Advice

Local Government Advice - Attachment

Northern Areas Council

February 2024

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A The Commission's approach

In providing the Advice for the Northern Areas Council (**Council**), the Essential Services Commission (**Commission**) has followed the approach it previously explained in the Framework and Approach – Final Report (**F&A**).[1]

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

- 2023-24 Annual Business Plan and Budget (adopted June 2023)
- 2023-24 – 2032-33 Long Term Financial Plan (adopted June 2023)
- Northern Areas Council 2023-24 Financial Reporting template (updated Nov 2023)
- Bridges Asset Management Plan 2017
- NAMS PLUS Concise Asset Management Plan Buildings (2017)
- NAMS PLUS Concise Asset Management Plan Public Open Space (2017)
- Plant Vehicles Equipment Asset Management Plan 2017
- Roads AMP 2016
- Storm Water Asset Management Plan 2017

The Commission notes that the Council's asset base is covered by its existing asset management plans (**AMPs**), and evidence is provided that asset valuations for those assets have been carried out within the last four years.[4] The Commission's advice will refer to the existing asset management plan, however the Commission's view is that the plan is significantly out of date and presents a considerable risk to the Council's financial sustainability.

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 Northern Areas 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, as well as its 2022-23 unaudited results, together with historical financial data, the number of rateable properties and council staff (Full Time Equivalent (**FTE**)) numbers

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 answered in assessing the Council's performance against these indicators to determine affordability, cost control and other sustainability risks.
4 Northern Areas Council 2022/23 annual report, p55, supplied by NAC subsequent to ESCOSA request for feedback on Advice.
5 *Local Government Act 1999* (**LG Act**) s122(1g)(a)(i).
6 As required under s122(1b) of the LG Act.

from 2012-13 onwards.[7] [8] All charts 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, as appropriate.

The Commission has reported estimates in nominal terms, for consistency with the Council's plans and actual rate levels, but it has compared estimated inflation impacts to these trends as a guide to identify 'real' rather than 'inflationary' effects. In the charts, the Consumer Price Index (**CPI**) line shows the cumulative growth in the CPI (Adelaide) series from 2012-13, and then projections of this series from 2023-24 based on the Reserve Bank of Australia (**RBA**) (Australia-wide) inflation forecasts (to the June quarter 2025), and the midpoint of the RBA target range (2.6 percent) thereafter.

Finally, in formulating this Advice, the Commission has had regard to the circumstances of the Council, including its location as a regional council, its income level ($14 million (21-22) and the size of its rates base (more than 4,257 ratepayers[9]).

Summary of the Northern Area's financial sustainability performance and the Commission's risk assessment

<table>
<tr><th>Financial sustainability indicators:</th><th colspan="3">Last 10 years from 2012-13 (Actual performance)</th><th>2022-23 estimate</th><th>Next 10 years from 2023-24 (Council forecasts)</th></tr>
<tr><td>Operating surplus ratio (target 0-10%)</td><td>Cumulative operating deficits</td><td colspan="2">Some volatility but overall Improved performance -----></td><td></td><td>Ratio projected within target from 2024-25 ----------------------------></td></tr>
<tr><td>Net financial liabilities ratio (target 0-100%)</td><td colspan="4">Ratio met historically --></td><td>Ratio projected within target range ----></td></tr>
<tr><td>Asset renewal funding ratio (target 90-110%)</td><td>Ratio below target range</td><td>Within target range</td><td colspan="2">Some volatility in asset renewal</td><td>Ratio projected within target range</td></tr>
<tr><td>Identified Risks:</td><td colspan="5"></td></tr>
<tr><td>Cost control risk</td><td colspan="4">Constrained operating expenses per property average growth of 1.1% to 2021-22 (CPI 2.0%)</td><td>On average, operating expenses growth less than forecast CPI but with risks ----></td></tr>
<tr><td>Affordability risk</td><td colspan="3">High rates revenue per property average growth of 6% pa to 2021-22 (CPI 2.0%)</td><td></td><td>Rate revenue per property average growth of 2.7% p.a. to 2032-33 (CPI forecast 2.6%) but with risks---------></td></tr>
</table>

- 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

[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.
[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, partly for inflation and partly for other revenue and spending initiatives. The material amendments to some of its main financial forecasts are listed in the table below (in nominal terms).[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)
Total operating income	131.5	132.6	1.1	0.9
Total operating expenses	124.5	126.2	1.7	1.4
Operating surplus / (deficit)	7	6.4	(0.6)	(0.6)
Capital expenditure on renewal of assets[11]	51.0	52.5	1.5	2.9
Capital expenditure on new and upgraded assets[12]	1.3	1.8	0.5	38.5

B.1 Changes to operating performance

The Council has budgeted (in 2023-24) a decrease in its operating performance, with a surplus of $6.4 million compared to a surplus of $7 million in the 2022-23 LTFP. In aggregate, the projections in its current and previous LTFPs (that is, over the ten-year comparative period to 2032-33, as shown in the table above) indicate the Council's cumulative operating performance decreased by $0.6 million in dollar terms. The projected operating surplus over the LTFP reflects the Council's efforts to achieve an operating breakeven or operating surplus.

