ESSENTIAL SERVICES COMMISSION OF SOUTH AUSTRALIA

Advice

Local Government Advice

District Council of Karoonda East Murray

February 2024

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District Council of Karoonda East Murray

AT A GLANCE

OVERVIEW

The Essential Services Commission finds the District Council of Karoonda East Murray's current and projected financial performance **mostly sustainable** taking into account the council's forecast moderate expense growth increase over the next ten years and the planned average rate increases of 4% p.a. per property over this period

RISKS IMPACTING SUSTAINABILITY

- If forecast growth in cash reserves does not eventuate, and the Council's grant revenue (proportionally) decreases, or is delayed, a greater burden of 'revenue shifting' will move to ratepayers
- Low forecast average expense growth of 2.5% p.a. is not realised, and realised expense growth is more in line with historical figures of 6% p.a.
- If rateable property numbers as a result of farm consolidation continues to reduce, part of the Council's revenue base (rates) and the operating surplus will be at risk

CONTINUE

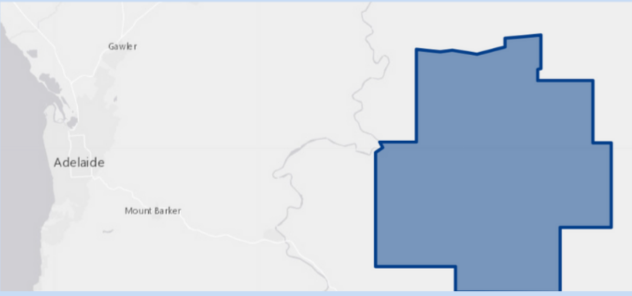
- Reviewing rateable property growth forecasts in the budget projections each year
- Monitoring the growth in expenses in its budgeting
- Reviewing the extent of cash reserve forecast in the context of the financial sustainability outlook

COMMISSION'S RECOMMENDATIONS

- Improve the transparency around assumptions and state explicitly the basis for preparation of annual business plans, budgets and the long-term financial plan
- Provide a version of the long-term financial plan in nominal terms when developed in real terms, for the benefit of ratepayers
- Report any actual cost savings in its annual budget and long-term financial plan
- Include efficiency goals and projected cost savings in its long-term financial plan
- Review the estimates of asset lives (and valuations) informing its forecast rate of asset consumption (and depreciation expenses) and asset renewal needs in the long-term financial plan and asset management plans
- Improve the transparency of its rate projections and associated indexation assumptions in its long-term financial plan

KEY FACTS

- Population in 2021 was **1,007**
- Council covers **4,415 square kilometres**
- **1,120** rateable properties in 2022-23
- **$1.9 million of rate income** in 2022-23
- Value of assets held in 2022-23 equals **$48.3 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	District Council of Karoonda East Murray
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 District Council of Karoonda East Murray

The Essential Services Commission (**Commission**) finds the District Council of Karoonda East Murray's (**Council**) current and projected financial performance is **mostly sustainable,** with historical surpluses achieved over most of the past 10 years and small surpluses forecast over the medium and long term. The Council's projected improvement to its financial performance is reliant on continued rate increases above inflation, and on achieving a lower cost growth than it has achieved in the past. The Council will continue to rely on grants income (its largest source of income) and rate contributions, to achieve forecast surpluses, but it is also forecasting to accumulate cash reserves that can be used to mitigate any unexpected increases in expenses or decreases in revenue.

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 considers it important for the Council to ensure that it continues to budget prudently, manages its cost base efficiently, reviews the extent of its cash reserves, and plan its asset needs appropriately.

Reporting

1. **Improve** the transparency around assumptions and state explicitly the basis for preparation of annual business plans, budgets and the long-term financial plan.
2. **Provide** a version of the long-term financial plan in nominal terms, when developed using real terms, for the benefit of ratepayers.
3. **Continue** its good practice of reviewing the rateable property growth forecasts in its budget projections each year to ensure that they remain current, and do not create a need for additional rate increases to generate the same level of projected revenue.

