ESSENTIAL SERVICES COMMISSION

The outcomes of rate capping

20 May 2021

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Foreword from the chairperson

Kate Symons

Chairperson

Kate was appointed chairperson of the Essential Services Commission in September 2019 after three years as a part-time commissioner. As a lawyer with qualifications in public administration and corporate governance, Kate brings particular expertise in risk, compliance and governance.

Kate has a passion for ensuring customer experiences are considered at every step of the regulatory process.

Local councils across Victoria play an important part in providing a range of essential services to the communities they serve. We all rely on our councils to maintain local roads, parks, libraries and sporting facilities, alongside providing other services such as residential waste collection. To do this work, councils raise revenue from several sources, including rates.

Since 2016–17, the amount councils can increase their average rates each year has been constrained by the rate capping framework. The framework includes a rate cap set each year by the Minister for Local Government and councils can apply to the Essential Services Commission for a higher cap if they need it. As part of the framework, we are responsible for reporting on the outcomes of rate capping and what this means for ratepayers, the community and councils.

This is our second biennial report on the outcomes of rate capping in Victoria. It looks at what happened to the local government sector's finances in the first four years of rate capping, including the first few months of the pandemic. It also looks at what happened to the rates and charges paid by Victorian ratepayers, and the quality of the services provided by councils to the community.

To complement the report, we have also published fact sheets on our website for each of the 79 councils in Victoria. These are designed to help readers better understand how councils are operating in a rate-capped environment. In response to previous feedback from councils and ratepayers, I am pleased to say that the fact sheets are now also available in an interactive version.

Improving the transparency of information about councils' rates, revenue, expenditure and financial positions can help ratepayers and community members understand the trade-offs. This in turn can lead to more constructive dialogue and engagement between councils and their community about the best way to meet their needs and expectations.

In the first four years of rate capping, ratepayers have paid lower rates than they would have done in the absence of rate capping. We also observed that, in general, the sector's financial health remained strong in the first three years of rate capping. However, in 2019–20 the initial impacts of the coronavirus pandemic reduced the sector's revenue. This was reflected in a slight deterioration in the sector's overall financial position.

The years ahead will be challenging for councils. They will face some uncertainty about their revenue (particularly councils that rely on population growth and development for their revenue growth). They must continue to maintain their infrastructure and provide services, and will have to balance the costs of service provision with the ability of their communities to pay. We have already seen many councils freeze rates in 2020–21 or propose rates freezes in their draft 2021–22 budgets to ease the burden on ratepayers. These decisions will have a long-term impact on the revenue bases of these councils.

It will be important for councils to engage with their communities about the challenges they face and the options available to them. The Local Government Act 2020 now includes principles of community engagement and we will continue to expect any council applying to us for a higher cap to demonstrate how they have engaged with their community.

I would like to take this opportunity to thank councils for assisting us by providing some limited rates data, as well as checking the accuracy of the data contained in their council's fact sheet. The commission looks forward to working with the sector and other government agencies over time to improve the quality and consistency of available data.

The commission also looks forward to continuing to promote the long-term interests of Victorian ratepayers and the community, while ensuring that councils have the financial capacity to deliver services to their communities.

Contents

Executive summary

Rate capping is a system that limits the amount councils can increase their average rates each year. This system has applied to annual rate increases since 2016–17. This report focuses on what happened in the first four years of rate capping (2016–17 to 2019–20).[1] The analysis in this report is based on numbers that have been adjusted for inflation.[2]

We are required to report every two years on the outcomes of the rate capping system.[3] The aim of these reports is to identify any impacts or trends that might be emerging across the local government sector.[4] These reports may inform the reviews of the rate capping system that are required to be undertaken every four years. The first of these reviews is due to be completed by December 2021.[5]

This report includes observations about the rates and charges, revenue, expenditure and financial position of the local government sector as a whole. For information about individual councils, see the fact sheets at https://www.esc.vic.gov.au/outcomes-reports.

Key observations

- **Rates:** Ratepayers have paid lower rates than they would have done in the absence of rate capping.
- **Annual changes:** Factors outside the rate capping system continue to determine the annual change in rates for each individual ratepayer.

Continued next page

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

2 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 2019–20 dollars. In our first report, published in May 2019, we did not adjust the analysis for the effects of inflation. Therefore, be careful if comparing the observations and numbers in this report to those in our last report.

3 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.

4 Our first report, examining the first two years of rate capping, was released in May 2019. This is our second report — it focuses on the first four years of rate capping.

5 The Minister for Local Government and the Assistant Treasurer must ensure under Section 158G of the Local Government Act 1989 that a review of the rate capping framework is completed by 31 December 2021.

Key observations (continued)

- **Revenue:** Growth in the sector's revenue from rates and charges slowed due to rate capping. But the sector's total revenue grew faster due to stronger growth in revenue from developer contributions and government grants. In a rate capped environment, councils are more dependent on these other sources of revenue for their revenue growth.
- **Expenditure:** The sector's total expenditure continued to grow, with higher revenue from contributions and grants enabling stronger growth in expenditure than before the introduction of rate capping.
- **Financial health:** In general, the financial health of the sector remained strong. The sector as a whole had a positive operating position and the ability to meet both short-term and long-term liabilities.
- **Effect of pandemic:** Councils may face some difficult decisions to maintain their long-term sustainability if revenue growth, particularly from contributions, user fees and statutory fees and fines, does not bounce back from the impacts of the coronavirus pandemic.

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

Rates and charges (Refer to Chapter 1)

Ratepayers have paid lower rates than they would have done in the absence of rate capping.

In the three years before the introduction of rate capping (between 2012–13 and 2015–16), the average annual increase in capped rates (per property) for the sector as a whole was 3 per cent. This was equal to $49 per year (in inflation-adjusted terms). In the first four years of rate capping, the average annual increase dropped to zero per cent. This means that ratepayers are paying lower rates than they would have been had historical increases continued.

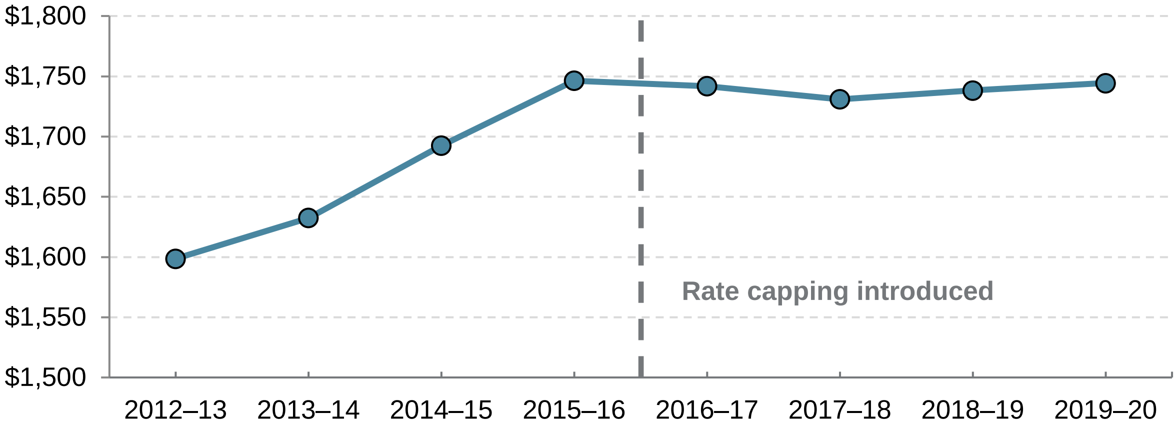
Most councils set increases in their average rates below the forecast level of inflation

The decrease in capped rate rises can be attributed to:

- 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

For the sector as a whole (inflation-adjusted, 2019–20 dollars)



Data source: Council annual reports (audited), Victorian Local Government Grants Commission – VGC 2 data 2012–13 to 2019–20 (unaudited data).

Rate caps apply to the ‘average’ rate. Factors outside the rate capping system continue to determine the annual change in rates for each individual ratepayer.

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.

These factors are all separate to the rate capping framework. They mean that most ratepayers will experience changes in their rates that are different to the rate cap.

Forty per cent of ratepayers each year had a decrease in their capped rates

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, in each of the four revaluation years[6] since the introduction of rate capping:

- 40 per cent of ratepayers had a decrease in their rates
- 16 per cent of ratepayers had an increase in their rates that was lower than the rate cap

[6] The four revaluation years were 2016–17, 2018–19, 2019–20 and 2020–21. 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 of ratepayers had an increase in their capped rates that was lower than the rate cap; and 13 per cent of ratepayers had an increase in their capped rates that was higher than the rate cap.

- 44 per cent of ratepayers had an increase in their rates that was higher than the rate cap.

In 2020–21, the share of ratepayers with increases in their rates above the rate cap fell to 39 per cent. This fall reflects some councils choosing to increase their capped rates by less than the applicable cap because of the coronavirus pandemic.

Revenue (Refer to Chapter 2)

Growth in the sector's total revenue increased in the first three years of rate capping.

Rates and charges are only one source of council revenue. In the first three years of rate capping, revenue from rates and charges represented between 24 per cent and 73 per cent of individual councils' total revenue. Other sources include Victorian and Australian Government grants, developer contributions, user fees and statutory fees and fines.

In the first three years of rate capping, the sector's total revenue grew by 4.2 per cent per year on average. This was higher than the 3.2 per cent growth rate in the three years before the introduction of rate capping.[7] In 2019–20, the sector's total revenue contracted, largely due to the impacts of the coronavirus pandemic. As most of the changes in revenue in 2019–20 were unrelated to rate capping, our observations in this report about the sector's revenue focus on the first three years of rate capping. The initial impact of the coronavirus pandemic on the sector's revenue are discussed separately.

For four of the five council groups — the interface (urban fringe), regional city, large shire and small shire groups — total revenue grew faster in the first three years of rate capping. For the metropolitan group of councils, total revenue grew at a slower rate.[8]

Part of this growth in total revenue is due to the growing population. For example, some of each council's grant funding is linked to the population of the council. Similarly, councils' total revenue from rates and charges will grow as the number of rateable properties grows. We account for the effect of population growth on revenue by looking at 'revenue per person'.

For the sector as a whole, stronger growth in revenue from contributions and grants offset the slowed growth in revenue from rates and charges.

[7] 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.

[8] See Appendix C for a list of the councils in each group.

Rates and charges were the main source of revenue for the sector and each of the council groups. In the three years before the introduction of rate capping, rates and charges was the sector's main source of revenue growth. Growth in revenue per person from rates and charges for the sector as a whole was 2.6 per cent and rates and charges accounted for 55 per cent of the sector's total revenue. While growth in revenue per person from contributions was higher at a sector level and for the metropolitan group, this was a smaller revenue source and contributed less to total revenue growth (in dollar terms). For the interface group, contributions was the main source of revenue growth (in dollar terms) despite being a smaller source of revenue. This was due to the relatively high percentage growth in contributions for this group.

In the first three years of rate capping, for the sector as a whole, growth in revenue per person from rates and charges slowed.[9] But growth in the sector's total revenue per person increased. This was because revenue from grants and contributions offset the lower growth in revenue from rates and charges.

Figure 2 shows, for each council group, the importance of each source of revenue to growth in total revenue. The importance of the revenue source is a combination of the growth rate [the position of the bubbles] and how much it contributes to total revenue [the size of the bubbles]. In the first three years of rate capping:

- Rates and charges continued to be the largest source of revenue for the sector and all council groups [the blue bubbles are the biggest]
- Growth in revenue per person from rates and charges decreased to almost nothing
- Revenue from grants and contributions drove growth in the sector's total revenue [for the sector, the grey and pink bubbles are the highest]. But the importance of each of these two revenue sources to total revenue growth differed between the council groups.
- Growth in revenue per person from contributions varied between the council groups, reflecting the different levels of development activity [the pink bubbles are both above and below the zero per cent line].
- Contributions was an important source of revenue growth for the interface group. For this group, revenue per person from contributions (representing about 31 per cent of the group's total revenue) grew by 10.4 per cent.
- The regional city, large shire and small shire groups had the highest growth in revenue per person from contributions (between 13.0 per cent and 21.9 per cent). But this was a less important source of revenue growth for these groups, as it represented a smaller share of their total revenue [the pink bubbles for these groups are relatively small].

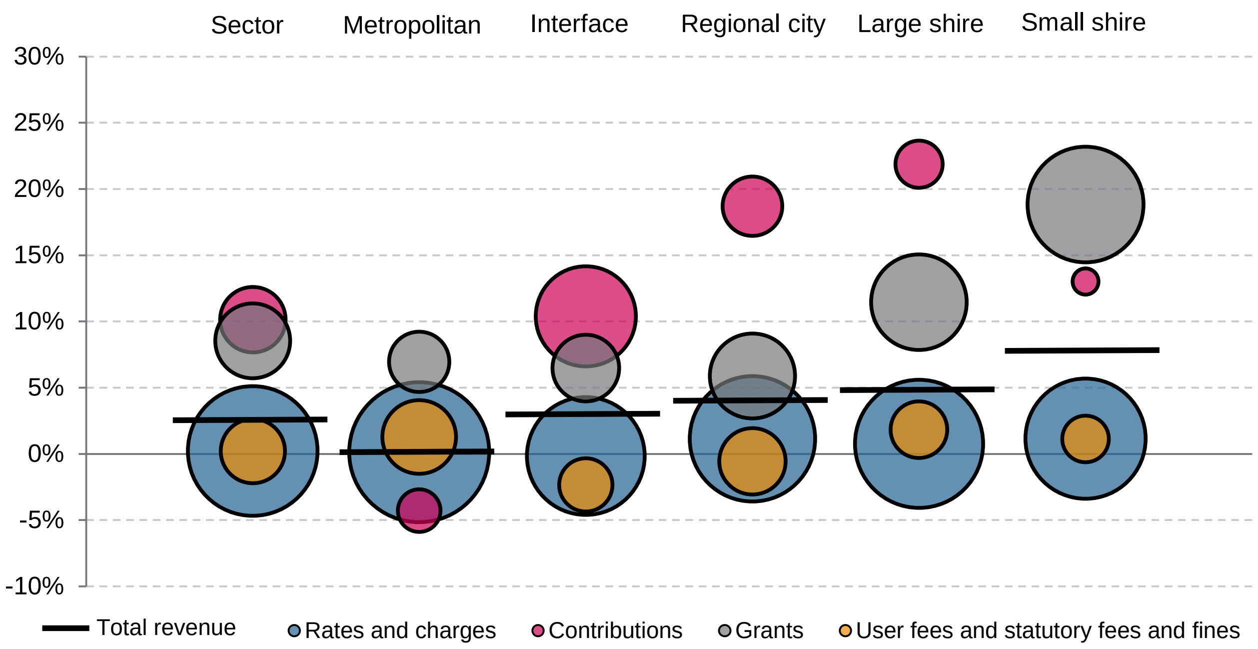
[9] This is growth in capped rates and service charges combined.

- Revenue per person from grants increased for all council groups, having decreased before the introduction of rate capping. But note the growth rates shown in Figure 2 are likely to overstate the rate of growth because they are not adjusted for the timing of financial assistance grant payments.[10] The increase in revenue from grants partly reflects the re-indexation (from 2017–18) of financial assistance grants from the Australian Government and a higher level of grants in 2018–19.
- Grants were a major source of revenue for the small and large shire groups (around 40 per cent and 28 per cent respectively). Therefore, the increase in revenue from grants had the biggest impact on these council groups.
- Revenue per person from user fees and statutory fees and fines remained relatively stable at a sector level [for the sector the orange bubble is near the zero per cent line]. The low growth in the metropolitan, large shire and small shire groups was offset by decreases in the interface and regional city groups.
- The metropolitan group of councils had the lowest growth in revenue per person. This group received the highest percentage of its revenue from rates and charges, and unlike the other council groups, it did not experience growth in revenue from contributions.[11]

[10] In the base year 2015–16, grant revenue was lower as some of the allocation for that year had been paid in advance in 2014–15. See Box 2.1 in Chapter 2 for more information.

[11] Growth in total revenue per person may be overstated in the other council groups due to the timing of grant payments and the higher level of grants these groups receive compared to the metropolitan group.

Figure 2 Average annual growth in revenue per person in the first three years of rate capping



Note: These growth rates are based on numbers that have been adjusted for inflation but have not been adjusted for the timing of financial assistance grant payments from the Australian Government. These growth rates are calculated from 2015–16 to 2018–19.

Data sources: Council annual reports (audited); Australian Bureau of Statistics (2020) 'ERP by LGA (ASGS 2019), 2001 to 2019', Estimated Resident Population, accessed 20 January 2021; Australian Bureau of Statistics (September 2020) 'TABLES 1 and 2. CPI: All Groups, Index Numbers and Percentage Changes' [time series spreadsheet], Consumer Price Index, Australia, accessed 20 January 2021.

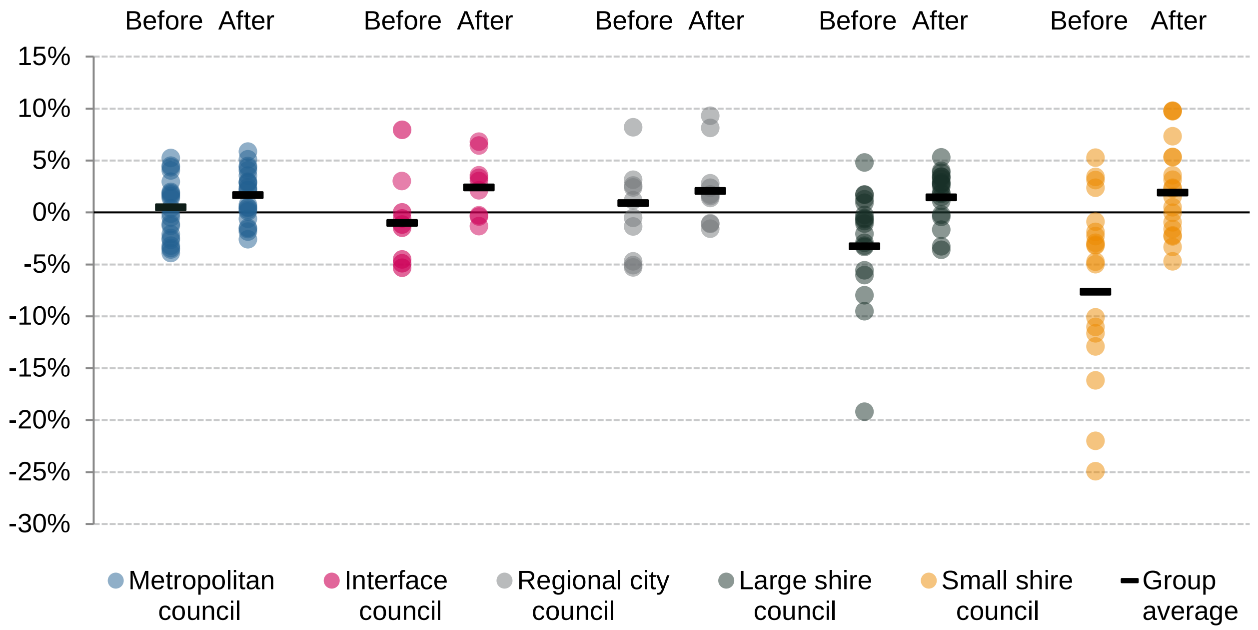
Expenditure (Refer to Chapters 3, 4 and 5)

The sector's total expenditure per person increased at a faster rate.

When population growth is taken into account (that is, we look at expenditure per person), the sector's expenditure had been reducing in the three years before the introduction of rate capping. In the first four years of rate capping, the sector's expenditure increased and kept pace with the growing population.[12]

[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, before and after the introduction of rate capping



Note: These growth rates are based on numbers that have been adjusted for inflation. They are calculated from 2012–13 to 2015–16 (before the introduction of rate capping) and from 2015–16 to 2019–20 (after the introduction of rate capping).

Data sources: Council annual reports (audited); Australian Bureau of Statistics (2020) 'ERP by LGA (ASGS 2019), 2001 to 2019', Estimated Resident Population, accessed 20 January 2021; Australian Bureau of Statistics (September 2020) 'TABLES 1 and 2. CPI: All Groups, Index Numbers and Percentage Changes' [time series spreadsheet], Consumer Price Index, Australia, accessed 20 January 2021.

The sector's expenditure per person grew in the first four years of rate capping with similar growth rates across all council groups. The stronger growth in expenditure was most notable for the small and large shire groups. Some councils within these groups had cut expenditure by more than 15 per cent per year on average over the three years before the introduction of rate capping.

The sector's expenditure growth was driven by growth in capital expenditure.

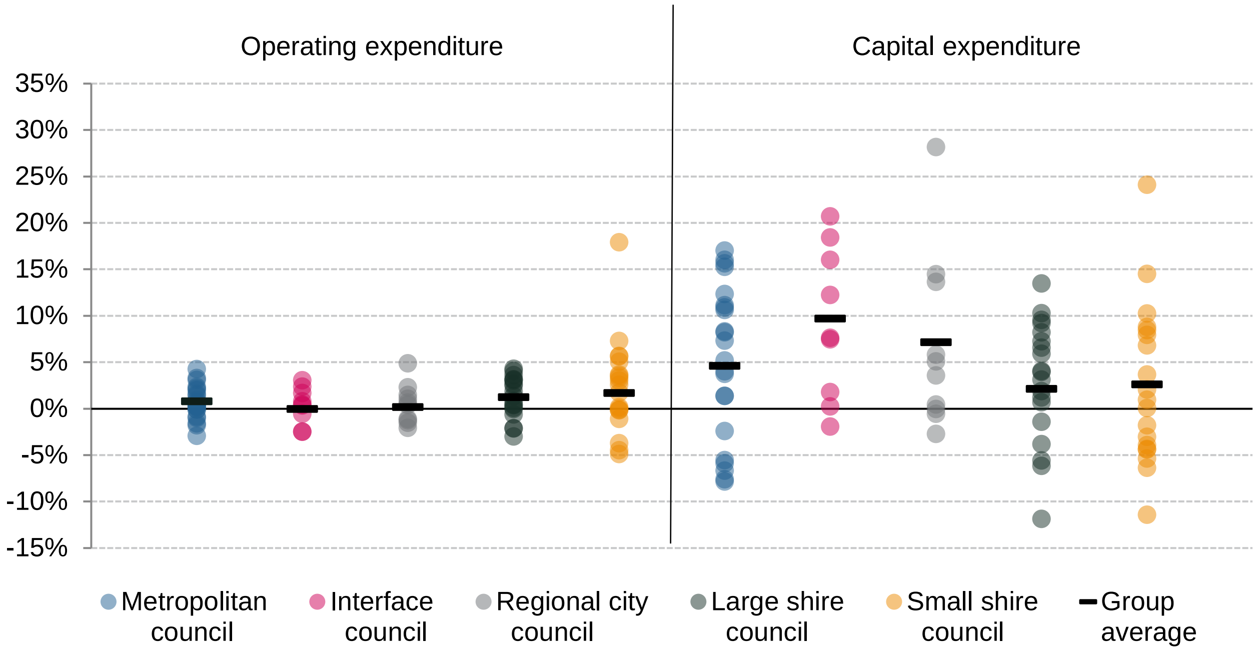
Council expenditure is categorised as either operating expenditure or capital expenditure:

- 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 first four years of rate capping).

