The Outcomes of Rate Capping

30 May 2023

Acknowledgement

We acknowledge the Traditional Owners of the lands and waterways on which we work and live.

We acknowledge all Aboriginal and Torres Strait Islander communities, and pay our respects to Elders past and present.

As the First Peoples of this land, belonging to the world's oldest living cultures, we recognise and value their knowledge, and ongoing role in shaping and enriching the story of Victoria.

An appropriate citation for this paper is:

Essential Services Commission 2023, The Outcomes of Rate Capping: 26 May

Contents

Executive summary

Rate capping is a system that limits the amount Victorian councils can increase their average rates each year. The Minister for Local Government sets the rate cap each year, which applies to all councils.[1] Councils have the option to apply to us for a higher rate cap.

The rate capping system has applied to annual rate increases since 2016–17. This report focuses on what happened in the six years of rate capping (2016–17 to 2021–22).[2] The analysis in this summary and report is based on numbers that have been adjusted for inflation.[3]

Reporting on outcomes

We are required to report every two years on the outcomes of the rate capping system.[4] The aim of these reports is to identify any impacts or trends that might be emerging across the local government sector.[5]

This report includes observations about the rates, revenue, expenditure, and financial position of the local government sector as a whole (the sector). It also highlights any differences between groups of similar councils. For information about individual councils, see the fact sheets and the interactive dashboard at https://www.esc.vic.gov.au/outcomes-reports and the dashboard.

1 The minister may choose to set a different rate cap for specified councils or groups of councils but has yet to do so.

2 Where we calculated growth rates for the six years of rate capping, we have taken 2015–16 as the base year.

3 This means that any increases in the dollar values or growth rates shown are above the level that can be explained by increases in the general cost of goods and services in the economy. The dollar amounts are shown in 2021–22 dollars.

4 Section 10E(3) of the *Essential Services Commission Act 2001* requires us to publish a report every two years containing an assessment of outcomes or trends arising from rate capping and identifying any impacts on the local government sector. In performing this function, our objective is to promote the purposes of the rate capping framework, which are to promote the long-term interests of ratepayers and the community in relation to sustainable outcomes in the delivery of services and critical infrastructure; and to ensure that councils have the financial capacity to perform their duties and functions.

5 Our first report, examining the first two years of rate capping, was released in May 2019. Our second report, examining the first four years of rate capping, was released in May 2021.

Key observations

- **Rates:** Ratepayers have paid lower rates than they would have done in the absence of rate capping.
- **Waste charges:** Ratepayers have paid more in service charges each year, due to changes in the waste market and the introduction of new charges by some councils.
- **Annual changes:** Factors outside the rate capping system (relative property values and differential rates) continue to determine the annual change in rates for each individual ratepayer.
- **Revenue:** The sector's total revenue remained stable in recent years and remains higher than the levels prior to rate capping. Stronger growth in the sector's revenue from contributions and grants offset slower growth in rates charges and a sharp decline in user fees and statutory fees and fines.
- **Expenditure:** The sector's total expenditure continued to grow, with a dip in in 2020–21. Growth was driven by increases in both operating and capital expenditure.
- **Financial health:** In general, the financial health of the sector remained sound. The sector as a whole had a positive operating position and the ability to meet both short-term and long-term liabilities. Results for individual councils was varied with some having stronger performance than others.

See page 62 for definitions of key terms used in this report.

Rates and charges

Ratepayers continued to benefit from low rate increases

Rate capping kept rate increases below historical levels.

In the six years of rate capping, annual growth in the sector's revenue from capped rates per property was negative (−0.4 per cent on average in inflation-adjusted terms). This is equivalent to a decrease of $7 per year. In the three years before the introduction of rate capping (2012–13 to 2015–16), the average annual increase was 3 per cent or $52 per year.

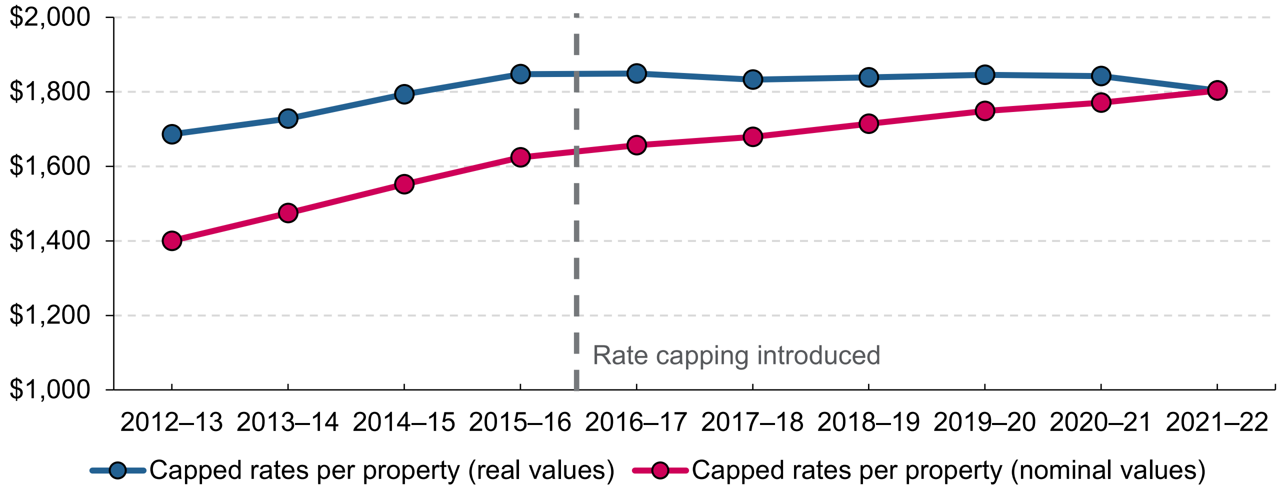
This means, on average, ratepayers paid less each year on capped rates *per property* after rate capping than they were paying prior to rate capping (see Figure 1).

The decrease in capped rates per property reflects:

- the Minister for Local Government setting annual rate caps equal to the forecast inflation rate
- only 11 out of 79 councils seeking, and being given, approval to increase their average rates by more than the minister's cap
- a very high level of compliance by councils with the applicable caps.

Figure 1 Revenue per property from capped rates in real and nominal values

For the sector as a whole (inflation-adjusted, 2021–22 dollars)



Notes: Real values means values that were adjusted for inflation using 2021–22 dollars.

Data sources: Council annual reports (audited); Victorian Local Government Grants Commission – VGC 2 data 2012–13 to 2021–22 (unaudited data); Australian Bureau of Statistics (December 2022) 'TABLES 1 and 2. CPI: All Groups, Index Numbers and Percentage Changes' [Index Numbers; All groups CPI; Melbourne], Consumer Price Index, Australia, accessed 17 January 2023.

In 2021–22, the sector's annual growth in revenue from capped rates per property decreased by 2 per cent (the highest decrease over the six years of rate capping). This reflects the difference between the rate cap (based on forecasts) and actual inflation. The decline is likely to continue in 2022–23, as the 1.75 per cent rate cap will be significantly below actual inflation for the financial year.

Factors outside the rate capping system continue to determine the annual change in rates for each individual ratepayer (see Box 1). These factors mean that most ratepayers will experience changes in their rates that are different to the rate cap.

Around 40 per cent of ratepayers had a decrease in their capped rates each year.

The most common reason for differences in individual rate increases is changes in property values. Since 2018–19, all properties have been revalued each year. On average, over the years in which revaluations occurred[6], more than half of ratepayers experienced an increase below the rate cap, specifically:

- 40.3 per cent of ratepayers had a decrease in their rates
- 15.5 per cent of ratepayers had an increase in their rates that was below the rate cap
- 44.2 per cent of ratepayers had an increase in their rates that was above the rate cap.

The proportion of ratepayers with rate increases above the rate cap was the lowest in 2020–21 (39 per cent), due to 17 councils setting their average rate increase to 0 per cent in response to the coronavirus pandemic.

Box 1 How does rate capping work?

The rate cap only limits how much a council can increase its general rates and municipal charges each year. Other charges on a rates bill such as waste charges are not capped.

The amount of rates that an individual ratepayer pays is determined by the rates levied by the council and the value of the ratepayer's property. The rate cap applies to the 'average' rate. Rate increases for individual ratepayers may differ from the increase in their council's 'average' rate because the:

- value of the property has increased or decreased more than other properties
- council changed the proportion of rates it collects from different types of properties
- property was reclassified as a different type of property.

The sector's rate debtors have grown over the 6 years of rate capping

Each council group's rates debtors have grown since the introduction of rate capping and all groups experienced an increase in the percentage of rates debtors to total rates and charges revenue.

The amount of rates debtors (overdue rates) for each council group trended upwards in the six years of rate capping. All groups saw a spike in 2019–20, likely a result of ratepayers experiencing financial difficulty due to the coronavirus pandemic. For most groups, the size of their rates debt

[6] The six revaluation years were 2016–17, 2018–19, 2019–20, 2020–21, 2021–22 and 2022–23. In 2017–18, properties were not revalued and there was much less variation in the rate increases of individual ratepayers: 1 per cent of ratepayers had a decrease in their capped rates; 87 per cent had an increase that was lower than the rate cap; and 13 per cent had an increase that was higher than the rate cap.

either decreased or plateaued. The exception being the metropolitan group with continued strong growth since 2019–20.

The rates and charges outstanding ratio is the level of rates debtors as a percentage of total rates and charges revenue.[7] A higher ratio can impact on a council's liquidity while the ratio is impacted by many factors, including the amount of rates going unpaid and the effectiveness of council's debt recovery.

The sector's rates debtors grew as a percentage of total rates and charges revenue each year since 2016–17.

Accessible and proactive financial hardship policies and processes can be effective in assisting customers through hardship and help council's manage potential impacts on council finances.

Revenue from service rates and charges increased in response to changes in the waste market

Councils also collected other charges that are not capped. The most significant are service rates and charges which are levied by most councils to recover the costs of providing waste services. As service charges are not capped, councils that fund waste costs through service charges are able to increase these charges in response to cost pressures – councils who fund waste costs through rates cannot.

> The sector's revenue from service charges increased in response to increased costs in the waste market.

In the six years of rate capping, revenue from service charges per property increased by $10 per year (4.5 per cent) on average. In comparison revenue per property from capped rates decreased by $7 per year (−0.4 per cent) on average.

The increase in waste charges reflects the introduction of new service charges for kerbside waste collection and broader changes in the market (for example, loss of service providers and expansion of services) that have increased waste costs. In the six years of rate capping, 10 councils introduced service charges for the first time. When councils introduce service charges, we ask them to reduce revenue from general rates so that the overall revenue impact is neutral. We report on the introduction of service charges as part of our compliance report.[8]

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7 We have adapted NSW's Office of Local Government rates and annual charges outstanding ratio for use within the Victorian local government sector.

8 See our annual compliance reports for more information: https://www.esc.vic.gov.au/local-government/council-compliance-rate-caps/council-compliance-reports.

Councils take varied approaches in how they fund their waste services, both in terms of the scope of services they deliver and the types of costs they choose to recover through waste charges. These differences are reflected in the range of service rates and charges revenue per property that can be observed across the sector. In 2021–22, service rates and charges per property ranged from $41 to $470, with an average of $312.

We consider that there could be benefits from improving the consistency and transparency of the sector's practices around service charges.

See Chapter 1 for more information about rates and charges.

Revenue

The sector's total revenue and revenue per person continued to grow, but at a slower rate over the six years of rate capping.

Rates and charges are only one source of council revenue. In the six years of rate capping, revenue from rates and charges represented between 22.6 per cent and 80.4 per cent of individual councils' total revenue. Other sources included Victorian and Australian Government grants, developer contributions, user fees, statutory fees and fines, and other revenue.

In the six years of rate capping, the sector's total revenue grew by 2 per cent per year on average. This was lower than the 3.2 per cent annual growth rate in the three years before the introduction of rate capping.[9] The lower growth is largely attributable to a decline in 2019–20, when the sector's total revenue contracted due to the impacts of the coronavirus pandemic.

We also accounted for the effect of changes in population on revenue by examining 'revenue per person'. In per person terms, the average annual growth in total revenue also increased at a slower rate in the six years of rate capping (0.6 per cent) compared to the three years before its introduction (1.1 per cent).

After rate capping, the revenue per person from contributions and grants grew faster than rates and charges, partially offsetting the fall in revenue from user fees and statutory fees and fines.

Rates and charges continue to be the largest source of revenue for the sector and each of the council groups. Revenue from grants was the second largest source.

In the six years of rate capping, growth in the sector's revenue from contributions and grants was highest (see Figure 2). Revenue per person from contributions grew by 2.8 per cent per year on

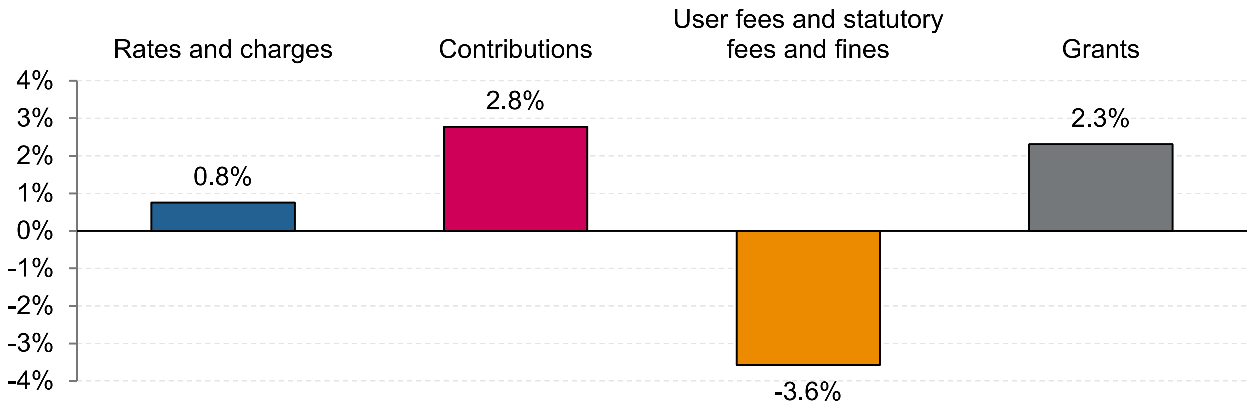
9 In calculating the growth in total revenue for the sector as a whole, we have adjusted for the timing of financial assistance grant payments from the Australian Government. See the Revenue chapter for more information.

average (down from 8.4 per cent per year before rate capping).[10] Revenue per person from grants grew by 2.3 per cent per year (up from −5.1 per cent per year before rate capping).

The sector's growth in revenue per person from rates and charges slowed to 0.8 per cent per year on average after rate capping (compared to 2.6 per cent per year before rate capping).[11] Revenue per person from user fees and statutory fees and fines declined by −3.6 per cent per year on average after rate capping (compared to a decline of −0.4 per cent per year before rate capping).

Figure 2 Growth in revenue per person 2015–16 to 2021–22, by source

For the sector as a whole (inflation-adjusted 2021–22 dollars)



Note: The numbers in this figure have been adjusted for the timing of financial assistance grant payments from the Australian Government.

Data sources: Council annual reports (audited); Australian Bureau of Statistics (2021) Regional population, ABS Website, accessed 17 January 2023; Australian Bureau of Statistics (December 2022) 'TABLES 1 and 2. CPI: All Groups, Index Numbers and Percentage Changes' [Index Numbers; All groups CPI; Melbourne], Consumer Price Index, Australia, accessed 17 January 2023.

See Chapter 2 for more information about revenue.

Expenditure

The sector's total expenditure per person increased.

When population growth is taken into account (that is, we look at expenditure per person), the sector's expenditure has grown over the six years of rate capping.[12]

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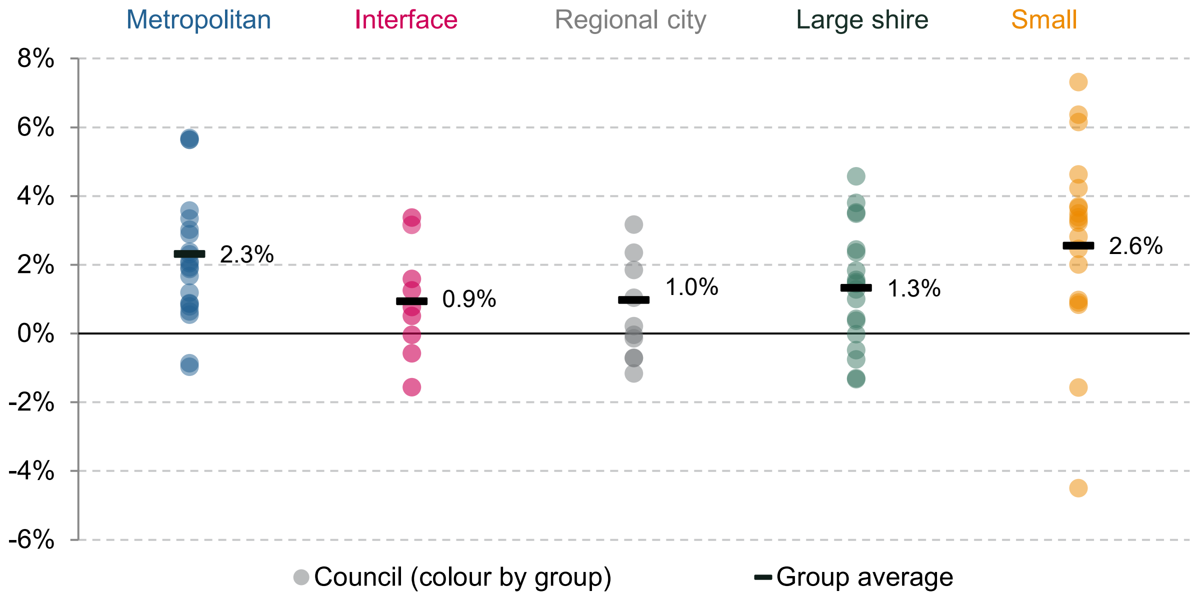
10 Where we calculated growth rates before rate capping, we have taken 2012–13 as the base year.

11 This is growth in capped rates and service charges combined.

12 We note that an increase in expenditure is not necessarily indicative of increased service delivery.

Figure 3 **Average annual growth in total expenditure per person 2015–16 to 2021–22**



Note: These growth rates are based on numbers that have been adjusted for inflation.

Data sources: Council annual reports (audited); Australian Bureau of Statistics (2021) Regional population, ABS Website, accessed 17 January 2023; Australian Bureau of Statistics (December 2022) 'TABLES 1 and 2. CPI: All Groups, Index Numbers and Percentage Changes' [Index Numbers; All groups CPI; Melbourne], Consumer Price Index, Australia, accessed 17 January 2023.

Total expenditure per person increased for all council groups. The metropolitan and small shire groups saw higher growth in expenditure per person, reflecting population growth trends, with metropolitan and small shire groups experiencing lower population growth over this period than the other three groups.

While there is some variability in growth rates between the groups, there was greater variability between individual councils. Some councils experienced expenditure per person growth rates significantly different to their group averages and 17 councils had negative growth rates, highlighting the fact that each council's financial situation is unique.

For the sector as a whole, there was growth in both capital expenditure and operating expenditure.

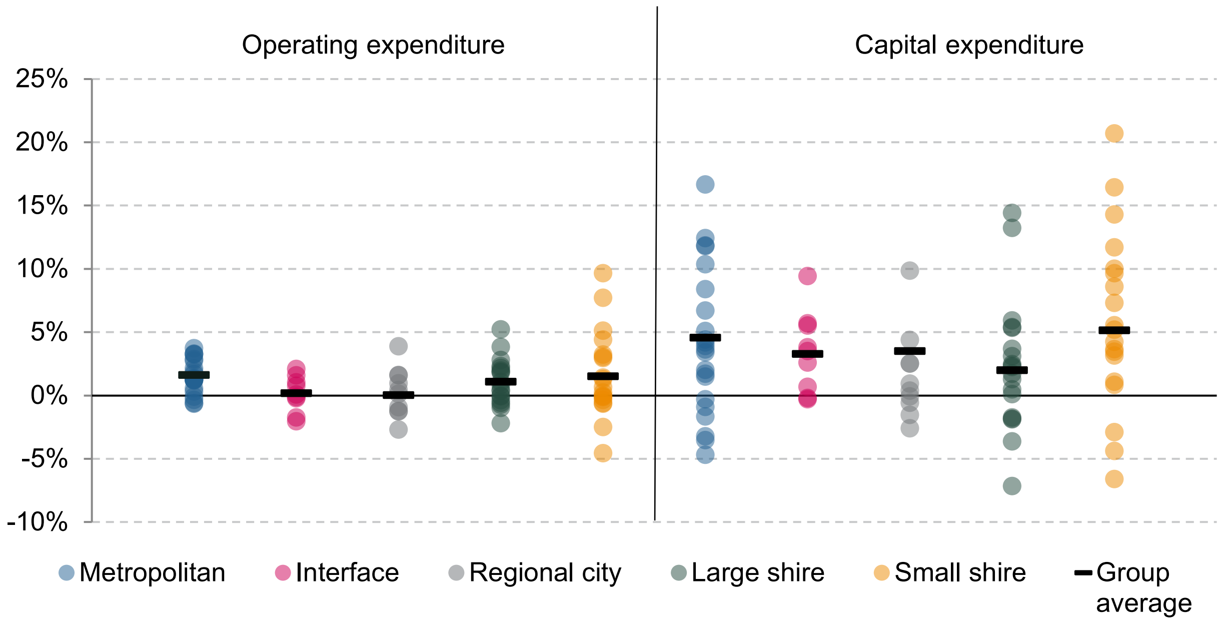
Council expenditure is categorised as either operating expenditure or capital expenditure:

- Operating expenditure relates to the day-to-day operations of the council. It includes employee costs and the cost of materials and services used to deliver services.
- Capital expenditure generally has a more long-term focus. It relates to the construction, renewal, upgrade or expansion of assets (such as roads, footpaths and buildings).

Most of the sector's expenditure is operating expenditure (around 74 per cent in the six years of rate capping).

All council groups experienced growth in operating expenditure per person. For the sector and for most council groups, capital expenditure per person also grew, with both operating expenditure and capital expenditure contributing to the growth in total expenditure per person. The exceptions to this were the regional city group and the large shire group, which experienced a reduction in capital expenditure per person. Figure 4 shows the difference in growth rates between councils and council groups.

Figure 4 Average annual growth in operating and capital expenditure per person 2015–16 to 2021–22



Note: These growth rates are based on numbers that have been adjusted for inflation.

Data sources: Council annual reports (audited); Australian Bureau of Statistics (2021) [Regional population](), ABS Website, accessed 17 January 2023; Australian Bureau of Statistics (December 2022) 'TABLES 1 and 2. CPI: All Groups, Index Numbers and Percentage Changes' [Index Numbers; All groups CPI; Melbourne], [Consumer Price Index](), Australia, accessed 17 January 2023.

For the sector, most of the growth in capital expenditure per person occurred in 2018–19 (19 per cent growth) with further growth in 2019–20 (5.2 per cent growth). This corresponds with an increase in grant funding in these years.

While there was a significant decrease in capital expenditure in 2020–21, likely due to coronavirus pandemic restrictions and challenges in the construction industry, there was renewed growth in 2021–22, suggesting these impacts may be transient.

The sector continued to undertake asset renewal and invest in new infrastructure to cater for the growing population.

The growth in capital expenditure per person in the six years of rate capping was largely in relation to new assets and asset upgrade projects. In per person terms, expenditure on these projects grew by 6.9 per cent and 6.2 per cent per year on average. Some growth also occurred in relation to asset expansion and asset renewal projects (2.7 and 1.3 per cent respectively).

This increased spending improved the sector's asset renewal ratio, which remained above 100 per cent each year since 2017–18. The asset renewal ratio is the level of spending on asset renewal and upgrade projects as a percentage of depreciation (which is the decrease in the value of assets due to age and use).

There was a notable drop in capital expenditure in 2020–21, likely driven by coronavirus pandemic restrictions and challenges face by the construction industry. As a result, 2020–21 is the only year since the introduction of rate capping that the sector's asset renewal ratio decreased. Despite this, spending appears to have returned to its longer-term upwards trend in 2021–22.

On average, in the six years of rate capping, the sector's combined spending on asset renewal and upgrade projects was more than the level of depreciation. This was also true for 47 of the 79 individual councils.

The sector's expenditure increased across most service areas.

For the sector, service expenditure per person increased on average over the six years of rate capping.[13] In particular, expenditure for waste-management increased for all council groups, reflecting disruption in the waste-disposal industry. Service functions where expenditure decreased included 'family and community services', 'local roads and bridges', and 'traffic and street management'.[14]

All councils reported on six measures of service quality – three of performance, and three of community satisfaction. Movement in these measures may indicate changes in either the level or quality of services provided. In the six years, there were mixed results. There were some improvements in service quality and satisfaction measures on average across the sector. But these

[13] For the purposes of this section and Chapter 5, service expenditure means recurrent operating expenditure, including depreciation. Capital expenditure and non-recurrent operating expenditure (such as one-off accounting adjustments) across the service areas have been omitted.

[14] There was also a decrease in spending on aged and disabled services. This reflects that most councils have either ended or reduced their provision of aged and disabled services in response to Australian Government reforms aimed at increasing the number of providers and choice in the market (for example, the introduction of the National Disability Insurance Scheme and the Commonwealth Home Support Programme).

were not reflected in the reported results of each council group, and average improvements in four of the measures up to 2020–21 were lost in 2021–22.

See Chapters 3.4 and 5 for more information on expenditure.

