

29/11/2019

The Hon Adem Somyurek MP  
Minister for Local Government  
Level 16, 121 Exhibition Street  
Melbourne VIC 3000

Dear Minister

### **Essential Services Commission advice on the rate cap for 2020–21**

The Essential Services Commission is responsible for administering the Fair Go Rates system and providing advice to the Minister for Local Government on the average rate cap for councils. On 31 October 2019, you requested the commission's advice on setting the average rate cap for councils for 2020–21, under section 185D(3)(a) of the *Local Government Act 1989* (the Act).

In response to that request, we provide this advice under section 185D(4) of the Act.

We recommend the average rate cap be set equal to the December CPI forecast for 2020–21 from the Department of Treasury and Finance. Our reasoning is set out in Attachment A. The department will release its budget update with the relevant CPI forecast by 15 December 2019. We note the department's latest CPI forecast (May 2019) for 2020–21 is 2.25 per cent.

We also recommend that a uniform cap continue to apply for all councils in 2020–21. We consider that the higher cap application process remains an efficient, transparent and participative mechanism to deal with the varying financial circumstances of individual councils.

As per your request, this advice will be published on our website following your announcement of the rate cap for 2020–21.

If you have any questions regarding this advice, please do not hesitate to contact Angelina Garces, Senior Regulatory Manager Local Government, on 03 9032 1337.

Yours sincerely



**Kate Symons**  
Chairperson

## Attachment A — rate cap formula

On 31 October 2019, you requested the commission's advice on setting the average rate cap for councils for 2020–21, under section 185D(3)(a) of the *Local Government Act 1989* (the Act):

- A recommendation for any adjustment(s) to be applied to Consumer Price Index (CPI) in setting the cap for all 79 local councils, a grouping of councils or any individual council.
- The rationale for any such adjustment(s) and the quantum of such adjustment(s).
- Should more than one option be recommended, indicate which is the preferred option.

We are of the view that our formula for establishing the average rate cap, as published in our final paper *Advising a local government efficiency factor* (March 2018), remains appropriate:

$$\text{Average rate cap} = ((1-\alpha) \times \text{CPI}_t) + (\alpha \times \text{WPI}_0)$$

The allowance made for labour costs in the average rate cap formula, through the Wage Price Index (WPI) component, served as a generalised acknowledgement that some costs, particularly direct and indirect labour costs, may have been inflexible in the short to medium term following the introduction of rate capping.

However, the formula applies a decreasing weighting ( $\alpha$ ) to the WPI component. From 2020–21 onwards, this weighting decreases to 0 per cent. In effect, the formula applies a 100 per cent weighting to the forecast CPI component for 2020–21.

We previously indicated that we may undertake another productivity analysis in 2020, however we do not consider a further study to be necessary at this point in time.