



Parliamentary Budget Office

Local government responsibilities, revenue, and expenditure

Submission to the inquiry into local
government funding and services

Parliamentary Budget Office

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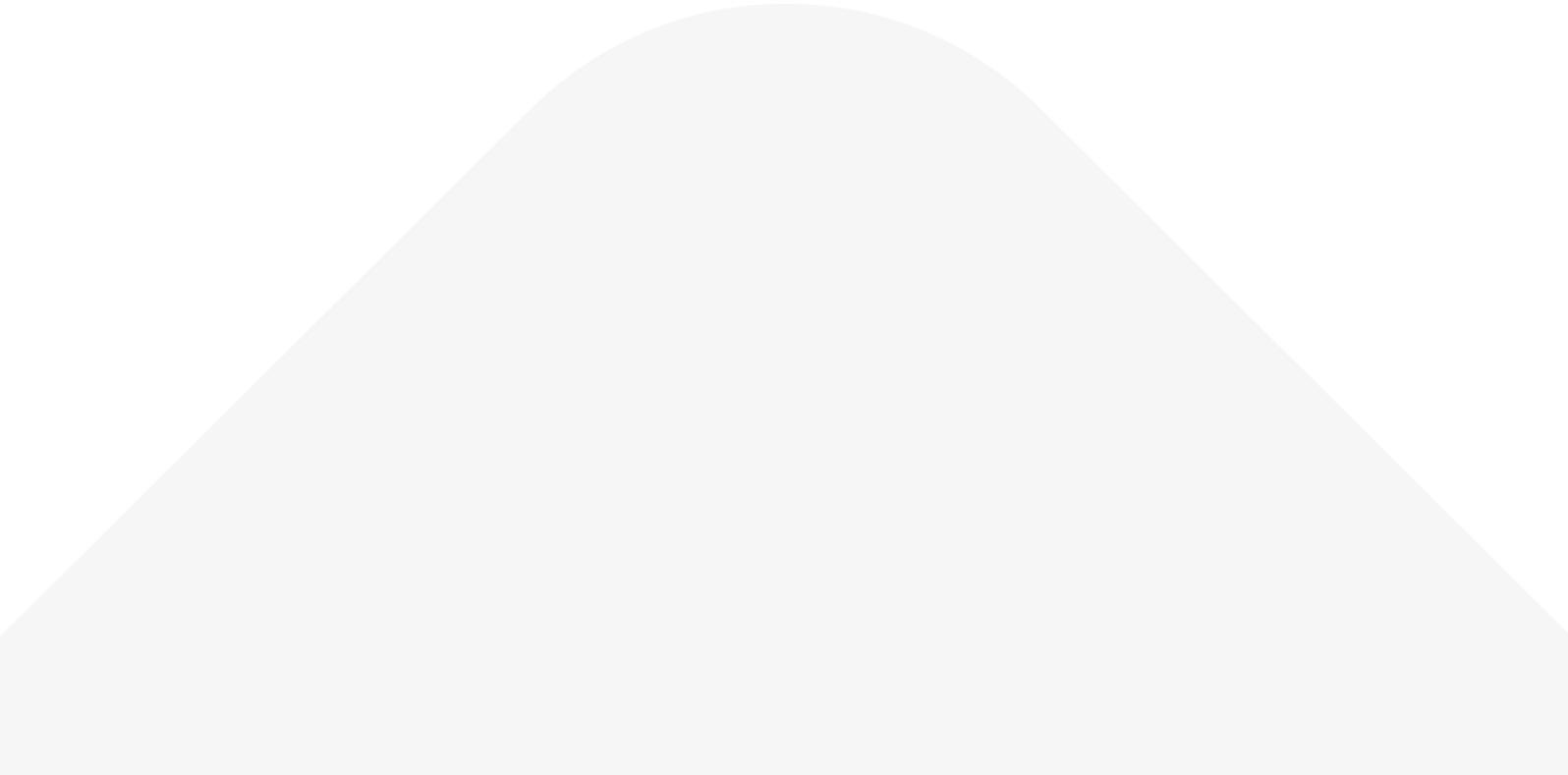
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In brief

In this submission, we outline Victorian council responsibilities for service delivery, revenue and expenditure. We also examine the imbalances in revenue and expenditure between levels of government and across types of councils.

Council responsibilities

Victorian councils provide services to their constituents, and invest in and maintain assets. Service responsibilities are outlined under more than 120 pieces of legislation however councils have discretion to provide other services to meet constituent needs. Councils services include:

- waste and recycling
- local road maintenance
- planning applications assessment
- maternal and child health services
- food safety regulation
- operation of council owned businesses.

Councils also undertake asset works to construct new assets or to renew, expand or upgrade existing assets. Council assets can include land, buildings and equipment such as:

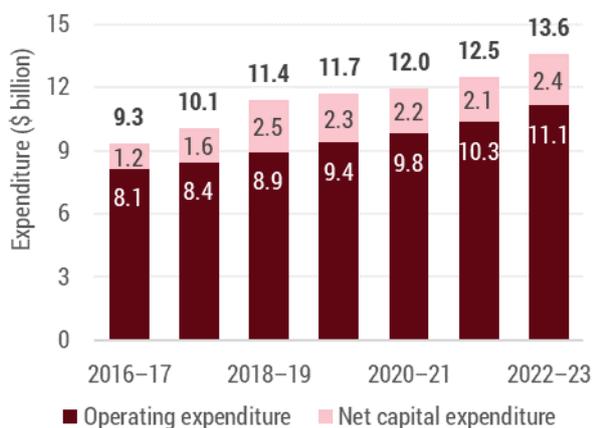
- Local roads and bridges
- Recreation and cultural facilities
- Traffic and street management
- Service related facilities.

Council expenditure

Victorian councils fund services and invest in new and existing assets. Total council expenditure consists of operating expenditure on services and net capital expenditure on assets.

Since 2016-17, total expenditure has grown by an average of 6.4% per year to \$13.6 billion in 2022-23.

Figure 1 – Council expenditure



Source: ABS and Parliamentary Budget Office.

In 2022-23, operating expenditure was \$11.1 billion accounting for 82.1% of total expenditure. This share has fallen since at least 2016-17 when it was 87.0%.

Net capital expenditure has outpaced operating expenditure but is also considerably more volatile. Since 2016-17, annual growth in:

- operating expenditure was between 3.8% and 7.7%
- net capital expenditure was between -7.9% and 51.4%.