Financial position

While the sector's operating position declined over the six years of rate capping, it remained positive in each of those years.

The average adjusted underlying result[15] for the sector over the six years of rate capping was 4 per cent. Most council groups reported positive but declining results up to 2019–20, where all groups except the metropolitan group reported a negative result due to the impacts of the coronavirus pandemic.

Council results can vary substantially year on year because of changes in accountings standards, significant one-off changes in revenue or costs (for example because of the impacts of floods or fire) and the prepayment of grant funding. Given this variation, simple year-on-year changes may not fully indicate council sustainability, so we also looked at four-year averages (2018–19 to 2021–22).

All groups except the small shire group reported a positive average result[16] over the four years (see Figure 5). The chart shows that metropolitan and interface councils, on average, reported higher results than others. Their higher results indicate the councils in urban and developing communities had more favourable ratios of revenue to expenditure.

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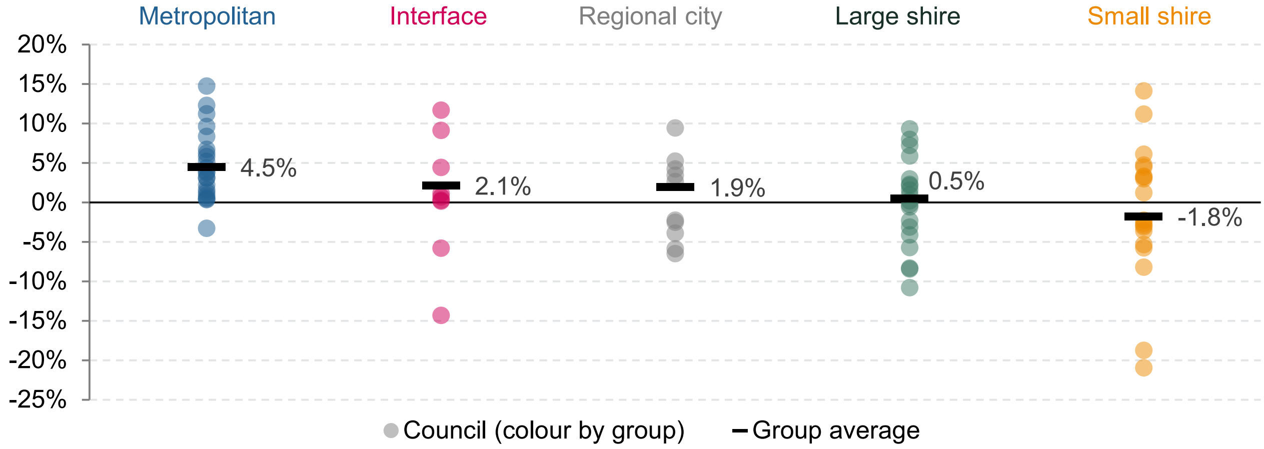
[15] Each council subtracts non recurrent items (such as non-monetary contributions from developers and one off capital grants) from its total income, to calculate its adjusted underlying revenue. Then, after subtracting its total expenditure, the resulting surplus or deficit is expressed as a percentage of the adjusted underlying revenue. We also call this the operating position.

[16] We calculate sector or group averages from the total expenditure and total adjusted underlying revenue for all the councils in the sector or group. The alternative, an average of results for individual councils, would not reflect the dollar significance of larger councils. In calculating these results, we did not adjust revenue for the timing of financial assistance grant payments from the Australian Government; see Chapter 6 for more information.

Figure 5 Average adjusted underlying result 2018–19 to 2021–22



Note: The adjusted underlying results in this figure have not been adjusted for the timing of financial assistance grant payments from the Australian Government, as the data is only available at a sector level (See Box 6.1 in Chapter 6). If data were available to adjust for the timing of grants at a group and individual council level, the four-year averages for the groups and individual councils would likely be lower than shown in this figure. These are the average of results from 2018–19 to 2021–22.

Data source: Local Government Performance Reporting Framework.

The chart also shows the variation in results (spread of dots) between councils reflecting their unique circumstances. Over the period, some councils performed strongly with positive average adjusted underlying results above 5 per cent. However, 27 councils reported a negative average adjusted underling result.[17] This included 1 metropolitan council, 2 interface, 5 regional city, 9 large shire and 10 small shire councils.

Overall, the results suggest that a third of councils may not have had enough revenue to continue funding the services they provided. Councils with ongoing negative results may face difficulty in continuing to deliver services at existing levels without increasing their revenue (from grants, rates or other sources) or reducing their expenditure (for example, by improving their efficiency). Otherwise, they may have to reduce the current range or level of their services over the longer term.

Councils can apply to us for a higher cap if the Minister's cap is not sufficient to meet their needs. In applying for a higher cap, a council needs to show:

- the reasons a higher cap is needed
- how the views of its community have been considered
- how the higher cap is an efficient use of resources and represents value for money
- whether other funding options have been considered and why these are not appropriate

[17] In our last report we found that there were 18 councils with a negative average underlying adjusted result over the four years between 2015–16 to 2020–21,

- the assumptions and proposals in the application are consistent with the council's long-term planning and financial management.

The sector as a whole had the ability to meet both short-term and long-term liabilities.

On average, over the six years of rate capping, the sector's working capital ratio[18] was 266 per cent. This means the sector had sufficient cash and other liquid assets[19] to repay all short-term debts due within a year. Councils' working capital may often fluctuate, as they save for large capital projects over several years, and then spend. Despite this, over this six-year period, most councils had average working capital ratios above 100 per cent.

The indebtedness ratio[20] for the sector averaged 18.8 per cent over the six years of rate capping. This means the sector had the ability to use the revenue they control (such as rates, fees and charges) to repay long-term liabilities (such as borrowings and future obligations). Most councils reported average indebtedness levels below 40 per cent. The total level of debt held by the sector decreased in real terms over the six years of rate capping by $287 million. In 2021–22 the sector held $165 of debt for every person in Victoria compared to $214 in 2016–17.

See Chapter 6 for more information on financial position.

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[18] The working capital ratio is defined as current assets (such as cash savings and assets held for sale) as a percentage of current liabilities (debts payable within 12 months).

[19] Liquid assets include cash and assets that can easily be converted into cash in a short amount of time (such as term deposits maturing within 12 months).

[20] Indebtedness is measured as a council's non-current liabilities (mainly bank loans, but also including future long service leave and landfill restoration obligations) as a percentage of its own-source revenue (which is revenue within the council's control, such as rates and charges, and user fees).

1. Rates and charges

This chapter focuses on what happened to councils' rates and charges over the six years of rate capping (2016–17 to 2021–22).[21] It analyses the changes in the rates and charges revenue received by the sector and how the rates paid by individual ratepayers have changed over time.

Key observations

- **Ratepayer benefits:** Ratepayers continued to benefit under rate capping in the six years after its introduction.
- **Average annual growth:** Although the sector's annual growth in revenue from capped rates was positive, the sector's growth in revenue from capped rates *per property* was negative in the six years after rate capping.
- **Sector's negative growth in 2021–22:** The sector's negative annual growth in revenue *per property* from capped rates was mainly observed in the 2021–22 rating year, reflecting the difference between the rate cap and actual inflation.
- **Total service rates and charges:** Service rates and charges made up the largest proportion of uncapped rates and charges. Revenue per property from service charges increased by $10 per year (4.5 per cent) on average. This reflects councils introducing new service charges and broader changes in the market that have increased waste costs.

This chapter focuses on the sector as a whole (the sector), – that is, all 79 councils in Victoria combined. It also highlights any differences between groups of similar councils (metropolitan, interface/urban fringe, regional cities, large shires, and small shires). [22] For information about individual councils, see the fact sheets and the interactive dashboard at https://www.esc.vic.gov.au/outcomes-reports. The analysis is based on real values, which are the values that have been adjusted for inflation.

See page 62 for definitions of key terms used in the report.

[21] Where we calculated growth rates for the six years of rate capping, we have taken 2015–16 as the base year. In this chapter, we have also examined 2022–23 where data was available.

[22] Sector or group averages have been calculated for the sector or group in aggregate. They are not the average of results for individual councils within the sector or group. See Appendix C for a list of the councils in each group.

1.1 How ratepayers benefited from rate capping

What is rate capping and how does it work?

Rate capping was introduced in 2016–17 to limit the percentage increase in councils' *general rates* and *municipal charges* ('capped rates') paid by an average ratepayer.[23] The rate cap is set by the Minister for Local Government each year and applies to all councils by default.[24]

Depending on their financial needs, councils have the option of applying for a higher cap above the minister's cap. Councils can apply for a higher cap in a single year or multiple years. A higher cap application is then evaluated and subject to approval or rejection by the Commission based on legislative criteria and objectives.

Ratepayers continued to benefit from low rate increases

Rate capping kept the rate increases lower than historical increases prior to rate capping.

In each year of rate capping, the minister set the cap equal to the forecast level of inflation. From 2016–17 to 2022–23, these caps ranged from 1.5 per cent to 2.5 per cent (see Table 1.1). Eleven councils had approved higher caps while most councils kept rate increases below or equal to the minister's cap. Councils with an approved higher cap consulted their communities and were able to show a long-term need for additional revenue. Out of these 11 councils, four had higher caps approved for multiple years.[25] Between 2021–22 and 2023–24, no councils applied for higher caps.

Except for a handful of non-compliant councils in 2017–18, 2018–19 and 2020–21, all councils were compliant with the rate cap in all other years from 2016–17 to 2022–23 (see Table 1.1). In most cases, non-compliant councils exceeded the rate cap by a small amount. We have only considered two cases of non-compliance to be material so far.[26] Importantly, as of 2021–22, all non-compliant councils have either refunded the amount of rates in excess of the cap or set lower rate increases in subsequent years. This means that ratepayers in these councils will not be disadvantaged over the long-term by their councils' non-compliance.[27]

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23 Section 1.3 of this Chapter examines charges that are not included in the rate cap. Appendix A outlines the legislative framework and how the rate cap works.

24 The Minister may choose to set a different rate cap for specified councils or groups of councils but has yet to do so.

25 Appendix B provides a summary of approved higher caps. More detail on the higher cap application process and individual applications can be found on our website.

26 See our council compliance reports for more information.

27 Except for Darebin City Council which did not propose to take further action for their non-compliance occurring in 2020–21 as the amount was minor ($814 for the entire council). This was discussed in our 2021–22 Compliance Report.

Table 1.1 Summary of rate caps and compliance

Year	Minister's cap	Number of councils with an approved higher cap	Number of compliant councils
2016–17	2.50%	6 (ranging from 3.05% to 6.34%)	79
2017–18	2.00%	4 (ranging from 3.50% to 5.55%)	76
2018–19	2.25%	4 (ranging from 2.57% to 5.55%)	75
2019–20	2.50%	4 (ranging from 3.50% to 13.94%)	79
2020–21	2.00%	3 (ranging from 3.50% to 5.55%)	76
2021–22	1.50%	No applications received	79
2022–23	1.75%	No applications received	79

The sector's average annual growth in revenue per property from capped rates was negative in the six years of rate capping

While the sector's revenue from capped rates continued to grow, growth in revenue from capped rates *per property* was negative in the six years of rate capping. This means, on average, ratepayers paid less in capped rates than they were paying prior to rate capping.

In real terms (or inflation-adjusted terms),[28] the sector's average annual growth in revenue from capped rates was 4.7 per cent in the three years before the introduction of rate capping (from 2013–14 to 2015–16) and fell to 1.6 per cent in the six years of rate capping (from 2016–17 to 2021–22).

Figure 1.1 illustrates year-on-year changes in revenue per property from capped rates. In real terms, the sector's average annual growth in revenue per property from capped rates was 3 per cent (equivalent to an increase of $52 per annum on average) before rate capping. In the six years of rate capping, the sector's revenue from capped rates per property showed a negative annual growth rate of −0.4 per cent on average (equivalent to a decrease of $7 per annum).[29]

In 2021–22, the sector's annual growth in revenue from capped rates per property decreased by 2 per cent (the highest decrease over the six years of rate capping). This reflects the difference between the rate cap and inflation. The rate cap was set to 1.5 per cent while actual inflation was

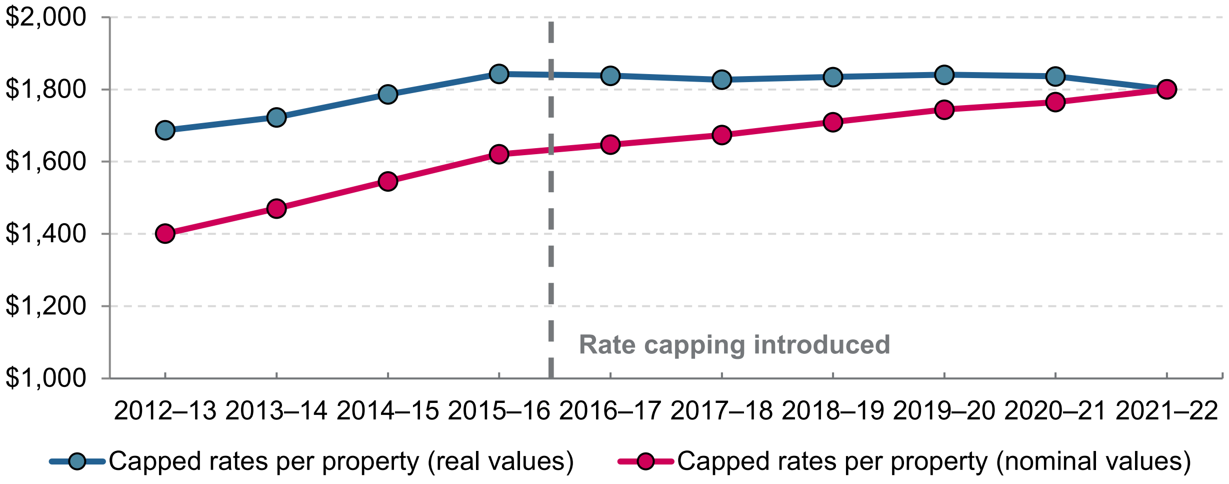
[28] 'In inflation-adjusted terms' means to adjust the underlying dollars by inflation. This accounts for changes in the value of the dollar over time, allowing for more accurate comparisons across each year.

[29] Over the period, growth in the sector's number of rateable properties was 2 percent per year compared to average annual growth of 1.6 per cent for revenue from capped rates).

around 4 per cent. This decline is likely to continue in 2022–23, as the 1.75 per cent rate cap will be significantly below actual inflation for the financial year.

Figure 1.1 Revenue per property from capped rates in real and nominal values

For the sector as a whole



Notes: Real values means values that were adjusted for inflation using 2021–22 dollars.

Data sources: Council annual reports (audited); Victorian Local Government Grants Commission – VGC 2 data 2012–13 to 2021–22 (unaudited data); Australian Bureau of Statistics (December 2022) 'TABLES 1 and 2. CPI: All Groups, Index Numbers and Percentage Changes' [Index Numbers; All groups CPI; Melbourne], Consumer Price Index, Australia, accessed 17 January 2023.

The rating system means that rate increases for individual ratepayers vary

Rate caps apply to the *average* rate. Individual ratepayers will experience changes in their rates that are different to the rate cap, due to factors outside the rate capping system. These include but are not limited to:

- **Changes in property valuations:** This is the major reason for differences in rates paid by each ratepayer. Property values determine the proportion of general rate revenue paid by each ratepayer. When a ratepayer's property increases or decreases in value relative to others' properties, rates applied to that individual will increase by more or less than the rate cap accordingly. Since 2018–19, all properties have been revalued on an annual basis. This means that the relative value of each property may change every year.
- **Changes in differential rates**, which are different rates in the dollar applied by some councils to different types of property.[30] Councils decide what proportion of rate revenue they collect

[30] The amount of general rates a ratepayer pays is determined by multiplying the value of their property by what is known as the 'rate in the dollar'. Some councils set a uniform rate in the dollar for different types of property, while others have different rates in the dollar for different types of property, such as a farm or a residential property.

from different classifications of property (for example, residential or commercial). They do this by using differential rates and/or a municipal charge. Rate increases will then vary for individual ratepayers depending on if a council changes its differential rates, introduces or removes a municipal charge, or reclassifies a property.[31]

More than half of all ratepayers experienced rate increases below the rate cap

Each year, more than half of all ratepayers experienced rate increases lower than the cap.

We asked councils to provide data on the distribution of increases in capped rates for individual ratepayers. We received data from most councils. These individual data can be viewed in the council factsheets.

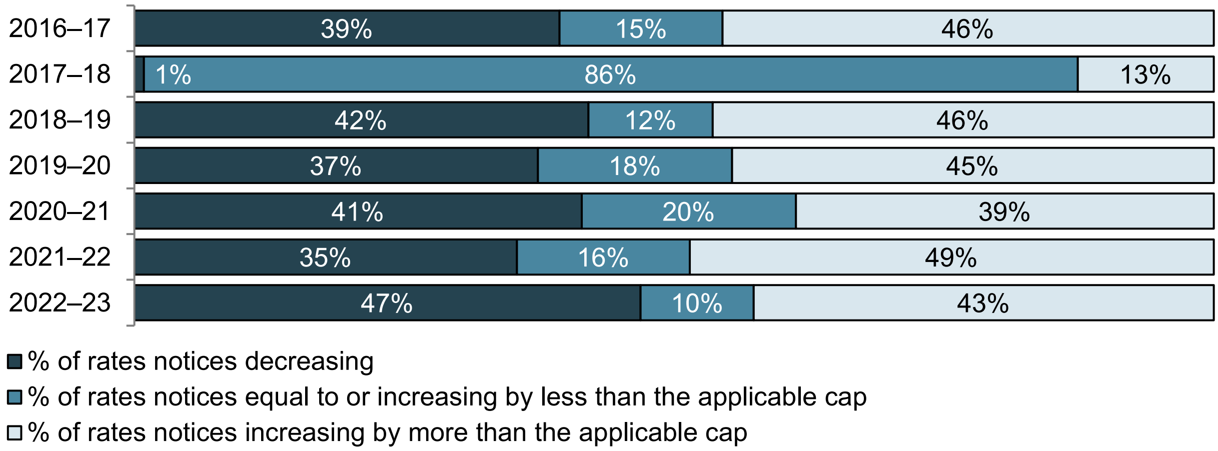
According to the data provided by councils, more than half of all ratepayers continued to experience either decreases in rates or rate increases that were less than the rate cap in each year there was a revaluation (see Figure 1.2). Taking an average of the six years in which revaluations occurred:[32]

- 40.4 per cent of ratepayers had a decrease in their rates
- 15.2 per cent of ratepayers had an increase in their rates that was below the rate cap
- 44.4 per cent of ratepayers had an increase in their rates that was above the rate cap.

[31] To ensure they are compliant with the rate cap, some councils amend their rates in the dollar or municipal charge after adopting their budgets. See our council compliance report for more information.

[32] These years included 2016–17, 2018–19, 2019–20, 2020–21, 2021–22, and 2022–23.

Figure 1.2 Distribution of rate increases for individual ratepayers



Note: Rates notices that did not change are included in the '% of rate notices equal to or increasing by less than the applicable cap' category.

Data sources: Data was provided to the commission by councils and has not been audited.

2017–18 was a non-revaluation year, so most ratepayers experienced rate increases below the rate cap. Specifically, 87 per cent of ratepayers experienced a rate increase below the rate cap, and 1 per cent of ratepayers experienced a rate decrease. Excluding the non-revaluation year in 2017–18, the proportion of ratepayers with rate increases above the rate cap was the lowest in 2020–21 (39 per cent), due to 17 councils setting their average rate increase to zero per cent in response to the coronavirus pandemic.

Annual changes in capped rates varied between different property types

The proportions of rates revenue collected from different types of ratepayers fluctuated. After rate capping, revenue *per property* from capped rates for rural ratepayers increased more than for other property types.

For the sector, the proportions of revenue from capped rates coming from different types of ratepayers fluctuated slightly between 2016–17 and 2021–22:

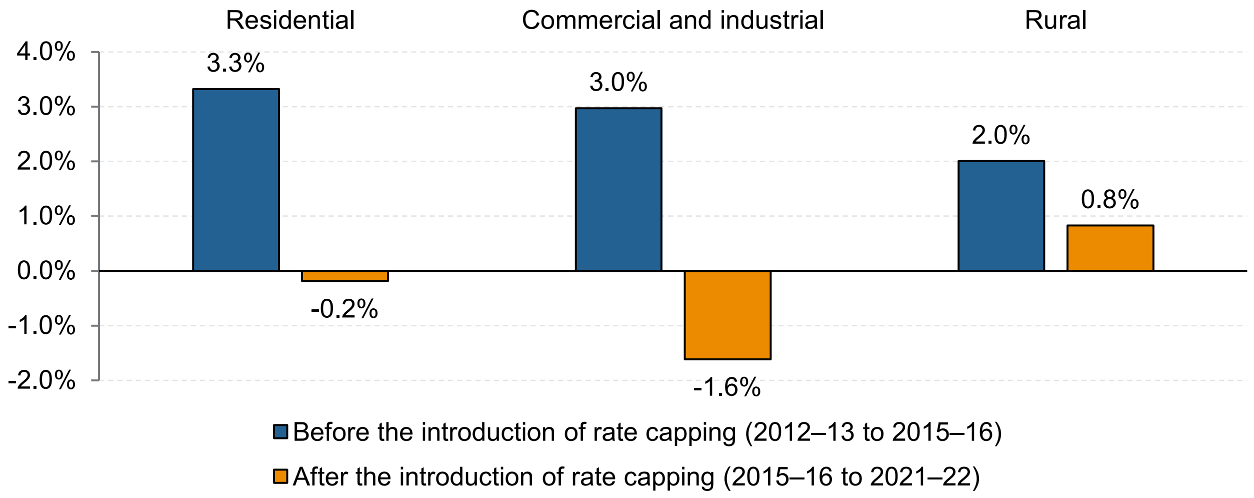
- The proportion from residential ratepayers increased from 75.4 per cent to 76.6 per cent.
- The proportion from commercial and industrial ratepayers decreased from 18.4 per cent to 16.9 per cent.

- The proportion from rural ratepayers also decreased from 5.9 per cent to 5.5 per cent.[33], [34]

The growth in revenue per property from capped rates also varied among different property types (see Figure 1.3).

Figure 1.3 Average annual growth in capped rates per property, by property type

For the sector as a whole



Note: These growth rates are based on numbers that have been adjusted for inflation. They are calculated from 2015–16 to 2021–22.

Data sources: Council annual reports (audited); Victorian Local Government Grants Commission – VGC 2 data 2012–13 to 2021–22 (unaudited data); Australian Bureau of Statistics (December 2022) 'TABLES 1 and 2. CPI: All Groups, Index Numbers and Percentage Changes' [Index Numbers; All groups CPI; Melbourne], Consumer Price Index, Australia, accessed 17 January 2023.

After rate capping, the average annual growth rates in revenue per property in the six years were negative for all property types, except for rural properties. In particular, the average annual growth in capped rates per property for rural ratepayers (including those with urban farms) was 0.8 per cent. This was due to a considerable increase in rural property valuations (7.6 per cent per year on average), together with a decline in its property number (−0.5 per cent per year on average) after rate capping.

33 Rural properties refer to properties such as farms (including urban farms), not properties in rural areas. For example, there can be rural properties in metropolitan councils, and there are many residential properties in rural areas.

34 The proportions add up to 99.6 per cent and 99 per cent as we have 'other' properties that do not fit the classifications due to data inconsistency.

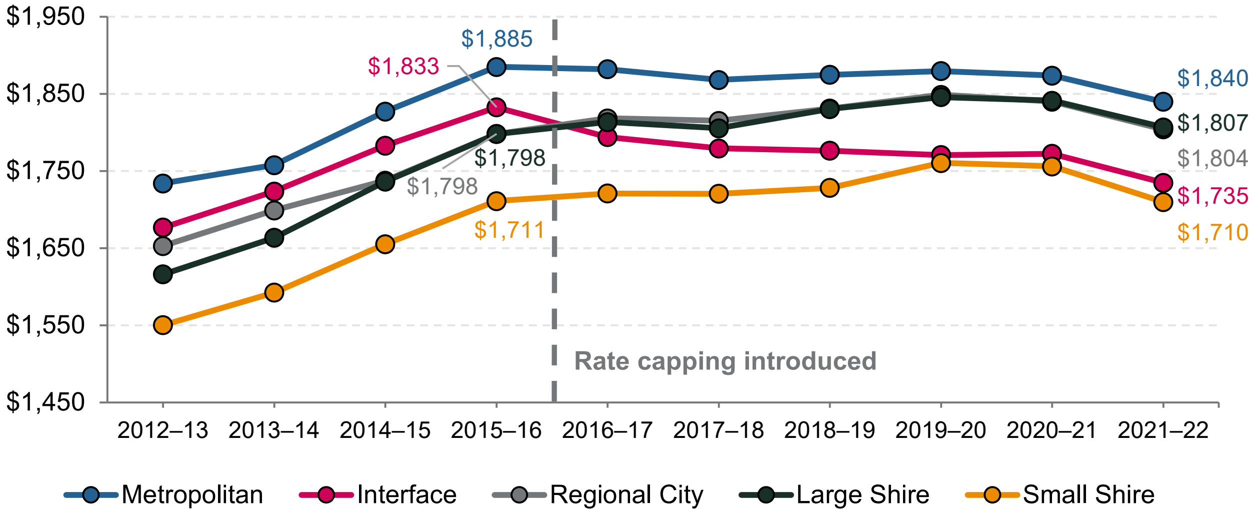
1.2 The impacts of rate capping on councils' rate revenue varied

After rate capping, the interface group experienced the largest decline in revenue *per property* from capped rates.

