Advice

Local Government Advice - Attachment

Clare and Gilbert Valleys Council

February 2024

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Table of contents

A The Commission's approach

In providing the Advice for the Clare and Gilbert Valleys Council (**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 set out 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]

- Annual Business Plan 2023-24 (adopted July 2023)
- 2023-24 Long Term Financial Plan, 2024-25 to 2033-34 (adopted July 2023)
- Strategic Plan 2023 – 2033 (adopted June 2023)
- 2022-23 Long Term Financial Plan, 2022-23 to 2031-32 (adopted July 2022)
- Building and Structures Infrastructure Asset Management Plan (adopted April 2021)
- Community Wastewater Management System (**CWMS**) Infrastructure Asset Management Plan (adopted July 2020)
- Stormwater Infrastructure Asset Management Plan (adopted May 2020)
- Transport Infrastructure Asset Management Plan (adopted May 2020)

The Commission notes that most of the Council's asset base is covered by its existing asset management plans (**AMPs**); however, the asset valuations for those assets were predominantly carried out five years ago, in the period 2017 to 2021.

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**),[4] 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,[5] 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, 2022-23 LTFP forecasts, historical financial data, the number of rateable properties and staff (Full Time Equivalent (**FTE**)) numbers from 2012-13 onwards.[6] [7] All charts and tables in the Advice are primarily sourced from these datasets. In addition, the Commission has reviewed the Council's audit committee reports and other public information.

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 considered in assessing the Council's performance against these indicators to determine affordability, cost control and other sustainability risks.
4 *Local Government Act 1999* (**LG Act**) s122(1g)(a)(i).
5 As required under s122(1b) of the LG Act.
6 Sourced from the Local Government Grants Commission (including data reported by the Office of the Valuer-General) and the Council's data.
7 The Council's estimates for the 2022-23 financial year, relied on when preparing this advice, were unaudited.

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 offices and the individual circumstances of the Council, consisting of:

- its location as a regional Council,
- its income level ($20.1 million), and
- the size of its rates base (more than 7,000 ratepayers[8]).

Summary of the Clare and Gilbert Valleys Council's financial sustainability performance and the Commission's risk assessment

<table>
<tr><th>Financial sustainability indicators:</th><th colspan="2">Last 10 years from 2012-13 (Actual performance)</th><th>2022-23 estimate</th><th colspan="2">Next 10 years from 2023-24 (Council forecasts)</th></tr>
<tr><td>Operating surplus ratio (target 0-10%)</td><td>On average, operating surpluses reported -------------></td><td colspan="2">On average, operating deficits reported ---------></td><td>Deficits projected from 2023-24 to 2028-29</td><td>Surpluses projected from 2029-30 ---------></td></tr>
<tr><td>Net financial liabilities ratio (target 0-100%)</td><td>Ratio within target range</td><td colspan="2">Ratio below zero (driven by higher cash balances and lower debt levels)</td><td colspan="2">Ratio projected below zero (driven by higher cash balances and no debt) ---------></td></tr>
<tr><td>Asset renewal funding ratio (target 90-110%)</td><td colspan="3">Volatility in renewal works spending, but on average within target range --></td><td colspan="2">Projected renewal works spending within target range ---></td></tr>
<tr><td>Identified Risks:</td><td colspan="5"></td></tr>
<tr><td>Cost control risk</td><td colspan="2">Operating expenses per property average growth 3.0% pa to 2021-22 (CPI 2.0%) ----></td><td>Small increase reported</td><td colspan="2">On average, operating expenses growth below forecast CPI -------------------------------></td></tr>
<tr><td>Affordability risk</td><td colspan="3">Rates revenue per property average growth of 2.7% pa to 2022-23 (CPI 2.6%) ---></td><td colspan="2">Modertae rate revenue per property average growth inline with forecast CPI (CPI 2.6%) ---></td></tr>
</table>

Red	Ratio outside suggested LGA target range or higher risk
Amber	Ratio close to suggested LGA target range or medium risk
Green	Ratio within suggested LGA target range or lower risk

[8] Based on the estimated number of property assessments in 2023-24.

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).[9] To ensure a comparable analysis of estimates between the 2022-23 and 2023-24 LTFPs, the Commission has reviewed nine overlapping years' statistics, 2023-24 to 2031-32, and identified material amendments accordingly.

Selected Financial Item	Sum of 2023-24 to 2031-32 estimates in 2022-23 LTFP ($ million)	Sum of 2023-24 to 2031-32 estimates in 2023-24 LTFP ($ million)	Change in 2023-24 estimates ($ million)	Change in 2023-24 estimates (percent)
Total operating income	196.2	211.8	15.6	8
Total operating expenses	196.2	214.1	17.6	9
Operating surplus / (deficit)	0.0	-2.3	-2.3	n/a
Capital expenditure on renewal of assets[10]	54.8	46.4	8.4	18
Capital expenditure on new and upgraded assets[11]	12.6	10.0	2.6	26

B.1 Changes to operating performance

The Council has forecast (in its 2023-24 LTFP) an increase in its operating income of $15.6 million (or 8 percent) across the nine-year comparative period to 2031-32 compared to the 2022-23 LTFP (as shown in the table above). This reflects the Council's efforts to offset the comparable increase in forecast operating expenses mainly driven by increases in 'material, contracts and other' expenses and in depreciation.

Overall, the Council is forecasting further operating deficits and is assuming deficits extend out to 2028-29 (compared to 2026-27 in its 2022-23 LTFP). This demonstrates some financial prudence (and risk) in the Council's budgeting, which aims to achieve a breakeven operating result over a rolling five-year average period; however it will not achieve that goal until later in the 2023-24 LTFP forecast period, in 2031-32.[12] The Council's historical and projected operating performance is discussed further in section C.1.

