Advice

Local Government Advice - Attachment

City of Victor Harbor

February 2024

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A The Commission's approach

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

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

- 2023-24 Annual Business Plan (adopted June 2023)
- 2022-23 Annual Business Plan (adopted June 2022)
- 2021/22-2030/31 Long Term Financial Plan (adopted September 2021)
- 2023/24-2032/33 Long Term Financial Plan (adopted September 2023)
- 2023-2024 Asset Management Plan #1 – Bridge, Stormwater, Kerb and Channel (adopted September 2023)
- 2023-2024 Asset Management Plan #2 – Roads, Footpaths, Traffic Devices and Car Parks (adopted September 2023)
- 2023-2024 Asset Management Plan #3 – Land, Buildings and Open Space (adopted September 2023)
- 2022-23 Annual Report (adopted November 2023)
- 2021-22 Annual Report (adopted November 2022)

The Commission notes that most of the Council's asset base is covered by its existing asset management plans. However, only asset valuations for car parks and traffic devices (valued 30 June 2022) and roads, kerbs and footpaths (valued 30 June 2022) have been valued within the last two years.[4] The remaining assets have been valued within the four years (excluding open space that was revalued 30 June 2018).

Given that the Commission must, in providing advice, have regard to the objective of Councils maintaining and implementing their infrastructure and asset management plans (**IAMPs**) (usually termed AMPs) and long-term financial plans (**LTFPs**),[5] it has also considered the Council's performance in that context. Findings regarding the content of the Council's AMPs, and the alignment between its LTFP and AMPs,[6] are discussed in section C.3.

The Commission has also reviewed the Council's template data which contains its 2023-24 LTFP forecasts for 2023-24 to 2032-33, as well as its 2021-22 LTFP forecasts, and historical financial data

1 Commission, *Framework and Approach – Final Report*, August 2022, available at www.escosa.sa.gov.au/advice/advice-to-local-government.
2 The indicators are specified in the *Local Government (Financial Management) Regulations 2011*. Since 2011, each Council has been required to refer to these three indicators in its plans, annual budget, mid-year budget review and annual financial statements. The Councils can adopt their own target range for each ratio, but the Commission has adopted the previously suggested Local Government Association (**LGA**) target ranges as a basis for its analysis, which were established and agreed during the development of the LGA Financial Sustainability Papers (2006-2011).
3 The F&A listed 29 analytical questions that the Commission has answered in assessing the Council's performance against these indicators to determine affordability, cost control and other sustainability risks.
4 City of Victor Harbor, *2022 – 2023 annual report*, November 2023, p. 156.
5 *Local Government Act 1999* (**LG Act**) s122(1g)(a)(i).
6 As required under s122(1b) of the LG Act.

and number of rateable properties and Council staff (Full Time Equivalent (**FTE**)) numbers from 2012-13 onwards.[7] [8] All charts and tables in the Advice are primarily sourced from these datasets. In addition, the Commission has reviewed the Council audit committee reports, and other public information, as appropriate.

The Commission has reported estimates in nominal terms, for consistency with the Council's plans and actual rate levels, but it has compared estimated inflation impacts to these trends as a guide to identify 'real' rather than 'inflationary' effects. In the charts, the Consumer Price Index (**CPI**) line shows the cumulative growth in the CPI (Adelaide) series from 2012-13, and then projections of this series from 2023-24 based on the Reserve Bank of Australia (**RBA**) (Australia-wide) inflation forecasts (to the December quarter 2025), and the midpoint of the RBA target range (2.5 percent) thereafter.

Finally, in formulating this Advice, the Commission has had regard to all discussions and engagement with the Council, including the face-to-face onsite meeting at the Council's chambers and the individual circumstances of the Council consisting of its location as an urban regional Council, its income level ($34 million in 2023-24) and the size of its rates base (more than 11,000 ratepayers[9]).

