Advice

Local Government Advice - Attachment

District Council of Kimba

February 2024

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A The Commission's approach

In providing the Advice for the Corporation of the District Council of Kimba (**Council**), the Essential Services Commission (**Commission**) has followed the approach in the Framework and Approach – Final Report (**F&A**).[1]

The Commission has considered the Council's strategic management plan (**SMP**) documents (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]

- Long-Term Financial Plan 2024-33 (adopted August 2023)
- Infrastructure and Asset Management Plan 2024-33 (adopted August 2023)
- CEO Report on Financial Sustainability (August 2023)
- Annual Business Plan and Budget 2023-2024 (adopted June 2023)
- Long-Term Financial Plan 2023-32 Annual Update (adopted December 2022)
- Annual Business Plan and Budget 2022-23 (adopted June 2022)
- Strategic Management Plan 2021-25 (adopted June 2020)

The Commission notes that most of the Council's infrastructure asset base is covered by its existing asset plans; however, revaluations on a large part of its assets (namely for sealed and unsealed rural roads) have been postponed until restoration works are completed following flood damage associated with Cyclone Tiffany in January 2022.[4]

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

The Commission has also reviewed the Council's template data which contains its 2023-24 LTFP forecasts for 2023-24 to 2032-33, 2022-23 LTFP forecasts, historical financial data, the number of rateable properties, and staff (Full Time Equivalent (**FTE**)) numbers from 2012-13 onwards.[7] [8] All charts

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 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.

5 *Local Government Act 1999* (**LG Act**) s122(1g)(a)(i).

6 As required under s122(1b) of the LG Act.

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

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

and tables in the Advice are primarily sourced from these datasets. In addition, the Commission has reviewed the Council audit committee reports, and other public information.

The Commission has reported estimates in nominal terms, consistent with the Council's updated financial plan information, also provided in nominal terms. The Commission 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 rural Council,
- its income level ($7.2 million), and
- the size of its rates base (around 890 ratepayers[9]).

Summary of the District Council of Kimba's financial sustainability performance and the Commission's risk assessment

Financial sustainability indicators:	Last 10 years from 2012-13 (Actual performance)		2022-23 estimate	Next 10 years from 2023-24 (Council forecasts)
Operating surplus ratio (target 0-10%)	Volatility and deficits in FY14 & FY16	Surpluses reported ($3.6m accumulated over 6 years)	Ratio of 9.7% reported	Lower surpluses projected from FY24 to FY33 -->
Net financial liabilities ratio (target 0-100%)	Ratio below zero (driven by higher cash balances and lower debt levels) --->			Ratio projected below zero (mainly driven by no borrowings assumption)
Asset renewal funding ratio (target 90-110%)	Ratio below target	On average, renewal works spending within target range ------------------------------ >		On average, projected renewal works spending within target range --------------->
Identified Risks:				
Cost control risk	Operating expenses per property average growth of 2.1% pa to 2020-21 (CPI 1.7%) ---------------------------------- >		69% increase (over 2 yrs.) partially funded by grants	Operating expenses per property average growth of -1.0% pa (reverting down from a higher cost base in FY23)
Affordability risk	High rates revenue per property average growth of 4.0% pa to 2022-23 (CPI 2.6%) ------------------------------->			Projected rate revenue per property average growth of 2.6% consistent with forecast CPI --- ->

Ratio outside suggested LGA target range or higher risk

Ratio close to suggested LGA target range or medium risk

Ratio within suggested LGA target range or lower risk

[9] Based on the estimated number of property assessments in 2022-23.

B Material plan amendments in 2023-24

The Council has made various amendments to its 2023-24 budget and forward projections, accounting for various revenue and spending initiatives. The material amendments to some of its main financial forecasts are listed in the table below (based on the Council's nominal terms calculations).[10] To ensure a comparable analysis of estimates between the 2022-23 and 2023-24 LTFPs, the Commission has reviewed the 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)
Grants, subsidies and contributions	31.0	21.3	-9.7	-31
Reimbursements	1.6	2.6	1.1	69
Total operating income	59.3	49.6	-9.6	-16
Materials, contracts and other expenses	24.8	19.7	-5.1	-21
Total operating expenses	54.7	49.1	-5.6	-10
Operating surplus / (deficit)	4.6	0.5	-4.1	-89
Capital expenditure on renewal of assets[11]	13.5	15.0	1.5	11
Capital expenditure on new and upgraded assets[12]	-	0.9	0.9	n/a

B.1 Updates to strategic management plans

In August 2023, the Council made amendments to its SMPs (including its LTFP and IAMP) to reflect recent events and updates in its region.[13] This corresponds to the requirements of the LG Act, which require councils to undertake a comprehensive review of SMPs (including AMPs) within two years after each general election of the council.[14]

The updates to its SMPs include significant changes to the road asset renewal program to repair the extensive damage sustained to the Council's road network resulting from the floods related to Cyclone Tiffany in January 2022, with the associated estimated replacement cost of approximately $8.9 million.[15] Based on discussions with the Council, future iterations of its plans are expected to be

