# DRAFT

# CEO SUSTAINABILITY REPORT

2024/25 TO 2033/34

CITY OF ADELAIDE

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# Background

The *Local Government Act 1999 (Act)* requires the Council's Chief Executive Officer to prepare a report on the Council's long term financial performance and position as soon as practicable after adopting the council's annual business plan for a particular year, taking into account the provisions of Council's Business Plan and Strategic Management Plans as part of a review of its long-term financial plan. This report on Financial Sustainability fulfils the legislative requirement.

### What do we mean by sustainability?

In general terms sustainability means that the Council can continue current practices, and Financial Sustainability therefore addresses whether Council can sustain our current financial or economic practices now and in the future. Or put more simply:

> *Can we afford it in the long term?*

While there is no legislated definition of financial sustainability, the following statement is the generally accepted definition by the South Australian and Australian Local Government Associations:

> *"A council's long-term financial performance and position is sustainable where planned long-term service and infrastructure levels and standards are met without unplanned increases in rates or disruptive cuts to services."*

For Local Government, challenges in financial sustainability pose the question:

> *Can we continue the sort of revenue and expenditure patterns of recent years while maintaining the levels of service expected by the community?*

What does Financial Sustainability mean for Local Government?

Neglecting financial sustainability can erode a council's capacity to ensure sufficient financial resources to absorb cyclical economic factors, social trends and financial shocks. Funding decisions therefore play an important role in providing Council with the capacity to meet financial sustainability in the medium and long term.

Financial sustainability is also central to the important issue of **intergenerational equity**. Intergenerational equity (or fairness) means costs associated with expenditure are spread over time reflecting the distribution of the benefits generated. In effect, the current generation is able to "pay their way" by funding the services and infrastructure they use and that investments in new infrastructure and assets funded through borrowings will not excessively burden future generations.

Intergenerational equity requires financial sustainability through the stability of revenue and costs, proportionality of revenues with benefits over time and a "balanced" operating result.

## Financial Principles and Finance Strategy

As part of the 2023/24 budget process, Council adopted a set of financial principles to assist with future decision-making to support long term financial sustainability. These principles seek to ensure an equitable approach to rating, fees and charges which match the cost of related Council services, a prudent approach to the use of borrowings and proceeds from the sale of assets, and sustainable investment in our infrastructure and delivery of services.

The financial principles previously adopted by Council include:

- Transparency in decision making
- Approach to rates, fees and charges is fair and equitable
- Service delivery reflects the needs of the community
- Continue to deliver a minimum of the current suite of services and asset maintenance, indexed in line with Consumer Price Index (CPI)
- Fees and charges reflect cost of services provided
- Maintain the current rating system
- Maintain an operating surplus
- Capitalise on external funding, fast-tracking projects that attract such funding, recognising the potential need for increased borrowings in order to respond to external funding opportunities which require matched funding
- Consider new and different revenue streams and the approach to commercial businesses to reduce reliance on existing revenue sources
- Adjust rate revenue after consideration of all other budget components and use growth in rate revenue to partly fund servicing new rateable properties and to service new borrowings
- New or enhanced services, assets or maintenance requiring an increase in operating costs are to be funded from the adjustment of priorities, rate or other revenues, and/or through savings – not from borrowings
- Capital renewal expenditure will be based on asset management plans and prioritised based on audit condition and risk
- Proceeds from divesting underperforming assets will provision a future fund, to invest in future revenue-generating assets
- Consider the disposal, purchase and /or repurposing of property assets to unlock the potential and future prosperity of the City, without incurring a financial loss
- Borrowings will be used to fund new and upgrade projects (which include major projects) and not used to fund operations, expenses or renewal projects.

These principles are foundational to a financial management approach that supports the achievement of long term financial sustainability.

The following additional financial principles have been used in the development of the 2024/25 LTFP to maintain financial sustainability whilst balancing the needs of the Community:

- Short term borrowings will be used to fund the Asset Renewal Repair Fund, to ensure the increased spending required through the revised Asset Management Plans can be spread over a longer period to meet community expectation and their capacity to pay is managed over time through sustainable rate increases
- Generate a cash flow from operations ratio greater than 100% to generate adequate cash from operations to replace assets over time and to service new debt associated with new and upgraded assets by being able to repay the principal and interest associated with those borrowings.

