Advice

Local Government Advice

District Council of Kimba

February 2024

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District Council of Kimba

AT A GLANCE

OVERVIEW

The Essential Services Commission finds the District Council of Kimba's current and projected financial performance **mostly sustainable** taking into account that the Council's future performance outcomes are reliant on continued support from grant income, the planned increases in rates income per property (in line with inflation of 2.6% p.a.), and continued monitoring of its cost growth

RISKS IMPACTING SUSTAINABILITY

- ⚠ Assumptions in the long-term financial plan and annual business plan are not sufficiently detailed, and are not in nominal terms
- ⚠ If cost growth levels exceed forecast and CPI levels, this would put pressure on the Council's operating performance
- ⚠ Asset valuations not being completed following the completion of road restoration works in 2024-25

CONTINUE

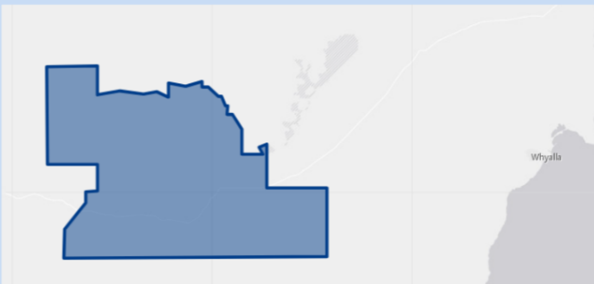
- ✔ Identifying, consulting and seeking funding on community priorities for new and upgraded assets
- ✔ Monitoring the growth in expenses in its budgeting
- ✔ Reviewing the extent of cash reserve forecasts in the context of its financial sustainability outlook

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
- Provide further information on the financial (and ratepayer) implications in the long-term financial plans and annual business plans
- Consider monitoring and reporting actual and projected cost savings in the annual budget and long-term financial plan
- Consider the intended uses of accumulated funds
- 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 the rate projections and associated indexation assumptions in the long-term financial plan, to enable comparisons across different planning periods

KEY FACTS

- Population in 2021 was **1,037**
- Council covers **3,986 square kilometres**
- **891** rateable properties in 2022-23
- **$2.1 million of rate income** in 2022-23
- Value of assets held in 2022-23 equals **$48.6 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 Kimba
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 Kimba

The Essential Services Commission (**Commission**) finds the District Council of Kimba's (**Council**) current and projected financial performance is **mostly sustainable**, driven by historical and projected operating surpluses and the forecast renewal of its infrastructure assets. This follows a period of extensive works to restore its road network due to flood damage associated with Cyclone Tiffany in January 2022. The Council's projected financial performance is reliant on continued support from grant income, its planned increases in rates income (in line with inflation), and continued monitoring of its cost growth.

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

Looking ahead, the Commission suggests the following steps, encouraging the Council to continue to budget appropriately, to consider monitoring and reporting of cost savings or efficiencies, to continue to update the assumptions underpinning its financial and asset management planning, and to look for opportunities to limit the extent of further rate increases.

Budgeting considerations

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** to identify, consult, and seek funding on community priorities for new and upgraded assets; and **consider** providing further information on the financial (and ratepayer) implications in its long-term financial plans and annual business plans (as appropriate).

Providing evidence of constraining cost growth

4. **Continue** to monitor the growth in expenses in its budgeting, especially with regards to 'materials, contracts and other' expenses, and to provide evidence of constraining cost growth from pre-flood levels.

5. **Consider** implementing the good practice of monitoring and reporting actual and projected cost savings in its annual budget and long-term financial plan, as appropriate.

Level of cash reserves

6. **Continue** to review the extent of cash reserves forecast in the context of its financial sustainability outlook; and **consider** the intended uses of the accumulated funds.

Refinements to asset management planning

7. **Review** the estimates of asset lives (and valuations) informing its forecast rate of asset consumption (and depreciation expenses) and asset renewal needs in its long-term financial plan and asset management plans.

