Advice

Local Government Advice

City of Victor Harbor

February 2024

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City of Victor Harbor

AT A GLANCE

OVERVIEW

The Essential Services Commission finds the City of Victor Harbor's current and projected financial performance **mostly sustainable** taking into account the Council's operating surpluses over the past 10 years, along with strong infrastructure growth and increasing contributions from ratepayers and government grants, and the planned average rate increases of 3.2% p.a. per property over the next 10 years

RISKS IMPACTING SUSTAINABILITY

- Each rateable property must cover a high amount of asset stock that requires ongoing maintenance and renewal costs
- Forecast growth in rateable properties is lower than anticipated and not realised
- If moderate growth in forecasted expenses is not realised and the Council maintains the current cost trajectory, ratepayers risk shouldering the burden through unexpected higher rate increases
- High levels of new capital / infrastructure projects creating a stream of future liabilities associated with each asset

CONTINUE

- Reviewing inflation forecasts in the budget and forward projections
- Reviewing the rateable property growth forecasts in the budget projections each year to ensure that they remain current
- Reporting in the annual business plan the estimated average annual change for the five categories of land use
- Seeking grant funding for the two projects, but only to the extent that at least a reasonable proportion of these capital costs can be recouped through time

COMMISSION'S RECOMMENDATIONS

- Undertake a review of the long-term financial plan on an annual basis in accordance with the LG Act
- Report any actual cost savings in the annual budget and long-term financial plan
- Include efficiency goals and projected cost savings in the long-term financial plan
- Consider reviewing the timing, scale and need for the Precinct and proposed Arts Centre
- Provide more funding for the renewal of assets
- Consider recovering the costs for the regional community, sport and recreation precinct and the arts and culture centre via user pay charges instead of general rates
- Consider publicly separating out each project (the regional community, sport and recreation precinct and the Arts and Culture Centre) from the Council's overall accounts

KEY FACTS

- Population in 2021 was **16,139**
- Council covers **386 square kilometres**
- **11,100** rateable properties in 2022-23
- **$26.2 million of rate income** in 2022-23
- Value of assets held in 2022-23 equals **$391.1 million**

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.

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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	City of Victor Harbor
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

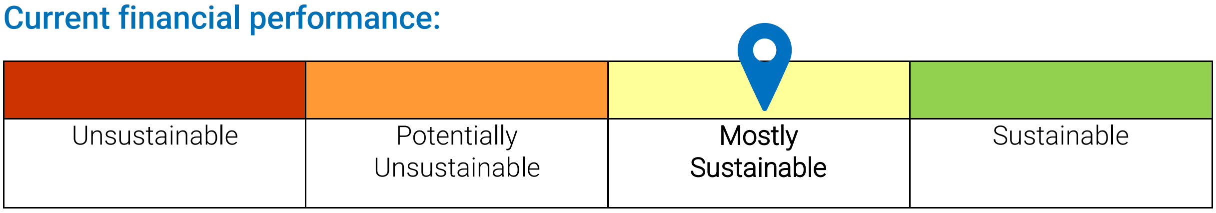
Legend: ✅ Low-risk ⚠ Moderate-risk 🛑 High-risk

1 The Commission’s key advice findings for the City of Victor Harbor

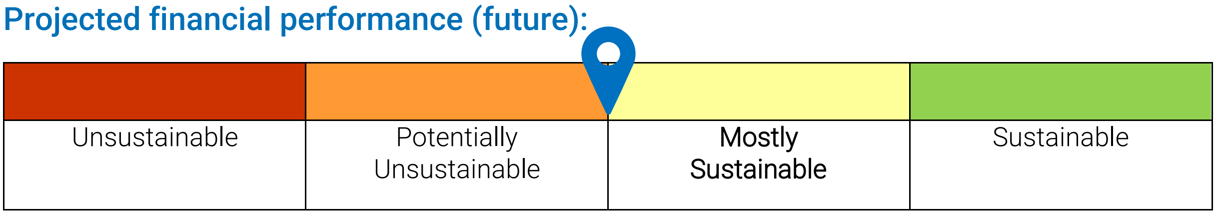
The Essential Services Commission (**Commission**) finds the City of Victor Harbor’s (**Council’s**) current financial performance to be **mostly sustainable**, with operating surpluses over the past 10 years, along with strong infrastructure growth and increasing contributions from ratepayers and government grants.

The Council’s operating cost growth has been significant, particularly related to its contract-related expense growth but also related to its employee expenses growth. It has generated significant additional annual revenue in recent years, primarily to offset annual ongoing operating costs that have risen as a consequence of higher service levels through the provision of significant new and upgraded assets (which creates some risk which, on the available evidence, is being monitored and mitigated). The Council has projected improvement in financial performance, albeit that outcome is reliant on continued rate increases above inflation (noting that a significant proportion of its ratepayers are on fixed incomes) and achieving lower cost growth than it has in the past.