## How do we monitor and communicate financial sustainability?

A suite of financial sustainability indicators (KFIs) is used to measure Council's financial performance, to guide decision making on major projects and significant components within the LTFP, and to secure its continued financial sustainability.

Three nationally recognised financial sustainability indicators have been adopted in principle by Local Government in Australia and are utilised by City of Adelaide. These are:

- The Operating Surplus Ratio
- The Net Financial Liabilities Ratio
- The Asset Renewal Funding Ratio.

Council also considers an additional four indicators to review the ability to borrow in line with its Prudential Borrowing Limit:

- Asset Test Ratio
- Interest Expense Ratio
- Leverage Test Ratio
- Cashflow from Operations Ratio.

In response, the City of Adelaide (CoA) has endorsed various Financial Principles which operate in conjunction with the Long Term Financial Plan to promote sustainability.

The Council will operate in accordance with a sustainable Long Term Financial Plan whereby:

> *Continuation of the Council's:*
>
> - *present expenditure, revenue and financing policies*
> - *likely developments in the Council's revenue-raising capacity, and*
> - *the demand for and costs of its services and infrastructure*
>
> *normal financial risks and shocks altogether are unlikely to necessitate substantial increases in council rates (or, alternatively, disruptive service cuts).*

### What does legislation require?

The *Local Government Act 1999 (Act)* outlines a number of requirements that councils must meet.

Section 122(1) of the Act requires councils to have strategic management plans and to report on those. These include, but are not limited to, a long-term financial plan and infrastructure and asset management plans, as a part of their suite of strategic management plans

Councils are also required to have an audit committee who necessarily provides input to any review of council's strategic management plans. The Audit Committees cannot include council staff or any of council's auditors, and may include persons who are not members of council (s126 of the Act), with between 3 and 5 members. The Terms of Reference for the City of Adelaide audit committee includes a section which states that membership will consist of four Independent Members (who are not members of any Council) and one Council Member. In addition, the Lord Mayor is considered an ex-officio member to the Committee.

The Act requires that long-term financial plans be reviewed on an annual basis (s122(4)(a). As a part of this review a council CEO must prepare a report on the council's financial sustainability (s122(4a)(a) of the Act.

The Act also provides for a cycle of planning which embeds financial sustainability into the development of the business plan and budget.

Within the Act, regulations require councils to disclose, in a consistent manner, actual and projected performance with respect to an operating surplus ratio, an asset renewal funding ratio (ARFR) and a net financial liabilities ratio in their annual budget and long term financial plan.

# Financial Sustainability Performance

This section summarises Council's financial sustainability position. It sets out each of the seven Key Financial Indicators, along with the Council's performance against each.

For each of the indicator there is:

- A brief description of the indicator
- Exactly what is being measured
- A Target for the indicator
- Councils result for the indicator (and a chart showing the previous year's Actual figure, the current year's Budget figure and the Projected Long Term Financial Plan's figures for the next nine years)
- An analysis and summary explanation of the current and projected results

## Conclusion

The analysis indicates that the City of Adelaide is currently financially sustainable and can remain so for the forecast period covered by the 2024/25 to 2033/34 Long Term Financial Plan.

In all cases, Council remains within each relevant indicator except for the Cashflow from Operations ratio which exceeds the target band resulting from the need to fund Significant Renewals. The results highlight matters where Council decisions can impact future financial sustainability. Long term financial sustainability is therefore subject to ongoing decisions and effort, particularly (but not limited to):

- Ensuring decisions are consistent with Council’s adopted financial principles
- Continued growth in revenue, through both rates and commercial activities, at or above the rate of growth in expenses
- Commitment to investment in new and upgrade assets in line with prudential borrowing limits
- Successfully securing external funding for the renewal of the Torrens Weir and Adelaide Bridge
- Ongoing advocacy for reductions in exemptions and mandatory rebates
- Use of the Future Fund for particular projects and initiatives.

