Advice

Local Government Advice

Clare and Gilbert Valleys Council

February 2024

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Clare and Gilbert Valleys Council

AT A GLANCE

OVERVIEW

The Essential Services Commission finds the Clare and Gilbert Valley Council's current and projected financial performance **potentially unsustainable** taking into account the council's forecast moderate expense growth increase over the next 10 years and the planned average rate increases of 3.3% p.a. per property over this period

RISKS IMPACTING SUSTAINABILITY

- Out of date asset management plans, asset valuations and condition grading
- Over-estimation of asset useful lives and conditions
- Uncertainty around depreciation expenses
- Under-estimation of asset future repair, renewal and replacement costs

CONTINUE

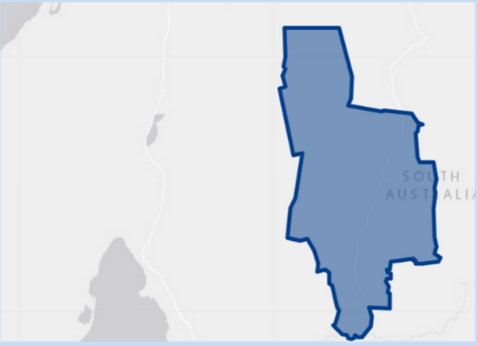
- Reviewing the capital expenditure program annually in the asset management plans
- Reviewing and considering options to limit future increases in rates to no more than expected inflation

COMMISSION'S RECOMMENDATIONS

- Review and provide greater transparency in the long-term financial plan
- Consider reporting the operating efficiency aims or cost reduction challenges
- Provide more information about the proposed capital works program
- Focus on constraining cost growth
- Report the actual and projected cost savings
- Review the estimates of asset lives (and valuations)
- Complete a review of the asset management plans

KEY FACTS

- Population in 2021 was **9,187**
- Council covers **1,840 square kilometres**
- **7,039** rateable properties in 2022-23
- **$15.2 million of rate income** in 2022-23
- Value of assets held in 2022-23 equals **$163.1 million**



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Glossary of terms

ABS	Australian Bureau of Statistics
AMP	Asset management plan (also called an IAMP)
Commission	Essential Services Commission, established under the *Essential Services Commission Act 2002*
CPI	Consumer Price Index (Adelaide, All Groups)
Council	Clare and Gilbert Valleys Council
CWMS	Community Wastewater Management System
ESC Act	*Essential Services Commission Act 2002*
F&A	Local Government Advice: Framework and Approach – Final Report
FTE	Full Time Equivalent
IAMP	Infrastructure and asset management plan (also called an AMP)
LG Act	*Local Government Act 1999*
LGA SA Financial Indicators Paper	Local Government Association of South Australia, Financial Sustainability Information Paper 9 - Financial Indicators Revised May 2019
LGGC	Local Government Grants Commission
LGPI	Local Government Price Index
LTFP	Long-term financial plan
Regulations	*Local Government (Financial Management) Regulations 2011*
RBA	Reserve Bank of Australia
SACES	The South Australian Centre for Economic Studies
SEIFA	Socio-Economic Indexes for Areas
SMP	Strategic management plan
SG	Superannuation Guarantee
The scheme or advice	Local Government Advice Scheme

Legend: Low-risk Moderate-risk High-risk

1 The Commission's key advice findings for the Clare and Gilbert Valleys Council.

The Essential Services Commission (**Commission**) finds the Clare and Gilbert Valley Council (**Council's**) current and projected financial performance is **potentially unsustainable**, driven by continued operating deficits (and growth in its cost base), and potential updates for higher asset renewal and depreciation costs. The Council's projected improvement to its financial performance is reliant on cost control, a reassessment of its asset renewal and repairs and maintenance programs, and further rates increases.

Current financial performance:

Unsustainable	**Potentially Unsustainable**	Mostly Sustainable	Sustainable

Projected financial performance (future):

Unsustainable	**Potentially Unsustainable**	Mostly Sustainable	Sustainable

Previous financial performance (past ten years):

Unsustainable	Potentially Unsustainable	**Mostly Sustainable**	Sustainable

The Commission notes the Council has progressively reduced its borrowings which has reduced its financial risk and is now forecasting over the long-term to accumulate cash reserves. This will provide it with some financial capacity as it considers the renewal of its asset base (and service levels) or consider reducing the impact of forecast rate increases on the community.