In its adopted LTFP and published annual budget for the 2023-24 budget year, the Council had forecasted an operating surplus ratio of 4 percent.[13] The material amendments to the adopted LTFP as of 30 September 2023, highlighted that the Council had amended its operating surplus ratio forecast for 2023-24 from 4 percent to negative 16.2 percent (deficit), predominantly driven by the timing of Council receiving a $2.2 million Grant (in 2022-23) in advance for the 2023-24 year.

Further amendments, compared to the LTFP, include:

- higher inflation estimates resulting in increased cost pressures for 'materials, contracts and other' expenses, as well as 'employee' expenses, as discussed in section B.

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

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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 LTFP estimates provided by the Council to the Commission (in an Excel template).

12 The capital expenditure estimates are based on the 2023-24 LTFP estimates provided by the Council to the Commission (in an Excel template).

13 Northern Areas Council – 2023-24 annual business plan available at Northern Areas Council | Northern Areas Council (nacouncil.sa.gov.au) page 11

B.2 Indexation adjustments

The Council has considered CPI, LGPI and interest rate forecasts in developing its cost and revenue estimates.[14] It made an upward revision to its assumptions in its 2022-23 LTFP estimates for income and expenditure.[15]

The updated inflation assumptions in its 2023-24 LTFP, show an increase in its cost and revenue estimates by up to 1.4 percent and 0.9 percent respectively over the 2023-24 to 2032-33 forecast period,[16] compared with the same estimates in its 2022-23 LTFP, and could be explained by the Council's higher inflation forecasts.

The Council has factored its current inflation forecasts into its LTFP projections, discussed in section C.1. However, its current inflation forecasts do still present a risk to its cost and income projections in the current inflationary environment as the average forecast growth per annum until 2032-33 is below that of the RBA's forecast CPI. The RBA currently forecasts the CPI (Australia-wide) to increase by 3.6 percent in the year to 30 June 2024 and by 3.1 percent in the year to 30 June 2025. Thereafter, it is reasonable to anticipate a return to long-run CPI averages (and growth of 2.6 percent per annum from 2025-26).[17]

An additional risk is presented from the 69 percent of asset valuations undertaken at 1 July 2020, and the lack of updated AMPs causing uncertainty about depreciation costs during a period of high inflation.[18] If costs increase above the Council's forecasts, there is a risk of not achieving the predicted OSR which may require the Council to either increase rates, reduce service levels, or increase borrowings.

The Commission notes the Council's stated assumptions[19] for indexation in its 2023-24 LTFP but is of the view that there is considerable uncertainty around those assumptions. Notwithstanding the need for the Council to find savings and reduce any inflationary impact on its community, the Commission has found that it would be appropriate for it to:

1. Manage its near-term forecast costs to ensure they are sufficiently constrained to enable achievement of the forecast operating surplus ratio.

B.3 Increase to capital expenditure estimates

The Council's 2023-24 LTFP indicates an increase in capital expenditure for asset renewals (by $1.5 million or 0.03 percent), and for new and upgraded assets (by $0.5 million or 38.5 percent), compared to the previous year's LTFP (for the period from 2022-23 to 2030-31). Over the 10-year projections in the 2023-24 LTFP, the Council has factored in a total of $59 million in capital renewal and replacement works and $1.8 million in new and upgraded capital works, accounting for 97 percent and 3 percent of the total capital expenditure program respectively.

The Council's Road assets represent the largest asset class, and is a major focus of its renewal investment, in the 2023-24 annual budget – accounting for 65 percent of all renewal capital expenditure.[20] Noting that the asset management plans are out of date and lack sufficient detailed data

[14] Northern Areas Council – long-term financial plan 2023-24 to 2032-33 available at Northern Areas Council | the material Northern Areas Council (nacouncil.sa.gov.au)

[15] Northern Areas Council – long-term financial plan 2023-24 to 2032-33 available at Northern Areas Council | the material Northern Areas Council (nacouncil.sa.gov.au)

[16] The set of ten years forecast in both the 2022-23 and 2023-24 LTFP projections.

[17] RBA, Forecast Table - August 2023, available at https://www.rba.gov.au/publications/smp/2023/aug/forecasts.html.

[18] Cumulative inflation of 13.7% 1.7.2020 to 30.6.2023. Refer to: https://www.abs.gov.au/statistics/economy/price-indexes-and-inflation/consumer-price-index-australia/sep-quarter-2023#capital-cities-comparison

[19] Northern Areas Council – long-term financial plan 2023-24 to 2032-33 available at Northern Areas Council | the material Northern Areas Council (nacouncil.sa.gov.au), p8.

[20] Northern Areas Council – long-term financial plan 2023-24 to 2032-33 available at Northern Areas Council | the material Northern Areas Council (nacouncil.sa.gov.au), pp51-52.

to confidently forecast capital expenditure for the period 2023-24 to 2032-33, there is a risk that the Council's capital expenditure budgets are inaccurate. See also section C3 below.

B.4 Changes between 2023-24 LTFP and annual business plan

The Northern Areas Council adopted its annual business plan and budget together with its LTFP 2023-24 in June 2023. This practice provides transparency to the community about forward projections. The Commission notes that the document financials are aligned from 2025-26 forwards, however the Annual Budget 2023-24 was not updated to match the LTFP forecast 2023-24. The Commission considers it would assist Council if its annual business plan and Budget were republished with updated 2023-24 forecasts.