The key operating income changes across the nine-year comparative period to 2031-32 includes:

- 5.1 percent (or $8.4 million) increase in rates revenue,
- 24.6 percent (or $4.4 million) increase in 'grants, subsidies and contributions', and
- 23.2 percent (or $2.2 million) increase in 'user charges'.

The key operating expense changes across the nine-year comparative period to 2031-32 includes:

- 10.3 percent (or $7.9 million) increase in 'materials, contracts and other' expenses, and

9 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.
10 The capital expenditure estimates are based on the 2023-24 LTFP estimates provided by the Council to the Commission (in an Excel template).
11 Footnote 10 applies.
12 Clare and Gilbert Valleys Council, *Long Term Financial Plan 2024-25 to 2033-34,* July 2023, p.7.

- 10.3 percent (of $6.3 million) increase in depreciation charges.

The Council advises that most of its operating income and operating expenses forecast are currently driven (among other things) by changes in external factors such CPI and Local Government Price Index (**LGPI**), increasing utility costs and contractor pricing, as well as grant funding from State and Federal Governments.

B.2 Indexation adjustments

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

The Council has assumed CPI inflation increases of 7.9 percent in 2023-24, 3.5 percent in 2024-25, 3.0 percent in 2025-26, and a reversion to approximately 2.6 percent annually from 2027-28.[13] While this is an upward revision it is somewhat comparable with the Council's previous forecasts of 4.3 percent in 2023-24, 2.9 percent in 2024-25, and 2.0 percent annually from 2026-27.[14] This is largely driven by higher-than-expected inflation outcomes in March 2023 when the CPI Adelaide (All Groups) increased by 7.9 percent[15] but is also driven by the Council's revision to its long-term CPI forecasts.

Based on these updated inflation assumptions in its 2023-24 LTFP, an increase in its cost and revenue estimates by up to 8 to 9 percent over the 2023-24 to 2031-32 forecast period,[16] compared with the same estimates in its 2022-23 LTFP, could reflect higher inflation forecasts. It also reflects the Council's sustainability increase of 1.5 percent per annum included in its 2023-24 LTFP, which appears to be needed to fund a higher operating cost base and to return the Council to an operating surplus position. The Council has noted that it is anticipating further price increases in construction, contracts and utility costs but has also stated it is committed to regularly reviewing both service levels and operating efficiency, although this has not been reported in any of its plans. The Commission considers that it would be prudent for the Council to make its efficiency aims explicit in its plans and/or consider reducing its cost base (in contrast to inflating its existing cost base). This is discussed further in section C.1.

The RBA currently forecasts the CPI (Australia-wide) to increase by 3.9 percent in the year to the June 2024 quarter and by 3.3 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).[17] The Commission notes the Councils inflation assumptions are consistent with these estimates, however there is also considerable uncertainty around various macro-economic assumptions and it is not clear the extent to which these have been factored into its plans.

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.

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[13] Clare and Gilbert Valleys Council, *Long Term Financial Plan 2024-25 to 2033-34,* July 2023, p.16.
[14] Clare and Gilbert Valleys Council, *Long Term Financial Plan 2022-23 to 2031-32,* July 2022, p.10.
[15] 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.
[16] The set of nine years forecast in both the 2022-23 and 2023-24 LTFP projections.
[17] RBA, Forecast Table - November 2023, available at https://www.rba.gov.au/publications/smp/2023/nov/forecasts.html.

B.3 Increase to capital expenditure estimates

The Council's 2023-24 LTFP indicates an increase in capital expenditure for asset renewals (by $8.4 million or 18 percent) and for new and upgraded assets (by $2.6 million or 26 percent), compared to the previous year's LTFP (for the period from 2023-24 to 2031-32). Over the 10-year projections in the 2023-24 LTFP, the Council has factored in a total of $62.5 million in capital renewal and replacement works and $13.6 million in new and upgraded capital works, accounting for 82.1 percent and 17.9 percent of the total capital expenditure program, respectively.

The Council did not provide an explanation for these amendments but has indicated it has brought forward infrastructure renewals with a focus on maintaining and repairing its existing assets such as its stormwater systems, footpaths, and roads, as well as undertaking building works to preserve the Riverton Community Hall and Clare Town Hall.[18] The Commission's review of the Council's 2023-24 LTFP and Annual Business Plan shows that there is limited detail on its capital works program and, as such, its ratepayers may not be fully informed or consulted on the Council's spending priorities. To this end, the Commission considers that it would be appropriate for the Council 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.

[18] Clare and Gilbert Valleys Council, *Long Term Financial Plan 2024-25 to 2033-34,* July 2023, p.4.