For all council groups, particularly the interface and regional city groups, growth in capital expenditure was higher than growth in operating expenditure in the first four years of rate capping. However, this was not the case for all councils and 23 councils experienced a decrease in capital expenditure per person [growth below 0 per cent]. 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 in the first four years of rate capping



Note: These growth rates are based on numbers that have been adjusted for inflation. They are calculated from 2015–16 to 2019–20.

Data sources: Council annual reports (audited); Australian Bureau of Statistics (2020) 'ERP by LGA (ASGS 2019), 2001 to 2019', Estimated Resident Population, accessed 20 January 2021; Australian Bureau of Statistics (September 2020) 'TABLES 1 and 2. CPI: All Groups, Index Numbers and Percentage Changes' [time series spreadsheet], Consumer Price Index, Australia, accessed 20 January 2021.

Councils with large capital works programs can smooth their expenditure over time. This is generally reflected in relatively stable growth in capital expenditure. Smaller councils, particularly those in the small and large shire groups, are more likely to have large year-on-year fluctuations in their capital expenditure.

For the sector as a whole, most of the growth in capital expenditure per person occurred in 2018–19 (16.4 per cent growth) with further growth in 2019–20 (3.1 per cent growth). This corresponds with an increase in grant funding in these years.

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 first four 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 8.7 per cent and 11.1 per cent per year on average. Some growth also occurred in relation to asset renewal projects (2.3 per cent).

This increased spending, particularly on asset upgrades, improved the sector's asset renewal ratio. 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).

On average, in the first four 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 48 of the 79 individual councils.

The sector's expenditure increased across most service areas.

For the sector as a whole, total service expenditure per person increased on average over the first four years of rate capping.[13] The only service functions where expenditure decreased were 'aged and disabled services' and 'family and community services'.[14,15]

There are some measures of service quality that are consistently reported by all councils. Changes in the average result for the sector as a whole or for a council group can provide a broad indication of changes in service quality at the sector or council group level. In the first four years of rate capping, there was some improvement in service quality and satisfaction measures on average across the sector.

Ratepayers and community members are best placed to assess any changes in either the quality of services or their alignment with the needs and preferences of the community.

[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] Service expenditure also decreased in a third category 'other'. This category is essentially a 'catch all' for expenditure not classified by councils under one of the other nine categories. This category makes up a small proportion of total service expenditure and can vary significantly from year to year.

[15] The decrease in spending on aged and disabled services reflects that most councils have either exited 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).

Financial position (Refer to Chapter 6)

The sector as a whole had a positive operating position in each of the first four years of rate capping.

The adjusted underlying result[16] for the sector as a whole was positive in each of the first four years of rate capping. On average, over the four-year period, the sector had an adjusted underlying result of 6.6 per cent.[17] This suggests there was enough revenue within the sector to fund the services provided.

Each of the council groups also had a positive adjusted underlying result on average, over the first four years of rate capping. These group averages are shown by the short black lines in Figure 5. The metropolitan and interface groups had higher adjusted underlying results on average over the four years, than the regional city, large shire and small shire groups.

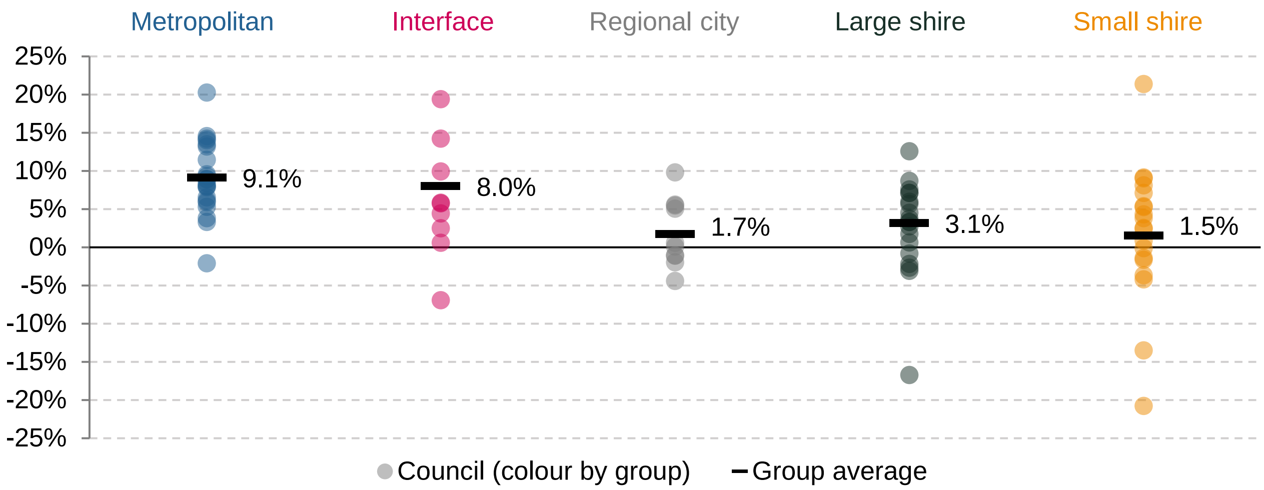
Figure 5 also shows the variation between councils within each group. Over the first four years of rate capping, there were 18 councils that had, on average, negative adjusted underlying results. These councils, mostly in the regional city, large shire and small shire groups, are shown as the dots below the zero per cent line in Figure 5.

The 18 councils with adjusted underlying results that were negative on average over the four years, may need to either increase their revenue (from grants, rates or other sources) or reduce their expenditure (for example, by improving their efficiency). If they do not, they may not be able to keep providing their current range and level of services.

[16] The adjusted underlying result shows the operating position of a council, expressed as a percentage of adjusted underlying revenue. A council's operating position is its surplus or deficit after non-recurrent revenues (such as one-off capital grants and non-monetary contributions from developers) have been removed.

[17] Sector or group averages have been calculated based on the aggregate amounts of expenditure and adjusted underlying revenue for the sector or group, not the average of the adjusted underlying results for councils within the sector or group. In calculating the adjusted underlying result for the sector, we have not adjusted revenue for the timing of financial assistance grant payments from the Australian Government. See Chapter 6 for more information.

Figure 5 Average adjusted underlying results in the first four years of rate capping



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 2016–17 to 2019–20.

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

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

On average, over the first four years of rate capping, the working capital ratio[18] for the sector as a whole was 284 per cent. This means there was sufficient cash and other liquid assets[19] within the sector to repay all short-term debts (those payable within a year). Fluctuations in working capital are common as many councils save, then spend, for large capital projects. Despite this fluctuation, over the four-year period, all councils had average working capital ratios that the Victorian Auditor–General's Office classifies as low risk.

The indebtedness ratio[20] for the sector as a whole was 18.7 per cent on average, in the first four years of rate capping. This means the sector had the ability to meet long-term liabilities (mainly

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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 like rates and charges and user fees).

repayment of debt). On average over the four-year period, all but eight councils had a level of indebtedness that the Victorian Auditor–General's Office classifies as low risk.

The total value of debt across the sector decreased by $258 million between 2016–17 and 2019–20.

There was some deterioration in the sector's financial indicators in 2019–20. This partly reflects the impacts of coronavirus on the sector's revenue.

In 2019–20, for the sector as a whole, and for each of the council groups, there was some deterioration in the adjusted underlying result, working capital ratio and indebtedness ratio.[21] This generally reflected lower growth in revenue (largely due to the impacts of coronavirus) relative to growth in expenditure and debt levels. Changes in accounting standards also affected these results.

In 2019–20, 37 councils had a negative adjusted underlying result. This was more than double the number with a negative result on average over the four-year period. However, all councils maintained a working capital ratio in 2019–20 that the Victorian Auditor–General's Office classifies as low risk.

The early impacts of the coronavirus pandemic

In general, the sector was in a healthy financial position before the pandemic. This meant that most councils were able to absorb the initial impacts of a decrease in revenue.

In the first three years of rate capping, the sector was able to increase its expenditure and generally improve its financial position, despite lower rate increases. This was largely due to an increase in the sector's revenue from grants and contributions.

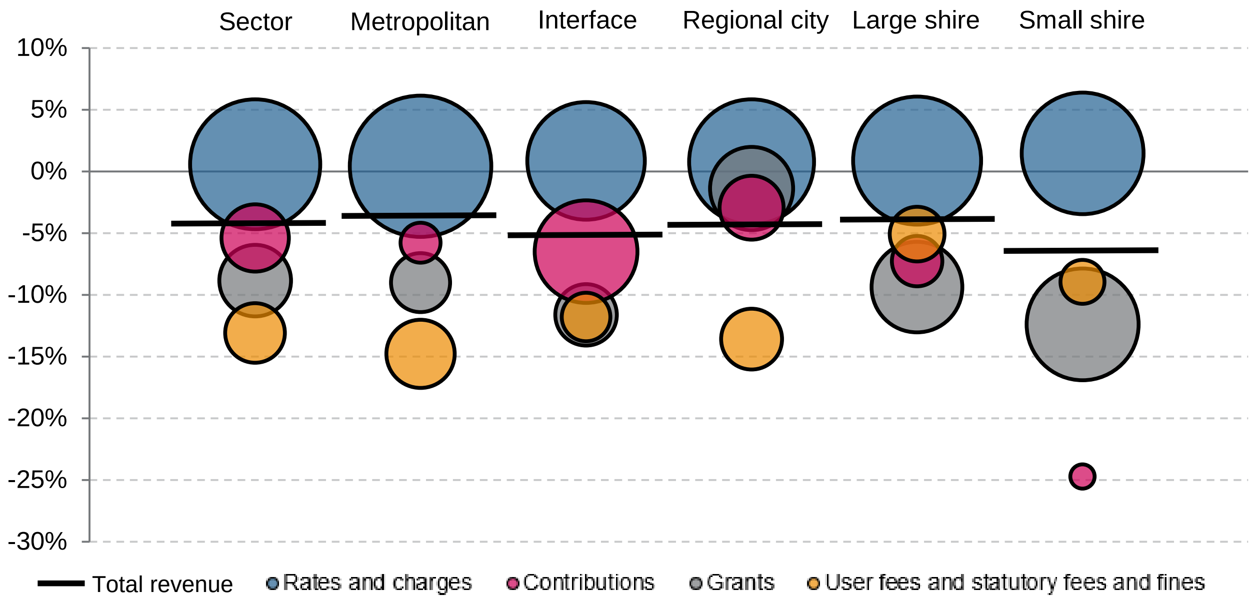
However, in 2019–20, the sector's reported revenue reduced without a corresponding reduction in expenditure.[22] This caused some deterioration in the sector's financial indicators.

The extent of the impact on revenue growth for the sector and each of the council groups can be seen in Figure 6.

[21] The one exception to this was the working capital ratio of the small shire group, which increased slightly.

[22] While expenditure reduced in some areas, many councils also increased expenditure in some areas to support their communities. The net effect was continued growth in expenditure.

Figure 6 Growth in revenue per person from 2018–19 to 2019–20, by source



Note: These growth rates are based on numbers that have been adjusted for inflation but have not been adjusted for the timing of financial assistance grant payments from the Australian Government.

Data sources: Council annual reports (audited); Australian Bureau of Statistics (2020) 'ERP by LGA (ASGS 2019), 2001 to 2019', Estimated Resident Population, accessed 20 January 2021; Australian Bureau of Statistics (September 2020) 'TABLES 1 and 2. CPI: All Groups, Index Numbers and Percentage Changes' [time series spreadsheet], Consumer Price Index, Australia, accessed 20 January 2021.

Figure 6 shows, compared to the average in the first three years of rate capping shown in Figure 2:

- Growth in revenue from rates and charges remained relatively stable. This is not surprising as rates notices had already been issued (and largely paid) when the pandemic started. Although councils may have foregone some revenue from rates and charges due to payment deferrals and interest waivers, this was not significant enough to decrease the sector's revenue from rates and charges. The stability in revenue from rates and charges cushioned some of the impact of decreases in revenue from each of the other sources. This was evident by the metropolitan group having both the highest growth in total revenue per person and the highest proportion of its revenue from rates and charges.
- Revenue from contributions decreased. This is most likely related to the impact of lockdown measures on development activity.
- Revenue from grants decreased for the sector as a whole and all council groups. However, this largely reflects the high level of revenue from grants received in 2018–19. The sector's revenue from grants in 2019–20 was broadly consistent with the amount received in 2016–17 and 2017–18.

- Revenue from user fees and statutory fees and fines was impacted the most by the coronavirus related lockdowns. The metropolitan, interface and regional city groups experienced decreases of between 12 and 15 per cent in revenue from user fees and statutory fees and fines.

Further revenue impacts of the coronavirus pandemic will be seen in 2020–21 and beyond

Looking forward, revenue from rates and charges in 2020–21 is likely to fall (in inflation-adjusted terms) at a sector level with some councils freezing rates and others offering rebates. Freezing rates, or increasing them by an amount less than the rate cap, will have a long-term impact for the councils that have chosen this option. This is because rate increases become part of the rates base on which future rate increases are calculated.

There were longer lockdowns in the 2020–21 financial year than in 2019–20 (particularly in the metropolitan and interface groups). Ongoing social distancing restrictions will reduce revenue from leisure centres and other recreation and cultural services. The result of these lockdowns and other restrictions is likely to be further decreases in revenue from user fees and statutory fees and fines.

In the medium term, revenue from contributions will be impacted by lower development activity due to slower projected population growth (driven by immigration).

> Councils may face some difficult decisions to maintain their long-term sustainability if revenue growth, particularly from contributions and user fees and statutory fees and fines, does not bounce back.

Rate capping, by its nature, means councils have less control over some of their revenue. In the first four years of rate capping, rates and charges was the largest source of revenue for all but 10 councils (mostly small shires). It was also the most stable and predictable source, particularly in 2019–20 when revenue from other sources reduced.[23]

In the past, councils were able to raise rates to:

- smooth fluctuations in other revenue sources
- increase their expenditure on infrastructure or services, or
- improve their financial position.

To do the same in a rate capped environment, councils need to get approval for a higher cap (if the increase is above the rate cap). This involves, among other things, consulting with their communities and demonstrating a long-term funding need.

[23] It is not yet clear what impact coronavirus will have on the stability of revenue from rates and charges in future years.

In the absence of a higher cap, councils will be more reliant on increases in revenue from other sources (particularly grants and contributions) to fund increases in their spending or to improve their financial position.

In the first three years of rate capping, the sector's revenue from contributions and grants grew. This enabled an increase in expenditure on infrastructure and services. The financial health of the sector as a whole also improved.

In 2019–20, the stability of revenue from rates and charges, combined with the sector's healthy financial position, meant the sector was able to absorb the initial revenue impacts of the coronavirus pandemic.

Going forward, councils are likely to face uncertainty about their revenue growth, particularly revenue from contributions. If revenue growth does not bounce back, councils may need to make some difficult decisions to maintain their long-term sustainability. Engaging with their communities will be integral to how the sector recovers from the impact of the coronavirus pandemic.

In our next report on the outcomes of rate capping, due in 2023, we will examine revenue growth in 2020–21 and 2021–22 and how the sector has responded.

Key terms used in this report

Term	Meaning
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.
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.
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 2019–20 dollars.
Minister's cap	This is 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.

Term	Meaning
Rate cap (alternatively 'applicable cap')	This is the maximum amount (percentage) that a council can increase its average rates in a rating year. It is a percentage amount. A council's rate cap may be set either by the minister (the minister's cap) or by the Essential Services Commission through an approval process (a 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).
The 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.

[a] General rates are charged under section 158 of the Local Government Act 1989. Municipal charges are charged under section 159 of the Local Government Act 1989. [b] To adjust the numbers for inflation, we used Australian Bureau of Statistics (September 2020) 'TABLES 1 and 2. CPI: All Groups, Index Numbers and Percentage Changes' [time series spreadsheet], Consumer Price Index, Australia, accessed 20 January 2021.

1. Rates and charges

This chapter looks at what happened to councils' rates and charges in the first four years of rate capping (2016–17 to 2019–20).[24] It examines changes in the rates and charges revenue received by the sector and how the rates paid by individual ratepayers have varied.

Key observations

- **Ratepayer benefits:** Ratepayers have paid lower rates than they would have done in the absence of rate capping.
- **Annual changes:** Rate caps apply to the 'average' rate. Factors outside the rate capping system continue to determine the annual change in rates for each individual ratepayer.
- **Service charges:** The sector's revenue from service charges (which are not capped) increased in response to changes in the waste market.

This chapter focuses on the sector as a whole – 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).[25] The analysis is based on numbers that have been adjusted for inflation.

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

1.1. Ratepayers have benefited from rate capping

The rate cap restricts councils' rate revenue

Rate capping was introduced in 2016–17 to restrict the amount by which councils can increase their general rates and municipal charges (their 'capped rates').[26] Rate capping works by limiting the percentage increase in capped rates paid by the average ratepayer.[27]

Each year, the Minister for Local Government sets the minister's cap (the rate cap that applies to all councils by default). Councils can then choose to apply to the Essential Services Commission

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[24] Where we have calculated growth rates for the first four years of rate capping, we have taken 2015–16 as the base year. In this chapter, we have also examined 2020–21 where data was available.

[25] 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.

[26] Section 1.3 of this Chapter examines charges that are not included in the rate cap.

[27] Appendix A outlines the legislative framework and how the rate cap works.

for a rate cap above the minister's cap (called a higher cap). The commission assesses and approves or rejects these applications based on legislative criteria and objectives.

Low rate caps and a high rate of compliance have benefited ratepayers

> Low rate caps and a high rate of compliance means that ratepayers are paying lower rates than they would have been in the absence of rate capping

In each of the first four years of rate capping, the minister set the minister's cap equal to the forecast level of inflation. These caps ranged from 2.00 per cent to 2.50 per cent.[28] In the three years before the introduction of rate capping, rates were increasing by around 6 per cent per year (in nominal terms).[29] This means that, in the first four years of rate capping, rate increases for the average ratepayer were around 4 per cent lower than historical increases.

While nearly all councils have kept rate increases below the minister's cap, 11 councils have had approved higher caps. Four of these councils had higher caps approved for multiple years (See Table 1.1). These councils consulted their communities and were able to show a long-term need for additional rate revenue.[30]

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 (out of 79)
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

[28] The minister's cap was 2.00 per cent in 2020–21, and it has been set at 1.50 per cent for the forthcoming 2021–22 rating year.

[29] 'In nominal terms' means that it has not been adjusted for inflation.

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

Overall, the sector demonstrated a high rate of compliance with the rate caps. All councils were compliant in 2016–17 and 2019–20, three were non-compliant in 2017–18 and 2020–21, and four were non-compliant in 2018–19. In most cases, non-compliant councils exceeded the rate cap by a small amount. Over the 5 years the commission has checked compliance, we have only considered two instances of non-compliance to be material.[31]

Importantly, as of 2019–20, all non-compliant councils have either refunded the amount of rates in excess of the cap or set lower rate increases in future years.[32] This means that ratepayers in non-compliant councils will not be disadvantaged over the long-term by their council's non-compliance.

Rate capping has lowered rate increases and resulted in ratepayers paying less than they would have if councils continued setting rate increases at historical levels (See Box 1.1).

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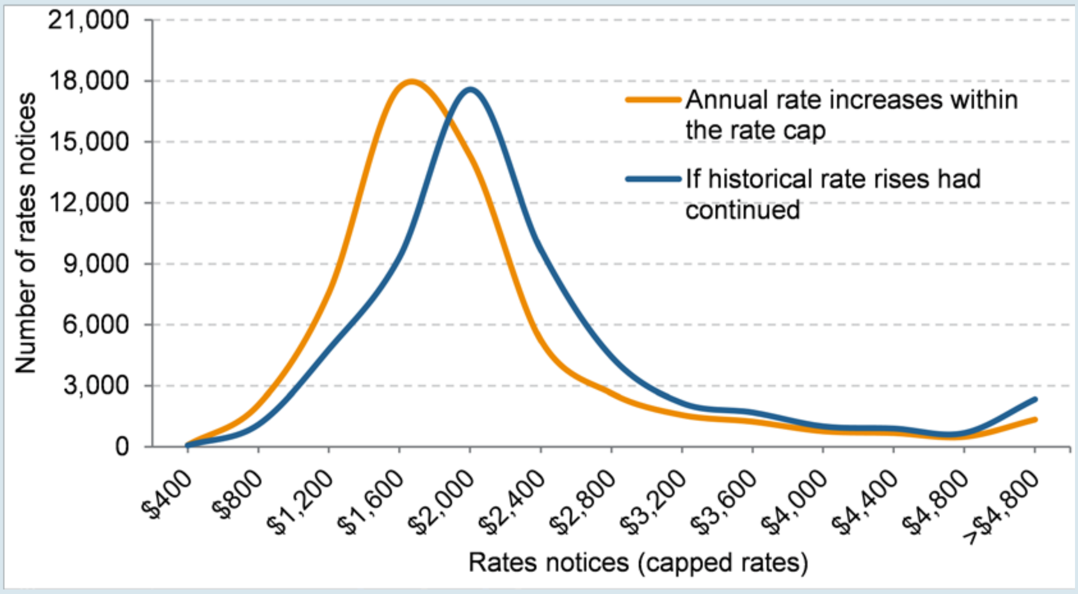
[31] https://www.esc.vic.gov.au/local-government/council-compliance-rate-caps/council-compliance-reports

[32] The full response that the three 2020–21 non-compliant councils take will not be known until the next financial year. This will be reported on in the 2021 Compliance Report.