Summary of the City of Victor Harbor's financial sustainability performance and the Commission's risk assessment

Financial sustainability indicators:	Last 10 years from 2012-13 (Actual performance)	2022-23 estimate	Next 10 years from 2023-24 (Council forecasts)
Operating surplus ratio (target 0-10%)	Surpluses within target -------->	Ratio not consistently achieved ---------->	Small operating surpluses ------------->
Net financial liabilities ratio (target 0-100%)	Ratio within target range ----------->		Ratio within target range ----------------->
Asset renewal funding ratio (target 90-110%)	Spending on renewal works below target range --->		Projected asset renewal in LTFP to align with AMP - required spending (ratio 100%) ----------------------------------->
Identified Risks:			
Cost control risk	Operating expenses per property average growth 3.8% pa to 2022-23 (CPI 2.0%)	Low cost growth	Projected operating expense per property average growth 2.3% to 2032-33 (CPI 2.6%) ----------------------->
Affordability risk	High rates revenue per property average growth of 4.5% pa to 2021-22 (CPI 2.0%)	High rates increase	Projected rate revenue per property average growth 3.2% to 2032-33 (CPI 2.6%) -->

Ratio outside suggested LGA target range or higher risk

Ratio close to suggested LGA target range or medium risk

Ratio within suggested LGA target range or lower risk

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

8 The Council's estimates for the 2022-23 financial year, relied on at the time of preparing this advice, were unaudited.

9 Based on the estimated number of property assessments in 2021-22.

B Material plan amendments in 2023-24

The Council has made various amendments to its 2023-24 budget and forward projections, partly for inflation and partly for other revenue and spending initiatives. The material amendments to some of its main financial forecasts are listed in the table below (in nominal terms).[10] The Council's LTFP contains a statement of uniform presentation of finances report to outline the Council's expected performance over a 10 year forecast.

The Council has stated that it was not able to finalise or review the 2022-23 LTFP due to highly abnormal staff shortages and absences during the year.[11] The Council has provided the Commission with a material amendments 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:

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.

To ensure a comparable analysis of estimates between the 2021-22 and 2023-24 LTFPs, the Commission has reviewed the eight overlapping years' statistics: 2023-24 to 2030-31 and identified material amendments accordingly.

Selected Financial Item	Sum of 2023-24 to 2030-31 estimates in 2021-22 LTFP ($ million)	Sum of 2023-24 to 2030-31 estimates in 2023-24 LTFP ($ million)	Change in 2023-24 estimates ($ million)	Change in 2023-24 estimates (percent)
Total Income	282.1	326.7	44.6	15.8
Total Expenses	276.8	325.6	48.8	17.6
Capital expenditure on renewal of assets[12]	43.4	56.8	13.4	30.8
Capital expenditure on new assets[13]	58.6	72.6	14.0	23.9
Net lending/borrowing	4.7	23.3	18.5	386.5

B.1 Changes to operating performance

In its 2023-24 LTFP, the Council has forecast increases to its total income projections to 2030-31 of $44.6 million or 15.8 percent in total, compared with its 2021-22 LTFP estimates (to 2030-31). Total expenses by $48.8 million or 17.6 percent.

The Council's historical and projected operating performance is discussed further in section C.1.

10 This table shows only selected financial items to demonstrate the material amendments made by the Council in its 2023-24 estimates. It excludes various financial items and individual items do not sum to totals.
11 City of Victor Harbor – Response to follow up questions letter -ESCOSA and Council meeting. December 2023, p. 2
12 The capital expenditure estimates are based on the 2023-24 and 2021-22 LTFPs.
13 The capital expenditure estimates are based on the 2023-24 and 2021-22 LTFPs.

B.2 Indexation adjustments

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 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:

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.

B.3 Increase to capital expenditure estimates

The Council's 2023-24 LTFP indicates an increase in capital expenditure for asset renewals (by $13.4 million or 30.8 percent), compared to the 2021-22 LTFP (for the period from 2023-24 to 2030-31). Capital expenditure in the Council's LTFP for 2023-24 for new and upgraded assets is an additional $14 million or 23.9 percent, compared to the 2021-22 LTFP (for the period from 2023-24 to 2030-31).