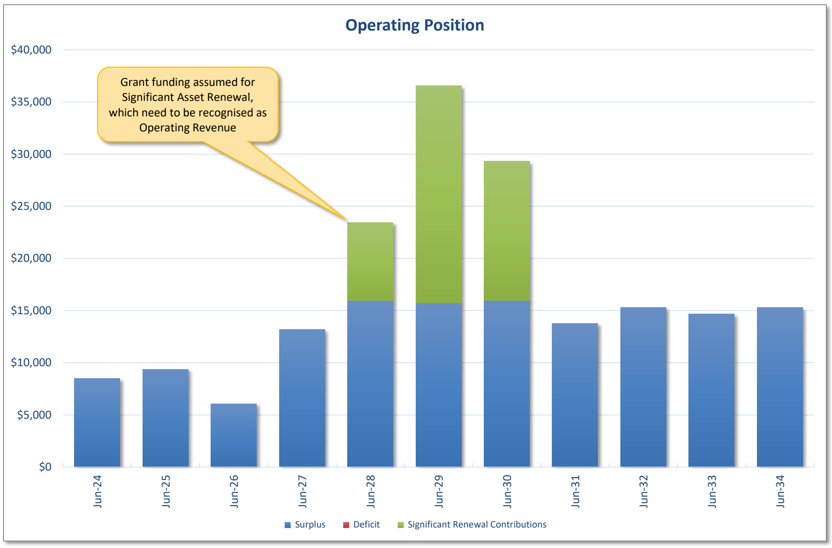
# Financial Sustainability Summary

## Operating Surplus

This indicator represents the difference between day-to-day income and expenses for a period.

A council's long-term financial sustainability is dependent upon ensuring that, on average over time, its expenses are less than associated revenues. If a council is not generating an operating surplus in most periods then it is unlikely to be operating sustainably. The target is to achieve between $2m and $10m in any given year.

The chart below shows the impacts of key assumptions assumed in the LTFP. In particular, the assumption to continue to invest in new and upgraded projects (to meet the emerging needs of the community) results in a higher level of assets, and related borrowings. As such, increased depreciation (from a higher asset base) and interest costs (from higher borrowings) see expenses growing at a faster rate than revenue (which is largely based on CPI increases). Depreciation is further exacerbated by the significant increase in the costs to deliver assets, both renewal and new and upgrade.



## Operating Surplus Ratio

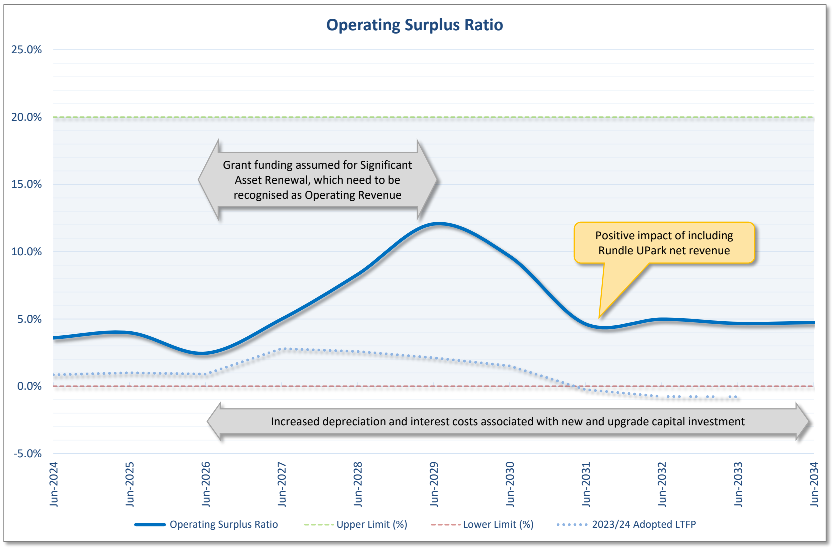
Definition: Operating surplus as a percentage of operating revenue

What is being measured: This indicator represents the percentage by which total revenue varies from day to day operating expenses. Financial sustainability is indicated where a council consistently achieves operating surpluses and has soundly based projections showing it can continue to do so in the future, having regard to asset management and the service level needs of its community.