Transparency of rate projections

8. **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 State Parliament to provide advice on material changes proposed by local councils in relation to elements of their strategic management plans (**SMPs**) and on the proposed revenue sources, including rates, which underpin those plans.[1]

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

The first cycle of the scheme extends over four years from 2022-23 to 2025-26, and the Commission has selected 17 councils for advice in the second scheme year (2023-24), including the Council.

This report provides the Local Government Advice for the Council in 2023-24.

The Council is obliged under the *Local Government Act 1999* (**LG Act**) to publish this advice and its response, if applicable, in its 2024-25 Annual Business Plan (including any draft Annual Business Plan) and subsequent plans until the next cycle of the scheme.[8] It does not need to publish the attachment to the advice (these will be available with the advice on the Commission's website[9]), nor is it compelled under the LG Act to follow the advice.

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

2.1 Summary of advice

The Commission finds the Council's financial position is **mostly sustainable**, driven by projected operating surpluses, albeit lower than in the past, in part due to the planning for rate increases in line with the Consumer Price Index (**CPI**).[10] The Council is projecting it will continue to retain a relatively higher cash balance (averaging $1.7 million per annum over its forecasts), which will provide it with some financial capacity to manage unforeseen events (and provide for working capital needs). Historically, the Council has been impacted by climate related events (such as flooding in January 2022) causing extensive damage to its road network, and it has been reliant on disaster funding and contractor support to re-establish the condition of its assets. This had led to significant one-off costs

1 Amendments to the LG Act (s122(1c) to (1k) and (9)) specify the responsibilities for the Commission and local councils for the Local Government Scheme Advice. The Commission must provide advice to each council in accordance with the matters outlined in s122(1e), (1f) and (1g).
2 Commonly referred to as asset management plans.
3 The objectives of the advice with reference to a council's LTFP and IAMPs are presented under LG Act, s122(1g). LG Act s122(1) specifies the requirements of a council's SMP, including the LTFP and IAMPs.
4 'Intergenerational equity' relates to fairly sharing services and the revenue generated to fund the services between current and future ratepayers.
5 Commission, *Framework and Approach – Final Report*, August 2022, pp. 2-3, available at www.escosa.sa.gov.au/advice/advice-to-local-government.
6 LG Act s122(1f)(a) and (1g)(a)(ii).
7 LG Act s122(1f)(b) and (1g)(b).
8 LG Act s122(1h).
9 The Commission must publish its advice under LG Act s122(1i)(a).
10 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.

and income impacting on its finances and, since the recent event, the Council has, at times, not had the capacity to undertake other projects or initiatives.

Past rate increases have generally been higher than inflation and have supported the Council's financial capacity, covering its operating and service sustainability. The Council's current financial plans show that it is forecasting to maintain its 2023-24 rates incomes in real terms (meaning only increases in line with CPI are being contemplated). As such, the Commission considers it would be good budgeting practice for the Council to continue to be focused on monitoring cost growth and considering efficiency improvements (particularly in 'materials, contracts and other' expenses) to ensure that it remains in a sustainable position moving forward.

Based on the financial projections in its LTFP, the Commission considers that the Council is aiming to improve its performance and reduce ratepayer impacts. However, the Commission suggests that the Council could consider further transparency improvements, such as presenting its financial plan in nominal terms (explicitly considering inflation) and improving transparency as to assumptions.

2.2 Detailed advice findings

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

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

2.2.1 Advice on material plan amendments in 2023-24

Key Points:

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

⚠ The 2023-24 long-term financial plan forecasts lower operating surpluses totalling $0.5 million compared to $4.1 million forecast in the 2022-23 long-term financial plan.

In August 2023, the Council made amendments to its SMPs (including its LTFP and IAMP) to reflect recent events in the region and to meet the requirements under the LG Act requiring councils to undertake regular reviews of SMPs. Updates to the Council's plans include significant changes to the road asset renewal program to repair the extensive damage sustained from floods associated with Cyclone Tiffany in January 2022.