2. Ensure updates to the long-term financial plan are reflected in key strategic management documents.

C Financial sustainability

C.1 Operating performance

The Council has experienced volatility in operating surplus/deficits between 2012-13 to 2019-20, however in 2020-21 and 2021-22, it achieved operating surpluses of $1.21 million and $2.04 million respectively. The Council's operating surplus ratio (OSR)[21] outlook in the short-term is forecast to be a surplus in 2022-23 followed by a deficit in 2023-24, before being forecast to sit within the LGA target range for OSR (between 0 and 10%). The longer term sees OSR rising from 2024-25 to 2032-33 to between 3.9% to 9.5% respectively. The Council experienced deficits of over $1m in each of the years 2012-13, 2013-14 and 2015-16 indicating it had difficulty in meeting its operating expenses at that time.

The Council has improved its position considerably in turning around from predominantly running deficits to forecasting predominant surpluses. However, the forecasts are optimistic when considered against RBA CPI forecasts and the Council has additional inherent risks because of outdated AMPs.

Total income growth averaged 5 percent per annum from 2012-13 to 2021-22, more than double the rate of total expense growth (which was relatively conservative, averaging 2.0 percent per annum). Rates revenue has increased on average by 6.4 percent per annum from 2012-13 to 2021-22[22] (when rateable property growth averaged 0.4 percent and CPI growth averaged 2.6 percent). Over the same period 'statutory charges' increased by an average of 4.3 percent per annum, and 'grants, subsidies and contributions' (accounting for 29 percent of total income) increased by an average of 6.2 percent per annum. Grants income has been 'lumpy' from year to year, however the three-year average of $775 per ratepayer in 2021-22 compares with the three-year average of $743 in 2018-19. That reflects an increase in value in real terms with growth of 4.3 percent when compared with average inflation during that period of 2.0 percent (during 2012-13 to 2021-22). As noted above, the Commission is aware of the variable payment dates for Financial Assistance Grants which may not be received in the same financial year to which they pertain.

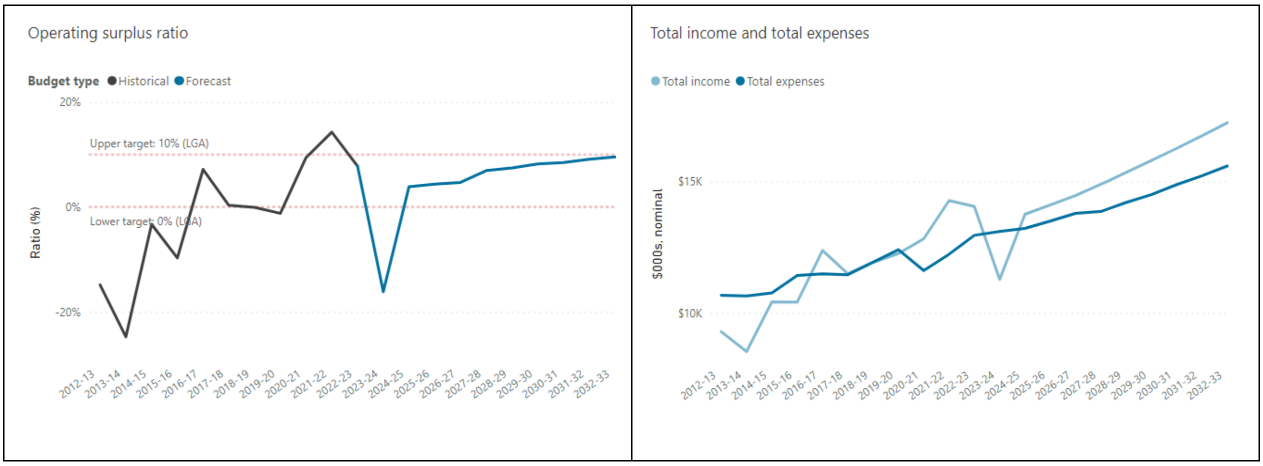
The Council's operating expense (from 2012-13 to 2021-22) growth was slightly below CPI primarily due to a significant decrease of 8.8 percent in 'finance costs' combined with modest increases in other expenses that were also below CPI growth for this period including materials and contracts, depreciation and employee costs (see chart overleaf). However, it is possible that depreciation has been under-reported in the period due to outdated AMPs.

The Council generated an operating surplus in the two years (2020 to 2022) and forecasts a surplus for 2022-23 followed by a deficit for 2023-24. However, the average surplus over the three year period 2021-22 to 2023-24 (to exclude the impact of grant timing) is $0.4 million. The Commission notes that the forecasted deficit in 2023-24 can be partly attributed to the timing of the Council's Financial Assistance Grants.

The near-term improvement to its projected operating performance is attributed to budgeting for continued rate revenue increases and slower expense growth (see top right chart over the page).

[21] 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).

[22] 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).



Looking forward, the Council is forecasting average annual rates revenue growth of 3 percent to 2032-33 which is slightly above the forecast long-term inflation.[23] This average growth in annual rates revenue is higher than expected expense growth of 2.0 percent. (Rates are discussed in more detail in section D).

The forecast average expense growth of 2.0 percent per annum is less than the RBA-based forecast inflation growth[24] and continues the Council's past performance in costs constraint (with average annual growth of 1.5 percent in the 10 years to 2021-22). The risk with forecast growth at 2 percent is that this expenditure constraint is essential to achieving the forecast operating surplus ratios, however higher inflation and/or other cost pressures may occur. The Commission notes that if depreciation is understated due to outdated AMPs or if materials and contracts costs increase in line with RBA forecast inflation, then expenses could be significantly higher than anticipated.