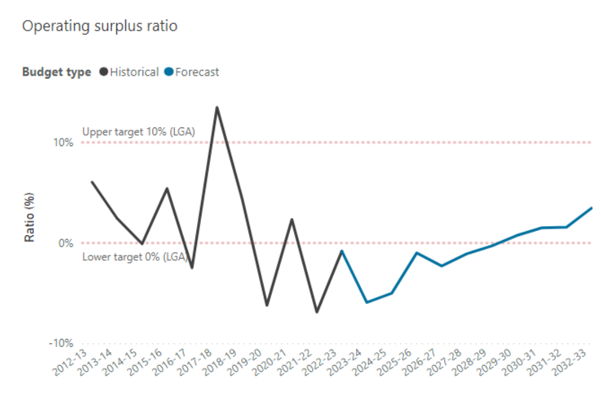
C Financial sustainability

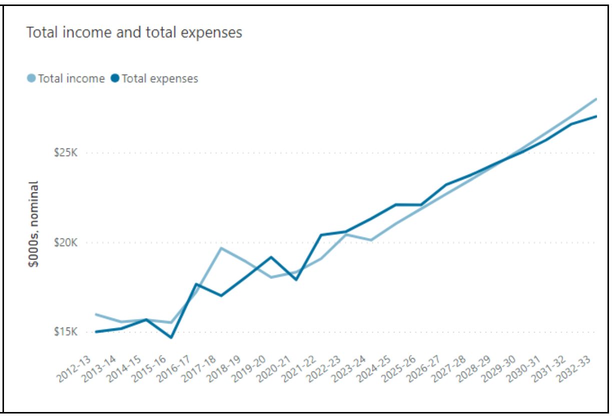
C.1 Operating performance

The Council has predominantly run operating deficits or low surpluses from 2018-19, and in 2022-23 it had an operating deficit of $0.2 million. Its operating surplus ratio[19] is not forecast to be positive again (with a surplus) until 2029-30 (then 0.7 percent) (see the left chart below).

The broad reason for the historical operating deficits is that operating income growth averaged 2.0 percent per annum from 2012-13 to 2021-22, while the rate of operating expense growth averaged 3.5 percent per annum.[20] As a result, the Council has mainly sustained operating deficits over the last five years to 2022-23 (based on an average operating balance over this period).

The long-term improvement to its projected operating performance is attributed to budgeting for continued rate revenue increases and slower expense growth than it had achieved in the past, on average (see the right chart below).





Rates revenue has 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), rising in real terms. Over the same period, 'grants, subsidies and contributions' (accounting for 15 percent of total operating income) increased by an average of 0.8 percent per annum. Grants income specifically has been 'lumpy' from year to year,[21] and the three-year average of $435 per ratepayer to 2022-23 compares with the three-year average of $350 to 2014-15, reflecting an increase in value in real terms. Finally, 'user charges' (accounting for 6 percent of total operating income) decreased by an average of 1.3 percent per annum, representing a real term decline.

The Council's operating expense growth (from 2012-13 to 2021-22) was primarily due to an average annual increase of 4.9 percent in 'materials, contracts and other' expenses[22] and 3.8 percent in depreciation charges (see the changes by expense type in specific time periods in the left chart over the page). In 2021-22, the Council reported a year-on-year increase of 30 percent in 'materials, contracts and other' expenses, resulting from additional maintenance works undertaken and the provision of $1.5

19 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).

20 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).

21 Due to the timing of different grants and sometimes advance grant payments (as for the 2023-24 grant allocation, which was received and accounted for in 2022-23).

22 This is despite the increase in the solid waste levy over the past 10 years which has impacted councils' waste management costs.

million in grant funding to a sporting organisation, which has impacted adversely on the Council's performance.[23]

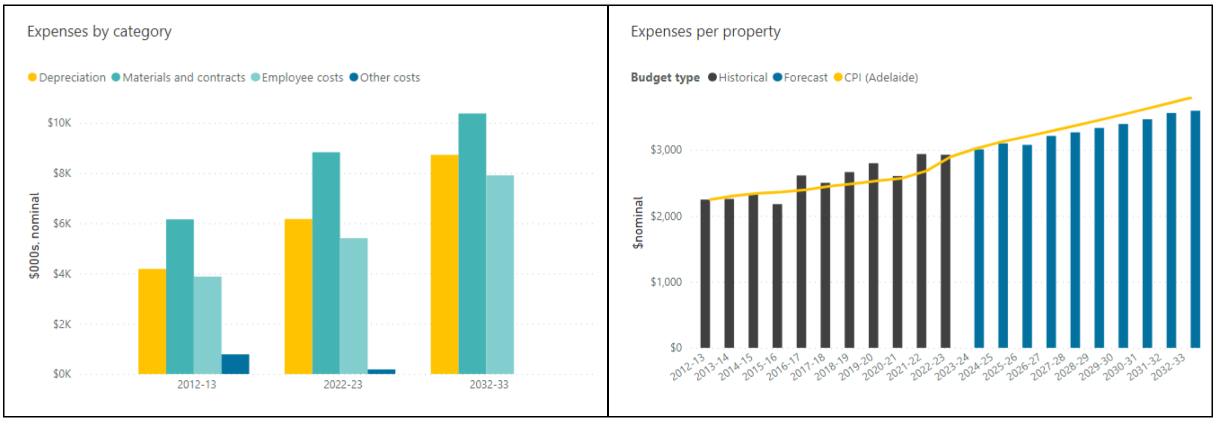
The Commission notes that the Council undertook a revaluation of its transport infrastructure and building assets in 2016-17, which resulted in a 20 percent increase in depreciation charges from the prior year (2015-16).[24] Since then, depreciation charges have accounted for an increasing proportion of total operating expenses (currently 30 percent of total operating expenses in 2022-23).

Moving forward, this may be significant, as the Council's asset valuations may require further updates or valuations may not reflect the asset condition, leading to an incorrect assessment of its operating performance and affordability risk. This is discussed further in section C.3.

Looking forward, the Council is projecting average annual rates revenue growth of 4.0 percent to 2032-33, which is above the forecast long-term inflation[25] and represents a real term increase in rates (mainly driven by the Council's assumed rate revenue increase of CPI plus 1.5 percent per annum).[26] This average growth in annual rates revenue is also higher than expected expense growth (rates are discussed in more detail in section D).

Lower forecast average expense growth of 2.7 percent per annum over the period to 2032-33 (driven by lower 'materials, contracts and other' expense growth of 1.9 percent over the same period) is approximately in-line with the RBA-based forecast inflation growth[27] and represents a change from the Council's past performance (with average annual growth of 3.5 percent in the 10 years to 2021-22).