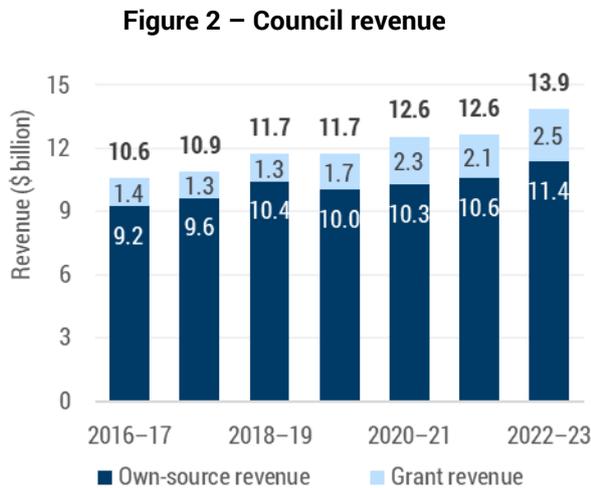
Council expenditure is driven by factors including:

- growth in population
- demographic shifts
- input costs (such as fuel and wages)
- asset cost escalation (inflation).

Council revenue

Councils get revenue from 2 main sources:

- Own-source revenue – the revenue they generate themselves from sources like rates and fees.
- Grant revenue – provided by the Australian and Victorian governments as general support or for specific purposes.



Source: ABS and Parliamentary Budget Office.

Like expenditure, total revenue has grown steadily albeit at a slower rate of 4.6% per year to \$13.9 billion in 2022-23.

In 2022-23, own-source revenue was \$11.4 billion accounting for 81.9% of total revenue.

Councils have become more reliant on grant revenue, which has grown from 12.8% of total revenue in 2016-17 to 18.1% in 2022-23.

Victorian Local Government Grants Commission data indicates that Australian Government grants make up more than half of grant revenue, however this share has fallen from 67.4% in 2016-17 to 58.5% in 2022-23.

Council revenues are explicitly or functionally constrained by factors including:

- Victorian Government cap on rate revenue
- value of properties subject to rates
- socio-economic status of residents
- council operation of businesses.

Vertical and horizontal fiscal imbalance

There are 2 kinds of fiscal imbalance relevant to Victorian councils.

- Vertical fiscal imbalance – the extent to which revenue generation and expenditure responsibilities are not aligned for different levels of government.
- Horizontal fiscal imbalance – the extent to which there is variation across councils in their ability to generate sufficient revenue to undertake their expenditure responsibilities.

Councils face an imbalance in either of these measures if they generate insufficient revenue to fund their expenditure responsibilities. What we include in expenditure responsibilities is crucial to this analysis, and we consider 2 measures of fiscal imbalance which we apply to both our vertical and horizontal fiscal imbalance analysis.

- **comprehensive fiscal imbalance** – the difference between own-source revenue and the combined funding requirement of operating and net capital expenditure.
- **operating fiscal imbalance** – the difference between own-source revenue and operating expenditure.

While we assess both measures, we focus on the comprehensive measure as it better explains whether councils can generate sufficient revenue to fund their responsibilities.

Vertical fiscal imbalance

Different levels of government have different expenditure responsibilities and abilities to generate revenue. Vertical fiscal imbalance arises when a level of government does not generate sufficient revenue to fund its expenditure responsibilities.

The Australian Government has an outsized capacity to generate revenue, driven by its responsibility for income taxes, and taxes on goods and services. The Victorian Government, by contrast has broad service delivery responsibility. It relies on redistributions from the Australian Government to meet its operating and other expenditures. The Victorian Government is subject to a vertical fiscal imbalance.

Figure 3 – Vertical fiscal imbalance per person, 2022-23



Notes: Own-source revenue is total revenue minus grants and subsidies. Own-purpose operating expenditure is total operating expense minus grants and transfers to other levels of government.

Source: ABS, Department of Treasury and Finance, Parliamentary Budget Office.

In 2022-23, Victorian councils are subject to a:

- **comprehensive vertical fiscal imbalance** of \$2,181 million equivalent to 19.2% of own-source revenue
- but not an **operating vertical fiscal imbalance** with a surplus of \$245 million or \$36 per person.

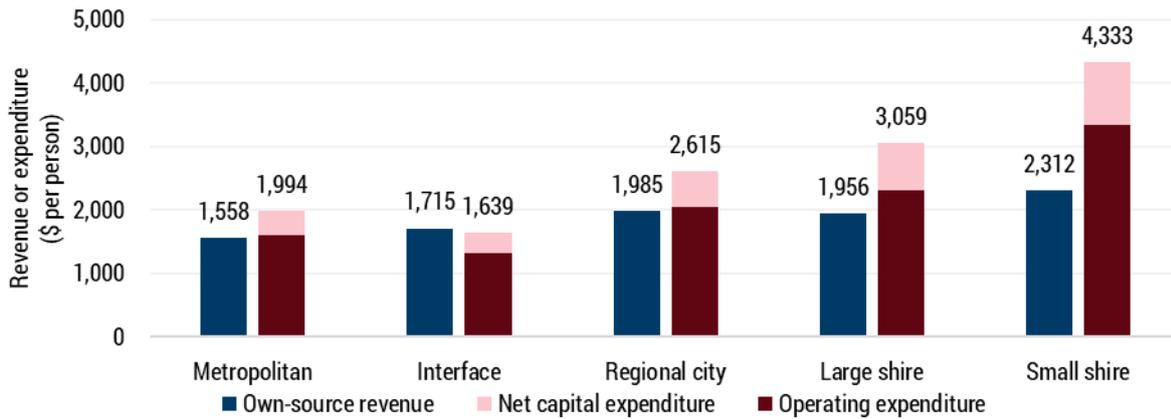
This means that when considering all council expenditures, they are reliant on grants from the Australian and Victorian government.

This result is consistent over time, with Victorian councils in **comprehensive vertical fiscal imbalance** since at least 2016-17 but not in an **operating vertical fiscal imbalance** in any year. The **comprehensive vertical fiscal imbalance** has grown over time – from \$0.1 billion in 2016-17 to \$2.2 billion in 2022-23.

Horizontal fiscal imbalance

Different types of councils have different relative expenditure responsibilities and abilities to generate revenue. Even within council types there is variation in what they spend and what revenue they can raise.

Figure 4 – Comprehensive horizontal fiscal imbalance per person, 2022–23

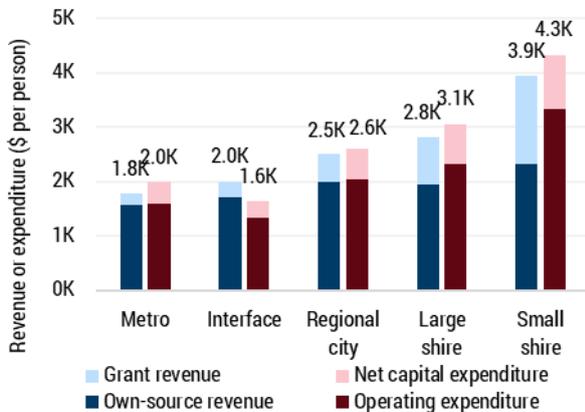


Note: Own-source revenue includes non-recurrent revenue; operating expenditure includes non-recurrent expenditure.
 Source: VLGGC and Parliamentary Budget Office.