Expenses per property (a metric which also accounts for growth) are expected to increase by an average of 1.7 percent per annum over this period, which would represent a significant cost reduction in real terms if accurate (based on current inflation projections) (see the right chart below).

The Council's template data (provided to the Commission) shows that employee numbers are assumed to increase from 53 FTEs in 2022-23 to 56 FTEs in 2023-24 and then remain constant. Some of its operating income and expense lines indicate negligible change in real terms or growth below current inflation forecasts. For example, grants income (when adjusted for the $2.2 million advance payment)

23 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.
24 See footnote 23.

indicates growth of 2.3 percent over the next ten years, which is less than forecast CPI for the period.[25] In addition, 'employee' expenses and 'materials, contracts and other' expenses are forecast to increase by an average of 2.4 percent and 1.1 percent per annum respectively, from 2023-24 to 2032-33. Overall, this would reflect much more constrained growth, below forecast inflation. This is a positive trend and will support the Council's improved financial sustainability outlook. However, the Commission notes that continued 'cost constraint' remains essential to achieving sustainability and there are inherent risks as mentioned above in the forecasts.

The Commission has observed the intention of the Northern Areas Council to conduct significant asset management plan reviews by the end of 2023 focused on achieving a sustainable and customer focused approach to service delivery.[26] Also see section C3 below.

To ensure the Council is positioned to achieve the real terms reduction in its cost base that it has forecast and improve its operating performance (without the need for further rate increases above inflation), the Commission encourages it to:

3. Manage cost growth in its budgeting, where possible, including related to employee expenses and materials, contracts and other expenses.
4. Review and update depreciation expenses based on revised asset management plans.
5. Continue its good practice of reporting any actual and projected cost savings in its annual budget (and long-term financial plan, as appropriate), to provide evidence of constraining cost growth and achieving efficiency across its operations and service delivery.

C.2 Net financial liabilities

With the Council's frequent operating deficits from 2012-16, its net cash flows after operating and investing activities (that is, capital-related) has averaged $0.5 million annually between 2012-13 and 2021-22.

The Northern Areas Council has predominantly used 'borrowings' to fund its renewal of existing assets between 2012-13 and 2021-22.[27] The Council expects that net financial liabilities will peak in 2023/24 before reducing due to an improvement in their cash position and no borrowing from 2023/2024 onward for this purpose.[28]

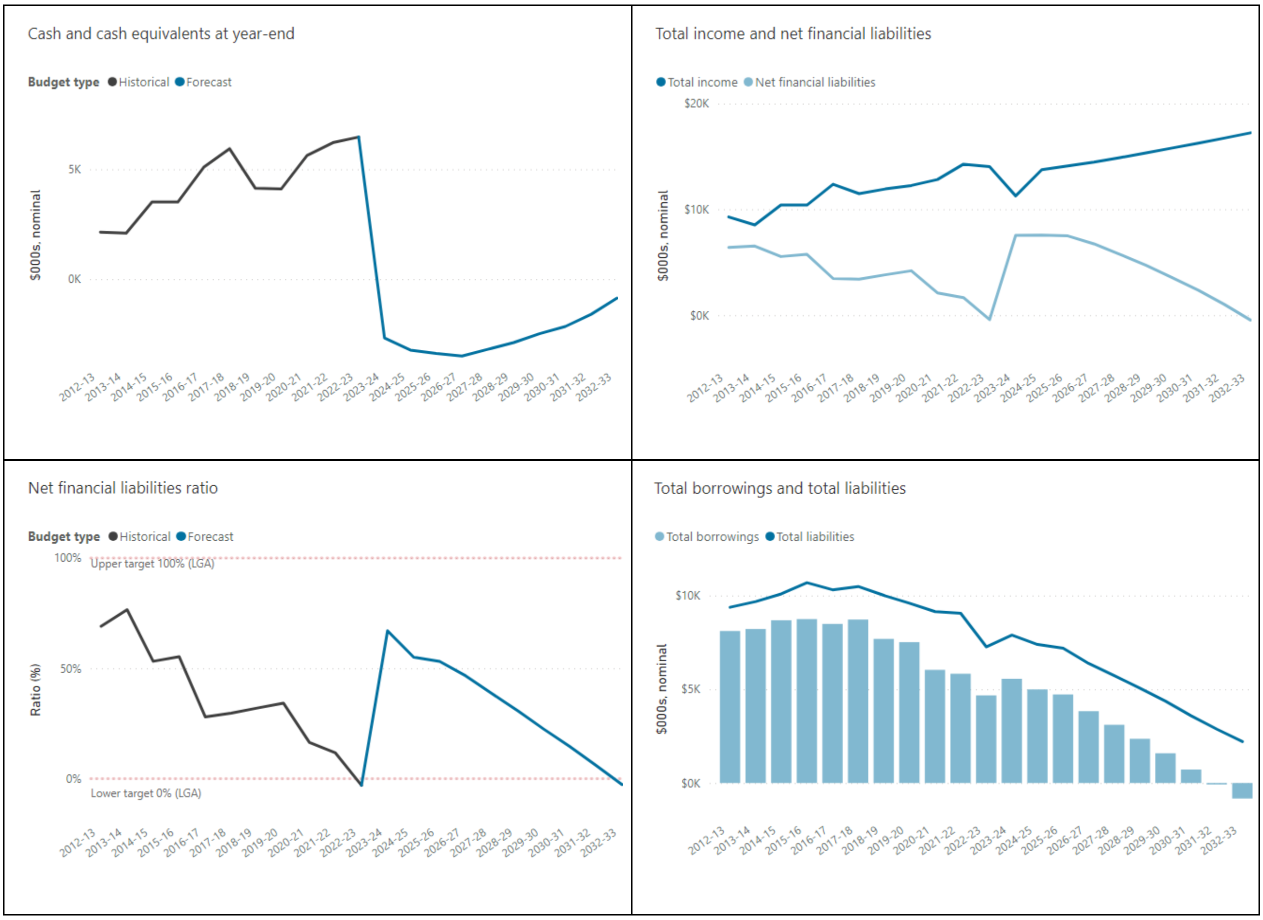
The spike in the Council's Net Financial Liabilities Ratio (2023-24) assumes that all budgeted works and those carried forward will be completed in line with budget forecasts, leading to reduced cash balances and CADs drawn. However, the Council advises that this is unlikely due to resource issues.[29] Given this advice, the Net Financial Liabilities Ratio in the short to long term will likely rise slightly, then gently trend upwards rather than a sharp rise thereafter trending downward.

