



29/11/2021

RM/21/32726

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

Dear Minister,

Essential Services Commission advice on the rate cap for 2022–23

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 8 November 2021, you requested the commission's advice on setting the average rate cap for councils for 2022–23, 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 forecast of the consumer price index (CPI) for 2022–23 from the Department of Treasury and Finance. However, given the uncertainty around the level of the CPI forecast, we do not recommend setting a rate cap outside of the historical range of 1.50 per cent to 2.50 per cent. This range balances the needs of ratepayers and the community with the long-term sustainability of councils. If the December CPI forecast falls outside of this range, we recommend that the average rate cap be set to the nearest percentage increase. Our reasoning is set out in Attachment A.

The department will release its budget update with the relevant CPI forecast by 15 December 2021. We note the department's latest CPI forecast (in May 2021) for 2022–23 is 1.75 per cent. However, we note that inflation expectations have increased since the May forecast.

We also recommend that a uniform cap continue to apply to all councils in 2022–23. 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.

Adjustment to December Budget Update CPI forecast – rate cap for all 79 councils (%)

December Budget Update CPI forecast	Adjustment to the CPI forecast	Recommended average rate cap
0.75	+ 0.75	1.50
1.00	+ 0.50	1.50
1.25	+ 0.25	1.50
1.50	No adjustment	1.50
1.75	No adjustment	1.75
2.00	No adjustment	2.00
2.25	No adjustment	2.25
2.50	No adjustment	2.50
2.75	- 0.25	2.50
3.00	- 0.50	2.50

If you have any questions regarding the report, please do not hesitate to contact Angelina Garces, Senior Regulatory Manager Local Government on (03) 9032 1337, or at angelina.garces@esc.vic.gov.au.

Yours sincerely



Kate Symons
Chairperson

Attachment A – rate cap rationale

On 8 November 2021, you requested the commission’s advice on setting the average rate cap for councils for 2022–23, 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.

Our advice for 2021–22 was that the rate cap should be set to a long-term average of CPI. We recommended this approach in response to the uncertainty created by the coronavirus pandemic. As the coronavirus pandemic response progresses to the next stage of recovery, we are returning to our original approach of recommending that the rate cap be set to the forecast CPI announced in the December Budget Update.

We note that the May Budget forecast of CPI for 2022–23 was 1.75 per cent. We do not know what the forecast CPI announced in the December Budget Update will be, however current expectations suggest that inflation will increase over the short to medium-term. We recommend making an adjustment to the CPI if there is a large change in the forecast CPI.

We are of the view that a rate increase within the range of 1.50 per cent and 2.50 per cent would best meet the objectives of the Fair Go Rates system. This range is based on past average rate caps (shown below). In the face of broader volatile price changes, setting the rate cap within this range would provide stability and balance the needs of ratepayers and the community with the long-term sustainability of councils.

Average rate caps, 2016–17 to 2021–22 (%)

	2016–17	2017–18	2018–19	2019–20	2020–21	2021–22
Average rate cap	2.50	2.00	2.25	2.50	2.00	1.50

If the December Budget Update forecast CPI falls within 1.50 and 2.50 per cent, we consider that it is reasonable to set the rate cap to that forecast CPI figure. However, if it falls outside of this range, then we recommend setting the rate cap to the closest historical percentage increase. For example, if the budget forecast CPI is above 2.50 per cent, then our recommendation is to set the rate cap to 2.50 per cent.

A rate cap lower than 1.50 may be beneficial for ratepayers in the short-term. However, a lower rate cap could deepen financial sustainability issues for councils, which would ultimately be borne by ratepayers and the community in the long-term.

A rate cap that is higher than 2.50 per cent could cause bill shock and further magnify affordability issues for ratepayers experiencing vulnerability.

Councils that cannot maintain financial capacity to perform their duties and achieve sustainable outcomes in the delivery of services and infrastructure may choose to apply for a higher cap. We are required to assess higher cap applications in consideration of the legislative matters and generally only approve higher caps when a council can demonstrate a long-term funding need.

For ratepayers, the current environment highlights the role rate cap and financial hardship policies have in addressing affordability concerns. Lower rate caps can decrease the overall rate burden on a community; however, it is a blunt tool and must also be balanced against the long-term sustainability of councils. In our view, well-functioning financial hardship policies and programs are more effective in targeting the affordability issues that ratepayers experiencing vulnerability are facing.