In 2022-23, all Victorian council types other than interface experienced a negative imbalance between their own-source revenue and their total expenditure:

- Metropolitan councils experienced the smallest negative imbalance, with average own-source revenue of \$1,558 per person, equivalent to 78.1% of total expenditure (\$1,994 per person).
- Small shire councils experienced the largest imbalance, with average own-source revenue of \$2,312 per person, equivalent to 53.4% of total expenditure (\$4,333 per person).

Figure 5 – Total revenue and expenditure



Source: PBO and VLGGC.

Councils’ ability to change their own-source revenue is constrained by Victorian government regulation limiting growth in rates revenue, fees and fines.

This makes it difficult for councils to address their horizontal fiscal imbalance and, therefore, their reliance on grants from other levels of government.

Including grant revenue, many council still face a shortfall in funding to meet their operating and net capital expenditures.

Even if councils had full autonomy to set the level of rates revenue they seek to raise, they face 2 natural constraints: the size of the rate base (value of properties) and ability of their rate payers to bear the burden.

Council with the largest horizontal fiscal imbalances, tend to have smaller rate bases and lower socio-economic status, an indicator of their ability to pay. Frequently, these councils already levy a larger relative rate burden on their residents than metropolitan and interface councils. This indicates that residents of councils paying the proportionally highest rates, the same councils that are most reliant on the Australian and Victorian government grants, may be the those least able to afford them.

About this submission

Request

On 25 September 2023, Ms Georgie Purcell MP, Chair of the Legislative Council Economy and Infrastructure Committee (the Committee), requested that the Parliamentary Budget Officer provide an independent submission to the Committee's inquiry into local government funding and services (the Inquiry).

Inquiry terms of reference

On 3 May 2023, the Legislative Council agreed to the following motion: that the Committee inquire into, consider and report on local government funding and service delivery in Victoria, including but not limited to:

1. the effects of cost-shifting from the state and federal governments to local councils in an examination of vertical and horizontal fiscal imbalances
2. whether local councils are adequately delivering on their core service delivery objectives
3. the overall revenue structure of local government
4. whether the existing revenue structure is sustainable and appropriate or if alternative models of funding would be more sustainable and appropriate
5. any other related matters.

Scope

In this submission we respond directly to the request from Ms Georgie Purcell MP, Chair of the Committee, which sought information on:

- Victorian council responsibilities for service delivery
- costs of delivering these services
- how councils are funded, including Australian government grants, state government grants, and own-source revenue
- vertical fiscal imbalance, including:
 - overall imbalance between council revenue and expenditure;
 - a breakdown of the imbalance by services (e.g. some services may be funded by specific Australian government grants)
 - a breakdown of the imbalance by council type (metro, suburban and regional) if relevant
- horizontal fiscal imbalance, including:
 - comparison of revenue-raising capacity
 - rates and actual revenue (per person) by council type
 - comparison of expenditure per person by council type.

Attachment B provides page number references against the request and the inquiry terms of reference.

Limitations

In this submission, we base our aggregate analysis of council finances on ABS Government Finance Statistics (GFS). The GFS provides a consistent framework for aggregate measures of council revenue, operating expenditure, and net capital expenditure across levels of government. For breakdowns by council type or service types, we base our analysis on the Victorian Local Government Grants Commission (VLGGC) annual survey of councils. There are some methodological and accounting differences between these sources. These relate to:

- the timing and reporting requirements of the VLGGC survey
- separate reporting of recurring and non-recurring revenue and expenditure items in the VLGGC survey.

Unless otherwise stated, the revenue and expense for each council type in this submission includes non-recurring operating expenditure and revenue.

Use and analysis of this data should consider that the underlying data is based on council responses to the survey each year and may include some errors. We made small adjustments to correct inconsistencies and possible input errors.

We have collated data for councils to a geographic type for the purposes of this submission; however, the revenue and expenditure for each individual council may differ markedly to the averages for its type.

We prepared this submission on 12 July 2024.

Background

In this section

In this section we outline council:

- governance
- types
- performance reporting.

The Victorian Constitution (formally the *Constitution Act 1975*) recognises local government as a distinct and essential tier of government. The Victorian Constitution establishes that councils include democratically elected councillors as well as an administration that implements and facilitates council functions and decisions.

Governance

The *Local Government Act 1989*, the *Local Government Act 2020* and associated regulations establish how councils operate. These acts:

- specify the purpose of councils – to govern for the benefit and wellbeing of the municipal community
- define roles and responsibilities of the elected council and council staff
- give powers to councils – including the ability to make local laws and levy rates
- outline requirements for governance and decision-making – including budgets and financial plans.

The Minister for Local Government oversees the system of local government in Victoria. Local Government Victoria, which is part of the Department of Government Services, supports the Minister, including:

- providing advice and publishing guidance for councils
- administering recurrent and capital funding to councils from the Victorian Government
- providing administrative and policy support to the Victorian Local Government Grants Commission.

Local Government Victoria collects information about council performance as part of the Local Government Performance Reporting Framework. The framework measures council performance in selected service areas, including statutory planning and waste management.

Victorian Local Government Grants Commission

The *Victorian Local Government Grants Commission Act 1976* establishes the Victorian Local Government Grants Commission. The commission's primary function is to recommend how the Australian Government should distribute Financial Assistance grants to Victorian councils.

The commission makes recommendations based on the Commonwealth *Local Government (Financial Assistance) Act 1995* and a set of national distribution principles. There are 6 main principles:

1. horizontal equalisation – that grants be allocated on this basis to ensure that each council can function, by reasonable effort, at a standard not lower than the average standard of other councils in the state or territory
2. effort neutrality – individual council policies relating to revenue and expenditure efforts don't affect the way grants are determined
3. minimum grant – the minimum grant for a council is not less than the amount which councils would receive if 30% of the total grants were allocated on a per capita basis
4. other grant support – allocation decisions consider other relevant grant support that councils receive to meet expenditure needs assessed
5. Aboriginal and Torres Strait Islanders – their needs are recognised in council allocations
6. council amalgamations – where amalgamations of two or more councils occur, the new council receives the funds that the former councils would have received separately.

The Victorian Local Government Grants Commission surveys councils annually as part of their methodology for recommending Australian Government grants.

Municipal Association of Victoria

The Municipal Association of Victoria is the peak body representing councils. It advocates for the sector and provides advice and business services, such as insurance and procurement. It also negotiates and signs partnership agreements where local government shares service responsibilities with the Victorian Government.