The Council's projections are somewhat reliant on a review of its operating cost base, and the implementation of its operating efficiency aims or cost reduction challenges which it should make explicit in its plans. This will assist it to achieve its own breakeven operating result target over a rolling five-year average period, which it is currently not forecasting to achieve until 2031-32.

The planned updates to its Asset Management Plans (**AMPs**) and asset valuations means that Council has some uncertainty around the valuation of its assets, with associated implications for depreciation, renewal expenditure and the relevant ratios. This could suggest the community may be exposed to further rate increases.

Budgeting considerations

1. **Review** and provide greater transparency (in its long-term financial plan), on the annual inflation and other relevant macro-economic assumptions as inputs to its projected revenue (including rates) and spending.
2. **Consider** reporting its operating efficiency aims or cost reduction challenges in its long-term financial plan and annual business plans, as appropriate.
3. **Ensure** its long-term financial plans and annual business plans include more information on its proposed capital works program to better inform the community about its expenditure priorities.

Continuing to provide evidence of ongoing cost efficiencies

4. **Focus** on constraining cost growth, where possible, including related to 'materials, contracts and other' expenses; and **report** its actual and projected cost savings in its annual budget and long-term financial plan, as appropriate.

Refinements to asset management planning

5. **Continue** to review its capital expenditure program annually in its asset management plans and consider options to better align the assumptions underpinning the expenditure allocations (and timing) with its long-term financial plan.
6. **Review** the estimates of asset lives (and valuations) informing its forecast rate of asset consumption (and depreciation expenses) in its long-term financial plan and need for asset renewals in its asset management plans, with a particular focus on the appropriateness of the estimated value of depreciation expenses in the context of asset renewal expenditure requirements.
7. **Complete** the planned reviews of its asset management plans, following a revaluation of its assets, with consideration of desired service levels, as appropriate.

Containing rate levels

8. **Continue** to review and consider options in limiting future increases in rates to no more than expected inflation, to help reduce any emerging affordability risk in the community.

2 About the advice

The Essential Services Commission (**Commission**), South Australia's independent economic regulator and advisory body, has been given a role by the State Parliament to provide advice on material changes proposed by local councils in relation to elements of their strategic management plans (**SMPs**) and on the proposed revenue sources, including rates, which underpin those plans.[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.[5] The other main purpose is for the Commission to consider ratepayer contributions in the context of revenue sources, as 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 Council.

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

2.1 Summary of advice

In general, the Commission finds the Council's financial position is at risk of being unsustainable, driven by an increasing cost base and forecast operating deficits. However, the Council is projecting to accumulate larger cash reserves which will provide it with some financial capacity to consider the renewal of its asset base or consider reducing the impact of forecast rate increases on the community. The Council is intending to target a breakeven operating result over a rolling five-year average period; however, it will not achieve this goal until later in its forecast period, in 2031-32. Historically, the Council has been impacted by climate related events (such as flooding) and has at times been unable to meet the ongoing renewal needs of its existing infrastructure base.[10]

The past rate increases have generally been in line with inflation and have also supported the Council's repayment of debt, increased its financial capacity, and covered its operating and service sustainability.

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).
10 As recommended by its AMPs.

However, based upon the evidence available to the Commission, the Council has not reduced its deficits through more effective cost constraint.

Its forward projections from 2023-24 (in its LTFP) forecast a gradual improvement in its financial sustainability outlook (over the medium to longer-term) because the forecast rate of operating income growth outpaces expense growth, through:

- continued average rate increases above the Reserve Bank of Australia (**RBA**)-based forecast inflation rate - this is generally aligned with the Council's own forecast inflation; however, it is forecasting an additional 1.5 percent per annum increase on rate revenues above inflation, and
- moderate cost constraint measures particularly in 'materials, contracts and other' expenses with lower average cost growth than it has experienced over the past 10 years (and almost 1 percent lower than the expected rate of RBA-based forecast inflation).

Based on the financial projections in its LTFP, the Commission considers that the Council is aiming to improve its performance and reduce ratepayer impact. However, the Commission has identified that the Council could make further improvements and encourages it to disclose further information on its capital expenditure program and operating efficiencies to further inform the community on its priorities and intentions regarding financial sustainability.