The LTFP for 2021-22 and 2023-24 include two significant projects (regional community, sport and recreation precinct (the Precinct) and an arts and culture centre (the Arts Centre)). Construction for the Precinct is expected to commence in 2024-25, subject to grant funding of $10 million, indexation and the annual business plan process.[14] Cost estimates for The Precinct have increased by $2 million from the 2021-22 LTFP[15] with the current capital estimate increasing to $21.07 million.[16] This is partly due to an increase in expenses for borrowings and maintenance for this facility. As such the 2023-24 LTFP includes an additional rate rise component of 5.5 percent spread across three years commencing in 2024-25.

Cost estimates for the Arts Centre have also increased by around $2 million from the 2021-22 LTFP.[17]with the current capital estimate increasing to $21.6 million.[18] The Council does not state in its LTFP how it will fund this additional cost. Construction is due to commence in 2031-32 subject to grant funding of $10m and the annual business plan process.

B.4 Increase in net lending

The Council's 2023-24 LTFP indicates an increase in net lending by $18.5 million or 386 percent, compared to the 2021-22 LTFP (for the period from 2023-24 to 2030-31). However, the Council's net financial liabilities ratio is forecast to be remain generally the same in 2023-24 LTFP compared to the 2021-22 LTFP. The Council is forecasting to achieve an average annual net financial liabilities ratio of 75 percent in 2023-24 LTFP (for the period from 2023-24 to 2030-31), compared to 76 percent in 2021-22 LTFP (for the period from 2023-24 to 2030-31). The slight increase in the ratio despite the increase in

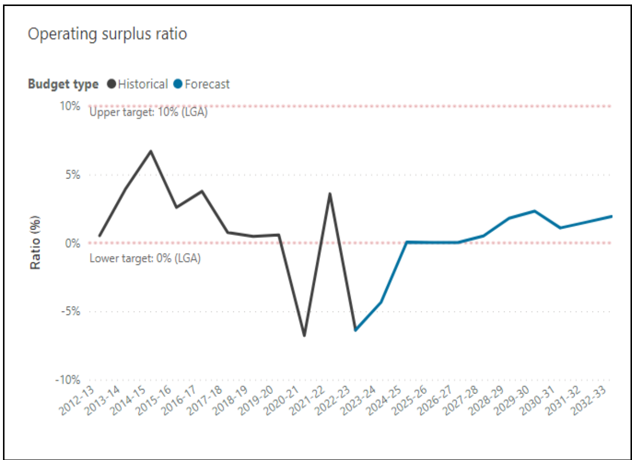
14 City of Victor Harbor, *2024 – 2033 long-term financial plan*, June 2023, p. 26.
15 City of Victor Harbor – Information requirements letter. September 2023, p. 3.
16 City of Victor Harbor, *2024 – 2033 long-term financial plan*, June 2023, p. 26.
17 City of Victor Harbor – Information requirements letter. September 2023, p. 3.
18 City of Victor Harbor, *2024 – 2033 long-term financial plan*, June 2023, p. 26.

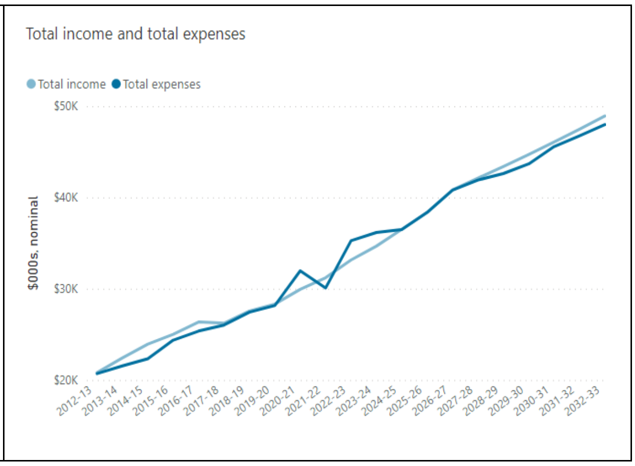
net lending, is likely the result of the Council forecasting an increase in income (for the period from 2023-24 to 2031-32). As total income is the denominator for the net financial liabilities ratio, increasing income can offset increasing borrowing, so keeping the ratio at a similar point.

