset indexation.

In relation to capital expenditure, the Council is proposing higher spend on both asset renewals, and new and upgraded assets, of 4 and 8 percent respectively. This reflects some approved projects being deferred, driven by difficulties in attracting interest from contractors, project scope changes and associated price increases.[20]

Overall, the amendments to the Council's plans show that it mostly forecasts operating deficits over the next 10 years. Financial sustainability is discussed below in section 2.2.2.

2.2.2 Advice on financial sustainability

Operating performance

Key Points:

- ✅ The average operating surplus ratio between 2012-13 and 2022-23 was 0.2 percent.
- ⚠ In its forward projections, the operating surplus ratio is not forecast to meet the suggested LGA target range (with a surplus) until 2030-31 (when it will be 0.5 percent).
- ⚠ The Whyalla airport operations show an accumulated operating deficit of $2.8 million over the last five years (from 2018-19 to 2022-23). With airport operations excluded, the Council registers a $1.3 million surplus over this period.
- 🛑 Between 2023-24 and 2032-33 the Council is forecasting an accumulated loss of nearly $5 million, primarily due to the Whyalla airport.

The Council has experienced some volatility in its operating performance from 2012-13 to 2022-23, however it has achieved an operating surplus ratio[21] of 0.2 percent, on average, over this period. In its forward projections, the operating surplus ratio is not forecast to meet the suggested LGA target range (with a surplus) until 2030-31 (when it will be 0.5 percent). Over the forecast period (from 2023-24 to 2032-33) the Council is forecasting accumulating a loss of nearly $5 million.

The historical operating performance is driven by average increases in its total operating income and total operating expenses of 4.4 percent per annum and 4.7 percent per annum respectively, both increasing at almost double the rate of historical CPI (from 2012-13 to 2022-23).[22] This also reflects higher year-on-year increases in its cost structure in 2022-23, notably in 'employee costs', 'materials,

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[20] The Council has resolved to reduce new and upgraded asset expenditure by 25 percent from 2025-26, recognising that the Council may need to cut back in the medium to longer-term if development in the Hydrogen industry does not occur as expected.

[21] 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).

[22] 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).

contracts and other' expenses, and depreciation charges of 12 percent, 14 percent and 10 percent respectively (with depreciation charges reflecting the indexation of its asset base).[23]

The Council's airport operations show an accumulated operating deficit of $2.8 million over the last five years (from 2018-19 to 2022-23) which has been a significant contributor to the Council's past financial performance.[24] Over this period, if airport operations are excluded, the Council registers a cumulative $1.3 million surplus. In general, the operating income for airport services was lower than the operating costs, and this was exacerbated by the COVID-19 pandemic due to travel restrictions. Recent upgrades and expansion of the airport infrastructure (partly funded through grants) has also increased depreciation and financing charges (due to additional borrowings). The Council has been absorbing some of the deficits relating to the airport as it has not been able to recoup all the costs due to the terms of its grant funding agreements. The Commission's analysis of the airport's historical and projected operating performance shows that it is not self-sustaining as some deficits have been funded from increased borrowings and existing cash balances (meaning that the cost recovery for the airport may not be set appropriately). Further, this suggests that some cost constraint and review of the airport's funding model (and charging structure) is needed to ensure appropriate recovery of the airport's costs, and in turn reduce the burden on the Council's budgets and ratepayers.[25]

On the income side (for the Council as a whole), the Council has had to increasingly rely on rates revenue which increased on average by 4.3 percent per annum from 2012-13 to 2022-23 (when rateable property growth was negligible and CPI growth averaged 2.6 percent).[26] The Council also receives 'grants, subsidies and contributions' and 'user charges' which have accounted for 19 percent and 12 percent (on average) of total operating income respectively.