The decline in revenue per property from capped rates varied among different council groups (see Figure 1.4). In the six years of rate capping, the average annual growth in revenue *per property* from capped rates was negative for the interface and metropolitan groups, but remained nearly unchanged for the regional city, large shire and small shire groups.[35]

Figure 1.4 Revenue per property from capped rates, by council group

Inflation-adjusted, 2021–22 dollars



Data sources: Council annual reports (audited); Victorian Local Government Grants Commission – VGC 2 data 2012–13 to 2021–22 (unaudited data); Australian Bureau of Statistics (December 2022) 'TABLES 1 and 2. CPI: All Groups, Index Numbers and Percentage Changes' [Index Numbers; All groups CPI; Melbourne], Consumer Price Index, Australia, accessed 17 January 2023.

Overall, after rate capping, revenue *per property* for all council groups remained relatively steady in comparison to before rate capping. However, there was a noticeable decline across all council groups in 2021–22.

Several factors that could influence the variations between groups (and the councils within them) include:

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[35] Mansfield Shire Council had an approved higher cap of 13.94% in 2019–20 to allow the council to shift revenue from service charges (which are not capped) to capped ones. The overall revenue increase was neutral to the council. However, this resulted in the council's average annual increase in capped rates per property being higher in the six years after rate capping (3%) than it was in the three years before its introduction (2.3%) in inflation-adjusted terms.

- **Differences in the rate increases councils decided to apply or were approved to apply (with a higher cap)**:
  - *Lower rate increases:* As the rate cap is a maximum, councils can, at their discretion, set average rate increases lower than the rate cap. For example, in 2020–21, seventeen councils adopted average rate increase of 0 per cent, which was below the minister's rate cap of 2 per cent, in response to the coronavirus pandemic.[36] These councils were across all groups, with the highest numbers from the large shire and small shire groups.
  - *Higher caps:* councils with an approved higher cap are able to apply higher average rate increases.
    - Ten councils set their rate increases in line with approved higher caps in one or more of the first four years of rate capping. These councils are all within the regional city, large shire or small shire groups,[37] which contributed to the slight upward trend for these council groups (see Figure 1.4).
    - Mansfield Shire Council had a higher cap of 13.94 per cent in 2019–20. This impacted on the overall rates increase for the small shire group in this particular year.
- **Movements in revenue between capped rates and service charges**:
  - *Introducing service charges:* Councils that introduced service charges typically reduced their capped rates to ensure the total change in revenue from capped rates and waste charges is neutral to the council.[38]
    - Most councils that introduced new service charges are in the metropolitan group, which contributed to their declining trend after rate capping (see Figure 1.4).
    - In 2016–17, Mornington Peninsula Shire Council decided to introduce a service charge and reduced capped rates. This contributes to the decline in revenue per property from capped rates for the interface group in that rating year (see Figure 1.4).
- **Differences in the type of property development or property growth that is occurring** can also affect capped rates per property. In particular, the development of a large commercial property will raise revenue per property by more than a new residential property due to its higher valuation. This also helps explain the decrease in capped rates per property for some councils. For example, the interface group experienced most of their growth in residential

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[36] See our 2020–21 compliance report and Appendix B for more information.

[37] While 11 councils have had approved higher caps, only ten have utilized them. In 2018–19, Monash City Council chose not to use their higher cap to recover the cost of recycling services, instead implemented a service charge.

[38] Revenue neutral means no additional revenue was raised as councils introduced new service charges but also reduced revenue from general rates. More information on councils' introduction of service rates or charges can be found in our council compliance reports.

properties which contributed to their large decline in capped rates per property after rate capping.

The sector's rate debtors have grown

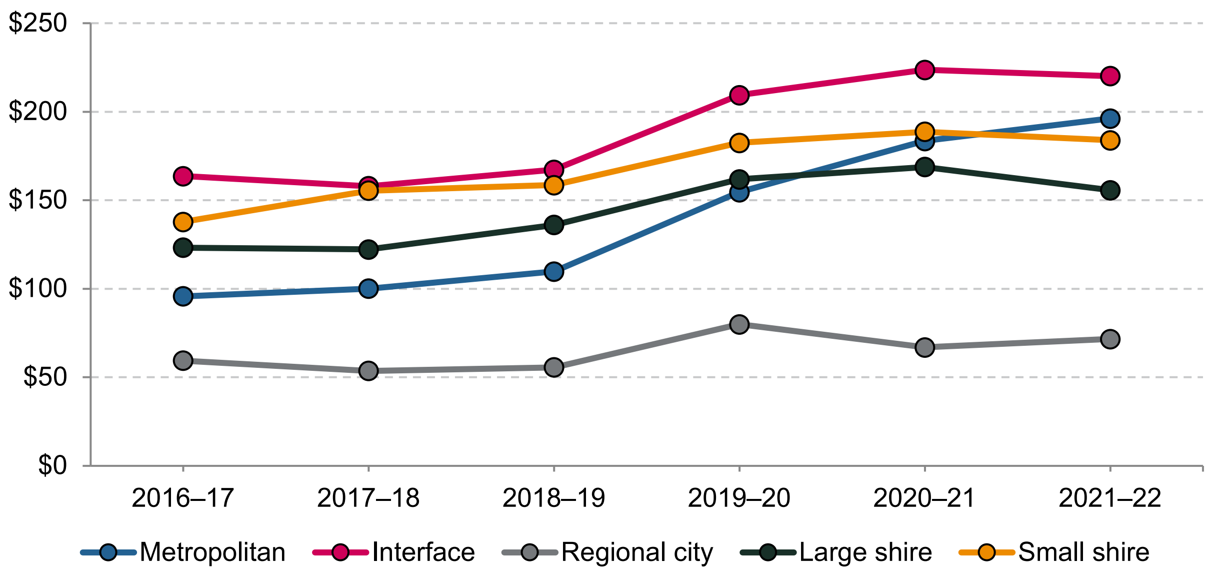
Each council group's rates debtors have grown since the introduction of rate capping.

The amount of rates debtors (overdue rates) for each council group has grown since the introduction of rate capping (see Figure 1.5). This was driven by a spike in 2019–20, likely a result of ratepayers experiencing financial difficulty due to the coronavirus pandemic.

While the regional city and large shire groups have seen their rates debtors per property decrease since 2019–20, the small shire and interface groups have plateaued and the metropolitan group has seen continued strong growth.

Figure 1.5 Rates debtors per property 2016–17 to 2021–22

Inflation adjusted, 2021–22 dollars



Data source: Council annual reports (audited); Victorian Local Government Grants Commission – VGC 2 data 2012–13 to 2021–22 (unaudited data); Australian Bureau of Statistics (December 2022) 'TABLES 1 and 2. CPI: All Groups, Index Numbers and Percentage Changes' [Index Numbers; All groups CPI; Melbourne], Consumer Price Index, Australia, accessed 17 January 2023.

The sector's rates and charges outstanding ratio increased

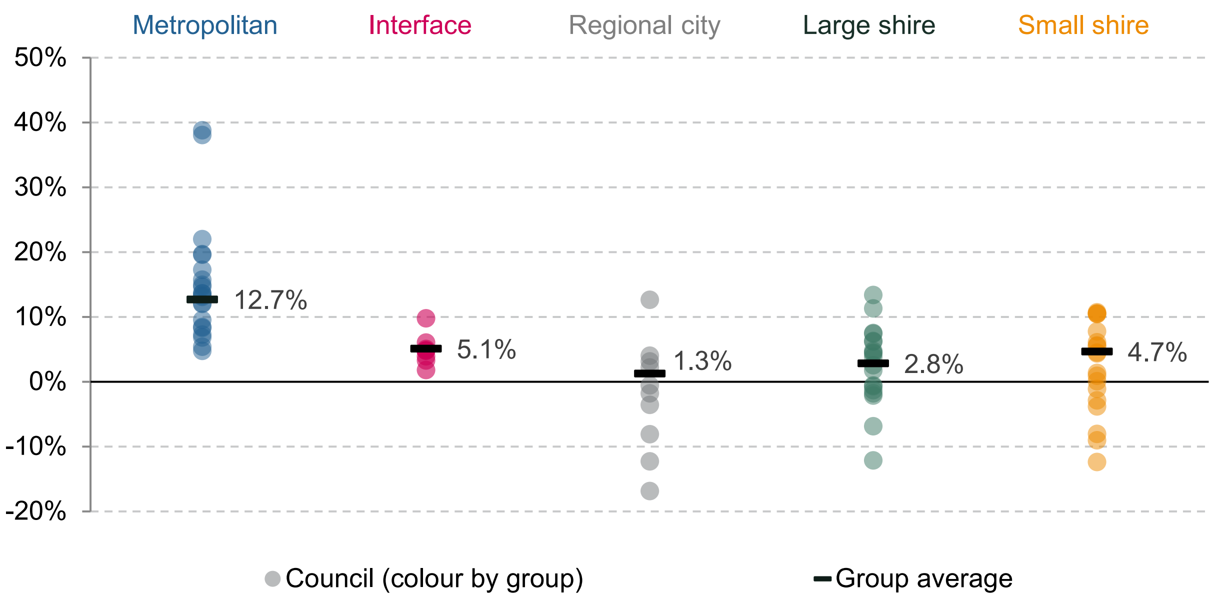
The rates and charges outstanding ratio is the level of rates debtors as a percentage of total rates and charges revenue.[39] A higher ratio can impact on a council's liquidity while the ratio is impacted by many factors, including the amount of rates going unpaid and the effectiveness of council's debt recovery.

The sector rates debtors grew as a percentage of total rates and charges revenue each year since 2016–17.

On average, each group also saw their rates and charges outstanding ratio increase since the introduction of rate capping (see Figure 1.6). This growth was linked to the growth in rates debtors discussed above, with the groups seeing the highest rates debtors growth also seeing the highest growth in rates and charges outstanding ratio and vice versa. As such, the metropolitan group saw the highest increase, with an average increase of 12.7 per cent for the group, while the regional city and large shire groups saw the lowest growth, with 1.3 per cent and 2.8 per cent respectively.

Figure 1.6 Average Annual growth in rates and charges outstanding ratio 2015–16 to 2021–22

Inflation-adjusted, 2021–22 dollars



Data source: Council annual reports (audited); Australian Bureau of Statistics (December 2022) 'TABLES 1 and 2. CPI: All Groups, Index Numbers and Percentage Changes' [Index Numbers; All groups CPI; Melbourne], Consumer Price Index, Australia, accessed 17 January 2023.

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[39] We have adapted NSW's Office of Local Government rates and annual charges outstanding ratio for use within the Victorian local government sector.

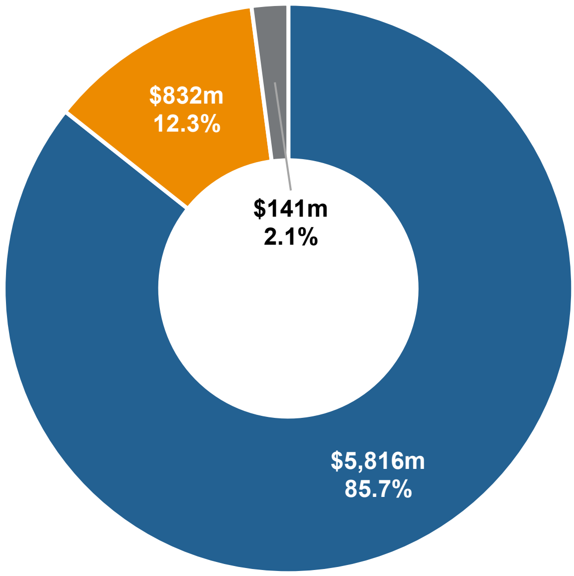
This increase in rates debtors highlights the importance of having well-functioning financial hardship policies and practices in place, not only for ratepayers experiencing financial hardship, but also for the financial health of councils.[40] Consideration of how councils can improve their policies to support ratepayers in hardship is also timely, given the rising cost of living and changing economic circumstances faced by Victorians.

1.3 Councils also collected other charges and levies that are not capped

Rate capping only applies to general rates and municipal charges. There are 'service rates and charges' and 'other rates and charges' that are not included in the rate capping system:

- **Capped rates (85.7 %)** – includes general rates and municipal charges
- **Service rates and charges (12.3%)** – primarily used to recover the costs of waste services
- **Other rates and charges (2.1%)** – including:
  - special rates and charges (e.g. charges for services provided in business districts such as marketing or economic development; or constructing footpaths, roads, kerbs and channels or drains)
  - supplementary rates and charges (on new or improved properties)
  - levies on cultural and recreational properties
  - revenue in lieu of rates (e.g. payments made by electricity generators instead of rates)

Figure 1.7 Composition of revenue from rates and charges, 2021–22



Data source: Council annual reports (audited)

[40] The Local Government Legislation Amendment (Rating and Other Matters) Act 2022 will insert new provisions into the Local Government Act 1989 that allow the Minister for Local Government to issue Guidelines on financial hardship. This includes a requirement for the minister to consult with the commission on those Guidelines.

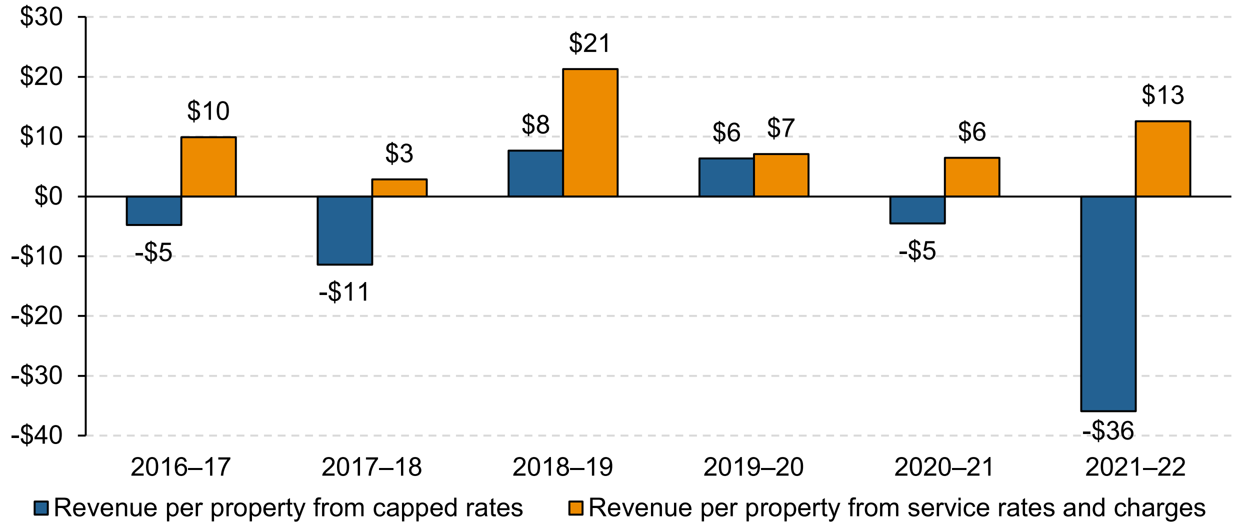
Revenue from service rates and charges increased in response to changes in the waste market

The sector's revenue from service charges increased in response to increased costs in the waste market.

In the six years of rate capping, revenue per property from capped rates decreased by $7 per year (−0.4 per cent) on average. Over the same period, revenue per property from service charges increased by $10 per year (4.5 per cent) on average. This reflects councils' decisions to introduce new service charges for kerbside waste collection and broader changes in the market that have increased waste costs.

Figure 1.8 Annual changes in revenue per property from capped rates and service charges

For the sector as a whole (inflation-adjusted 2021–22 dollars)



Data sources: Council annual reports (audited); Victorian Local Government Grants Commission – VGC 2 data 2012–13 to 2021–22 (unaudited data); Australian Bureau of Statistics (December 2022) 'TABLES 1 and 2. CPI: All Groups, Index Numbers and Percentage Changes' [Index Numbers; All groups CPI; Melbourne], Consumer Price Index, Australia, accessed 17 January 2023.

Ten councils introduced kerbside waste charges for the first time

In 2015–16, the year before rate capping, 13 councils did not use service charges to recover the cost of waste collection and funded these services through their revenue from general rates and municipal charges. As service charges are not capped, councils that fund waste costs through service charges are able to increase charges in response to cost pressures – other councils cannot.

When councils introduce service charges, we ask them to reduce revenue from general rates so that the overall revenue impact is neutral. We report on the introduction of service charges as part of our compliance report.[41] Between 2016–17 and 2021–22, six councils introduced service charges for the first time. In 2022–23, four more metropolitan councils introduced service charges. This is budgeted to increase total service rates and charges revenue to $1.01 billion, or 14.2 per cent of total rates and charges revenue, in 2022–23.

Changes in the waste market increased costs

Since 2018 there have been several changes in the waste market that may have contributed to increases in waste charges. This includes:

- The China Sword Policy, in which China banned the importation of most recyclables, and subsequent collapse of a domestic service provider. This likely explains the large increase in service rates and charges revenue during 2018–19, as councils increased charges in response to increased recycling costs.
- The Victorian Government announced the Circular Economy Policy in 2019, which included several changes to strengthen the municipal waste sector. Notably, the policy outlined the rollout of a four-bin system and increases in the waste levy.[42]
- General inflationary pressures, which likely contributed to the increase in service charges in 2021–22. Unlike capped rates, councils can increase service charges to match changes in costs.

Council practices for charging ratepayers for waste services varies

We observe that councils take different approaches in how they fund their waste services. This applies to both the types of costs and scope of services that councils choose to recover. For example, some councils only recover the direct costs while others also recover indirect costs, including for capital works. In terms of the types of service, some councils only charge for kerbside waste collection, while others recover the cost of 'community waste' such as street cleaning and litter collection.

These differences are reflected in the range of service rates and charges revenue per property that can be observed across the sector. In 2021–22, for councils that mandate a waste charge, the average service rates and charges per property was $311, with the highest $469, and the lowest $41 (see Figure 1.9).

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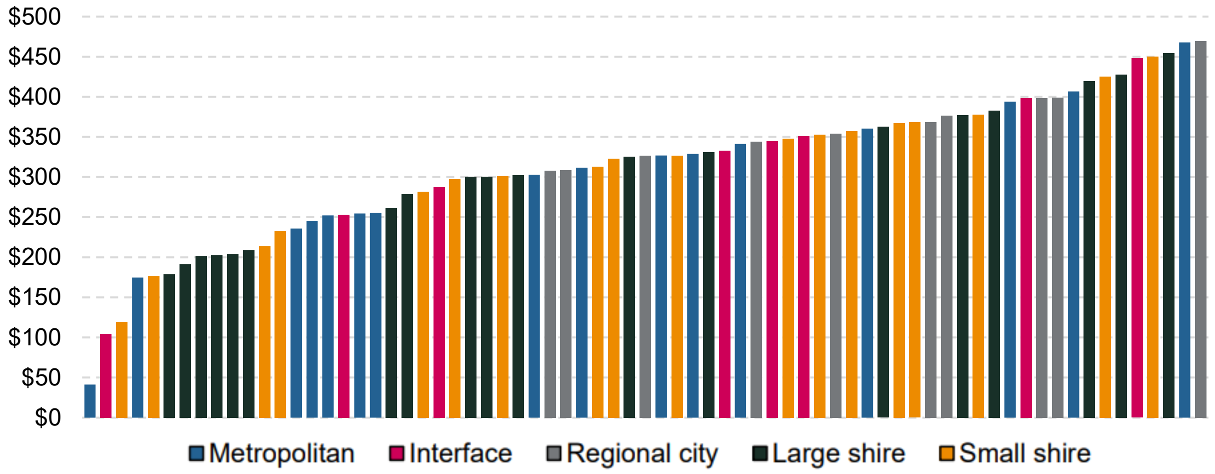
[41] See our annual compliance reports for more information: https://www.esc.vic.gov.au/local-government/council-compliance-rate-caps/council-compliance-reports.

[42] The four-bin system refers to a requirement for councils to provide a glass, food organics and garden organics, mixed recyclables and household rubbish service. The waste levy is paid on all waste received at landfills.

We consider that there could be benefits from improving the consistency and transparency of the sector's practices around service charges.

Figure 1.9 Service rates and charges revenue per rateable property, 2021–22



Note: The list of councils' service rates and charges per rateable property can be found in Appendix D.

Data sources: Council annual reports (audited)

2. Revenue

This chapter focuses on what happened to councils' revenue and revenue per person over the six years of rate capping (2016–17 to 2021–22).[43] It examines the different sources of council revenue and how each source contributed to growth in the sector's total revenue and revenue per person. In this chapter, total revenue refers to revenue from: rates and charges, grants, contributions, user fees and statutory fees and fines, and other revenue.[44]

Key observations

- **Total revenue and revenue per person:** Both total revenue and revenue per person in the six years of rate capping continued to grow but at a slower rate than prior to the introduction of rate capping.
- **Sources of revenue:** In the six years of rate capping, rates and charges remained the largest source of revenue, followed by revenue from grants.
- **Roles of contributions and grants:** After rate capping, stronger growth in the sector's revenue per person from contributions and grants offset slower growth in revenue from rates and charges and a sharp decline in revenue from user fees and statutory fees and fines.
- **Average annual growth in sources of revenue by council groups:** After rate capping, the metropolitan group experienced the highest average annual growth in rates and charges and was the only group with negative growth in contributions. The small shire group reported the largest average annual growth in grants. The small shire group also had the smallest negative growth in revenue from user fees and statutory fees and fines, while the interface group faced the largest decrease.

The chapter focuses on the sector as a whole (the sector) – that is, all 79 councils in Victoria combined. It also highlights any differences between groups of similar councils (metropolitan, interface/urban fringe, regional cities, large shires, and small shires).[45] For information about individual councils, see the fact sheets and the interactive dashboard at

[43] Where we calculated growth rates for the six years of rate capping, we have taken 2015–16 as the base year.

[44] We discussed council revenue from rates and charges in more details in Chapter 1.

[45] Sector or group averages have been calculated for the sector or group in aggregate. They are not the average of results for individual councils within the sector or group. See Appendix C for a list of the councils in each group.

https://www.esc.vic.gov.au/outcomes-reports. The analysis is based on numbers that have been adjusted for inflation.

See page 62 for definitions of key terms used in this report.

2.1 Total revenue and total revenue per person increased

The sector's total revenue and revenue per person continued to grow but at a slower rate in the six years of rate capping.

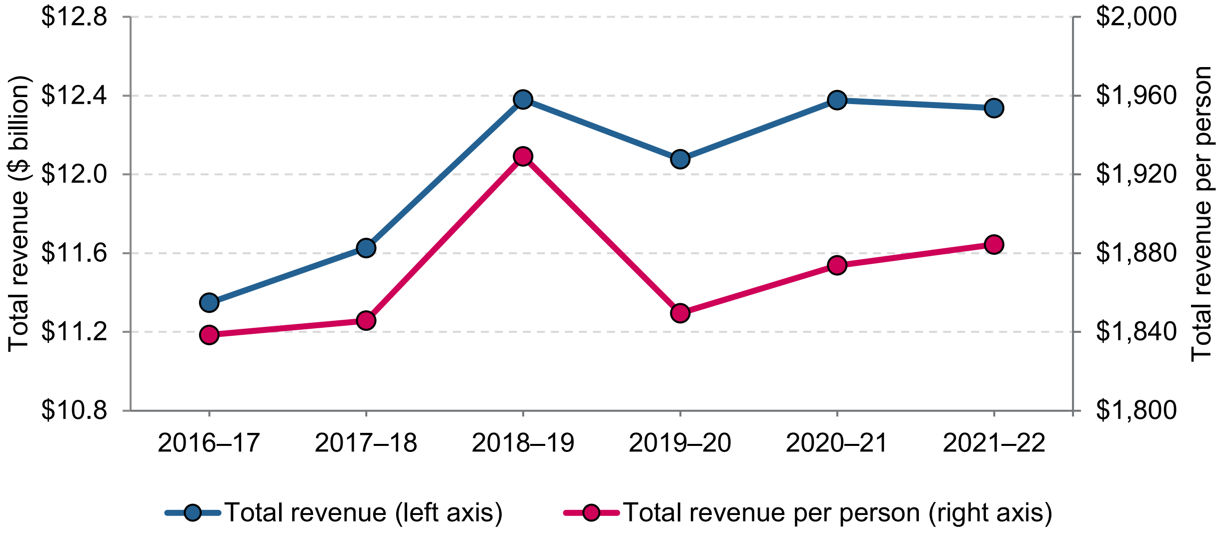
For the sector, total revenue increased, but at a lower average annual rate in the six years of rate capping (2 per cent) than in the three years before its introduction (3.3 per cent).[46] The slower growth is largely attributable to a decline in 2019–20, when the sector's total revenue contracted – due to the impacts of the coronavirus pandemic. As shown in Figure 2.1, both the sector's total revenue and revenue per person increased from 2016–17 to 2018–19 before dipping in 2019–20 and then returning to an upwards trend from 2020–21 onwards.

The small shire and large shire groups experienced the highest average annual growth in total revenue after rate capping (4.7 per cent and 4.5 per cent, respectively), followed by the interface group (4.1 per cent). Population growth can partly explain the growth in total revenue and the differing growth rates between council groups.

[46] In calculating these growth rates for the sector, we have adjusted the sector's revenue and revenue per person from grants for the timing of financial assistance grant payments from the Australian Government. See Box 2.1 for more information.

Figure 2.1 Total revenue and total revenue per person 2016–17 to 2021–22

For the sector as a whole (inflation-adjusted 2021–22 dollars)



Note: The numbers in this figure have been adjusted for the timing of financial assistance grant payments from the Australian Government.