The Council's net financial liabilities ratio has trended downward between 76.6 and 11.6 percent between 2013-14 and 2021-22 respectively (see the below left chart over the page). This is well within the suggested LGA target range for the indicator of between zero and 100 percent (averaging 37.4 percent over this period) and is at a level which demonstrates that the Council is only accumulating liabilities that its operating income can reasonably service (see the top right chart over the page).[30]

The Council has forecast that following additional borrowing in 2023-24 (noting comment above regarding completion of budgeted works), the net financial liabilities ratio will decrease between 2024-

25 Based on the Council's Excel template provided to the Commission. Forecast average is based on the 10-year period from 2023-24 to 2032-33 adjusted for the 2023-24 grant of $2.2 million received in advance.
26 Northern Areas Council – 2023-24 annual business plan, June 2023, p.7
27 Northern Areas Council *Long-term financial plan*, June 2023.
28 Northern Areas Council Long-term financial plan, June 2023. p.7
29 Meeting between NAC and ESCOSA 19 Oct 2023
30 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, p. 7-8).

25 to 2032-33 to an average of 33.1 percent, which reflects both the cessation of borrowing and other liabilities, and the projected operating income growth (at an average of 4.8 percent per annum). As previously stated, the Council is relying predominantly on further rates revenue growth and a subdued growth in operating expenses to improve its overall financial sustainability.



Based on the Council's projected repayment of borrowings, and relatively low forecast net financial liabilities ratio in the longer-term, the Commission notes that it might have the opportunity to utilise more debt to further address its deferred asset renewal or new asset expenditure requirements. However, its forecast annual end of year cash position is negative $0.5 million in 2024-25, and it would need to consider its operating capacity for further borrowing repayments, given its forecast operating deficit in the short-term.

C.3 Asset renewals expenditure

Between 2012-13 and 2021-22, the Council's total capital expenditure averaged $4.6 million per annum (of which $3.8 million was on asset renewals and replacements). The Council's asset renewal funding ratio (IAMP-based) was below the suggested LGA target range of 90 to 110 percent over these years,[31] and averaged 85.3 percent between 2012-32 and 2021-22. This indicates that the Council underperformed in meeting its asset service sustainability requirements over this period, as it utilised increased rate and grant funding and borrowings while it also sought to address its recurring operating deficits.

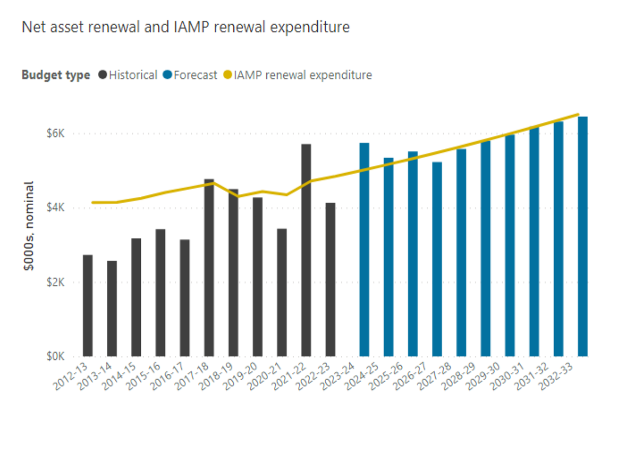
31 The IAMP-based method is the current industry standard whereby asset renewal/replacement expenditure is divided by the recommended expenditure in the IAMP (or AMP). Ideally, this will show the extent to which a council's renewal or replacement expenditure matches the need for this expenditure, as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