Target: The Local Government Act (SA) 1999 target is to achieve an average operating surplus ratio between 0% and 10% over any five-year period. However, as a Capital City Council, the City of Adelaide has significant responsibilities in improving its public realm and considers that an average operating surplus ratio between 0% and 20%, over any five-year period, is a more appropriate target. A result in excess of this may indicate that council is setting rates and/or other fees and charges at levels well in excess of expenses and this has negative intergenerational equity implications.

In addition, operating deficits are not sustainable or equitable in the long term as they result in services consumed by current ratepayers being paid for by future ratepayers. A fair and equitable tax system is one in which taxes paid by each generation is in proportion to the benefits each generation receives.

Explanation of LTFP Projected Results: The ratio sits within target ranges over the life of the LTFP, reflecting sustainable surpluses based on an increase to base rating revenue to funding renewals, following by CPI increases thereafter. Of not is the shar increase from 2026-2029 which reflects treating grant income associated with Significant Renewals as operating revenue. The underlying structural budget is sustainable over the life of the LTFP.



### Net Financial Liabilities

This indicator represents the money owed to others less money held, invested or owed to Council.

A council's indebtedness should be managed to ensure its liabilities and associated costs can be met without the prospect of disruptive service cuts and/or excessive rate increases (ie without impinging on financial sustainability). There is in essence no right or wrong target level for net financial liabilities (defined as total liabilities less financial assets) as this depends on infrastructure plans. The ideal target is that net financial liabilities are no greater than annual operating revenue and not less than zero.

### Net Financial Liabilities Ratio

Definition: Financial liabilities as a percentage of operating income

What is being measured: This indicator represents the significance of the net amount owed compared with operating revenue. It measures the extent to which Council is managing its debt and highlights that borrowings are often an effective means of financial sustainability, rather than trying to fund all assets from operating income. A steady ratio means Council is balancing the need to borrow against their affordability of debt. An excessive ratio means Council is borrowing beyond their means and cannot generate the income required to service assets and operations.

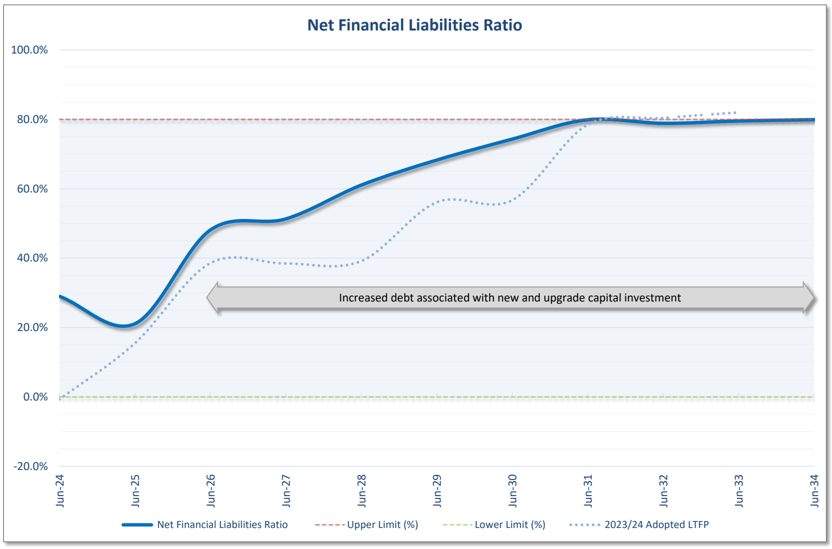
Target: The LGA recommends that the target for Net Financial Liabilities should be greater than zero (and less than 100%, that is, the amount owed is equal to or less than total annual income). A target below zero indicates that Council places a higher priority on accumulated financial assets than applying funds generated from ratepayers to the provision of services and/or infrastructure renewal. This could leave a council open to accusations that it is overcharging ratepayers relative to its funding needs.

The more conservative target set by City of Adelaide is that liabilities as a percentage of total operating revenue will not exceed 80%.