The Victorian Government and the Municipal Association of Victoria signed the Victorian State-Local Government Agreement in 2014. The agreement outlines principles and processes for the 2 levels of government to work together, particularly regarding new legislation, regulations or program delivery which councils may administer or run on behalf of the Victorian Government.

The principles include that:

- the diversity of council financial capacity and the Victorian Government's fiscal position should be mutually recognised
- the use of intergovernmental agreements should be promoted to ensure that roles and responsibilities are articulated, and full financial considerations are made.

As part of this agreement, the Victorian Government committed to consult councils when planning new primary legislation, or new or revised regulation, that the Victorian Government intends councils to enforce. Under the agreement, the Victorian Government should consider the impact of this work, including any cost and resource impacts on councils.

Council types

There are 79 councils in Victoria, which vary in size, population and community need. Local Government Victoria classifies councils into 5 comparator groups, or types. Attachment D provides a list of councils in each type, along with the size of municipality and population.

Figure 6 – Council types

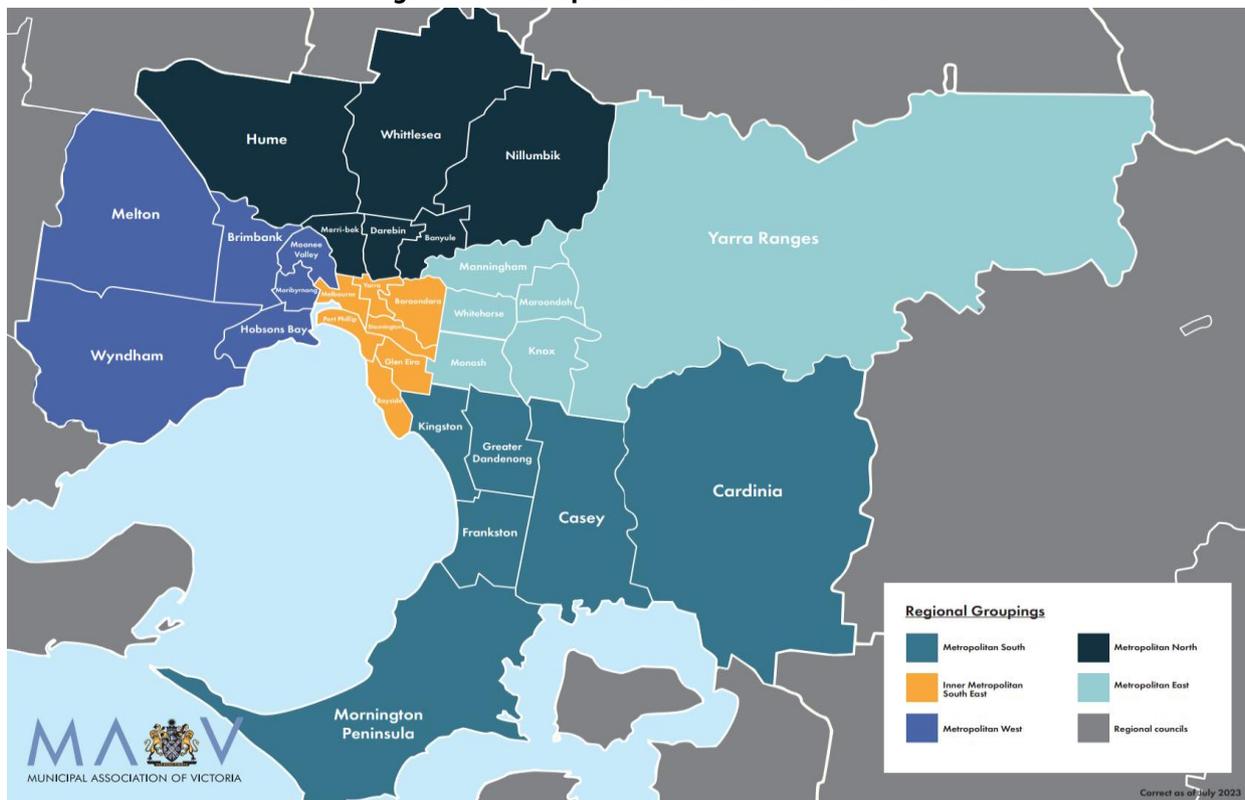
| Type | Number of councils | Total area (km2) | Total population | Population density (people/km2) |
|---------------|--------------------|------------------|------------------|---------------------------------|
| Metropolitan | 22 | 1,453.2 | 3,167,135 | 2,179 |
| Interface | 9 | 7,379.6 | 1,949,221 | 264 |
| Regional city | 10 | 39,382.2 | 860,463 | 22 |
| Large shire | 19 | 93,333.5 | 643,529 | 7 |
| Small shire | 19 | 85,664.4 | 194,140 | 2 |

Note: Area and population are based on Australian Bureau of Statistics estimated resident population data for 2023.

Source: Parliamentary Budget Office.

Metropolitan and interface councils can be grouped into 5 geographic areas across the broader metropolitan area. More than 75% of Victoria’s population lives across the 31 councils in this region.