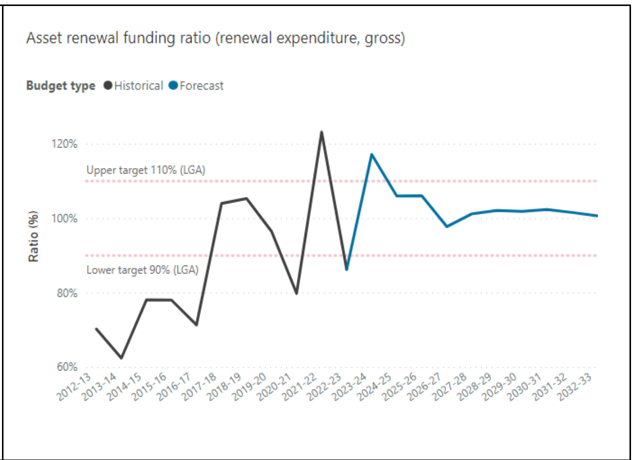
From 2023-24, the Council is projecting to increase its asset renewals spending profile with projected annual asset renewal expenditure averaging $5.9 million to 2032-33, in nominal terms (see the top charts below). As a result, its asset renewal funding ratio (IAMP-based) is expected to trend within the suggested LGA target range (averaging 101.9 percent from 2023-24 to 2032-33). The additional funding will partially offset the previous years' deferred renewal expenditure and coincides with much lower forecast spending on new or upgraded assets (estimated to average $.5 million from 2023-24 to 2026-27), then cease.

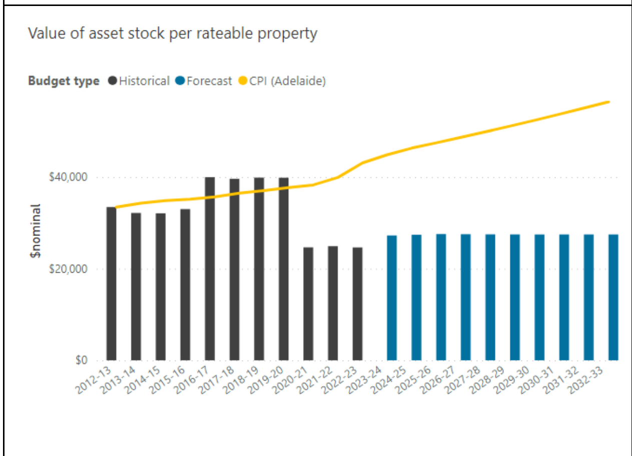
The Council has predicted no new/upgraded capital expenditure from 2027-28 onwards in its LTFP. The Commission notes that the Council has historically expended average new capital expenditure of $0.7 million per annum over the previous 10 years and could have reasonably made longer-term forecasts despite the absence of any known capital expenditure. Furthermore, the Commission also notes that the Council advised that new capital expenditure was frequently linked to grant funding, and that it had forecast grant funding for the same period in the absence of any new capital expenditure. This may create a risk that forecast grant funding inflates the operating surplus ratio and understates the net financial liabilities ratio.

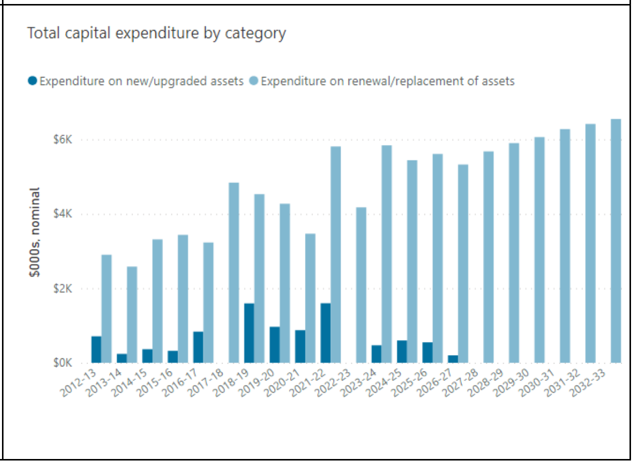
The Northern Areas Council has reduced its asset base over the past 10 years notwithstanding total capital expenditure averaging $3.8 million per annum (plus $0.7 million per annum on new or upgraded assets) between 2012-13 and 2021-22 (see the bottom right chart below). This was in part due to service consolidation in smaller towns and sales of building assets. This has led to an average decrease in the value of the asset stock per property of 3.2 percent for each year over the 10 years to 2021-22 (see the bottom left chart below). By implication, this indicates the Council's asset stock has declined in real terms (or the increase is lower than historical inflation).

The Council's historical capital spending profile has given rise to an accumulation of deferred asset renewals (indicated by actual asset renewal expenditure being lower than required under the AMPs). However, over the term of its LTFP, the Council is forecasting to partly address this, by forecasting a higher asset renewal funding ratio in the later periods of the LTFP projections (see the right chart below).