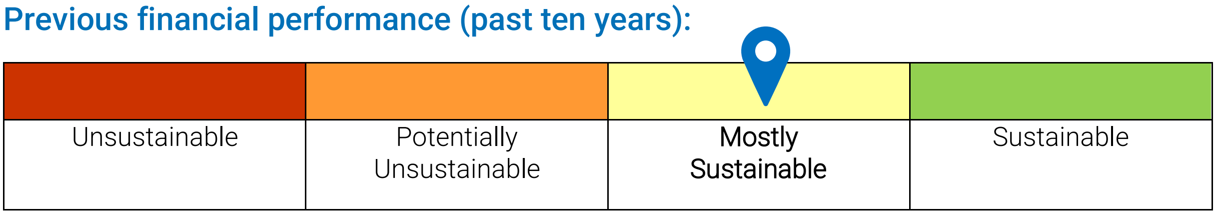
Current financial performance:



Projected financial performance (future):



Previous financial performance (past ten years):



However, it faces emerging risks in relation to rateable property growth and, related to that, the costs associated with proposed major infrastructure projects.

Given those factors, its projected (future) financial performance is **mostly sustainable**, risking forecast operating deficits (in the short term) if the forecast growth in rateable properties does not occur, either at all or takes longer to materialise, from its revenue base, including rates revenue, being stretched to meet the service level requirements of cost growth resulting from new properties and growing infrastructure base.

Noting that the Council’s projections are reliant on higher growth assumptions, the Commission considers it important for the Council to continue to closely monitor growth outcomes, to ensure that its costs align to actual growth achieved – including having contingency plans to defer or avoid costs and new infrastructure if forecast growth does not eventuate. In addition, the Council should focus on achieving scalability, so that the marginal cost of serving a new ratepayer is financially sustainable.

Budgeting considerations

1. **Undertake** a review of its long-term financial plan on annual basis in accordance with s.122(4)(a)(i) of the LG Act.
2. **Continue** its good practice of reviewing inflation forecasts in its budget and forward projections, given the potential for higher short-term inflation outcomes, followed by a return to long-term averages.
3. **Continue** its good practice of reviewing the rateable property growth forecasts in 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.

Provide evidence of ongoing cost efficiencies

4. **Report** any actual cost savings in annual budgets (and long-term financial plans, as appropriate), to provide evidence of cost growth constraint and efficiency achievement across its operations and service delivery.
5. **Include** efficiency goals and projected cost savings in long-term financial plans, to provide further evidence of cost growth constraint and efficiency achievement across its operations and service delivery.

Refinements to asset management planning

6. **Consider** reviewing the timing, scale and need of the Precinct and proposed Arts Centre.
7. **Provide** more funding for asset renewal, rather than prioritising initiatives which involve new or upgraded infrastructure.

Reporting and containing rate level

8. **Continue reporting** in annual business plans the estimated average annual change for its five categories of land use, together with the quantum of annual revenue it expects to collect from these different categories of rates.
9. **Consider** recovering the costs for the Precinct and proposed Arts Centre via user pay charges instead of general rates.
10. **Consider** publicly separating out each project in the Council's overall accounts.
11. **Continue** to seek grant funding for the Precinct and Arts Centre projects, noting the need to recoup a reasonable proportion of grant-funded capital costs over time from users.

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 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.[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 17 Councils for advice in the second scheme year (2023-24), including the City of Victor Harbor.

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.[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 Council for providing relevant information, and for meeting with and engaging with Commission staff to assist the Commission in preparing this advice.

2.1 Summary of advice

The Commission finds the City of Victor Harbor's (**Council's**) current financial performance to be mostly sustainable, with operating surpluses over the past ten years, along with strong infrastructure growth and increasing contributions from ratepayers and government grants.

The Council's operating cost growth has been significant, particularly related to its contract-related expense growth but also related to its employee expenses growth. It has generated significant additional annual revenue in recent years, primarily to offset annual ongoing operating costs that have risen as a consequence of higher service levels through the provision of significant new and upgraded assets (which creates some risk which, on the available evidence, is being monitored and mitigated). The Council has projected improvement in financial performance, albeit that outcome is reliant on continued rate increases above inflation (noting that a significant proportion of its ratepayers are on fixed incomes) and achieving lower cost growth than it has in the past.

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1 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).

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).

However, it faces emerging risks in relation to rateable property growth and, related to that, the costs associated with proposed major infrastructure projects.

Given those factors, its projected (future) financial performance is **mostly sustainable**, risking forecast operating deficits (in the short term) if the forecast growth in rateable properties does not occur, either at all or takes longer to materialise, from its revenue base, including rates revenue, being stretched to meet the service level requirements of cost growth resulting from new properties and growing infrastructure base.

The Council's operating cost growth has been significant, particularly related to its contract-related expenses growth but also in part to its employee expenses growth.[10] The Council has generated significant additional annual revenue in recent years, primarily to offset annual ongoing operating costs that have risen because of higher service levels delivered through significant new and upgraded assets.

In terms of growth in rateable properties, the Council has forecast an increase to 0.9 percent per annum (10 years to 2032-33), which is higher than historical growth of 0.4 percent per annum (10 years to 2021-22). The Commission has observed that the Council has good existing practices in relation to forecasting and monitoring expected growth in rateable property levels. It encourages and advises the Council to continue to consolidate and focus on those practices – noting the risks which may emerge if it fails to do so.