Provide evidence of ongoing cost efficiencies

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

Budgeting

6. **Continue** to monitor the growth in expenses in its budgeting, especially with regard to 'materials, contracts and other' expenses.

Level of cash reserves

7. **Continue** to review the extent of cash reserves forecast in the context of its financial sustainability outlook.

Refinements to asset management planning

8. **Review** the estimates of asset lives and valuations (including roads) informing its forecast rate of asset consumption (and depreciation expenses) in its long-term financial plan and infrastructure asset management plans.

Transparency of rate projections

9. **Improve** the transparency of its rate projections and associated indexation assumptions in its long-term financial plan, to enable comparisons across different planning periods.

2 About the advice

The Essential Services Commission (**Commission**), South Australia's independent economic regulator and advisory body, has been given a role by the Parliament to provide advice on material changes proposed by local Councils in relation to elements of their strategic management plans (**SMPs**) and on the proposed revenue sources, including rates, which underpin those plans.[1]

One of the main purposes of the Local Government Advice Scheme (**advice** or **the scheme**) is to support Councils to make 'financially sustainable' decisions relating to their annual business plans and budgets in the context of their long-term financial plans (**LTFPs**) and infrastructure and asset management plans (**IAMPs**)[2] – both required as part of a Council's SMP.[3] Financial sustainability is considered to encompass intergenerational equity,[4] as well as program (service level) and rates stability in this context.[5] The other main purpose is for the Commission to consider ratepayer contributions in the context of revenue sources, outlined in the LTFP.[6] In addition, the Commission has discretion to provide advice on any other aspect of a Council's LTFP or IAMP it considers appropriate, having regard to the circumstances of that Council.[7]

The first cycle of the scheme extends over four years from 2022-23 to 2025-26, and the Commission has selected 17 Councils for advice in the second scheme year (2023-24), including the District Council of Karoonda East Murray (**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 providing relevant information, as well as meeting and engaging with Commission staff to assist the Commission in preparing this advice.

2.1 Summary of advice

The Commission finds the Council's current and projected financial performance is **mostly sustainable,** with historical surpluses achieved over most of the past ten years and with small surpluses forecast over the medium and long term.

The Council's projected improvement to its financial performance is reliant on continued rate increases above inflation and achieving a lower cost growth than what it has achieved in the past. The Council will continue to rely on grants income (its largest source of income) and rate contributions, to achieve forecast surpluses.

Historically, more than half of the Council's total income came from 'Grants, subsidies and contributions' (56 percent in 2021-22).

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).

The Council may face challenges arising from factors such as its remoteness, lower rates base, supply constraints and inflationary pressures (among other things), which have the potential to materially change its financial performance from year-to-year. Farm consolidation has also slowed the growth in rateable properties in the Council's area, with no growth factored into the Council's 10-year forecast. If this trend continues and the number of rateable properties was to reduce in the Council's area, this would likely reduce the Council's revenue.

Given those factors, if the Council is unable achieve its projected surpluses and cash reserves, it could be at risk of becoming unsustainable, potentially risking having to forecast operating deficits (in the short term). The surpluses and cash reserves that the Council is forecasting, if they can be achieved, will help it mitigate unexpected increases in expenses or decreases in revenue.

The Council's forward projections from 2023-24 forecast a gradually improved financial sustainability outlook with the rate of operating revenue growth set to outpace expense growth, through:

- continued rate increases on the community, above the rate of the Reserve Bank of Australia (RBA)-based forecast inflation,
- lower average cost growth than it has experienced over the past 10 years, and
- the continued prioritisation of its asset spending away from new and upgraded assets moving more towards renewal and rehabilitation capital works projects.

The Commission notes that Council has implemented (in recent years) efficiencies and cost saving measures along with a focus of continuous improvement, which the Commission considers as good practice. In addition, it has developed a financial strategy that aims to return Council to an operating surplus in the 2024-25 financial year and each year thereafter, albeit noting that will involve above CPI rate increases for each year of its 10-year forecast.

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 2022-23 plans), its financial sustainability (in the context of its long-term operating performance, net financial liabilities, and asset renewals expenditure), and its current and projected rate levels.

