Submission to the review of the rate cap mechanism

Municipal Association of Victoria – September 2025

The Municipal Association of Victoria welcomes the opportunity to make a submission to the review of the rate cap mechanism.

The rate cap has formed a part of Victorian local government for a decade now. The Municipal Association of Victoria is not calling for the cessation of rate capping. However, we are concerned that the current implementation of the rate cap has already impacted the ability of councils to provide for their communities, and will do so increasingly into the future.

Our recommendations:

1. The adoption of a Local Government Cost Index rather than CPI to inform the rate cap
2. The introduction of a "catch-up" mechanism when setting the rate cap, to address projections varying from actual figures
3. The consideration of a population-based mechanism to address where supplementary rates fail to keep the rate base in line with population increases
4. Improving the process for applying for a rate cap variation
5. Examine the interaction of Payment in Lieu of Rates schemes with the rating system

A local government cost index

Currently rate capping policy is to set the cap based on Treasury forecasts of the Consumer Price Index for that period. The CPI is a very generalized measure aimed at a household basket of goods, it does not represent the types of goods and services that councils are procuring.

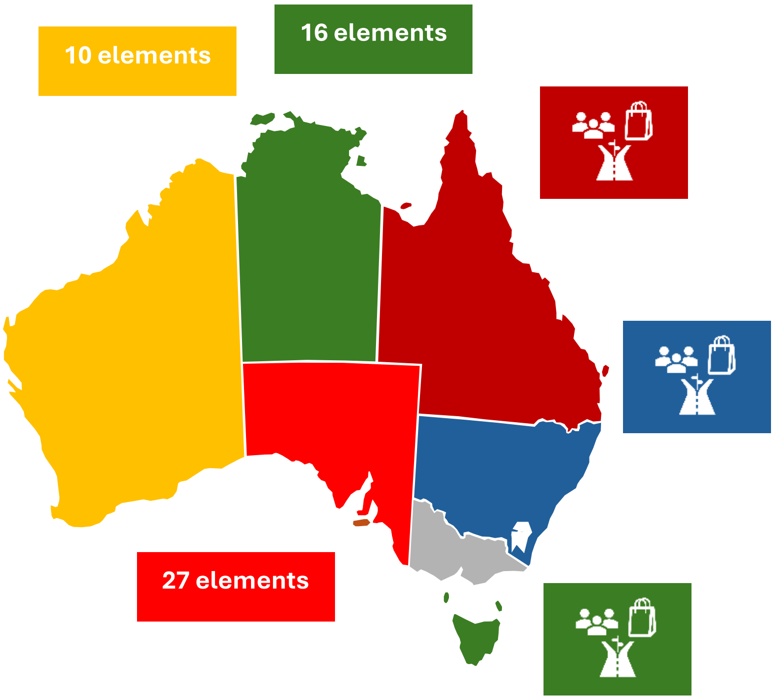
Victoria is the only Australian jurisdiction without a current local government cost index.

In New South Wales, the Independent Pricing and Regulatory Tribunal (IPART), part of the NSW Government, publishes a cost index and it forms the basis of their rate pegging system.

In other jurisdictions the relevant local government peak body publishes an index.

In Queensland, New South Wales, and Tasmania the indices consist of three elements – a labour component (such as the wage price index), an asset component (such as the road and bridge construction producer price index), and a miscellaneous/other component (represented by the Consumer Price Index).

In the Northern Territory, South Australia, and Western Australia, the indices consist of more granular component indices – such as gas, water, machinery and equipment.