In terms of major infrastructure, the Council already has high infrastructure levels (equivalent to approximately $30,000 per ratepayer, or some $362.4 million in total)[11] and is planning to commence two major multi-year capital projects (with costs in the order of $20 million each), subject to receiving partial grant funding on both projects: a regional community, sport and recreation Precinct (**Precinct**) and an Arts and Cultural Centre (**Arts Centre**).[12] It will be important for the Council to monitor costs associated with both existing infrastructure as well as with the proposed two major projects. In the latter context, the Council will need to carefully consider and plan for how it might recover capital costs (depreciation) associated with the projects, to ensure asset condition is maintained (for the community's benefit) over time. These risks may be exacerbated if forecast rateable property growth levels are not realised: the additional costs of new infrastructure will be borne by a lower-than-anticipated ratepayer base.

The Council's forward projections from 2023-24 forecast a gradually improved financial sustainability outlook, with:

- the rate of operating revenue growth set to outpace expense growth,
- continued rate increases, above the rate of the Reserve Bank of Australia (RBA)-based forecast inflation,
- lower average cost growth than experienced over the past 10 years, and
- the prioritisation of asset spending away from new and upgraded assets towards renewal and rehabilitation capital works projects.

The Commission notes the Council's current good practice of reporting in its annual business plan the estimated average annual change for its five categories of land use, together with the quantum of annual revenue it expects to collect from these different categories of rates. This provides greater clarity and transparency to its ratepayers. For this reason, the Commission considers that it would be appropriate for the Council to:

1. **Continue reporting** in its annual business plans the estimated average annual change for its five categories of land use, together with the quantum of annual revenue it expects to collect from these different categories of rates.

10 Materials, contracts and other expenses and employee expenses have increased by an annual average of 5.3 percent and 3.5 percent in the 10 years to 2021-22.

11 For 2021-22.

12 City of Victor Harbor, 2024-2033 *long-term financial plan*, June 2023, pp. 14.

The Commission considers that there may be opportunities to achieve greater savings and efficiencies in the Council's recurrent budget and encourages it to review and report on those. This could include cross council collaboration with equipment, skills and resources shared with neighbouring councils. In general, a focus on managing growth-related assumptions and consulting with its community about rate contributions and service levels should help the Council to identify and act upon opportunities to mitigate any affordability risks to the community.

2.2 Detailed advice findings

The next sections summarise the Commission's more detailed observations, findings and advice regarding the Council's material changes to its 2023-24 plans (compared with the 2021-22 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.[13]

2.2.1 Advice on material plan amendments in 2023-24

Key Points:

- A review of the 2022-23 long-term financial plan was not undertaken.
- An additional increase in income of $44.6 million (15.8 percent) in total operating income and $48.8 million (17.6 percent) in total operating expenses from the 2021-22 to the 2023-24 long-term financial plan.

The Council was not able to finalise or review the 2022-23 LTFP due to staff shortages and absences during the year.[14] The Council has, however, provided to the Commission a letter outlining the material amendments from the 2021-22 to the 2023-24 LTFPs.

While that information is useful for the purposes of this advice, for public transparency reasons the Council should:

2. **Undertake** a review of its long-term financial plan on annual basis in accordance with s.122(4)(a)(i) of the LG Act.

The Council's 2023-24 LTFP includes increases to both its projected income and expenditure items to 2030-31, compared with the 2021-22 forecasts,[15] as follows:

- An additional increase in income of $44.6 million (15.8 percent) in total operating income and $48.8 million (17.6 percent) in total operating expenses.
- An additional $13.4 million or 30.8 percent in capital expenditure on renewal of assets and $14 million or 23.9 percent on capital expenditure on new assets.

The inflation index applied in the 2023-24 LTFP assumes an increase of 7.9 percent in 2023-24 before decreasing to 3.6 percent in 2024-25 and 3.0 percent in 2025-26. Thereafter, indexation has been applied at 2.5 percent each year to 2032-33. This is an upward revision to the assumptions in its 2021-22 LTFP estimates, which projected average CPI growth of 3.3 percent annually between 2023-24 and 2030-31.

The RBA currently forecasts the CPI (Australia-wide) to increase by 3.6 percent in the year to the June 2024 quarter and by 3.1 percent in the year to June 2025. Thereafter, it is reasonable to anticipate a

13 The attachment will be available on the Commission's website with the Advice.
14 City of Victor Harbor – Response to follow up questions letter -ESCOSA and Council meeting. December 2023, pp. 2.
15 The overlapping forecast period in both LTFPs (2021-22 to 2030-31 and 2023-24 to 2032-33).

return to long-run averages (and growth of 2.5 percent per annum from 2025-26, based on the midpoint of the RBA's 2 to 3 percent target range).

The Commission notes that the Council's stated assumptions for indexation in its 2023-24 LTFP are based on its annual review of these forecasts. The Commission considers that such annual reviews of assumptions reflect best practice and supports the Council in continuing to undertake such annual reviews. For this reason, it would be appropriate for the Council to:

3. **Continue** its good practice of reviewing inflation forecasts in its budget and forward projections, given the potential for higher short-term inflation outcomes, followed by a return to long-term averages.

2.2.2 Advice on financial sustainability

Operating performance

Key Points:

- Operating surpluses consistently observed between 2012-13 to 2021-22, with the operating surplus ratio averaging 1.6 percent in that time.
- 'Materials, contracts and other' expense increased at 5.3 percent from 2012-13 to 2021-22, and Employee and depreciation expenses both increased by an average of 3.5 and 4.7 percent per annum, respectively.
- Average operating expenses per rateable property between 2023-24 and 2032-33 are forecast to increase on average by 2.3 percent per annum, which is 0.3 percent less than the long-term RBA-based forecast inflation over the same period.
- The operating surplus ratio is forecast to meet the suggested LGA target range from 2023-24 to 2032-33 averaging 0.5 percent per annum, but this is heavily reliant on rateable property growth of 0.9 percent per annum being realised, which is more than double that of historical property growth.