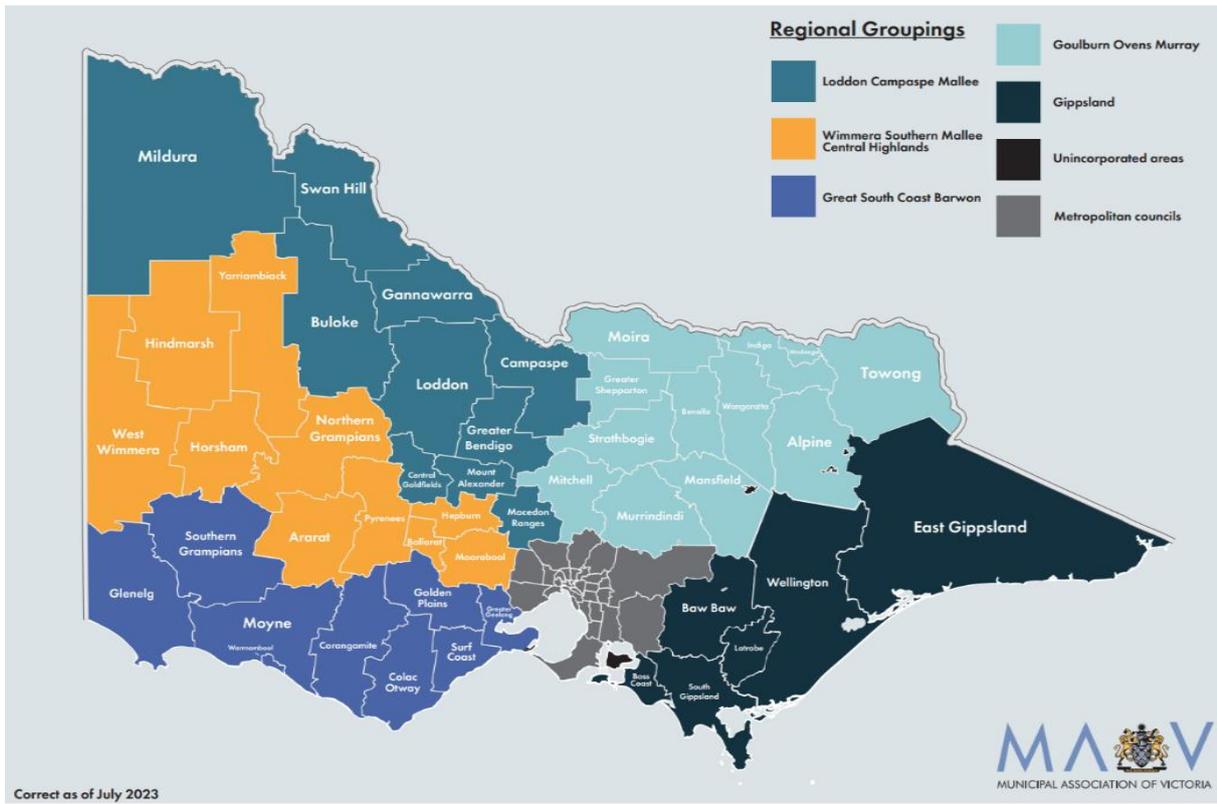
Figure 7 – Metropolitan councils in Victoria



Source: Municipal Association of Victoria.

Regional, large and small shire councils can be similarly grouped into 5 geographic areas across regional Victoria. While all councils have specific community needs and unique challenges, councils often work together regionally to advocate for funding. They may also share services or procurement as part of their group.

Figure 8 – Regional councils in Victoria



Source: Municipal Association of Victoria.

Council responsibilities

In this section

In this section we discuss:

- legislature and other mechanisms outlining council responsibilities
- council services and other responsibilities.

Victorian councils provide services to their constituents, and invest in and maintain assets.

Determining council responsibilities

Legislated responsibilities

Council responsibilities, which include managing assets and delivering services, are governed by more than 120 pieces of legislation. For example:

- the *Local Government Act 1989* gives councils control and management of local roads, sewers and drains
- the *Planning and Environment Act 1987* establishes councils as the planning authority for planning schemes in force in their municipality
- the *Emergency Management Act 2013* requires councils to prepare local emergency management plans and facilitate community emergency preparedness activity
- the *Public Health and Wellbeing Act 2008* requires councils to develop and enforce public health policies and programs in their local area, coordinate immunisation services for children and support public health planning.

Councils share some service delivery responsibilities with the Victorian Government. Some of these services receive funding from the Victorian Government, while other responsibilities are delegated under legislation with no funding.

The Municipal Association of Victoria has signed several partnership and service agreements which clarify these responsibilities. For example, the Municipal Association of Victoria and the Environment Protection Authority Victoria have signed an agreement relating to shared regulatory responsibilities for litter, illegal dumping and noise.

Under the *Local Government Act 2020*, councils must prepare and adopt a council plan every 4 years. These plans outline council initiatives and priorities for services, infrastructure and amenities.

Other responsibilities

Councils may choose to provide additional services, including services that are optional under legislation. Under the *Local Government Act 2020*, when councils plan for services, councils must also engage with the local community to get feedback about what services they would like to see provided.

This means that many councils deliver services that are not legislatively required, but are expected by the community, such as libraries, kindergarten, aged care and disability support services.

Council services and other responsibilities

Each council delivers a different mix of services and asserts to meet the needs of its communities, including some which are unique to their location. For example, some councils own airports and may manage associated services, such as Mildura Rural City Council, which owns Mildura Airport.

In this submission, we use the council service functions from the Victorian Local Government Grants Commission survey to classify the services that councils deliver.

Figure 9 – Council functions and services

| Function | Services | Examples of services |
|------------------------------|--|--|
| Governance | Public order and safety, financial and fiscal affairs, natural disaster relief | Council operations and building maintenance, health inspections, insurance, natural disaster relief and restitution works |
| Family & Community Services | Community health and welfare services | Play centres, preschool programs, community bus hire, neighbourhood houses, maternal and child health centres |
| Aged & Disabled Services | Residential care, community care services | Senior citizens centres, home care, personal care, respite care, meals on wheels |
| Recreation & Culture | Sports grounds and facilities, parks and reserves | Sports complexes, gardens, bicycle tracks through parks, marinas and jetties, art galleries support, libraries |
| Waste Management | Residential and commercial waste | Garbage and recycling bins, hard waste, council tips and transfer stations, sale of recycled material, commercial waste collection and disposal |
| Traffic & Street Management | Footpaths, kerbs and channels | Traffic lights, road signs, roundabouts, parking facilities and fines, street lighting and cleaning, school crossing supervision |
| Environment | Programs that protect biodiversity and habitat, drainage | Flood mitigation, beach restoration, fire access tracks, underground drains, weirs for controlling run-off, control of vermin and noxious weeds |
| Business & Economic Services | Community development and planning, building control | Subdivisions, planning, building and scaffolding inspections and fees, tourist information centres, caravan parks, ferries, airports, fees for commercial businesses |
| Local Roads & Bridges | Road and bridge works | Roads, bridges, bicycle lanes, joint road works with other public bodies |

Source: Victorian Local Government Grants Commission.

Council expenditure

In this section

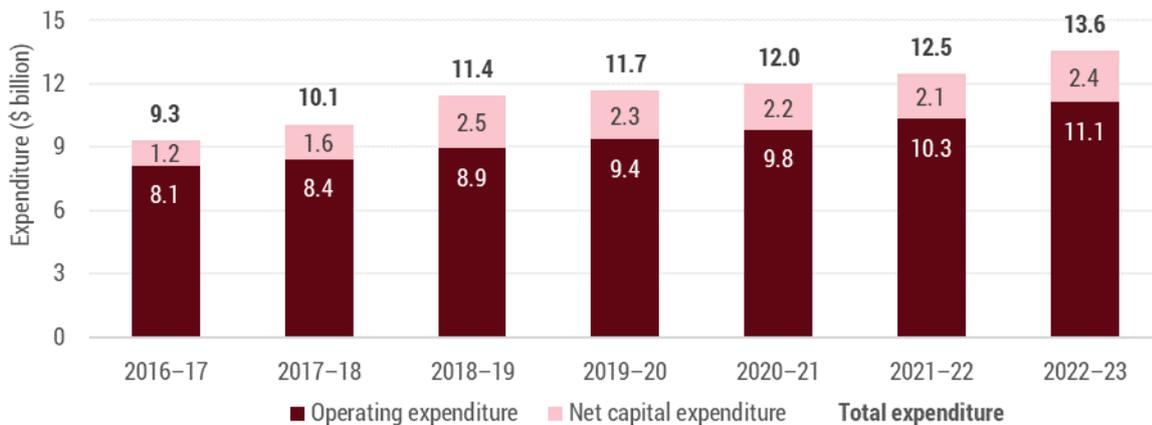
In this section we discuss:

- expenditure on services (operating expenditure)
- operating expenditure across Victorian councils
- asset investment (net capital expenditure).