The Council has published its LTFP in real terms, meaning the presentation of its financial forecasts do not incorporate inflation expectations and, therefore, the implications that this may have for ratepayers may be less transparent.[12] For the purposes of the Commission's Advice, the Council provided its financial forecasts in nominal terms; however, it did not provide the inflation forecasts it used to convert its LTFP into nominal terms when providing the conversion to the Commission.[13] Given the objective of open and transparent consultation, there is likely to be benefit in future published versions of the LTFP

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

12 District Council of Kimba, *Long Term Financial Plan 2024-33,* August 2023, p. 5.

13 To provide some guidance the Commission notes that the RBA currently forecasts the CPI (Australia-wide) to increase by 3.3 percent in the year to the June 2024 quarter, 3.1 percent in the year to June 2025, and by 2.6 percent in the year to June 2026. Thereafter, it is reasonable to anticipate a return to long-run averages (and growth of 2.5 percent per annum from 2026-27, based on the midpoint of the RBA's 2 to 3 percent target range). RBA, Statement of Monetary Policy, February 2024, p. 4, available at https://www.rba.gov.au/publications/smp/2024/feb/pdf/statement-on-monetary-policy-2024-02.pdf.

also being made available in nominal terms, clearly identifying all indexation and inflation assumptions used. This should provide a more meaningful context to the community regarding the Council's expectations with respect to rates and charges, allowing for improved community input regarding the expectations of the Council with respect to cost control and service levels. In this context, 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 Council's 2023-24 LTFP forecasts lower operating surpluses, totalling $0.5 million compared to $4.1 million forecast in its 2022-23 LTFP.[14] This reflects a range of changes to its operating income and expenditure, notably:

- 'Grants, subsidies, and contributions' decreased by $9.7 million, reflecting the Council's revised treatment of disaster recovery grants, where it had 'grossed up' the funding in its 2023-32 LTFP but has now 'netted off' that funding in 'amounts received specifically for new or upgraded assets' to remove any distortion to its operating result. Timing differences have also impacted forecasts associated with financial assistance grants.[15]

- Reimbursements have increased by $1.1 million, in part due to assumed one-off private works to be undertaken by the Council.

- A revision to the reporting of 'materials, contracts and other' expenses, resulting in a reduction of reported expenditure by $5.1 million. This is primarily related to the Council's expenditure associated with disaster recovery in its 2023-24 LTFP being 'netted off' against 'amounts received specifically new and upgraded assets' (below the operating surplus / (deficit) line).

Following the update to its IAMP in August 2023, the Council has updated its 10-year asset renewal projections for the majority of asset categories (indicating an 11 percent increase over the 9-year comparable period).[16] As part of that process, the Council carried out condition assessments, useful life surveys and undertook a reassessment and revaluation of some asset categories due to high levels of inflation, meaning that future costs have also changed. The Commission acknowledges the good practice of the Council in this regard.

For new and upgraded asset expenditure, lower levels are forecast (compared to a historical period); however, the Council states that although it is considering some projects, it has not included them in the LTFP as it is seeking further grant funding. The Council aims to seek grant funding for new assets or upgrades and will consult with its community before considering including any financial impacts in its LTFP. The Commission considers that, if project estimates and costings have been obtained or a business case proposed, then the Council could consider including these intentions (and the impacts) in its LTFP, as well as the implications for ratepayers. This could be done, for example, through scenario or sensitivity analysis to a base case (as applicable). The Commission considers it would be appropriate for the Council to:

3. Continue to identify, consult, and seek funding on community priorities for new and upgraded assets; and consider providing further information on the financial (and ratepayer) implications on its long-term financial plans and annual business plans (as appropriate).

14 The overlapping nine years forecast in both the 2022-23 and 2023-24 LTFPs.
15 Sometimes advance grant payments are received by the Council (for example the 2023-24 grant allocation was received and accounted for in 2022-23).
16 As per the Council's material amendments statement provided to the Commission in September 2023.

2.2.2 Advice on financial sustainability

Operating performance

Key Points:

- Operating surpluses achieved between 2016-17 and 2022-23, with the operating surplus ratio averaging 11.4 percent in that time.
- The operating surplus ratio is forecast to average 1.1 percent per annum between 2023-24 and 2032-33.
- The reasons for the high historical operating surpluses relate to the increases in 'grants, subsidises, and contributions', some of which were due to the receipt of disaster recovery grant funding for the rectification of damaged roads associated with a flooding event in January 2022.
- Total operating expenses (particularly 'materials, contracts and other' expenses, and 'employee costs') increased substantially in the last two years, increasing by 170 percent and 24 percent respectively from pre-flood (2020-21) operating cost levels. This represents a total increase of $2.6 million, mostly related to contractor engagement and remediation works associated with damage to the road network.
- The lower forecast average expense growth of negative 1.0 percent per annum reflects an average change off a much higher cost base in 2021-22 and 2022-23.