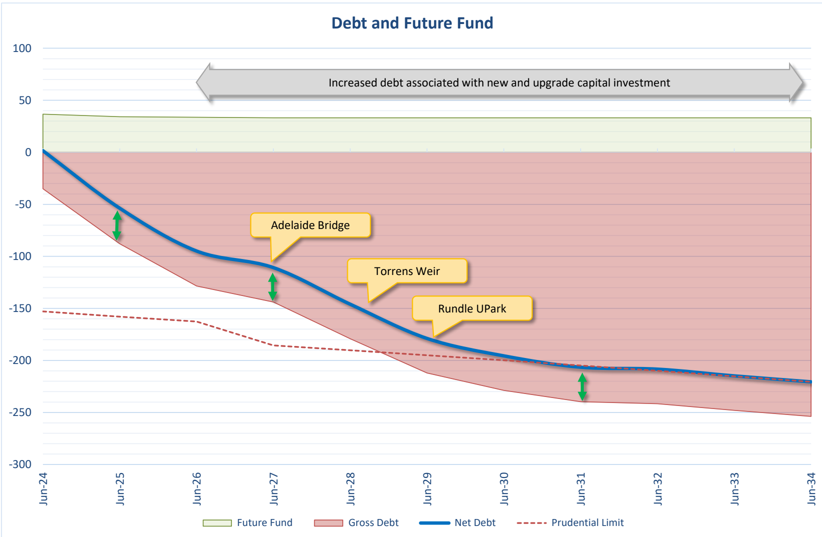
Explanation of LTFP Projected Results: City of Adelaide's net financial liabilities are, within the prescribed target for the life of the plan. Lower ratios in the short term highlight low levels of debt, steadily increasing over the life of the LTFP reflecting increased borrowings to deliver on Council's commitment to invest in new and upgraded assets and fund a large portion of significant renewals.

Note that Councils new and upgrade capital program has been adjusted from 2028/29 onwards to work within existing prudential limits.

Any increase in contributions towards the significant renewals will allow Council to either maintain a lower level of debt and/or invest more in new and upgrade projects.




The level of borrowings is projected to be within acceptable prudential limits, assisting Council to maintain long-term sustainability. Typical prudential limits set by financial institutions as part of covenants associated with loans are around 80% of asset values. Council has therefore set a conservative limit at 50% of saleable property assets (see below), providing additional comfort in excess of generally accepted banking norms.




It should be noted that the Council has created a Future Fund that ring fences proceeds from the sale of surplus or underperforming assets, to reinvest into revenue generating assets. The funds generated from asset sales effectively offset the level of borrowings Council would otherwise incur had the assets not been disposed. Accordingly, Council pays less interest over time, incurring interest on a lower ‘offset’ balance of borrowings.

### Asset Renewal Funding Ratio (ARFR)

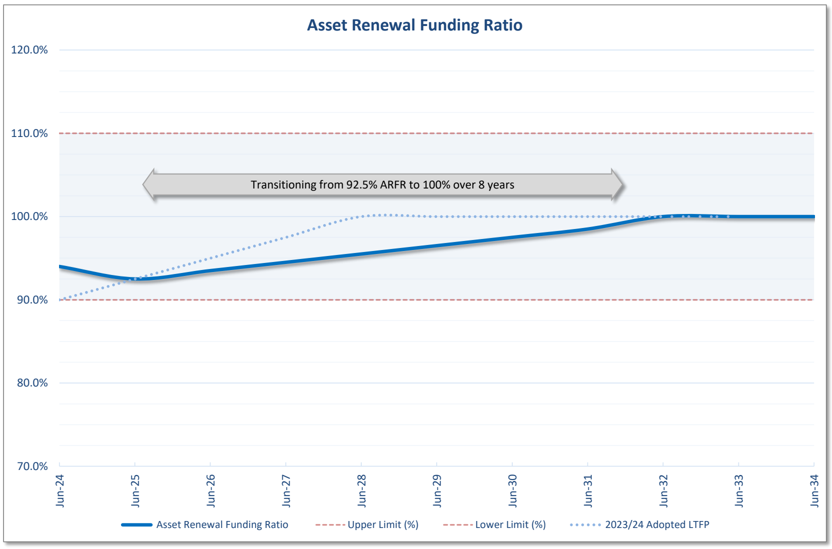
Definition: Expenditure on asset renewals as a percentage of forecast expenditure required as per the asset management plans.