In providing this advice, the Commission has followed the approach it previously explained in the Framework and Approach – Final Report (F&A). The attachment explores these matters further.[10]

2.2.1 Advice on material plan amendments in 2023-24

Key Points:

⚠ The long-term financial plan is prepared in real terms, meaning the presentation of its financial forecasts do not incorporate inflation expectations. Therefore, the implications that this may have for ratepayers may be less transparent.

10 The attachment will be available on the Commission's website with the Advice.

⚠ The Council could make its macro-economic or operating assumptions more explicit, including forecasts for CPI, asset indexation, commodity prices, utility prices, and escalations in material contracts (among other things). As there may be uncertainty around various macro-economic variables, this may add further risk to the reliability of its financial plans.

The Council's 2023-24 LTFP includes increases to both its projected income and expenditure items to 2031-32, compared with the 2022-23 forecasts,[11] as follows:

- An additional increase in income of $9 million (19.4 percent) in total operating income and $8.7 million (18.9 percent) in total operating expenses.
- An increase of $2 million or 12 percent in capital expenditure on new and renewal of assets.

The Commission notes that, as the Council's published LTFP is in real terms (adjusted to not include inflation), its intentions on how it proposes to manage the impact of inflation and the implications this may have for ratepayers are less transparent. Also, the Council did not provide the inflation forecasts it used to convert its LTFP into nominal terms when providing the conversion to the Commission.

To provide some guidance on how the Council's 2024-23 LTFP forecasts for 2023-24 to 2032-33 income and expenditure compare relative to inflation, the Commission notes that the RBA currently forecasts the CPI (Australia-wide) to increase by 3.6 percent in the year to the June 2024 quarter, and by 3.1 percent in the year to June 2025. Thereafter, it is reasonable to anticipate a return to long-run averages (and average growth of 2.6 percent per annum from 2024-25 to 2032-33, based on the RBA's 2 to 3 percent target range).[12] The subsequent sections have regard for this as relevant.

While the Council may wish, for its own purposes, to identify real-term changes only in its financial planning, the meaning of this may not be transparent to all its ratepayers. This is because it need not highlight the council's estimate of the nominal rates and charges, which would be more indicative of the Council's expectations of the community's contribution toward its income. Given this, and the objective of open and transparent consultation, there would be benefit in utilising nominal terms when publishing the LTFP, and to clearly identify all indexation and inflation assumptions used. This will likely provide a more meaningful context to the community regarding the Council's expectations with respect to rates and charges and allowing for improved community input regarding their expectations of the Council with respect to cost control and service levels.

In general, and notwithstanding the need for the Council to endeavour to find savings and reduce any inflationary impact on its community, the Commission recommends that the Council:

1. Improve the transparency around assumptions and state explicitly the basis for preparation of annual business plans, budgets and the long-term financial plan.
2. Provide a version of the long-term financial plan in nominal terms, when developed using real terms, for the benefit of ratepayers.

The Commission notes that the Council could make its macro-economic or operating assumptions more explicit; for example, this could include forecasts (as applicable) for CPI, asset indexation, commodity prices, utility prices, and escalations in material contracts (among other things). As there may be uncertainty around such macro-economic variables, this may add further risk to the reliability of

[11] The overlapping forecast period in both LTFPs (2021-22 to 2030-31 and 2023-24 to 2032-33).
[12] RBA, Forecast Table - November 2023, available at: https://www.rba.gov.au/publications/smp/2023/nov/economic-outlook.html.

its financial plans: transparency as to those assumptions would therefore aid both decision-making and community understanding.

2.2.2 Advice on financial sustainability

Operating performance

Key Points:

- Operating surpluses were recorded in eight of the 10 years between 2012-13 and 2021-22, and the operating surplus ratio is forecast to meet the suggested LGA target range in nine out of ten years to 2032-33.

- From 2012-13 to 2021-22, operating expenses increased by an average of 6 percent per annum, and operating income increased by an average of 5.5 percent per annum, which compares to annual inflation growth of 2.0 percent over this period.