Comparison of local government cost indices across Australia

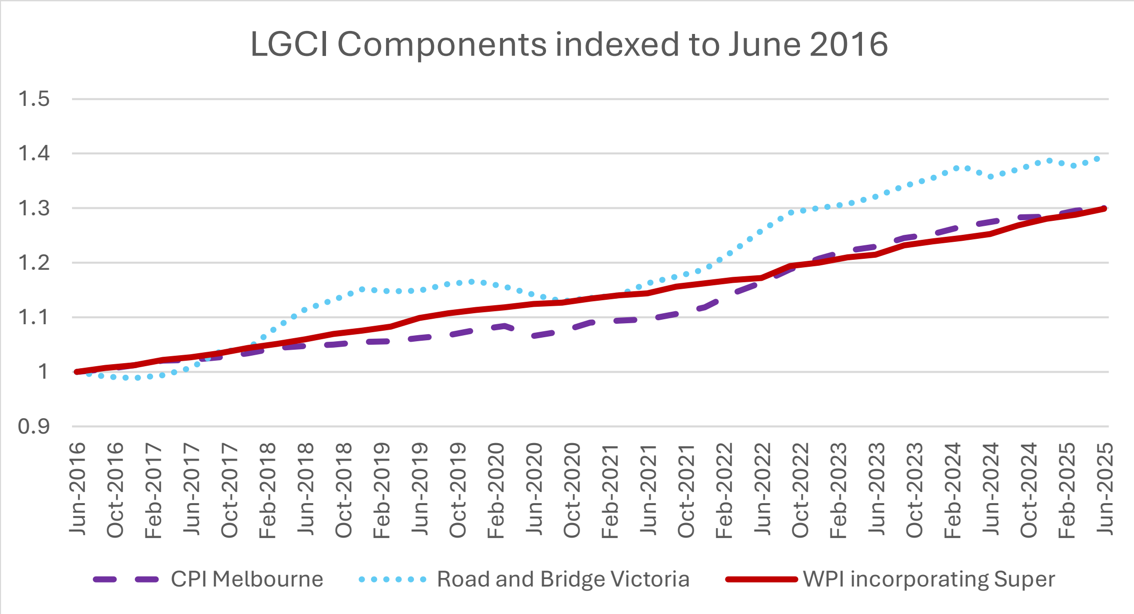
The Municipal Association of Victoria has developed a proposal for a cost index for Victorian local government. It consists of three elements:

- [**40%**] Labour cost – using the Wage Price Index for the Victorian Public Sector, and adjusting for changes to the Superannuation guarantee rate
- [**30%**] Asset costs – using the Producer Price Index for Road and Bridge Construction in Victoria
- [**30%**] Other Costs – using the Consumer Price Index for Melbourne

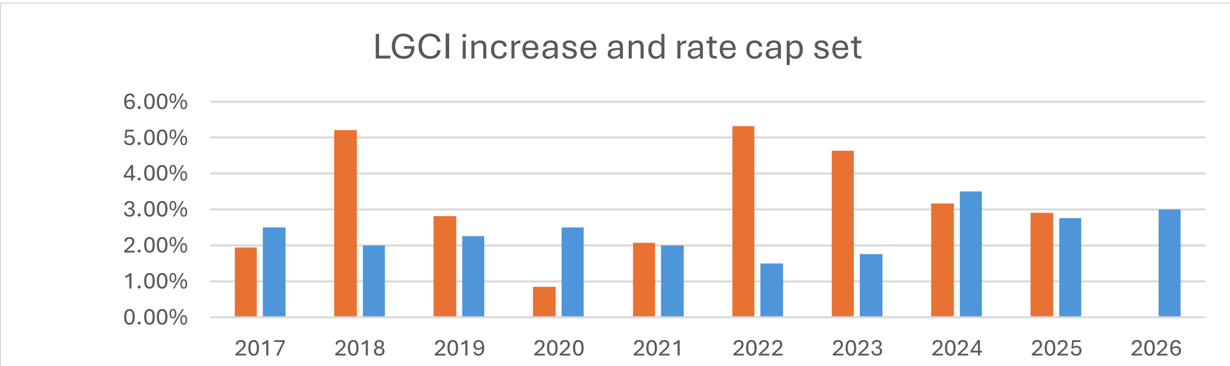
In testing various models we found that using a more granular index with more components did not significantly change the results, and thus a simpler model was favoured.