10 This table shows only selected financial items to demonstrate the material amendments made by the Council in its 2023-24 estimates. It excludes various financial items and individual items do not sum to totals.
11 The capital expenditure estimates are based on the 2023-24 Annual Business Plan estimates provided by the Council to the Commission (in an Excel template).
12 Footnote 11 applies.
13 District Council of Kimba, *Special Council Meeting Agenda – 23 August 2023, Item 4.1 Updated Long Term Financial Plan – 2024-33 and Infrastructure and Asset Management Plan 2024-33,* p. 6, available at https://www.kimba.sa.gov.au/__data/assets/pdf_file/0018/1453410/Special-Council-Meeting-Agenda-23rd-August-2023.PDF.
14 LG Act s122(4)(a) and (b). General elections were last held for SA Councils on 11 November 2022.
15 The Council's transportation assets represent over 50 percent of the value of its asset base (on a book value and replacement cost basis).

amended following the completion of road works and to return these assets to pre-flood condition. The Council and its contractors are on schedule to complete all repairs by 30 June 2025.[16]

The Commission notes that the Council published its LTFP in real terms. As a result, there is a risk that its intentions on how it proposes to manage the impact of inflation and the implications that this may have for ratepayers may be less transparent. The Council did not provide to the Commission the inflation forecasts used to convert its LTFP into nominal terms.

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 has forecast 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 for 2025-26, based on the midpoint of the RBA's 2 to 3 percent target range).[17] Subsequent sections have regard to 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 real-terms presentation may not highlight the Council's estimate of the nominal rates and charges – nominal presentation may 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 future published versions of the LTFP also being made available in nominal terms, clearly identifying all indexation and inflation assumptions. This would provide a more meaningful community description of the Council's expectations with respect rates and charges, allowing for improved community input regarding their expectations of the Council with respect to cost control and service levels.

The Commission notes that the Council's LTFP indicates that rate revenues (and CWMS charges) are not forecast to increase in real terms, meaning that CPI-only increases are being considered. In 2023-24, the Council resolved to increase rates in line with actual CPI of 7.9 percent,[18] and it is also forecasting to apply CPI-based increases to some of its operating expenses (such as wages).

In general, and notwithstanding the need for the Council to endeavour to 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.

B.2 Changes to operating performance

The Council has forecast (in its 2023-24 LTFP) a decline in operating performance, with lower surpluses totalling $0.5 million across the nine-year comparative period to 2031-32 compared to $4.1 million forecast in the 2022-23 LTFP (as shown in the table above). This reflects a range of changes to its operating income, notably:

16 These works may have brought forward renewals for the Council, however it is not clear whether the Council is factoring this into its LTFP and IAMP. The Commission understands it is possible that once works are complete after 30 June 2025, this will reduce the need for renewals works in the short to medium term, which, if factored in, might reduce expected rate increases, other things being equal.

17 RBA, Forecast Table - November 2023, available at https://www.rba.gov.au/publications/smp/2023/nov/forecasts.html.

18 CPI Adelaide (All groups) increased by 7.9 percent in the year to March 2023 quarter. Available at https://www.abs.gov.au/statistics/economy/price-indexes-and-inflation/consumer-price-index-australia/sep-quarter-2023.n

- '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' this funding in 'amounts received specifically for new or upgraded assets' to remove any distortion to its operating result. Further, some grant programs have now concluded, along with changes to the funding formula for ongoing grants (such as financial assistance grants (**FAG**), and roads to recovery grants). Timing differences have also impacted forecasts associated with FAGs.[19]
- Reimbursements have increased by $1.1 million, in part due to assumed one-off private works to be undertaken by the Council.

The notable changes to the Council's operating expenditure include:

- 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 for new and upgraded assets' (below the operating surplus / (deficit) line). The Council's disaster recovery works concludes in 2024-25.

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

B.3 Changes to capital expenditure estimates

The Council's 2023-24 LFTP indicates an increase in capital expenditure for asset renewals (by $1.5 million or 11 percent), and a lower increase for new and upgraded assets (by $0.9 million), compared to the previous year's LTFP (for the period from 2023-24 to 2031-32). The changes between the two LTFPs reflect the recent update of the Council's IAMP, including a review of the 10-year renewal for the majority of asset categories.[20] To inform its IAMP, the Council carried out conditions assessments and 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 road asset renewal program has been a primary focus of its review, due to extensive damage sustained to road networks from the storm and flood experienced in January 2022 related to Cyclone Tiffany. As noted previously, it is not yet clear the extent to which these assumptions may change following the completion of works.

The Council has planned for low levels of expenditure on new and upgraded assets and increased footpath expenditure (following its 10-year IAMP review). Further, some variances in 2023-24 reflect the carryover from the previous year due to resourcing constraints associated with additional work arising from the flood event. The Council stated that although it is considering some projects for new and upgraded assets,[21] it has not included them in the LTFP, as they are currently unfunded. The Council intends to seek grant funding for these projects to ensure it remains in a sustainable position, and it intends to update the LTFP and IAMP once sources of funding become firm.

The Commission considers that, if project estimates and costings have been obtained or a business case proposed, the Council could consider including these intentions (and 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 in its long-term financial plans and annual business plans (as appropriate).

[19] Sometimes advance grant payments are received by the Council (for example, the 2023-24 grant allocation was received and accounted for in 2022-23).
[20] As per the Council's material amendments statement provided to the Commission in September 2023.
[21] The Council engages with its community to identify to determine priorities for future projects and for 2023-24 the Council identified 2 new projects following community consultation.