The Council has reported nine operating surpluses[16] within the period 2012-13 to 2021-22, with an average operating surplus ratio[17] of 1.6 percent over these years. This is within the lower portion of the suggested LGA target range for the ratio.[18] In the same period, the Council's operating income growth and operating expense growth increased at more than twice the rate of inflation: operating income growth averaged 4.6 percent per annum and operating expense growth averaged 4.2 percent per annum,[19] while average annual CPI growth was 2.0 percent.[20]

The increase in income was due to an average increase in rates revenue of 4.9 percent per annum, and a 6.7 percent increase in grants, subsidies and contributions. At the same time, property growth averaged 0.4 percent annually.

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

17 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).

18 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 CPI (All groups). Average annual growth in the LGPI published by the South Australian Centre for Economic Studies was similar (at 2.0 percent), available at https://www.adelaide.edu.au/saces/economic-and-social-indicators/local-government-price-index.

On the cost side, its 'materials, contracts and other' expenses increased at 5.3 percent across the period 2012-13 to 2021-22. Employee and depreciation expenses both increased by an average of 3.5 and 4.7 percent per annum during that same time.

The Commission has observed that the Council has good existing practices in relation to forecasting and monitoring expected growth in rateable property levels. It advises that the Council should continue to consolidate and focus on those practices – noting the risks (explained below) which may emerge if it fails to do so.

The Council is forecasting growth in rateable properties to be 0.9 percent per annum (10 years to 2032-33), which is higher than historical growth of 0.4 percent per annum (10 years to 2021-22). The Commission notes that achieving this forecast rateable property growth would require new housing expansion at twice the rate of the historical expansion and would need to be completed at a rapid pace – which may be challenging in the current construction environment. The Council has advised the Commission that it has parcels of land that are either currently subdivided or in the pipeline for subdivision for residential, retail and commercial spaces.[21] The Council is also forecasting an increase in commercial development, due to the growth in population and visitors to the area.[22]

Average operating expenses per rateable property are projected to increase at 2.3 percent (nominally) in the 10 years to 2032-33 (the increase over the 10 years to 2021-22 was 3.8 percent). At the same time, average operating income per property is forecast to increase by 3 percent (nominally) in the 10 years to 2031-32, which is above RBA-based forecast inflation.

The Council is forecasting an average operating surplus ratio of 0.5 percent in the 10 years to 2032-33. The Commission notes that, if the Council's growth in rateable properties remains at 0.4 percent instead of the forecast 0.9 percent for the 10 years to 2032-33, then there is likely to be a negative impact on the Council's operating performance in those years. If the forecast growth in rateable properties does not occur, and the Council cannot reverse the increases in costs in the short-term (for example, if contracts are locked in), this could place pressure on rate levels.
Noting that the Council's projections are reliant, in part, on higher growth assumptions, the Commission considers it important for the Council to ensure that its costs align to actual growth achieved – including having contingency plans to defer or avoid costs and new infrastructure if forecast growth does not eventuate. For example, should growth not occur as forecast, existing ratepayers could bear a greater share of the capital costs and the stream of future liabilities associated with the Council's two major projects (the regional community, sport and recreation precinct and the arts and culture centre).
In this overall context, the Commission acknowledges the Council's good practice of reviewing its rateable property forecasts annually, which should enable it to mitigate and manage the potential risks discussed above. The Commission therefore encourages the Council to:

4. Continue its good practice of reviewing the rateable property growth forecasts in 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.

The Commission notes that the Council is forecasting lower average cost growth than it has experienced over the past 10 years. If the historical cost growth trajectory is maintained the Council may need to increase rates further to achieve operating surpluses. The risk appears greater in the short term with a deficit forecast for 2023-24 and very small surpluses forecast for the next four years to 2027-28 (the Council is forecasting a negative operating surplus ratio in 2023-24 of 4.3 percent and an average of only 0.2 percent in the next four years to 2027-28).

The Council is also proposing an additional rate rise component in 2024-25 to 2026-27 for the construction of the Precinct. This is due to an increase in expenses for borrowings and maintenance relating to the new facility. The impact for the Precinct-related component is an overall increase in rates of 5.5 percent, spread across the three years.

21 Correspondence (email) from the Council to the Commission, January 31, 2024.
22 Correspondence (email) from the Council to the Commission, January 31, 2024.

To improve its operating position without the need for long-term rate increases, the Council may need to consider plans or strategies focusing on cost reduction to bring its operating budget into a surplus position sooner and maintain an operating surplus thereafter. It may also wish to consider the need, scale and timing of its two major infrastructure projects. These are likely to contribute to increasing costs, with the Council, in part, relying on spreading these costs over high forecasts in rateable property growth. Those forecasts are more than twice the actual average annual growth delivered over the last ten years and would need to be delivered in what is generally accepted to be a more challenging construction environment than seen over that prior period.