C Financial sustainability

C.1 Operating performance

The Council has reported nine operating surpluses[19] within the period 2012-13 to 2021-22, with an average operating surplus ratio[20] of 1.6 percent over these years (see left chart below). This is within the lower portion of the suggested LGA target range for the ratio.[21] 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 (see right chart below),[22] while average annual CPI growth was 2.0 percent.[23]





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.

On the cost side, its 'materials, contracts and other' expenses increased at 5.3 percent across the period 2012-13 to 2021-22 (see left chart over page). 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.

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19 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).

20 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).

21 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).

23 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.

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.[24] The Council is also forecasting an increase in commercial development, due to the growth in population and visitors to the area.[25]

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) (see right chart over the page). 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.

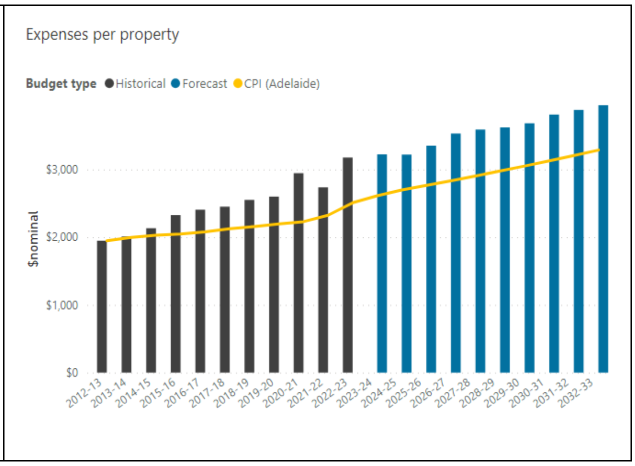
Noting that the Council's projections are reliant, in part, on higher growth assumptions, the Commission considers it important for the Council to ensure that its costs align to actual growth achieved – including having contingency plans to defer or avoid costs and new infrastructure if forecast growth 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 Precinct and the Arts 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:

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

The Council's template data (provided to the Commission) shows that employee numbers are to remain generally constant at current levels (of 118 FTEs), and its employee expenses are forecast to increase by an average of 2.5 percent per annum from 2023-24 to 2032-33. In addition, 'Materials, contracts and other' expenses and costs for depreciation are forecast to increase by an average of 2.6 percent and 4.1 percent per annum respectively, from 2023-24 to 2032-33. The estimated rate of growth in these expenses over the next 10 years, combined with higher rate increases, if achieved mean the Council's operating balance remain in surplus from 2024-25.

24 Correspondence (email) from the Council to the Commission, January 31, 2024.
25 Correspondence (email) from the Council to the Commission, January 31, 2024.



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. Rates are discussed in more detail in Section D.

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 achieve a satisfactory operating performance (without the need for further rate increases above inflation), the Commission encourages it to:

4. Report any actual cost savings in its annual budget (and long-term financial plan, as appropriate), to provide evidence of constraining cost growth and achieving efficiency across its operations and service delivery.