Total council expenditure consists of operating expenditure on services and net capital expenditure on assets.

In 2022-23, Victorian councils reported \$13.6 billion in total expenditure, up \$1.1 billion on the previous year. Since 2016-17, total council expenditure has grown by an average of 6.4% per year.

Figure 10 – Council expenditure



Source: ABS and Parliamentary Budget Office.

Most Victorian council expenditure is operating expenditure, since 2016-17 it has averaged 82.3% total council expenditure. By 2022-23, operating expenditure had grown to \$11.1 billion, reflecting annual average growth of 5.4% per year.

While net capital expenditure makes up a smaller share of total council expenditure – 17.9% in 2022-23 – it is a growing share. This reflects an annual average growth rate of 12.2%. which is significantly faster than operating expenditure.

In addition to outpacing operating expense, growth net capital expenditure is more volatile. Since 2016-17, annual growth in:

- operating expenditure was between 3.8% and 7.7%
- net capital expenditure was between -7.9% and 51.4%.

Operating expenditure

We can break operating expenditure down by:

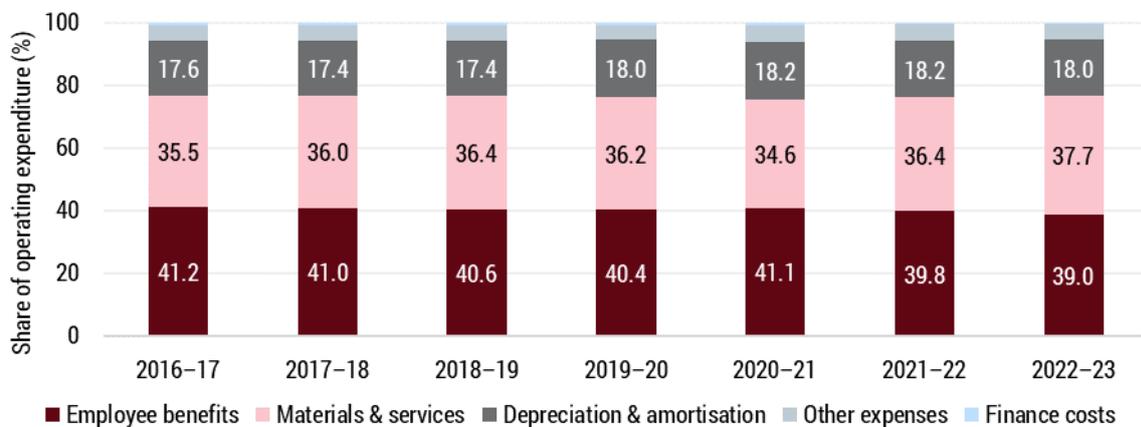
- type – the input cost (e.g. employee expenses)
- function – the nature of service (e.g. waste management)

Output expenditure by type

Councils have multiple types of operating expenditure including:

- employee costs, such as staff salaries and benefits
- materials and services, such as utilities and payments to contractors
- depreciation and amortisation, relating to council-controlled assets
- other expenses, such as councillor allowances, and bad and doubtful debts.

Figure 11 – Types of expenditure (all councils)



Note: This excludes some non-recurrent expenditure reported separately to the VLGGC.
 Source: VLGGC and Parliamentary Budget Office.

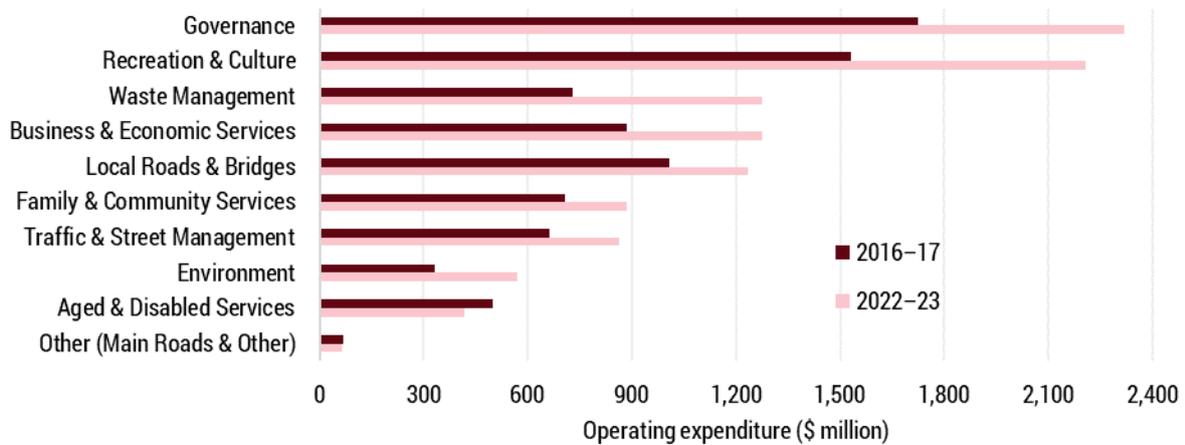
Employee benefits and materials and services comprise 76.6% of operating expenditure in 2022-23. The mix of expenditure types has remained largely stable since 2016-17, however employee expenses have fallen slightly.

Operating expenditure by function

Councils provide services and other funding across a range of functions, including:

- governance
- recreation and culture
- waste management
- local roads and bridges
- family and community services
- aged and disabled care services.

Figure 12 – Operating expenditure by function (all councils)



Note: This excludes some non-recurrent expenditure reported separately to the Victorian Local Government Grants Commission.
 Source: VLGGC and Parliamentary Budget Office.

Victorian councils spent \$2,317.1 million on governance services in 2022–23. Across governance and the second highest expenditure function, recreation and culture services, councils spent \$4,524.4 million or 40.7% of total operating expenditure.

Since 2016-17, expenditure on all functions has grown other than aged and disabled services, and other services. The fastest growing services were waste management (9.7% per year), environment (9.5% per year), recreation and culture (6.3% per year), and business and economic services (6.3% per year).