The lower forecast average expense growth of 2.6 percent per annum over the next 10 years (driven by lower 'materials, contracts and other' expenses growth of 1.8 percent) is approximately in line with RBA-based forecast inflation.[27] While this represents a material change from the Council's past performance (with average annual growth of 4.7 percent in the 10 years to 2022-23), the Council's projected costs are increasing on a higher cost base. This combined with annual average rates revenue growth of 4.6 percent per annum to 2032-33, is expected to gradually improve the Council's operating performance. To improve its operating performance, the Council may need to consider more meaningful savings targets, and it's not clear to the Commission what savings have been achieved historically, or what cost challenges it is placing on its budgets. It is also noted the Council's current plans do not forecast growth in rateable property numbers which can add more risk of its expansion activities on its ratepayers.

The Commission notes that unless the Council puts in place measures to constrain its costs and generally mitigate its financial sustainability risks (as it recognises in its plans),[28] significant burden will be placed on ratepayers through higher rate contributions. Such measures could include (among other things) seeking efficiency in its operating costs or divesting some of its assets or services that do not provide benefit to the greater community. Related to this the Commission has observed some initiatives being considered, as the Council states it is committed to developing a Service Review Framework focused on identifying community need, achieving efficiency and effectiveness with the aim to achieve ongoing savings that can be passed onto the ratepayer, or redirected to areas identified as requiring higher need.[29] Further, in reviewing its plans, ratepayers could benefit from more transparency or

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23 Based on the Council's Financial Report Template provided to the Commission in an Excel document. Also see City of Whyalla, *2022-23 Annual Report*, available at https://www.whyalla.sa.gov.au/__data/assets/pdf_file/0039/1519689/Annual-Report-2023_FINAL_small.pdf.

24 Based on the Commission's analysis of the Council's ABPs over the period 2018-19 to 2022-23, where historical financial information is available on the Whyalla airport.

25 The Council states that the airport has undergone extensive upgrades, and the long-term funding model will be phased in over a number of years to avoid a large one-off increase. See City of Whyalla, *Annual Business Plan 2023-24*, July 2023, p. 40.

26 Based on CPI Adelaide (All groups). Available at https://www.abs.gov.au/statistics/economy/price-indexes-and-inflation/consumer-price-index-australia/sep-quarter-2023.

27 The forecast average annual growth in the CPI from 2023-24 to 2032-33 is estimated to be 2.6 percent based on the RBA forecasts for the CPI (Australia-wide) to December 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.

28 City of Whyalla, *Annual Business Plan 2023-24*, July 2023, pp. 23-24.

29 City of Whyalla, *Annual Business Plan 2023-24*, July 2023, p. 26.

reporting around the Council's budget to allow them to review the financial sustainability of the airport compared to the Council's other services.[30]

Against this background, and as part of the Council's continuing review of its plans, the Commission has found that it would be appropriate for the Council to:

3. **Complete** its planned Service Review Framework and report its actual and projected cost savings in its annual business plan and long-term financial plan, to provide evidence of constraining cost growth and achieving efficiency across its operations and service delivery.
4. **Implement** its planned long-term funding model for the airport to ensure appropriate recovery of the airport's costs, to reduce the burden on the Council's budgets and the potential for cross-subsidies by ratepayers.
5. **Improve** the transparency of the Council's budgeting and forecasts to remove any budget distortion associated with the airport.

Net financial liabilities

Key Points:

- ⚠ Net cash flows after operating and investing activities (i.e. capital-related) averaged negative $1.0m per annum between 2012-13 and 2022-23, which was primarily used to fund its capital expenditure requirements.
- ✔ The net financial liabilities ratio has averaged 24.7 percent over the period from 2012-13 and 2022-23 ranging between negative 6.9 percent and 46.4 percent.
- ✔ The net financial liabilities ratio is estimated to peak at 71.3 percent in 2024-25, progressively declining to 35.5 percent in 2032-33.

With the Council's frequent operating deficits (which include depreciation expenses), its net cash flow after operating and investing (that is, capital-related) activities has averaged negative $1.0 million per annum between 2012-13 and 2022-23. This net cash flow (in addition to the Council's existing cash balances and borrowing capacity) has been primarily used to fund its capital expenditure requirements. Overall, the Council has relied primarily on rates revenue and operating and capital grant funding to support its financial liabilities.