The Commission notes that there are risks emerging in relation to the Council's planned updates to its AMPs, asset valuations and condition assessments, which could affect the assessment of its operating sustainability as well as increasing affordability risks. This is because if significant asset revaluations are needed to accurately reflect forward-looking assets costs, depreciation charges will increase (based on the Council retaining the same asset stock and providing the same level of services), placing more pressure on the operating surplus ratio, and the Council will therefore have less capacity to build cash reserves or finance additional borrowings.

2.2 Detailed advice findings

The next sections summarise the Commission's more detailed observations and advice findings regarding the Council's material changes to its 2023-24 plans (compared with the previous year's plans), its financial sustainability (in the context of its long-term operating performance, net financial liabilities, and asset renewals expenditure), and its current and projected rate levels.

In providing this advice, the Commission has followed the approach explained in the Framework and Approach – Final Report (**F&A**). The attachment explores these matters further.[11]

2.2.1 Advice on material plan amendments in 2023-24

Key Points:

✅ An additional $8.4 million (or 18 percent) for asset renewals, and an additional $2.6 million (or 26 percent) for new and upgraded capital works.

⚠️ A decline in operating performance by $2.3m which results in the Council delaying its forecast operating surplus by three years to 2029-30.

🛑 Operating efficiencies or cost reduction challenges are not fully disclosed in its plans and further transparency is needed on assumptions driving the Council's revenue and spending forecasts.

[11] The attachment (to this advice) will be available on the Commission's website with the advice.

The Council's 2023-24 LTFP includes a small decline in its projected operating performance and increases to its projected capital expenditure estimates, as compared with the 2022-23 forecasts,[12] as follows:

- A decline in operating performance by $2.3 million, which results in the Council delaying its forecast operating surplus by three years to 2029-30. This is mainly driven by changes in 'materials, contracts and other' expenses and depreciation charges being greater than changes in operating income. Overall, the Council's forecast operating income has increased by 8 percent compared to a 9 percent increase in operating expenses.[13] This accounts for higher inflation forecasts and a 1.5 percent increase in the Councils rate revenue above inflation.[14]
- An additional $8.4 million (or 18 percent) for asset renewals, and an additional $2.6 million (or 26 percent) for new and upgraded capital works. The Council advises the increases are driven by bringing forward infrastructure renewals associated with repairing existing assets and works to preserve the Riverton Community Hall and Clare Town Hall.

The Council mostly applies a CPI-based inflation adjustment to its cost and revenue estimates; and the increase in rates revenue is primarily a result of the increase in CPI, as well as an additional 1.5 percent to improve the Council's ability to fund higher forecast costs and improve financial sustainability over the long-term.

Based on discussions with the Council, the Commission notes it is committed to regularly reviewing both service levels and operating efficiency; however, this has not been reported in any of its plans. In addition, as there has been some uncertainty around a number of macro-economic variables, it is not clear how the Council has factored these into its revenue and spending forecasts. Therefore, the Commission has found that it would be appropriate for it to:

1. Review and provide greater transparency (in its long-term financial plan), on the annual inflation and other relevant macro-economic assumptions as inputs to its projected revenue (including rates) and spending.
2. Consider reporting its operating efficiency aims or cost reduction challenges in its long-term financial plan and annual business plans, as appropriate.

The Commission has also observed that the Council did not provide an explanation of material amendments in relation to its capital expenditure changes. Additionally, a review of the Council's 2023-24 LTFP and 2023-24 Annual Business Plan indicates there is limited detail on its capital works program and, as such, its ratepayers may not have been fully informed of or effectively consulted on the Council spending priorities. The Commission considers that it would be appropriate for it to:

3. Ensure its long-term financial plans and annual business plans include more information on its proposed capital works program to better inform the community about its expenditure priorities.

2.2.2 Advice on financial sustainability

Operating performance

Key Points:

[12] The overlapping nine years forecast in both the 2022-23 and 2023-24 LTFPs.
[13] Ibid.
[14] CPI Adelaide (All groups) increased by 7.9 percent in the year to March 2023 quarter and has reduced in the year to June 2023 and September 2023 quarters to 6.9 percent and 5.9 percent, respectively. Available at https://www.abs.gov.au/statistics/economy/price-indexes-and-inflation/consumer-price-index-australia/sep-quarter-2023.