Expenses per property (a metric which accounts for growth) are expected to increase by an average of 2.0 percent per annum over this period, which would represent a cost reduction in real terms (based on current inflation projections) (see the right chart below).



The Council's template data shows that employee numbers are assumed constant at current levels (58 FTEs), and some of its operating income and expense lines indicate negligible change in real terms or growth in line with long-term inflation forecasts. For example, grants income represents a forecast of $2.5 million per annum (on average in nominal terms), compared to a historical average of $3.0 million

23 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.

24 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.

25 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.

26 Clare and Gilbert Valleys Council, *Long Term Financial Plan 2024-25 to 2033-34,* July 2023, p.5.

27 Footnote 28 applies.

per annum.[28] In addition, 'materials, contracts and other' expenses are forecast to increase by an average of 1.9 percent per annum from 2023-24 to 2032-33.

Overall, this would reflect contained growth, below forecast inflation. While this is a positive trend, it is not clear what the Council is intending to do differently that is driving this improvement. It is also noted that the Council's long-term outlook to improve financial sustainability relies on both continued cost constraint and growth in operating income.

The Commission has observed some good practices of the Council, which states that it is focused on operating a balanced or breakeven budget over a rolling 5-year period.[29] The Council also notes that there have been a number of factors that have recently impacted on its financial performance, notably the recent flood event and some major unscheduled maintenance items. With the Council's recent and forecast operating deficits, the Commission considers there may be some risk in its operating performance should further unforeseen events or major repairs and maintenance arise.

Overall, 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. The Commission recognises that the Council may be challenged by inflationary pressures and supply constraints (among other things) which have impacted on its financial performance in 2022-23. However, as part of its continuing review, it may now need find productivity improvements (to reduce any inflationary impact on its community) in the absence of reducing services levels or further increasing rates on the community. It may also need to consider additional selling of surplus assets, which will bring in cash and reduce future maintenance costs and depreciation. 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.

C.2 Net financial liabilities

Despite the Council's frequent operating deficits from 2012-13, its net cash flows after operating and investing (that is, capital-related) activities have averaged $0.7 million annually between 2012-13 and 2021-22. These are the cash flows generally available for debt repayments (and are after interest payments) and are different to the chart over the page which shows cash held by the Council at the end of each year, including financing activities, which has averaged $7.8 million.

The Council has historically used borrowings from the Local Government Finance Authority of South Australia (**LGFA**) to fund its capital expenditure. However, it has not used debt (as a large funding source) over the period 2012-13 to 2021-22, and instead has made progressive debt repayments totalling $9.2 million over the same period.[30] In 2022-23, the Council has reported it had borrowed $1.4 million, which was provided as 'loans to community groups:, the Commission notes that this community support (while it does not represent a major financial impost) was not previously included in any of its plans.

The Council's net financial liabilities ratio has trended between 15.2 and negative 16.6 percent between 2012-13 and 2021-22 (see the bottom left chart below).[31] Since 2015-16, this ratio has been below zero, which is also below the suggested LGA target range for the indicator of between zero and 100 percent (averaging negative 10.8 percent over the period between 2015-16 to 2021-22). When viewed in isolation, the ratio is at a level which demonstrates the Council has the financial capacity where its

[28] Based on the Council's Excel Financial Reporting template provided to the Commission. Historical average is based on the 11-year period from 2012-13 to 2022-23; and forecast average is based on the 10-year period from 2023-24 to 2032-33.

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

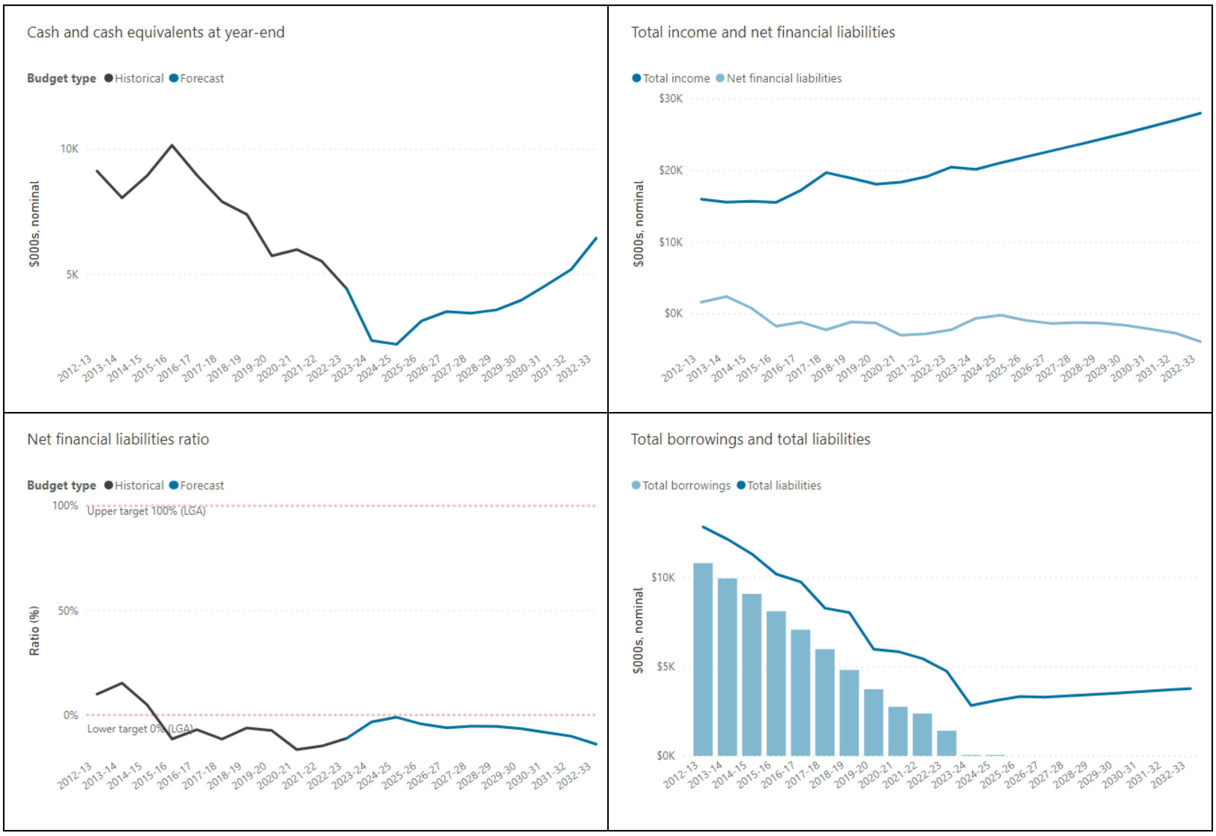
[30] Based on the Council's Excel Financial Reporting template provided to the Commission.