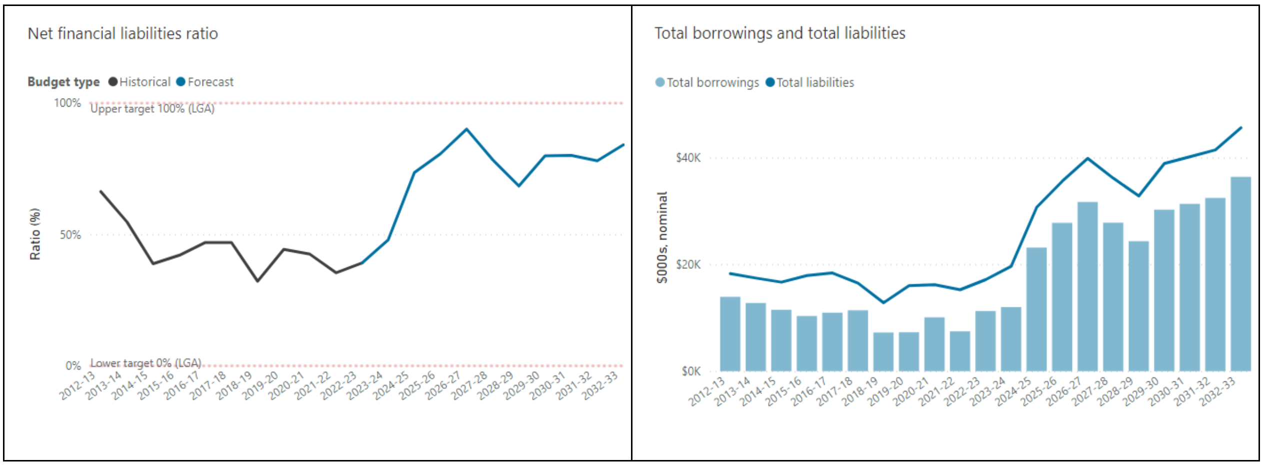
5. Include efficiency goals and projected cost savings in long-term financial plans, to provide further evidence of cost growth constraint and efficiency achievement across its operations and service delivery.

C.2 Net financial 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[26] averaging 45 percent

[26] 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.

between 2012-13 and 2022-23 (see left chart below). 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[27] and construction of the Precinct in 2026-27 and in 2031-32 for the construction of the Arts Centre. 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) (see right chart above).

In 2031-32, the ratio is forecast to reach 84.1 percent when funding will be required to construct and 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.[28] 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 percent towards the construction of the facility.[29]

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 Harbor 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 Harbor 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

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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, p. 7-8).

27 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.

28 City of Victor Harbor, *2024 – 2033 long-term financial plan*, June 2023, p. 14.

29 City of Victor Harbor, *2024 – 2033 long-term financial plan*, June 2023, p. 14.

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 Harbor 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 Harbor 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.[30] 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[31] 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.

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.[32] 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:

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

C.3 Asset renewals expenditure

Between 2012-13 and 2021-22, the Council averaged 71 percent on its asset renewal funding ratio[33] (under the 'IAMP-based' approach),[34] implying an underspend on the renewal and rehabilitation needs of

30 City of Victor Harbor, *2024 – 2033 Long-term financial plan*, June 2023, p. 16

31 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, p. 7-8).

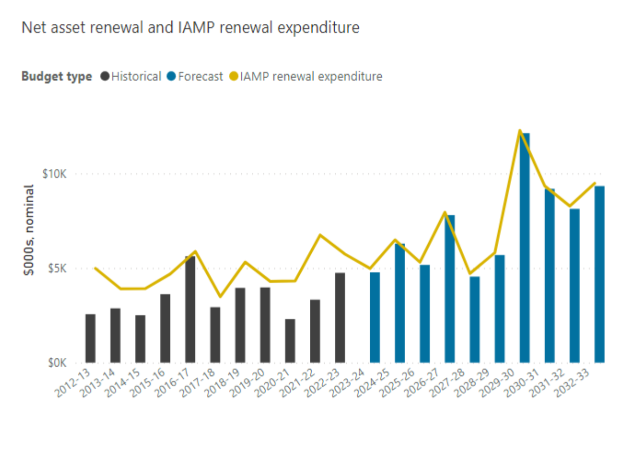
32 Refer to Councils in Focus rates data for 2021-22 available at: https://councilsinfocus.sa.gov.au/councils/city_of_victor_harbor The Commission is not relying on these rate comparisons for its advice; the data source provides one indicator, among many, which has informed its advice on the appropriateness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