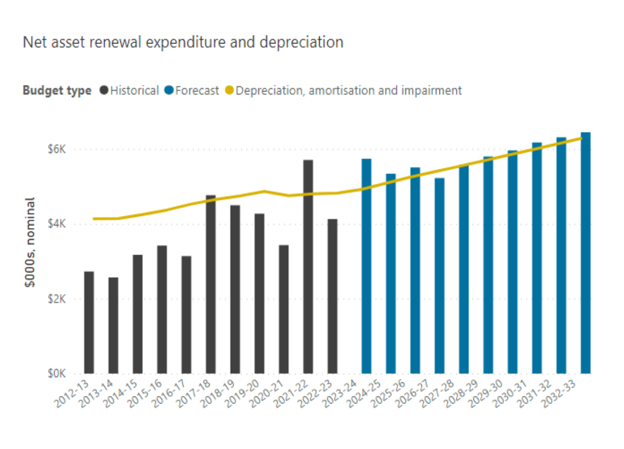


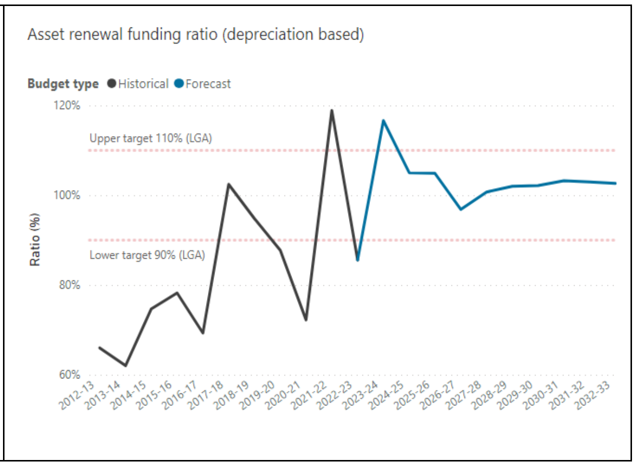


For these reasons, the Commission considers that it would be appropriate for it to:

6. **Adhere** to the principles underpinning its long-term financial plan projections to provide more funding to the renewal of its assets, rather than prioritising initiatives which involve new or upgraded infrastructure.

Asset renewals can also be evaluated by the depreciation-based asset renewal funding ratio,[32] which is forecasted to track within the recommended range (for the IAMP-based ratio) of 90-110 percent, averaging 103.7 percent per annum to 2032-33 (see charts below). In part this reflects a shift in the Council's asset spending priorities towards asset renewals (focussed on transport assets) rather than new and upgraded asset expenditures. Historically (between 2012-13 to 2017-18) depreciation expenses have broadly tracked in line with renewal capital expenditure (totalling $21.4 million over five years). This earlier period may indicate an intergenerational equity[33] risk, as the Council had partly funded capital expenditure (through depreciation) but had deferred or under invested on its asset renewal needs.[34]





The Council currently has individual AMPs for transport, buildings and other structures, major plant, CWMS, stormwater and water infrastructure assets. In formulating its AMPs, the Council noted several matters such as customer levels of service, utilisation and demand for its assets, life cycle management, and risk management planning. However, insufficient data on asset condition and service level requirements (as noted in the reports) affect their validity.

While these plans cover most of the Council's asset base, 69 percent of the asset valuations are dated from 1 July 2020 and AMP plans were prepared 2016-2017 and have not been updated since. This presents a major risk that both forecast renewal capital expenditure and forecast depreciation are incorrect. An additional key risk is that understated depreciation may lead to negative impacts on OSR and the NFLR. In its meeting with the Commission, the Council advised that they have experienced resource issues that have contributed to the lack of AMP updates, and that it is their intention to update its asset management plans in 2023-24 and asset valuations in 2024-25.

32 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.

33 'Intergenerational equity' relates to fairly sharing of services and the revenue generated to fund the services between current and future ratepayers.

34 The Commission recognises this situation was ameliorated somewhat during 2021-22 by $5.8 million of capital expenditure on renewal/replacement of assets addressing some of the deferred backlog.

The Council's key documents indicate that it is proposing several amendments to its AMPs, as follows:[35]

- Incorporation of updated valuation data (2024-25) into AMPs
- Review of key asset classes (roads, buildings, bridges, stormwater and CWMS)
- Swimming pool asset reviews
- Plant and equipment review
- Roadworks efficiency review
- Remote telemetry for CWMS
- Finalisation of irrigation review.

The Commission considers that updated AMPs are essential to mitigate risks arising from the lack of regular revaluation of assets and assessments of asset conditions, such as asset failure or significant unexpected expense which may impact ratepayers in the form of reduced services or increased rates. The Commission notes that if 2020-21 valuation data is incorporated into AMPs in 2023-24, it will already be outdated and that revaluations proposed in 2024-25 should be incorporated into the AMPs when complete to give the most up to date figures that reflect the changes to the macro-economic environment, and the current asset condition.

7. Update asset management plans and asset valuations regularly and at least every four years to ensure an accurate alignment between the asset valuation and renewal expenditure requirements in the AMPs and the latest long-term financial plan projections.

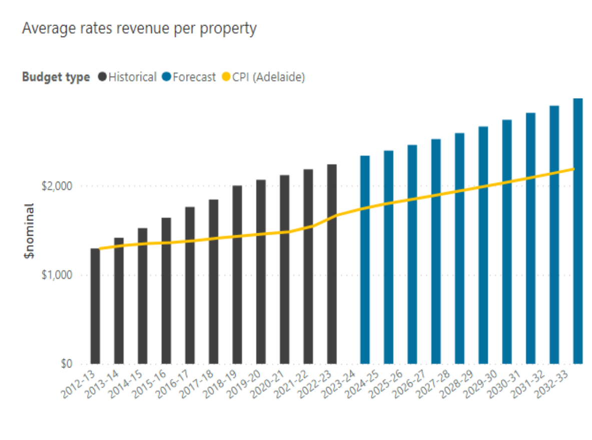
[35] Northern Areas Council – 2023-2024 annual business plan and Northern Areas Council Long-term financial plan 2023-24 to 2032-33