[31] The net financial liabilities ratio is defined as: Net financial liabilities ÷ Total operating income. This ratio measures the extent to which a council's total operating income covers, or otherwise, its net financial liabilities. The suggested LGA target range is between zero and 100 percent of total operating income, but possibly higher in some circumstances (LGA SA Financial Indicators Paper, pp. 7-8).

operating income can cover its net financial liabilities (see the right chart below). However, when viewed in the context of the Council's historical and forecast operating deficits, and potentially any upward revisions to asset valuation and depreciation,[32] this suggests it is at risk of being unsustainable.

In its 2023-24 LTFP the Council has forecast that the ratio will continue to be below zero, that it will have negligible borrowings by 30 June 2025, and that it will not take on additional borrowings from the period 2025-26 onwards (see the right chart over the page).

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 (an average of 3.7 percent per annum) and an accumulation of cash balances ($6.4 million is estimated by 30 June 2033). 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 fund any additional renewals of its infrastructure, as appropriate.



Based on discussions with the Council, the Commission notes the Council's conservative budgeting practices, for example through targeting breakeven operating balance, and regular repayment of its borrowings. However, its higher operating cost base as well as the need for further asset reviews means that there is some uncertainty to its sustainability, especially in the short to medium term. Further, the Commission has not undertaken benchmarking of the Council's costs, for example considering its unique geographic or economic circumstances (such as being in a regional area that is recognised as a tourist destination or having a higher proportion of primary production ratepayers), and has only considered the Council's own historical and forecast trends.

In the context of its financial capacity and considering the substantial repayment of borrowings the Council has made over the last 10 years, it may be in a position (in the medium to longer-term) to utilise

32 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.

accumulated cash reserves to address any changes to its asset renewal expenditures or repairs and maintenance programs, as appropriate.

C.3 Asset renewals expenditure

The Council has, on occasions, underperformed on its asset renewal funding ratio,[33] particularly in the three years between 2014-15 to 2016-17, but overall, it has achieved an average of 96 percent over the 10-year period between 2012-13 and 2021-22,[34] (see the top charts over the page). This signifies that the Council has, in some periods, underspent on the renewal and rehabilitation needs of its asset stock over this period, but in other periods has undertaken additional works above what its infrastructure and asset management plans had forecast. Historically, over the last 10 years, the Council's spending on renewal and rehabilitation of its assets has averaged $4.3 million each year.

From 2023-24 to 2032-33, the ratio is forecast to average 105 percent, reflecting the additional renewal expenditure brought forward to 2023-24 resulting from the deterioration of some of the Council's assets due to a recent flood event as well as associated with some major unscheduled maintenance items.[35] Average annual spending on renewal or rehabilitation of assets is projected to $6.1 million (in nominal terms). Typically, the Council's transport asset renewals (covering road, footpaths, and bridges) represent the majority of its asset renewal expenditure program, and in the 2023-24 budget transport assets will reflect approximately 64 percent of total asset renewals.[36]

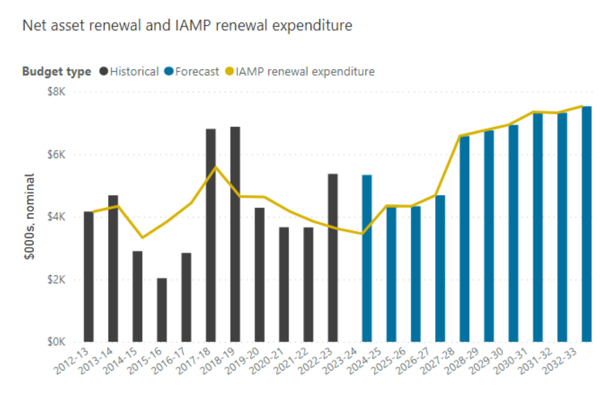
The Council has reduced its asset base over the past 10 years notwithstanding total capital expenditure averaging $5.5 million per annum (including $1.2 million per annum on new or upgraded assets) between 2012-13 and 2021-22 (see the bottom right chart below). The Commission notes the reduction is also affected by Council's asset disposal program (and associated fair value adjustments), including impairments in its asset revaluation reserve;[37] however, the Council's asset base had already declined in the earlier period between 2012-13 to 2016-17. Overall, this has led to a small average decline in the value of the asset stock per property of -$371 or 1.6 percent for each year over the 10 years to 2021-22 (see the bottom left chart below).

