

7 December 2015  
**Our ref:** C/15/18371

The Hon Natalie Hutchins MP  
Minister for Local Government  
Level 27, 1 Spring Street  
Melbourne VIC 3000

Dear Minister

**ESSENTIAL SERVICES COMMISSION'S ADVICE ON THE AVERAGE RATE CAP  
FOR 2016-17**

On 2 December 2015, you requested the Commission's advice on the following matters in setting the average rate cap, pursuant to section 185D(3)(a) of the *Local Government Act 1989* (the Act):

- A recommendation for any adjustments to be applied to Consumer Price Index (CPI) in setting the cap for all or any councils, and
- The rationale for any such adjustments and the quantum of such adjustments.

In response to your request and pursuant to 185D(4) of the Act, we provide the following advice.

The methodology outlined in our final report *A Blueprint for Change – Local Government Rate Capping and Variation Framework Review* (September 2015), was based on the following formula:

**Average rate cap = (0.6 x CPI) + (0.4 x WPI) – zero efficiency factor**

which applied a 60 per cent weighting to the rate of increase in the CPI and a 40 per cent weighting to the Wage Price Index (WPI), less an efficiency factor. The CPI and WPI measures were based on the latest available forecasts from the Department of Treasury and Finance (DTF). Our final report considered that the efficiency factor should be set at zero in the first year of the rate capping framework.

On 27 November 2015, the DTF updated its forecasts of growth in the CPI and WPI measures. The forecast rates of increase in the CPI and WPI for 2016-17 are 2.50 and 3.25 per cent, respectively. Applying these forecasts to the formula shown above (and maintaining a zero value for the efficiency factor) suggests the following average rate cap:

**Table 1: Average rate cap for 2016-17**

Average rate cap	2016-17
(a) Average rate cap based on CPI only	<b>2.50</b>
or	
(b) Adjusted average rate cap based on:	<b>2.80</b>
• 60 per cent weighting applied to rate of increase in CPI and	
• 40 per cent weighting applied to rate of increase in WPI	

On the basis of the information currently held by the Commission, we are not in a position to advise you on alternative rate caps for different classes of councils in 2016-17.

Using DTF's forecasts for future years (as at 27 November 2015) and applying a gradually increasing efficiency factor, suggests the following *estimates* for the rate cap:

**Table 2: Estimates for the average rate cap**

Year	2017-18	2018-19
CPI forecast (DTF)	2.50	2.50
WPI forecast (DTF)	3.50	3.50
Efficiency Factor	0.05	0.10
<b>Average rate cap (estimate)</b>	<b>2.85</b>	<b>2.80</b>

If you or your staff have any queries, please contact me on 9032 1316 or Andrew Chow on 9032 1323.

Yours sincerely



Dr Ron Ben-David  
**Chairperson**

cc: The Hon Robin Scott MP, Minister for Finance