The Commission notes that the Council has not factored any explicit savings into its 2022-23 annual business plan and budget nor is there is any mention of efficiency gains or goals to be achieved in its forward budget or long-term financial plan. To ensure the Council is positioned to deliver its proposed operating performance, the Commission encourages it to:

5. Report any actual cost savings in its annual budgets (and long-term financial plans, as appropriate), to provide evidence of constraining cost growth and achieving efficiency across its operations and service delivery.
6. Include efficiency goals and projected cost savings in its long-term financial plan, to provide further evidence of projected cost growth constraint and efficiencies across its operations and service delivery.

Net financial liabilities

Key Points:

- The net financial liabilities ratio will meet the suggested LGA target range in its 2023-24 forecast and has projected an increase in the ratio from 48 percent in 2023-24 to 84.1 percent in 2032-33.
- The net financial liabilities ratio is forecast to peak at 90.1 percent in 2026-27. Total borrowings also increase by $3.9 million from the previous year to reach $31.7 million in 2026-27 (total borrowings were $12 million in 2023-24).
- The net financial liabilities ratio is forecast to increase to an average of 78.1 percent in the five years to 2032-33, which reflects both the higher trend in borrowings and other liabilities.

The Council has predominantly used borrowings from the Local Government Finance Authority of South Australia (LGFA) to fund capital expenditure, with its net financial liabilities ratio[23] averaging 45 percent between 2012-13 and 2022-23. This is within the suggested LGA target range of between zero and 100 percent for the indicator.

The Council is intending to take on additional borrowings in both the short and longer term to help fund its corporate systems project[24] and construction of the Precinct in 2026-27 and in 2031-32 for the construction of an Arts and Culture Precinct. As a result, the net financial liabilities ratio is forecast to peak at 90.1 percent in 2026-27. Total borrowings are also forecast to increase by $3.9 million from the previous year, to reach $31.7 million in 2026-27 (total borrowings were $12 million in 2023-24).

In 2031-32, the ratio is forecast to reach 84.1 percent when funding will be required to construct and

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).

24 The Council is replacing its corporate software system which is used for its day-today organisational activities. The project is in third and final year.

deliver the Precinct and the Arts Centre. Total borrowings are forecast to increase by $4.2 million from the previous year to reach $36.4 million (its highest level).

The Council has undertaken community consultation on the Precinct project and asked the community to consider the potential cost implications of developing the Precinct. Two scenarios were presented for feedback: under the first, the Council would contribute $10M towards the project construction and under the second it would contribute $20M, with the associated (potential) cost to ratepayers required being $45 per year for three years or $60 per year for three years, respectively.[25] According to the Council's 2023-24 LTFP, this additional rate rise component would be driven by an increase in expenses for borrowings and maintenance on the new facility. However, the Commission notes that there will also be ongoing costs once the project is complete. It was also made clear that the project would be subject to Council achieving external funding of at least 50% towards the construction of the facility.[26]

In the context of contributions, the Commission observes that the Council does not technically "contribute" to the funding of the Precinct. It is the Victor Harbour ratepayers that provide this funding, alongside contributions via sources independent of the Council. Even if the Council were to use reserves, these would have been accumulated through historical rates and charges paid by the Victor Harbour ratepayers. Overall, the two options put forward by the Council are variations on the theme of how much funding ratepayers will pay across the short and long term, as they will repay any loans and associated interest on these. They do not constitute differing level of contribution by the Council.

Further, the Commission also observes that community support from those that will fund the Precinct is not resounding. Of the 193 responses, 41 percent were supportive of the increase and around 27 percent did not support the rate increase. A further 10 percent indicated they were unsure if they supported the increase and the remaining 22 percent indicated they were not the Council's ratepayers but had an interest in the facility.

The Commission observes that people who are not Victor Harbour ratepayers may well favour facilities for which they bear no financial risk but can benefit from, by accessing facilities funded by the contributions of the Victor Harbour community. Excluding these responses gives a less favourable result, with opinion from those who do bear the financial risk being divided. Given this and the observations regarding the Council's rateable property growth assumptions, the Commission considers there is benefit in the Council reviewing the timing, scale and need of the Precinct and proposed Arts Centre. That said, the Council may also consider wider economic benefits arising from the projects – and if it does so it should be transparent about those assumptions in the public documents and plans.

As it stands, the Council has estimated that its net financial liabilities ratio will meet the suggested LGA target range in its 2023-24 forecast and has projected an increase in the ratio from 48 percent in 2023-24 to 84.1 percent in 2032-33. The ratio is forecast to increase to an average of 78.1 percent in the five years to 2032-33, which reflects both the higher trend in borrowings and other liabilities.

The Council's borrowing mix consists of a target of at least 30 percent of its gross debt to be in fixed rate borrowings and that no more than 25 percent of these borrowings to mature in any one year.[27] However, the Council does not provide any interest rate sensitivity analysis in its long-term financial plan. The analysis could be used to show its community what the potential impact to the Council's operating expenditure is over its 10 year LTFP as a result of, for example, a 1 percentage point increase or decrease in its effective interest rate in each year.

In addition, the Commission also notes that the Council has forecast its net financial liabilities ratio to be mostly within its internal target range each year to 2031-32, and within the suggested LGA target range[28] for the same period. However, when considered within the context of affordability risk among its rate payers and an average annual operating surplus ratio of only 0.5 percent to 2031-32 it may be appropriate for the Council to consider strategies which might support it to reduce its level of net financial liabilities.