The Council has reported operating surpluses in the last seven years from 2016-17 to 2022-23, with an operating surplus ratio[17] averaging 11.4 percent over that period. This follows an earlier period of operating deficits and increased volatility, with the ratio averaging negative 2.6 percent from 2012-13 to 2015-16. In its 10-year forward projections to 2032-33, the Council is forecasting lower operating surpluses, with an average ratio of 1.1 percent: within the suggested LGA target range.

The reasons for the historical operating surpluses relate to the increases in 'grants, subsidises, and contributions', some of which were due to the receipt of disaster recovery grant funding for the rectification of damaged roads associated with a flooding event in January 2022. However, not all the Council's costs (associated with the disaster event) were funded through the relevant grants, and it estimates the net cost to the Council will be approximately $1 million.[18]

Before the disaster event (and in the eight-year period to 2020-21), the average increases in operating income and expenses were 2.5 percent and 2.3 percent per annum respectively.

Over the period from 2012-13 to 2022-23, the Council's largest source of income has come from 'grants, subsidies, and contributions', which accounted for 50 percent of total operating income. This includes a significant increase in the last two years to provide Council with funding for rectification works to damaged roads caused by flooding in January 2022.[19] The second largest source was rates revenue (accounting for 38 percent of total operating income), which has increased on average by 4.1 percent

[17] The operating surplus ratio is defined as: Operating Surplus (Deficit) ÷ Total Operating Income. The general target is to achieve, on average over time, an operating surplus ratio of between zero and 10 percent (Local Government Association of South Australia, *Financial Sustainability Information Paper 9 - Financial Indicators Revised,* May 2019 (LGA SA Financial Indicators Paper), p. 6).

[18] Based on further information provided by the Council to the Commission in February 2024. The Council received grants for 'counter disaster operations and immediate repair works (stage 1 works) and the reconstruction of essential public assets (stage 2 works).

[19] The Council has also received grants such as the Drought Extension Programme and the National Radioactive Waste Management Facility Community Benefits Programme (in addition to the Financial Assistance Grants and Roads to Recovery Grants).

per annum from 2012-13 to 2022-23,[20] when rateable property growth was negligible and CPI growth averaged 2.6 percent.[21]

Total operating expenses - particularly 'materials, contracts and other' expenses, and 'employee costs'- increased substantially in the last two years by 170 percent and 24 percent respectively, from pre-flood (2020-21) operating cost levels.[22] This represents a total increase of $2.6 million, mostly related to contractor engagement and remediation works associated with damage to the road network.[23]

Looking forward, the Council is projecting average annual rates income growth of 2.6 percent from 2023-24 to 2032-33, in line with the forecast long-term inflation rate[24] and consistent with the Council's stated LTFP assumption to keep rate revenue increases in line with CPI. Grant income is forecast to be relatively flat across LTFP projections to 2032-33, averaging $2.4 million per annum (in nominal terms), indicating a decrease in real terms (but higher than its grants before the flood event in January 2022).

The lower forecast average expense growth of negative 1.0 percent per annum reflects an average change off of a much higher cost base in 2021-22 and 2022-23. However, if forecast increases were viewed in the context of the Council's operating cost base (pre-flood in 2020-21), then average expense growth would be 3.5 percent per annum (consistent with the Commission's view of actual and forecast CPI over the period from 2020-21 to 2032-33). The Council is continuing works to repair flood damaged road infrastructure and is budgeting for higher 'material, contracts and other' expenses in 2023-24.