Weightings are based on an examination of council expenditure profiles over time and comparison with other jurisdictions.

We have modelled the LGCI going back to the introduction of rate capping and provided a comparison to the actual rate caps set in each year.



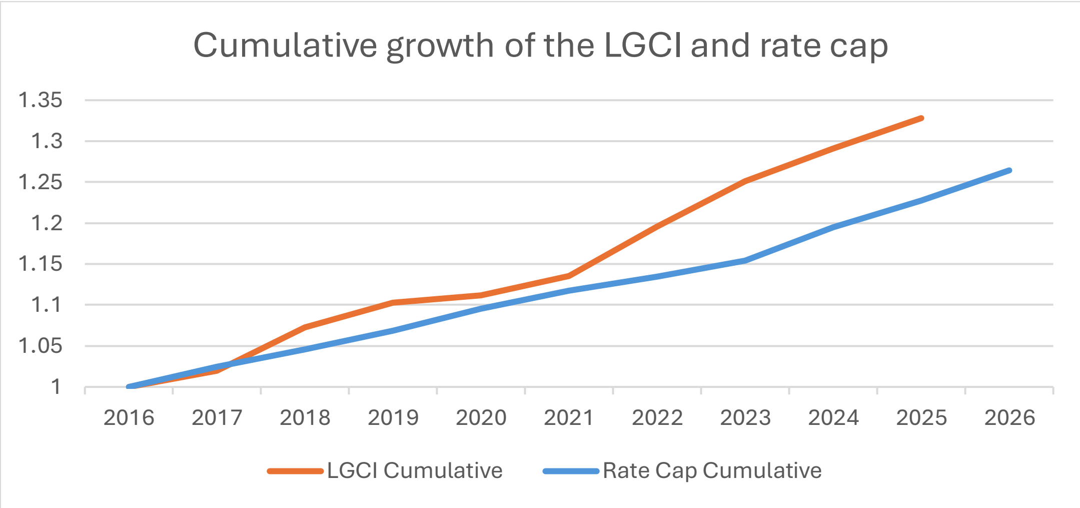
In most years we have found the LGCI reports costs faced by councils exceeding the rate cap for that period.



	Jun-2017	Jun-2018	Jun-2019	Jun-2020	Jun-2021	Jun-2022	Jun-2023	Jun-2024	Jun-2025	Jun-2026
LGCI Increase	1.95%	5.21%	2.81%	0.85%	2.07%	5.32%	4.64%	3.16%	2.90%	0
Rate Cap	2.50%	2%	2.25%	2.50%	2%	1.50%	1.75%	3.50%	2.75%	3.00%

We have also looked at these figures cumulatively over the same period. These figures assume a council increasing rates by the full rate cap each year.

We find that the cost increases facing councils have increased 44% above the permitted growth of their rate base through the cap (32.8% increase in the LGCI compared to 22.8% cumulative rate cap increase to June 2025). Over time the gap is growing larger.