What is being measured: This indicator expresses expenditure on asset renewals as a percentage of the projected funding required. It illustrates whether existing assets are being replaced or renewed at the rate they are being consumed and ensures consistent service delivery as determined by the Infrastructure and Asset Management Plans.

Target: A ratio lower than 100% suggests that Council is not maintaining assets and infrastructure in order to optimise asset lives. A ratio higher than 100% suggests that Council is replacing assets earlier than needed or at a level in excess of that set in the asset management plans. Adoption of a target ratio between 90% and 110%, is in line with the *Local Government Act (SA) 1999*.

Explanation of LTFP Projected Results: It is assumed that over the long term financial plan, asset renewals will be funded in line with the Asset Management Plans. In the previous term, Council resolved to set the ARFR (previously the Asset Sustainability Ratio) at 90%. This term of Council recognises the potential impact of this decision and the possible under-investment in assets and infrastructure and, as such, the LTFP assumes transitioning the ARFR from 90% to 100% over the next eight years.

Averages for asset renewal reflect an even performance over the life of the plan. The ration from 2031/32 onwards is directly representative of the transition from 90% to 100%. This ratio should be continually monitored as asset management plans are reviewed and updated.



### Borrowings Ratios and Prudential Limits

Definition

- Asset Test Ratio: Borrowings as a percentage of total saleable property assets
- Interest Expense Ratio: Annual interest expense relative to General Rates Revenue (less Landscape Levy)
- Leverage Test Ratio: Total borrowings relative to General Rates Revenue (less Landscape Levy) expressed as the number of years of General Rates Revenue required to repay borrowings

What is being measured: The maximum level of debt is prescribed by Council by way of prudential limits. While Council does not place a physical monetary limit on the level of borrowings, an upper limit is determined through its financial indicators. When borrowing, Council will consider these indicators in terms of total borrowings, and the ability to service the interest incurred and debt repayments.

Target: The Treasury Policy reviewed in 2022 ensures Council's ability to manage cash and borrowings in accordance with prescribed limits.

The Prudential limits set within the Treasury Policy are:

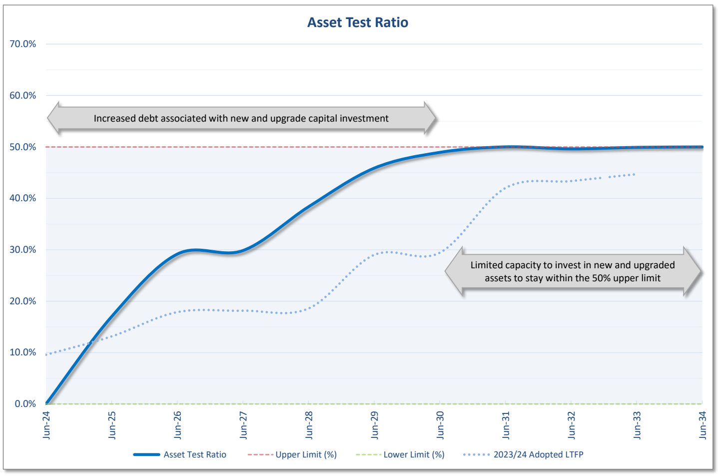
- Asset Test Ratio: Maximum of 50%
- Interest Expense Ratio: Maximum of 10%
- Leverage Test Ratio: Maximum 1.5 Years

Prudential limits are breached when one of the ratios fall outside the targets stipulated in the policy. The breach must be reported with remediation actions to the CEO immediately.

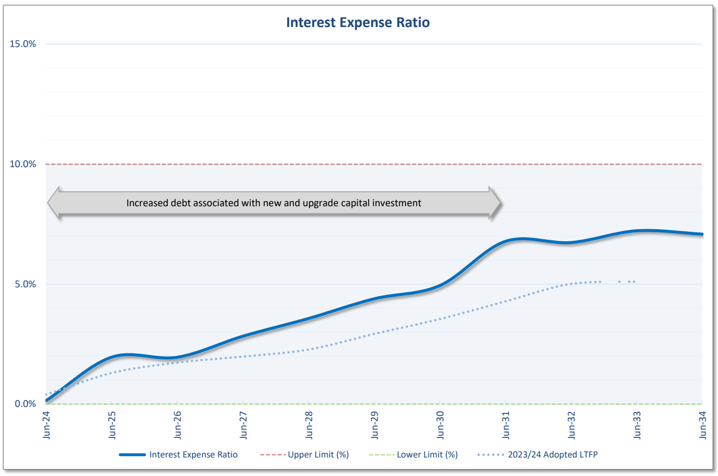
Explanation of LTFP Projected Results: City of Adelaide's borrowings are within the prescribed targets across the Long Term Financial Plan.