Box 1.1 Illustrating the benefits to ratepayers of rate capping (case study)

Distribution of rate increases in 2020–21, example council



Note: Historical rate rises are calculated as 3 per cent higher than the rate cap each year from 2016–17 to 2020–21.

The chart uses an example of a metropolitan council to show how rate capping affected the amount of rates paid by the ratepayers in that council.

The **orange line** shows the distribution of rates notices in 2020–21.

The **blue line** shows what ratepayers would have paid in 2020–21 if rates had increased 3 per cent higher than the rate cap per year between 2016–17 and 2020–21. Higher rate increases would have shifted the curve to the right, and all ratepayers (regardless of where they sit on the curve) would be paying higher rates.

Importantly, the shape of the curve, and where each ratepayer sits on the curve is determined by other elements of the rating system (such as valuations and differentials). This is explained in the section 1.2 of this chapter.

Growth in revenue per property from capped rates slowed

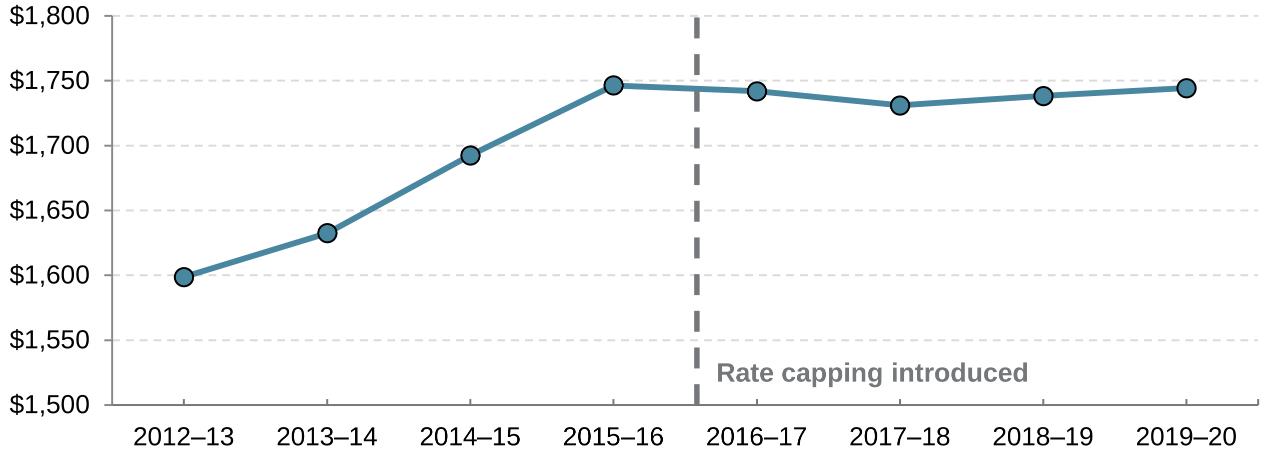
The growth in revenue per property from capped rates slowed.

In the first four years of rate capping, the average annual increase in revenue per property from capped rates was lower for the sector as a whole. This was true for all councils, except for one of the councils that had an approved higher cap.[33]

Revenue per property from capped rates for the sector as a whole increased by an average of 3 per cent per year between 2012–13 and 2015–16. This was the equivalent of $49 per year (in inflation-adjusted terms).[34] In the first four years of rate capping, the average annual increase dropped to zero per cent (in inflation-adjusted terms) (See Figure 1.1).

Figure 1.1 Revenue per property from capped rates

For the sector as a whole (inflation-adjusted, 2019–20 dollars)



Data sources: Council annual reports (audited); Victorian Local Government Grants Commission – VGC 2 data 2012–13 to 2019–20 (unaudited data); Australian Bureau of Statistics (September 2020) 'TABLES 1 and 2. CPI: All Groups, Index Numbers and Percentage Changes' [time series spreadsheet], Consumer Price Index, Australia, accessed 20 January 2021.

While the increase in revenue per property from capped rates slowed for all council groups, the degree to which it slowed varied (as shown in Figure 1.2)

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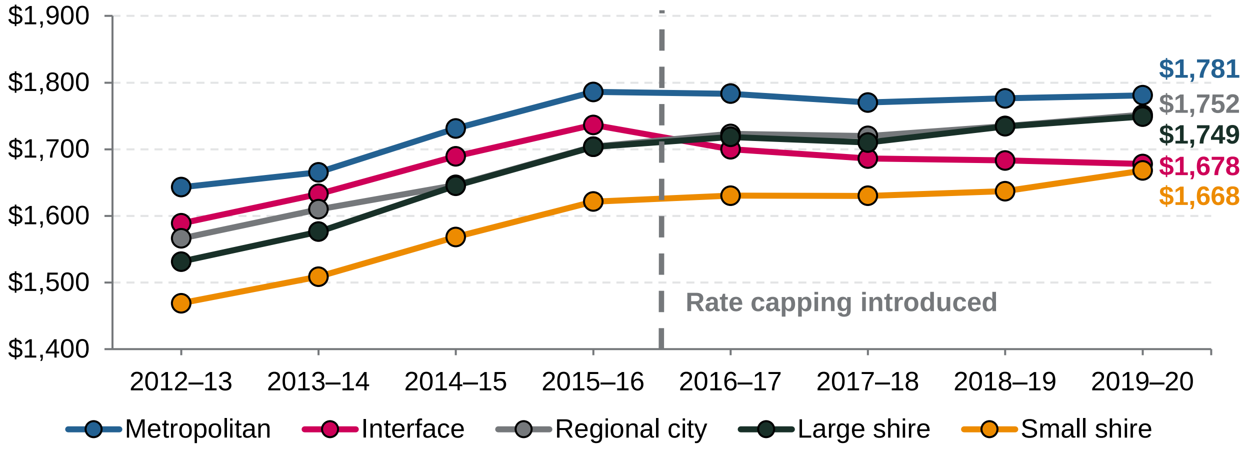
33 Mansfield Shire Council had an approved higher cap of 13.94 per cent in 2019–20 to allow the council to shift revenue from service charges (which are not capped) to capped rates. The overall revenue increase was neutral to council. However, this resulted in council's average annual increase in capped rates per property being higher in the first four years of rate capping than it was in the three years before the introduction of rate capping.

34 'In inflation-adjusted terms' means to adjust the underlying dollars by inflation. This accounts for changes in the value of the dollar (in terms of what households can purchase over time), allowing for a more accurate comparison across each year.

Figure 1.2 Revenue per property from capped rates, by council group

Inflation-adjusted, 2019–20 dollars



Data sources: Council annual reports (audited); Victorian Local Government Grants Commission – VGC 2 data 2012–13 to 2019–20 (unaudited data); Australian Bureau of Statistics (September 2020) 'TABLES 1 and 2. CPI: All Groups, Index Numbers and Percentage Changes' [time series spreadsheet], Consumer Price Index, Australia, accessed 20 January 2021.

Reasons for the differences between groups (and the councils within them) include:

- Differences in the rate increases councils apply:
  - Higher caps — councils with approved higher caps are able to apply higher average rate increases:
    - Ten councils have set 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.[35]
    - The above-average increase for the small shire group in 2019–20 was partially a result of Mansfield Shire Council's 13.94 per cent higher cap.[36]
  - Lower rate increases — as the rate cap is a maximum, and councils can and do set lower average rate increases.

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

[36] Mansfield Shire Council's 13.94 per cent rate increase was approved to allow the council to shift revenue from service charges (which are not capped) to capped rates. The overall revenue increase was neutral to council.

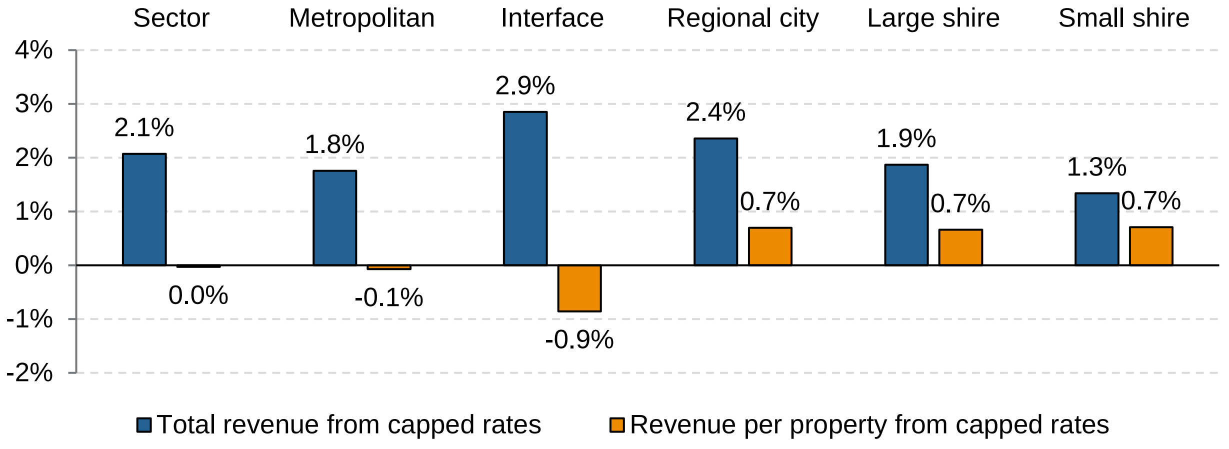
- Movements in revenue between capped rates and service charges
  - Introducing service charges — councils that have introduced service charges have typically reduced capped rates to ensure that the total change in revenue from capped rates and waste charges is neutral to the council.
    - Most councils that have introduced new service charges are in either the metropolitan or interface groups.
    - Mornington Peninsula Shire Council's decision to introduce a service charge and reduce capped rates explains the large decrease in revenue from capped rates for interface councils in 2016–17.
- Differences in the type of property development that is occurring:
  - Property growth — the type of property development can also affect capped rates per property. For example, the development of a large commercial property will increase revenue per property by more than a new residential property, as the large commercial property will pay more in rates due to its higher valuation. This explains the decrease in capped rates per property for some councils, where most of their growth is in residential properties, particularly in the interface group.

Growth in total revenue from capped rates increased

For the sector as a whole, revenue from capped rates increased at an annual average of 2.1 per cent in the first four years of rate capping. This compares to an average annual increase of 4.7 per cent in the three years before the introduction of rate capping.

Revenue from capped rates continued to increase at a faster rate than revenue per property. This is largely due to steady growth in the number of rateable properties. Figure 1.3 compares the growth in revenue per property with the growth in total revenue from capped rates. This illustrates how an increase in the number of properties can cause growth in revenue per property to be lower than growth in total revenue. For example, in the first four years of rate capping, the interface group's total revenue from capped rates grew faster than any other group, but on a per property basis it decreased.

Figure 1 .3 Average annual growth in revenue from capped rates (totals and per property) in the first four years of rate capping



Note: These growth rates are based on numbers that have been adjusted for inflation. They are calculated from 2015–16 to 2019–20.

Data sources: Council annual reports (audited); Victorian Local Government Grants Commission – VGC 2 data 2012–13 to 2019–20 (unaudited data); Australian Bureau of Statistics (September 2020) 'TABLES 1 and 2. CPI: All Groups, Index Numbers and Percentage Changes' [time series spreadsheet], Consumer Price Index, Australia, accessed 20 January 2021.

Interested readers may wish to view the council fact sheets for the results of individual councils or analyse the data provided on our website https://www.esc.vic.gov.au/local-government/rate-capping-outcomes-reports

1.2. The rating system means that rate increases for individual ratepayers vary

Rate caps apply to the 'average' rate. Factors outside the rate capping system continue to determine the annual change in rates for each individual ratepayer.

Individual ratepayers experience different increases (both above and below the rate cap) in their capped rates for several reasons:[37]

- Changes in property valuations — property values determine the proportion of general rate revenue paid by each ratepayer. As properties change in value relative to other properties, rate increases for individuals will vary.

[37] Rates notices also include charges that are not capped. Changes in these charges may also result in increases in ratepayers' total rates bills that are higher than the rate cap. These charges are discussed separately in Section 1.3.

- Changes in differential rates[38] — councils decide what proportion of rate revenue they collect from different classifications of property. They do this by using differential rates and/or a municipal charge. Rate increases will vary for individual ratepayers if a council changes its differential rates, introduces or removes a municipal charge, or changes the classification of a property.[39]

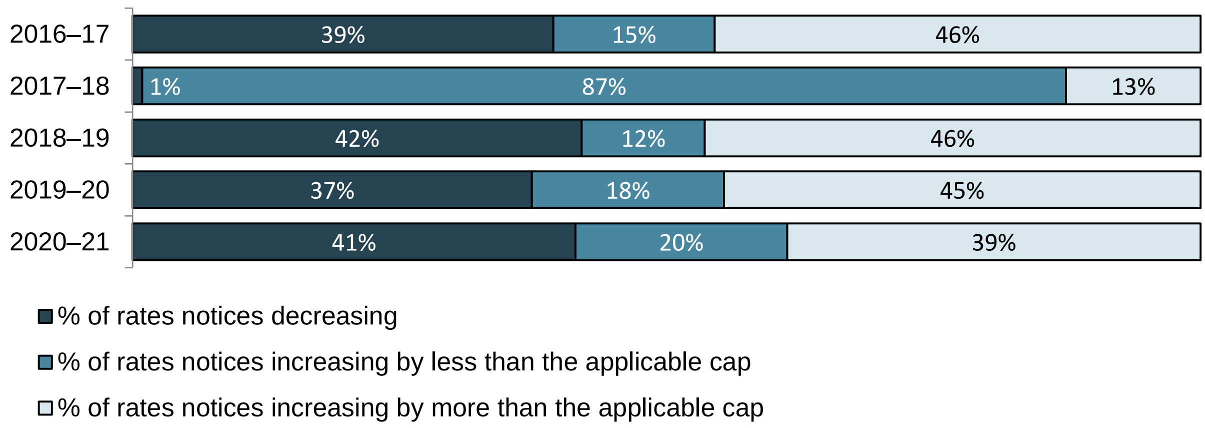
More than half of all ratepayers experienced rate increases below the rate cap

In each year, more than half of all ratepayers experienced rate increases that were below the rate cap.

Changes in property values is the most common reason for variation in individual rate increases. 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. Ratepayers whose property value increases by more than others will see their rates increase by more than the rate cap. Ratepayers whose property value increases by less than others will see their rates increase by less than the rate cap (or even decrease).

To help illustrate how individual rate increases vary, we asked all councils to provide data about the distribution of increases in capped rates for individual ratepayers. We received data from 73 councils. The individual council data can be viewed in the council fact sheets.

Figure 1.4 Distribution of rate increases for individual ratepayers



Data source: data has been provided to the commission by councils and has not been audited.

[38] 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'. Differential rates are when a council sets different rates in the dollar for different types of property, such as a farm or a residential property. Some councils have only one rate in the dollar, but others have many.

[39] A municipal charge is a flat charge applied to all ratepayers within a council area. Not all councils apply a municipal charge. Municipal charges are charged under section 159 of the Local Government Act 1989.

Based on the data provided by councils, more than half of all ratepayers experienced decreases in rates or rate increases that were below the rate cap in each year there was a revaluation (See Figure 1.4). Taking an average of the four years in which revaluations occurred (2016–17, 2018–19, 2019–20 and 2020–21):

- 40 per cent of ratepayers had a decrease in their rates
- 16 per cent of ratepayers had an increase in their rates that was lower than the rate cap
- 44 per cent of ratepayers had an increase in their rates that was higher than the rate cap

Prior to 2018–19, properties were only revalued every second year so in 2017–18 properties were not revalued. In that year, most ratepayers experienced rate increases around the rate cap. Specifically, 13 per cent experienced a rate increase above the rate cap, 87 per cent experienced a rate increase below the rate cap, and 1 per cent experienced a decrease.

In 2020–21, the number of ratepayers with rate increases above the rate cap fell to 39 per cent. This is likely due to the 16 councils that set their average rate increase to zero in response to the coronavirus pandemic.

Annual changes in rates have differed between property types

> The share of rate revenue collected from different categories of ratepayers (residential, commercial and industrial, and rural) remained stable. However, rate revenue per property for rural properties increased faster than rate revenue from other types of property.

For the sector as a whole, the proportion of revenue from capped rates coming from different types of ratepayers remained relatively stable between 2012–13 and 2019–20:

- The proportion from residential ratepayers increased from 74.1 per cent to 76.3 per cent.
- The proportion from commercial and industrial ratepayers decreased from 19.1 per cent to 17.4 per cent.
- The proportion from rural ratepayers decreased from 6.5 per cent to 5.6 per cent.[40,41]

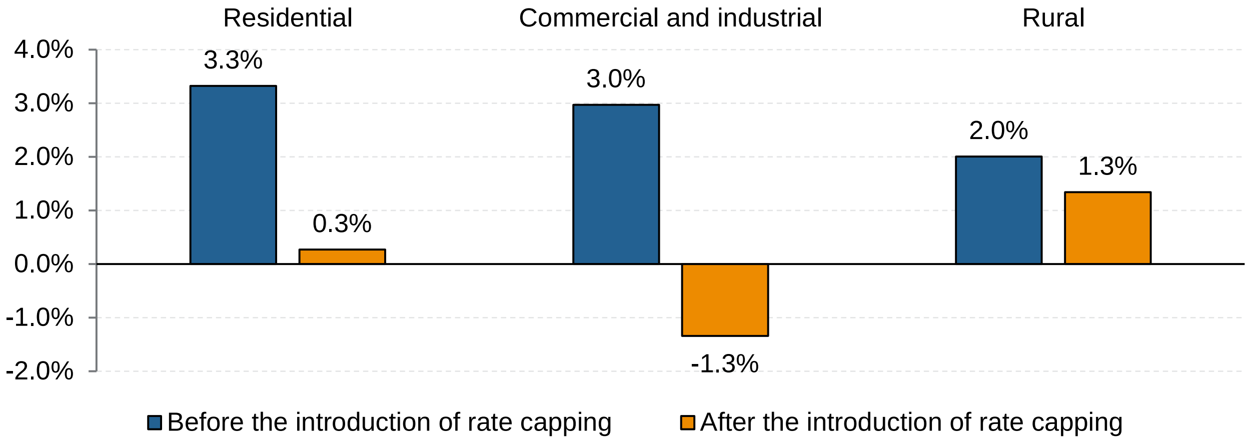
[40] Rural properties refers to properties such as farms, not properties in rural areas. For example, there can be rural properties in metropolitan councils and there are many residential properties in rural areas.

[41] The proportions add up to 99.7 per cent and 99.3 per cent due to 'other' properties that do not fit the classifications. In reporting this data, some councils make a distinction between commercial and industrial while others do not. Due to this inconsistency, the commercial and industrial categories have been aggregated for this report. However, some of the council fact sheets we have published on our website will report commercial and industrial as separate categories, to ensure they accurately reflect how each individual council reports the data.

In terms of revenue per property from capped rates, the growth slowed for all categories in the first four years of rate capping (See Figure 1.5). However, for rural ratepayers (that is, farms) the decrease in growth was less than the decrease for all other types of property. This reflects changes in the number and valuation of properties, including the increase in the average value of farm properties relative to other properties in regional Victoria.

Figure 1.5 Average annual growth in capped rates 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 2012–13 to 2015–16 (before the introduction of rate capping) and from 2015–16 to 2019–20 (after the introduction of rate capping).

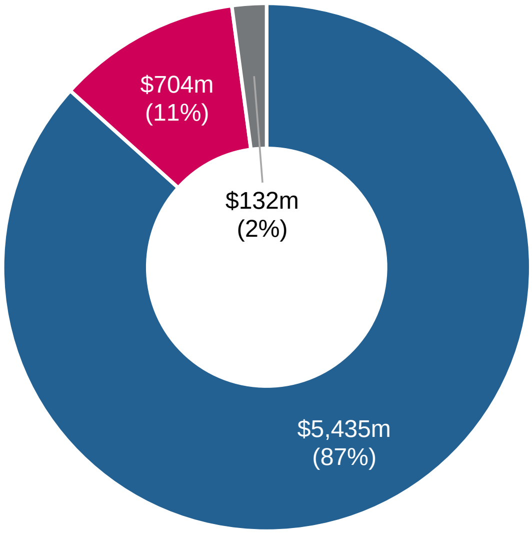
Data source: Council annual reports (audited); Victorian Local Government Grants Commission – VGC 2 data 2012–13 to 2019–20 (unaudited data); Australian Bureau of Statistics (September 2020) 'TABLES 1 and 2. CPI: All Groups, Index Numbers and Percentage Changes' [time series spreadsheet], Consumer Price Index, Australia, accessed 20 January 2021.

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 other charges and levies that are not included in the rate cap. In 2019–20, the proportion of all rates and charges for the sector as a whole was:

- **Capped rates (87%)** — includes general rates and municipal charges
- **Service charges[42] (11%)** — primarily used to recover the costs of waste services
- **Other rates and charges (2%)**, including:
  - 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)

Figure 1.6 Composition of revenue from rates and charges, 2019–20



Data source: Council annual reports (audited)

Service charges make up the largest council component of ratepayers' rates notices that are not capped.[43] As of 2020–21, 71 councils levy service charges to recover the cost of providing kerbside waste collection services. Some councils also use service charges to fund community waste services (such as street cleaning) and drainage services.

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

In response to changes in the waste market, the sector's revenue from service charges increased faster than revenue from capped rates.

In the three years before the introduction of rate capping revenue per property from capped rates increased by $49 per year on average. Over the same period, revenue per property from service

[42] These are charged under section 162 of the Local Government Act 1989.