Data sources: Council annual reports (audited); Australian Bureau of Statistics (2021) Regional population, ABS Website, accessed 17 January 2023; Australian Bureau of Statistics (December 2022) 'TABLES 1 and 2. CPI: All Groups, Index Numbers and Percentage Changes' [Index Numbers; All groups CPI; Melbourne], Consumer Price Index, Australia, accessed 17 January 2023.

In per person terms, the average annual growth in total revenue also increased at a slower rate in the six years of rate capping (0.6 per cent) compared to the three years before its introduction (1.1 per cent). The small shire and large shire groups had the highest average annual growth in revenue per person, while the metropolitan group had the smallest growth after rate capping.

2.2 Overview of sources of council revenue

In addition to revenue from rates and charges,[47] council revenue also comprises contributions, grants, user fees and statutory fees and fines, and other revenue which are uncapped.

- **contributions** – both monetary and non-monetary – from developers or landowners for the provision of new infrastructure for commercial and residential developments
- **grants** – from both the Victorian and Australian Governments
- **user fees and statutory fees and fines** – including parking fees and fines, planning permit fees, and other fees for services (such as council operated childcare services and leisure centres)

[47] Refer to Chapter 1 where we discussed council revenue from capped rates and charges in more detail. In this chapter, revenue from rates and charges also includes revenue from service charges which are uncapped.

- **'other' revenue** – such as revenue from the sale of assets or profits from joint ventures.

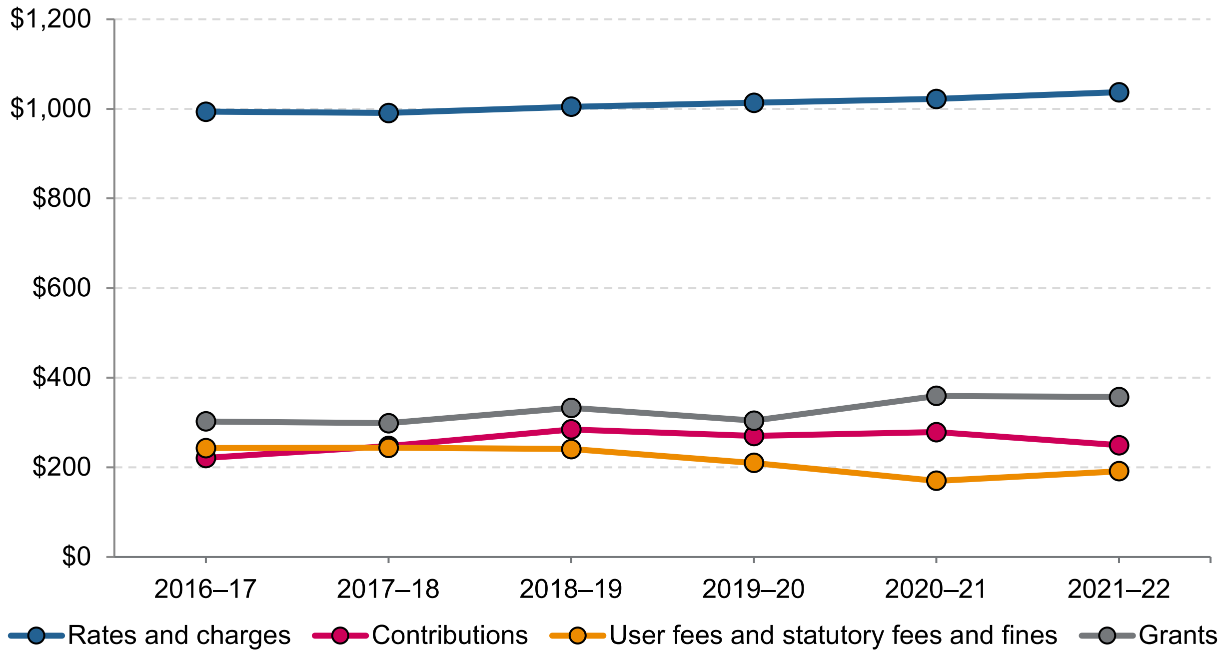
Rates and charges and grants continued to be councils' largest sources of revenue

Rates and charges remained councils' largest source of revenue, followed by revenue from grants.

For the sector, revenue from rates and charges continued to be the largest source of revenue followed by grants (see Figure 2.2).[48] Revenue from contributions overtook revenue from user fees and statutory fees and fines to become the third largest source of revenue for councils from 2018–19. However, this started to reverse in 2021–22.

Figure 2.2 Revenue per person 2016–17 to 2021–22, by source

For the sector as a whole (inflation-adjusted 2021–22 dollars)



Note: The numbers in this figure have been adjusted for the timing of financial assistance grant payments from the Australian Government.

Data sources: Council annual reports (audited); Australian Bureau of Statistics (2021) Regional population, ABS Website, accessed 17 January 2023; Australian Bureau of Statistics (December 2022) 'TABLES 1 and 2. CPI: All Groups, Index Numbers and Percentage Changes' [Index Numbers; All groups CPI; Melbourne], Consumer Price Index, Australia, accessed 17 January 2023.

[48] We have adjusted revenue from grants for the advance payment of financial assistance grants in some years. See Box 2.1 for further information.

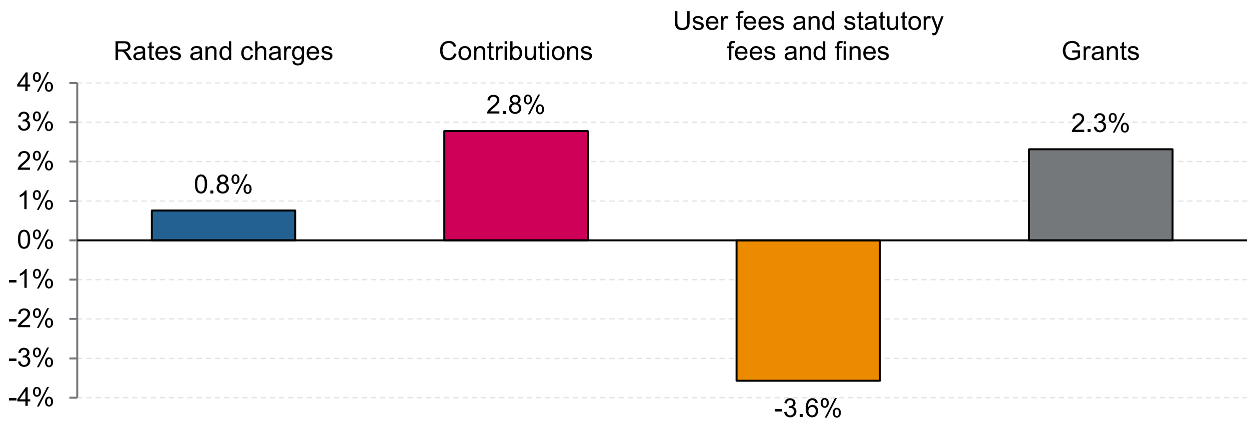
Revenue per person from contributions and grants increased while revenue from user fees and statutory fees and fines decreased

After rate capping, the revenue per person from contributions and grants grew faster than rates and charges, partially offsetting the fall in revenue from user fees and statutory fees and fines.

In the six years of rate capping, the highest growth in the sector's revenue came from contributions (2.8 per cent per year) and grants (2.3 per cent per year) (see Figure 2.3). This was partially offset by slower growth in revenue from rates and charges (0.8 per cent per year) and a large decline in user fees and statutory fees and fines (−3.6 per cent per year).

Figure 2.3 Growth in revenue per person 2015–16 to 2021–22, by source

For the sector as a whole (inflation-adjusted 2021–22 dollars)



Note: The numbers in this figure have been adjusted for the timing of financial assistance grant payments from the Australian Government. These growth rates are based on numbers that have been adjusted for inflation.

Data sources: Council annual reports (audited); Australian Bureau of Statistics (2021) Regional population, ABS Website, accessed 17 January 2023; Australian Bureau of Statistics (December 2022) 'TABLES 1 and 2. CPI: All Groups, Index Numbers and Percentage Changes' [Index Numbers; All groups CPI; Melbourne], Consumer Price Index, Australia, accessed 17 January 2023.

Variation in sources of revenue by council group after rate capping

The importance of each revenue source to growth in total revenue varied across council groups. This was due to the differences in both growth rates and how much each source contributes to the group's total revenue.

The metropolitan group experienced the highest average annual growth in rates and charges (1.4 per cent) and was the only group with negative growth in contributions (−5.9 per cent). The small shire group reported the largest average annual growth in grants (10.1 per cent). The small shire group also had the smallest negative growth in revenue from user fees and statutory fees and fines (−1 per cent per year on average), while the interface group faced the largest decrease (−4.7 per cent per year on average).

The following sections of this chapter examine how each source contributed to overall growth in revenue at the sector and group level.[49]

2.3 Growth in revenue per person from rates and charges decreased for all council groups

In the six years of rate capping, rates and charges remained the largest source of revenue for all council groups, particularly the metropolitan group. The average annual growth in revenue per person from rates and charges decreased for all groups.

Rates and charges continued to be the largest source of revenue for all council groups and for the sector (see Table 2.1).

Table 2.1 Average annual growth in revenue per person from rates and charges

	In the three years before the introduction of rate capping	In the six years of rate capping	
	% growth	% growth	% of total revenue
Sector as a whole	2.6%	0.8%[a]	53.7%
Metropolitan	2.5%	1.4%	63.4%
Interface	2.1%	0.1%	45.2%
Regional city	3.7%	0.8%	49.7%
Large shire	3.1%	0.1%	51.3%
Small shire	3.5%	0.4%	45.5%

Note: These growth rates are based on numbers that have been adjusted for inflation. They are calculated from 2012–13 to 2015–16 (the three years before the introduction of rate capping) and from 2015–16 to 2021–22 (the six years after rate capping). [a] This is higher than the growth rate in capped rates per property discussed in Chapter 1 because it includes growth in service charges. It is also calculated on a per person rather than a per property basis.

Data sources: Council annual reports (audited); Australian Bureau of Statistics (2021) Regional population, ABS Website, accessed 17 January 2023; Australian Bureau of Statistics (December 2022) 'TABLES 1 and 2. CPI: All Groups, Index Numbers and Percentage Changes' [Index Numbers; All groups CPI; Melbourne], Consumer Price Index, Australia, accessed 17 January 2023.

49 Our analysis omits 'other' revenue due to its relatively small dollar value and the reporting inconsistencies across councils.

Chapter 1 outlined changes in the sector's revenue from capped rates (general rates and municipal charges) and service charges. This chapter combines capped rates and service charges into a single 'rates and charges' revenue source. Chapter 1 looked at capped rates and service charges on a per property basis whereas this chapter examines revenue from rates and charges on a per person basis. This enables comparisons with other revenue sources. Readers should note that the growth rates in revenue from rates and charges in this chapter will be different from those in Chapter 1.

Overall, growth in revenue per person from rates and charges was much lower in the six years after rate capping for the sector and for all council groups. The metropolitan group experienced the highest growth rate after rate capping.

For more details on the variations in growth rates between each group, see the separate discussions in Chapter 1.

2.4 Growth in revenue per person from grants increased

Grants are an important source of revenue for the small shire and large shire groups in particular

> In the six years of rate capping, growth in the sector's revenue per person from grants increased. Relative to other council groups, grants played a more important role for the small shire and large shire councils.

Councils receive grants from both the Victorian and Australian Governments. The nature and purpose of grants can vary depending on whether:

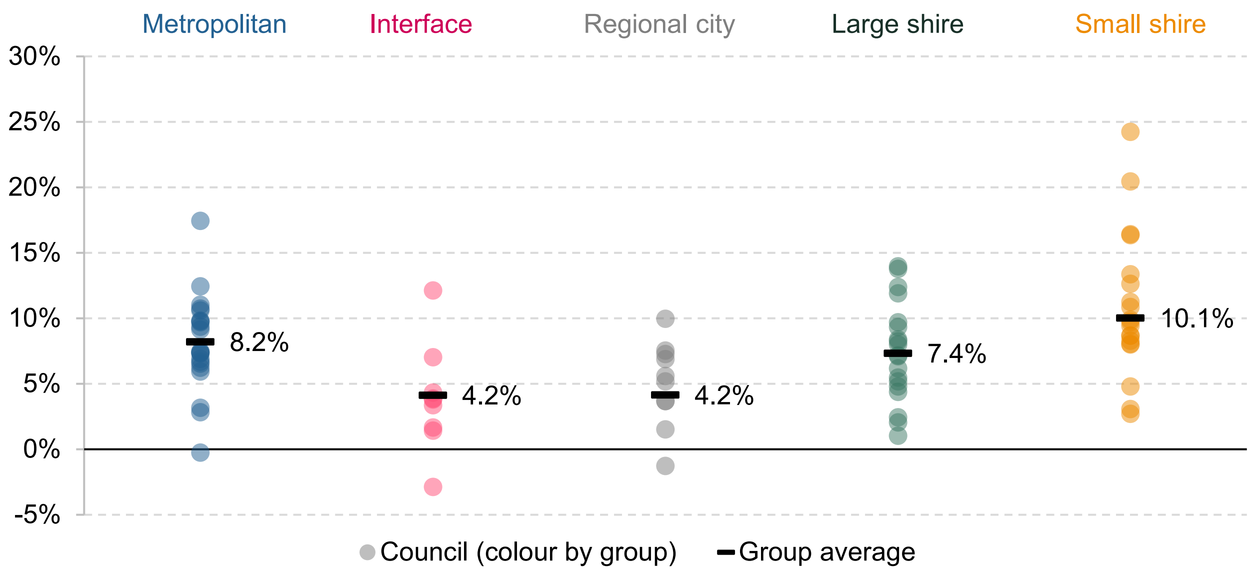
- it is an operating grant (allocated to cover council operating expenses) or capital grant (used to fund capital works)
- the grant funding is open to all councils or limited to selected councils
- the funding is recurrent (expected to be received again within the current planning period) or non-recurrent (one-off, often for capital works).

The different types and purposes of grants mean that year-to-year fluctuations in revenue from grants is common. Small shire and large shire councils are most affected by these fluctuations as they rely more on grants. For example, in the six years of rate capping, grants accounted for around 42.5 per cent of small shire councils' total revenue and 28.5 per cent of large shire councils' total revenue, whereas grants only made up 12.4 per cent of the metropolitan group's revenue.

Figure 2.4 illustrates the average annual growth in revenue per person from grants. In the 6 years of rate capping, the small shire groups observed the largest average annual growth (10.1 per cent) while the regional city and interface groups experienced the smallest average annual growth (4.2 per cent).

Figure 2.4 Average annual growth in revenue per person from grants, by group

2015–16 to 2021–22



Note: These numbers are unadjusted grants. These growth rates are based on numbers that have been adjusted for inflation.

Data sources: Council annual reports (audited); Australian Bureau of Statistics (2021) Regional population, ABS Website, accessed 17 January 2023; Australian Bureau of Statistics (December 2022) 'TABLES 1 and 2. CPI: All Groups, Index Numbers and Percentage Changes' [Index Numbers; All groups CPI; Melbourne], Consumer Price Index, Australia, accessed 17 January 2023.

The fact that grants comprised a larger proportion of revenue for the small and large shire groups reflected government programs to create jobs, improve roads, finance infrastructure projects, and support service delivery and procurement for councils in these groups.[50] Grants also played an important role in helping these councils recover from the impacts of natural disasters such as the 2016–17 floods or the 2019–20 bushfires.

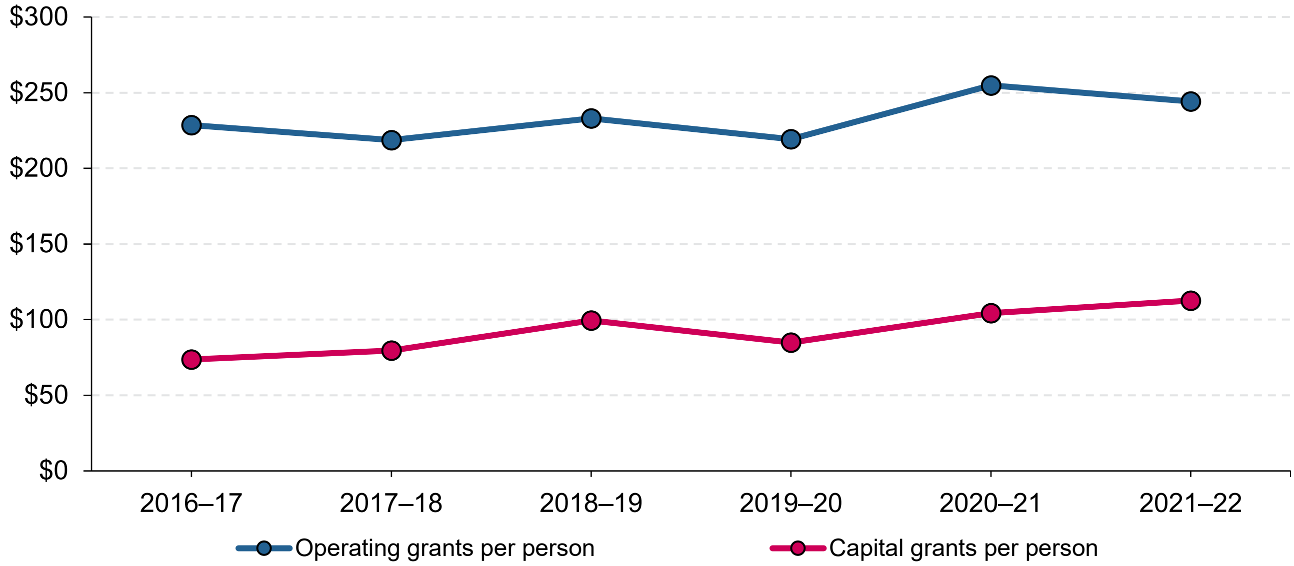
[50] See, for example, Regional Jobs and Infrastructure Fund, Fixing Country Roads Program, Rural Councils Transformation Program, and other Financial Assistance Grant to Local Government.

Growth in revenue per person from grants was largely driven by growth in operating grants

As discussed above, grants can be either for operating purposes or capital purposes. Figure 2.5 shows that revenue per person from operating grants remained more than double those from capital grants. In the six years of rate capping, revenue per person from operating grants experienced a higher average annual growth rate (7.4 per cent) compared to revenue per person from capital grants (4.1 per cent).

Both operating grants and capital grants rose significantly in 2020–21, with capital grants continuing to grow in 2021–22. This growth was driven by grants aimed at helping communities recover from the impacts of the coronavirus pandemic. For instance, councils were provided with funding to enable them to support their local hospitality businesses to set up parklets for outdoor dining, waive permit fees, invest in lighting and other infrastructure, support improved public infrastructure, and help communities stay connected.[51]

Figure 2.5 Revenue per person from operating grants and capital grants 2016–17 to 2021–22



Note: The numbers in this figure have been adjusted for the timing of financial assistance grant payments from the Australian Government.

Data sources: Council annual reports (audited); Australian Bureau of Statistics (2021) Regional population, ABS Website, accessed 17 January 2023; Australian Bureau of Statistics (December 2022) 'TABLES 1 and 2. CPI: All Groups, Index Numbers and Percentage Changes' [Index Numbers; All groups CPI; Melbourne], Consumer Price Index, Australia, accessed 17 January 2023.

[51] See, for example, Covid Safe Outdoor Activation Fund, More Funding to Councils for Outdoor Dining, Let's Stay Connected Fund, or Community Safety Infrastructure Grants.

How timing of financial assistance grant payments affects the sector's revenue from grants

Another major cause of fluctuations in councils' revenue from grants was the timing of financial assistance grant payments from the Australian Government (see Box 2.1). We are able to adjust for the advance payment of grants at the sectors level, but not at the group and council level. This means the growth rates we have reported at a group level for revenue from grants and total revenue may be overstated.

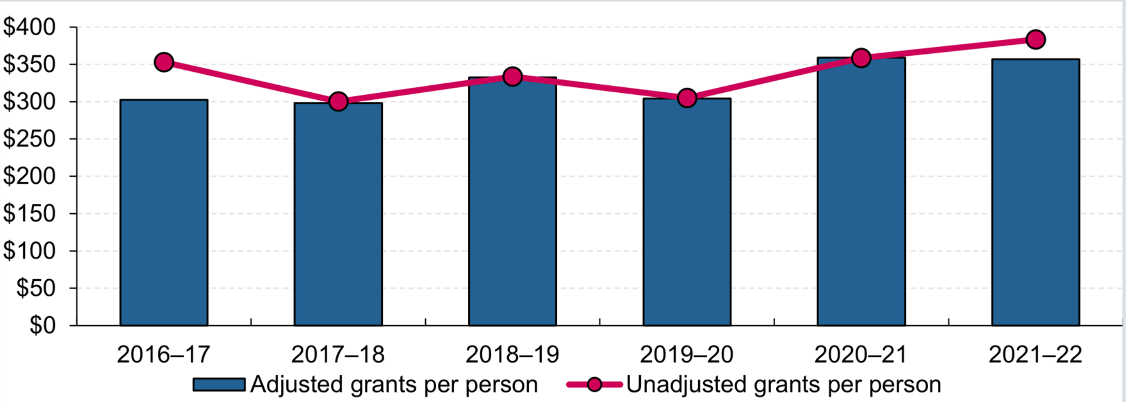
Box 2.1 How the timing of financial assistance grant payments affected year-on-year changes in the sector's revenue from grants

Councils are required to report financial assistance grant revenue in the year it is received, even if it is a payment for the following year. From 2016–17 to 2020–21, councils received about half of their annual financial assistance grants from the Australian Government in advance of the years to which they related. In 2021–22, councils received nearly 75 per cent of the 2022–23 grant allocation in advance. This resulted in higher revenue from grants in 2016–17 and 2020–21, which is also reflected in higher total revenue. The advance payment of grants in 2014–15 also means that revenue from grants and total revenue were lower in 2015–16.

Using 2015–16 as the base year to calculate growth rates results in a significant difference depending on whether we adjust for the timing of grant payments. The sector's average annual growth in revenue per person from grants (unadjusted for the timing of payment) was 6.7 per cent in the six years after the introduction of rate capping. When adjusted for the timing of grant payments, the growth rate falls to 2.3 per cent.

Revenue per person from grants – adjusted (bar chart) and unadjusted (line chart) for the timing of financial assistance grant payments

For the sector as a whole (inflation-adjusted, 2021–22 dollars)



Data source: Council annual reports (audited); Victorian Local Government Grant Commission annual allocation reports; Australian Bureau of Statistics (2021) Regional population, ABS Website, accessed 17 January 2023; Australian Bureau of Statistics (December 2022) 'TABLES 1 and 2. CPI: All Groups, Index Numbers and Percentage Changes' [Index Numbers; All groups CPI; Melbourne], Consumer Price Index, Australia, accessed 17 January 2023.

2.5 Growth in revenue per person from contributions slowed

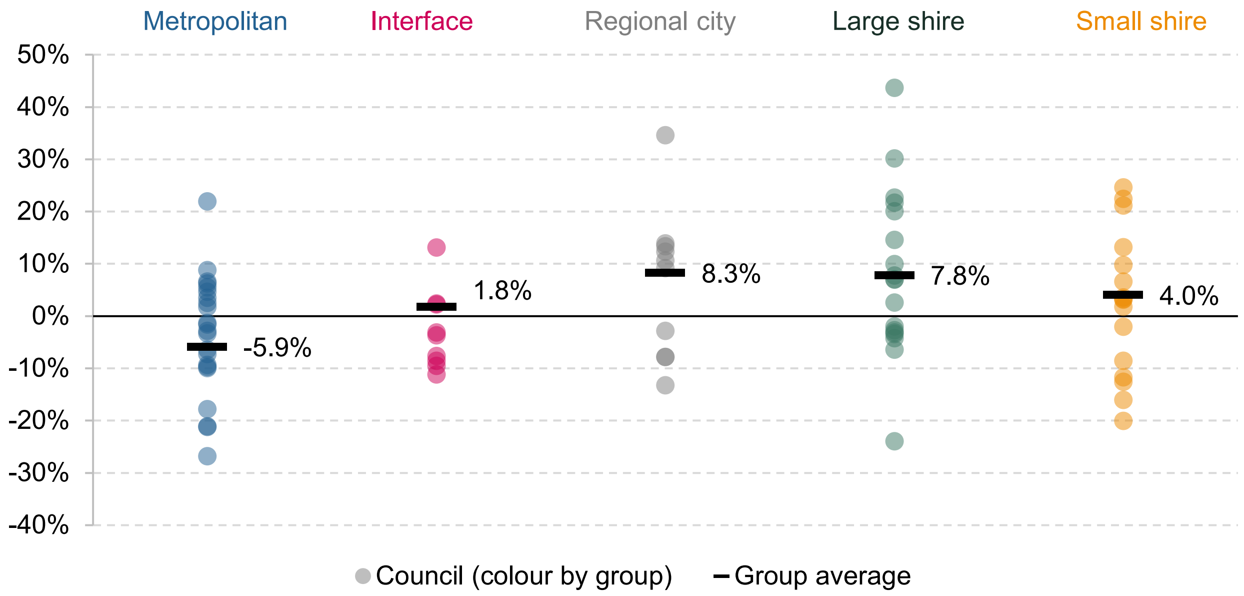
In the six years of rate capping, growth in revenue per person from contributions slowed but remained positive for the sector as a whole. Only the metropolitan group experienced negative growth in revenue per person from contributions.