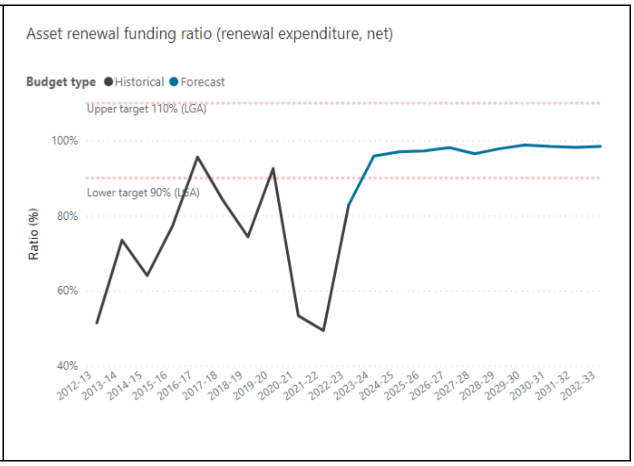
33 The IAMP-based method is the current industry standard whereby asset renewal/replacement expenditure is divided by the recommended expenditure in the IAMP (or AMP). Ideally, this will show the extent to which a Council's renewal or replacement expenditure matches the need for this expenditure, as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

34 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'.

its existing asset stock over this period (see right chart below). The Council's spending on renewal and rehabilitation of assets averaged $3.3 million each year (over this period) (see left chart below).

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).





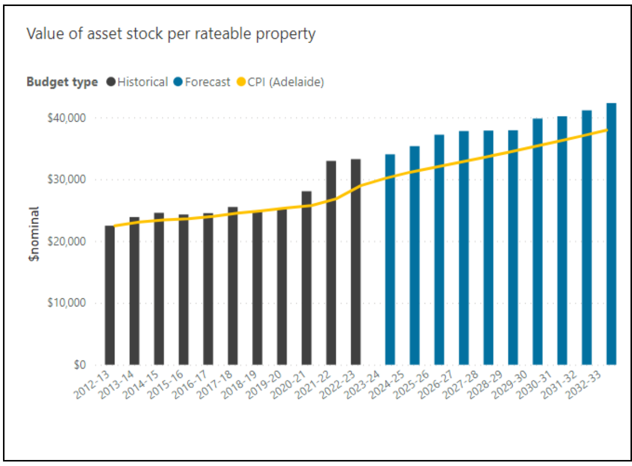
From 2012-13 to 2021-22, the Council spent more on new and upgraded assets than the renewal and rehabilitation of its existing stock, averaging $5 million per annum on new or upgraded assets, compared with $3.5 million per annum on the renewal of its existing asset base (see right chart over page).

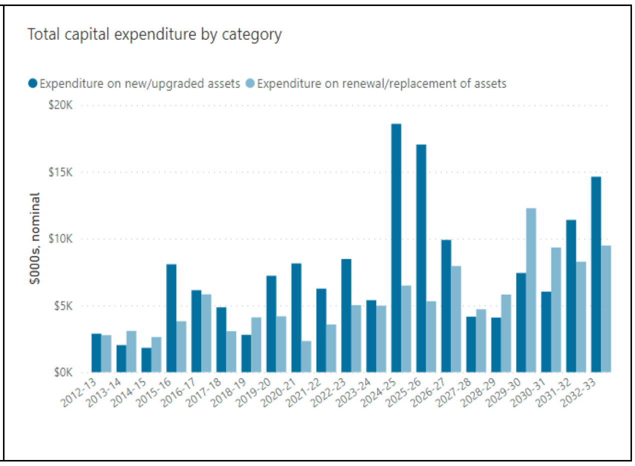
The expenditure on new and upgraded assets includes a portion of grant funding for certain projects. The growth in its asset base reflects a combination of capital expenditure and other asset accumulation by the Council (including those assets provided by developers), as well as asset revaluations over 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 (see left chart over the page).

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.[35] On 30 June 2022 roads, kerbs, footpaths, car parks and traffic devices were revalued, resulting in an asset revaluation increase of $56.9 million.[36]

35 City of Victor Harbor, *2020-21 annual report*, November 2021, p. 129.
36 City of Victor Harbor, *2021-22 annual report*, November 2022, p. 146.