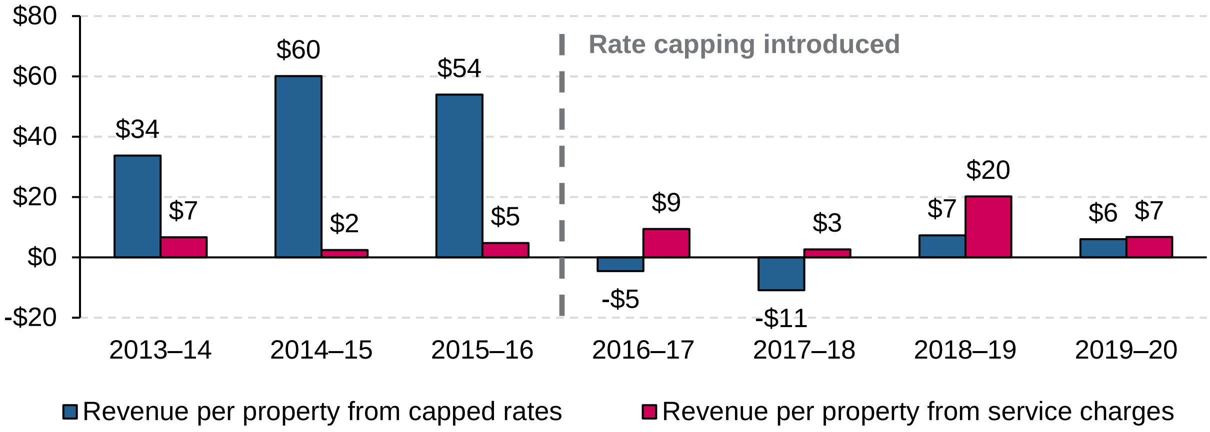
[43] Rates notices also include the Fire Services Property Levy, however this is not a council charge.

charges increased by $5 per year on average. This meant a combined increase of $54 per year on average. (See Figure 1.7)

In the first four years of rate capping, on average, revenue per property from capped rates was stable. Over the same period, revenue per property from service charges increased by $10 per year on average. This means that, although revenue per property from service charges grew faster in the first four years of rate capping, this did not fully offset the effect of the rate caps.

Figure 1.7 Annual change in revenue per property from capped rates and service charges

For the sector as a whole (inflation-adjusted 2019–20 dollars)



Data source: Council annual reports (audited); Victorian Local Government Grants Commission – VGC 2 data 2012–13 to 2019–20 (unaudited data); Australian Bureau of Statistics (September 2020) 'TABLES 1 and 2. CPI: All Groups, Index Numbers and Percentage Changes' [time series spreadsheet], Consumer Price Index, Australia, accessed 20 January 2021.

There are two main reasons why, in the first four years of rate capping, revenue from service charges increased by more than revenue from capped rates:

- Six councils introduced new service charges for kerbside waste collection and one council introduced a new service charge for public litter removal. Nearly all of these councils reduced revenue from capped rates by an equal amount to ensure that the change in total revenue from capped rates and service charges was neutral to the council.[44]
- For many councils, the cost of waste disposal increased in 2018–19 as a result of disruptions in the international recycling market. In response, many councils increased their service charges in 2018–19 to recover these higher costs.

[44] In 2018–19, two councils introduced service charges that were not revenue neutral to the council. See our Council Rate Cap Compliance Report 2018–19 for details.

2. Revenue

This chapter focuses on what happened to councils' revenue in the first three years of rate capping (2016–17 to 2018–19).[45] It examines the different sources of council revenue and how each source contributed to growth in the sector's total revenue. Changes in the sector's revenue in 2019–20, largely due to the impacts of the coronavirus pandemic, are discussed separately at the end of the chapter.

Key observations

- **Total revenue:** Growth in the sector's total revenue increased in the first three years of rate capping.
- **Contributions and grants:** For the sector as a whole, stronger growth in revenue from contributions and grants offset slowed growth in revenue from rates and charges in these years.
- **Effect of pandemic:** Growth in the sector's total revenue slowed in 2019–20, partly reflecting the impact of the coronavirus pandemic. Steady growth in revenue from rates and charges cushioned the decrease in revenue from contributions, grants, and user fees and statutory fees and fines.

This chapter focuses on the sector as a whole – that is, all 79 councils in Victoria combined. It also highlights any difference between groups of similar councils (metropolitan, interface/urban fringe, regional cities, large shires and small shires).[46] The analysis is based on numbers that have been adjusted for inflation.

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

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

[46] 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.

2.1. Growth in total revenue increased

In the first three years of rate capping, growth in the sector's total revenue increased.

For the sector as a whole, total revenue grew faster in the first three years of rate capping (4.2 per cent) than in the three years before its introduction (3.2 per cent).[47] The small shire and interface groups had the highest growth in total revenue.

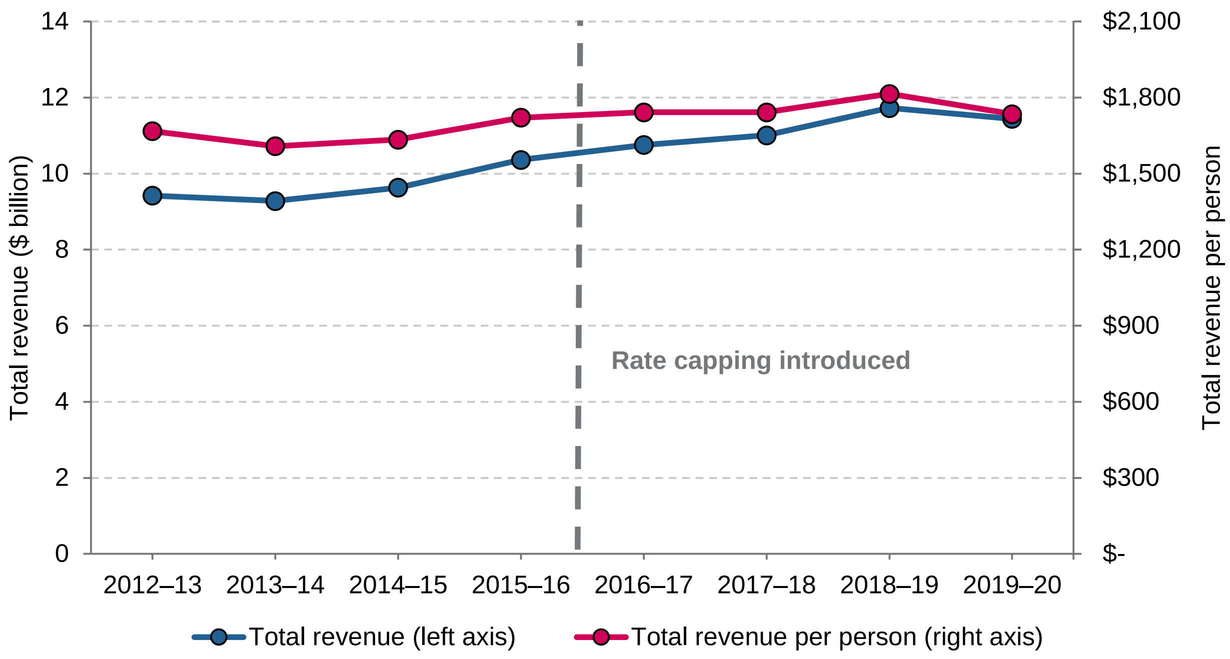
Population growth explains part of the growth in revenue and the differing growth rates between the council groups. We have accounted for the differences in population growth by examining revenue in per person terms.

In per person terms, total revenue also increased at a faster rate in the first three years of rate capping (1.8 per cent) than in the three years before its introduction (1.1 per cent). (See Figure 2.1)

47 In calculating these growth rates for the sector as a whole, we have adjusted the sector's revenue 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

For the sector as a whole (inflation-adjusted, 2019–20 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 (2020) 'ERP by LGA (ASGS 2019), 2001 to 2019', Estimated Resident Population, accessed 20 January 2021; Australian Bureau of Statistics (September 2020) 'TABLES 1 and 2. CPI: All Groups, Index Numbers and Percentage Changes' [time series spreadsheet], Consumer Price Index, Australia, accessed 20 January 2021.

Figure 2.1 shows a drop in total revenue in 2019–20, which was due to the impact of the coronavirus pandemic and changes to accounting standards.

2.2. Sources of council revenue

For the sector as a whole, stronger growth in revenue from contributions and grants offset the slowed growth in revenue from rates and charges.

In addition to rates and charges (discussed in chapter 1) council revenue also consists of:

- contributions — both monetary and non-monetary — from developers or landowners for the provision of new infrastructure for commercial or 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 service (such as council operated childcare services and leisure centres)
- 'other' revenue, such as revenue from the sale of assets or profits from joint ventures.

The sector gets most of its revenue from rates and charges

For the sector as a whole, revenue from rates and charges was the largest source of revenue (See Figure 2.2). In the first three years of rate capping, most of the growth in the sector's revenue came from contributions and grants, as growth in revenue from rates and charges slowed. Revenue per person from contributions and from grants[48] grew at 10.1 per cent and 2.0 per cent respectively. This compares with revenue per person from rates and charges, which grew at 0.2 per cent.

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

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

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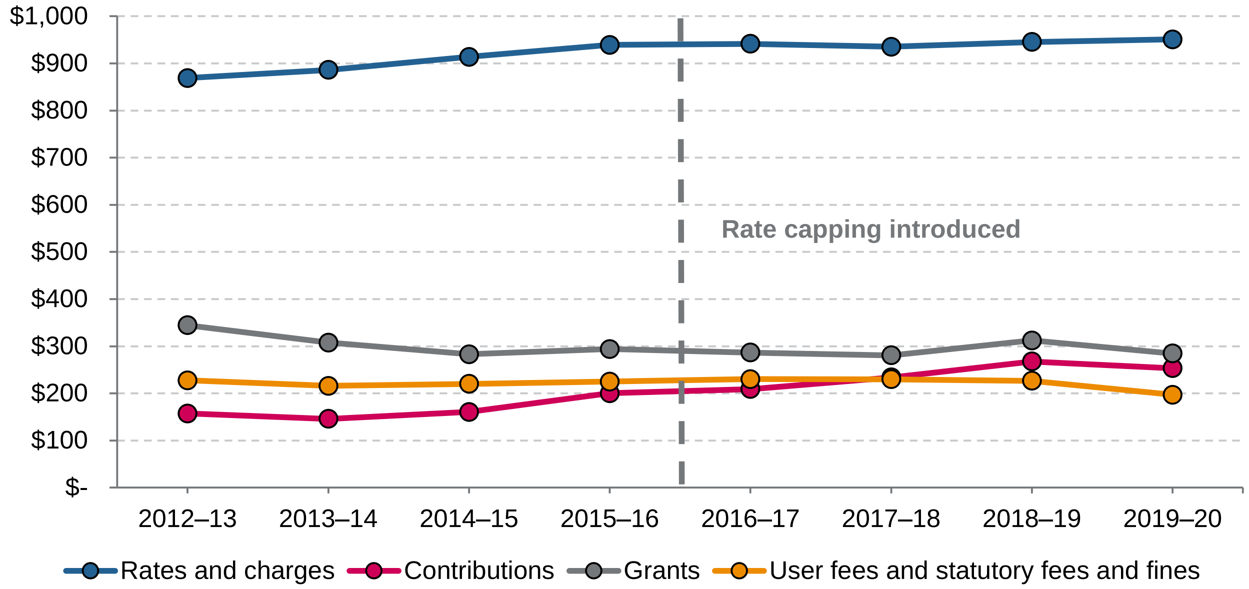
[48] We have adjusted revenue from grants for the advance payment of financial assistance grants in some years. See Box 2.1 for further information.

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

Figure 2.2 **Revenue per person, by source**

For the sector as a whole (inflation-adjusted, 2019–20 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 (2020) 'ERP by LGA (ASGS 2019), 2001 to 2019', Estimated Resident Population, accessed 20 January 2021; Australian Bureau of Statistics (September 2020) 'TABLES 1 and 2. CPI: All Groups, Index Numbers and Percentage Changes' [time series spreadsheet], Consumer Price Index, Australia, accessed 20 January 2021.

2.3. Growth in revenue from rates and charges slowed

In the first three years of rate capping, growth in the sector's revenue from rates and charges slowed.

Rates and charges was the largest source of revenue for the sector as a whole and all council groups (See Table 2.1).

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. But you should note the growth rates in revenue from rates and charges in this chapter will be different from those in Chapter 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 first three years of rate capping	
	% growth	% growth	% of total revenue
Sector as a whole	2.6%	0.2%[a]	52.7%
Metropolitan	2.5%	0.1%	61.6%
Interface	2.1%	−0.2%	43.4%
Regional city	3.7%	1.1%	49.3%
Large shire	3.1%	0.8%	51.5%
Small shire	3.5%	1.2%	45.1%

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 2018–19 (the first three years of rate capping). [a] This is higher than the zero per cent increase in capped rates per property noted 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 (2020) 'ERP by LGA (ASGS 2019), 2001 to 2019', Estimated Resident Population, accessed 20 January 2021; Australian Bureau of Statistics (September 2020) 'TABLES 1 and 2. CPI: All Groups, Index Numbers and Percentage Changes' [time series spreadsheet], Consumer Price Index, Australia, accessed 20 January 2021.

Growth in revenue per person from rates and charges slowed in the first three years of rate capping for the sector as a whole and for all council groups.

For more detail on the variations in growth rates between each group, see the separate discussions in Chapter 1 on revenue from capped rates and revenue from service charges.

2.4. Growth in revenue from contributions increased

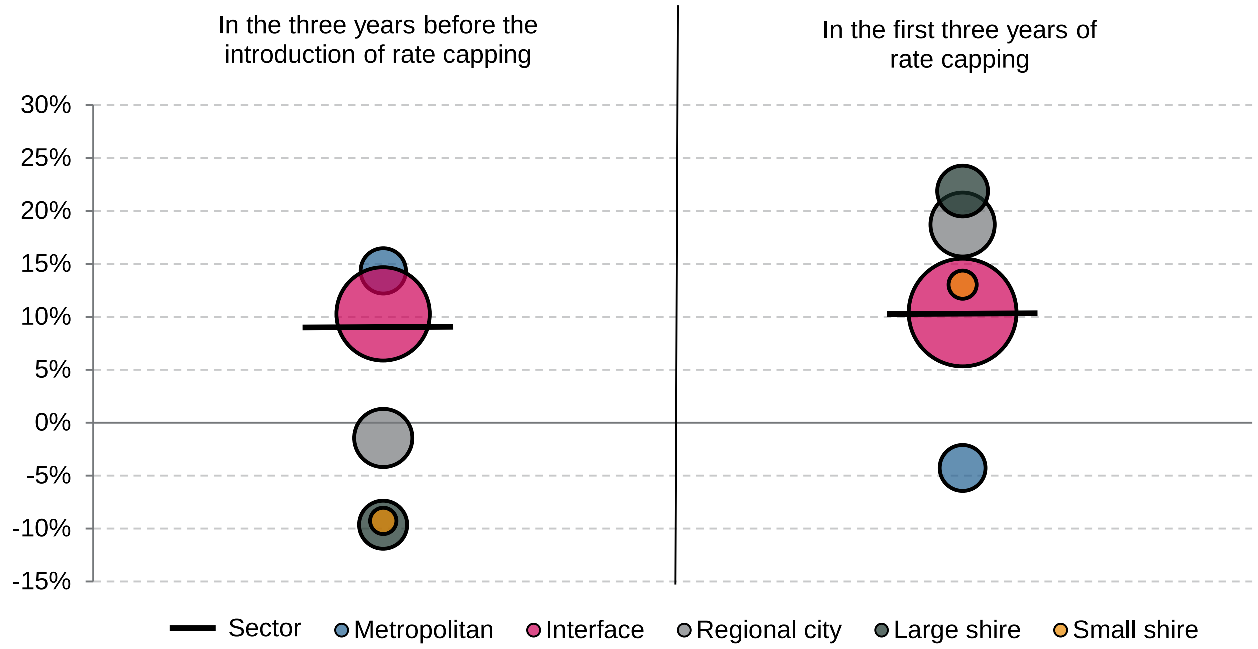
In the first three years of rate capping, growth in the sector's revenue from contributions increased.

For the sector as a whole, the growth in revenue per person from contributions increased in the first three years of rate capping (See Figure 2.3). This also occurred across all council groups, except for the metropolitan group.

Higher growth in revenue from contributions in large part reflects property growth. However, differences in revenue from contributions remain, even after examining it in per person terms. These differences could be due to a number of reasons including:

- Changes to the legislative framework relating to contributions.[50]
- Growth in revenue from contributions may be more reflective of projected future population growth than current.
- The timing of project completion affects when contributions are transferred to councils.
- Variations in arrangements between councils and developers about the amount and timing of contributions.

Figure 2.3 Average annual growth in revenue per person from contributions



Note: The position of the bubbles shows how much revenue from contributions increased or decreased and the size of the bubbles shows how much this revenue source contributed to the group's total revenue. These growth rates are based on numbers that have been adjusted for inflation. They are calculated from 2012–13 to 2015–16 (before the introduction of rate capping) and from 2015–16 to 2018–19 (the first three years of rate capping).

Data sources: Council annual reports (audited); Australian Bureau of Statistics (2020) 'ERP by LGA (ASGS 2019), 2001 to 2019', Estimated Resident Population, accessed 20 January 2021; Australian Bureau of Statistics (September 2020) 'TABLES 1 and 2. CPI: All Groups, Index Numbers and Percentage Changes' [time series spreadsheet], Consumer Price Index, Australia, accessed 20 January 2021.

[50] For example, in 2016, the maximum amount councils could charge for the community infrastructure levy increased from $900 to $1150 per lot (in nominal terms). From 2019–20, the maximum amount will increase in line with inflation following changes to section 46L of the Planning and Environment Act 1987. The community infrastructure levy may be paid either by developers or new property owners.

For the interface group, revenue from contributions was the main source of revenue growth. This reflected both strong growth and the large share of the group's revenue it accounted for (31 per cent in the first three years of rate capping).

Growth in revenue from contributions was higher for the large shire, regional city and small shire groups than for the interface group. However, the effect on total revenue growth for these groups was limited as contributions was a relatively small revenue source for these groups.

The metropolitan group was the only council group that had a decrease in revenue from contributions in the first three years of rate capping.

2.5. Growth in revenue from grants increased

In the first three years of rate capping, growth in the sector's revenue from grants increased.

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 select 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 fluctuation in revenue from grants is common. Smaller councils (and their council groups) are most affected by these fluctuations as they rely more on grants.[51]

Another major cause of fluctuation in councils' revenue from grants has been the timing of financial assistance grant payments from the Australian Government (See Box 2.1). For the sector as a whole, we have adjusted revenue from grants for the advance payments (reallocating the share of grants paid in advance to the year to which the payment related). However, we have not adjusted revenue from grants at the group level due to data limitations. This means the growth rates we have reported at a group level for revenue from grants and total revenue may be understated for the period before the introduction of rate capping and overstated for the first four years of rate capping.

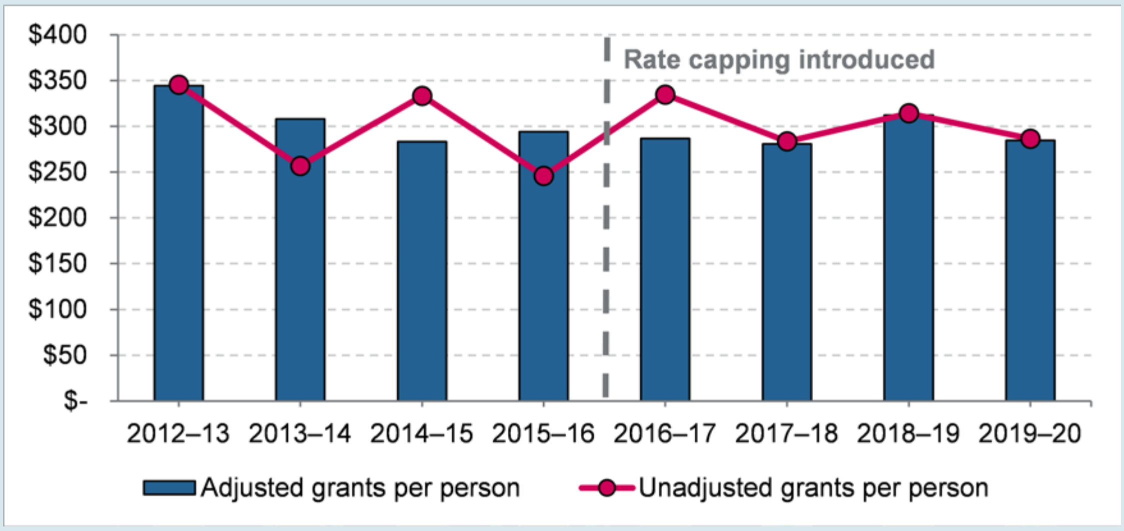
[51] Victorian Local Government Grants Commission Annual Allocation Reports', Victorian Local Government Grants Commission, accessed 20 January 2021, https://www.localgovernment.vic.gov.au/council-funding-and-grants/victoria-grants-commission/annual-reports-and-consultations.

Box 2.1 **How the timing of financial assistance grant payments has 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. In 2014–15 and 2016–17, councils received about half of their annual financial assistance grants from the Australian Government in advance of the years to which they related. This resulted in higher revenue from grants in these years, which is 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. Because we have used 2015–16 to calculate growth rates (both before and after the introduction of rate capping), there is a significant difference in these growth rates depending on whether we adjust for the timing of grant payments.

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, 2019–20 dollars)



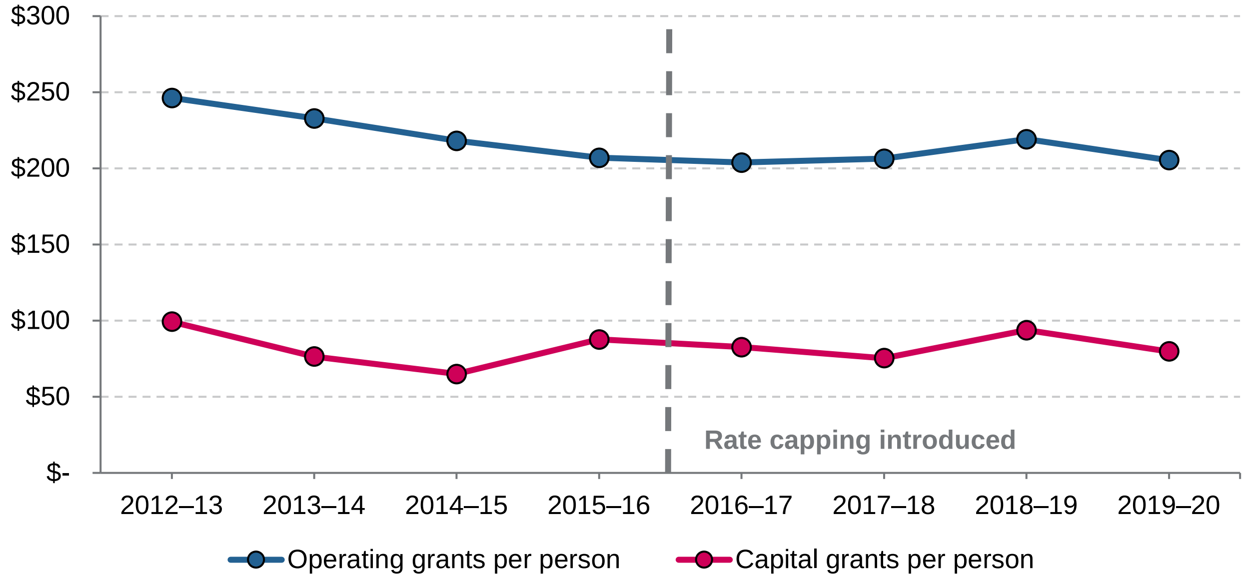
Data sources: Council annual reports (audited); ABS (2020) 'ERP by LGA (ASGS 2019), 2001 to 2019', Estimated Resident Population, accessed 20 January 2021; ABS (September 2020) 'TABLES 1 and 2. CPI: All Groups, Index Numbers and Percentage Changes' [time series spreadsheet], Consumer Price Index, Australia, accessed 20 January 2021.