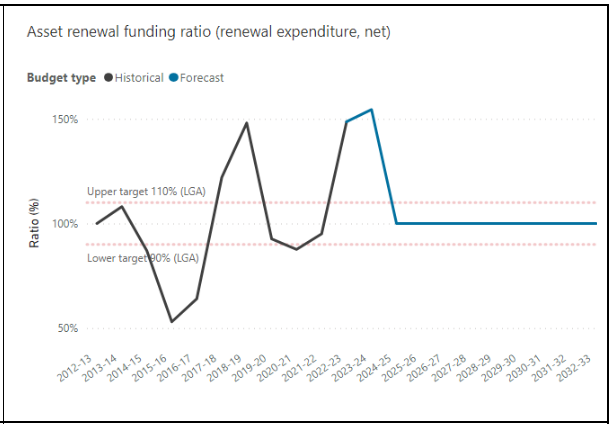
Based on discussions with the Council, it has experienced significant increases in construction costs, and supply and labour constraints has impacted on the region. Furthermore, the Council has recognised that its historical capital spending profile and weather events have increased the volatility of its historical asset renewal funding ratio, however, is also seeking to undertake asset reviews to ensure it maintains its service levels to the community.

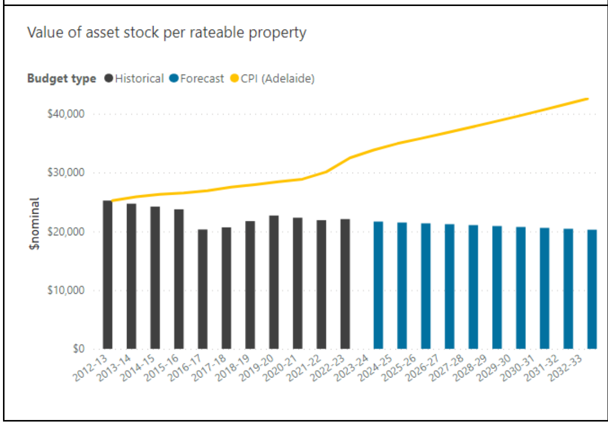
Against this background, the Commission considers that it would be appropriate for the Council to:

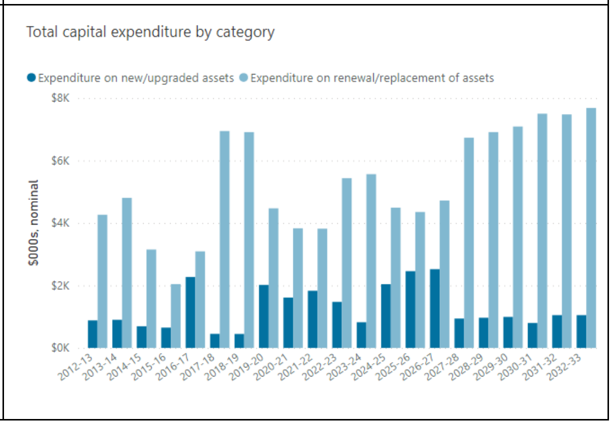
5. Continue to review its capital expenditure program annually in its asset management plans and consider options to better align the assumptions underpinning the expenditure allocations (and timing) with its long-term financial plan.

[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). 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'.
[35] Clare and Gilbert Valleys Council, *Long Term Financial Plan 2024-25 to 2033-34,* July 2023, p.9.
[36] Clare and Gilbert Valleys Council, *Annual Business Plan 2023-24,* July 2023, p.33.
[37] In 2020-21 and 2021-22 the Council recorded an impairment expense of $1.2 million and $0.6 million, respectively, and are predominantly associated with roads, footways and kerbing assets. Clare and Gilbert Valleys Council, *Annual Report 2021/2022*, p. 55, available at https://www.claregilbertvalleys.sa.gov.au/__data/assets/pdf_file/0029/1255844/Annual-Report-2021-2022.pdf.









Asset renewals can also be evaluated by the depreciation-based asset renewal funding ratio,[38] which is projected to track below the recommended minimum level (for the IAMP-based ratio) of 90 percent, averaging 80 percent per annum to 2032-33 (see the right chart below). However, towards the later part of the forecasts (from 2027-28 to 2032-33), the Council is increasing its asset renewal spending. It is important to understand the extent to which the depreciation values reflect the current cost of the assets, and it is not clear to the Commission whether this is the case in the Council's plans, and if it will have a negative impact on this ratio.

In the context of the Council's historical volatility in its IAMP-based asset renewal funding ratio, and its assessment of higher depreciation (which is contributing to 30 percent of total operating costs in 2022-23),[39] there may be some 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 completely 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

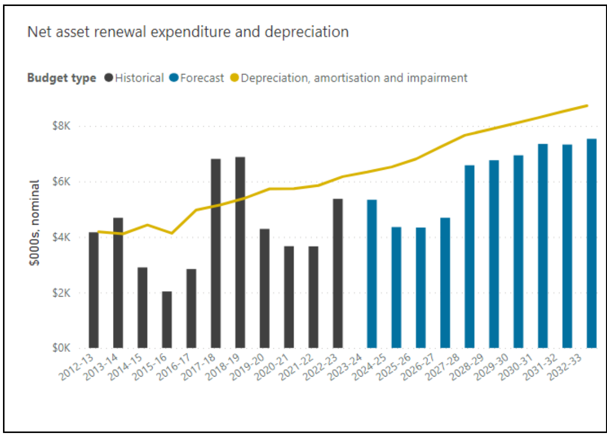
38 The Council's asset renewal funding ratio by the depreciation-based method (where asset renewal/replacement expenditure is divided by depreciation expenses). This ratio shows the extent to which capital expenditure on the renewal and replacement of assets matches the estimated rate at which these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

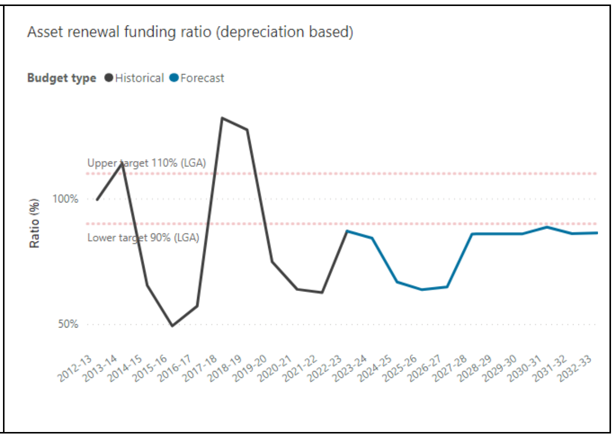
39 Based on the Council's 2022-23 unaudited estimates reported to the Commission in an Excel template.