Over the period 2012-13 to 2022-23, the Council's net financial liabilities ratio averaged 24.7 percent (or has ranged between negative 6.9 percent and 46.4 percent), however has typically been within the suggested LGA target range for this ratio.[31] The Council has estimated that the net financial liabilities ratio will peak at 71.3 percent in 2024-25 with total borrowings projected of $29.0 million (with $8.3 million related to the airport).[32] The ratio will then progressively decline to 35.5 percent in 2032-33, which reflects a marginally lower trend in borrowings and the projected operating income growth (an average of 3.1 percent per annum).

The Council applies a target of 80 percent for its net financial liabilities ratio (below the 100 percent suggested by the LGA), and recognises that it may not have the capacity to service further debt funded assets costs.[33] When viewed in the context of the Council's historical and forecast operating deficits,

30 This assumes the Council has an appropriate cost allocation methodology between the airport and other council services (so that all airport costs can be reasonably identified).

31 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).

32 City of Whyalla, *Annual Business Plan 2023-24*, July 2023, pp. 43 and 62.

33 City of Whyalla, *Annual Business Plan 2023-24*, July 2023, p 24.

including any upward revisions to asset valuation and depreciation,[34] this may present a sustainability risk (as councils have a continuing obligation to fund its asset renewals and debt servicing costs).

The Commission observes that there is limited information on the Council's borrowing assumptions, for example in relation to average debt term, refinancing assumptions, and the level of fixed and variable borrowings, which could assist in understanding the Council's financial and sustainability risks. Therefore, the Commission considers it would be appropriate for the Council to:

6. Improve the transparency of borrowings assumptions in its long-term financial plan and annual business plan, as appropriate.

Asset renewals expenditure

Key Points:

- Between 2012-13 and 2021-22, total capital expenditure averaged $10.1 million per annum (including $5.5 million on asset renewals and $4.6 million on new and upgraded assets) and, based on the asset renewal expenditure requirements specified in its AMP, it has generally underperformed on meeting its asset service sustainability requirements during that time.
- Between 2012-13 and 2021-23, the asset renewal funding ratio averaged 85%.
- The forecast asset renewal funding ratio over the next 10 years is projected to be 104%.
- Historical spending (over the last 10 years) on asset renewals has been below the rate of depreciation, in some years by a significant margin. Renewal spending is forecast to account for 69 percent of depreciation expense on average to 2032-33.

Between 2012-13 and 2022-23 the Council's total capital expenditure averaged $10.1 million per annum (including $5.5 million on asset renewals and $4.6 million on new and upgraded assets) and, based on the asset renewal expenditure requirements specified in its AMP, it has generally underperformed on meeting its asset service sustainability requirements during that time. In eight of the last 11 years, it has underspent on the renewal and rehabilitation needs of its asset stock, and in other years it has overspent – indicating significant spend volatility compared to its AMP. The Council's asset renewal funding ratio (IAMP-based) was below the suggested LGA target range of 90 to 110 percent,[35] and averaged 85 percent between 2012-13 and 2022-23.

From 2023-24, the Council's asset renewal spending profile is increasing, reflecting the Council's intention to focus more on its asset renewal spending priorities.[36] As such, its asset renewal funding ratio (IAMP-based) is expected to trend in line with the suggested LGA target range (averaging 104 percent from 2023-24 to 2032-33).

The Council has grown its asset base, particularly over the last five years (from 2018-19 to 2022-23) and predominantly relates to new or upgraded asset expenditure, which averaged $8 million per annum over this period. It is noted, the airport accounted for approximately 38 percent of total expenditure on new or upgraded assets, with significant projects (in the last three years), being the airport Runway, Apron and

[34] For example, if significant asset revaluations are needed to accurately reflect forward looking asset costs, the Council's LTFP looks unsustainable, based upon the Council seeking to keep the same asset stock and provide the same services. This is because the depreciation charge will increase, placing more pressure on the operating surplus ratio, and the Council will have less capacity to build cash reserves or finance additional borrowings.

[35] 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). The suggested LGA target range for the ratio is 90 to 110 percent (LGA SA Financial Indicators Paper, p.9).

[36] City of Whyalla, *Annual Business Plan 2023-24*, July 2023, p. 40.