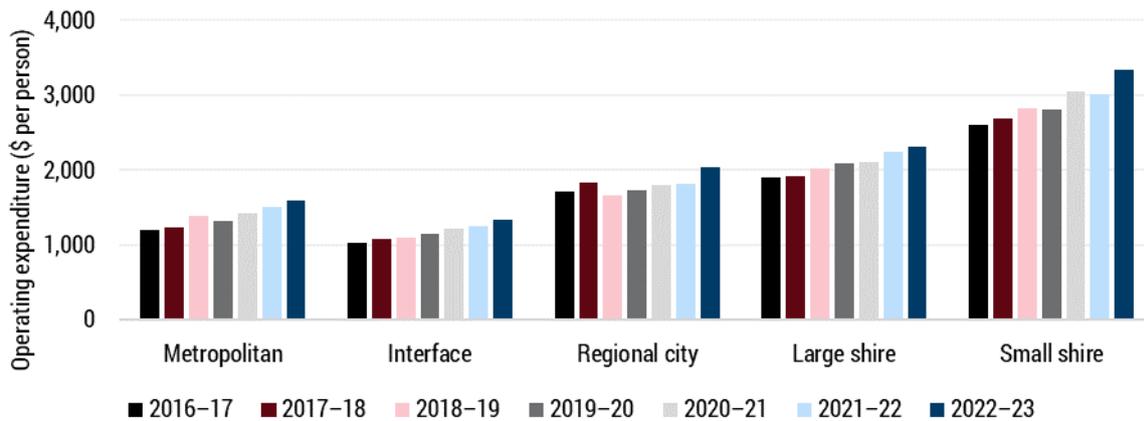
Operating expenditure across Victorian councils

The 79 Victorian councils can be categorised into 5 geographic types.

- Metropolitan councils
- Interface councils
- Regional city councils.
- Large shire councils
- Small shire councils

The Victorian population is not evenly spread across these council types. In 2022-23, metropolitan councils accounted for 46.5% of the population, combined with interphase councils this rose to 75.1%. Controlling for population we see that metropolitan and interface councils are the lowest spending of all council types.

Figure 13 – Operating expenditure per person



Source: VLGGC and Parliamentary Budget Office.

Since 2016-17, average council operating expenditure per person has grown by an average of 4.1% per year. Victorian Local Government Grant Commission data suggests this growth has not been uniform across council types with annual average growth of:

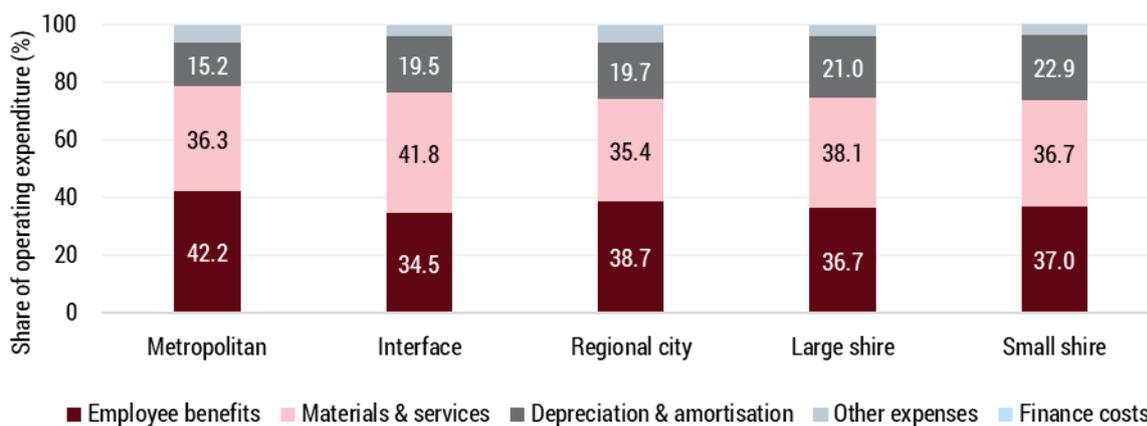
- 4.9% for metropolitan councils and 4.4% for interface councils
- 3.0% for regional city councils, 3.4% for large shire councils and 4.2% for small shire councils.

There are a range of factors which affect council expenditure by type and function.

Variation in operating expenditure by type

Council types dedicate different shares of their expenditure to different types of spending.

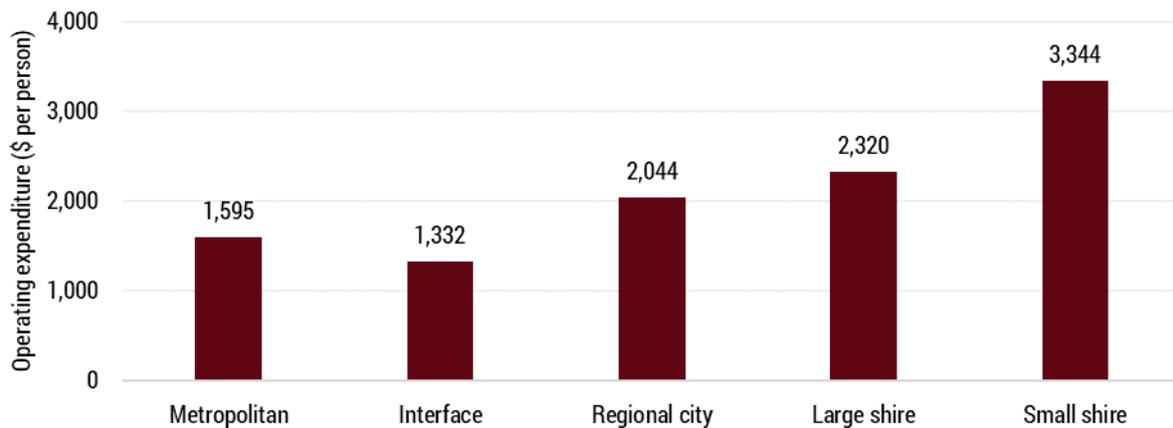
Figure 14 – Council expenditure by council type, 2022-23



Note: This excludes some non-recurrent expenditure reported separately to the VLGGC.

Source: VLGGC and Parliamentary Budget Office.

Large and small shire councils reported proportionally more depreciation and amortisation expenses compared to metropolitan councils, where depreciation was at 15.2% of total expenditure in 2022-23. This is due to the share of assets, particularly local roads, under small shire councils' control.

Figure 15 – Roads managed per person (2022–23)

Source: Parliamentary Budget Office

Small and large shire councils together report managing more than 65% of the local road network. This is equivalent to around 220 metres and 68 metres respectively for every person in their regions. These councils maintain more assets than other council types, but raise revenue from a smaller population.