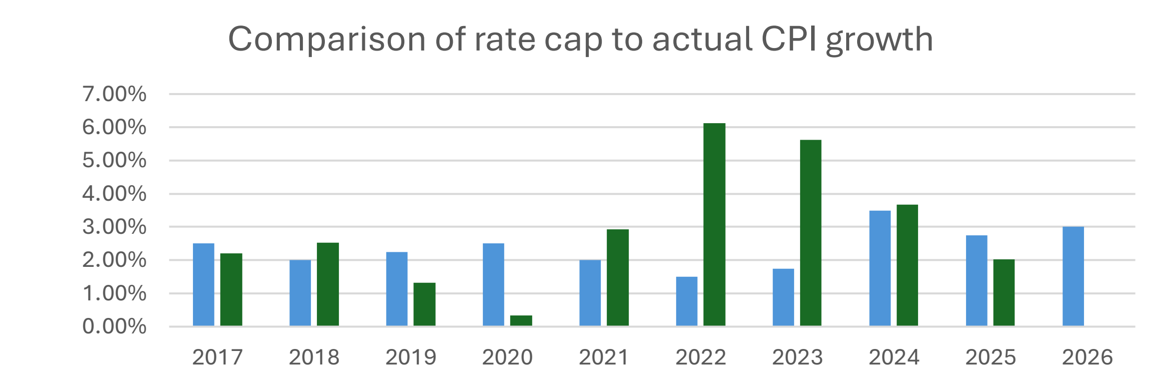


A catch-up mechanism

One of the challenges under the current rate capping policy is that the rate cap only looks forward.

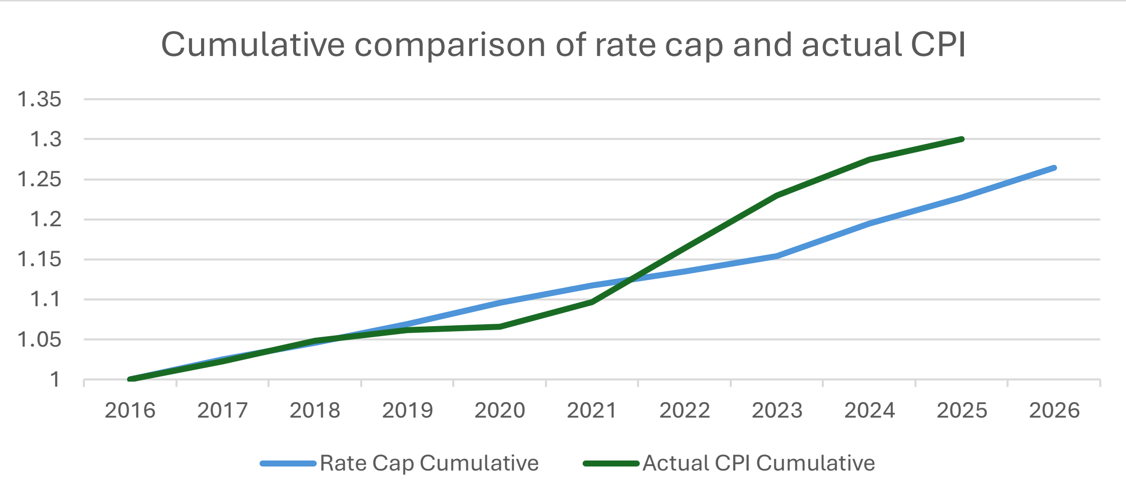
Each year the rate cap is set based largely on Treasury forecasts of CPI growth across the relevant period. However, no consideration is given to variation of actual CPI growth from the forecasts used to set prior rate caps.

We can see the effects of this by comparing the rate cap to the actual CPI growth for the same period.



	Jun-2017	Jun-2018	Jun-2019	Jun-2020	Jun-2021	Jun-2022	Jun-2023	Jun-2024	Jun-2025	Jun-2026
Rate Cap	2.50%	2%	2.25%	2.50%	2%	1.50%	1.75%	3.50%	2.75%	3.00%
Actual CPI	2.21%	2.52%	1.32%	0.35%	2.94%	6.13%	5.62%	3.67%	2.02%	

Again, when examined cumulatively over the life of the rate cap this leads to a significant difference.



A solution to this would be adjusting the rate cap for coming years based on the variance of actual cost index growth compared to the forecasts used to set prior rate caps. For example:

$$RC_1 = \left(\frac{(1+A_0) \times (1+F_1)}{(1+RC_0)}\right) - 1$$

- Year 1 = the target year
- Year 0 = the base year
- RC = Rate Cap
- A = Actual growth in cost index for the period
- F = Forecast growth in cost index for the period

Corrections could also take place over multiple years to reduce volatility from year to year. The actual growth in the cost index would be tracked against the growth so far represented by the rate cap, and future rate caps adjusted up or down within a bounded limit.