Contributions can be divided into monetary and non-monetary. Non-monetary contributions remained nearly triple monetary contributions in the six years of rate capping.

Monetary contributions experienced a higher growth rate (3.4 per cent per year on average) than non-monetary contributions (2.5 per cent per year on average), bringing about an overall annual growth by 2.8 per cent in revenue per person from contributions for the sector (see Figure 2.6).

The metropolitan group was the only council group that reported negative growth in revenue per person from contributions. However, the effect on total revenue growth was small because contributions only accounted for a small proportion of the group's total revenue (5.2 per cent). Similarly, the effect on total revenue growth for the small shire, large shire and regional city groups was limited as contributions were a relatively small revenue source for these groups. On the other hand, for the interface group, revenue from contributions accounted for a large share of the group's total revenue (32.6 per cent).

Figure 2.6 Average annual growth in revenue per person from contributions, by group 2015–16 to 2021–22



Notes: These growth rates are based on numbers that have been adjusted for inflation. Four councils were excluded from our calculation (three of them did not receive contributions in 2015–16 and one did not receive in 2021–22).

Data sources: Council annual reports (audited); Australian Bureau of Statistics (2021) Regional population, ABS Website, accessed 17 January 2023; Australian Bureau of Statistics (December 2022) 'TABLES 1 and 2. CPI: All Groups, Index Numbers and Percentage Changes' [Index Numbers; All groups CPI; Melbourne], Consumer Price Index, Australia, accessed 17 January 2023.

2.6 Growth in revenue per person from user fees and statutory fees and fines was negative for all council groups

In the six years of rate capping, revenue per person from user fees and statutory fees and fines declined sharply for the sector as a whole and across all council groups.

For the sector, revenue per person from user fees and statutory fees and fines fell by 3.6 per cent after rate capping, with the largest decline occurring in 2020–21 (see Figure 2.7).[52] This could be due to the impact of the pandemic and reduction of services where councils had to close their facilities during the lockdown and restriction periods. Revenue from this source increased in 2021–22, mostly observed in user fees, likely reflecting the re-opening of council services.

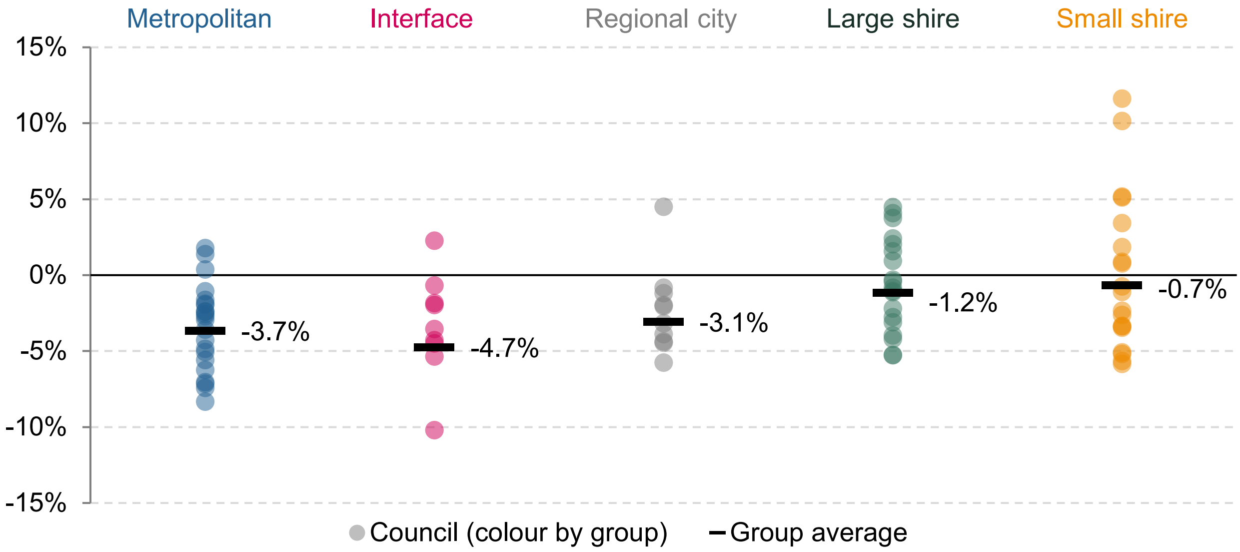
[52] 'Use fees and statutory fees and fines' includes parking fees and fines, planning permit fees, and other fees for service (such as council operated childcare and leisure centres).

The metropolitan group was most affected by these changes, with 15 per cent of total revenue coming from this source. Specifically, the metropolitan group saw an average annual growth in revenue of negative 3.7 per cent from this source in the six years of rate capping. Meanwhile, the interface group faced the largest percentage drop (−4.7 per cent), but had less exposure due to user fees and statutory fines only representing 8 per cent of the group's total revenue.

Fluctuations in revenue from user fees and fines tended to have small impacts on total revenue for most council groups. This is because revenue from user fees and statutory fees and fines represented a small proportion of their total revenue (ranging from 6.4 per cent to 15 per cent).

Figure 2.7 Average annual growth in revenue per person from user fees and statutory fees and fines, by group

2015–16 to 2021–22



Note: These growth rates are based on numbers that have been adjusted for inflation.

Data sources: Council annual reports (audited); Australian Bureau of Statistics (2021) Regional population, ABS Website, accessed 17 January 2023; Australian Bureau of Statistics (December 2022) 'TABLES 1 and 2. CPI: All Groups, Index Numbers and Percentage Changes' [Index Numbers; All groups CPI; Melbourne], Consumer Price Index, Australia, accessed 17 January 2023.

3. Expenditure

This chapter looks at what happened to councils' expenditure over the six years of rate capping (2016–17 to 2022–23).[53] It examines the different types of council expenditure and how each has grown. Councils spend money to build, upgrade, renew or expand infrastructure and to provide services. Councils' spending on the different categories of infrastructure and on the different service areas is discussed in Chapters 4 and 5.

Key observations

- **Total expenditure:** The sector's total expenditure per person continued to grow.
- **Capital expenditure:** For the sector as a whole, capital expenditure increased faster than operating expenditure.
- **Operating expenditure:** For the sector as a whole, expenditure per person on both materials and services and employee costs increased.

This chapter focuses on the sector as a whole (the sector) – that is, all 79 councils in Victoria combined. It also highlights any differences between groups of similar councils (metropolitan, interface/urban fringe, regional cities, large shires and small shires).[54] For information about individual councils, see the fact sheets and the interactive dashboard at https://www.esc.vic.gov.au/outcomes-reports. The analysis is based on numbers that have been adjusted for inflation.

See page 62 for definitions of key terms used in this report.

3.1 Growth in the sector's total expenditure increased

The sector's total expenditure per person increased, although there was a slight decrease in 2020–21.

For the sector, total expenditure grew in the six years of rate capping (see Figure 3.1).

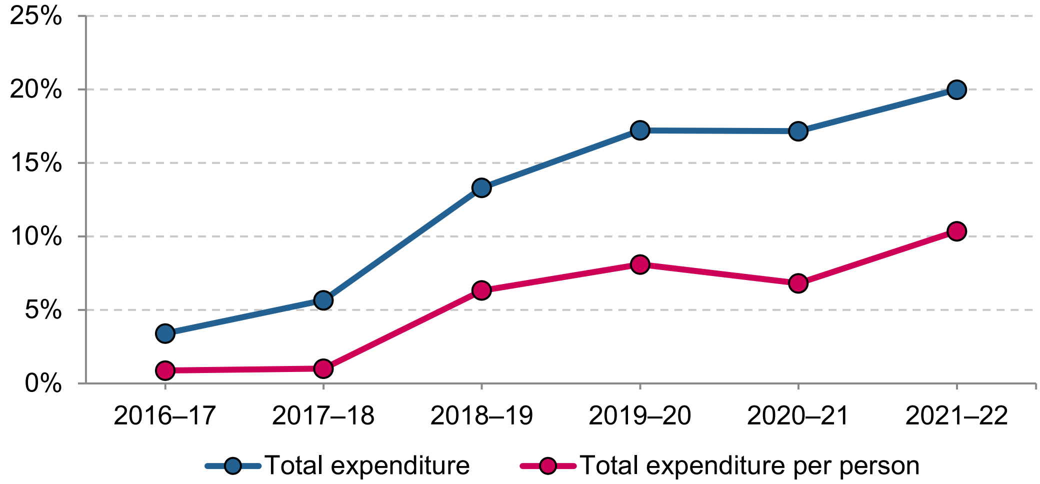
[53] Where we calculated growth for the six years of rate capping, we have taken 2015–16 as the base year.

[54] Sector or group averages have been calculated for the sector or group in aggregate. They are not the average of results for individual councils within the sector or group. See Appendix C for a list of the councils in each group.

Population growth explains part of the growth in expenditure as councils provide services to more people. We have accounted for population growth by examining expenditure in per person terms.[55] In the six years of rate capping expenditure growth outpaced population growth, shown by total expenditure per person increasing.

Figure 3.1 Net growth in total expenditure and total expenditure per person 2015–16 to 2021–22

For the sector as a whole (inflation adjusted, 2021–22 dollars)



Data sources: Council annual reports (audited); Australian Bureau of Statistics (2021) Regional population, ABS Website, accessed 17 January 2023; Australian Bureau of Statistics (December 2022) 'TABLES 1 and 2. CPI: All Groups, Index Numbers and Percentage Changes' [Index Numbers; All groups CPI; Melbourne], Consumer Price Index, Australia, accessed 17 January 2023.

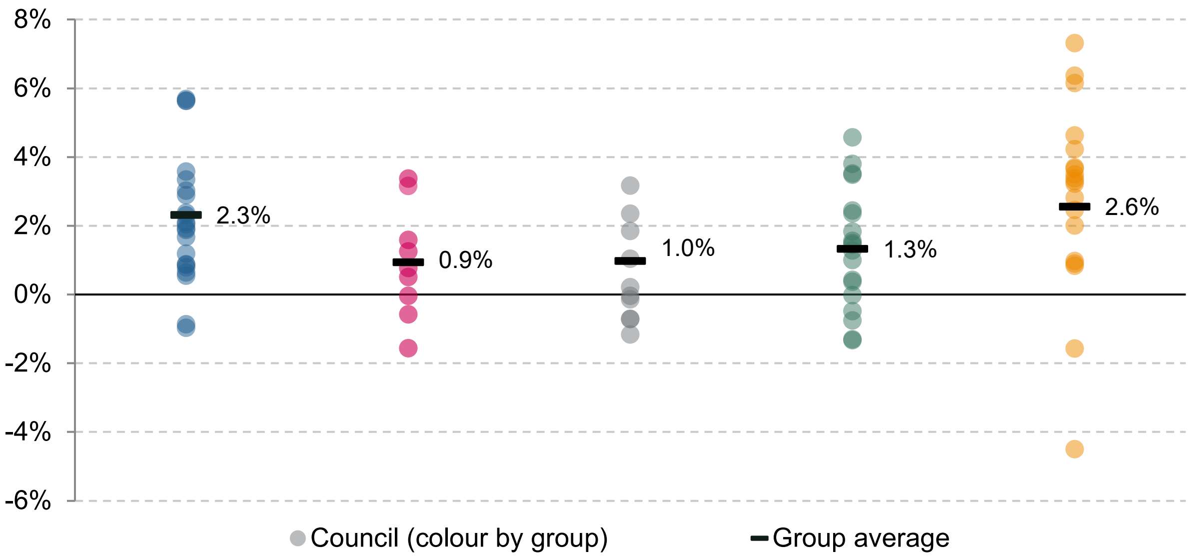
3.2 Growth in expenditure differed between council groups

In the six years of rate capping, total expenditure per person increased for all council groups (see Figure 3.2). The metropolitan and small shire groups saw the highest expenditure growth per person. This higher growth is in line with population growth trends, with the metropolitan and small shire groups seeing lower population growth over this period than the other three groups.

While there is some variability in growth rates between the groups, there was greater variability between individual councils. Some councils experienced expenditure per person growth rates significantly different to their group averages and 17 councils had negative growth rates, highlighting the fact that each council's financial situation is unique.

55 Growth in expenditure can also be due to general increases in the prices of goods and services in the broader economy. We have accounted for this by adjusting values for inflation.

Figure 3.2 Average annual growth in total expenditure per person 2015–16 to 2021–22



Note: These growth rates are based on numbers that have been adjusted for inflation.

Data sources: Council annual reports (audited); Australian Bureau of Statistics (2021) Regional population, ABS Website, accessed 17 January 2023; Australian Bureau of Statistics (December 2022) 'TABLES 1 and 2. CPI: All Groups, Index Numbers and Percentage Changes' [Index Numbers; All groups CPI; Melbourne], Consumer Price Index, Australia, accessed 17 January 2023.

3.3 Growth in total expenditure was driven by growth in both capital expenditure and operating expenditure

Council expenditure is classified as either operating expenditure or capital expenditure. Operating expenditure relates to the day-to-day operations of the council. Capital expenditure relates to the construction, renewal, upgrade or expansion of assets and generally has a more long-term focus.

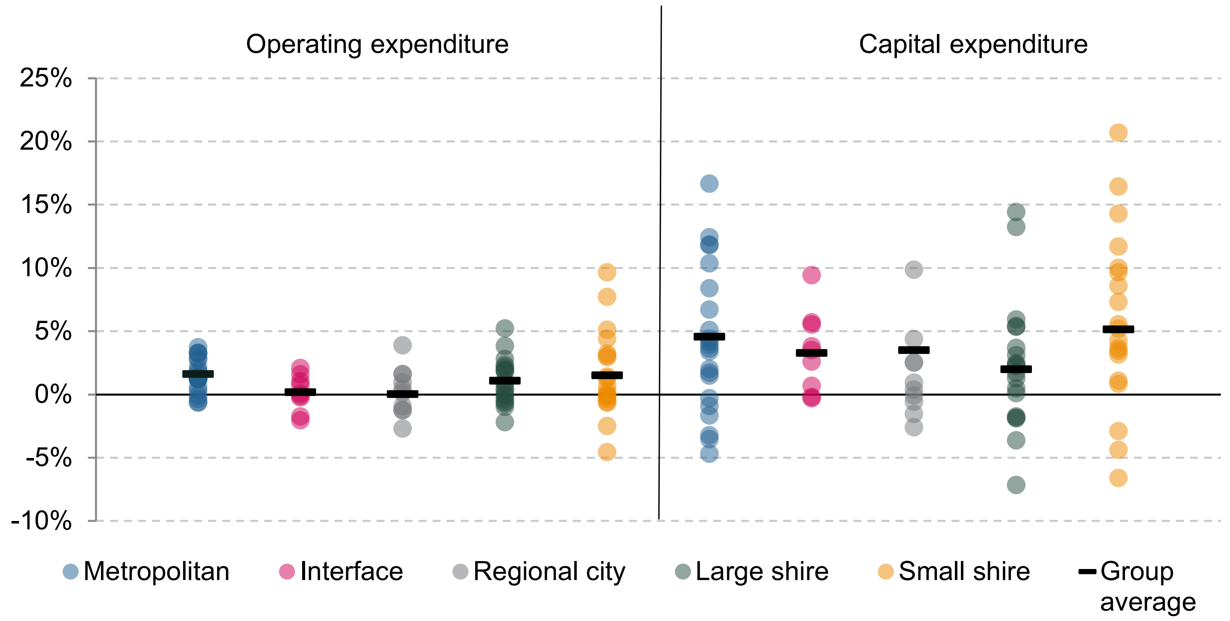
Most of the sector's expenditure is operating expenditure. In the six years since the introduction of rate capping, 74 per cent of the sector's total expenditure was operating expenditure.

Growth in capital expenditure varied between councils

Figure 3.3 shows the growth in operating and capital expenditure per person in the six years of rate capping.

All council groups experienced growth in both operating and capital expenditure per person. However, there was variation at the council level, particularly for capital expenditure.

Figure 3.3 Average annual growth in operating and capital expenditure per person 2015–16 to 2021–22



Note: These growth rates are based on numbers that have been adjusted for inflation.

Data sources: Council annual reports (audited); Australian Bureau of Statistics (2021) Regional population, ABS Website, accessed 17 January 2023; Australian Bureau of Statistics (December 2022) 'TABLES 1 and 2. CPI: All Groups, Index Numbers and Percentage Changes' [Index Numbers; All groups CPI; Melbourne], Consumer Price Index, Australia, accessed 17 January 2023.

For the sector, there was a large increase in capital expenditure in 2018–19 and further growth in 2019–20. Most council groups experienced their highest growth in capital expenditure per person in 2018–19. However, the regional city group had higher growth in 2019–20. Overall, in the six years of rate capping, the metropolitan and small shire groups had the highest growth in capital expenditure.

While there was a significant decrease in capital expenditure in 2020–21, likely due to coronavirus pandemic restrictions, there was renewed growth in 2021–22, suggesting these impacts may be transient.

Capital expenditure typically varies more from year to year than operating expenditure. Large increases in capital expenditure may be due to one-off costs such as those related to flood or bushfire recovery. In some cases, councils will have received specific-purpose grants to cover some of the increased capital expenditure.

3.4 Employee costs and materials and services expenditure grew

For the sector as a whole, expenditure per person on both materials and services and on employee costs increased.

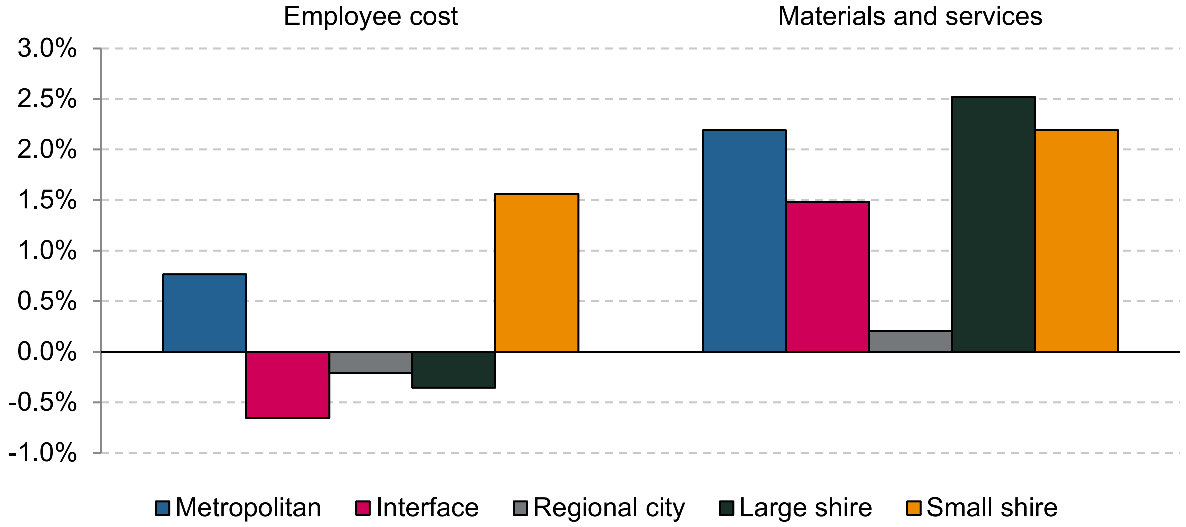
Operating expenditure comprises:

- employee costs — wages, superannuation, and leave entitlements (of casual and permanent staff, but not contractors)
- materials and services — such as contractor and consultant fees, utilities, IT costs and other materials required to deliver services
- other operating costs — such as community grants, councillors' allowances, borrowing costs, and accounting losses related to asset disposals and revaluations.

In the six years of rate capping, the growth in operating expenditure per person across the sector was driven by growth in materials and services costs and employee costs. Growth in expenditure per person on materials and services increased for all council groups. The metropolitan and small shire groups also saw an increase in employee costs per person, while the interface, regional city and large shire groups saw a decrease (see Figure 3.4).

Figure 3.4 Average annual growth in expenditure per person on employee costs and materials and services

2015–16 to 2021–22



Note: These growth rates are based on numbers that have been adjusted for inflation.

Data sources: Council annual reports (audited); Australian Bureau of Statistics (2021) Regional population, ABS Website, accessed 17 January 2023; Australian Bureau of Statistics (December 2022) 'TABLES 1 and 2. CPI: All Groups, Index Numbers and Percentage Changes' [Index Numbers; All groups CPI; Melbourne], Consumer Price Index, Australia, accessed 17 January 2023.

Employee costs

Employee costs is the largest expenditure category for the sector, accounting for 36 per cent of total expenditure in the six years of rate capping. As such, changes in employee costs can significantly affect a council's financial position.

Growth in employee costs is a product of both employee numbers and salaries. Employee salaries are based on the enterprise agreements between councils and their employees. These agreements lock in specified salary increases over a period of time. These increases have in the past been close to both the Wage Price Index[56] and the Consumer Price Index[57] (see Figure 3.5) at around 1.5–3.5 per cent. However, many of these enterprise agreements are coming up for renegotiation and, given the current higher inflationary environment, councils may start to see higher salary increases locked in for future years.

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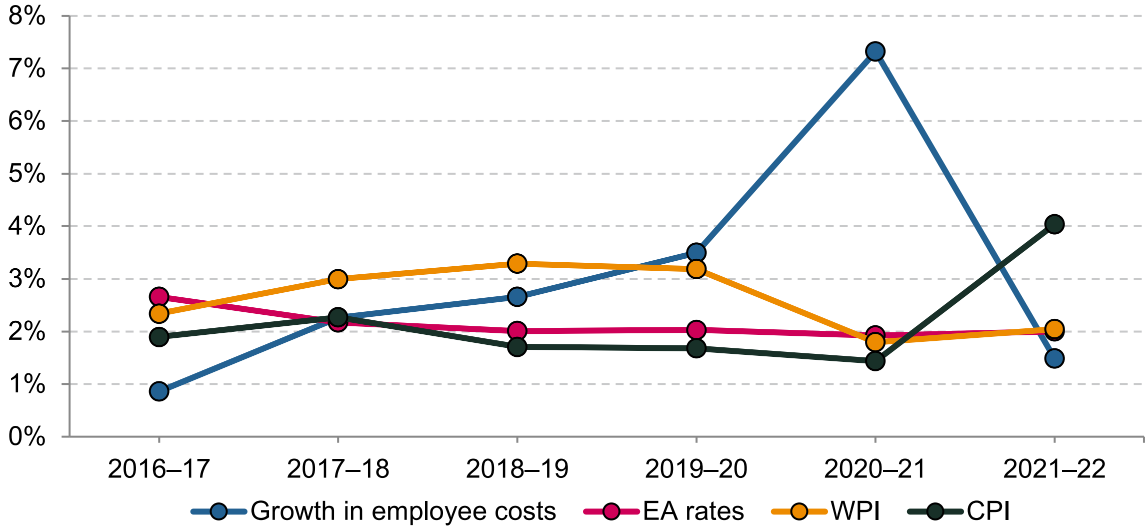
56 The Wage Price Index measures changes in the price of labour excluding bonuses for the public sector in Victoria.

57 In this section and in Figure 3.5, growth in employee costs per person, and average salary increases under councils' enterprise agreements have not been adjusted for inflation to enable comparison against the Consumer Price Index and the Wage Price Index.

There was a notable spike in employee costs per person in 2020–21, with growth doubling from the previous year before returning to a lower rate of growth in 2021– 22 (see Figure 3.5). A key driver of this was Victorian Government funded coronavirus pandemic recovery programs, such as the Work for Victoria program. These programs allowed councils to take on temporary staff whose pay was subsidised, leading to higher than normal expenditure on employee costs without an increased financial burden.

Figure 3.5 Growth in employee costs per person compared to average increases under enterprise agreements (EA rate), the Wage Price Index (WPI) and Consumer Price Index (CPI)

For the sector as a whole



Note: In calculating growth in employee costs shown in this figure, we have calculated the average of individual council results and not adjusted the numbers for inflation. The CPI is based on changes between financial years for the Melbourne component of CPI.

Data sources: Council annual reports (audited); Australian Bureau of Statistics (2021) Regional population, ABS Website, accessed 17 January 2023; Australian Bureau of Statistics (December 2022) 'TABLES 1 and 2. CPI: All Groups, Index Numbers and Percentage Changes' [Index Numbers; All groups CPI; Melbourne], Consumer Price Index, Australia, accessed 17 January 2023, Australian Bureau of Statistics (December 2022) 'Table 4a. Total hourly rates of pay excluding bonuses: public sector by state, original (financial year index numbers for year ended June quarter)', Wage Price Index, Australia, accessed 22 February 2023; Estimates based on Fair Work Commission, 'Enterprise agreement decisions', *Archived decisions & orders*, fwc.gov.au, accessed 5 May 2023.

Materials and Services

Materials and services expenditure is another significant expenditure category, accounting for 32 per cent of total expenditure in the six years of rate capping. Expenditure on materials and services can change from year to year through either changes in amounts purchased or changes in prices.

Materials and services expenditure per person had been trending upwards until 2019–20, when it began to level off prior to a drop in 2020–21. This was likely driven by the beginning of coronavirus pandemic restrictions, with councils suspending many of their services and, as a result, purchasing fewer materials and services.

2021–22 saw a spike in expenditure on materials and expenditure. This was likely caused by a combination of coronavirus_pandemic restrictions ending, increasing the amounts purchased as council services resumed, and high CPI, driving up the prices paid.

4. Infrastructure

This chapter looks at the sector's spending on the different categories of capital projects over the six years of rate capping (2016–17 to 2021–22).[58] It focuses on spending on asset renewal and upgrade projects.