- The estimated rate of growth in the average total operating expense (for the 10 years to 2032-33) is lower than the estimated rate of growth for total income for the same period. The Council is forecasting that it will remain in surplus each year from 2024-25 to 2032-33, with an annual average operating surplus ratio of 2.4 percent.

The Council has recorded eight operating surpluses[13] between 2012-13 and 2021-22, and the operating surplus ratio[14] is forecast to meet the suggested LGA target range in nine out of ten years to 2032-33.

From 2012-13 to 2021-22, operating expenses increased by an average of 6 percent per annum and operating income increased by an average of 5.5 percent per annum, which compares to annual inflation growth of 2.0 percent over this period.[15]

The Council's operating expense growth (from 2012-13 to 2021-22) was primarily due to an average annual increase in employee costs of 7 percent, and a 6.6 percent increase in 'materials, contracts and other' expenses.[16] The estimated rate of growth in those expenses projected over the next 10 years (an average of 2.6 percent per annum for each category previously mentioned), combined with higher rate increases, will help the Council's operating performance remain in surplus.

Rates revenue has increased on average by 6.1 percent per annum from 2012-13 to 2021-22 (when rateable property growth averaged just 0.1 percent and CPI growth averaged 2.0 percent). Over the same period, user charges' (accounting for 5 percent of total operating income) increased by an average of 18.8 percent per annum.

In 2021-22, more than half of the Council's total income came from 'Grants, subsidies and contributions' (56 percent). For the 10 years to 2021-22, 'Grants, subsidies and contributions' also contributed more than half of the Council's total income (the annual average contribution was 59 percent).

The Council receives various grants, subsidies and contributions from the state and federal government. The federal assistance grant (**FAG**) is typically the largest grant the Council receives each year. In the 5 years to 2021-22, the FAG contributed around 55 percent of total grant revenue. The FAGs

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

14 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).

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

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).

are untied grants that help councils provide services to their communities. The FAGs are legislated, providing some level of certainty to councils, although the amount and timing of receipt of the grant is not consistent.

Not all grants provide a stable and predictable level of income for the Council. Given the small size of the Council, if its grants income was reduced or delayed, then it risks a greater burden of revenue shifting to existing ratepayers in order to achieve operating surpluses. The Commission notes that the Council has identified its dependence on recurring grant income, in particular FAGs, supplementary local road funding, and roads to recovery funding, as a risk.[17]

The Commission notes that, should the risk eventuate, the Council may not have sufficient assets with a resale value that could be sold. It does, however, have cash reserves that could absorb some of the impact. The Council is forecasting its cash balance to increase year on year to reach $2.9 million in 2032-33 (from $114,000 in 2023-24). The cash reserves provide the Council with the flexibility to address unexpected increases in expenses, or decreases in revenue.

However, if the forecast growth in cash reserves does not eventuate, and the Council's grant revenue decreases or is delayed, it risks a greater burden of revenue shifting to its ratepayers in order to achieve operating surpluses.

Looking ahead, the Council is projecting total income growth of 3.2 percent to 2032-33, with average annual rates growth of 4 percent for the same period. This forecast is underpinned by a financial strategy that returns Council to an operating surplus in the 2024-25 financial year. The strategy was developed in response to the Council recording two operating deficits in the five years to 2021-22, and forecasting a small deficit in 2022-23. The key plank in this strategy is to levy a 3 percent plus CPI increase in rate revenue for each of the years ending 30 June 2024 and 30 June 2025, 2 percent plus CPI for the year ending 30 June 2026, and 1% above CPI for each year thereafter.[18]

Combined with a more disciplined approach to cost control, and the Council's focus on savings and efficiencies, this strategy will also help the Council increase its cash and cash equivalent balance that is forecast to increase from $114,000 in 2023-24 to $2.3 million in 2032-33, an annual increase of 40 percent for this time.

Income from 'Grants, subsidies and contributions' is also forecast to increase at 2.6 percent to 2032-33. Total income growth and average annual rates growth are forecast to increase above forecast long-term inflation.[19]

Lower forecast average expense growth of 2.7 percent per annum is slightly above the RBA-based forecast inflation growth[20] and lower than the Council's past performance (with average annual growth of 6 percent in the 10 years to 2021-22).