In general, the Council's long-term trend in operating income and expenses indicates that these are aligned to growth in CPI over the period to 2032-33 (reflecting its long-term planning assumption to not increase these in real terms). This is a positive trend, noting that the Council's long-term outlook shows a more constrained operating performance (that is, lower forecast operating surpluses). As with any forecasts, the Commission understands there could be some risks (for example higher costs associated with weather events or for large unscheduled maintenance of its assets), and it is clear the Council does not have the scale to manage such events and may need State or Federal Government assistance if such events come to pass.

The Commission recognises that the Council and its community are subject to the constraints arising from remoteness, lower rates base, supply constraints and inflationary pressures (among other things), which can materially change financial performance from year to year. However, the Commission nevertheless considers that it would be prudent for the Council to mitigate any risk to its ratepayers through monitoring of expenses (such as 'materials, contracts and other' expenses), and seeking to find productivity improvements, where possible, to achieve its planning assumptions (particularly in reducing the need to increase rates above CPI). Therefore, the Commission has found that it would be appropriate for it to:

4. Continue to monitor the growth in expenses in its budgeting, especially with regards to 'materials, contracts and other' expenses, and to provide evidence of constraining cost growth from pre-flood levels.

5. Consider implementing the good practice of monitoring and reporting its actual and projected cost savings in its annual budget and long-term financial plan, as appropriate.

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 Based on CPI Adelaide (All groups), available at https://www.abs.gov.au/statistics/economy/price-indexes-and-inflation/consumer-price-index-australia/sep-quarter-2023.

22 Based on the Council's Financial Report Template provided to the Commission in an Excel document.

23 CPI Adelaide (All groups), available at https://www.abs.gov.au/statistics/economy/price-indexes-and-inflation/consumer-price-index-australia/sep-quarter-2023.

24 The forecast average annual growth in the CPI from 2022-23 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.

Net financial liabilities

Key Points:

- The Net Financial Liabilities ratio averaged negative 49.5 percent from 2012-13 to 2022-23 and the ratio is forecast to continue to be below the suggested LGA target range (but to a lesser extent than historically), as it assumes no additional borrowings in the period to 2032-33.
- The Council states in the 2023-24 long-term financial plan that it will not incur significant debt until a strategy is identified dealing with how to repay the debt. The Commission considers this to be an appropriate view on the use of borrowings.
- When the net financial liabilities ratio is 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.

Despite the Council's frequent operating surpluses over the last 11 years, its net cash flows after operating and investing (that is, capital-related) activities have averaged $0.1 million per annum between 2012-13 and 2022-23. As such, the Council remains sustainable from a cash flow perspective, noting it does not have any borrowings and has a reported a cash balance of $2.3 million at 30 June 2023 (or approximately $2,622 per ratepayer).

Over the period 2012-13 to 2022-23, the Council's net financial liabilities ratio averaged negative 49.5 percent; below the suggested LGA target range for this ratio.[25] The forecasts show that this ratio will continue to be below the suggested LGA target range (but to a lesser extent than historically), as it assumes no additional borrowings in the period 2032-33. This also reflects the Council's moderate operating income growth and average forecast cash balances of $1.7 million.

The Council has a conservative view of borrowings, as it is more reliant on grant funding (which can fluctuate from year to year) and, to a lesser extent, on its ratepayer base (of approximately 890 rateable properties in 2022-23), where there is limited capacity or scale in the region to raise further income. The Council states in its 2023-24 LTFP that significant debt will not be incurred until a strategy has been identified that will highlight how Council will repay the additional debt;[26] the Commission considers this to be an appropriate view on the use of borrowings.

When the net financial liabilities ratio is viewed in isolation, it is at a level which demonstrates that the Council has the financial capacity for its operating income to cover its net financial liabilities. The Council recognises that the ratio is driven by its cash reserves and a conservative view of borrowings, which provides a reserve for unforeseen expenditure requirements to manage inflation risk and generally financial sustainability risk.[27]

The Commission understands that the Council regularly reviews the level of its cash reserves as part of its budgets and long-term planning processes; however, in general there could be improved disclosure on the reasons (or principles) for the level of its cash reserves. In this context, it would be useful to understand the intended uses of these funds and, ultimately, whether some should be returned to ratepayers (through an adjustment in rates). As the Commission has not made an assessment in this regard, it would be appropriate for the Council to:

6. **Continue** to review the extent of cash reserves forecast in the context of its financial sustainability outlook; and **consider** the intended uses of the accumulated funds.