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:

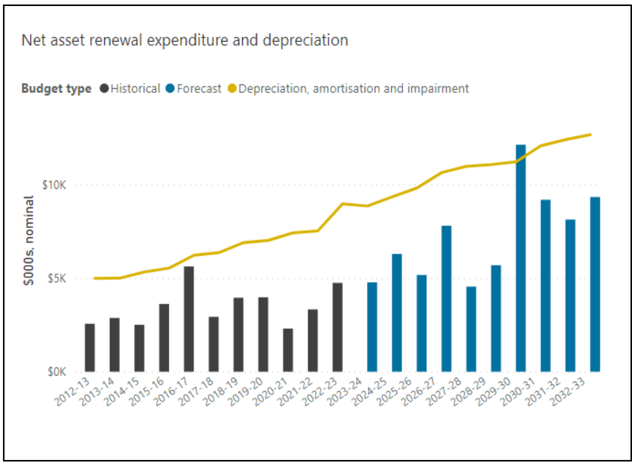
7. Provide more funding for asset renewal, rather than prioritising initiatives which involve new or upgraded infrastructure.

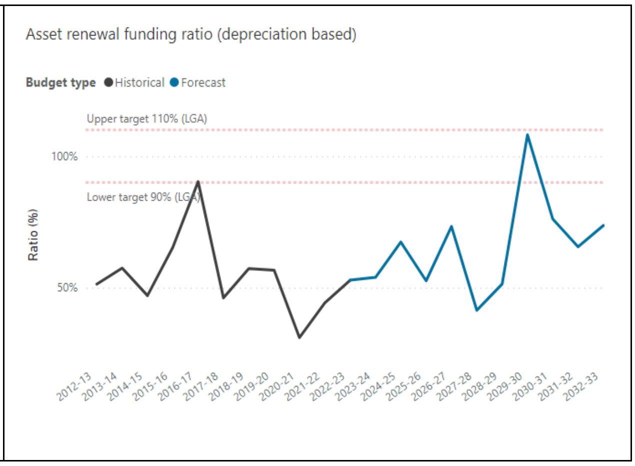
Asset renewals can also be evaluated by the depreciation-based asset renewal funding ratio,[37] which is projected to track lower than the recommended[38] minimum level (for the IAMP-based ratio) of 90 percent, averaging 66.4 percent per annum to 2032-33 (see right chart over page). While the ratios 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) (see left chart over page) and the gap is set to increase over the 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.

37 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.

38 The suggested LGA target range for the (IAMP-based) ratio is 90 to 110 percent (LGA SA Financial Indicators Paper, p. 9).





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.

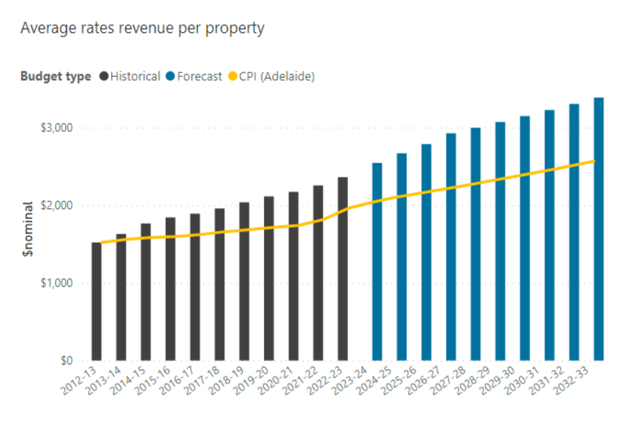
The Commission's notes that the Council is gradually revaluing its asset base. However, its asset base is high for a council of its size which it will find challenging to manage. On balance, the Council's strategic planning processes does not appear to align with observed good practice for a Council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