Taxiway Upgrade ($6.9 million), Airport Terminal Upgrade ($6.8 million), and Point Lowly Lighthouse Cottages ($1.9 million).

The Council recognises in its ABP that it has a sustainability risk,[37] and that new and upgraded asset investment will incur ongoing costs, such as interest, maintenance, and depreciation, however, the Council is also focused on ensuring preparedness to capitalise on growth opportunities in the region. The Commission considers that this direction may be unaffordable for ratepayers without further funding commitments (on appropriate terms); and it is suggested that the Council could be better placed (from a financial and asset sustainability perspective) if it were more focused on the renewal of its existing asset stock, rather than increasing investment in new and upgraded assets. For this reason, the Commission considers that it would be appropriate for it to:

7. **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 (particularly without funding commitments such as grants (on appropriate terms), contributions, or subsidies).

The Commission notes the Council's historical spending (over the last 10 years) on asset renewals has been below the rate of depreciation, in some years by a significant margin. Renewal spending is forecast to account for 69 percent of depreciation expense on average to 2032-33.[38] In this context is it important to understand the extent to which the depreciation values reflect the current cost of the asset, and if the Council's spending priorities are being appropriately allocated to the renewal and rehabilitation of its assets. In assessing the Council's asset renewal ratios, it appears that it had deferred or under invested on its asset renewal needs but could also be because assets are no longer needed or in some instances renewals are done to a lower specification.[39]

Based on discussions with the Council, it states that asset revaluations for 2023-24 are approximately 11 percent higher than the asset indexation applied in its ABP. Additionally, there may be some scope to reassessing asset lives (such as for transport assets) which could indicate that for some assets the asset lives are shorter in the depreciation calculation than occurs in practice. Therefore, the Commission considers that it would be appropriate for the Council to:

8. **Continue** to review the estimates of asset lives (and valuations) informing its forecast rate of asset consumption (and depreciation expenses) and asset renewal needs in its long-term financial plan and asset management plans.

In general, the Commission's review of the Council's asset management planning practices (along with discussions with the Council) indicate that asset condition and valuations are appropriately understood and considered. It is noted that the Council has reported desktop valuations for most of its assets as of 30 June 2023, and condition audits were carried out over the last 4 years. However, further updates to its Asset Management Strategy (adopted in March 2020) may be needed to align to the current economic environment and/or possible changes in service levels and rationalisation to achieve financial sustainability (as previously discussed). Further, it is noted that councils are required to undertake a comprehensive review of its strategic management plans (including asset management plans) within two years after each general election of the council. Therefore, the Commission considers that it would be appropriate for it to:

9. **Complete** the planned reviews of its asset management plans, with consideration of desired service levels, the level of the asset stock, and financial sustainability objectives, as appropriate.

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37 City of Whyalla, *Annual Business Plan 2023-24*, July 2023, p. 24. Includes the CEO Report on Financial Sustainability.

38 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 69 percent to 2032-33. 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. Prior to 2013, the calculation of the ratio in the sector was based on the 'depreciation method' and was known as the asset sustainability ratio until 2018.

39 The Council recognises it does not have the capacity to fund the infrastructure for a city that was designed for a larger population. See City of Whyalla, *Annual Business Plan 2023-24*, July 2023, p. 23.

2.2.3 Advice on current and projected rate levels

Key Points:

- Rate revenue per property growth has averaged 4.1 percent or $63 per annum for each property between 2012-13 and 2021-22, which is 2.1% above CPI for the same period.
- The forecast rate increases for 2023-24 is 8.7 percent per property.
- The forecast rate increases per property from 2023-24 to 2031-32 is projected to be an average of 4.1 percent per annum or a cumulative increase of $983 over this period which is meaningfully above the RBA-based inflation forecast of an average of 2.6 percent per annum.
- Affordability risk for further average rate increases appears to be high based on a range of factors including:
  - the relative low socio-economic indexes for areas (SEIFA) economic resources ranking for the Council area,
  - higher proportional unemployment in the region than other regions,
  - lower property values (than metropolitan areas),
  - an assessment of the economic resources available to the community,
  - prior effects of cumulative rate increases,
  - future effects of forecast cumulative rate increases, and
  - a number of community concerns (written submissions).