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25 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).

26 District Council of Kimba, *Long Term Financial Plan 2024-33,* August 2023, p. 5.

27 District Council of Kimba, *Long Term Financial Plan 2024-33,* August 2023, p. 10.

Asset renewals expenditure

Key Points:

- Between 2012-13 and 2022-23 the Council's total capital expenditure averaged $5.5 million per annum (including $4.3 million on asset renewals and $1.2 million on new and upgraded assets).
- The asset renewal ratio averaged 96 percent between 2012-13 and 2022-23.
- From 2023-24 to 2032-33, the ratio is forecast to average 105 percent.
- Historical spending (over the last 10 years) on asset renewals has been below the rate of depreciation, in some years by a significant margin. Renewal spending is forecast to account for 80 percent of depreciation expenses on average to 2032-33.
- The Council's assessment of depreciation (currently contributing to 30 percent of total operating costs in 2022-23), may suggest a risk to its financial forecasts, where the incorrect recording of depreciation could lead to an incorrect assessment of its operating performance and sustainability.

Between 2012-13 and 2022-23, the Council's total capital expenditure averaged $1.8 million per annum (including $1.1 million on asset renewals and $0.7 million on new and upgraded assets). Based on the asset renewal expenditure requirements specified in its AMPs, and since 2015-16, it has on average met the quantum of its asset service sustainability requirements. In some years, it has underspent on the renewal and rehabilitation needs of its asset stock and, in other years, it has overspent – indicating some spend volatility compared to its AMP. Overall, the Council's asset renewal funding ratio (IAMP-based) was marginally below the suggested LGA target range of 90 to 110 percent,[28] and averaged 87 percent between 2012-13 and 2022-23.

From 2023-24, the Council's asset renewal spending profile is increasing, following the Council's review of its IAMP in August 2023 and its revised projections that are reflected in its 2023-24 LTFP.[29] As such, its asset renewal funding ratio (IAMP-based) is expected to trend in line with the suggested LGA target range (averaging 90.6 percent from 2023-24 to 2032-33).

Over the last three years (from 2020-21 to 2022-23), the Council has grown its asset base with total capital expenditure averaging $2.7 million per annum (predominantly being allocated to asset renewals). This reflects the asset expenditure and rectification works associated with the flood damage to the Council's road network in January 2022.

The Commission notes that the Council's historical capital expenditure (for example since 2019-20) and forecast spending (for example to 2027-28) has (and is forecast) to outpace depreciation by $8.9 million. While this could reflect the level of growth in asset expenditure (for example related to the works associated with restoring its road infrastructure),[30] it may also suggest that depreciation schedules have not been reviewed and updated, or that some of the works are yet to be capitalised. Additionally, the Commission understands that the revaluation of rural roads (sealed and unsealed) has

28 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).

29 District Council of Kimba, *Infrastructure and Asset Management Plan 2024-33,* August 2023, p. 3, available at District-Council-of-Kimba-Infrastructure-and-Asset-Management-Plan-2024-33.pdf.

30 The Council estimates (provided to the Commission) indicates that approximately 22 percent of total disaster recovery works (over the period from 2022-23 to 2024-25) is related to capital expenditure.

been postponed until the conclusion of restoration works anticipated to be completed by the end of the 2024-25 financial year.[31]

In this context, it is important for the Council to endeavour to understand the extent to which the depreciation values reflect the current cost of the asset, and if the Council is appropriately allocating funds to the renewal and rehabilitation of its assets. In this regard there may be some risks to the Council's financial forecasts, where the incorrect recording of depreciation could lead to an incorrect assessment of its operating performance and sustainability. Overall, there may be a need for the Council to review asset lives and asset valuation to reduce its asset and financial sustainability risk, and to ensure the most update-to-date information is reflected in its strategic management plans. Therefore, the Commission considers it would be appropriate for the Council to:

7. Review the estimates of asset lives (and valuations) informing its forecast rate of asset consumption (and depreciation expenses) and asset renewal needs in its long-term financial plan and asset management plans.