The Council's template data provided to the Commission shows that employee numbers are assumed constant at current levels (16 FTEs), and its employee expenses are forecast to increase by an average of 2.6 percent per annum from 2023-24 to 2032-33. In addition, 'Materials, contracts and other' expenses and costs for depreciation are forecast to increase by an average of 2.6 percent and 2.9 percent per annum respectively, from 2023-24 to 2032-33.

The estimated rate of growth in the average total operating expense (for the 10 years to 2032-33) is lower than the estimated rate of growth for total income for the same period. The Council is forecasting that it will remain in surplus each year from 2024-25 to 2032-33, with an annual average operating surplus ratio of 2.4 percent - below the Council's past performance (with an average operating surplus ratio of 7.7 percent in the 10 years to 2021-22).

[17] District Council of Karoonda East Murray, *2024-33 long-term financial plan* June 2023, page. 9.

[18] District Council of Karoonda East Murray, 2024-33 *long-term financial plan* June 2023, page. 3.

[19] 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.

[20] Footnote 23 applies.

Total expenses per property (a metric which accounts for growth) are expected to increase by an average of 2.7 percent per annum over this period, which would represent a slight cost increase in real terms (based on current inflation projections). At the same time, average total income per property is forecast to increase by 3.2 percent (nominally), above the forecast inflation.

The Commission notes that historically, the Council area has experienced farm consolidation in its area helping to slow the growth in rateable properties (rateable property growth was 0.1 percent in the 10 years to 2021-22). If this trend were to continue, it risks both metrics previously mentioned increasing, and a greater burden of revenue shifting to its remaining ratepayers in order to achieve operating surpluses. The Commission notes that the Council has adopted a conservative approach, and is forecasting no growth in rateable properties in the 10 years to 2032-33. The Commission notes the Council's good practice of reviewing its rateable property forecast annually and encourages the Council to:

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

These projections highlight the importance of the forecast growth in expenses and income. The small increase in expenses per property in real terms is reliant on the Council's disciplined approach to cost control. The Council has implemented (in recent years) efficiencies and cost savings, along with a focus of continuous improvement which the Commission considers to be good practice.

By way of example, the Council has reduced its reliance on sub-contractors by bringing certain functions, such as assessing transport permits, back in-house. Cross-council collaboration has also been an increased focus, with equipment, skill and resource sharing a regular occurrence. The Commission notes, for example, that the Council is using the neighbouring Berri Barmera Council's equipment to repair local bitumen roads.[21]

The Commission notes that the various cost savings and efficiency strategies implemented have helped the Council reduce its 'materials, contract and other' expenses by 13 percent from 2020-21 to 2021-22. To ensure the Council is positioned to achieve further cost constraint that it has forecast, and improve its operating performance (without the need for further rate increases above inflation), the Commission encourages it to:

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

5. **Include** efficiency goals and projected cost savings in its long-term financial plan, to provide further evidence of projected cost growth constraint and efficiencies across its operations and service deliveries.

As noted above, the Council's remoteness, lower rates base, supply constraints and inflationary pressures (among other things) may give rise to material changes in its financial performance from year-to-year. As such, the Commission considers it would be prudent for the Council to mitigate any risk to its ratepayers through monitoring of its expenses (such as 'materials, contracts and other' expenses), and seeking to find productivity improvements, where possible, to achieve its planning assumptions and to reduce the need for further rate increases above CPI. Therefore, the Commission has found that it would be appropriate for it to:

6. **Continue** to monitor the growth in expenses in its budgeting, especially with regards to 'materials, contracts and other' expenses.