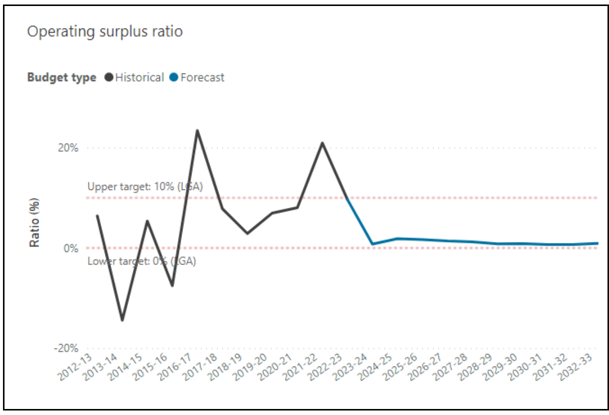
C Financial sustainability

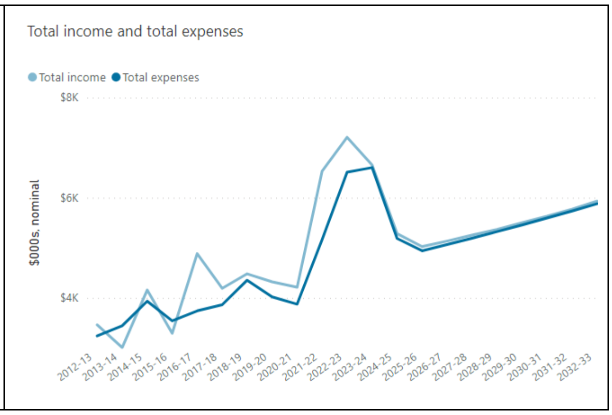
C.1 Operating performance

The Council has reported operating surpluses in the last seven years from 2016-17 to 2022-23; however, in the earlier period from 2012-13 to 2015-16, the Council reported, on average, operating deficits. Its operating surplus ratio[22] is forecast at a lower level (compared to its recent past), at an average of 1.1 percent per annum from 2023-24 to 2032-33 (see the left chart below).

A reason for the Council's recent operating surpluses is increases in 'grants, subsidises and contributions', some of which was driven by disaster recovery grant funding for the rectification of damaged roads associated with the 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.[23] Overall, the increase in operating income averaged 7.6 percent per annum from 2012-13 to 2022-23, while the rate of operating expense growth averaged 7.2 percent per annum,[24] albeit both had some volatility historically.[25] It is noted this is impacted by much larger increases in the last two years. In the eight-year period to 2020-21, before the flooding event, the average increases in operating income and expenses were 2.5 percent and 2.3 percent per annum respectively, when average annual CPI was 1.7 percent (over the same period).[26]

The long-term projections of the Council's operating performance are attributed to some constraints in its budgeting, such as slower rate revenue increases than it has achieved in the past, and lower expenses growth (on average), although the Council is generally budgeting off a higher operating cost base (see the right chart below). This approach appears reasonable (in the absence of reviewing detailed operating and capital budgets), as the Council is continuing works to restore its roads to pre-flood levels.





22 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).

23 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).

24 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).

25 Volatility in operating income is primarily due to the timing differences and amount of grants income received over the period. Sometimes advance grant payments are received (as it was for the 2023-24 grant allocation, which was received and accounted for in 2022-23).

26 CPI Adelaide (All groups). Available at https://www.abs.gov.au/statistics/economy/price-indexes-and-inflation/consumer-price-index-australia/latest-release.

The Council's largest source of income over the period from 2012-13 to 2022-23 was 'grants, subsidies and contributions', which accounted for 50 percent of total operating income.[27] While income growth from that source was relatively stable in the period to 2020-21, it has increased significantly in the last two years, in order to provide Council with funding for the rectification works to damaged roads caused by flooding in January 2022.[28]

The second largest source of operating income was rates revenue (accounting for 38 percent of total operating income), which has increased on average by 4.1 percent per annum from 2012-13 to 2022-23 when rateable property growth was negligible and CPI growth averaged 2.6 percent, rising in real terms (above the rate of inflation).

The Council's operating expense growth (from 2012-13 to 2022-23) was primarily due to an average annual increase of 11.2 percent in 'materials, contracts and other' expenses, 4.1 percent in depreciation expenses and 3.9 percent in 'employee' expenses (see the changes by expense type in specific time periods in the left chart over the page). As previously noted, the Council's operating expense growth (in the last two years from 2021-22 to 2022-23) driven by flood damage works and one-off increases, have been a key contributor. For example, over two years, 'materials, contracts and other' expenses and 'employee' costs have increased by 170 percent and 24 percent respectively (or a total increase of $2.6 million), mostly related to contractor engagement and remediation works (however, this has been predominantly funded through grants).[29]

Looking forward, the Council is projecting average annual rates revenue growth of 2.6 percent from 2023-24 to 2032-33, in line with the forecast long-term inflation rate,[30] and representing no change in rates revenue in real terms. It is noted that the Council's projected increases are lower than its historical average increases of 4.1 percent per annum and are also in line with its stated LTFP assumption to keep rate revenue increases in line with CPI. Rates are discussed in more detail in section D.

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 Council states in its LTFP that it anticipates that financial assistance grants will increase in line with CPI; however, it is not clear in the data provided to the Commission that this will be the case.

The Council is forecasting lower average expense growth of negative 1.0 percent per annum; however, this reflects a change off a higher cost base in 2021-22 and 2022-23. If these increases are 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). As part of the continuing works to repair flood damage, the Council is forecasting higher 'material, contracts and other' expenses in 2023-24 and is on schedule to complete all repairs by 30 June 2025.