- Predominantly ran operating deficits or low surpluses from 2018-19 to 2022-23, with the operating surplus ratio averaging -2.2 percent over this period.
- The operating surplus ratio is not forecast to be in surplus until 2029-30.
- Heavily reliant on rates revenue which increased on average by 3.5 percent per annum from 2012-13 to 2021-22 (when rateable property growth averaged 0.4% and CPI growth averaged 2.0 percent).
- Lower forecast average expense growth of 2.7 percent per annum over the next 10 years is comparable with RBA-based forecast inflation.
- Focused on operating a balanced budget or breakeven budget over a rolling 5-year period.

The Council has predominantly run operating deficits or low surpluses from 2018-19 to 2022-23, with the operating surplus ratio[15] averaging negative 2.2 percent over this period. In its forward projections, the operating surplus ratio is not forecast to meet the suggested LGA target range (with a surplus) until 2029-30 (when it will be 0.7 percent).

The reasons for the historical operating deficits are driven by average annual increase of 4.9 percent in 'materials, contracts and other' expenses, and 3.8 percent in depreciation charges (from 2012-13 to 2021-22).[16] This also reflects a year-on-year increase of 30 percent in 'materials, contracts and other' expenses in 2021-22, resulting from additional maintenance works undertaken and the provision of $1.5 million in grant funding to a sporting organisation.[17] The increase in depreciation charges reflects the revaluation of its transport infrastructure and building assets in 2016-17, which resulted in a 20 percent increase from 2015-16 levels.[18] This may be significant, as the Council's asset valuations may require further updates or may not reflect the asset condition, leading to the risk of an incorrect assessment of its operating performance.

On the income side, the Council has had to increasingly rely on rates revenue which increased on average by 3.5 percent per annum from 2012-13 to 2021-22 (when rateable property growth averaged 0.4 percent and CPI growth averaged 2.0 percent).[19] Rates revenue has reflected an increasing proportion of total income over the last 10 years, growing from 67 percent (in 2012-13) to 76 percent of total operating income (in 2022-23).

The Council also receives a combination of 'grants, subsidies and contributions', 'user charges,' and 'statutory charges' to support its services to the community. However, in aggregate, these have largely remained unchanged over 10 years, indicating income from these sources has reduced in real terms. The Council may need to understand the reasons for this and consider reviewing its cost recovery model; for example, for its Community Wastewater Management System (**CWMS**) operations, to minimise any cross subsidy by its ratepayers.

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15 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).

16 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).

17 Based on the Council's Financial Report Template provided to the Commission in an Excel document. Also see: Clare and Gilbert Valleys Council, *Annual Report 2021/2022*, p. 69, available at https://www.claregilbertvalleys.sa.gov.au/__data/assets/pdf_file/0029/1255844/Annual-Report-2021-2022.pdf.

18 Clare and Gilbert Valleys Council, *Annual Report 2016/2017*, p. 11, available at https://www.claregilbertvalleys.sa.gov.au/__data/assets/pdf_file/0011/212060/Annual-Report-and-Financials-for-2016-2017.pdf.

19 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 lower forecast average expense growth of 2.7 percent per annum over the next 10 years (driven by lower 'materials, contracts and other' expenses growth of 1.9 percent) is approximately in line with RBA-based forecast inflation.[20] This, combined with annual average rates revenue growth of 4.0 percent to 2032-33, is expected to slowly improve the Council's operating performance. While this is a positive trend, it is unclear what action the Council is intending to undertake to achieve this improvement.

The Commission has observed some good practices of the Council, which states that it is focused on operating a balanced budget or breakeven budget over a rolling 5-year period; however, the Council is not forecast to meet this goal until 2031-32.[21] This deferral adds some risk to its financial sustainability, particularly if unforeseen events or major repairs and maintenance costs arise, as has occurred in the past.[22] The Council needs to effectively manage inflationary pressures and supply constraints (among other factors) which have impacted on its financial performance in recent years. It may be appropriate for the Council to review its current 'material, contracts and other' expenses (which accounted for 43 percent of total operating expenses in 2022-23) to ensure it is positioned to achieve the real terms reduction in these costs.