Sector growth in revenue per person from grants (unadjusted for the timing of payment) was −10.7 per cent in the three years before the introduction of rate capping and 8.5 per cent in the first three years of rate capping. When we adjust for the timing of grant payments, these growth rates become −5.1 per cent before and 2.0 per cent after the introduction of rate capping.

There was a significant increase in revenue from grants in 2018–19

Figure 2.4 shows that growth in revenue from grants for the first three years of rate capping mainly occurred in 2018–19. This reflected large increases in revenue from grants in the small shire, metropolitan and large shire groups. A significant part of the increase in grants related to non-recurrent grants (both operating and capital grants).

Figure 2.4 Revenue per person from operating grants and capital grants



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 (2020) 'ERP by LGA (ASGS 2019), 2001 to 2019', Estimated Resident Population, accessed 20 January 2021; Australian Bureau of Statistics (September 2020) 'TABLES 1 and 2. CPI: All Groups, Index Numbers and Percentage Changes' [time series spreadsheet], Consumer Price Index, Australia, accessed 20 January 2021.

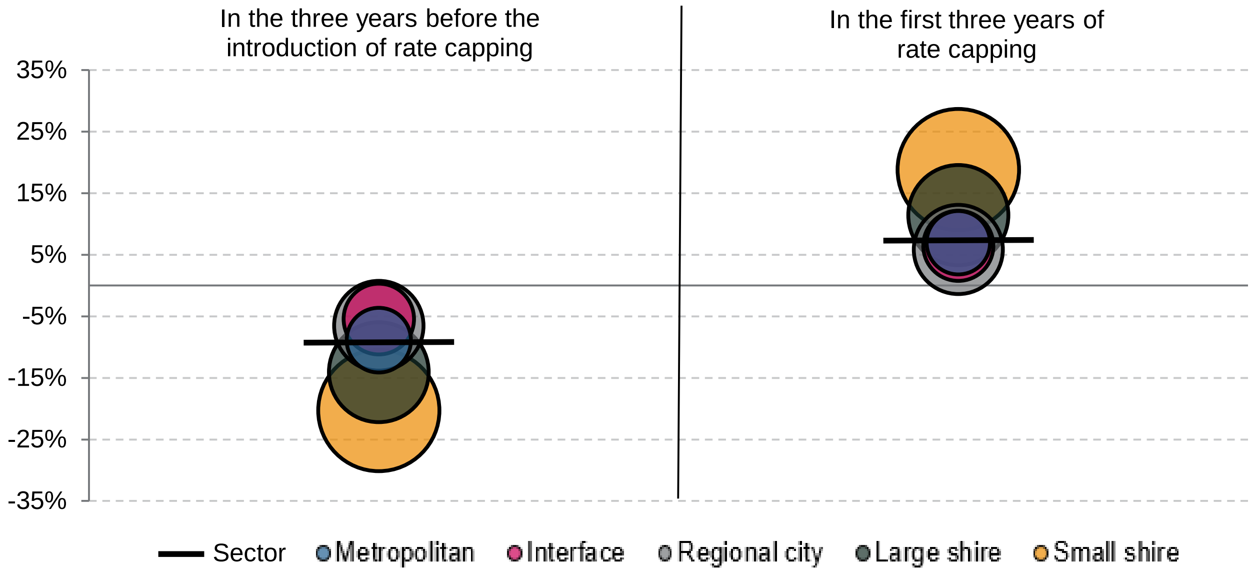
Figure 2.4 shows that the majority of revenue from grants was for operating purposes. In the first four years of rate capping, revenue from operating grants was relatively stable. This followed a period of gradual decline, which is partially due to the Australian Government freezing the indexation of financial assistance grant payments between 2014–15 and 2016–17. In contrast, revenue from capital grants fluctuated from year to year, reflecting the non-recurrent (one-off) nature of many capital grants.

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

For the sector as a whole, and all council groups, growth in revenue per person from grants increased in the first four years of rate capping. (See Figure 2.5)

For the small and large shire groups, revenue from grants was an important source of revenue growth in the first three years of rate capping. This was because it represented a large share of these groups' total revenue (42 per cent for the small shire group and 29 per cent for the large shire group).

Figure 2.5 Average annual growth in revenue per person from grants



Note: The position of the bubbles shows how much revenue from grants increased or decreased and the size of the bubbles shows how much this revenue source contributed to the group's total revenue. These growth rates are based on numbers that have been adjusted for inflation, but have not been adjusted for the timing of financial assistance grant payments from the Australian Government. These growth rates are calculated from 2012–13 to 2015–16 (before the introduction of rate capping) and from 2015–16 to 2018–19 (the first three years of rate capping).

Data sources: Council annual reports (audited); Australian Bureau of Statistics (2020) 'ERP by LGA (ASGS 2019), 2001 to 2019', Estimated Resident Population, accessed 20 January 2021; Australian Bureau of Statistics (September 2020) 'TABLES 1 and 2. CPI: All Groups, Index Numbers and Percentage Changes' [time series spreadsheet], Consumer Price Index, Australia, accessed 20 January 2021.

The increase in revenue from grants for the small and large shire groups partly reflects government grant programs like the:

- Regional Jobs and Infrastructure Fund[52] to finance infrastructure projects and create jobs
- Fixing Country Roads Program[53] to fund the improvement of roads

[52] 'Regional Jobs & Infrastructure Fund', Regional Development Victoria, accessed 25 March 2021, https://www.rdv.vic.gov.au/about-rdv/regional-jobs-and-infrastructure-fund.

[53] 'Fixing Country Roads Program', Regional Roads Victoria, accessed 25 March 2021, https://regionalroads.vic.gov.au/about-us/fixing-country-roads-program.

- Rural Councils Transformation Program[54] to support joint service delivery and procurement.

Some small shire and large shire councils also received grants to assist their recovery from the 2016–17 floods.

2.6. Revenue from user fees and statutory fees and fines remained relatively stable

In the first three years of rate capping, the sector's revenue from user fees and statutory fees and fines remained relatively stable.

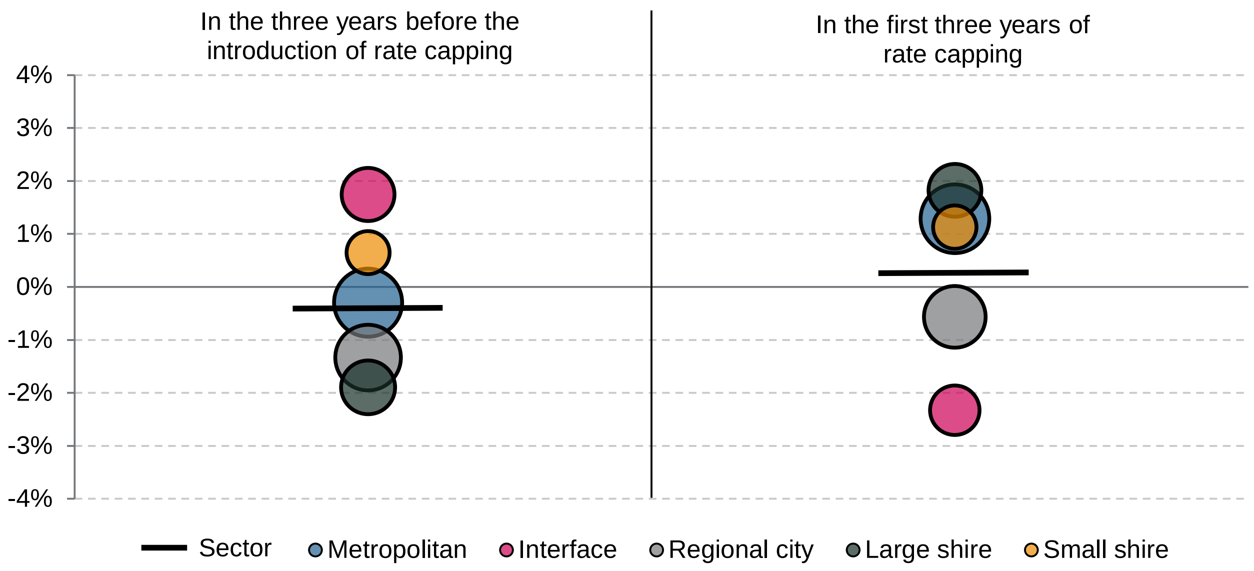
At the council level, revenue from user fees and statutory fees and fines can fluctuate, due to changes in either the amount of the fees and fines or the levels of services provided.[55] One such change in the first three years of rate capping was an increase in statutory planning fees in 2016–17. In most years, these fluctuations are relatively small and have a limited impact on total revenue for most council groups. This is because revenue from user fees and statutory fees and fines represents a small proportion of their total revenue. The metropolitan group is most affected by these fluctuations with 17 per cent of total revenue in the first three years of rate capping coming from this source.

For the sector as a whole, there was almost no growth in revenue per person from user fees and statutory fees and fines in the first three years of rate capping (See Figure 2.6). Decreases in the interface and regional city groups offset low growth in the metropolitan, large shire and small shire groups.

54 'Rural Councils Transformation Program', Department Jobs, Precincts and Regions, accessed 25 March 2021, https://www.localgovernment.vic.gov.au/media-releases/rural-councils-transformation-program.

55 'User fees and statutory fees and fines' includes parking fees and fines, planning permit fees, and other fees for service (such as council operated childcare services and leisure centres).

Figure 2.6 Average annual growth in revenue per person from user fees and statutory fees and fines



Note: The position of the bubbles shows how much revenue from user fees and statutory fees and fines increased or decreased and the size of the bubbles shows how much this revenue source contributed to the group's total revenue. These growth rates are based on numbers that have been adjusted for inflation. They are calculated from 2012–13 to 2015–16 (before the introduction of rate capping) and from 2015–16 to 2018–19 (the first three years of rate capping).

Data sources: Council annual reports (audited); Australian Bureau of Statistics (2020) 'ERP by LGA (ASGS 2019), 2001 to 2019', Estimated Resident Population, accessed 20 January 2021; Australian Bureau of Statistics (September 2020) 'TABLES 1 and 2. CPI: All Groups, Index Numbers and Percentage Changes' [time series spreadsheet], Consumer Price Index, Australia, accessed 20 January 2021.

2.7. Changes in revenue in 2019–20

In 2019–20, the sector's revenue from rates and charges grew similarly to the first three years of rate capping. However, revenue from contributions, grants, and user fees and statutory fees and fines decreased.

In 2019–20, council revenue was affected by:

- the initial impact of the coronavirus pandemic (in the last quarter of the year), including:
  - the closure of leisure facilities
  - reduced revenue from parking fees and infringements
  - rate deferrals or waivers and refunds of some fees and fines

- changes to accounting standards[56], which affected when revenue was recognised.

Figure 2.7 shows the change in revenue from each source between 2018–19 and 2019–20. Bubbles below the zero per cent line indicate a decrease in this revenue source. These growth rates can be compared to the growth rates in the first three years of rate capping, which are shown in Table 1.1 and Figures 2.3, 2.5 and 2.6.

Growth in revenue from rates and charges remained relatively stable. This was because rates notices had already been issued (and largely paid) when the pandemic started. Although councils may have foregone some revenue from rates and charges (for example, due to payment deferrals and interest waivers), this was not significant enough to decrease the sector's revenue from rates and charges.

Revenue from contributions decreased. This may be due to lower development activity as a result of the coronavirus restrictions and uncertainty around the economic outlook. The small shire group had the largest decrease in revenue from contributions in percentage terms. However, revenue from contributions was only a small proportion of total revenue for this group.

Revenue from grants decreased. As discussed earlier in the chapter, there was a significant increase in non-recurrent (one-off) grants in 2018–19. In 2019–20, non-recurrent grants returned to previous levels and revenue from grants decreased. In addition, changes to accounting standards affected when revenue from grants was recognised. Under the new standards, where a grant is linked to a performance obligation, the revenue from the grant is only recognised when the performance obligation is met.[57] In contrast, the old accounting standards recognised revenue from grants when it was received. This change may mean revenue from grants decreased because councils were not able to report some of the grants they received as revenue in 2019–20. Such grants will be reported as revenue in future years once performance obligations are met.

Revenue from user fees and statutory fees and fines was impacted the most by the coronavirus pandemic. This was unsurprising considering the prolonged restrictions. The metropolitan and regional city groups experienced the biggest decreases (15 per cent and 14 per cent respectively). These groups also collect more revenue from user fees and statutory fees and fines than the other groups.

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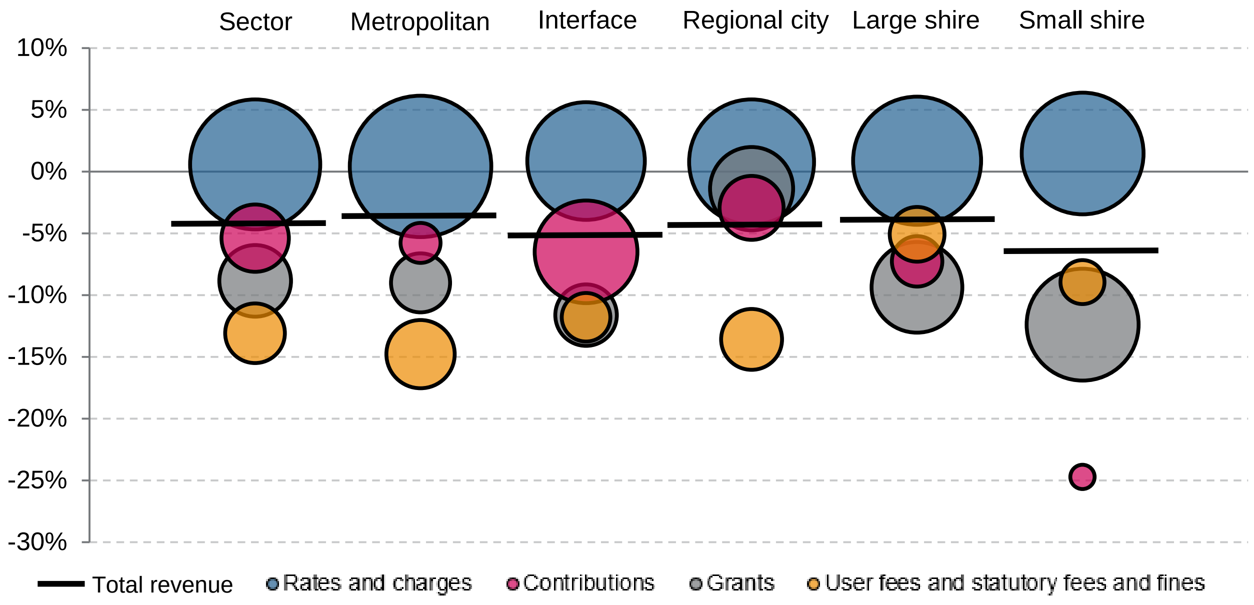
[56] The changes to accounting standards relate to AASB15 and AASB1058

[57] Examples of performance obligations that might be linked to a grant include the transfer of goods or assets, or the provision of specified services.

Figure 2.7 Growth in revenue per person from 2018–19 to 2019–20



Note: The position of the bubbles indicates the growth rate. The size of the bubbles shows how much revenue from that source contributed to the sector or group's total revenue. These growth rates are based on numbers that have been adjusted for inflation but have not been adjusted for the timing of financial assistance grant payments from the Australian Government.

Data sources: Council annual reports (audited); Australian Bureau of Statistics (2020) 'ERP by LGA (ASGS 2019), 2001 to 2019', Estimated Resident Population, accessed 20 January 2021; Australian Bureau of Statistics (September 2020) 'TABLES 1 and 2. CPI: All Groups, Index Numbers and Percentage Changes' [time series spreadsheet], Consumer Price Index, Australia, accessed 20 January 2021.

Further revenue impacts of the coronavirus pandemic will be seen in 2020–21 and beyond

Looking forward, revenue from rates and charges in 2020–21 is likely to fall (in inflation-adjusted terms) at a sector level with some councils freezing rates and others offering rebates. Freezing rates, or increasing them by an amount less than the rate cap, will have a long-term impact for the councils that have chosen this option. This is because rate increases become part of the rates base on which future rate increases are calculated.

There were longer lockdowns in the 2020–21 financial year than in 2019–20 (particularly in the metropolitan and interface groups). Ongoing social distancing restrictions will reduce revenue from leisure centres and other recreation and cultural services. The result of these lockdowns and other restrictions is likely to be further decreases in revenue from user fees and statutory fees and fines.

In the medium term, revenue from contributions will be impacted by lower development activity due to slower projected population growth (driven by immigration).

In the years leading up to the introduction of rate capping, councils were able to increase rates when revenue from their other sources contracted. Councils' ability to smooth fluctuations in their revenue through rate increases is restricted in a rate-capped environment. Councils will only be able to increase their average rates by more than the rate cap if they successfully apply for a higher cap.

3. Expenditure

This chapter looks at what happened to councils' expenditure in the first four years of rate capping (2016–17 to 2019–20).[58] 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 increased.
- **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 materials and services increased, but employee costs per person decreased.

This chapter focuses on the sector as a whole – 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] The analysis is based on numbers that have been adjusted for inflation.

See page xxi 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.

For the sector as a whole, total expenditure grew faster in the first four years of rate capping than in the three years before its introduction.[60] (See Figure 3.1)

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[58] Where we have calculated growth rates for the first four 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.

[60] We note that the average growth rates in the three years before the introduction of rate capping and in the four years after were calculated with reference to 2015–16 (the final year before rate capping was introduced). In 2015–16, expenditure per person decreased due to both faster population growth and slower expenditure growth in that year. This may have understated growth prior to the introduction of rate capping and overstated growth following the introduction of rate capping in comparison to the overall trend. However, the average growth in expenditure per

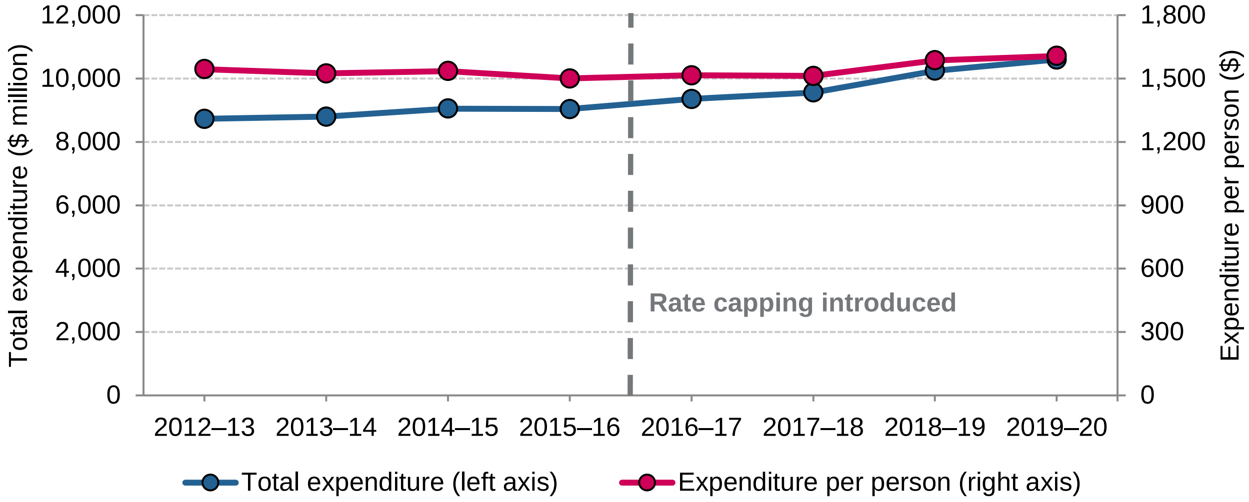
Population growth explains part of the growth in expenditure as councils provide services to more people. We have accounted for population growth by examining expenditure in per person terms.[61]

In the first four years of rate capping, total expenditure per person also increased, despite higher population growth. Expenditure per person had decreased in the three years before the introduction of rate capping.

Slower growth in expenditure before the introduction of rate capping may reflect councils becoming more efficient or cutting costs. This may have been in response to decreases in some revenue sources (see Chapter 2) or in preparation for the introduction of rate capping.

Figure 3.1 Total expenditure and total expenditure per person

For the sector as a whole (inflation-adjusted, 2019–20 dollars)



Data sources: Council annual reports (audited); Australian Bureau of Statistics (2020) 'ERP by LGA (ASGS 2019), 2001 to 2019', Estimated Resident Population, accessed 20 January 2021; Australian Bureau of Statistics (September 2020) 'TABLES 1 and 2. CPI: All Groups, Index Numbers and Percentage Changes' [time series spreadsheet], Consumer Price Index, Australia, accessed 20 January 2021.