Key observations

- **Spending on infrastructure:** The sector continued to undertake asset renewal and invest in new infrastructure.
- **Categories of spending:** The sector's spending on each of the different categories of capital project increased.
- **Focus of spending:** The focus of spending on the different categories of capital project remained relatively stable.
- **Asset renewal:** The sector's asset renewal ratio increased in the six years of rate capping. Spending on asset renewal and upgrade was, on average over the six years, above 100 per cent of the level of depreciation.

This chapter focuses on the sector as a whole (the sector) – that is, all 79 councils in Victoria combined. It also highlights any differences between groups of similar councils (metropolitan, interface/urban fringe, regional cities, large shires and small shires).[59] For information about individual councils, see the fact sheets and the interactive dashboard at https://www.esc.vic.gov.au/outcomes-reports. The analysis is based on numbers that have been adjusted for inflation.

See page 62 for definitions of key terms used in this report.

58 Where we calculated growth rates for the six years of rate capping, we have taken 2015–16 as the base year.

59 Sector or group averages have been calculated for the sector or group in aggregate. They are not the average of results for individual councils within the sector or group. See Appendix C for a list of the councils in each group.

4.1 Capital works spending continued to grow

For the sector as a whole, spending on new assets, asset upgrades and asset renewal projects increased.

As noted in Chapter 3, total capital expenditure per person for the sector increased in the six years of rate capping.

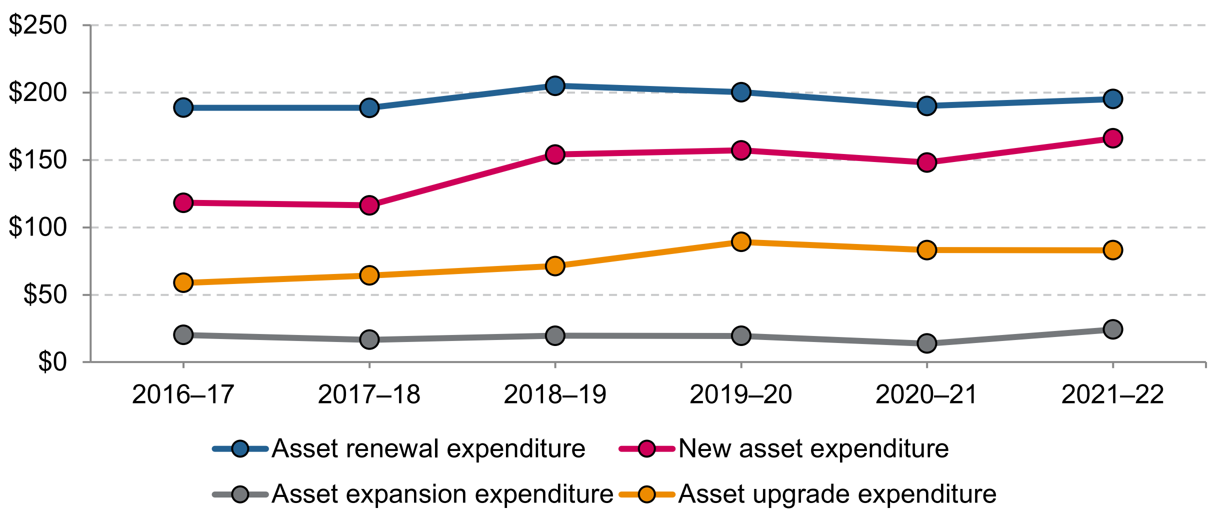
Councils categorise their capital spending by the type of project it relates to:

- New – creates an asset to provide a service that does not currently exist.
- Renewal – addresses wear and tear to improve the condition of an asset beyond regular maintenance and repair. This excludes the improvement of an asset above its original standard (see 'upgrade' or 'expansion').
- Upgrade – enhances an existing asset to provide an improved level of service.
- Expansion – expands the capacity of an existing asset to service more people.

The sector's spending per person on all categories increased in the six years of rate capping (see Figure 4.1). There was significant growth in 2018–19 and in 2021–22.

Figure 4.1 Capital spending per person, by category of project

For the sector as a whole (inflation-adjusted, 2021–22 dollars)



Data sources: Council annual reports (audited); Australian Bureau of Statistics (2021) Regional population, ABS Website, accessed 17 January 2023; Australian Bureau of Statistics (December 2022) 'TABLES 1 and 2. CPI: All Groups, Index Numbers and Percentage Changes' [Index Numbers; All groups CPI; Melbourne], Consumer Price Index, Australia, accessed 17 January 2023.

The highest growth in spending per person in the six years of rate capping was on new assets and asset upgrades. Spending per person on these categories grew at an average of 6.9 per cent and 6.2 per cent per year, respectively.

Spending per person on asset expansion saw more moderate growth of 2.7 per cent per year on average. Asset renewal fluctuated over the period with growth of 1.2 per cent per year on average with a sharp dip in 2020–21.

Growth in spending per person on each of the categories followed a similar pattern at the council group level. In the six years of rate capping, spending per person on asset upgrades, asset renewals and new assets increased for all groups. Asset expansion fluctuated, with an increase for all but the interface and regional city groups.

There was a notable drop in 2020–21, likely driven by coronavirus pandemic restrictions, which limited or halted construction work, and other challenges faced by the construction industry, such as limited supplies of materials and higher prices for these materials. Despite this, in 2021–22 each category of spending appears to have returned to its longer-term trend.

4.2 There was little change in the focus of the sector's capital spending

The focus of spending on the different types of capital projects remained relatively stable.

In the six years of rate capping, spending on new assets and asset upgrades increased as a share of total capital spending. Despite these increases, the sector continued to spend more on asset renewal than on any other category. This suggests there were no significant changes in the focus of the sector's capital spending or its approach to asset management.

Asset renewal was the biggest area of capital spending for the metropolitan, large shire and small shire groups over the six years. This was true for the regional city group only until 2019–20 when the group spent more on new assets. For the interface group, the biggest area of capital spending was new assets. This focus on new assets by the regional city and interface groups is typical of councils with growing populations.

4.3 The sector's asset renewal ratio increased

The sector's spending on asset renewal and upgrade projects was, on average, above 100 per cent of the level of depreciation.

The asset renewal ratio is the level of spending on asset renewal and upgrade projects as a percentage of depreciation (which is the decrease in the value of assets due to age and use).[60] We use the asset renewal ratio to indicate whether the asset renewal gap may be growing (see Box 4.1).

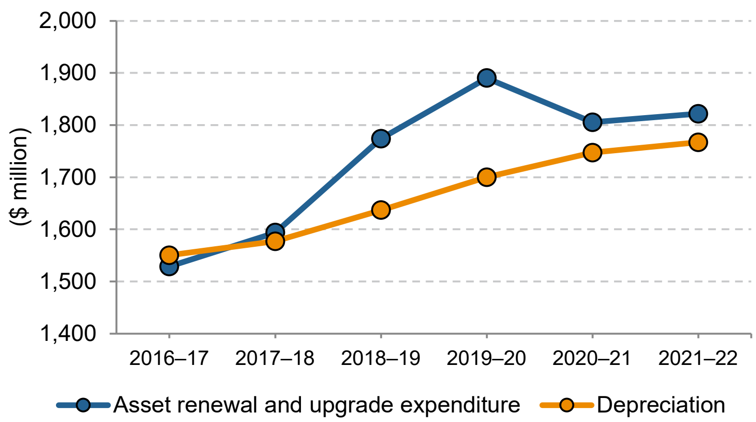
An asset renewal ratio of 100 per cent indicates that spending on asset renewal and asset upgrades fully offsets the annual decline in the value of assets.

For the sector, the asset renewal ratio increased in each of the six years of rate capping.

Capital spending tends to have more year-on-year variation than other types of spending. This is particularly so at the council and group level. For this reason, we have looked at the average asset renewal ratio over time to get a better idea of the sector's position. On average over the six years of rate capping, the asset renewal ratio for the sector was 104 per cent.

Figure 4.2 Comparison of spending on asset renewal and upgrade projects against depreciation

For the sector as a whole (inflation-adjusted, 2021–22 dollars)



Year	Asset renewal ratio (%)
2016–17	99
2017–18	101
2018–19	108
2019–20	111
2020–21	103
2021–22	103

Note: The asset renewal ratios for 2016–17 and 2017–18 are different to those published in our last report in 2019. This is because the definition of the asset renewal ratio included in the Local Government Performance Reporting Framework was updated to include spending on asset upgrade projects in addition to spending on asset renewal. We have recalculated the ratios for previous years based on the revised definition.

Data source: Council annual reports (audited); Local Government Performance Reporting Framework.

60 We have adopted the same definition as the Local Government Performance Reporting Framework. This definition has changed since we published our first report in 2019. Previously it did not include spending on upgrade projects. To look at changes in the ratio over time, we have recalculated the ratios for previous years based on the revised definition (that is, including spending on both asset renewal and upgrade projects).

Box 4.1 Monitoring the asset renewal gap

Councils spend varying amounts to maintain or improve their assets. This amount may not be enough to keep their assets in the condition needed to maintain service levels. Any shortfall is the 'renewal gap'.

Capital spending tends to occur in peaks and troughs. This means it can be hard to distinguish under-investment from normal capital spending patterns. A lot of the infrastructure councils manage is long-lived (such as roads, paths and buildings). So, the impact of under-investment in maintenance and renewal can take a long time to appear. Monitoring the renewal gap helps to detect under-investment before the impact becomes visible or too costly to repair.

There is no widely accepted measure of the renewal gap. Councils have different operating environments and service level preferences. There is a lack of consensus around how the renewal gap could be determined objectively and on a consistent basis across councils. Such a measure would also require a full assessment of asset conditions, which may be costly and may not be done regularly by every council.

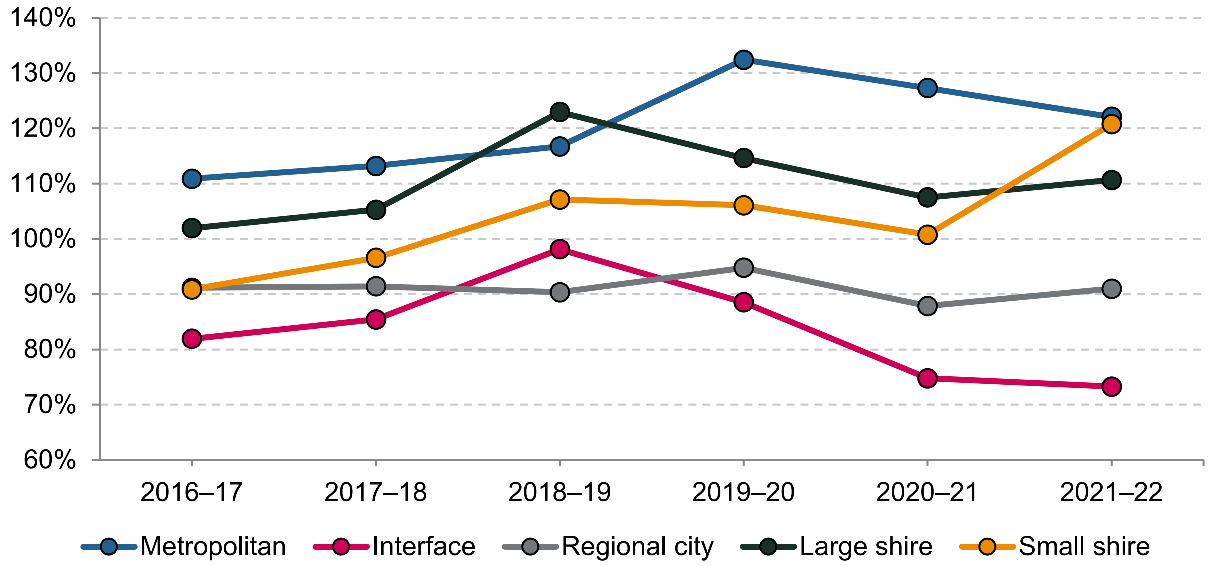
In this report, we have used the asset renewal ratio reported in the Local Government Performance Reporting Framework. We use this measure to provide an indication of whether the renewal gap is increasing or decreasing.

We note that this measure may not accurately reflect the actual condition of council assets. It does not account for past spending on assets and cannot provide an indication of the cumulative size of any asset renewal gap. Nor does it account for council choices to expand existing assets, or invest in new assets, in place of renewing or upgrading assets.

Councils are best placed to assess the condition of their assets and more accurately measure their renewal gap. This information should be shared with their communities to determine the levels and types of capital spending that will best meet the needs of their community.

For the metropolitan, large shire and small shire groups, the asset renewal ratio increased in the six years of rate capping (see Figure 4.3). Meanwhile, the interface and regional city groups saw fluctuations, with a net decrease in their asset renewal ratio over the same period.

Figure 4.3 Asset renewal ratios, by group



Data source: Council annual reports (audited); Local Government Performance Reporting Framework.

There may be good reasons why the ratio is lower or higher in any given year. Councils' spending on renewal projects tends to occur in peaks and troughs. Spending is typically in line with an asset management plan rather than intended to offset depreciation each year. However, a sustained gap between depreciation and spending on asset renewal and upgrade projects may indicate that the asset renewal gap is growing.

Figure 4.4 sets out the asset renewal ratio for each council group on average over the six years of rate capping. The metropolitan, large shire and small shire groups all had ratios at or above 100 per cent on average. The ratios of the interface and regional city groups were below 100 per cent on average. This is consistent with these groups focusing their capital spending on new assets.[61] The assets of these groups tend to be relatively new and thus have less need for renewal or upgrade in the short-term.

Of the 79 councils, 48 had an asset renewal ratio of 100 per cent or more on average in the six years of rate capping. Of the 31 councils with an asset renewal ratio under 100 per cent, 16 of them had asset renewal ratios of 90 per cent or more.

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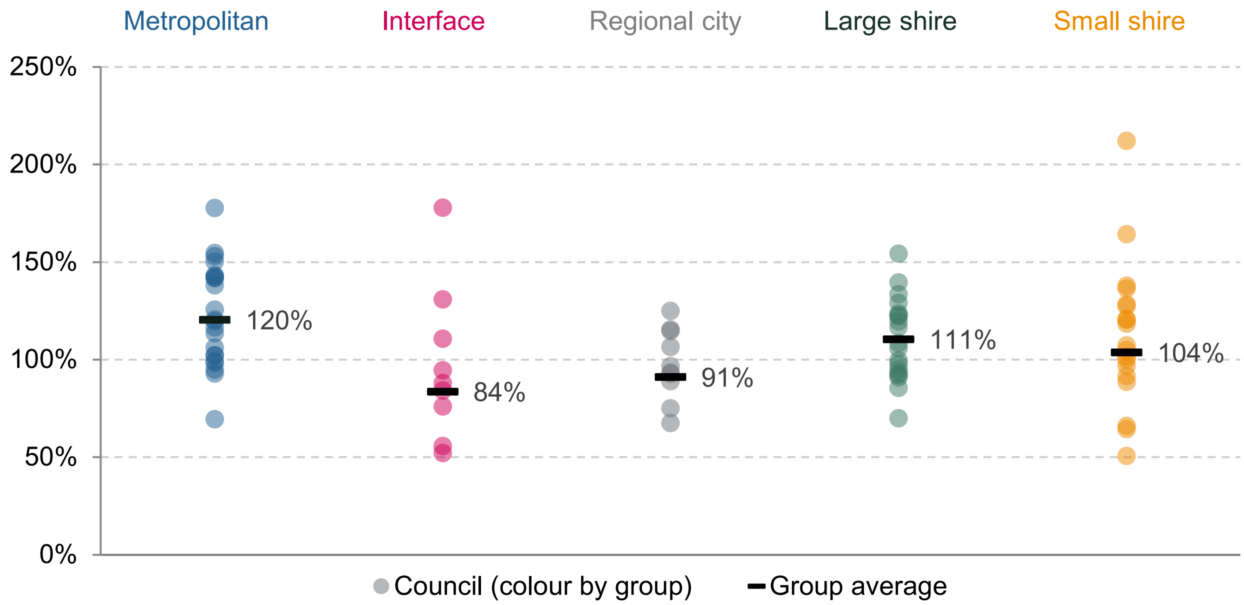
[61] On average in the years of rate capping, the interface group's share of capital spending on asset renewal and upgrade projects combined was the lowest among the council groups.

Figure 4.4 Average asset renewal ratios 2016–17 to 2021–22, by group



Note: These are the average of results from 2016–17 to 2021–22.

Data sources: Council annual reports (audited); Local Government Performance Reporting Framework.

5. Services

This chapter looks at what happened to councils' spending on services in the six years of rate capping (2016–17 to 2021–22).[62] We also examine selected measures of service quality and community satisfaction.

Key observations

- **Service expenditure:** The sector's expenditure increased in most service areas.
- **Service quality and satisfaction:** The sector as a whole showed mixed results in performance indicators, with improvements in some areas. There was also some overall improvement in satisfaction indicators, despite a noticeable downturn across all satisfaction measures in 2021–22.

This chapter focuses on the sector as a whole (the sector) – that is, all 79 councils in Victoria combined. It also highlights any differences between groups of similar councils (metropolitan, interface/urban fringe, regional cities, large shires and small shires).[63] For information about individual councils, see the fact sheets and the interactive dashboard at https://www.esc.vic.gov.au/outcomes-reports. The analysis is based on numbers that have been adjusted for inflation.

See page 62 for definitions of key terms used in this report.

5.1 The sector's service expenditure increased

Service expenditure per person increased for the sector as a whole and for all council groups.

Councils provide services that vary greatly in terms of level and cost, reflecting the diversity of their communities. We used data the councils reported to the Victorian Local Government Grants

[62] Where we calculated growth rates for the six years of rate capping, we have taken 2015–16 as the base year.

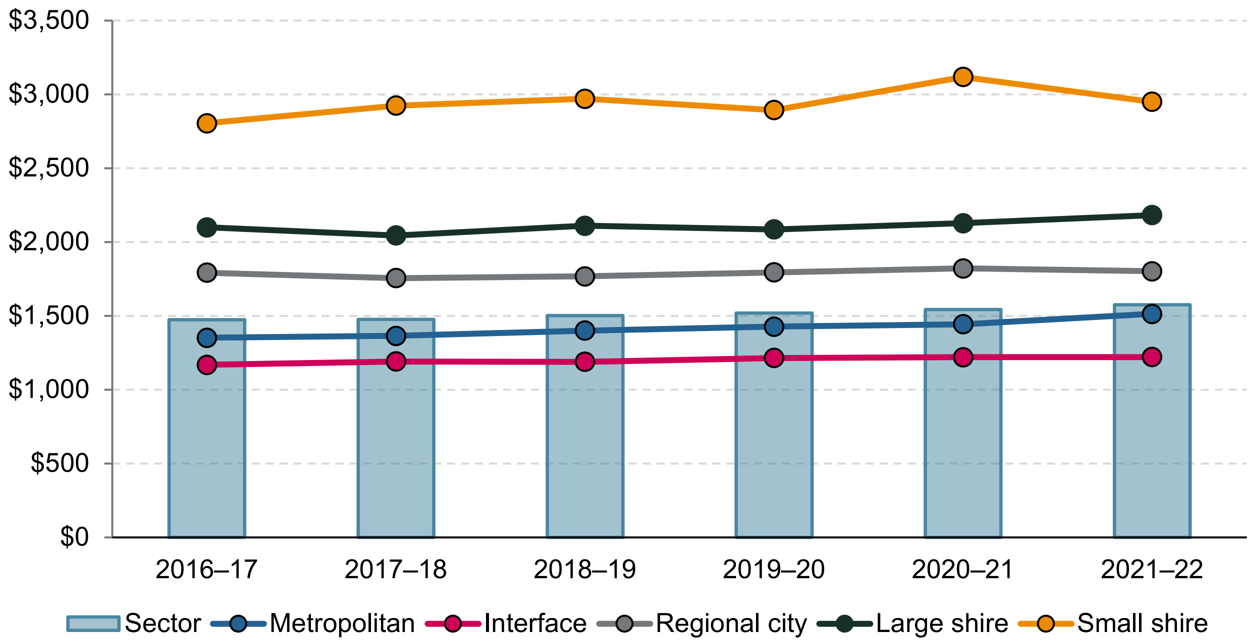
[63] Sector or group averages have been calculated from totals for the sector or group in aggregate. They are not the average of results for individual councils. See Appendix C for a list of the councils in each group.

Commission[64] to examine changes in service expenditure in the six years of rate capping.[65]

For the sector, service expenditure per person increased steadily over the six years from 2016–17 to 2021–22 (see Figure 5.1). Service expenditure per person also trended upwards for all council groups. The smallest increase was 0.2 per cent or $4 annually on average for the regional cities. The largest increases were 1.8 per cent or $25 annually for the metropolitan group, and the small shire group with 1.4 per cent or $39 annually.

Figure 5.1 Service expenditure per person

Inflation-adjusted, 2021–22 dollars



Data sources: Victorian Local Government Grants Commission – VGC1 data 2016–17 to 2021–22 (unaudited); Australian Bureau of Statistics (2021) Regional population, ABS Website, accessed 17 January 2023; Australian Bureau of Statistics (December 2022) 'TABLES 1 and 2. CPI: All Groups, Index Numbers and Percentage Changes' [Index Numbers; All groups CPI; Melbourne], Consumer Price Index, Australia, accessed 17 January 2023.

Since rate capping started, 2020–21 was the only year in which all five council groups increased their average expenditure. Across the sector, after adjusting for inflation the average increase in that year was 1.5 per cent per person, or $23.

64 Councils report their expenditure to the Victorian Local Government Grants Commission across a set of broad service functions. These functions reflect the services provided by councils at a high level, although the categorisation of expenditure into these service areas may not be consistent across councils.

65 Expenditure discussed in this chapter is recurrent operating expenditure, including depreciation. Capital expenditure and non-recurrent operating expenditure (such as one-off accounting adjustments) across the service areas was omitted due to the higher level of fluctuation from year to year. The operating expenditure levels discussed in the expenditure section of this report exclude depreciation.

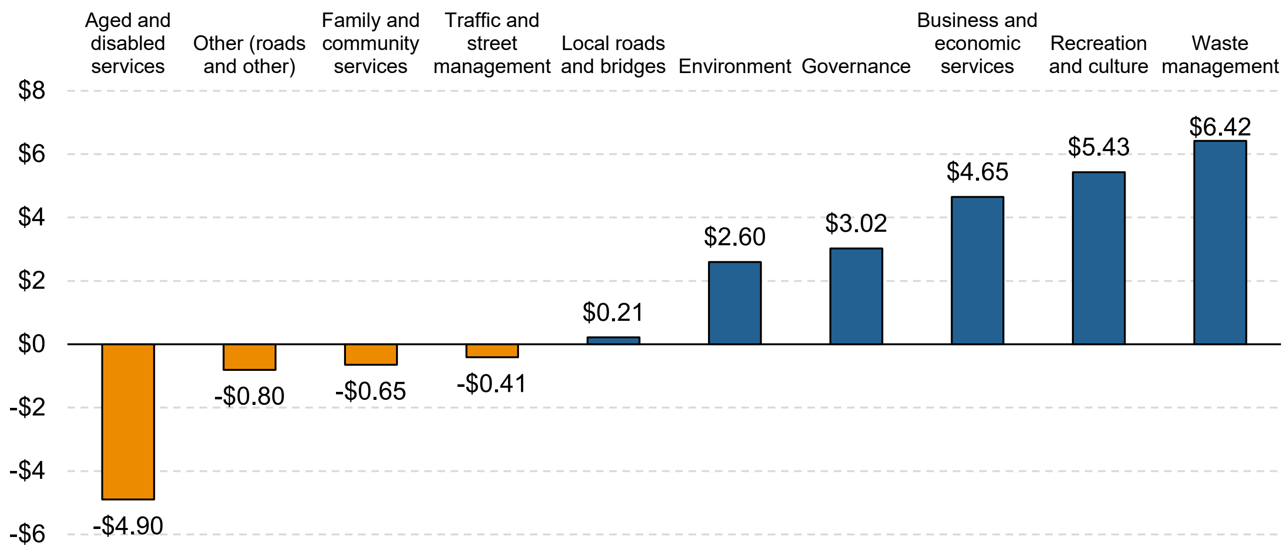
There were increases in expenditure in most service areas

For the sector as a whole, service expenditure per person increased in all but four service areas: aged and disabled services, other (roads and other), family and community services, and traffic and street management.

For funding and reporting purposes, councils allocate their service expenditure to ten standard categories or areas. Figure 5.2 shows these service areas, and whether the sector's average annual expenditure per person increased or decreased over the six years of rate capping. Those service areas above the $0 axis had an increase in expenditure per person and those below had decreased expenditure per person.

Figure 5.2 Average yearly change in service expenditure per person 2015–16 to 2021–22

For the sector as a whole (inflation-adjusted, 2021–22 dollars)



Data sources: Victorian Local Government Grants Commission – VGC1 data 2014–15 to 2019–20 (unaudited); Australian Bureau of Statistics (2021) Regional population, ABS Website, accessed 17 January 2023; Australian Bureau of Statistics (December 2022) 'TABLES 1 and 2. CPI: All Groups, Index Numbers and Percentage Changes' [Index Numbers; All groups CPI; Melbourne], Consumer Price Index, Australia, accessed 17 January 2023.

At the sector level, and on average for each of the five council groups, expenditure per person in the provision of aged and disabled services decreased across the six years to 2021–22. The amounts involved were small, however; none greater than an annual decrease of $6, on average for the large shires. Most councils in recent years have stopped providing these services or reduced them, in response to Australian Government reforms in the area (for example, the introduction of the National Disability Insurance Scheme and the Commonwealth Home Support Programme).