Against this background, and as part of the Council's continuing review of its plans, it may now need to find productivity improvements (to reduce any inflationary impact on its community) in the absence of reducing service levels or further increasing rates on the community. Therefore, the Commission has found that it would be appropriate for it to:

4. **Focus** on constraining cost growth, where possible, including related to 'materials, contracts and other' expenses; and **report** its actual and projected cost savings in its annual budget and long-term financial plan, as appropriate.

Net financial liabilities

Key Points:

- Net cash flows after operating and investing activities (i.e. capital-related) averaged $0.7m per annum between 2012-13 and 2021-22, which was primarily used to repay borrowings totalling $9.2m.
- The net financial liabilities ratio has averaged -4.5 percent over the period from 2012-13 to 2021-22 which is below the suggested LGA target range.
- Based on the low forecast net financial liabilities ratio over the next 10 years, Council may have the financial capacity to utilise more cash to address changes to its asset renewal expenditure.

Despite the Council's frequent operating deficits from 2012-13 (which include depreciation expenses), its net cash flow after operating and investing (that is, capital-related) activities has averaged $0.7 million per annum between 2012-13 and 2021-22. This net cash flow (in addition to the Council's existing cash balances) has been primarily used to repay its borrowings (totalling $9.2 million over this period). Therefore, the Council remains sustainable from a cash flow perspective, noting that its two largest income sources (rates revenue and grant income) were sufficient to fund its operating and capital expenditure program over this period.

Over the period 2012-13 to 2021-22, the Council's net financial liabilities ratio averaged negative 4.5 percent (or has ranged between 15.2 and negative 16.6 percent) and, since 2015-16, has been below the

20 The forecast average annual growth in the CPI from 2023-24 to 2032-33 is estimated to be 2.6 percent based on the RBA forecasts for the CPI (Australia-wide) to December 2025 (and the Commission's calculations of average annual percentage growth) and the midpoint of the RBA's target range (2.5 percent) from 2025-26.

21 Clare and Gilbert Valleys Council, *Long Term Financial Plan 2024-25 to 2033-34,* July 2023, p.7.

22 Clare and Gilbert Valleys Council, *Long Term Financial Plan 2024-25 to 2033-34,* July 2023, p.9.

suggested LGA target range for this ratio.[23] The forecasts show that the Council will continue to be below the LGA target range, as it will have negligible borrowings by 30 June 2025 and it has not forecast additional borrowings from the period 2025-26 onwards. As a result, the net financial liabilities ratio will progressively decline over the period to 2032-33, which also reflects the Council's operating income growth and an accumulation of cash balances.

Based on the Council's low forecast net financial liabilities ratio, it has the financial capacity where its operating income can cover its net financial liabilities. However, when viewed in the context of the Council's historical and forecast operating deficits, and potential upward revisions to asset valuation and depreciation,[24] this suggests it is at risk of becoming unsustainable. The Council's long-term forecasts suggests that it may have some financial capacity with the build-up of existing cash balances which could be utilised to address changes to its asset renewal expenditure forecasts, as appropriate.

Asset renewals expenditure

Key Points:

- ✅ Between 2012-13 and 2021-22, total capital expenditure averaged $5.5 million per annum (including $4.3 million on asset renewals and $1.2 million on new and upgraded assets).
- ✅ Between 2012-13 and 2021-22, the asset renewal funding ratio averaged 96%.
- ✅ The forecast asset renewal funding ratio over the next 10 years is projected to be 105%.
- 🛑 Asset management plans for major infrastructure assets are based on asset valuations carried out approximately 5 years ago. This poses a risk that depreciation expenses, asset renewal and replacement costs are underestimated in the current economic climate.

Between 2012-13 and 2021-22 the Council's total capital expenditure averaged $5.5 million per annum (including $4.3 million on asset renewals and $1.2 million on new and upgraded assets). Based on the asset renewal expenditure requirements specified in its AMPs, it has on average met the quantum of its asset service sustainability requirements. In some years, it has underspent on the renewal and rehabilitation needs of its asset stock, and in other years it has overspent - indicating significant spend volatility compared to its AMP. Overall, the Council's asset renewal funding ratio (IAMP-based) was within the suggested LGA target range of 90 to 110 percent over these years,[25] and averaged 96 percent between 2012-13 and 2021-22.