Expenses per property (a metric which also accounts for growth) is also expected to change at the same rate as overall expenses – as the Council does not forecast any change in rateable properties or population from current levels of around 890 and 1,080, respectively. The Council's overall trend in forecast operating expenses appears to 'normalise' following the completion of flood damage works; and, as noted previously, this appears to be in line with the long-term increase in CPI (see the right chart over the page).

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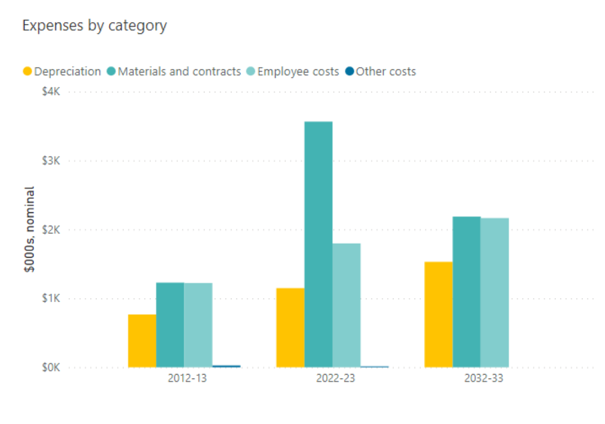
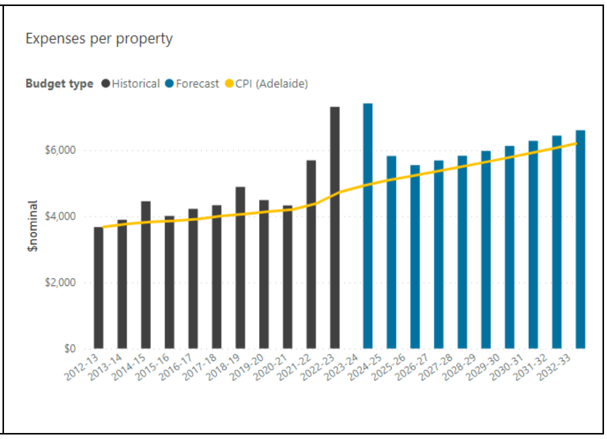
27 According to data supplied by the SA Local Government Grants Commission for 2021-22, Kimba ranks second among councils in the State for dependence upon income from grants.

28 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).

29 Based on discussions with the Council in November 2023.

30 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.





The Council's template data shows that employee numbers are assumed constant at current levels (17 FTEs), which has been relatively consistent over the last 10 years (noting this ignores the impact associated with additional contractors or additional time worked by existing employees due to the flood event in January 2022).[31] The Council states it has been challenged in attracting and securing locally based skilled employees, in part due to the remoteness of its region (for example the Council has had difficulties securing a diesel mechanic, and assistant manager of infrastructure and civil works). Lack of housing and service shortages (such as health services and childcare availability) also impact on the expansion of the local workforce and population.

Overall, the Council's long-term trend in operating income and expenses indicate 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 may 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 will need State or Federal Government assistance should they eventuate.

The Commission recognises that the Council (and its community) is subject to the constraints arising from its remoteness, lower rates base, supply constraints and inflationary pressures (among other things), which can materially change its financial performance from year to year. However, the Commission considers it would be prudent for the Council to mitigate risks 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 (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.

31 Based on the Council's Excel Financial Reporting template provided to the Commission.

C.2 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 annually between 2012-13 and 2022-23.[32] 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 $2.5 million.

The Council has no outstanding debt on 30 June 2023, but has previously used debt through the Local Government Finance Authority of South Australia (LGFA) to fund its capital expenditure and working capital needs.[33] However, the Council's preference has been to predominantly use its grants, its existing cash balances, and income generation for its capital needs.

In its 2023-24 LTFP, the Council states significant debt will not be incurred until a strategy has been identified that will highlight how it will repay the additional debt.[34] As such, the Council is not forecasting an accumulation of debt over the period from 2023-24 to 2032-33. Over this period, its cash balances are forecast to average $1.7 million, lower than in the past - reflecting the Council's residual funding needed from its cash balances. The Council considers that this level of cash provides it with an appropriate reserve for unforeseen expenditure requirements, to manage inflation risk and generally financial sustainability risk.[35]

The Council's net financial liabilities ratio has trended between negative 76.4 percent and negative 49.5 percent between 2012-13 and 2022-23 (see the bottom left chart over the page). This is below the suggested LGA target range for this indicator of between zero and 100 percent.[36] When viewed in isolation, the ratio is at a level which demonstrates that the Council has the financial capacity for its operating income to cover its net financial liabilities (see the top right chart over the page). The Council recognises that this ratio is mainly driven by its cash reserves and a conservative view of borrowings. The Council states that this conservative view is based on it being reliant on grant funding sources (which can fluctuate from year to year) and, to a lesser extent, on its ratepayer base (of approximately 890 rateable properties in 2023-24), where there is limited capacity or scale in the region to raise further income.

Over the forward years the Council has estimated the ratio will remain negative (peaking at negative 6.9 percent in 2029-30), mainly for the reasons discussed above and as no borrowings are being forecast in the 2023-24 LTFP. In addition, if the Council were to utilise more borrowings, it has a target of 50 percent for its net financial liabilities ratio (below the 100 percent suggested by the LGA).[37]

32 This figure provides a general indication on whether the Council has a capacity to repay borrowings or has an emerging cash flow sustainability issue. A negative or relatively small figure should be viewed in the context of the Council's revenue base and existing cash balances, as it may be able to service these cash flow deficits over a period.