Local roads and bridges was variable, as was traffic and street management; the sector saw slight annual changes in expenditure per person of less than $1 across the six years. The small shire and regional city groups experienced the largest annual reductions for these two service areas combined, with average annual reductions of $4 and $1 over the six years. Coronavirus pandemic-related reductions in business activity may have been a factor. The large shire councils increased their average expenditure per person in those two areas over the period, by a total of $3 per year for the six years. Other variations, for metropolitan and interface councils, were less marked.

In contrast, in the areas of waste management and environment services, expenditure per person increased for all council groups in the sector. The average annual increase for the sector over the six years was $9 per person. The highest increase ($11 per person on average) was reported by regional cities; the lowest ($7) by large shires. This reflects significant disruption in the waste and recycling sector in recent years, with the collapse of service providers and ongoing reforms to the sector. It may also include increased waste and cleaning costs arising from the coronavirus pandemic in 2019–20 to 2021–22.

All council groups increased their expenditure on recreation and culture, with an average annual increase of $5 per person over the six years for the sector. The metropolitan group's increase of $7 per person was highest. Governance expenditure increased by $3 per person for the sector as a whole. Business and economic services also increased, led by metropolitan councils for whom this was the largest annual increase over the period, at $9 per person. Some of the increase may reflect additional coronavirus pandemic-related public health costs.

5.2 Service quality and community satisfaction are also important

Service expenditure data may indicate changes in the level of service provision in some areas – the number of services delivered.[66] However, the quality of services, and their alignment with the needs and preferences of the community, are also important.

Ratepayers and community members are well placed to judge changes in service quality.

Service delivery varies across the sector, reflecting different compositions, expectations and priorities of communities. The type, level, and quality of services that a council provides also vary, depending on factors such as:

- the geography and topography of their region

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[66] As well as a change in the level of service provision, changes in service expenditure could also reflect changes in efficiency, costs or the categorisation of expenditure between service areas.

- the demographic and economic profile of their communities
- their financial circumstances and
- the assets and infrastructure at their disposal.

Ratepayers and community members are best placed to assess their council's services and determine whether service quality is changing. Such assessments could be informed by personal experience of their council's services, information available through the Local Government Performance Reporting Framework[67] or more detailed service-quality data published by their council.

This section presents a sample of measures reported consistently by all councils. These measures give a broad indication at a sector level of whether service quality is improving or deteriorating in these areas.

Selected measures of service quality

> Changes in service quality measures indicate improvement in service quality in some areas, but a reduction in service quality in others. No clear pattern emerged.

The Local Government Performance Reporting Framework requires all councils to report on aspects of service quality. We included three of the reported service quality measures in our individual council and council group fact sheets, which you can find on our website.[68] Figure 5.3 shows the results for the sector.

The sector's percentage of **sealed local roads maintained to condition standards** fluctuated year to year but remained broadly similar over time.

The number of **kerbside collection bins missed** trended upwards for the sector, indicating a reduction in the standard of service. This may reflect the growing complexity of waste and recycling processes and the introduction of service providers unfamiliar with existing requirements, as well as flow-on effects of the coronavirus pandemic. However, the overall movement was slight – a little worse than one more bin in ten thousand.

The sector's percentage of **planning applications decided within required timeframes** increased between 2016–17 and 2019–20, then reduced – particularly in 2021–22. Factors

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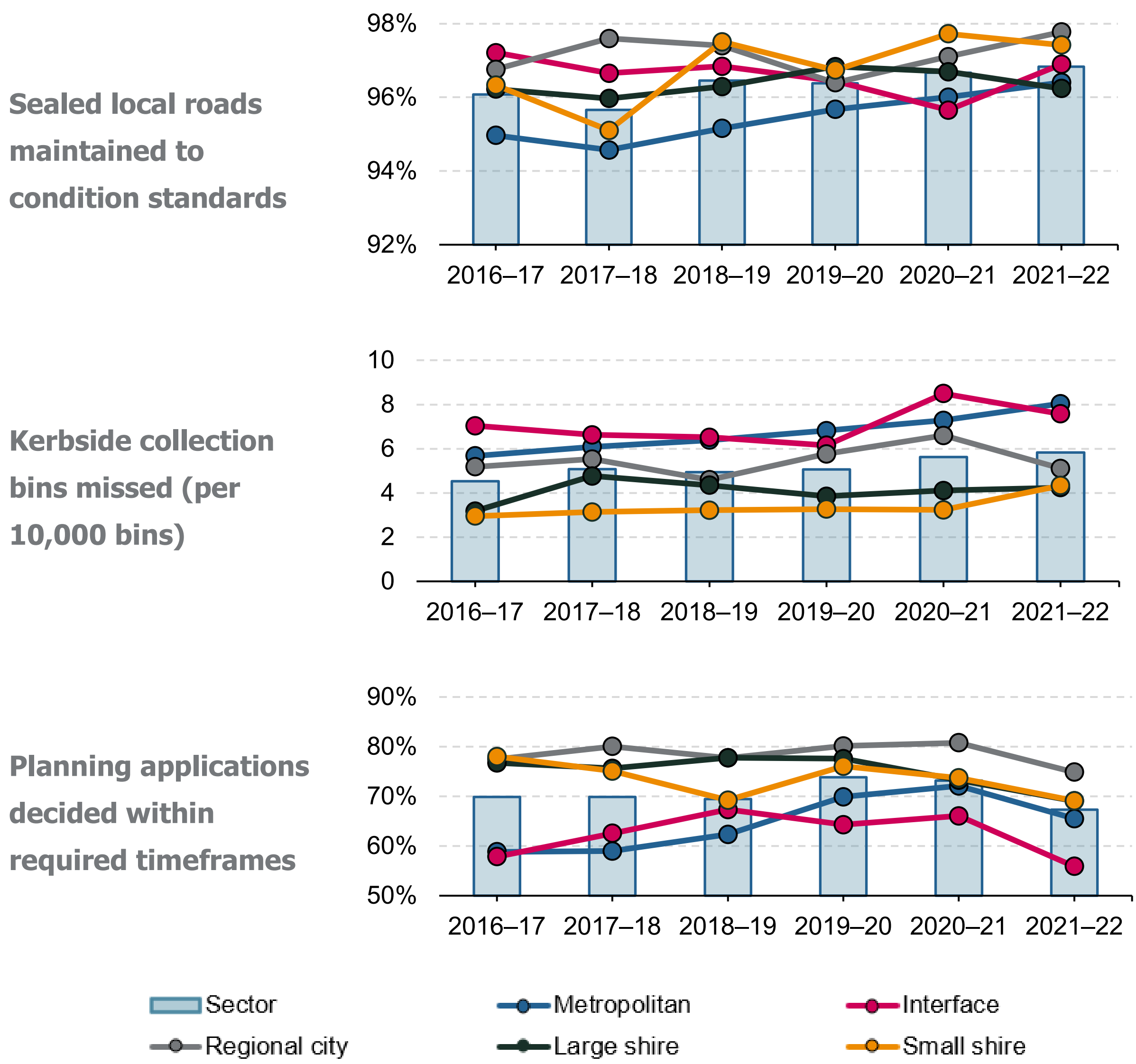
67 The Local Government Performance Reporting Framework is a mandatory system of performance reporting for all Victorian councils. It is administered by Local Government Victoria and council data was previously accessed through the knowyourcouncil website. Although the website is no longer available, the dataset can be downloaded from https://www.localgovernment.vic.gov.au/strengthening-councils/performance-reporting.

68 These measures were chosen because they were of relevance to the most ratepayers and community members.

contributing to this reduction could include staff shortages and turnover, training issues and other flow-on effects of the coronavirus pandemic.

Figure 5.3 Selected measures of service quality



Note: 2021–22 data was not available for Towong shire coucil. To allow for comparsison over time Towong's results have been exlduded from the small shire group and sector results for all years.

Data source: Local Government Performance Reporting Framework.

The trend in each indicator varied across council groups in the six years of rate capping:

- There was an overall upward trend in **planning applications decided within required timeframes** for metropolitan councils. Their indicator showed an improvement of seven percentage points over the period, despite a lower result in 2021–22. Performance trended downwards for both the large and small shire groups. All groups, led by the interface group, reported a lower indicator in 2021–22 than in the year before.

- All council groups saw an overall upward trend in **kerbside collection bins missed** (a reduction in the standard of service). The trend was of the order of one or two bins in every ten thousand. However, interface and regional city councils both reported some improvement in 2021–22.
- The metropolitan, regional city and small shire groups reported some improvement in the percentage of **sealed local roads maintained to condition standards**, although this change was less than two percentage points over the six years. The interface and large shire groups showed a slight deterioration.

Community satisfaction measures improved

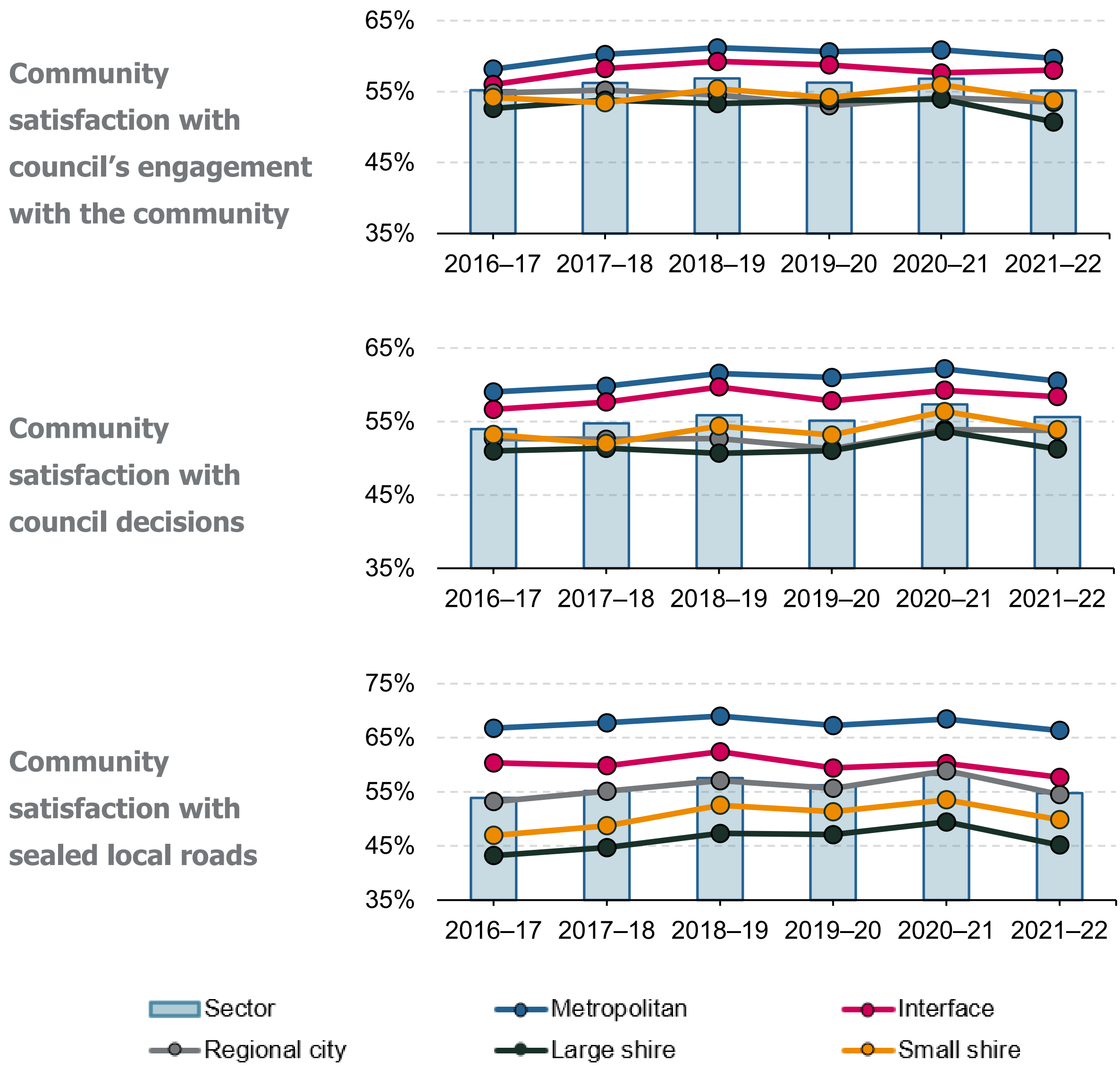
For the sector as a whole, there was clear improvement in the satisfaction measures over the first five years of rate capping. All council groups saw improvement in at least one of the three measures over the period.

However, there was a notable decline across the community satisfaction measures in 2021–22, with only the interface group reporting an improvement in satisfaction with council engagement with the community.

The Local Government Performance Reporting Framework includes three measures of community satisfaction.[69] The satisfaction indicators for each year are averaged for all councils in a group. The movements in these indicators over time were around three to six percentage points (see Figure 5.4).

[69] These results are drawn from the annual Community Satisfaction Survey undertaken by some councils and from separate surveys by councils that choose to do their own. More information about the annual Community Satisfaction Survey can be found at https://www.localgovernment.vic.gov.au/our-programs/council-community-satisfaction-survey.

Figure 5.4 Community satisfaction measures



Note: 2021–22 data on community satisfaction with councils' enagagement with the community and with council decisions was not available for Towong shire council. To allow for comparsison over time Towong's results for those measures have been exlduded from the small shire group and sector results for all years.

Data source: Local Government Performance Reporting Framework.

For the sector there was improvement in all three satisfaction indicators over the first five years of rate capping, followed by decreases for all indicators in 2021–22. Results varied between council groups:

- **councils' engagement with the community:** trended upwards until 2020–21 for all groups except regional cities, who showed no clear trend. The sector, and all groups except the interface councils, reported a year-on-year decline in 2021–22.

- **council decisions:** trended upwards for the sector, with regional city and large shire groups showing the biggest improvement. However, although all groups (and the sector) reported some increase in satisfaction in 2020–21, all reported a downturn in 2021–22
- **sealed local roads:** trended upwards for large shires, regional cities and small shires (and the sector) but downwards for the interface group. The indicator for the metropolitan group fluctuated. There was a general downturn for all groups and the sector in 2021–22.

Each council group (and the sector) saw a significant improvement in **community satisfaction with council decisions** and some improvement at least in one other measure. The small shire group showed some improvement across all three measures.

6. Financial position

This chapter looks at what happened to councils' financial positions over the six years of rate capping (2016–17 to 2021–22). We examine councils' operating positions (adjusted underlying results). We also look at their ability to pay bills, loans and other debts as reported in their working capital and indebtedness ratios.

Key observations

Overall financial health: the financial health of the sector as a whole, remained sound.

- **Operating position:** the sector's operating position, while declining over the period, remained positive. On average, all council groups except the small shires had enough revenue to fund the group's activities.
- **Working capital:** All councils had average levels of working capital above 100 per cent, which can be considered low risk. But in 2021–22, two councils reported a figure below that target.
- **Indebtedness:** Most councils reported low levels of indebtedness. Only seven councils had average indebtedness ratios above 40 per cent. One of these reported an average level above 70 per cent, which could be considered high risk.

This chapter focuses on the sector as a whole (the sector) – that is, all 79 councils in Victoria combined. It also highlights any differences between groups of similar councils (metropolitan, interface/urban fringe, regional cities, large shires and small shires).[70] For information about individual councils, see the fact sheets and the interactive dashboard at https://www.esc.vic.gov.au/outcomes-reports.

The analysis is based on numbers that have been adjusted for inflation.

See page 62 for definitions of key terms used in this report.

[70] Sector or group averages have been calculated for the sector or group in aggregate. They are not the average of results for individual councils within the sector or group. See Appendix C for a list of the councils in each group.

6.1 The sector's financial position remained largely positive

The operating position for the sector as a whole was positive in each of the six years of rate capping, despite declining significantly from 2018–19 to 2019–20.

The adjusted underlying result for a council shows its operating position, and whether the council ended the year with a surplus of operating revenue over expenditure. Here, 'adjusted' means that the council first subtracts any non-recurrent or non-monetary capital items (such as one-off capital grants and contributions for capital assets) from revenue. The adjusted revenue from operations, less the expenditure, gives an operating surplus or deficit. This figure is then expressed as a positive or negative percentage of the council's adjusted revenue, and termed the adjusted underlying result. The reporting process makes comparisons with other councils meaningful.

The sector had a positive adjusted underlying result in each of the six years of rate capping. However, not all council groups maintained a positive result each year.

The sector's operating position varied from year to year

The adjusted underlying result for the sector declined steadily before 2018–19. It then decreased sharply in 2019–20 and again slightly in 2020–21, after which there was some improvement (see Box 6.1).

Four council groups reported an average positive result in each year from 2016–17 to 2018–19, with only the small shires reporting a negative in the middle year. In 2019–20, however, only the metropolitan group reported a positive result. The year after, the small shire group's operating position decreased by six percentage points, contributing to an overall decline for the sector. However, in 2021–22, the small shire group's result was zero and four council groups reported a positive result.

Over the period, most councils reported substantial variation year on year. Variations could be related to changes in accounting standards (such as the valuation of council assets) or the costs of natural disasters (such as floods and fires). Since 2019–20, many councils have reported significant changes in revenue and costs, due to the initial impacts of the coronavirus pandemic and then the subsequent recovery.

Part of the variation also came from the advance receipt of part of councils' annual financial assistance grants, otherwise scheduled for the following year (see Box 6.1). Without this prepayment, the position of the councils and groups would have appeared less favourable.

Box 6.1 Adjusted underlying result and advance payment of financial assistance grants

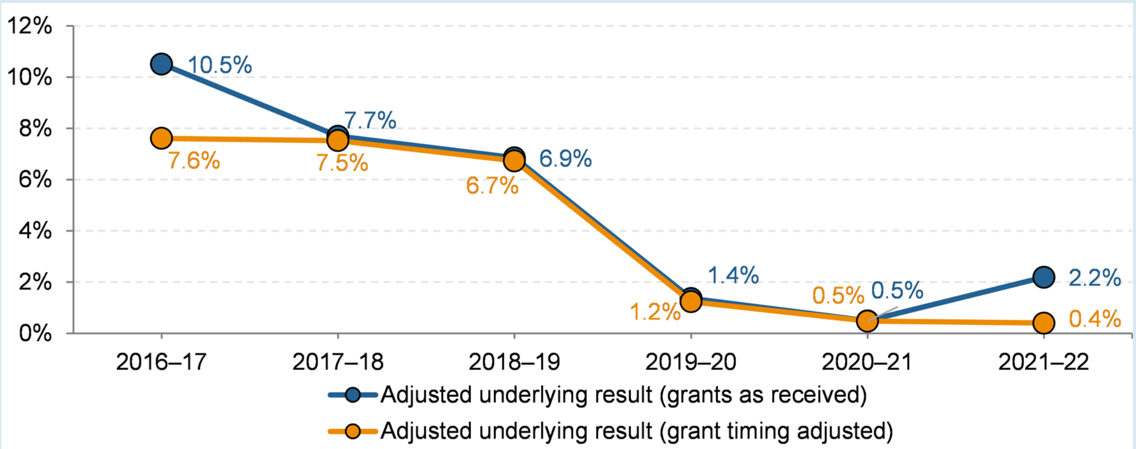
Councils are required to report financial assistance grant revenue in the year it is received, even if it is a payment for the following year.

From 2016–17 to 2020–21, councils received about half of their annual financial assistance grants from the Australian Government in advance. In 2021–22, they received nearly 75 per cent. This resulted in higher revenue in 2016–17 and 2021–22, reflected in the relatively higher average results.

Correcting the data, by moving relevant payments to year they are related to, shows the impact of these advanced payments on the sector's result. We can only make this correction at the sector level because we do not have the detail to adjust at the group or council level.

Adjusted underlying result, with and without adjustment for the timing of financial assistance grants

For the sector as a whole



Data source: Local Government Performance Reporting Framework, Victorian Local Government Grants Commission.

Given this variation, simple year-on-year changes may not fully indicate council sustainability. For this reason we look at four-year averages from 2018–19 to 2021–22. It also allows for comparison with our report for the previous four years, 2016–17 to 2019–20.

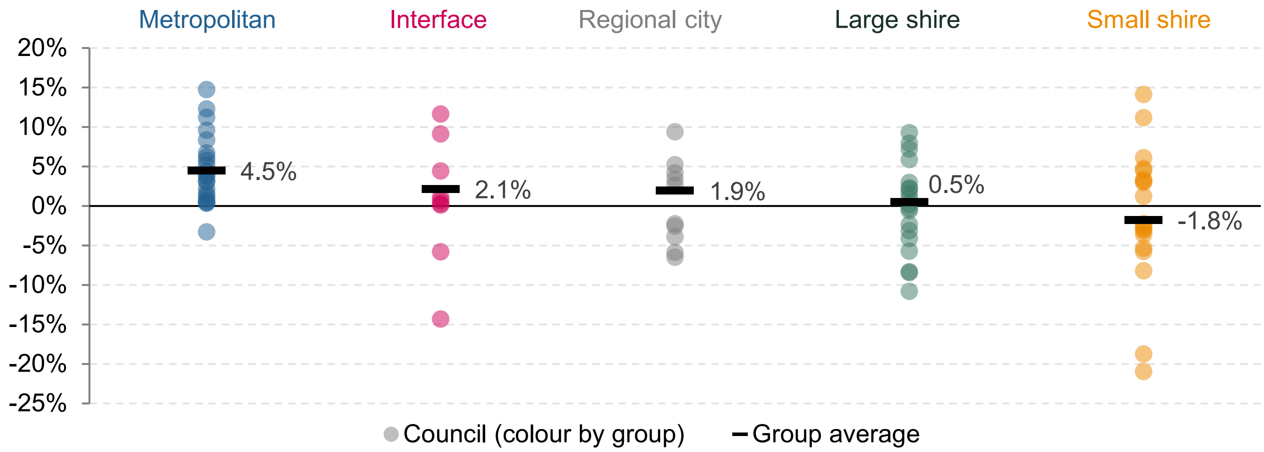
Most councils had positive operating positions

From 2018–19 to 2021–22, 52 of 79 councils had positive average operating positions. These included all but one of the metropolitan councils and all but two of the interface councils. Half the regional city councils also had positive operating positions.

For the sector, the average adjusted underlying result over the four capped years 2018–19 to 2021–22, was 2.7 per cent. This is well down from the average of 6.6 per cent we reported for 2016-17 to 2019-20. Nevertheless, an ongoing positive result suggests that the sector was able to fund the levels of service provided.

However, 27 councils reported an average adjusted underlying result that was negative.[71] This included half of the large and small shires and regional cities, one metropolitan and two interface councils (see Figure 6.1).

Figure 6.1 Average adjusted underlying result 2018–19 to 2021–22



Note: The adjusted underlying results in this Figure have not been adjusted for the timing of financial assistance grant payments from the Australian Government, as the data is only available at a sector level (see Box 6.1). If data were available to adjust for the timing of grants at a group and individual council level, the four-year averages for the groups and individual councils would likely be lower than shown in this figure. These are the average of results from 2018–19 to 2021–22.

Data source: Local Government Performance Reporting Framework.

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[71] Our previous report for 2016–17 to 2019–20, on the first four years of rate capping, found only 18 councils with a negative operating position.

It is quite common for councils to report a negative operating result from time to time. However, councils that do so repeatedly may not have enough revenue to keep providing their usual range and level of services. Such councils would need to receive more one-off grants, or to increase their operating revenue or reduce their expenditure.

It is worth noting that all 27 councils with an average negative operating result had sufficient working capital and relatively low levels of debt. Only three had indebtedness levels of 50 per cent or above, meaning they may have some difficulty in repaying debt levels from their own source revenue. These measures are discussed in the following sections.

6.2 Most councils had sufficient working capital to meet their immediate financial obligations

In 2021–22, for the first time in six years of rate capping, two councils reported a working capital ratio of less than 100 per cent. Their current assets in 2021–22 were less than their current liabilities.

Working capital, or liquidity, shows a council's current assets as a percentage of its current liabilities. A council's current liabilities are any matters the council is bound to settle within 12 months, while a council's current assets would include:

- cash held for specific use in the short-term (12 months or less)
- unrestricted cash
- non-current assets held for sale and
- other short-term assets such as inventories.

When a council can report working capital greater than 100 per cent, this means it has enough assets available to meet its short-term liabilities, with funds remaining to deal with unexpected expenses. A council with a working capital ratio of less than 100 per cent may have some difficulty in repaying short-term liabilities as they fall due.

In 2021–22, two councils reported lower ratios: 85 per cent and 59 per cent. All other councils reported a working capital greater than 100 per cent over the six years of rate capping.