From 2023-24, the Council's asset renewal spending profile is increasing, reflecting expenditure brought forward as a result of the deterioration of some of its assets.[26] As such, its asset renewal funding ratio (IAMP-based) is expected to trend in line with the suggested LGA target range (averaging 105 percent from 2023-24 to 2032-33).

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

25 The IAMP-based method is the current industry standard whereby asset renewal/replacement expenditure is divided by the recommended expenditure in the IAMP (or AMP). The suggested LGA target range for the ratio is 90 to 110 percent (LGA SA Financial Indicators Paper, p.9).

26 Clare and Gilbert Valleys Council, *Long Term Financial Plan 2024-25 to 2033-34,* July 2023, p.9.

Based on discussions with the Council, it has experienced significant increases in materials and construction costs, and supply and labour constraints are impacting on the region. Furthermore, the Council has recognised that its historical capital spending profile and weather events have increased the volatility of its historical asset renewal funding ratio; however, is also seeking to undertake asset reviews to ensure that it maintains its service levels to the community. It is not entirely clear how the Council's forecasts in its AMPs align with the forecasts in its LTFP. The Commission considers that it would be appropriate for the Council to:

5. Continue to review its capital expenditure program annually in its asset management plans and consider options to better align the assumptions underpinning the expenditure allocations (and timing) with its long-term financial plan.

The Commission notes the Council's historical spending (over the last 10 years) on asset renewals has been below the rate of depreciation, in some years by a significant margin. Renewal spending is forecast to account for 80 percent of depreciation expenses on average to 2032-33.[27] The Council's assessment of depreciation (currently contributing to 30 percent of total operating costs in 2022-23),[28] may suggest a risk to its financial forecasts, where the incorrect recording of depreciation could lead to an incorrect assessment of its operating performance and sustainability. The Commission is unable to fully assess the risks in its renewal spending (and higher depreciation) as several factors will require further consideration, for example:

- higher asset revaluations, driven by higher rates of inflation and construction costs, may be increasing the Council's assessment of depreciation
- asset lives may be assumed shorter in the depreciation calculation than occurs in practice,
- the scale of asset write-offs (for example roads being damaged due to flooding) and subsequent level of reinvestment may be increasing depreciation, and / or
- the Council may not be renewing its assets at a pace indicated by the rate of asset consumption.

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

6. Review the estimates of asset lives and valuations informing its forecast rate of asset consumption and depreciation expenses in its long-term financial plan and need for asset renewals in its asset management plans, with a particular focus on the appropriateness of the estimated value of depreciation expenses in the context of asset renewal expenditure requirements.

Further, the Council's AMPs for its major infrastructure assets (i.e., transport, buildings and structures, stormwater and CWMS assets) were initially based on asset valuations carried out approximately five years ago. The Council has indicated it has a priority to revalue its major infrastructure assets, along with the planned reviews of its AMPs, and it acknowledges this will better inform the Council's planned asset renewal program and operating and maintenance budgets.

The Commission encourages it to periodically and strategically revisit its asset valuation schedule, and then update its plans accordingly. This is particularly important as councils are required to undertake a comprehensive review of its strategic management plans (including asset management plans) within two years after each general election of the Council.[29] Therefore, the Commission considers that it would be appropriate for it to:

27 The Council's asset renewal funding ratio by the depreciation-based method (where asset renewal/replacement expenditure is divided by depreciation expenses) is forecast to average 80 percent to 2032-33. This ratio shows the extent to which capital expenditure on the renewal and replacement of assets matches the estimated rate at which these assets are used or consumed. Prior to 2013, the calculation of the ratio in the sector was based on the 'depreciation method' and was known as the asset sustainability ratio until 2018.

28 Based on the Council's 2022-23 unaudited estimates reported to the Commission in an Excel template.

29 LG Act s122(4)(a) and (b). General elections were last held for SA Councils on 11 November 2022.

7. **Complete** the planned reviews of its asset management plans, following a revaluation of its assets, with consideration of desired service levels, as appropriate.

2.2.3 Advice on current and projected rate levels

Key Points:

⚠ Rate revenue per property growth has averaged 3.0 or $55 per annum for each property in the period between 2012-13 and 2021-22 which is 1.0% above CPI for the same period.