25 City of Victor Harbor, *2024 – 2033 long-term financial plan*, June 2023, pp. 14.
26 City of Victor Harbor, *2024 – 2033 long-term financial plan*, June 2023, pp. 14.
27 City of Victor Harbor, *2024 – 2033 long-term financial plan*, June 2023, pp. 16.
28 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).

In that context, the Commission has noted that the Council's LTFP does not outline how it proposes to reduce its level of net financial liabilities. By not doing so, the Council risks a greater burden of revenue shifting to existing ratepayers to achieve operating surpluses that can be used to repay borrowings, noting that the average rate per rateable property is already high.[29] This highlights the potential benefits of the Council reviewing the proposal for the Precinct and Art Centre noted previously. For this reason, the Commission considers that it would be appropriate for the Council to:

7. **Consider** reviewing the timing, scale and need of the proposed Precinct and Arts Centre.

Asset renewals expenditure

Key Points:

- Between 2012-13 and 2021-22, the Council averaged 71 percent on its asset renewal funding ratio (under the 'IAMP-based' approach), implying an underspend on the renewal and rehabilitation needs of its existing asset stock over this period. Over this period, the spending on renewal and rehabilitation of assets averaged $3.3 million each year.
- From 2023-24 to 2032-33, the asset renewal ratio is forecast to rise to an average of 97 percent. Average annual spending on renewal or rehabilitation of assets is projected to increase to $7.3 million (in nominal terms).
- The asset stock per rateable property was $32,963 in 2021-22, which is high relative to other councils, and this is forecast to increase at an annual rate of 2.5 percent in the 10 years to 2032-33, reaching $42,321 per rateable property in 2032-33.
- There is a risk that the Council is understating its depreciation and asset renewal expense and overstating its operating surplus ratio, requiring a greater burden of revenue from existing ratepayers to achieve operating surpluses due to lapsing asset revaluations.
- There is a risk that the Council may not be able to adequately manage its asset stock over the longer term, particularly with two potential new, large infrastructure projects (the Precinct and the Arts Centre) that will each create a stream of additional future liabilities.

Between 2012-13 and 2021-22, the Council averaged 71 percent on its asset renewal funding ratio[30] (under the 'IAMP-based' approach),[31] implying an underspend on the renewal and rehabilitation needs of its existing asset stock over this period. The Council's spending on renewal and rehabilitation of assets averaged $3.3 million each year (over this period).

From 2023-24 to 2032-33, the ratio is forecast to rise to an average of 97 percent. Average annual spending on renewal or rehabilitation of assets is projected to increase to $7.3 million (in nominal terms). Included in this future spend on renewals is a portion of funding allocated for the Council's fleet, plant, equipment, furniture and fittings (annual average of $1million in the 10 years to 2032-33).

From 2012-13 to 2021-22, the Council spent more on new and upgraded assets than the renewal and rehabilitation of its existing stock, averaging $5 million per annum on new or upgraded assets, compared with $3.5 million per annum on the renewal of its existing asset base.

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29 Refer to Councils in Focus rates data for 2021-22 available at: https://councilsinfocus.sa.gov.au/councils/city_of_victor_harbor The Commission is not relying on these rate comparisons for its advice; the data source provides one indicator, among many, which has informed its advice on the appropriateness of the rate levels.

30 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).

31 The quoted averages for the ratio are based on 'net asset renewal expenditure' (after the sale of replaced assets) rather than 'gross asset renewal expenditure'.

The expenditure on new and upgraded assets includes a portion of grant funding for certain projects. The growth in its asset base reflects a combination of capital expenditure and other asset accumulation by the Council (including those assets provided by developers), as well as asset revaluations over this period. This has led to an average annual increase in the value of the asset stock per property of 4.3 percent, or $1,164 each year over the 10 years to 2021-22.

The Commission notes that the Council's asset stock per rateable property was $32,963 in 2021-22, which is high relative to other councils and is forecast to increase at an annual rate of 2.5 percent in the 10 years to 2032-33, reaching $42,321 per rateable property in 2032-33. The Council's high level of asset stock could present a challenge to effectively manage over the longer term for a community of Council's size. The Council will need to assess the risk of adding new infrastructure in the context of creating a stream of future liabilities associated with each asset. If the Council's rateable property growth is less than the Council's expectations the risk of this will increase, particularly if the Council's two significant projects (the Precinct and the Arts Centre) are undertaken. This is because a greater burden of revenue could be required from existing ratepayers in order to maintain its growing asset base and achieve forecast surpluses.

The Commission also notes that the Council is using an external party to value its assets and is spreading the asset class revaluations across a 4-year cycle. On 1 July 2020, land and buildings were revalued, resulting in a $29.5 million asset value increase.[32] On 30 June 2022 roads, kerbs, footpaths, car parks and traffic devices were revalued, resulting in an asset revaluation increase of $56.9 million.[33]

The Council's land, buildings, open space assets and stormwater assets have not been revalued in the last two years. Of note, the cost of asset replacement during this period has risen. The risk associated with not valuing assets, and/or not accurately assessing the condition of those assets (including their remaining life), is that the deprecation expense may be understated, and assets may not be renewed within the appropriate time. This could result in assets requiring replacement sooner than otherwise expected and/or that renewal costs potentially being higher than anticipated.