The Council's rate revenue per property growth has averaged 4.1 percent or $63 per annum for each property in the period between 2012-13 and 2021-22 (encompassing negligible rateable property growth) and is more than double CPI growth of an average of 2.0 percent per annum over that period.

In 2023-24, the Council has budgeted for an average rate increase of 8.7 percent, higher than anticipated for this year in its previous LTFP projection (an estimated 4.0 percent increase in average rates was previously forecast for 2023-24). The increase reflects the Council's higher short-term inflation expectations and associated operating cost pressures and contributes toward the upgrade of infrastructure. Further, the Council has included in its rate revenue projections an additional 1.9 percent on top of CPI to maintain its financial sustainability,[40] although this will not provide for a breakeven operating result until the end of the decade.

Its 2023-24 LTFP projections indicate an average increase of $983 to existing rates in total to 2032-33 (to $3,216 per annum), meaningfully above the RBA-based inflation forecast of an average inflation (2.6 percent per annum).[41] Most ratepayers are expected to experience similar average increases, however it receives larger contributions from heavy industry ratepayers (such from Santo Limited's Port Bonython sites) and separately from GFG Alliance's under a mutual agreement covering its integrated steelworks and port, and iron ore mining sites. The Commission considers there may be benefit in the Council revisiting this agreement to ensure an equitable contribution is received for the use of the Council's assets and services.

Affordability risk within the community for the further rate increases appears to be high based on a range of factors, including an assessment of the economic resources available to the community,[42] and

40 City of Whyalla, *Long Term Financial Plan 2021-2030,* March 2020, p. 2.

41 The forecast average annual growth in the CPI from 2023-24 to 2032-33 is estimated to be 2.6 percent based on the RBA forecasts for the CPI (Australia-wide) to December 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.

42 The City of Whyalla area is ranked 7 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 (2021), where a lower score (e.g., 1) denotes relatively lower access to economic resources in general, compared with other areas, available at

the number of community concerns on affordability and cost of service provision. However, the Commission notes the Council's community consultation processes are comprehensive and are focused on understanding concerns on rates affordability and service provision.[43] Overall, the Commission considers it would be appropriate for it to:

10. **Continue** the good practice of consulting with the community on its strategic management plans, with a focus on understanding the community's preferences on service levels and managing emerging affordability risk.

Affordability risk could be impacted in the context of the Council's financial sustainability risks, which is evident from the forecast operating deficits (to 2029-30), uncertainty around its future asset renewal, service levels, and new investment needs driven principally by the proposed development of a hydrogen industry in Whyalla. The associated implications for the Council's funding requirements (for capital expenditure, borrowings, and depreciation) could mean the community may be exposed to further rate increases, if additional external funding is not sourced (on appropriate terms) or further efficiencies are not realised.

Nonetheless, given historical and forecast rate increases and the current economic conditions affecting many communities' capacity to pay, it would be appropriate for the Council to:

11. **Continue** to review and consider options in limiting any further average rate increases above inflation, including through considering alternative funding models with the support of State and Federal Governments, as appropriate.

2.3 The Commission's next advice and focus areas

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

- ongoing performance against its LTFP estimates and its goal to achieve an operating breakeven position,
- improved disclosure of its key planning assumptions in its LTFPs and ABPs,
- material changes to the LTFP and IAMP following its comprehensive review,
- identification and reporting of cost savings and operating efficiencies, and
- how it has sought to address the emerging financial sustainability risks and affordability risks.

https://www.abs.gov.au/statistics/people/people-and-communities/socio-economic-indexes-areas-seifa-australia/2021.

43 The Council sought community engagement through public information sessions, a focus group session, and allowed interested parties to view its proposed plans and make written or verbal submissions. See City of Whyalla, *Special Council Meeting Agenda – 29 May 2023, Item 4.2.3 Submissions on Draft 2023/24 Annual Business Plan and Budget*, pp. 51-52, available at https://www.whyalla.sa.gov.au/__data/assets/pdf_file/0035/1347956/agenda-COMPLETE-29-may-2023.pdf.

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