⚠ The forecast rate increases for 2023-24 is 5.8% per property and is made up of 9.4% increase for primary producers and 4.8% increase for residential ratepayers.

⚠ Affordability risk for further average rate increases appears moderate based on a range of factors including an assessment of the economic resources available to the community, however increasing risks are emerging for further rate rises above inflation.

The Council's rate revenue per property growth has averaged 3.0 percent or $55 per annum for each property in the period between 2012-13 and 2021-22, which has exceeded CPI growth of an average of 2.0 percent per annum over that period. Compared to similar councils the Council has average rate levels for residential and non-residential categories.[30]

In 2023-24, the Council has budgeted for an average rate increase of 5.8 percent, higher than anticipated for this year in its previous LTFP projections (a 4.3 percent increase in rate revenues was previously forecast for 2023-24). The increase reflects the Council's higher short-term inflation expectation and associated operating cost pressures. Further, the Council has included in its rate revenue projections an additional 1.5 percent on top of CPI, to maintain its financial sustainability.[31]

Its 2023-24 LTFP forecasts an average increase of $771 to existing rates in total to 2032-33 (to $3,060 per annum). While this is consistent with the Council's assumed escalation over this period (and relatively low growth in rateable properties of approximately 0.7 percent per annum), average annual rate increases are above the RBA-based forecast of average inflation (2.6 percent per annum).[32] Primary production ratepayers are experiencing higher rate increases (of 9.4 percent in 2023-24) relative to residential ratepayers (4.8 percent) but also account for relatively lower rate revenue contributions (on a capital valuation basis).[33]

Affordability risk within the community for the further rate increases appears to be moderate based on a range of factors, including an assessment of the economic resources available to the community[34] and

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

31 Clare and Gilbert Valleys Council, *2023-24 Long Term Financial Plan*, July 2023, p. 5.

32 The forecast average annual growth in the CPI from 2023-24 to 2032-33 is estimated to be 2.6 percent based on the RBA forecasts for the CPI (Australia-wide) to December 2025 (and the Commission's calculations of average annual percentage growth) and the midpoint of the RBA's target range (2.5 percent) from 2025-26.

33 On a capital valuation basis (in 2023-24), primary production land use represents 63 percent of the aggregate capital value in the Council area, while on a revenue basis, primary production ratepayers accounts for 48 percent of total rates revenue.

34 The Clare and Gilbert Valley's Council area is ranked 51 among 71 South Australian '*local government areas*' (including Anangu Pitjantijatjara and Maralinga Tjarutja Aboriginal community areas and 'unincorporated SA') on the Australian Bureau of Statistics Socio-Economic Indexes for Areas Index of Economic Resources (2021), where a lower ranking (eg, 1) denotes relatively lower access to income and other economic resources, compared with other areas, available at https://www.abs.gov.au/statistics/people/people-and-communities/socio-economic-indexes-areas-seifa-australia/2021.

little evidence of community concerns on affordability.[35] Affordability risk could be impacted in the context of the Council's financial sustainability risks, which is evident from the forecast operating deficits (to 2028-29), uncertainty around the valuation of its assets and updates to its asset management planning. The associated implications for depreciation, renewals expenditure and the relevant ratios could mean that the community may be exposed to further rate increases.

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

8. Continue to review and consider options in limiting future increases in rates to no more than expected inflation, to help reduce any emerging affordability risk in the community.

2.3 The Commission's next advice and focus areas

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

- ongoing performance against its LTFP estimates and its goal to achieve an operating breakeven position,
- improved disclosure of its capital spending forecasts and other relevant assumptions in its LTFP,
- identification and reporting of cost savings and operating efficiencies,
- updates to its asset management plans, and associated updates to asset valuations and condition assessments, and
- how it has sought to address the financial sustainability risks or emerging affordability risks.

35 Clare and Gilbert Valleys Council, *Special Council Meeting Agenda - 5 July 2023, Item 1. Public submissions Draft 2023-2024 Annual Business Plan & Budget and Draft 2023-2024 to 2032-2033 Long Term Financial Plan,* available at https://www.claregilbertvalleys.sa.gov.au/__data/assets/pdf_file/0024/1428162/5-July-2023-Special-Council-Meeting-agenda.pdf.

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