As a consequence, the risk for the Council is that it may be understating its depreciation and asset renewal expense and overstating its operating surplus ratio, requiring a higher revenue from existing ratepayers in order to achieve forecast operating surpluses.

This is contributing to the risk that the Council may not be able to appropriately fund the management of its asset stock over the longer term, particularly with two potential new projects that will create a stream of additional future liabilities for each asset/project. The Commission considers that it would be appropriate for the Council to:

8. Provide more funding to the renewal of its assets, rather than prioritising initiatives which involve new or upgraded infrastructure.

Asset renewals can also be evaluated by the depreciation-based asset renewal funding ratio,[34] which is projected to track lower than the recommended[35] minimum level (for the IAMP-based ratio) of 90 percent, averaging 66.4 percent per annum to 2032-33. While the ratios reflect a small shift in the Council's asset spending priorities towards asset renewals rather than new and upgrade asset expenditures, the amount of spending is below the LG target range of 90-110 percent.

Historically (between 2012-13 to 2021-22) depreciation expenses outpaced renewal capital expenditure by a significant margin (totalling $26 million over ten years) and the gap is set to increase over the

32 City of Victor Harbor, *2020-21 annual report*, November 2021, p. 129.
33 City of Victor Harbor, *2021-22 annual report*, November 2022, p. 146.
34 The Council's asset renewal funding ratio by the depreciation-based method (where asset renewal/replacement expenditure is divided by depreciation expenses). 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.
35 The suggested LGA target range for the (IAMP-based) ratio is 90 to 110 percent (LGA SA Financial Indicators Paper, p. 9).

forecast period to $34 million. This indicates that assets may not require renewal as often as the depreciation schedule predicts, or that under expenditure (on renewals) may be occurring.

The Council has individual asset management plans (AMP) for the following asset classes: land, buildings, open space, roads, footpaths, car parks and traffic devices, bridges, stormwater, kerb and channel. The AMPs provide a breakdown of the assets within each respective asset class and the proposed capital works are fed into the Council's LTFP.

The Council's capital works programme includes 10 years of asset renewal projections, in alignment with Council's long-term financial plan. Asset revaluations are spread across a four-year cycle and, along with current asset portfolio data and condition data including useful lives, are updated into the AMP's.

The Commission notes that the 10-year forward renewal plan is a rolling indicator of future renewal investment requirements based on the expected remaining life of the Council's assets and each asset class's renewal strategy.

The Commission's notes that the Council is gradually revaluing its asset base. However, its asset base is high for a council of its size which it will find challenging to manage. On balance, the Council's strategic planning processes does not appear to align with observed good practice for a Council of its size and complexity.

2.2.3 Advice on current and projected rate levels

Key Points:

Rate revenue per property growth has averaged 4.5 percent per annum for each property in the period between 2012-13 and 2021-22, which is 2.5 percent above CPI for the same period.

Forecast rate revenue growth increase of 3.2 percent per annum per property from 2023-24 to 2032-33, which is 0.6 percent above the RBA-based forecast of inflation over the same period.

Affordability risk among the community for these further increases may be high, for the following reasons:

- The current economic environment is putting pressure on many communities' financial capacity, including those in the Council area.
- The Council has a mid-range socio-economic index for area (SEIFA) economic resources ranking.
- According to the Council's 2023-24 LTFP, around 39 percent of the Council's community are welfare dependent and 42 percent of the population are aged over 65 years old.
- The Council already has relatively high average rates.

The Council's rate revenue per property growth has averaged 4.5 percent, or $81 per annum for each property, over the past 10 years,[36] to reach an estimated $2,254 per property in 2021-22. This has exceeded CPI growth of an average of 2.0 percent per annum over this period, resulting in rates increasing in real terms (but also encompasses 0.4 percent average annual growth in rateable property numbers).[37]

Current rate levels partially reflect the Council's recent history of spending growth, predominantly on capital expenditure (on renewals, and new and upgraded assets), higher employee related costs, and materials, contract and other expenses.

36 From 2012-13 to 2021-22.
37 CPI Adelaide (All groups). Average annual growth in the LGPI published by the South Australian Centre for Economic Studies was similar (at 2.0 percent). Available at https://www.adelaide.edu.au/saces/economic-and-social-indicators/local-government-price-index.

The Council has budgeted for an average rate increase of 6.6 percent, or $153 per property, for its existing ratepayers in 2023-24.[38] The rates increase reflects higher short-term inflation (estimated by the Council to be 7.9 percent).[39] The Council's growth in rateable properties between 2012-13 and 2021-22 was 0.4 percent. In 2022-23, it had 11,097 rateable properties and the Council expects this to increase to 11,214 in 2023-24, a 1.1 percent growth in rateable properties.[40]

Between 2023-24 and 2032-33, the average rate across all categories is forecast to increase from $2,543 per property to $3,386, per property,[41] [42] a cumulative increase of $842 per property. This equates to a 3.2 percent average annual increase (between 2023-24 and 2032-33), which is above the RBA-based forecast average inflation of 2.6 percent per annum.[43]

The Council's has two significant intergenerational capital projects, the Precinct and the Art Centre, which are included in its latest LTFP and IAMPs. Cost estimates have increased by $2m for each project from the 2021-22 LTFP[44] to $21.07 million for the precinct and $21.6 million for the arts centre.[45]

The Commission considers there is benefit in the Council considering whether or not it can, or should, recover the costs of these projects via a separate charge relating to the demand for the facilities instead of through the general rates. The Council already has relatively high average rates (across most ratepayers)[46] and community feedback from those that will bear the financial risk appears divided.