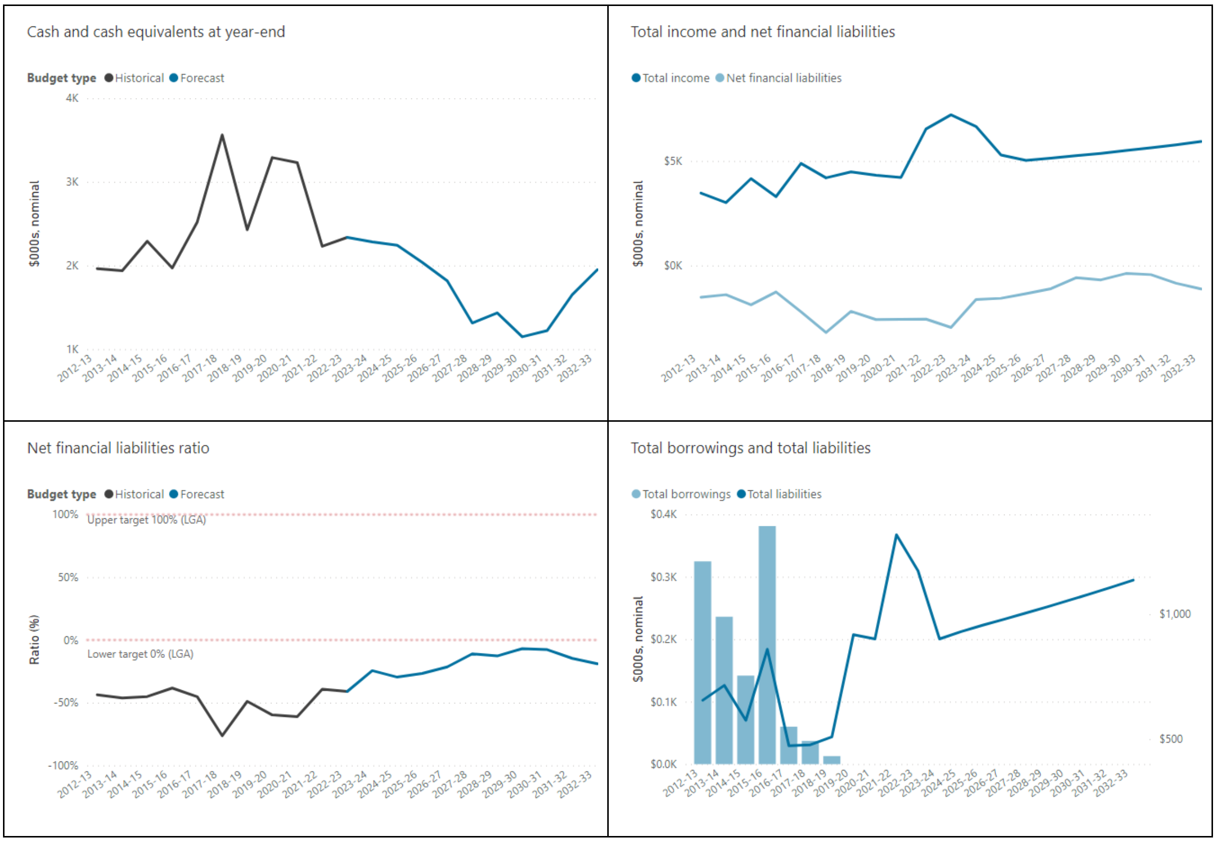
33 The Council states it has a cash advance debenture facility of $1.4 million with the LGFA which has been utilised to mitigate the risk of cash flow shortages as a result of the timing of funding provisions from the reconstruction and repair of the road network following the recent flood event in January 2022.

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

35 Ibid, p. 10.

36 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).

37 Based on the Council's ratio analysis provided to the Commission in August 2023.



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 it 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.

C.3 Asset renewals expenditure

The Council has, on occasions, underperformed on its asset renewal funding ratio,[38] particularly in the periods between 2012-13 and 2014-15, and 2018-19. Overall, it achieved an average of 87 percent over the 11-year period between 2012-13 and 2022-23, [39] marginally below the lower end of the LGA's suggested target range (see the top charts over the page). The ratio showed some volatility over this period, indicating that the Council has, at some times, underspent on the renewal and rehabilitation needs of its asset stock, while in other periods has undertaken additional works above what its infrastructure and asset management plans had forecast. The Council's spending on renewal and rehabilitation of assets averaged $1.1 million each year (in nominal terms) from 2012-13 to 2022-23.