[21] District Council of Karoonda East Murray, *Council Agenda, Monday 22 January 2024 pp 9 &10 available at* https://www.dckem.sa.gov.au/__data/assets/pdf_file/0028/1531297/23-January-2024-Council-Agenda-Public.pdf

Net financial liabilities

Key Points:

- ⚠ The net financial liabilities ratio has averaged negative 20 percent over the period from 2012-13 and 2021-22.
- ⚠ The Council has forecast that its net financial liabilities ratio will remain negative in nine out of the ten years for the forecast period to 2032-33, and remain below the suggested LGA target range, with an annual average forecast ratio of negative 22 percent.
- ✓ From 2012-13 to 2021-22, the Council had no borrowings, and is forecasting no borrowings each year to 2032-33.
- ✓ The forecast cash balance of $2.3 million in 2032-33 will provide the Council with the flexibility to manage inflation risk and address unexpected increases in expenses, or decreases in revenue.

The Council's net financial liabilities ratio[22] result was negative in nine out of the ten years from 2012-13 to 2021-22. The annual average over this period was negative 20 percent, which is outside the suggested LGA target range. The Council has forecast that its net financial liabilities ratio will remain negative in nine out of the ten years for the forecast period to 2032-33 and remain below the suggested LGA target range. The annual average forecast from 2023-24 to 2032-33 is negative 22 percent.

The Council uses a conservative funding strategy that does not involve utilising debt. From 2012-13 to 2021-22, the Council had no borrowings, and is forecasting no borrowings each year to 2032-33. The cash and cash equivalent balance is forecast to increase from $114,000 in 2023-24 to $2.3 million in 2032-33, an annual increase of 40 percent for this time.

The Council's negative net financial liabilities is forecast to increase from $0.61 million in 2023-24 to negative $2.7 million in 2032-33. Furthermore, the net financial liabilities ratio is forecast to reduce from 1 percent in 2023-24 to negative 38 percent in 2032-33. This is below the suggested LGA target range for this indicator of between zero and 100 percent.[23]

When viewed in isolation, the ratio is at a level which demonstrates the Council has the financial capacity where its operating income can cover its net financial liabilities. The ratio is mainly driven by its cash reserves and a conservative view of borrowings. Given the Council's reliance on grant funding sources (which can fluctuate from year-to-year), and to a lesser extent on its ratepayer base (of approximately 1,120 rateable properties in 2023-24) where there is limited capacity or scale in the region to raise further income, the Council's cash position could be viewed as prudent. The forecast cash balance provides the Council with the flexibility to manage inflation risk and address unexpected increases in expenses or decreases in revenue. Therefore, the Commission considers that it would be appropriate for the Council to:

7. **Continue** to review the extent of cash reserves forecast in the context of its financial sustainability outlook.

[22] 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).

[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).

Asset renewals expenditure

Key Points:

- Between 2012-13 and 2021-22, total capital expenditure averaged $2.2 million per annum (including $1.7 million on asset renewals and $0.5 million on new and upgraded assets).
- Between 2012-13 and 2021-23, the asset renewal funding ratio averaged 104%.
- The forecast asset renewal funding ratio over the next 10 years is projected to be 100%.

Between 2012-13 and 2021-22, the Council averaged 104 percent on its asset renewal funding ratio[24] (under the 'IAMP-based' approach),[25] signifying an appropriate level of spending on the renewal and rehabilitation needs of its asset stock over this period. The Council's spending on renewal and rehabilitation of assets averaged $1.7 million each year (over this period). From 2023-24 to 2032-33, the ratio is forecast to be within the appropriate range, at an average of 100 percent. Average annual spending on renewal or rehabilitation of assets is also projected to decrease to $1.5 million (in nominal terms) from 2023-24 to 2032-33.

From 2012-13 to 2021-22, the Council spent more on the renewal and rehabilitation of its existing assets stock ($1.7 million per year) than on new and upgraded assets ($0.5 million per year).

The expenditure on new and upgraded assets includes a portion of grant funding for certain projects. The growth in its asset base reflects a combination of capital expenditure and asset accumulation by the Council, as well as asset revaluations over this period. This has led to an average annual increase in the value of the asset stock per property of 3.7 percent over the 10 years to 2021-22. By implication, this indicates that the Council's asset stock has increased in real terms (or the increase is higher than historical inflation).