In addition, recovering the costs through rates will require ratepayers who do not use these services to nevertheless pay for them. While it may be the case that some contribution would be appropriate, given potential wider positive economic outcomes arising from the two projects (increased tourism, use of other entertainment facilities, such a local restaurants and pubs, and the like), having separate charges based on covering (partly or entirely) the costs of the Precinct and Arts Centre would place more focus on ensuring the infrastructure is sized to meet demand. This, in turn, would emphasise the need for careful design and community consultation at the appropriate level, as well as the need for transparency as to user-pays versus wider economic benefit assumptions. The Council could also consider seeking a contribution or joint ownership with neighbouring councils given residents of these councils are likely to use these facilities.

The Commission also considers there is benefit in the Council considering separating both the Precinct and Arts Centre out in its public accounts. This will help the Council to identify whether the projects are covering their costs and the extent, if any, of any subsidy contributed through general rates. Additionally, it will help improve transparency regarding the performance of the projects. The Commission also considers that it may also be necessary for competitive neutrality reasons, if these projects are competing with private sector ventures in the same market. As a result, the Commission considers it appropriate for the Council to:

38 Based on the Council's 2023-24 annual business plan and its Excel template (with the 2023-24 forecasts) provided to the Commission. The Commission has used $28.5 million (in 2023-24 budgeted rates revenue) compared to unaudited 2022-23 estimates. Individual rate level changes may be higher or lower depending on the rates category and property value.

39 City of Victor Harbor, *2023-24 long-term financial plan*, June 2023, p. 10.

40 City of Victor Harbor, *2023-24 annual business plan*, June 2023, p. 64.

41 This includes rates growth of 0.9 percent expected each year.

42 The rates and property growth estimates are based on the 2023-24 LTFP estimates provided by the Council to the Commission (in an Excel template).

43 The forecast average annual growth in the CPI from 2023-24 to 2032-33 is estimated to be 2.6 percent based on Reserve Bank of Australia (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.

44 City of Victor Harbor – Information requirements letter. September 2023, pp. 3.

45 City of Victor Harbor, *2024 – 2033 long-term financial plan*, June 2023, pp. 26.

46 Refer to Councils in Focus rates data for 2021-22 available at: https://councilsinfocus.sa.gov.au/councils/city_of_victor_harbor The Commission is not relying on these rate comparisons for its advice; the data source provides one indicator, among many, which has informed its advice on the appropriateness of the rate levels.

9. **Consider** recovering the costs of the Precinct and the Arts Centre via user pay charges instead of general rates.

10. **Consider** publicly separating out each project in the Council's overall accounts.

The Council has advised the Commission that the Precinct and the Arts Centre are both subject to grant funding of 50 percent each. It has further advised that no funding agreements have yet been signed. The Commission considers there is benefit in ensuring the Council is able to recoup the capital costs of the grant (e.g. through passing depreciation onto the users of the facility). For this reason, the Commission has found that it would be appropriate for the Council to:

11. **Continue** to seek grant funding for the Precinct and Arts Centre projects, noting the need to recoup a reasonable proportion of grant-funded capital costs over time from users.

In 2023-24, the Council's residential ratepayers will pay rates which will represent an average increase of $155 per property (6.6 percent) above 2022-23 levels. On balance, the community's affordability risk for these further increases appears to be high. The current economic environment is putting more pressure on many communities' financial capacity across the State, including those in this Council area. The Commission also note that the Council has a mid-range socio-economic index for area (SEIFA) economic resources ranking.[47] At the same time, according to the Council's 2023-24 LTFP around 39 percent of the Council's community are welfare dependent[48] and 42 percent of the population are aged over 65 years old.[49] The Council already has relatively high average rates (across most ratepayers).[50] In the 2023-24 budget process, the Council's public consultation report concluded that there was a strong message within the consultation findings that the community is concerned about the impact the rate increases will have on their household budgets in the current economic climate.[51]

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:

- progress on improving its operating surpluses,
- ongoing performance against its LTFP estimates (including review of growth assumptions),
- achievement of cost savings and efficiencies and its continued reporting of these in its plans, and
- how it sought to address the emerging financial sustainability risks and affordability risks.

[47] The City of Victor Harbor area is ranked 34 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 https://www.abs.gov.au/statistics/people/people-and-communities/socio-economic-indexes-areas-seifa-australia/2021.

[48] City of Victor Harbor, *2023-24 long-term financial plan*, June 2023, p. 10.

[49] City of Victor Harbor, *2023-24 annual business plan*, June 2023, p. 11.

[50] Refer to Councils in Focus rates data for 2021-22 available at: https://councilsinfocus.sa.gov.au/councils/city_of_victor_harbor The Commission is not relying on these rate comparisons for its advice; the data source provides one indicator, among many, which has informed its advice on the appropriateness of the rate levels.

[51] City of Victor harbor, *Draft 2023/2024 annual business plan, Community Engagement Survey – Public Consultation*, available at: *https://www.victor.sa.gov.au/__data/assets/pdf_file/0030/1428159/Community-Engagement-Report_Draft-2023-24-Annual-Business-Plan.pdf*

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