3.2. Growth in expenditure differed between the council groups

As noted above, for the sector as a whole, total expenditure per person decreased in the three years before the introduction of rate capping. This was also the case for the small shire, large shire and interface groups. However, there was variation between councils within these groups. In

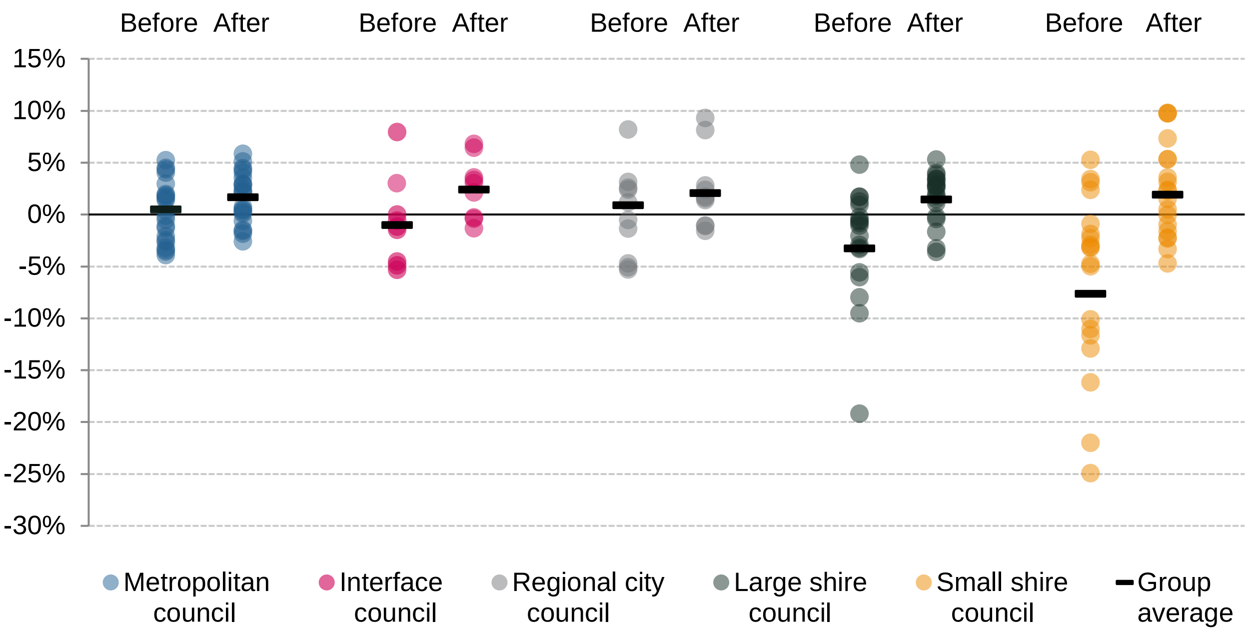
person in the first four years of rate capping was still above the average growth over the whole seven-year period from 2012–13 to 2019–20.

[61] 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.

contrast, expenditure per person for the metropolitan and regional city groups increased before the introduction of rate capping. (See Figure 3.2)

In the first four years of rate capping, all council groups' total expenditure per person increased. There was also less variation in growth rates between groups and individual councils. The small and large shire groups had the biggest differences between the growth rates before and after the introduction of rate capping. This was due to their decreasing expenditure per person in the three years before the introduction of rate capping.

Figure 3.2 Average annual growth in total expenditure per person, before and after the introduction of rate capping



Note: These growth rates are based on numbers that have been adjusted for inflation. They are calculated from 2012–13 to 2015–16 (before the introduction of rate capping) and from 2015–16 to 2019–20 (after the introduction of rate capping).

Data sources: Council annual reports (audited); Australian Bureau of Statistics (2020) 'ERP by LGA (ASGS 2019), 2001 to 2019', Estimated Resident Population, accessed 20 January 2021; Australian Bureau of Statistics (September 2020) 'TABLES 1 and 2. CPI: All Groups, Index Numbers and Percentage Changes' [time series spreadsheet], Consumer Price Index, Australia, accessed 20 January 2021.

3.3. Growth in total expenditure was driven by growth in capital expenditure

For the sector as a whole, capital expenditure increased faster than 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 four years before the introduction of rate capping, 76 per cent of the sector’s total expenditure was operating expenditure. In the first four years of rate capping, this decreased to 74 per cent.

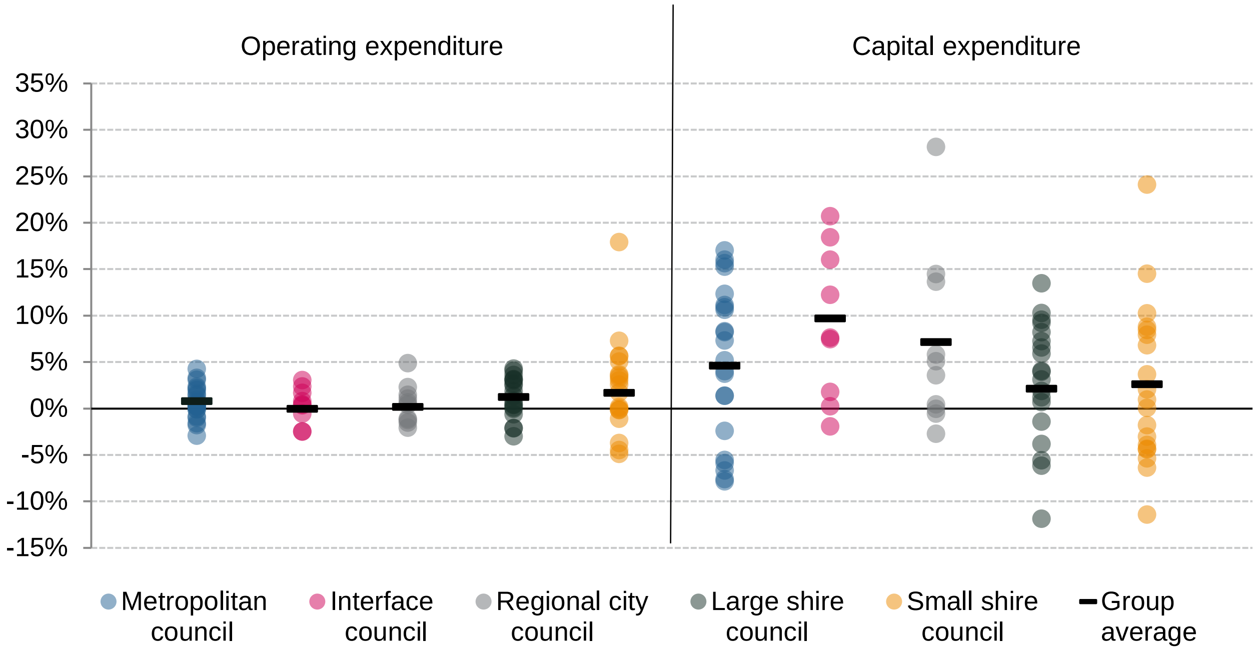
Growth in capital expenditure varied between councils

Figure 3.3 shows the growth in operating and capital expenditure per person in the first four years of rate capping. For the sector as a whole and for all council groups, growth in total expenditure was driven by growth in capital expenditure. The interface and regional city groups in particular had strong growth in capital expenditure per person. But for some councils, capital expenditure per person decreased.

For the sector as a whole, there was a large increase in capital expenditure in 2018–19 and further growth in 2019–20. All council groups, except the regional city group, experienced their highest growth in capital expenditure per person in 2018–19. The regional city group had higher growth in 2019–20. Overall, in the first four years of rate capping, the interface and regional city groups had the highest growth in capital expenditure.

Capital expenditure typically varies more from year to year than operating expenditure. Large increases in capital expenditure may be due to one-off costs like 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.

Figure 3.3 Average annual growth in operating and capital expenditure per person in the first four years of rate capping



Note: These growth rates are based on numbers that have been adjusted for inflation. They are calculated from 2015–16 to 2019–20.

Data sources: Council annual reports (audited); Australian Bureau of Statistics (2020) 'ERP by LGA (ASGS 2019), 2001 to 2019', Estimated Resident Population, accessed 20 January 2021; Australian Bureau of Statistics (September 2020) 'TABLES 1 and 2. CPI: All Groups, Index Numbers and Percentage Changes' [time series spreadsheet], Consumer Price Index, Australia, accessed 20 January 2021.

3.4. Growth in employee costs slowed

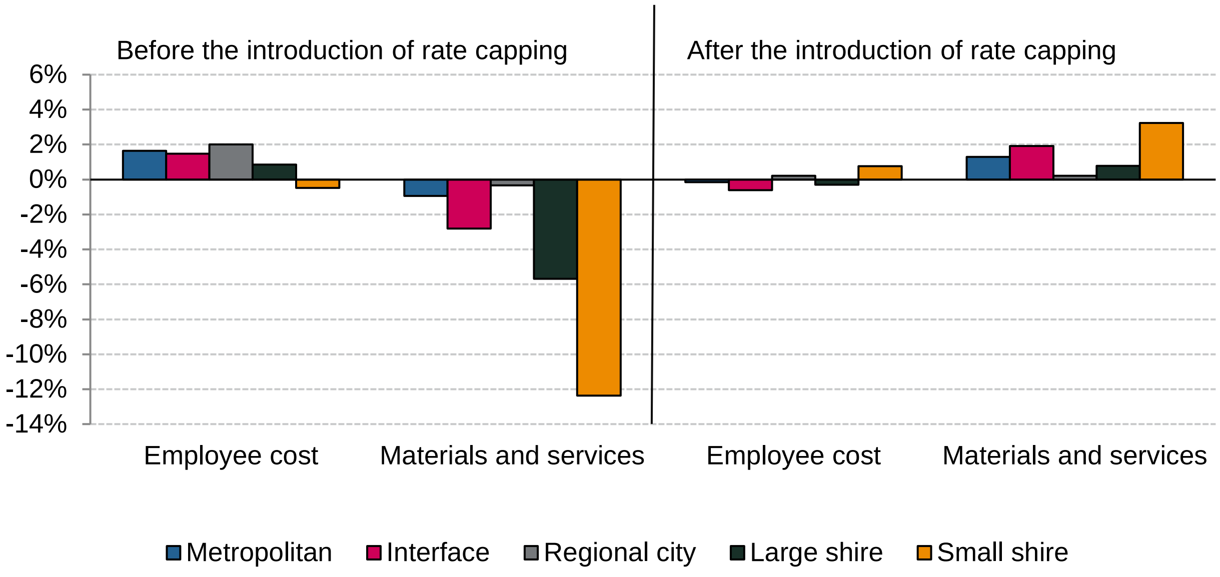
For the sector as a whole, expenditure per person on materials and services increased, but employee costs per person decreased.

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 first four years of rate capping, operating expenditure per person for the sector as a whole increased. This was driven by growth in expenditure per person on materials and services. Growth in expenditure per person on materials and services increased for all council groups. All council groups (except the small shire group) saw a decrease or slower growth in employee costs per person. (See Figure 3.4)

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



Note: These growth rates are based on numbers that have been adjusted for inflation. They are calculated from 2012–13 to 2015–16 (before the introduction of rate capping) and from 2015–16 to 2019–20 (the first four years of rate capping).

Data sources: Council annual reports (audited); Australian Bureau of Statistics (2020) 'ERP by LGA (ASGS 2019), 2001 to 2019', Estimated Resident Population, accessed 20 January 2021; Australian Bureau of Statistics (September 2020) 'TABLES 1 and 2. CPI: All Groups, Index Numbers and Percentage Changes' [time series spreadsheet], Consumer Price Index, Australia, accessed 20 January 2021.

Average salary increases decreased

Growth in employee costs is a factor of both employee numbers and salaries. Employee salaries are based on the enterprise agreements that councils enter into with their employees. These agreements lock in specified salary increases over a period of time. In 2013–14, both the growth in the sector's employee costs per person (unadjusted for inflation) and the average salary increase under enterprise agreements were above 3 per cent. This was higher than the annual rate of change in both the Wage Price Index[62] and the Consumer Price Index (See Figure 3.5).[63]

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

[63] 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.

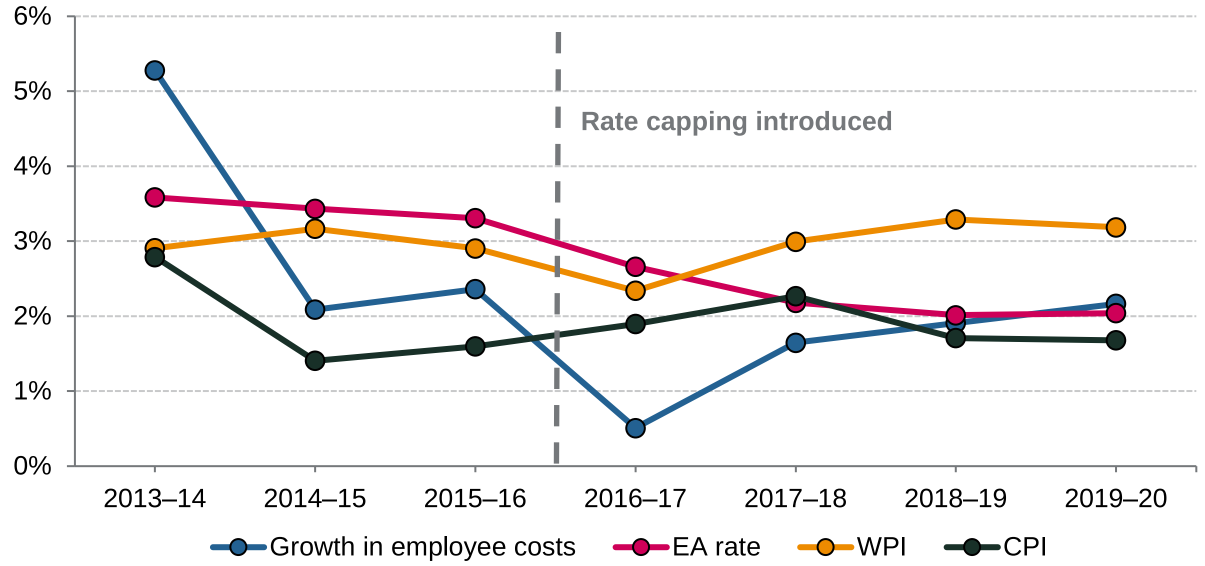
In the two years before the introduction of rate capping (2014–15 and 2015–16), growth in employee costs per person for the sector as a whole dropped below the Wage Price Index.

In the first four years of rate capping, growth in the sector's employee costs per person was lower again, trending close to the Consumer Price Index. Annual increases under enterprise agreements also trended closer to the Consumer Price Index. [64]

For the sector as a whole, employee costs was the largest expenditure category. It accounted for 36 per cent of total expenditure in the first four years of rate capping. Therefore, keeping the annual growth rate close to the rate cap has contributed to maintaining the sector's financial sustainability.

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 not adjusted the numbers for inflation.

Data sources: Council annual reports (audited); Australian Bureau of Statistics (2020) 'ERP by LGA (ASGS 2019), 2001 to 2019', Estimated Resident Population, accessed 20 January 2021; Australian Bureau of Statistics (September 2020) 'TABLES 1 and 2. CPI: All Groups, Index Numbers and Percentage Changes' [time series spreadsheet], Consumer Price Index, Australia, accessed 20 January 2021; Australian Bureau of Statistics (June 2020) 'Table 4a. Total hourly rates of pay excluding bonuses: public sector by state, original (financial year index numbers for year ended June quarter)' [time series spreadsheet], Wage Price Index, Australia, accessed 20 January 2021; Estimates based on Fair Work Commission, 'Enterprise agreement decisions', *Archived decisions & orders*, fwc.gov.au, accessed 20 January 2021.

64 In 2018–19 and 2019–20, actual inflation rates were below the level of forecast inflation, on which enterprise agreements are most likely to have been based. The minister's annual rate caps have also been set equal to forecast inflation.

4. Infrastructure

This chapter looks at the sector's spending on the different categories of capital projects in the first four years of rate capping (2016–17 to 2019–20).[65] It focuses in particular on spending on asset renewal and upgrade projects.[66]

Key observations

- **Spending on infrastructure:** The sector continued to undertake asset renewal and invest in new infrastructure to cater for the growing population.
- **Categories of spending:** The sector's spending on each of the different categories of capital project (except asset expansion) 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 first four years of rate capping. Spending on asset renewal and upgrade projects was, on average over the four years, above 100 per cent of the level of depreciation.

This chapter focuses on the sector as a whole – 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).[67] The analysis is based on numbers that have been adjusted for inflation.

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

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

[66] In this chapter, we have used 2013–14 as the base year for comparison as we do not have access to complete data for prior years.

[67] 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, the total capital expenditure per person for the sector as a whole increased in the first four years of rate capping. This increase of 5.6 per cent per year compares to a 3.6 per cent per year decrease on average in the two years before the introduction of rate capping (between 2013–14 and 2015–16).

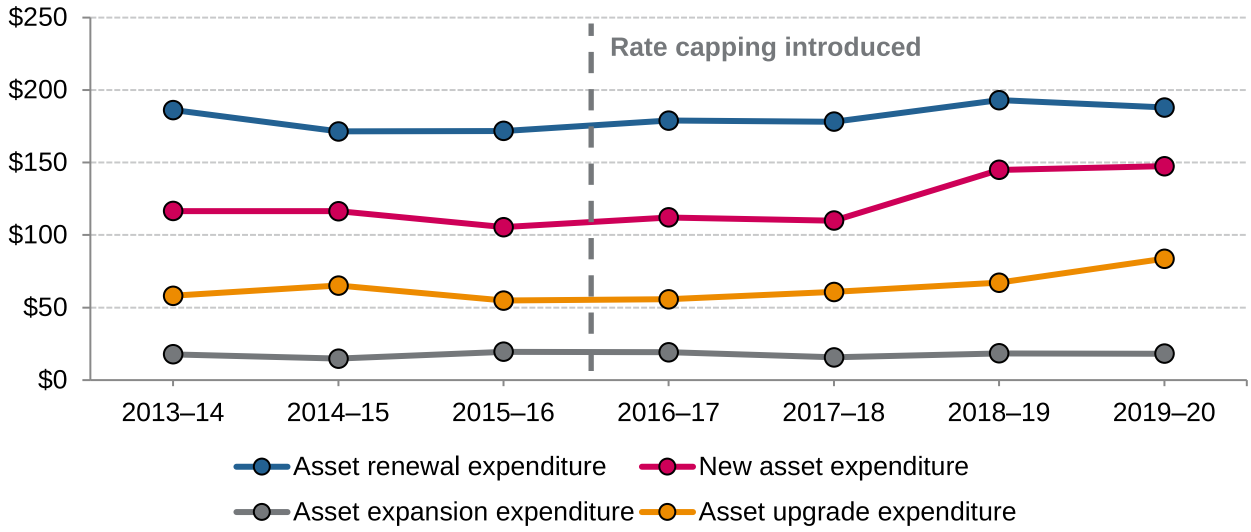
Councils categorise their capital spending by the type of project it relates to:

- 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.

For the sector as a whole, spending per person on all categories (except asset expansion) increased in the first four years of rate capping (See Figure 4.1). There was significant growth in 2018–19 in particular.

Figure 4.1 Capital spending per person, by category of project

For the sector as a whole (inflation-adjusted, 2019–20 dollars)



Data sources: Council annual reports (audited); Australian Bureau of Statistics (2020) 'ERP by LGA (ASGS 2019), 2001 to 2019', Estimated Resident Population, accessed 20 January 2021; Australian Bureau of Statistics (September 2020) 'TABLES 1 and 2. CPI: All Groups, Index Numbers and Percentage Changes' [time series spreadsheet], Consumer Price Index, Australia, accessed 20 January 2021.

For the sector as a whole, the highest growth in spending per person in the first four years of rate capping was on asset upgrades and new assets. Spending per person on these categories grew at an average of 11.1 per cent (upgrades) and 8.7 per cent (new assets) per year. This spending had decreased in 2015–16.

Spending per person on asset renewal saw more moderate growth of 2.3 per cent per year on average. Spending per person on asset expansion decreased by 1.7 per cent per year on average. This was the only category where spending had grown on average in the two years before the introduction of rate capping.

Growth in spending per person on each of the categories followed a similar pattern at the council group level. In the first four years of rate capping, spending per person on:

- asset upgrades increased for all groups
- asset renewal increased for all but the regional city group
- new assets increased for all but the small shire group
- asset expansion decreased for all but the metropolitan group.

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 first four years of rate capping, spending on new assets and asset upgrades increased as a share of total capital spending. Despite these increases, the sector as a whole 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. This was also true for the regional city group 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).[68] We use the asset renewal ratio as an indicator of whether the asset renewal gap may be growing (See Box 4.1).

[68] We have adopted the same definition as the Local Government Performance Reporting Framework. This definition has changed since we published our last 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'. Before its introduction, there were concerns across the sector about the effect of rate capping on councils' financial capacity to fund the renewal gap.[a]

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). Thus, 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.

[a] Essential Services Commission 2015, A Blueprint for Change, Local Government Rate Capping & Variation Framework Review — Final Report, September, pp. 33-36.

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

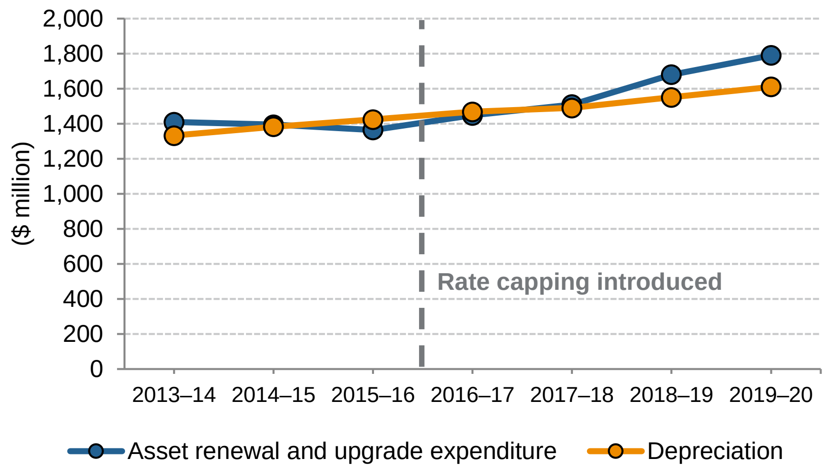
For the sector as a whole, the asset renewal ratio increased in each of the first four years of rate capping. This followed decreases in the two years before the introduction of rate capping (See Figure 4.2).

Capital spending tends to have more year-on-year variation than other types of spending. This is particularly so at a 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 three years before the introduction of rate capping, the asset renewal ratio for the sector as a whole was 101 per cent.[69] This increased to 105 per cent on average in the first four years of rate capping.

The increase in the ratio was because spending on asset renewal and upgrade projects increased faster than depreciation. It was not because the level of depreciation decreased.