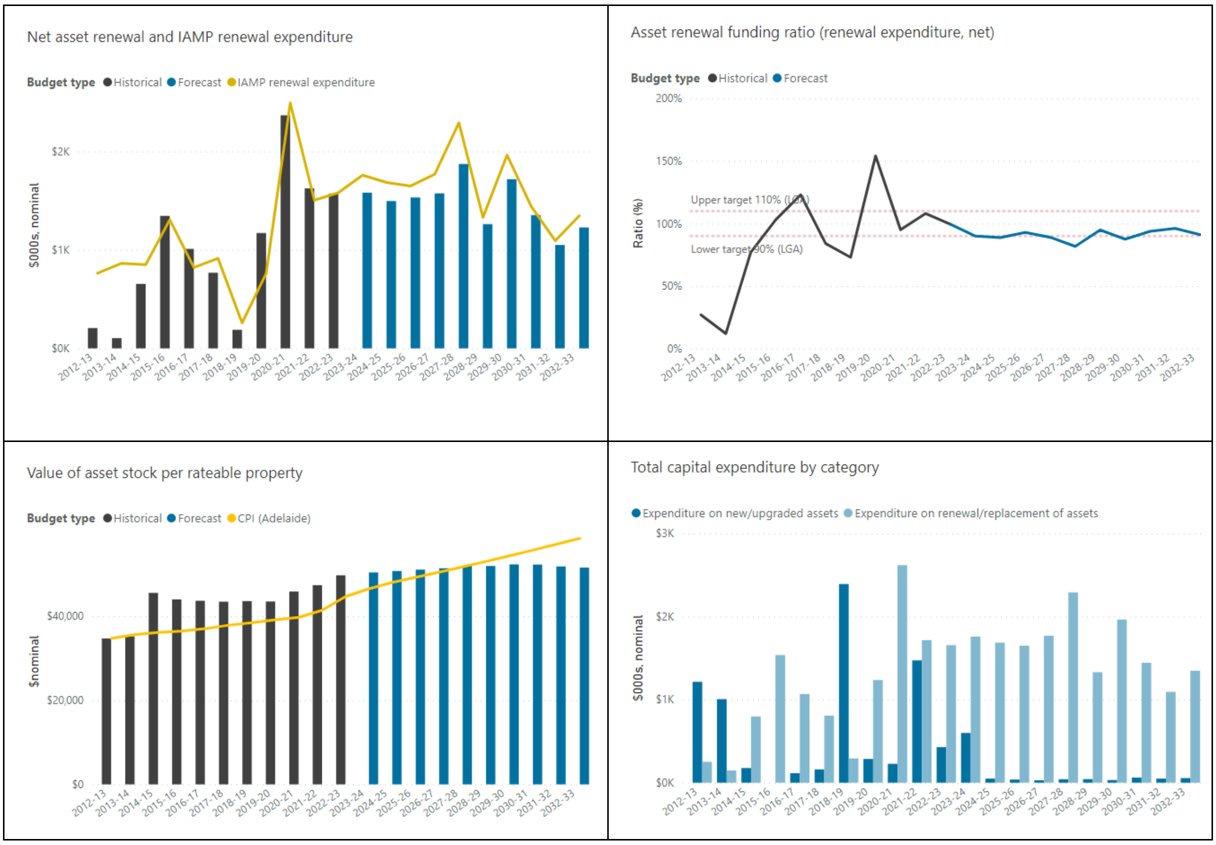
From 2023-24 to 2032-33, the ratio (based on 'net asset renewal expenditure') is forecast to average 90.6 percent, which follows the Council's review of its IAMP in August 2023 and its revised projections

38 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).

39 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'.

which have been reflected in its 2023-24 LTFP.[40] As a result, average annual spending on the renewal and rehabilitation of assets is projected to increase to $1.6 million (in nominal terms). The majority of the Council's asset renewal expenditure program (over the period from 2023-24 to 2032-33) is allocated to road resealing and road re-sheeting (51 percent), followed by plant and equipment renewal (36 percent).[41]

The Council has grown its asset base, particularly over the last 3 years (from 2020-21 to 2022-23) with total capital expenditure averaging $2.7 million per annum, predominantly being allocated to asset renewals, which averaged $2.0 million per annum over the period (see the bottom right chart below). This reflects the extensive asset expenditure and rectification works associated with the flood damage to the Council's road network in January 2022. However, it is not clear on the extent to which this additional expenditure has been capitalised (or included in its asset base), as these road works are still progressing. The Council's asset stock per property of has increased by $1,504 or 3.7 percent for each year over the 10 years to 2022-23 (see the bottom left chart below). The projected asset stock per property shows a relative decline in real terms due to overall slower annual growth in total capital expenditure, but also higher depreciation charges (compared to the recent past).



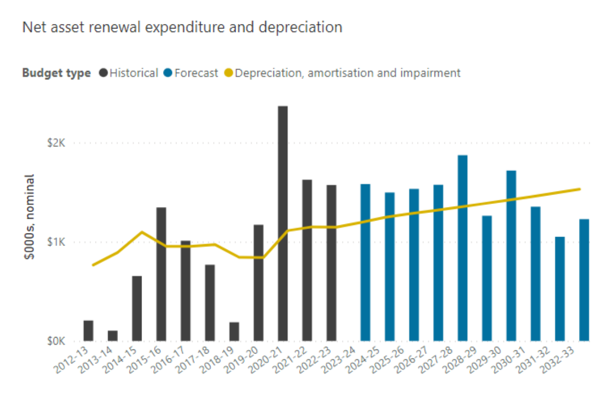
Asset renewals can also be viewed in the context of the depreciation-based asset renewal funding ratio,[42] which has generally tracked (on average) above the recommended minimum level (for the IAMP-based ratio) of 90 percent, over the period from 2012-13 to 2022-23, albeit that the ratio showed significant volatility, historically. In recent years (for example since 2019-20) and over the forecast