2.2.3 Advice on current and projected rate levels

Key Points:

⚠ Rate revenue per property growth has averaged 3.5 percent per annum for each property in the period between 2012-13 and 2021-22, which is 1.5 percent above CPI for the same period.

✔ The average rate income per annum for each property is forecast to grow by 2.6 percent between 2022-23 and 2032-33 which is consistent with the RBA-based forecast of average inflation.

⚠ Affordability risk within the community for the further rate increases appears to be moderate based on a range of factors, including:

- an assessment of the economic resources available to the community,
- its lower rate base (of about 890 ratepayers),
- greater reliance on grant funding,
- its current planning assumption to keep its rate revenue increases in line with CPI, and
- minimal community concerns expressed during the 2023-24 budget process.

The Council's rate revenue per property growth has averaged 3.5 percent, or $64 per annum, for each property in the period between 2012-13 and 2021-22, which has exceeded CPI growth of an average of 2.0 percent per annum over that period. Compared to similar councils, the Council has higher average rate levels for residential and non-residential ratepayers (but is in-line with the Statewide average).[32]

In 2023-24, the Council has budgeted for an average rate increase of 7.9 percent, higher than anticipated for this year in its previous LTFP projections (the Commission estimates a 3.4 percent increase in average rates was previously forecast for 2023-24). The increase reflects the change in inflation between planning periods, and the Council's objective to not increase rates revenue in real terms (that is, only CPI increases are being considered).[33]

[31] District Council of Kimba, *General Purpose Financial Statements for the year ended 30 June 2023*, p. 21, available at https://www.kimba.sa.gov.au/__data/assets/pdf_file/0019/1510264/District-Council-of-Kimba-Annual-Report-2022-23.pdf.

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

[33] District Council of Kimba, *Long Term Financial Plan 2024-33,* August 2023, p. 3.

The Council's 2023-24 LTFP forecasts an average increase of $653 to existing rates in total to 2032-33 (to $3,154 per annum), which is consistent with its assumed escalation over that period (and assumed no growth in rateable properties). The average rate increases are also consistent with the RBA-based forecast of average inflation (2.6 percent per annum).[34] The Council has recently updated its rating methodology from a site value (or land value) to a capital value approach, thereby redistributing the rates burden across different land use categories; however, the Council has not disclosed the rate increases in its ABP across its rate categories.[35] On a proportional revenue basis, primary production ratepayers are estimated to account for 79 percent of 2023-24 budgeted rates revenue, followed by residential (12 percent), silos (4 percent), commercial (2 percent) and vacant land (2 percent).

As 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:

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

Affordability risk within the community for the further rate increases appears to be moderate, based on a range of factors, including an assessment of the economic resources available to the community,[36] its lower rate base (of about 890 ratepayers) and greater reliance on grant funding, its current planning assumption to keep its rate revenue increases in line with CPI, and minimal community concerns expressed during the 2023-24 budget process.

2.3 The Commission's next advice and focus areas

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

- consideration of inflation and indexation assumptions, and whether it has prepared its financial projections in nominal terms,
- ongoing performance against its LTFP estimates and changes in key assumptions,
- monitoring and reporting of any cost savings and operating efficiencies,
- management of cash reserves and the uses of the accumulated funds,
- updates to asset valuations and depreciation assessments and associated updates to its asset management plans, and
- how it has sought to manage affordability risk within its community.

[34] 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.

[35] District Council of Kimba, *Annual Business Plan and Budget 2023-2024,* June 2023, p. 14.

[36] The District Council of Kimba area is ranked 58 among 71 South Australian '*local government areas*' (including Anangu Pitjantjatjara and Maralinga Tjarutja Aboriginal community areas and 'unincorporated SA') on the Australian Bureau of Statistics SEIFA Index of Economic Resources (2021), where a lower score (e.g., 1) denotes relatively lower access to economic resources in general, compared with other areas, available at https://www.abs.gov.au/statistics/people/people-and-communities/socio-economic-indexes-areas-seifa-australia/2021.

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