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

For the sector as a whole (inflation-adjusted, 2019–20 dollars)



Year	Asset renewal ratio (%)
2013–14	106
2014–15	101
2015–16	96
2016–17	99
2017–18	101
2018–19	108
2019–20	111

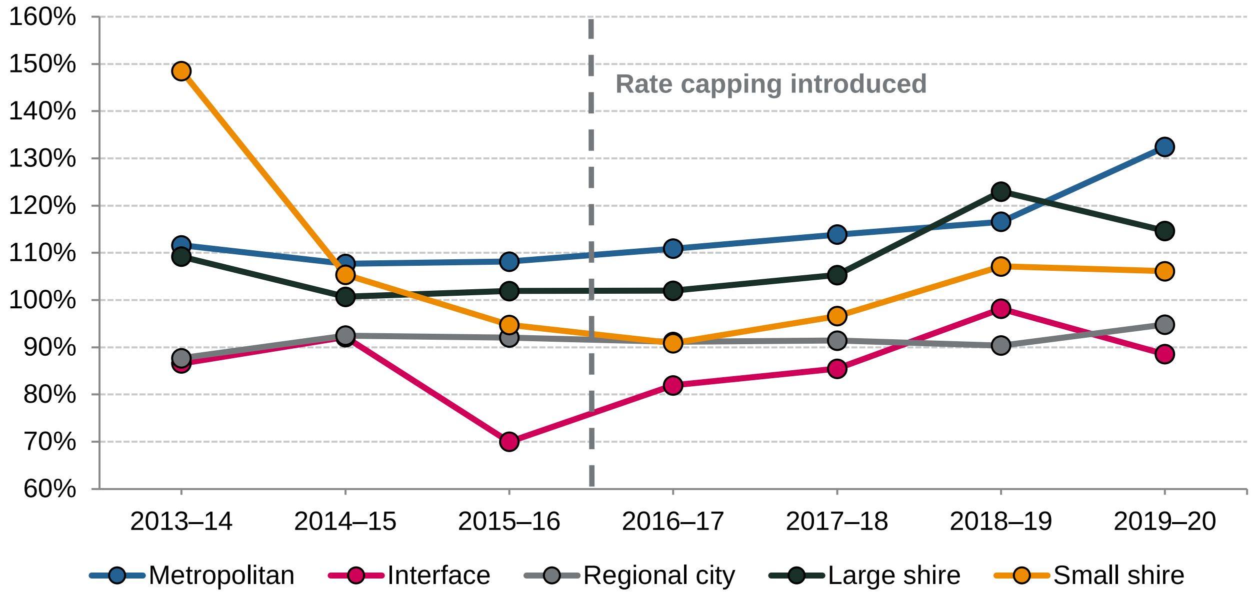
Note: The asset renewal ratios for 2013–14 to 2017–18 are different to those published in our last report in 2019. This is because the definition of the asset renewal ratio included in the Local Government Performance Reporting Framework has been updated to include spending on asset upgrade projects 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.

[69] Due to a lack of data, we have calculated the asset renewal ratio using an estimated value for depreciation in 2013–14 (estimated as a proportion of the total depreciation and amortisation). If 2013–14 is excluded, the asset renewal ratio for the sector was 98 per cent over the two years before the introduction of rate capping.

For each of the council groups, the asset renewal ratio increased in the first four years of rate capping (See Figure 4.3). However, there was some fluctuation over this period.

Figure 4.3 Asset renewal ratios



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 first four 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.[70] 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 first four years of rate capping. For 54 of the 79 councils, the asset renewal ratio was higher on average in the first four years of rate capping than it was in the two years before the introduction of rate capping.

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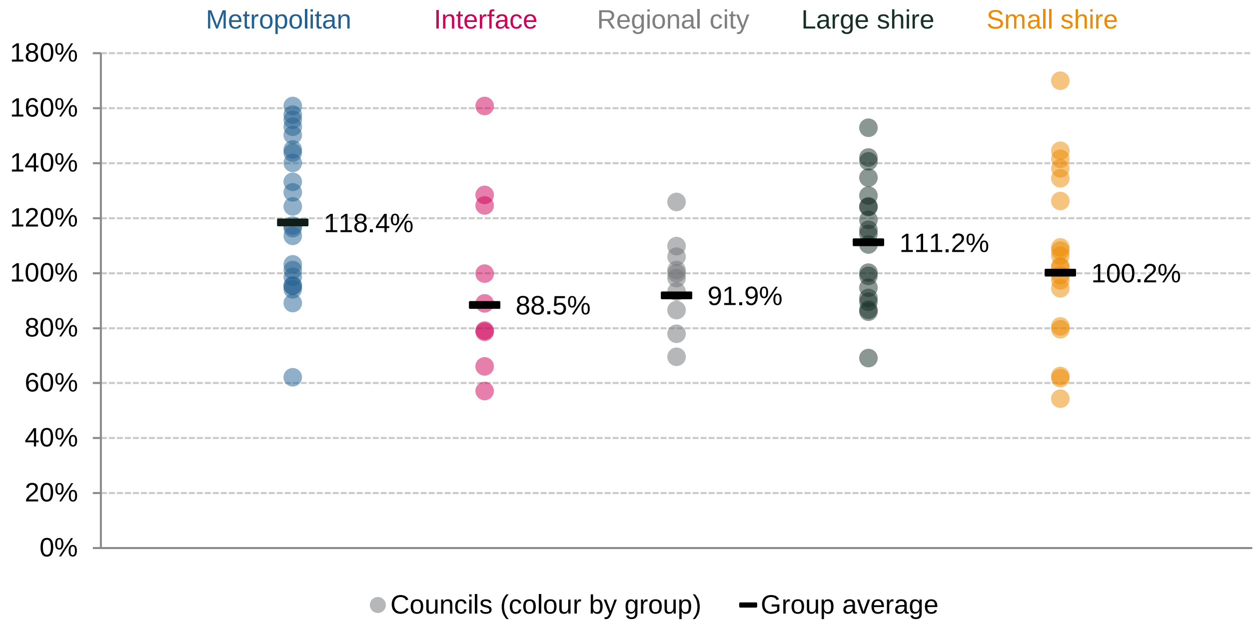
[70] On average in the first four years of rate capping, the interface group's share of capital spending on asset renewal and upgrade projects combined was the lowest among the council groups (47 per cent).

Figure 4.4 Average asset renewal ratios in the first four years of rate capping



Note: These are the average of results from 2016–17 to 2019–20.

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 first four years of rate capping (2016–17 to 2019–20).[71] It also examines selected measures of service quality and community satisfaction.

Key observations

- **Service expenditure:** The sector's expenditure increased across most service areas.
- **Service quality and satisfaction:** Measures of service quality and community satisfaction showed mixed results. For the sector as a whole, all three community satisfaction measures improved. For each council group, at least one service quality measure and one community satisfaction measure improved.

This chapter focuses on the sector as a whole – 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).[72] The analysis is based on numbers that have been adjusted for inflation.

See page xxi 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 except the large shire group.

There is a lot of variation in the services provided by councils, reflecting the diversity of the communities they serve. We have used data reported to the Victorian Local Government Grants Commission[73] to examine changes in service expenditure in the first four years of rate capping.[74]

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

[72] 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.

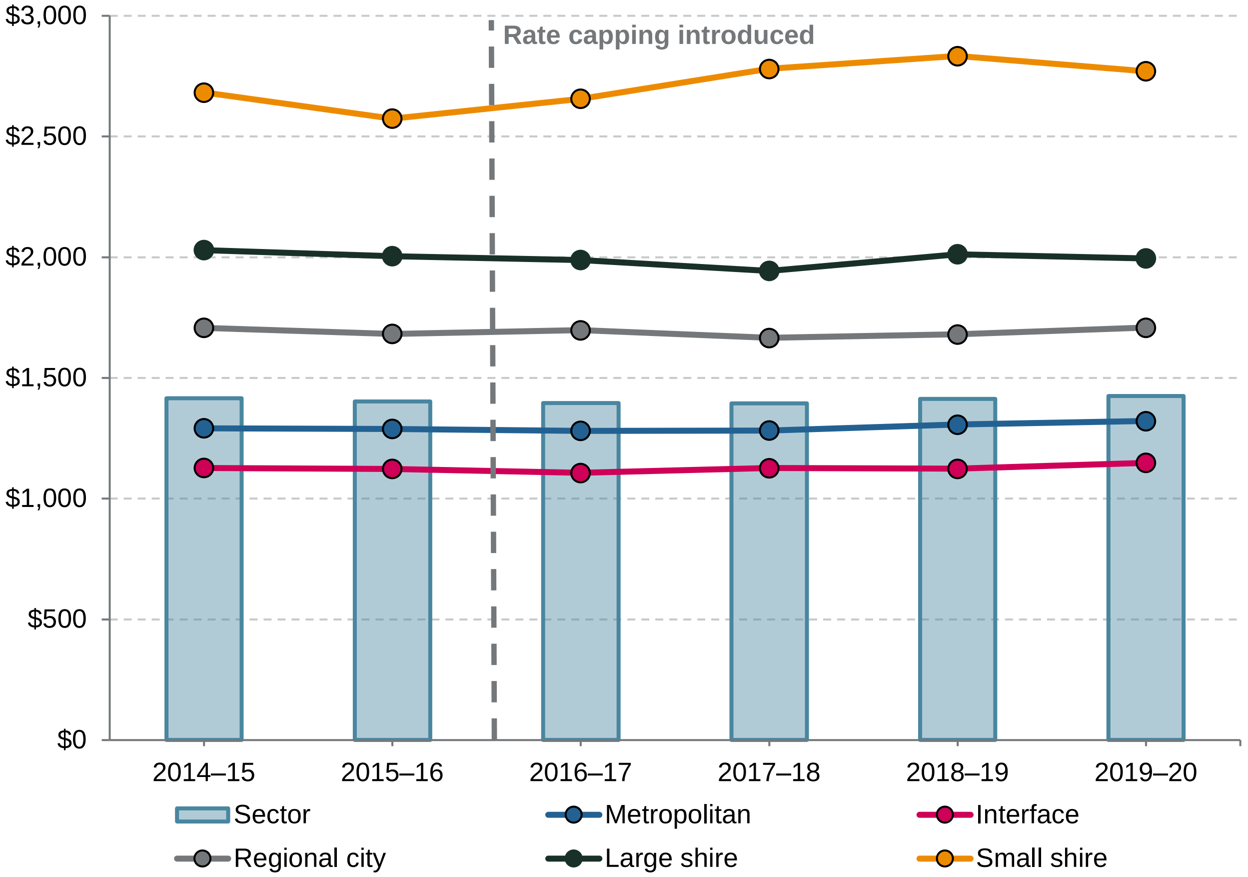
[73] Councils report their expenditure to the Victorian Local Government Grants Commission across a set of broad service functions. These functions reflect the services provided by councils at a high level, although the categorisation of expenditure into these service areas may not be consistent across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

[74] 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 has been

For the sector as a whole, total service expenditure per person increased on average over the first four years of rate capping (See Figure 5.1). Service expenditure per person also increased for all council groups except the large shire group.

Figure 5.1 Service expenditure per person

Inflation-adjusted, 2019–20 dollars



Data sources: Victorian Local Government Grants Commission – VGC1 data 2014–15 to 2019–20 (unaudited); Australian Bureau of Statistics (2020) 'ERP by LGA (ASGS 2019), 2001 to 2019', Estimated Resident Population, accessed 20 January 2021; Australian Bureau of Statistics (September 2020) 'TABLES 1 and 2. CPI: All Groups, Index Numbers and Percentage Changes' [time series spreadsheet], Consumer Price Index, Australia, accessed 20 January 2021.

There was no overall decrease in service expenditure for the sector as a whole in 2019–20 in response to the coronavirus pandemic, unlike the impact on revenue. However, lockdowns and other impacts of coronavirus are likely to have changed the allocation of expenditure between service functions. The average annual changes in expenditure for the different service areas (discussed below) may partly reflect these changes in allocation of expenditure.

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.

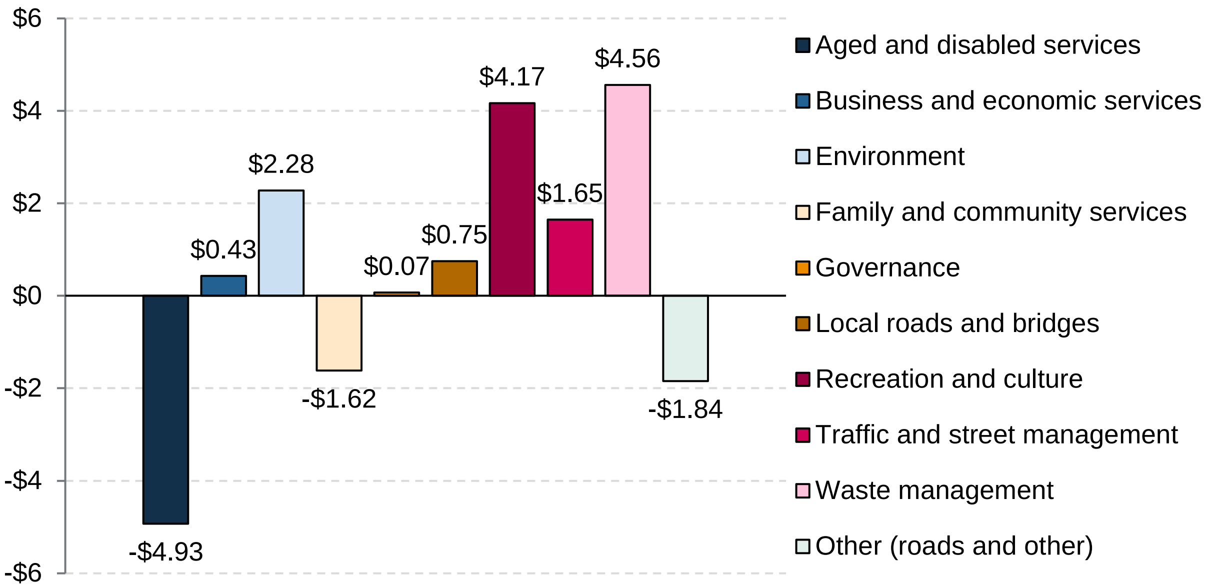
There were increases in expenditure in most service areas

> For the sector as a whole, service expenditure per person increased in all but three service areas — aged and disabled services, family and community services, and 'other'.

Figure 5.2 shows whether, for the sector as a whole, average annual expenditure per person in each service area increased or decreased in the first four 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 annual increase or decrease in service expenditure per person in the first four years of rate capping

For the sector as a whole (inflation-adjusted, 2019–20 dollars)



Data sources: Victorian Local Government Grants Commission – VGC1 data 2014–15 to 2019–20 (unaudited); Australian Bureau of Statistics (2020) 'ERP by LGA (ASGS 2019), 2001 to 2019', Estimated Resident Population, accessed 20 January 2021; Australian Bureau of Statistics (September 2020) 'TABLES 1 and 2. CPI: All Groups, Index Numbers and Percentage Changes' [time series spreadsheet], Consumer Price Index, Australia, accessed 20 January 2021.

At a sector level, expenditure per person increased in all but three service areas — aged and disabled services, family and community services, and 'other'.

Expenditure per person on the waste-management and environment service areas increased for the sector as a whole and all council groups. This may reflect changes in the waste and recycling industry (and potentially increased waste and cleaning costs relating to the coronavirus pandemic in 2019–20). All council groups except the regional city group also had increased expenditure per person on recreation and culture.

Expenditure per person on aged and disabled services decreased across all council groups. Most councils have either stopped providing these services or reduced them in response to Australian Government reforms in these areas (for example, the introduction of the National Disability Insurance Scheme and the Commonwealth Home Support Programme).

Expenditure per person on 'family and community services' decreased for all council groups (except the small shire group).

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.[75] However, it is also important to consider any changes in the quality of services or their alignment with the needs and preferences of the community.

Ratepayers and community members are best positioned to judge changes in service quality

Service delivery varies across the sector reflecting the different composition, expectations and priorities of communities. The types, levels, and quality of service that councils provide also vary depending on factors like:

- the geography and topography of their region
- 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 to 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[76] or more detailed service quality data published by their council.

This section presents a sample of measures that are 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.

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

[76] The Local Government Performance Reporting Framework is a mandatory system of performance reporting for all Victorian councils. It is administered by Local Government Victoria (knowyourcouncil.vic.gov.au).

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.

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 are available on our website.[77] Figure 5.3 shows the results for the sector as a whole. Information on the other service quality measures can be found at www.knowyourcouncil.vic.gov.au.

For the sector as a whole, the percentage of 'planning applications decided within required timeframes' trended upwards between 2016–17 and 2019–20. This indicates an improvement in this measure of service quality.

However, the number of 'kerbside collection bins missed' also trended upwards on average across the sector — in this case indicating a reduction in the standard of service. This measure may have been impacted by recent market disruptions in the waste and recycling industry (including the collapse of some operators in that industry).

The percentage of 'sealed local roads maintained to condition standards' fluctuated year to year, but remained at a broadly similar level over time.

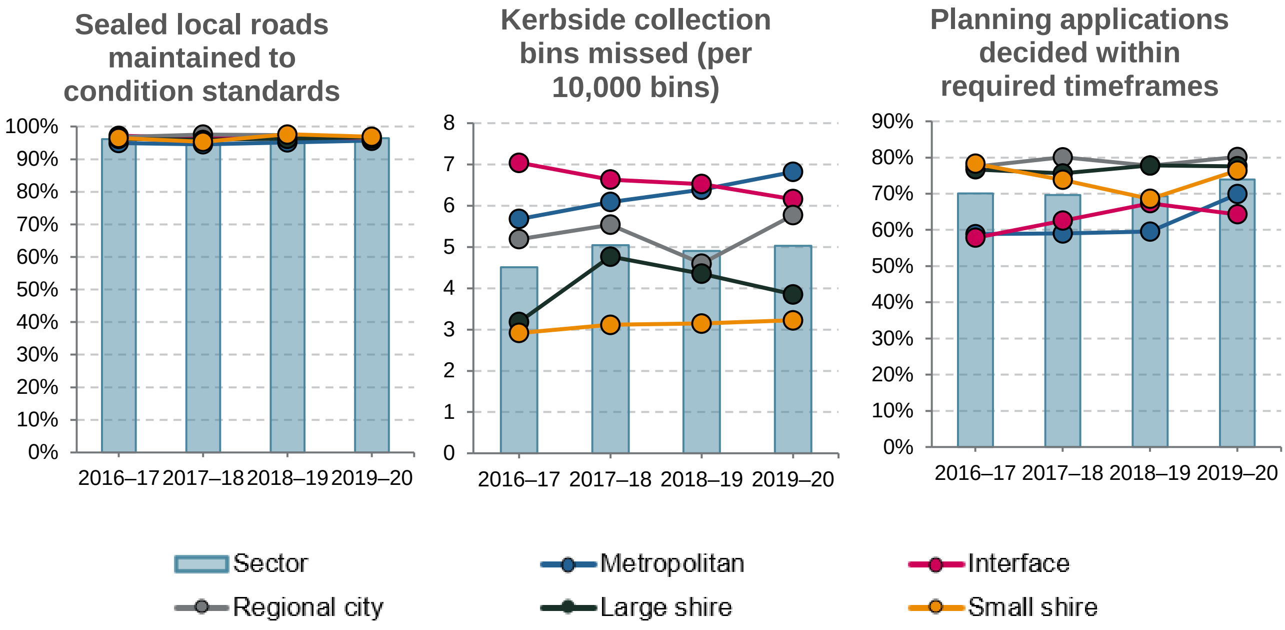
The trend in each indicator varied across the council groups between 2016–17 and 2019–20:

- All groups except the interface and regional city groups saw an improvement in the percentage of 'sealed local roads maintained to condition standards'.
- All groups except the interface group saw an increase in 'kerbside collection bins missed' (a reduction in the standard of service).
- All groups except the small shire group saw improvement in the percentage of 'planning applications decided within required timeframes'.

While there was variation across council groups, for each group, at least one service quality indicator has shown improvement in the first four years of rate capping.

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

Figure 5.3 Selected measures of service quality



Data source: Local Government Performance Reporting Framework (knowyourcouncil.vic.gov.au).

Community satisfaction measures improved

For the sector as a whole, there was improvement in all three community satisfaction measures. All council groups saw improvement in at least one satisfaction measure.

The Local Government Performance Reporting Framework also includes three measures of community satisfaction taken from an annual independent survey of community members.[78] While some councils include more than three measures of community satisfaction in the survey (including a measure of overall performance), data for the sector as a whole is limited to the three measures shown in Figure 5.4. More information about the annual Community Satisfaction Survey can be found at https://www.localgovernment.vic.gov.au/our-programs/council-community-satisfaction-survey.

There was an improvement, on average, across the sector in all three indicators between 2016–17 and 2019–20, despite a decrease in satisfaction in 2019–20.

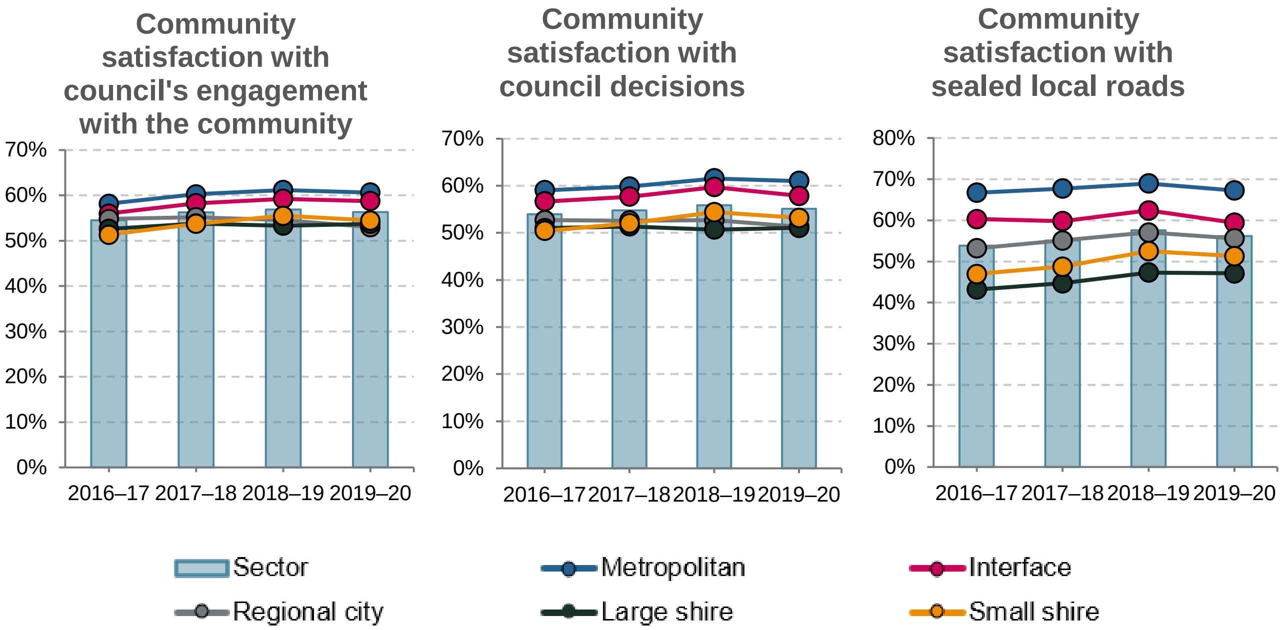
[78] Not all councils participate in the annual Community Satisfaction Survey. Results in the Local Government Performance Reporting Framework are drawn from this survey and from separate surveys by councils that choose to do their own.