- the Council may not be renewing its assets at a pace indicated by the rate of asset consumption.

For these reasons, the Commission considers that it would be appropriate for it 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.





The Council currently has individual AMPs for transport, buildings and structures, stormwater and CWMS assets. These cover most of the Council's asset base with transport (roads, footways, kerbing and bridges), and buildings and structures representing approximately 76 percent of the total carrying value of all its assets as of 30 June 2022.[40] The Council's remaining asset classes includes land and improvements (11 percent), CWMS (6 percent), stormwater drainage (3 percent), Plant, machinery and equipment (3 percent), and other minor assets (1 percent).

In formulating its AMPs, the Council has considered a number of matters such as community and technical levels of service, utilisation and demand of its assets, condition assessments, standards of construction, renewal and maintenance for roads, and risk management. These matters have informed the Council's planned operating and maintenance budgets, and asset renewal needs over the period to 2028-29.

The Commission notes that the valuations of these assets were mostly carried out some time ago, for example:[41]

- Stormwater drainage and CWMS, valued as at 1 July 2017
- Roads, footpaths and kerbing, valued as at 1 July 2018
- Building and other structures, valued as at 1 July 2019
- Bridge infrastructure, valued as at 1 July 2021

Further, the Council's AMPs (for example for transport assets) indicate that they were developed in 2016, based on 2010 field assessments, and updated annually thereafter. In September 2016, a major flood event damaged its road network and during 2017-18 when repair works were substantially

[40] Clare and Gilbert Valleys Council, *Annual Report 2021/2022*, p. 73, available at https://www.claregilbertvalleys.sa.gov.au/__data/assets/pdf_file/0029/1255844/Annual-Report-2021-2022.pdf.
[41] Ibid, p. 76.

completed the Council reinspected the road condition in early 2018, with cross drains, floodways and bridge inspections ongoing.[42]

The AMPs were scheduled for an update in 2022, following the next full asset revaluation, but this does not appear to have occurred. The Commission encourages the Council 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.[43]

In general, the Commission's review of the AMPs (along with discussions with the Council) has found that, on balance, the Council's strategic planning processes are appropriate; however further updates on its asset valuation and condition assessment may now be needed. In addition, improved disclosure on how its renewal, operating, and repairs and maintenance expenditure forecasts (included in its AMPs) align with the LTFP will add further credibility to the Council's asset management planning.

Against this background, the Commission considers that it would be appropriate for it to:

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

42 Clare and Gilbert Valleys Council, *Infrastructure Asset Management Plan – Transport (13 May 2020)*, p. 5, available at https://www.claregilbertvalleys.sa.gov.au/__data/assets/pdf_file/0031/722938/Infrastructure-Asset-Management-Plan-Transport.pdf.
43 LG Act s122(4)(a) and (b). General elections were last held for SA Councils on 11 November 2022.

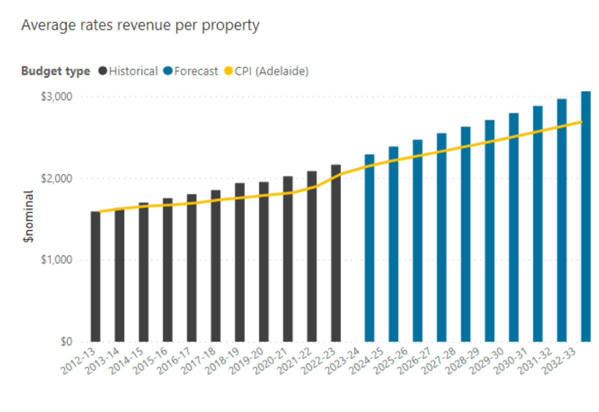
D Current and projected rate levels

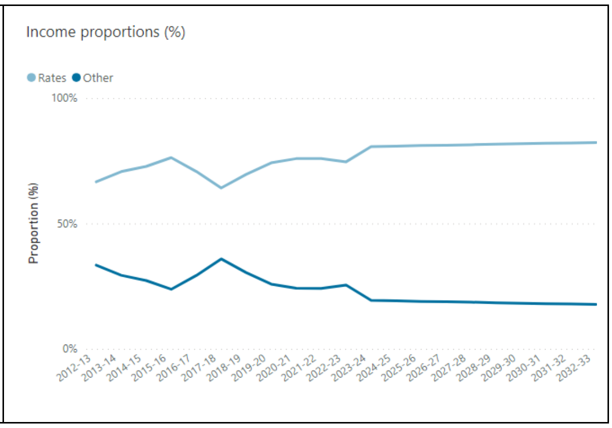
D.1 Historical rates growth

The Council's rate revenue per property growth has averaged 3.0 percent or $55 per annum for each property over the past 10 years,[44] reaching an estimated $2,085 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, but also encompasses negligible average annual growth in rateable property numbers of 0.4 percent per annum, representing a real term increase in rates.[45] Current rate levels partially reflect its recent history of spending growth, particularly operating expenses growth which has trended above CPI growth.