The Asset Test Ratio shows that Council has capacity in its total saleable assets to be able to meet the repayment of borrowings should the assets need to be sold in order to repay debt.

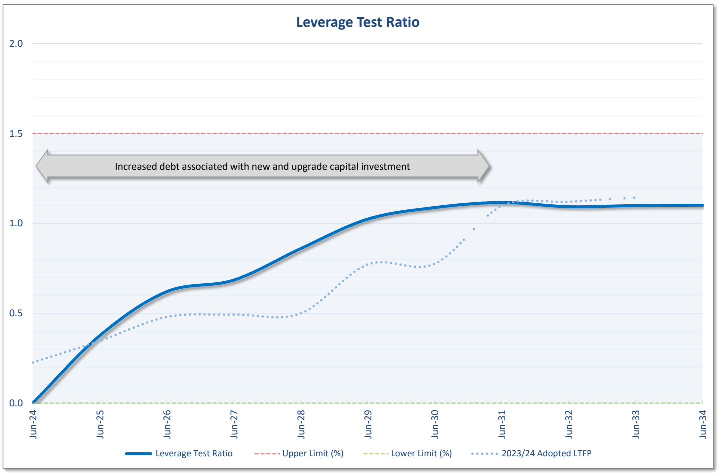
The increasing ratio reflects the cumulative impact of utilising debt to deliver on Council's commitment to invest in the City, in addition to debt required to fund significant renewals (that is, the Torrens Weir, Adelaide Bridge and Rundle UPark). This has limited the ability to deliver new and upgraded assets from 2029/30 to remain within the target ratio. The sale and development of property assets will impact prudential limits, and hence the Asset Test Ratio, in periods where transactions occur.




Similarly, the steady increase in borrowings, sees the Interest Expense Ratio for the life of the plan increasing, albeit sitting comfortably within the target range and beginning to reduce from 2032/33.




The Leverage Test Ratio shows the time it would take to repay borrowings from general rates revenue as an indication of payback period. The plan supports Council’s ability to repay the debt if called upon from less than 1½ year’s rates revenue in any year of the plan, and tracks in line with the other two prudential borrowing indicators.



## Cashflow from Operations Ratio

Definition: Operating Income as a percentage of Operating Expenditure plus expenditure on renewal/replacement of assets.

What is being measured: This ratio measures Cash Flow from Operations as a percentage of forecast expenditure in the asset management plans, in addition to expenditure on delivering services

This indicator shows whether Council is generating adequate cash from its operations to cover the replacement of assets over time.

A lower ratio indicates that Council is not generating enough cash from operations to cover asset replacement (less than 100%). As a result, Council will need to fund the replacement of assets from unsustainable sources of income resulting in increased levels of borrowings over time.

Target: A result greater than 100% suggests Council's operations will generate enough cashflow to support the funding of asset replacement over time.

Explanation of LTFP Projected Results: Most years of the LTFP project a positive result. The marginally lower than target result in year 3 of the plan (2025/26) is reflective of the proposed second $10m contribution to the Adelaide Aquatic Centre. Years 4 to 7 of the plan reflect the significant renewals required in these years.

This ratio highlights the risk in Council's ability to fully fund the larger renewals that are identified in the LTFP. This is not to suggest deficiency in renewal, but rather highlight the opportunity in advance to seek alternative funding sources such as State or Federal grants to assist with the funding of significant asset renewal projects for the benefit of the wider SA metropolitan area.

The underlying structural cash flow (that is, adjusting for expenditure on significant renewals) delivers an average projection between 100% and 105%, suggesting Council's cashflow is sustainable.