We note that our model of a Local Government Cost Index is retrospective rather than predictive. Adopting such a model, based on the latest available data rather than a forecast of future increases, would limit the need for a catch-up mechanism at the expense of introducing a guaranteed time lag between increases to costs and the associated increase in revenue raising capacity.

Population factor

In Victoria population growth factors into the rate cap largely through the inclusion of supplementary valuations in the base rate for the previous year. That is, increases in the rate base throughout the year, such as from subdivision to accommodate new residential development, are treated as though they were part of the existing rate base.

IPART in NSW conducted a review of their rate pegging methodology to examine the inclusion of a population factor in each council's rate cap. The basis for this review was a concern that supplementary valuations were not adequately representing increased service and infrastructure needs in high growth areas. In essence, real per capita rate income was declining.

As a result of that review IPART has incorporated a population factor into its rate pegging formula.

$$\textit{Population factor} = \max(0, \textit{change in population} - \textit{supplementary valuations percentage})$$

IPART's approach means that the final rate peg is individual to each council, consisting of a base increase and then modified by individual factors including the population factor.

The MAV believes that although this would introduce some complexity to communication around the rate cap, it would be worthwhile to help ensure that councils can continue to service growing communities.

Rate cap variations

In reporting on the financial status of the sector, state government entities such as Local Government Victoria have frequently cited the relative lack of rate cap variation applications as evidence of overall good health.

We do not agree with this assessment. We believe that the current system for variations discourages applications.

We commend the Essential Service Commission for issuing updated guidance, including guidance tailored for councils seeking to incorporate waste charges into their general rate revenue. However, our understanding is that for many councils applying for a rate cap variation is still prohibitively burdensome administratively. In addition to guidance, we urge the Government to work with councils to identify improvements to the legislated requirements of the variation process. This could include more specific pathways for scenarios such as revenue neutral applications, or where a common impact requires variations across all or significant parts of the sector.

It is also our hope that in adopting proposed changes to the rate cap mechanism itself, we will limit the need for variation applications.

We also note the experience of New South Wales. Rate capping has a cumulative impact on council revenue over time. In the short term it is possible for councils to address this budgetarily through measures which aren't readily apparent on the ground, such as reductions in capital expenditure. They may then be forced to review service offerings, as we have seen councils pulling out of areas such as aged care. Finally though, finances may reach a tipping point where the revenue base and the expenditure profile of a council are radically mismatched.

In 2025 alone IPART has approved special variations of 70% over two years, 38% over two years, and 33% over three years, as well as refused an application for a variation of 87% over two years. The previous year applications for 48% over two years, 36% over two years, and 33% over three years were approved.

We are concerned that if not addressed the current application of the rate cap will hollow out council finances to the degree where Victoria requires similarly radical adjustments.

Payment in Lieu of Rates

Currently the dominant narrative regarding Payment in Lieu of Rates (PILOR) has been one of energy transition, given its applicability to renewable energy projects.

For councils however, the core issue is not energy policy but ensuring a sustainable and equitable revenue base to meet infrastructure and service demands.

The intent of the rating system is that all developments contribute fairly to the local community. Traditionally, rate revenue has offset the impacts of development through funding infrastructure, services, and amenity.

The PILOR scheme displaces councils' rate revenue, significantly distorting the tax burden within a municipality. This raises a fundamental equity issue – why should any development, whether renewable energy or another sector – not pay its fair share.

The PILOR scheme as it currently operates poses further challenges to councils. It is administratively burdensome, often requiring councils to bring in specific expertise to assist with the implementation of a PILOR agreement. It also raises the volatility of revenue from year to year, impacting councils capacity to budget and plan appropriately.

We believe bringing development currently considered under PILOR closer to the traditional rating system – potentially through the use of differential rates and/or the possibility of a discount for facilities operating significantly under-capacity – would represent a fairer outcome for councils and communities.

If you wish to discuss this submission further, please contact the MAV via CEOoffice@mav.asn.au