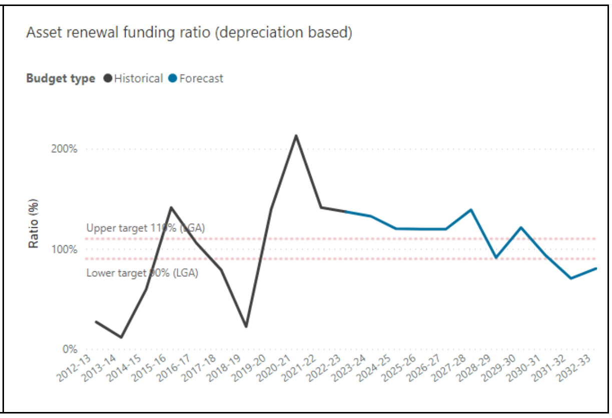
40 District Council of Kimba, *Infrastructure and Asset Management Plan 2024-33,* August 2023, p. 3, available at District-Council-of-Kimba-Infrastructure-and-Asset-Management-Plan-2024-33.pdf.

41 Ibid, p. 3. Percentages are based on the Council's real terms projections of its asset renewal expenditure program.

42 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.

period (for example to 2027-28), total capital expenditure and asset renewal expenditure have (and are projected) to outpace depreciation by $8.9 million and $5.7 million, respectively. While this could reflect the level of growth in asset expenditure (for example related to the works associated with restoring its road infrastructure),[43] it could also suggest that depreciation schedules have not been reviewed or updated since the works have been carried out to rectify damaged roads due to the flood event in January 2022.[44]





In this context, it is important for the Council to understand the extent to which 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 risk to the Council's financial forecasts, where the incorrect recording of depreciation could lead to an incorrect assessment of its operating performance and sustainability. The Commission recognises that recent road works undertaken by the Council and associated one-off cost and income items have impacted on its financial accounts. As such, the Commission is unable to assess the appropriateness of the level of funding related to the decline in value of its assets.

Based on the Council's material amendments to its IAMP, the Commission understands the Council has considered recent asset condition assessments, the useful life of its assets, and the inflationary environment impacting on its asset renewal expenditure program.[45] Additionally, the Commission understands the revaluation of rural roads (sealed and unsealed) has been postponed until the conclusion of restoration works, anticipated to be completed by the end of the 2024-25 financial year.[46]

There appears to be some 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.

[43] 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.

[44] It is possible to argue that the depreciation charge going forward is either too low (because the asset stock is in a worse condition despite the renewals), or that it is too high (because the renewal work undertaken has improved the asset condition), so increased the asset life, of the assets sooner than planned.

[45] Material Amendments Statement provided to the Commission in September 2023.

[46] 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.

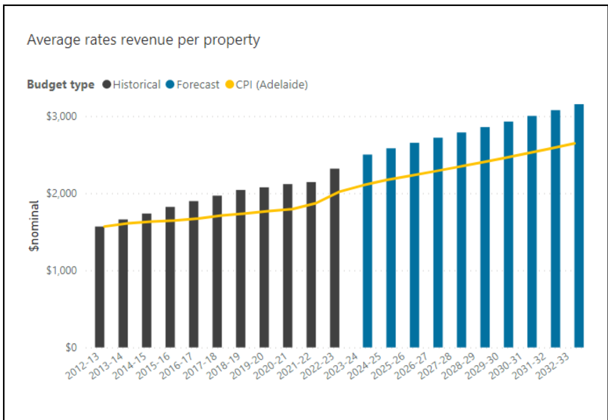
D Current and projected rate levels

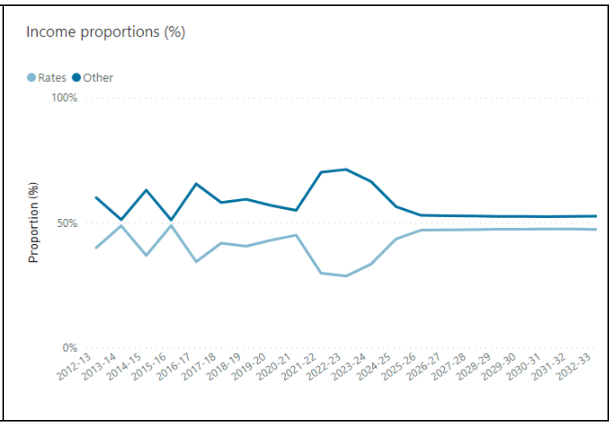
D.1 Historical rates growth

The Council's rate revenue per property growth has averaged 3.5 percent, or $64 per annum, for each property over the past 10 years,[47] to reach an estimated $2,144 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 growth in rateable property numbers of 0.3 percent per annum, representing a real term increase in rates.[48]

The Council's rates income accounted for approximately 40 percent of its total operating income over the period 2012-13 to 2021-22 (see the chart below to the right); however the Council remains reliant on income from 'grants, subsidies and contributions', which has accounted for 48 percent (on average) of total operating income over the same period.[49]

The Commission notes the Council has marginally higher average rate levels compared to similar councils (but is in-line with the Statewide average). This reflects its marginally higher-rate levels for residential and non-residential ratepayers, compared to similar councils.[50]





D.2 Proposed 2023-24 rate increases

The Council has budgeted for an average rate increase of 7.9 percent, consistent with its assessment of CPI at the time its budget was prepared,[51] and this represents an increase of approximately $161 per rateable property in 2023-24.[52] This rate increase was higher than it had anticipated charging for this year in its 2022-23 LTFP; that is, the Commission estimates a 3.4 percent increase in average rates was previously forecast for 2023-24.[53] The rates increase reflects the Council's objective to not increase rate

47 From 2012-13 to 2021-22.

48 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.