The Council's forward projections indicate that the value of the assets per property will decrease in the 10 years to 2032-33, by an average of 0.3 percent per annum: lower than the RBA-based forecast rate of inflation (2.6 percent per annum). The fall in the value of assets per property is likely due to the reduction in forecast expenditure in new and upgraded capital items and the infrequent revaluation of the council's asset base.

Asset renewals can also be viewed in the context of the depreciation-based asset renewal funding ratio,[26] which has generally tracked (on average) above the recommended minimum level (for the IAMP-based ratio) of 90 percent, over the period from 2012-13 to 2022-23, albeit the ratio showed significant volatility, historically.

According to the Council's 2021-22 annual report, infrastructure, property, plant and equipment had a carrying amount value of $45.2 million.[27] The Council's three largest asset classes contribute 84 percent of the Council's infrastructure, property, plant and equipment assets. Two of those asset classes (buildings and the CWMS) had an external valuation conducted in June 2021. As of 30 June 2022, the carrying amount for buildings was valued at $5 million or 11 percent of the total for infrastructure,

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

25 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'.

26 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.

27 District Council of Karoonda East Murray, *2021-22 annual report* June 2022, page. 21.

property, plant and equipment assets. The CWMS had a carrying amount of $3m or 7 percent as of 30 June 2022.

The Commission notes that sealed and unsealed roads is the Council's largest asset comprising $30.2 million or 66 percent of its infrastructure, property, plant and equipment assets. According to the Council's 2021-22 annual report, the last revaluation for roads occurred in July 2019. The Commission notes that the Council's depreciation expense in 2021-22 was $1.5 million of which $0.9 million was for roads (around 61 percent of the Council's total depreciation expense). An increase in the revaluation of roads could result in a higher depreciation charge which may require higher operating income (and potentially higher rates revenue) in order to generate an operating surplus for the Council. Therefore, in accordance with the Council's planned reviews, it would be appropriate for it to:

8. Review the estimates of asset lives and valuations (including roads) informing its forecast rate of asset consumption (and depreciation expenses) in its long-term financial plan and infrastructure asset management plans.

The Council aims to stage external asset condition assessments generally over a four-year cycle, and uses internal assessments on a regular basis (monthly for high-use assets) to assess asset conditions. These projections, as they stand, would contribute to the Council's sustainability into the future and reflect a period of asset and service consolidation. Nevertheless, the Commission notes that the Council's annual review of its LTFP will also need to incorporate further revisions to the asset value estimates.

According to its SAMP the Council has an IAMP for the following asset classes: sealed roads, unsealed roads, plant & equipment, community wastewater management system, buildings, structures & other.

The Council's IAMP was adopted in August 2023 and contains a breakdown of the assets within each respective asset class. The IAMP also includes 10 years of asset renewal projections, in alignment with Council's long-term financial plan.

The Commission's review of the SAMP and IAMP has found that the Council's strategic planning processes aligns with good practice for a Council of its size and complexity.

2.2.3 Advice on current and projected rate levels

Key Points:

- Rate revenue per property growth has averaged 6 percent or $71 per annum for each property between 2012-13 and 2021-22, which is 4.0% above CPI for the same period.
- The forecast rate increases per property from 2023-24 to 2031-32 are projected to be an average of 4.0 percent per annum or a cumulative increase of $799 over this period, which is meaningfully above the RBA-based inflation forecast of an average of 2.6 percent per annum.
- Affordability risk for further average rate increases appears to be moderate, based on a range of factors including:
  - the relative mid-range socio-economic indexes for areas (SEIFA) economic resources ranking for the Council area,
  - relatively low average rates,
  - no community concern via written submissions over further rate increases.

The Council's rate revenue per property growth has averaged 6 percent, or $71, per annum for each property over the past 10 years,[28] reaching an estimated $1,596 per property in 2021-22. This has exceeded CPI growth of an average of 2.0 percent per annum over this period, resulting in rates

[28] From 2012-13 to 2021-22.

increasing in real terms (but also encompassing 0.1 percent average annual growth in rateable property numbers).[29] Current rate levels partially reflect the Council's history of spending growth, predominantly on capital expenditure (on renewals, and new and upgraded assets), higher employee-related costs, and 'materials, contracts and other' expenses.