Working capital can change for many reasons

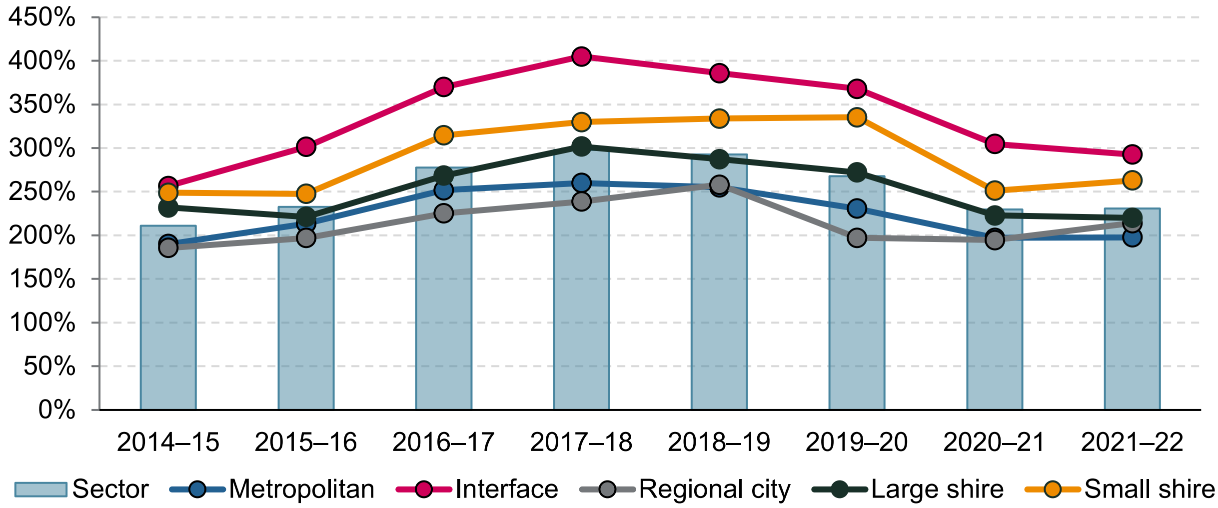
The changes in working capital for the sector may reflect councils:

- building up their cash reserves to fund future capital works – for example, new assets or asset renewal (working capital should decline for these councils, once the expenditure takes place)
- building up cash reserves to repay loans in the future, or using cash reserves to increase their long-term investments

- deferring capital works (sometimes councils defer planned works into future years and delay payment for those works, but working capital should decline once the expenditure takes place)
- making provision for landfill rehabilitation moving from non-current to current liabilities
- responding to reduced revenue or increased costs due to the impact of the coronavirus pandemic
- responding to changed accounting standards – for example, standards relating to the recognition of leases and unearned income.

In the six years of rate capping, the working capital ratios reported by councils in the sector averaged 266 per cent. Three small shire councils and two interface councils reported an average working capital ratio above 450 per cent over the six years of rate capping. Small shire councils are more likely than the larger metropolitan and regional city councils to build up cash reserves to fund their capital investment. Interface councils' high working capital ratios may reflect extensive capital works programs and the timing of developer contributions they receive.

Figure 6.2 Working capital ratios



Data source: Local Government Performance Reporting Framework.

6.3 Debt levels remained low across the sector

In each of the six years of rate capping, the sector as a whole reported an indebtedness ratio of 20 per cent or lower. This indicates that the sector is unlikely to have difficulty in repaying debt levels from own-source revenue.

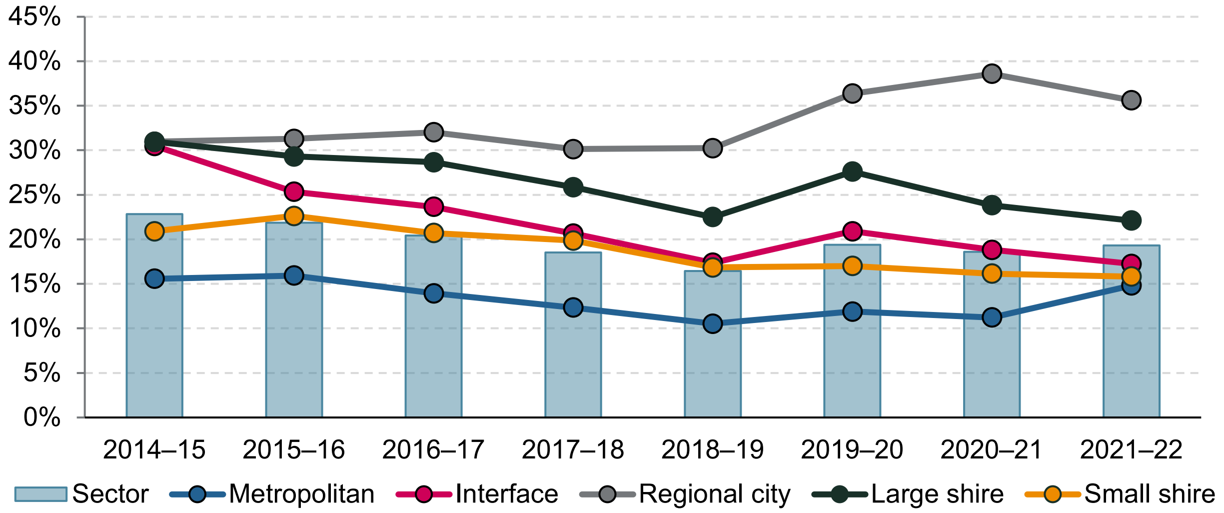
The indebtedness ratio indicates a council's ability to repay its present levels of debt from own source revenue. It is the ratio of a council's non-current liabilities as a percentage of its own-source revenue, where:

- non-current liabilities include interest-bearing long-term loans and borrowings, and provisions for future costs (such as landfill remediation, or long-service leave)
- own-source revenue includes:
  - rates and charges
  - user fees and statutory fees and fines
  - revenue from joint ventures and the sale of assets.

A council with relatively high or rising indebtedness ratio may find increasing difficulty in repaying debt levels from own-source revenue.

The five council groups reported a range of average indebtedness ratios – all below 40 per cent, a figure that may represent a moderate level of debt (see Figure 6.3).

Figure 6.3 Indebtedness ratios



Data source: Local Government Performance Reporting Framework.

From 2018–19 to 2019–20, all council groups – and 52 of the 79 councils individually – increased their level of indebtedness. The increase was close to 6 percentage points on average, for those councils. Such an increase may reflect both lower own-source revenue (due in part to the impacts of coronavirus) and higher reported liabilities relating to a change in accounting standards.[72]

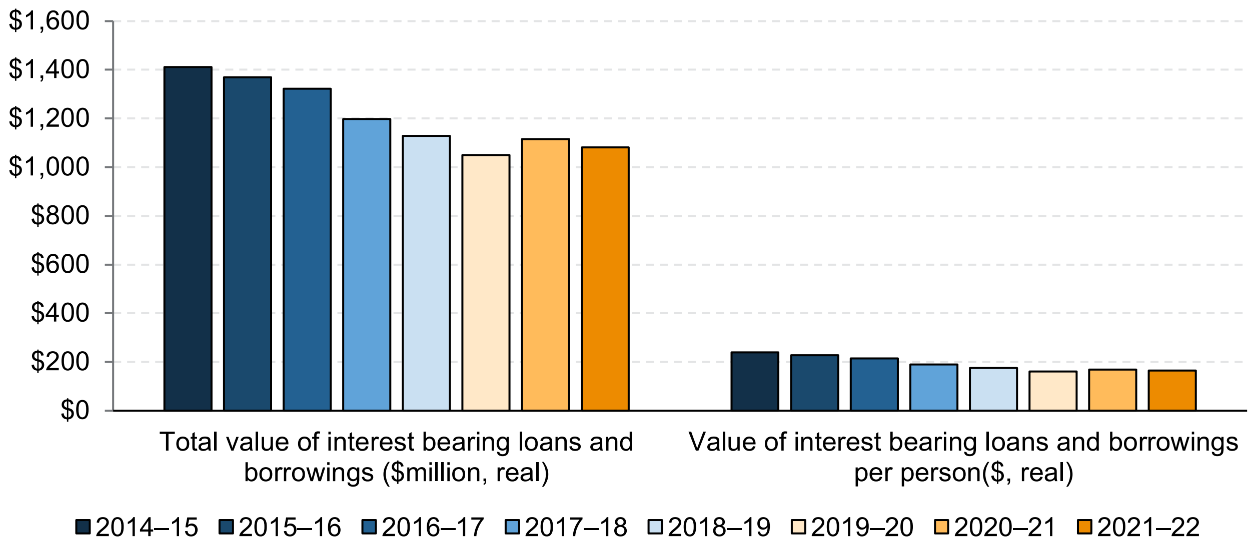
Over the six years of rate capping, only seven councils reported an average indebtedness ratio of greater than 40 per cent. Six other councils reported holding no interest-bearing loans since the start of rate capping.

[72] The change in accounting standards means that the future cost of leasing property and equipment for more than a year now appears as a long-term liability, increasing the indebtedness indicator.

The sector paid off some debt

The total value of debt held by councils, adjusted for inflation, went down, by $287 million over the six years of rate capping (see Figure 6.4).[73] The decrease was in the range of three to nine per cent each year, although there was an increase of a similar size in 2020–21.

Figure 6.4 Council interest bearing loans and borrowings



Data sources: Council annual reports (audited); Australian Bureau of Statistics (2021) Regional population, ABS Website, accessed 17 January 2023; Australian Bureau of Statistics (December 2022) 'TABLES 1 and 2. CPI: All Groups, Index Numbers and Percentage Changes' [Index Numbers; All groups CPI; Melbourne], Consumer Price Index, Australia, accessed 17 January 2023.

In 2021–22, the sector held $165 of debt for every person in Victoria. In real terms, this was 27 per cent less than the value of debt per person in 2015–16.

Borrowings include both long-term and short-term (12 months or less) debt held by councils. Councils typically have policies or strategies in place to guide their decisions about debt. What is appropriate for each council will depend on the council's circumstances, particularly its capacity to repay any loan.

Debt finance can be a key element of a prudent and responsible long-term financial plan. Borrowing money to fund the construction of 'long-lived' assets can help spread the costs of these assets over time. Long-lived assets, by their nature, will service both current and future ratepayers. Smoothing the costs over time also helps ensure those who benefit are also those who pay.

[73] Progressively fewer councils reported that they held debt: from 70 at the start of rate capping in 2016–17, to 59 in 2021–22.

Key terms used in this report

Term	Meaning
Asset: • Current asset • Non-current asset	Value controlled by the council, arising from past transactions or other events such as acquiring property or business investments: • that council is planning to use sell or trade, this year or next year, such as cash • longer-term assets such as land and property and equipment
Average rate increase	This is used to determine a council's compliance with the rate cap. It is the percentage difference between the base average rate (BAR) and the capped average rate (CAR), as defined by sections 185B and 185C of the Local Government Act (See Appendix A for more detail). If a council's average rate increase is less than or equal to the rate cap, the council is compliant.
Average rates	This refers to the rates paid by the average ratepayer and is calculated as total revenue from general rates and municipal charges divided by the number of rateable properties. See Appendix A for more information.
Capital expenditure: • New • Renewal • Expansion • Upgrade	Large expenditure, generally on long-life assets such as roads or buildings, producing benefits to last for more than 12 months: • creating a new asset and new service or output • replacing an asset or returning the service level up to original level • extending the service of existing asset at current level to new users • enhancing an existing asset to provide a higher level of service
Capped rates	Capped rates comprise general rates and municipal charges.[a]
Council group	A council group is a group of similar councils. The five council groups we refer to in this report are: metropolitan, interface (metropolitan fringe), regional cities, large shires and small shires. See Appendix C for a list of the councils in each group.

Continued next page

Term	Meaning
Depreciation:	The regular reduction in the value of a council's physical assets over time, usually reflecting wear and tear
Expenditure: • Recurrent • Non-recurrent	Costs reducing a council's revenue; the payment of expenses incurred by the council to obtain assets or services: • operating expenses on routine functions of an organisation, such as wages/salaries, rentals, interest on debt • other costs, including costs for unplanned events
Indebtedness:	Non-current liabilities as a percentage of own source revenue
Inflation-adjusted	This means the numbers and analysis have been adjusted by the Consumer Price Index to take into account the effects of inflation (the increases in the general cost of goods and services in the economy).[b] When reported values or growth rates are inflation adjusted, any increases are above the level that can be explained by increases in the general cost of goods and services in the economy. The dollar amounts in this report are shown in 2021–22 dollars.
Leviable	With respect to rates and charges, means all that a council may levy under ss 158–159 of the *Local Government Act 1989* unless s 154 of the Act excludes the land. The exclusions apply mainly to land used for public, municipal or charitable purposes, or for mining or transport.
Liability: • Current liability • Non-current liability	A present obligation of the council, arising from past events, where settlement is expected to result in reduced economic benefits: • one that council is planning to settle or trade this year or next • longer-term liabilities such as provisions for employee entitlements
Minister's cap	The rate cap set by the Minister for Local Government each year. It applies by default to all councils unless they seek and obtain approval for a higher cap from the Essential Services Commission.
Municipal charges	Councils can levy a municipal charge[a] to recover some of the costs of administering the council.

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Key term used in this report

Term	Meaning
Nominal terms *or* Nominal value	Expressed as an amount in the dollars of the relevant period, with no adjustment for inflation since that time, in contrast with 'real terms'
Operating expenditure: • Employee expenses • Maintenance • Other	Recurrent expenses on goods and services; includes the following: • wages & salaries, leave, termination pay, superannuation plans • routine attention to capital assets so they last their planned lives • other workplace costs such as rent, fuel, office supplies
Other rates and charges	These are excluded from rate capping. They include special rates and charges (for example, charges for service provided in business districts); supplementary rates and charges (on new or improved properties); levies on cultural and recreational properties; revenue in lieu of rates (such as payments made by electricity generators instead of rates).
Rate cap (alternatively 'applicable cap')	This is the maximum percentage amount that a council can increase its average rates in a rating year. A council's rate cap will either be the minister's cap or an approved higher cap.
Rate capping	Rate capping is a system that limits the amount councils can increase their general rates and municipal charges each year. This system has applied to annual rate increases since 2016–17.
Rates	Refers to general rates and municipal charges.[a] These have been capped since 2016–17.
Rates and charges	Refers to capped rates, services charges and 'other rates and charges'. 'Other rates and charges' includes special rates and charges; (e.g. charges for services provided in business districts); supplementary rates and charges (on new or improved properties); levies on cultural and recreational properties; revenue in lieu of rates (such as payments made by electricity generators instead of rates).
Real terms	Expressed as an amount in the dollars of the current (reporting) period, adjusted for inflation since the time of the transaction that is reported

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Term	Meaning
Rebate:	A form of discount allowed by some councils, recognising community benefit. The rebate, or other concession or waiver, applies to the leviable rate after any rate capping and the FGRS.
Revenue	Income for councils. Source of revenue per person, in 2021–22 dollars, was just over half from rates, with the remainder almost equally from grants, developer contributions and user fees and statutory fees and fines. Grants come from the Victorian and Australian Governments.
Sector as a whole	This is all 79 individual councils combined.
Service charges	This refers to charges for services provided by councils as referred to in section 162 of the Local Government Act 1989. These are primarily used to recover the cost of kerbside waste collection services. Some councils also use service charges to fund community waste services (such as street cleaning) and drainage services.
Working capital	Current assets as a percentage of current liabilities

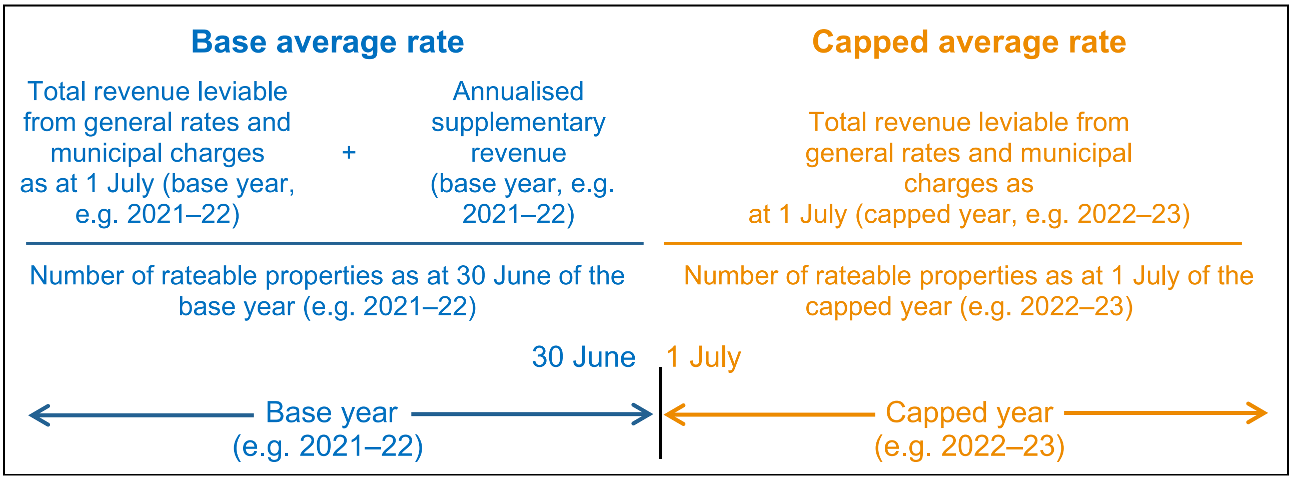
Appendix A: Rate cap explanation

The rate cap limits increases in each council’s average rates

The rate cap limits the maximum amount a council can increase its average rates in a rating year. It is a percentage amount (for example, 2.50 per cent).

‘Average rates’ refers to the rates paid by the average ratepayer and is calculated as total revenue from general rates and municipal charges divided by the number of rateable properties (as shown in Figure A.1). The rate cap does not include other charges and levies such as service rates and charges, special rates and charges, revenue in lieu of rates and the Fire Services Levy.

Figure A.1 Average rate



Note: The base year includes annualised supplementary revenue from general rates and municipal charges. This ensures that the rate cap includes new properties and any changes to property values that occur throughout the year.
[a] Section 185B, Local Government Act 1989. [b] Section 185C, Local Government Act 1989.

A council is compliant if the capped average rate does not exceed the base average rate by more than the rate cap. The percentage difference is called the average rate increase. In other words, if a council’s average rate increase is less than or equal to the applicable rate cap, the council is compliant.

Each year the commission assesses each council’s compliance with the rate cap. More information about this process and past compliance reports can be found on our website.

Appendix B: Higher cap applications

We approved 11 councils' higher cap applications, including four applications covering multiple years.

Figure B.1 Councils with approved higher caps

	2016–17	2017–18	2018–19	2019–20	2020–21	2021–22	2022–23	2023–24
Ministers' cap	2.50%	2.00%	2.25%	2.50%	2.00%	1.50%	1.75%	3.50%
Buloke Shire Council	3.05%							
Horsham Rural City Council	3.50%							
Moorabool Shire Council	3.50%							
Murrindindi Shire Council	4.30%							
Pyrenees Shire Council	3.83%	3.50%	3.50%					
Towong Shire Council	6.34%	5.55%	5.55%	5.55%	5.55%			
Hindmarsh Shire Council		4%						
West Wimmera Shire Council		3.50%	3.50%	3.50%	3.50%			
Monash City Council			2.57%					
Mansfield Shire Council				13.94%				
Warrnambool City Council				4.50%	4.50%			
Number of higher caps	**6**	**4**	**4**	**4**	**3**	**0**	**0**	**0**

Notes: In 2019, Warrnambool Shire Council applied for a higher cap for three years, but only the first two were approved. We did not receive any applications for a higher cap from 2021–22 to 2023–24.

We surveyed the councils with approved higher caps to check whether councils applied the higher caps that had been approved.

Four councils advised they applied a lower cap as follow:

- Monash advised that the council applied the minister's cap and introduced a recycling levy instead of applying the higher cap to recover increased costs of waste management.
- Towong advised that council received significant unbudgeted grant funding for road asset management and for flood and fire relief and recovery, and chose to apply a 4.80 per cent cap in both 2018–19 and 2019–20 and a zero per cent cap in 2020–21, rather than the approved higher cap of 5.55 per cent.
- Both West Wimmera and Warrnambool advised that the councils applied the minister's cap for the 2020–21 rating year, instead of the approved higher caps of 3.50 per cent for West Wimmera and 4.50 per cent for Warrnambool for the year.

When we surveyed councils with approved higher caps, we also asked how the council used any additional revenue received in the rating year for which the higher cap was approved.[74] All councils that applied a higher cap confirmed they have used the additional revenue for the purposes specified in their applications. At a high level (noting some applications had multiple reasons), councils sought the additional revenue for:

- reducing (uncapped) waste-management charges (Mansfield)
- infrastructure management (Pyrenees, Towong, Warrnambool, West Wimmera)
- service delivery (Towong, West Wimmera)
- financial sustainability (Towong, West Wimmera)

More information on higher cap applications and approvals can be found on our website at https://www.esc.vic.gov.au/local-government/higher-rate-cap-applications/recent-higher-cap-applications.

[74] Although higher caps from previous years continue to affect revenue, we only asked councils how the additional revenue received in the initial year had been used.

Appendix C: Council groups

Table C.1 Metropolitan councils

Councils in this group	
Banyule City Council	Manningham City Council
Bayside City Council	Maribyrnong City Council
Boroondara City Council	Maroondah City Council
Brimbank City Council	Melbourne City Council
Darebin City Council	Merri-bek City Council
Frankston City Council	Monash City Council
Glen Eira City Council	Moonee Valley City Council
Greater Dandenong City Council	Port Phillip City Council
Hobsons Bay City Council	Stonnington City Council
Kingston City Council	Whitehorse City Council
Knox City Council	Yarra City Council

Table C.2 Interface councils

Councils in this group	
Cardinia Shire Council	Nillumbik Shire Council
Casey City Council	Whittlesea City Council
Hume City Council	Wyndham City Council
Melton City Council	Yarra Ranges Shire Council
Mornington Peninsula Shire Council	

Table C.3 Regional city councils

Councils in this group	
Ballarat City Council	Latrobe City Council
Greater Bendigo City Council	Mildura Rural City Council
Greater Geelong City Council	Wangaratta Rural City Council
Greater Shepparton Council	Warrnambool City Council
Horsham Rural City Council	Wodonga City Council

Table C.4 Large shire councils

Councils in this group	
Bass Coast Shire Council	Moira Shire Council
Baw Baw Shire Council	Moorabool Shire Council
Campaspe Shire Council	Mount Alexander Shire Council
Colac Otway Shire Council	Moyne Shire Council
Corangamite Shire Council	South Gippsland Shire Council
East Gippsland Shire Council	Southern Grampians Shire Council
Glenelg Shire Council	Surf Coast Shire Council
Golden Plains Shire Council	Swan Hill Rural City Council
Macedon Ranges Shire Council	Wellington Shire Council
Mitchell Shire Council	

Table C.5 Small shire councils

Councils in this group	
Alpine Shire Council	Mansfield Shire Council
Ararat Rural City Council	Murrindindi Shire Council
Benalla Rural City Council	Northern Grampians Shire Council
Buloke Shire Council	Pyrenees Shire Council
Central Goldfields Shire Council	Borough of Queenscliffe Council
Gannawarra Shire Council	Strathbogie Shire Council
Hepburn Shire Council	Towong Shire Council
Hindmarsh Shire Council	West Wimmera Shire Council
Indigo Shire Council	Yarriambiack Shire Council
Loddon Shire Council	

Appendix D: Service charge revenue per property

Table D1 shows the service charge revenue per property for all councils that mandate a waste charge. The amount of revenue can vary as these councils fund different levels and types of waste services. Some councils only use waste charges to fund kerbside waste collection while others also use waste charges to fund community waste services, such as litter collection.

Table D.1 Councils' service charge revenue per rateable property in 2021–22

Council	Revenue per property ($)
Wangaratta Rural City Council	469
Frankston City Council	468
Moira Shire Council	454
Benalla Rural City Council	450
Nillumbik Shire Council	448
Macedon Ranges Shire Council	427
Bass Coast Shire Council	419
Brimbank City Council	407
Central Goldfields Shire Council	402
Mildura Rural City Council	399
Ballarat City Council	398
Mornington Peninsula Shire Council	398
Boroondara City Council	394
Mount Alexander Shire Council	383
Hepburn Shire Council	378
Mitchell Shire Council	377
Greater Bendigo City Council	377
Warrnambool City Council	369
Strathbogie Shire Council	368
Borough of Queenscliffe	367
Surf Coast Shire Council	363
Stonnington City Council	360

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Table D.1 (continued)

Council	Revenue per property ($)
Indigo Shire Council	357
Greater Geelong City Council	354
Murrindindi Shire Council	353
Cardinia Shire Council	351
Alpine Shire Council	348
Casey City Council	345
Latrobe City Council	344
Greater Dandenong City Council	341
Yarra Ranges Shire Council	333
Baw Baw Shire Council	331
Maroondah City Council	329
Towong Shire Council	327
Glen Eira City Council	327
Greater Shepparton City Council	327
Moorabool Shire Council	325
Pyrenees Shire Council	323
Ararat Rural City Council	313
Bayside City Council	312
Horsham Rural City Council	308
Wodonga City Council	308
Manningham City Council	303
Swan Hill Rural City Council	302
Northern Grampians Shire Council	301
Golden Plains Shire Council	301
Moyne Shire Council	301
Gannawarra Shire Council	297
Wyndham City Council	287
Mansfield Shire Council	282

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Table D.1 (continued)

Council	Revenue per property ($)
Campaspe Shire Council	279
East Gippsland Shire Council	261
Merri-bek City Council	255
Knox City Council	255
Melton Shire Council	253
Moonee Valley City Council	252
Hobsons Bay City Council	245
Kingston City Council	236
Buloke Shire Council	232
Loddon Shire Council	227
Hindmarsh Shire Council	214
Southern Grampians Shire Council	209
Colac Otway Shire Council	204
Corangamite Shire Council	202
Wellington Shire Council	202
South Gippsland Shire Council	191
Glenelg Shire Council	179
Yarriambiack Shire Council	177
Maribyrnong City Council	175
West Wimmera Shire Council	119
Whittlesea City Council	104
Monash City Council	41

Data sources: Council annual reports (audited)

Table D.2 Service charge revenue per rateable property in 2021–22, by council group

Council group	Average revenue per property ($)
Regional City	365
Interface	315
Small shire	307
Large Shire	301
Metropolitan	294

Data sources: Council annual reports (audited)