Across the council groups, there was some variation. On average between 2016–17 and 2019–20 there was:

- an improvement in community satisfaction with councils' engagement with the community for all council groups except the regional city group
- an improvement in community satisfaction with council decisions for all council groups except the regional city group
- an improvement in community satisfaction with sealed local roads for all council groups except the interface group.

Each council group saw improvement in at least one community satisfaction measure. Three of the five council groups (the metropolitan, large shire and small shire groups) improved across all three measures.

Figure 5.4 Community satisfaction measures



Data source: Local Government Performance Reporting Framework (knowyourcouncil.vic.gov.au).

6. Financial position

This chapter looks at what happened to councils' financial positions in the first four years of rate capping (2016–17 to 2019–20). 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:** In general, the financial health of the sector remained strong.
- **Operating position:** The sector's operating position remained positive in each of the first four years of rate capping. On average, each council group had enough revenue to fund the group's activities.
- **Working capital:** All councils had average levels of working capital that the Victorian Auditor–General's Office classifies as low risk.
- **Indebtedness:** All but eight councils had average levels of indebtedness that the Victorian Auditor–General's Office classifies as low risk.

This chapter focuses on the sector as a whole – 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).[79] The analysis is based on numbers that have been adjusted for inflation.

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

6.1. The sector's financial position remained positive

The operating position for the sector as a whole was positive in each of the first four years of rate capping.

The adjusted underlying result shows a council's operating position, and whether or not 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 remaining revenue from operations,

[79] 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.

minus expenditure, yields an operating surplus or deficit. This is then reported as a percentage of the council's adjusted revenue figure, to make comparisons with other councils meaningful.

The sector as a whole had a positive adjusted underlying result in each of the first four years of rate capping. Between 2016–17 and 2018–19, all council groups reported positive adjusted underlying results in each year – except for the small shire group in 2017–18. In 2019–20, all groups except the metropolitan group reported a negative result.

The sector's operating position varied from year to year

Over the four-year period, there was substantial year-on-year variation in reported operating positions. Some of this came from the advance receipt of part of councils' annual financial assistance grant in some years (see Box 6.1 for more detail). Some variation was related to changes in accounting standards. Other fluctuations reflect natural disasters such as floods and fires. In 2019–20, many councils reported higher costs and lower income, from the impacts of coronavirus on their normal operations.

Given this variation, simple year-on-year changes may not clearly indicate council sustainability. For this reason, we look at the four-year average.

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

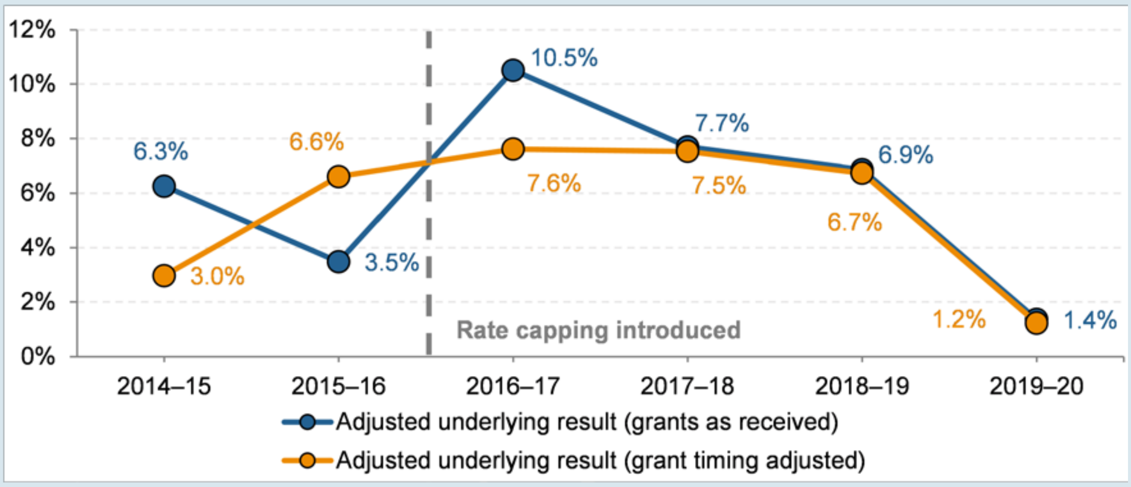
Councils are required to report financial assistance grant revenue in the year it is received, even if it is a payment for the following year.

In 2014–15 and 2016–17, councils received about half of their annual financial assistance grants from the Australian Government in advance of the years to which they related. This resulted in higher revenue in these years, which is reflected in the relatively higher average results. The advance payment of grants in 2014–15 also means that adjusted underlying results were likely understated in 2015–16 due to the lower revenue received in that year.

Adjusting for the timing of financial assistance grant payments results in a much smoother trend in adjusted underlying result for the sector as a whole.

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.

We can adjust for the timing of grant payments for the sector as a whole by moving relevant portions of the grants to the year they related to. However, we are unable to make this adjustment at the individual council or group level.

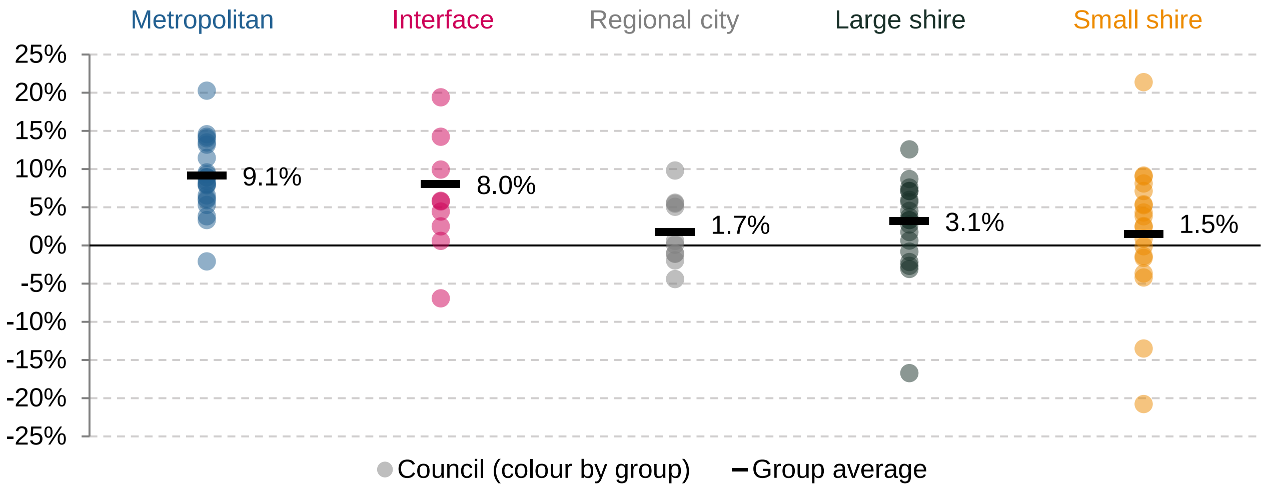
6.2. Most councils had positive operating positions

In the first four years of rate capping, 18 of 79 councils had, on average, negative operating positions.

For the sector as a whole, the average adjusted underlying result over the first four years of rate capping was 6.6 per cent. An ongoing positive result suggests that the sector as a whole was able to fund the levels of service provided.

However, 18 councils reported a negative average adjusted underlying result over the four-year period.[80] Most of these councils were either small shires (seven) or large shires (five), while four were regional city councils, one metropolitan council and one interface council (See Figure 6.1).

Figure 6.1 Average adjusted underlying results in the first four years of rate capping



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 2016–17 to 2019–20.

Data source: Local Government Performance Reporting Framework.

[80] Our 2019 report on the outcomes of rate capping observed that 18 councils had reported an adjusted underlying deficit, on average for 2014–15 to 2017–18. Two years later, while 4 of those councils have moved to an average surplus, the other 14 report a continuing deficit on average for 2016–17 to 2019–20.

It is quite common for councils to report a deficit from time to time. However, councils that report ongoing negative results might 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 increase their operating revenue or reduce their expenditure.

It is worth noting that all 18 councils with average negative operating results remain low risk in terms of working capital and that only three are considered medium risk and one high risk for indebtedness. These measures are discussed in the following sections.

6.3. All councils had sufficient assets to meet their immediate financial obligations

In the first four years of rate capping, all councils had average levels of working capital that the Victorian Auditor–General's Office classifies as low risk. This means they had enough assets available to meet their short-term liabilities, with funds remaining to deal with unexpected expenses.

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. 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.

The Victorian Auditor−General's Office considers that any 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. Figure 6.2 shows that no council group would have had difficulty meeting the group's liabilities in any year between 2014–15 and 2019–20. The working capital ratio for each group increased over this period, despite a decrease in 2019–20.

Working capital can change for many reasons

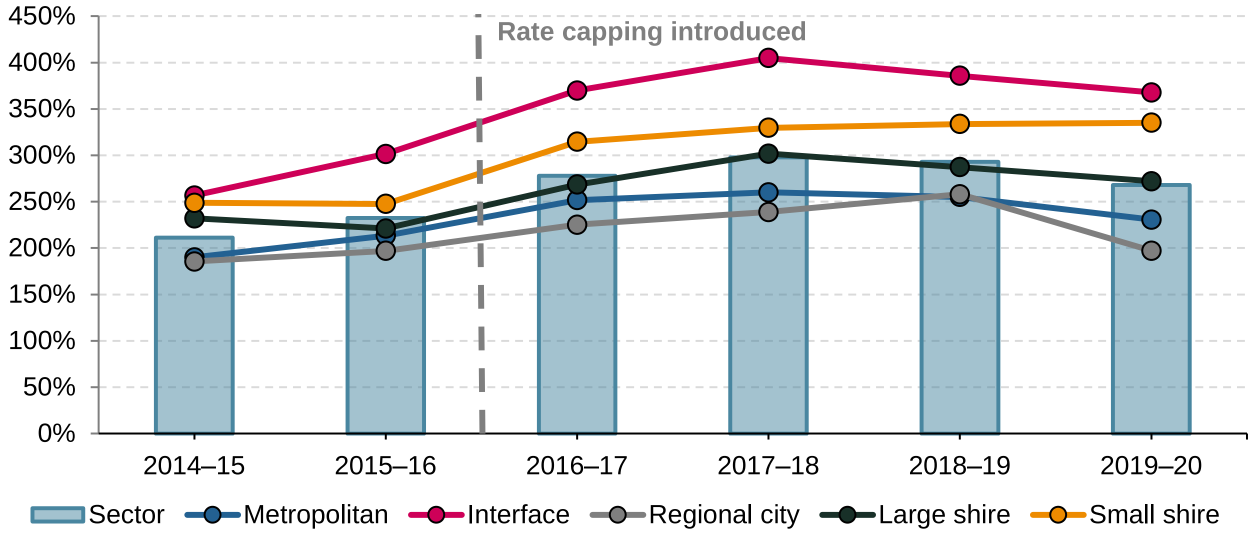
The changes in working capital for the sector may reflect councils:

- 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 coronavirus
- responding to changed accounting standards – for example, standards relating to the recognition of leases and unearned income.

In the first four years of rate capping, the average working capital ratio for the sector as a whole was 305 per cent. Only eight councils had an average below 200 per cent. Only one metropolitan council and two regional cities averaged below 150 per cent.

Figure 6.2 Working capital ratios



Data source: Local Government Performance Reporting Framework.

Two councils in the small shire group reported an average working capital ratio above 650 per cent over the first four years of rate capping. This lifted the average ratio for the whole group. Small shire councils are more likely to build up cash reserves to fund their capital investment than the larger metropolitan and regional city councils. This is because they have more limited revenue from rates and other own-source income, and therefore less capacity to repay loans.

Some interface councils also reported high working capital ratios. These may reflect extensive capital works programs and the timing of developer contributions they receive.

6.4. Debt levels remained low across the sector

In the first four years of rate capping, all but eight councils had average levels of indebtedness that the Victorian Auditor–General's Office classifies as low risk. This means they had enough revenue to meet their long-term liabilities.

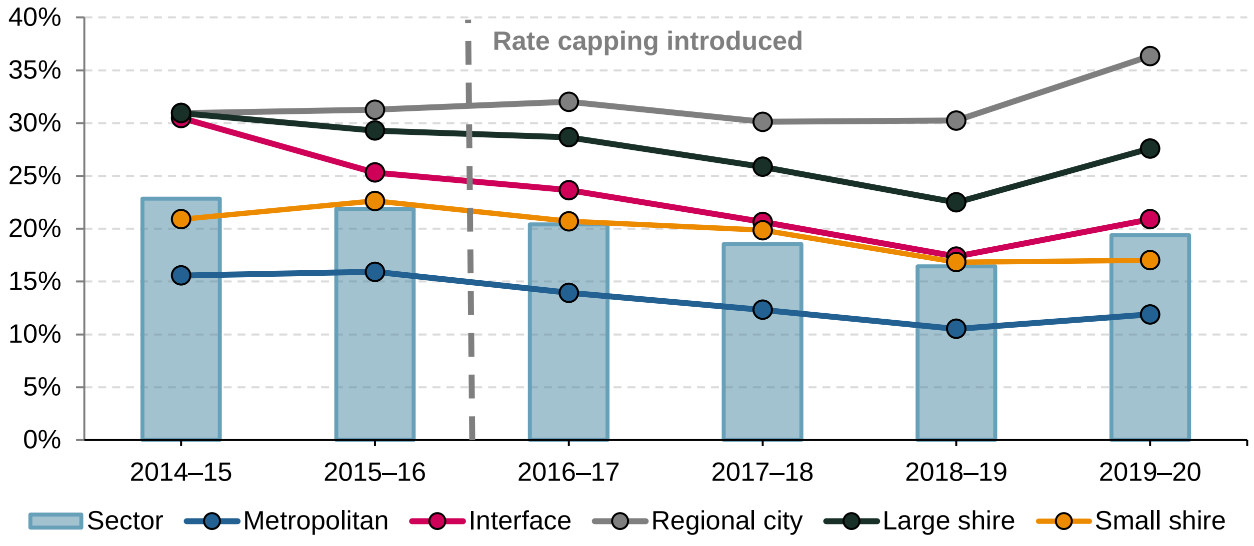
The indebtedness ratio shows a council's non-current liabilities as a percentage of its own-source revenue. Non-current liabilities include interest-bearing long-term loans and borrowings, and provisions for future costs (such as landfill remediation or long-service leave). Own-source revenue includes:

- rates and charges
- user fees and statutory fees and fines
- revenue from joint ventures and the sale of assets.

The sector as a whole maintained an indebtedness ratio below 25 per cent in each of the first four years of rate capping (see Figure 6.3). This is well within the Victorian Auditor–General's low risk category for this indicator. The Victorian Auditor–General's Office considers that any council with an indebtedness ratio of more than 40 per cent may have some difficulty in repaying debt levels from own-source revenue.

Figure 6.3 shows that no council group would have had difficulty meeting the group's long-term liabilities from the group's own-source revenue in any year between 2014–15 and 2019–20. Over the first four years of rate capping, eight councils have reported an average ratio of more than 40 per cent. They include four regional cities, two large shires, one small shire and one interface council. Only one of these councils had an average ratio over the four years that was considered high risk.[81]

Figure 6.3 Indebtedness ratios



Data source: Local Government Performance Reporting Framework.

[81] The Victorian Auditor–General's Office considers a council's financial sustainability to be high risk if indebtedness is above 60 per cent.

For the sector as a whole and for all council groups, indebtedness trended downwards before an increase in 2019–20. The increase in 2019–20 reflects both lower own-source revenue (due in part to the impacts of coronavirus) and higher reported liabilities relating to a change in accounting standards.[82]

The sector paid off some debt

The number of councils holding debt reduced from 70 in 2016–17, to 61 in 2019–20, with the total value of debt decreasing by $258 million over this time (See Table 6.1).[83] In 2019–20, the sector held $151 of debt for every person in Victoria, which was 26 per cent less than the value of debt per person in 2016–17.

Table 6.1 Councils with interest-bearing loans and borrowings

Inflation-adjusted, 2019–20 dollars

	2014–15	2015–16	2016–17	2017–18	2018–19	2019–20
Number of councils holding debt	76	73	70	68	66	61
Total value of interest-bearing loans and borrowings held ($million)	1,337.5	1,297.7	1,252.4	1,134.4	1,069.5	994.6
Value of interest-bearing loans and borrowings per person ($/person)	226.92	215.51	202.91	179.47	165.53	150.80

Data sources: Council annual reports (audited); Australian Bureau of Statistics (2020) 'ERP by LGA (ASGS 2019), 2001 to 2019', Estimated Resident Population, accessed 20 January 2021; Australian Bureau of Statistics (September 2020) 'TABLES 1 and 2. CPI: All Groups, Index Numbers and Percentage Changes' [time series spreadsheet], Consumer Price Index, Australia, accessed 20 January 2021.

Councils typically have policies or strategies in place to guide their decisions about debt financing. What is appropriate for each council will depend on the council's circumstances, particularly its capacity to repay any loan.

[82] 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.

[83] Borrowings include both long-term and short-term (12 months or less) debt held by councils.

It is important to remember that 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.

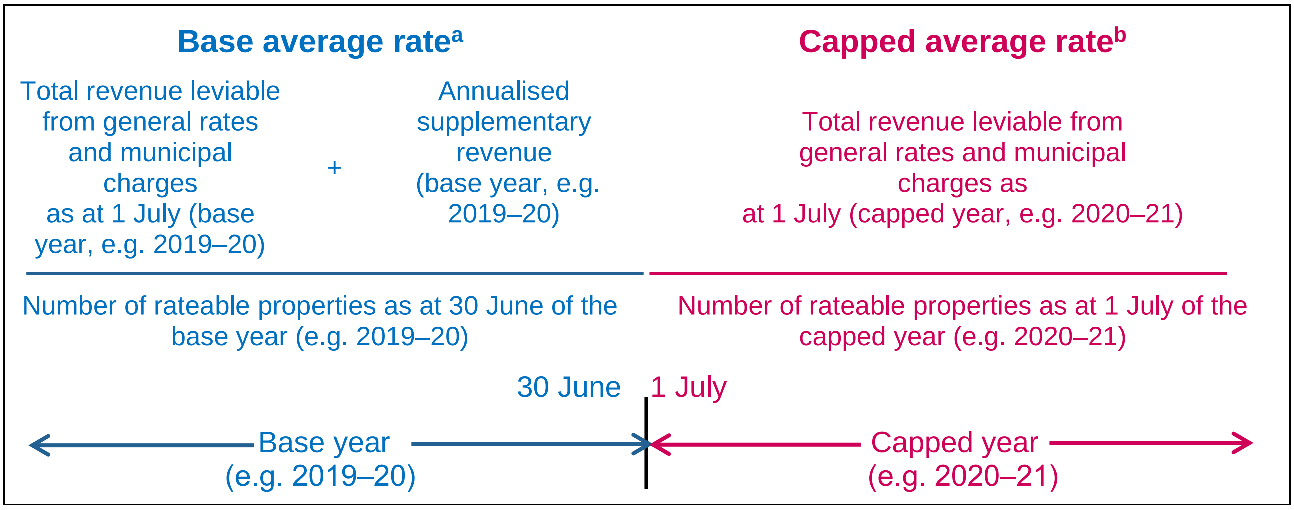
Appendix A: Rate cap explanation

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 rates



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 in the first five years of rate capping, 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
Minister's cap	**2.5%**	**2.0%**	**2.25%**	**2.5%**	**2.0%**	**1.5%**
Buloke Shire Council	3.05%					
Horsham Rural City Council	3.5%					
Moorabool Shire Council	3.5%					
Murrindindi Shire Council	4.3%					
Pyrenees Shire Council	3.83%	3.5%	3.5%			
Towong Shire Council	6.34%	5.55%	5.55%	5.55%	5.55%	
Hindmarsh Shire Council		4%				
West Wimmera Shire Council		3.5%	3.5%	3.5%	3.5%	
Monash City Council			2.57%			
Mansfield Shire Council				13.94%		
Warrnambool Shire Council				4.5%	4.5%	
Number of higher caps	**6**	**4**	**4**	**4**	**3**	**0**

Notes: In 2019, Warrnambool applied for a higher cap for three years. However, we approved only the first two. We did not receive any applications for a higher cap for the 2021–22 rating year.

We surveyed the councils with approved higher caps in the first four years of rate capping to check whether councils applied the higher caps that had been approved.

Two councils advised they applied a lower cap:

- 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, rather than the approved higher cap of 5.55 per cent.

As the 2020–21 rating year has not finished, for the purposes of this report, we did not survey councils about higher caps approved for 2020–21. However, based on the information provided by councils for our annual compliance report, none of the three councils with approved higher caps for 2020–21 chose to apply these higher caps.

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.[84] All councils that applied a higher cap confirmed they has 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 (https://www.esc.vic.gov.au/local-government/higher-rate-cap-applications/recent-higher-cap-applications).

[84] 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	Monash City Council
Frankston City Council	Moonee Valley City Council
Glen Eira City Council	Moreland 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	