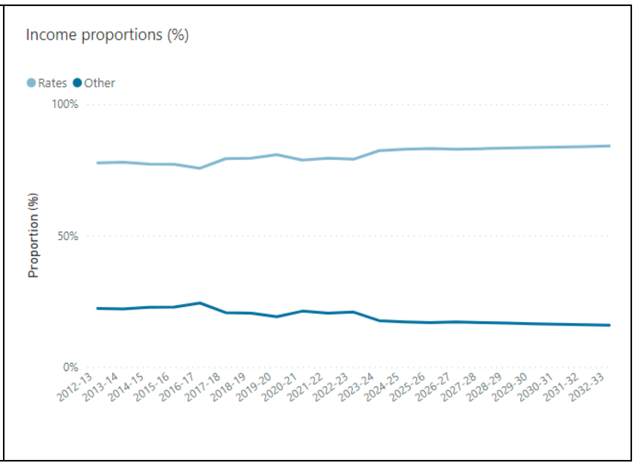
D Current and projected rate levels

D.1 Historical rates growth

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,[39] to reach an estimated $2,254 per property in 2021-22 (see the left chart below). 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).[40] Current rate levels partially reflect its 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.

The Council remains reliant on its rate base for its operating sustainability. As the chart below indicates (to the right), rates revenue is forecast to account for 79 percent of budgeted operating income in 2022-23, compared with 78 percent of income in 2012-13.





The Council's general rate revenue consists of two components – one based on a fixed charge and the other on the value of the land (differential rate).

After applying rebates, the Council will collect general fixed rate revenue of 18 percent of its general rates revenue. The maximum amount that the Council can collect from the fixed charge is 50 percent of general rates revenue. [41] [42] In 2023-24, the Council's fixed charge will be $479 per rateable property with the balance derived from general rates (after rebates) to be collected from a differential rate.

The differential charge payable per property is based on a rate in the dollar that is applied to the capital value of property. The rate in the dollar may vary based on land use and the Council currently has the following five rate types declared: commercial, industrial, residential, primary production and vacant land. On a proportional revenue basis, residential ratepayers account for 80 percent, commercial 8 percent, primary production 6 percent and vacant land 6 percent (industry is less than 1 percent) of total general rate revenue in 2023-24.

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

39 From 2012-13 to 2021-22.
40 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.
41 City of Victor Harbor, *2023-24 annual business plan*, June 2023, page. 62.
42 *Local Government Act 1999* (LG Act) s151(10).

and transparency to its ratepayers. For this reason, the Commission considers that it would be appropriate for the Council to:

8. **Continue 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.

The Commission notes that the average differential rate per rateable property for the residential type will increase to $1,954 in 2023-24 (from $1,857 in 2022-23). As such the average rate per rateable property for the residential type will be $2,433 (of which $479 is the fixed charge applicable to all rateable properties).

D.2 Proposed 2023-24 rate increases

The Council has budgeted for an average rate increase of 6.6 percent, or $153 per property, for its existing ratepayers in 2023-24.[43] The rates increase reflects higher short-term inflation (estimated by the Council to be 7.9 percent).[44] 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.[45]

Other than 'general rates' income, the Council also collects the Regional Landscape Levy, on behalf of Green Adelaide and is expected to collect $0.67 million (net of rebates) in 2023-24.[46]

D.3 Projected further rate increases

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,[47] [48] 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.[49]

D.4 The Precinct and the Arts Centre

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[50] to $21.07 million for the Precinct and $21.6 million for the Arts Centre.[51]

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

43 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.
44 City of Victor Harbor, *2023-24 long-term financial plan*, June 2023, p. 10.
45 City of Victor Harbor, *2023-24 annual business plan*, June 2023, p. 64.
46 City of Victor Harbor, *2023-24 annual business plan*, June 2023, p. 64.
47 This includes rates growth of 0.9 percent expected each year.
48 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).
49 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.
50 City of Victor Harbor – Information requirements letter. September 2023, p. 3.
51 City of Victor Harbor, *2024 – 2033 long-term financial plan*, June 2023, p. 26.

of through the general rates. The Council already has relatively high average rates (across most ratepayers)[52] 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:

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.

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.

D.5 Affordability risk

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.[53] At the same time, according to the Council's 2023-24 LTFP around 39 percent of the Council's community are welfare dependent[54] and 42 percent of the population are aged

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52 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.

53 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.

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

over 65 years old.[55] The Council already has relatively high average rates (across most ratepayers).[56] 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.[57]

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

56 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.

57 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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