49 Based on information and discussions with the Council, there are currently limited opportunities to raise additional income from other sources such as parking, aged care and through development activity.

50 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. Other rate charges such as for waste management and the regional landscape levy do not form part of this comparison.

51 CPI Adelaide (All groups) increased by 7.9 percent in the year to March 2023 quarter. Available at https://www.abs.gov.au/statistics/economy/price-indexes-and-inflation/consumer-price-index-australia/sep-quarter-2023.

52 District Council of Kimba, *Annual Business Plan and Budget 2023-2024,* June 2023, p. 14. The Commission has used the Council's existing rateable property estimate of 891 (which assumes no growth in rateable properties).

53 Based on the Council's Excel Financial Reporting template provided to the Commission. The Council has not published its rate increase projections in its LTFP; however, it has provided nominal projections of its financial plans to the Commission.

revenue in real terms (that is, only CPI increases).[54] Further the Council has stated that the increase in rates income (of $144,000) will assist it in covering increased costs in its operating and capital budgets.[55] It is also noted that the Council has undertaken extensive repair and reconstruction works on its road network which was damaged by floods related to Cyclone Tiffany in January 2022; however, not all of the Council's costs were able to be externally funded by disaster recovery grants.[56]

The Council has also reviewed and updated its rating arrangements which came into effect for ratepayers in 2023-24. This meant that the Council was required to change 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.[57] The Council has a rating policy which has a stated principle that the rate in the dollar should be the same for all properties except where there is clearly a different level of services available to ratepayers (or some other circumstance which warrants variation from the broad principle),[58] and this appears appropriate.

It is noted that some ratepayer categories (such as residential, commercial, industrial, and other) will have the same 'rate in the dollar' applied to their rateable property values; while primary producers represent a relative 20 percent discount (on a 'rate in the dollar' basis), and silos and vacant land represent a relative premium of 233 percent and 500 percent respectively (on a 'rate in the dollar' basis).[59] 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).

Other than 'general rates' revenue (which represents around 87 percent of total rates revenue in 2022-23),[60] the Council collects income from the CWMS charge, waste management,[61] and the Regional Landscape Levy (around 5, 4 and 4 percent of total rates revenue respectively).

D.3 Projected further rate increases

Over the forward years of its LTFP, the Council states it is projecting that rate revenue will not increase in real terms, meaning that rate increases are projected to be in line with CPI changes. It is noted that the Council's LTFP is based on real (2023-24) dollar values for all future years, which reflects the Council's preferred approach in assisting it to consider comparisons between years.

In December 2023, the Commission requested the Council to provide nominal financial information to aid in the comparison of past and projected financial performance (and enable comparisons across different planning periods). Importantly this provides the Council with a mechanism to review and consider long-term changes in indexation associated with its revenue and cost estimates.

The Council provided to the Commission nominal projections of its financial plan information and, based on that, the Council is projecting average rate increases for its existing ratepayers of approximately 2.6 percent per annum from 2023-24 to 2032-33 reflecting lower average increase in rates than it has imposed in the past (of 4.0 percent per annum over the period from 2012-13 to 2022-23).

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54 District Council of Kimba, *Long Term Financial Plan 2024-33,* August 2023, p. 3.
55 District Council of Kimba, *Annual Business Plan and Budget 2023-2024,* June 2023, p. 14.
56 District Council of Kimba, *Annual Report 22-23*, pp. 4-6, available at https://www.kimba.sa.gov.au/__data/assets/pdf_file/0019/1510264/District-Council-of-Kimba-Annual-Report-2022-23.pdf.
57 The Council's 'land use' categories consist of residential, commercial, industrial, vacant land, primary production, silos, and other. In 2022-23 the Council used a three zone structure consisting of bulk handling zone, rural zone, and all other zones.
58 District Council of Kimba, *1.8 Rating Policy 2024,* June 2023, available at: https://www.kimba.sa.gov.au/__data/assets/pdf_file/0029/383159/1.8-Rating-Policy.pdf.
59 Ibid. The Council states the differential rates are necessary for reasons of equity, benefit, and ability to pay given the nature, mix and significant site valuation variations of land between different rating areas above.
60 Before discretionary rebates and penalties.
61 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.

In total, the Councils 2023-24 LTFP effectively projects a cumulative increase of $653 per existing ratepayer (to $3,154 per annum) by 2032-33, in line with the RBA-based inflation forecast of an average of 2.6 percent per annum[62] (refer to the previous chart on the left side).[63] As a result of further rates increases (and other forecasting assumptions discussed previously), the percentage of the Council's total income contributions from ratepayers is projected to average around 45 percent, or approximately 5 percent higher than its historical average.

The Commission considers that it would be appropriate for the Council to:

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.

D.4 Affordability risk

Affordability risk among the community for these further rates increases appears to be moderate, on balance, when considering:

- the Council's relatively high socio-economic indexes for areas (SEIFA) economic resources ranking for the Council area,[64]
- its lower rate base (of about 890 ratepayers) and Council's greater reliance on grant funding,
- the higher proportion of primary production ratepayer income which are likely to have lower affordability risk than residential ratepayers,
- the Council's current planning assumption to keep its rate increases in line with CPI, and
- minimal community concerns expressed on the current and proposed levels of rates affordability.

62 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.

63 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 can be different to Council's inflation and rate increase assumptions.

64 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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