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 81 percent of budgeted operating income in 2023-24 (and thereafter), compared with 67 percent of income in 2012-13.

The Commission notes that the Council has average rate levels compared to similar councils, however this also reflects its relatively low rate-levels for non-residential categories (compared to Statewide averages), and average rates for residential ratepayers.[46]





D.2 Proposed 2023-24 rate increases

The Council has budgeted for an average rate increase of 5.8 percent or $126 per property for its existing ratepayers in 2023-24,[47] higher than anticipated for this year in its 2022-23 LTFP projections (that is, a 4.3 percent increase in rate revenues was previously forecast for 2023-24, whereas currently the Council is forecasting a 7.0 percent increase in rate revenues).

The rate revenue increase reflects higher short-term inflation (estimated by the Council to be 7.9 percent for the quarter ended 31 March 2023), and cost pressures associated with employee costs and in fuel, materials and contractors.[48] The Council has also assumed property growth in the area will be minimal[49] (continuing at approximately 0.7 percent per annum, based on the last five years historical

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44 From 2012-13 to 2021-22.

45 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.

46 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 one indicator, among many, which has informed its advice on the appropriateness of the rate levels.

47 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 $16.222 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.

48 Clare and Gilbert Valleys Council, *Annual Business Plan 2023-2024,* July 2023, p.9.

49 Clare and Gilbert Valleys Council, *Annual Business Plan 2023-2024*, July 2023, p. 26.

average), and is not an important determinant in 2023-24 rates revenue (including for its long-term forecasts).

Different rate categories are subject to varying changes, with residential ratepayers to pay a lower increase of 4.8 percent or $104 per property on 2022-23 levels. Primary production ratepayers (i.e., agriculture, livestock, horticulture, and commercial forestry) are budgeted to pay the largest increase of 9.4 percent or $234 per property. The Commission notes that these ratepayers are otherwise on relatively lower differential rates,[50] and the Council has budgeted to maintain this relative rates burden between residential and primary production ratepayers from year to year.[51]

On a proportional revenue basis, primary production ratepayers account for around 48 percent of 2023-24 budgeted rates revenue, followed by residential ratepayers (41 percent), and commercial ratepayers (6 percent). On a capital valuation basis (in 2023-24), primary production land use represents 63 percent of the aggregate capital value in the Council area,[52] despite the relatively lower rate contributions (as a group) than residential ratepayers.

Other than 'general rates' revenue (which represents around 82 percent of total rates revenue in 2022-23),[53] the Council collects income from the CWMS charge, waste collection,[54] and the Regional Landscape Levy (around 8, 6 and 3 percent of total rates revenue respectively).

D.3 Projected further rate increases

Over the forward years of its LTFP, the Council is projecting average rates increases for its existing ratepayers of approximately 3.3 percent per annum from 2023-24 to 2032-33. On a rate revenue basis, the Council has included an additional 1.5 percent on top of CPI for the life of its LTFP,[55] reflecting the Council's consideration of its future financial sustainability as well as the community's capacity to pay.

In total, the LTFP effectively projects a cumulative increase of $771 per existing ratepayer (to $3,060 per annum) by 2032-33, consistent with the Council's assumed inflation growth over this period and its relatively low growth in rateable properties (of approximately 0.7 percent per annum). The projected rate increase per rateable property is above the RBA-based inflation forecast of an average of 2.6 percent per annum[56] (refer to the previous page chart on the left side).[57]

As a result of further rates increases, the percentage of the Council's total income contributions from ratepayers is projected to average around 82 percent, compared to a historical average of around 72 percent.

D.4 Affordability risk

The community affordability risk for these further rate increases appears to be moderate, on balance, considering:

50 Rate in the dollar applied to the capital value of the property in the Council area. Clare and Gilbert Valleys Council, *Annual Business Plan 2023-24,* July 2023 p. 30.
51 Clare and Gilbert Valleys Council, *Annual Business Plan 2023-2024*, July 2023, p. 28.
52 Clare and Gilbert Valleys Council, *Annual Business Plan 2023-24,* July 2023, p. 27.
53 Before discretionary rebates.
54 The Commission notes the increase in the solid waste levy over the last 10 years, which has impacted waste management costs in the local government sector.
55 The Council's assumed CPI projections are based on the May 2023 economic report from the RBA to June 2025 with a longer-term projection toward the higher end of the RBA's 2 – 3 percent target range. Clare and Gilbert Valleys Council, *2023-24 Long Term Financial Plan,* July 2023, p. 5.
56 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.
57 The CPI forecasts in the chart are based on RBA forecasts and then a return to long term averages (2.5 percent per annum), which are different to Council's inflation forecasts (as was discussed in section B.1).

- the Council's relatively high socio-economic indexes for areas (**SEIFA**) economic resources ranking for the Council area,[58]
- the current relatively average rates (across most ratepayers) without further forecast increases above inflation,
- the Council's differential rating policy applying to primary production ratepayers which are on relatively lower rates on a capital value basis (compared to residential ratepayers),
- little evidence of community concerns on affordability (based on the three written submissions received),[59] and
- the effect of cumulative increases in rates per existing ratepayer of approximately 3.3 percent per annum to the period 2032-33, above the forecast rate of inflation.

Affordability risk can also be viewed in the context of the Council's financial sustainability risks, evident from the Council's forecast operating deficits (to 2028-29), uncertainty around the valuation of its assets and needed 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.

As the current economic environment is putting more pressure on many communities' capacity to pay, including those of the Council, the Commission considers 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.

[58] The Clare and Gilbert Valleys Council area is ranked 51 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 (eg, 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.

[59] 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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