The Council's general rate revenue consists of single general rate (with a minimum rate) to capital valuations on all rateable properties within the council area. The Council applies a minimum rate, as it considers it appropriate that all rateable properties make a base level contribution to the cost of administering the Council's activities and to the cost of creating and maintaining the physical infrastructure that supports each property. The Council has increased the minimum rate for 2023-24 to $425 from $375 in 2022-23, or 13.3 percent.

The Council has budgeted for an average rate increase (for general ratepayers) of 12 percent, or $179, per property for its existing ratepayers in 2023-24.[30] The increase reflects higher short-term inflation along with the Council's financial strategy to meet a 3 percent plus CPI increase in rate revenue for the financial years ended 30 June 2024 and 2025, 2 percent plus CPI for the year ended 30 June 2026, and 1 percent above CPI for each year thereafter.[31]

Other than 'general rates' income, the Council also collects the Regional Landscape Levy, on behalf of Murrayland and Riverland regional landscape board, and is expected to collect $80,718 (net of rebates) in 2023-24.[32] In addition, the Council charges a service rate for Community Wastewater Management Systems and kerbside bin collection services. The CWMS charge has increased to $530 in 2023-24 per unit of occupied land from $515 in 2022-23. The annual service charge for kerbside waste management has increased to $175 in 2023-24[33] from $165 in 2022-23. The rate is set at a level that will recover the whole-of-life costs of these services.[34]

Between 2023-24 and 2032-33, the average rate is forecast to increase from $1,900 to $2,699,[35] a cumulative increase of $799 per property. This equates to a 4 percent average annual increase (between 2023-24 and 2032-33), above the RBA-based forecast average inflation of 2.6 percent per annum. [36]

The rate type declared by the Council is an increase on 2022-23 levels, with ratepayers are to pay an additional $203 per property (12 percent).[37] While the current economic environment is putting more pressure on many communities' capacity to pay for further rate increases, including those of the Council, on balance, the affordability risk for the community in respect of these further increases appears to be moderate. The Commission notes that the Council has a mid-range socio-economic index (SEIFA) economic resource ranking[38] and has relatively low average rates (across most ratepayers). In the 2023-24 budget process, the Council's public consultation report received no submissions (out of a

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[29] 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.

[30] 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 $2.128 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.

[31] District Council of Karoonda East Murray, *2024-33 long-term financial plan*, page. 3.

[32] District Council of Karoonda East Murray, *2023-24 annual business plan*, June 2023, p. 25.

[33] District Council of Karoonda East Murray, *2023-24 annual business plan*, June 2023, p. 26.

[34] District Council of Karoonda East Murray, *2024-33 long-term financial plan*, page. 23.

[35] There is no rates growth forecast by the Council each year.

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

[37] This includes general and other rates (CWMS charge and kerb side bin collection) per property.

[38] District Council of Karoonda East Murray area is ranked 37 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 (2016), 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.

total of 19) that expressed concerns about further rate increases.[39]

As previously stated, the Council has developed its LTFP in real (2023-24) dollar values for all future years (which reflects the Council's preferred approach). The forecast rate revenue increases in nominal terms have not been disclosed. The Commission considers that nominal forecasts may assist the Council and its community in comparing past and projected financial performance (and enable comparisons across different planning periods). Therefore, the Commission considers that it would be appropriate for the Council to:

9. Improve the transparency of its rate income projections and associated indexation assumptions in its long-term financial plan, to enable comparisons across different planning periods.

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 District Council of Karonda East's:

- progress on improving its operating surpluses and increasing its cash reserves,
- achievement of cost savings and efficiencies and its continued reporting of these in its plans, and
- actions to address any misalignment between the capital expenditure and depreciation estimates in its LTFP and various AMPs.

[39] District Council of Karoonda East Murray, *Ordinary Council Meeting Agenda -29 August 2023 – Public Consultation,* available at https://www.dckem.sa.gov.au/__data/assets/pdf_file/0030/1458066/29-August-2023-Special-Council-Meeting-Agenda_Redacted.pdf

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