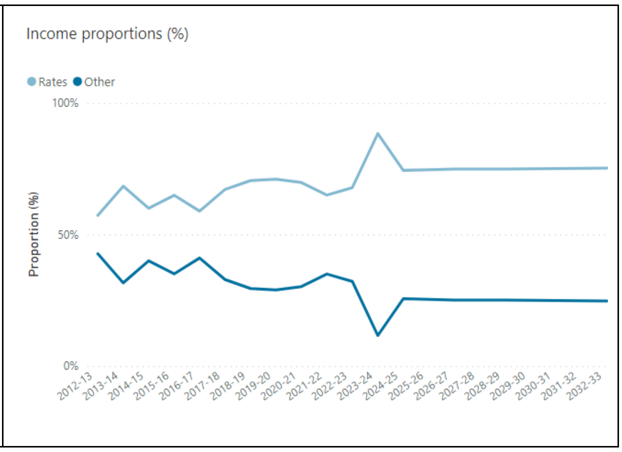
D Current and projected rate levels

D.1 Historical rates growth

The Council's rate revenue per property growth has averaged 6 percent or $178.40 per annum for each property over the past 10 years,[36] to reach an estimated $2,182 per property in 2022-23. (see the left chart below). This has exceeded CPI growth by an average of 4 percent per annum over this period, but also encompasses 0.4 percent average annual growth in rateable property numbers.[37] High levels of historic rate growth has enabled capital expenditure levels to rise and improve the council's operating performance, partly through the reduction of borrowings and associated finance costs.

The Council remains reliant on its rate base for its operating sustainability. As the chart below indicates (to the right), rates revenue accounted for 65 percent of budgeted operating income in 2012-13 to 2021-22 (and an average of 76 per cent thereafter). The Commission notes that the Council has relatively high average rates, reflecting its relatively high-rate levels for non-residential categories, and slightly above average rates for residential ratepayers.[38]





D.2 Proposed 2023-24 rate increases

The Council has budgeted for an average rate increase of 4.3 percent or $97 per property for its existing ratepayers in 2023-24.[39] The rates increase reflects higher short-term inflation and Council's need to raise income to maintain current service levels.[40] The Council has also assumed growth in the area will be minimal[41] (at an average of 0.2 percent per annum).

Other than 'general rates' revenue (which represents around 65 percent of total rates revenue in 2021-22), the Council collects income from statutory and user charges,[42] waste collection and disposal charges, the CWMS charge, and the Regional Landscape Levy.

36 From 2012-13 to 2021-22.

37 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 .

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

39 Based on the Council's 2023-24 Excel template (with the 2023-24 forecasts) provided to the Commission.

40 Northern Areas Council long-term financial plan 2023-24 to 2032-33, June 2023, p9.

41 Northern Areas Council long-term financial plan 2023-24 to 2032-33, June 2023, p9.

42 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.

D.3 Projected further rate increases

Over the forward years of its LTFP, the Council is projecting average rates increases for its existing ratepayers of 2.7 percent per annum from 2023-24 to 2032-32.

In total, the LTFP effectively projects a cumulative increase of $740 per existing ratepayer (to $2,978 per annum) by 2032-33, which is consistent with the Council's assumed inflation growth over this period, and slightly above the RBA-based inflation forecast of an average of 2.6 percent per annum[43] (refer back to the previous page chart on the left side).[44]

As a result of further rates increases, the percentage of the Council's total income contributions from ratepayers is projected to average 75 percent, compared to a historical average of 65 percent.

D.4 Affordability risk

Affordability risk among the community for further rate increases appears to be high, given the council's approach to constraining operating costs is based on depreciation levels which may not be accurate, and on ongoing deferral of renewal capital expenditure (reducing associated materials and labour costs). The Council has optimistic forecasts and once AMP updates and revaluations are undertaken, it may not achieve its planned reductions in operating expenses.

Ratepayers are at risk due to the incomplete and out of date information in AMPs in a period when the economic environment has fundamentally changed, and an asset renewal backlog exists. The risks include potential reductions in service levels or increases in rates. It is difficult to accurately determine an affordability risk when considering:

- the Council's relative average socio-economic indexes for areas (SEIFA) economic resources ranking for the Northern Areas Council area,[45]
- the current relatively moderate average rates (across most ratepayers) without further forecast increases above inflation for ratepayers,
- the effect of cumulative increases in rates per existing ratepayer of approximately 3 percent per annum to the period 2032-33, slightly above the forecast rate of inflation,
- the optimistic constraints on forecast expenditure,
- the outdated AMPs and aged asset valuations for 69 percent of assets, and
- the overall financial sustainability risks of the Council and its LTFP trend towards an operating surplus by 2024-25.

However, as the current economic environment is putting more pressure on most communities' capacity to pay for further rate increases, including those of the Northern Areas Council, the Commission considers it would be appropriate for the Council to:

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43 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.

44 The CPI forecasts in the chart are based on RBA forecasts and then a return to long term averages (2.5 percent per annum), which are different to Council's inflation forecasts (as was discussed in section B.1).

45 The Northern Areas Council area is ranked 38 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.

8. **Update** its long-term financial plan immediately following each update of asset management plans and asset valuations to accurately forecast its financial position and provide transparency with trade-off options to ratepayers about potential higher rates.

9. **Complete** the update of asset management plans, assets valuations and a revised long-term financial plan within 12 months to provide ratepayers with more certainty about future rate increases.

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