Variation in expenditure by service

The Victorian Local Government Grants Commission survey provides information on expenditure by function area at a high level. The Local Government Reporting Framework, however, provides more detail about the expenses of specific services across councils

Councils report their performance annually under the framework, including the direct costs of providing select services. Each council may have specific factors which impact on their costs in any year, and councils share commentary about the reasons for changes in performance indicators along with their data submissions.

Direct costs vary across services, which indicate individual council level factors affecting expenditure, alongside council location, population density and scale of services. There is little variation across council types to deliver:

- maternal child health services
- statutory planning services
- kerbside rubbish bin collection.

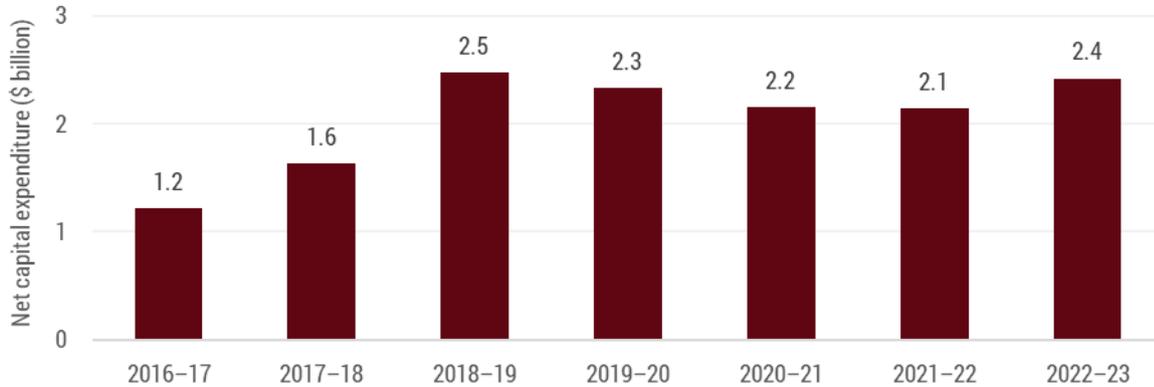
In contrast, we observe substantial cost differentials between council types to deliver:

- governance services with outlying high costs in interface councils since 2020-21
- resealing and to a lesser extent reconstruction of sealed local roads is higher in metropolitan and interface councils
- kerbside collection of recyclables is notably higher for small shire councils and to a lesser extent for large shire councils.

Net capital expenditure

Victorian council (non-financial) assets include land, buildings and equipment. Council net capital expenditure includes investment in new assets, and renewal, expansion and upgrade of existing assets.

Figure 16 - Net capital expenditure



Source: ABS.

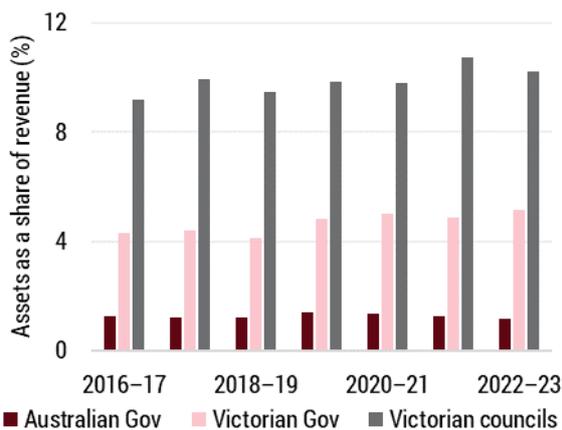
In 2022-23, councils reported a total of \$2.4 billion in net capital expenditure, up 12.9% from the prior year. Metropolitan and interface councils made up around 61% of total expenditure on capital assets.

Share of council-managed assets

Victorian councils manage higher values of assets in proportion to their revenue than other levels of government. Councils have significant expenditure responsibilities, stemming from the maintenance of assets and with smaller proportion of revenue to draw upon.

In 2022-23, council assets were worth more than 10 times revenue for the year, in comparison to asset to revenue ratios of 1.1 and 5.2 for the Australian Government and Victorian Government, respectively.

Figure 17 – Assets as a share of revenue



Source: ABS and Parliamentary Budget Office.

This means Victorian councils manage more assets in proportion to their revenue, including costs of maintaining and replacing assets, with less revenue than other levels of government.

One of the most prominent council-controlled assets are local roads. Victorian councils manage more than 80% of the road network, reporting more than 133,000km of road assets in the 2022-23 Victorian Local Government Grants Commission survey.

Council revenue

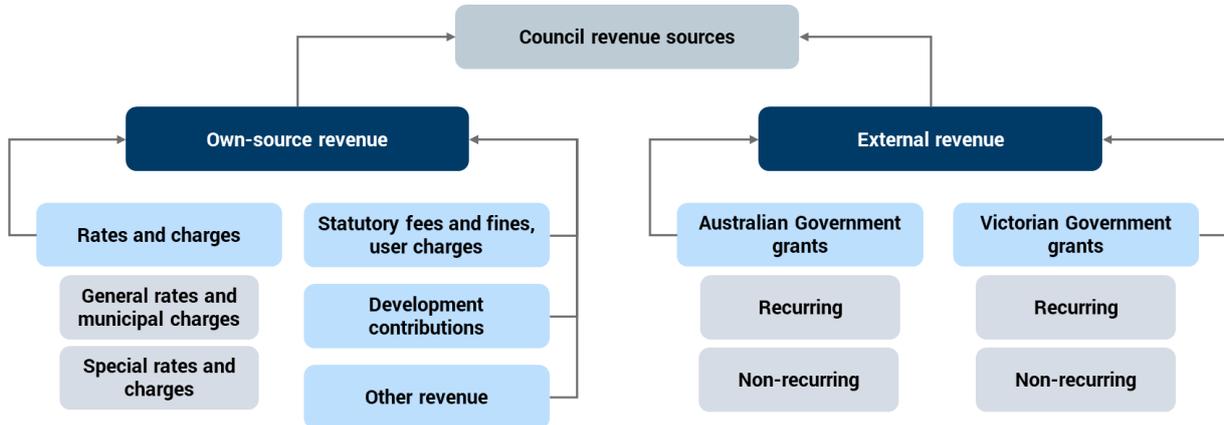
In this section In this section, we discuss sources of council revenue:

- own-source revenue
- grant revenue.

Councils fund their operating and net capital expenditure through a mix of revenue they raise themselves (own-source revenue) and transfers from other levels of government (grants).

Own-source revenue comes from a range of sources, including rates, development contributions, fees and charges. Councils receive grants from both the Australian and Victorian governments. These grants can be either recurring, for ongoing functions of councils, or non-recurring, for a specific time-limited purpose.

Figure 18 – Sources of council funding

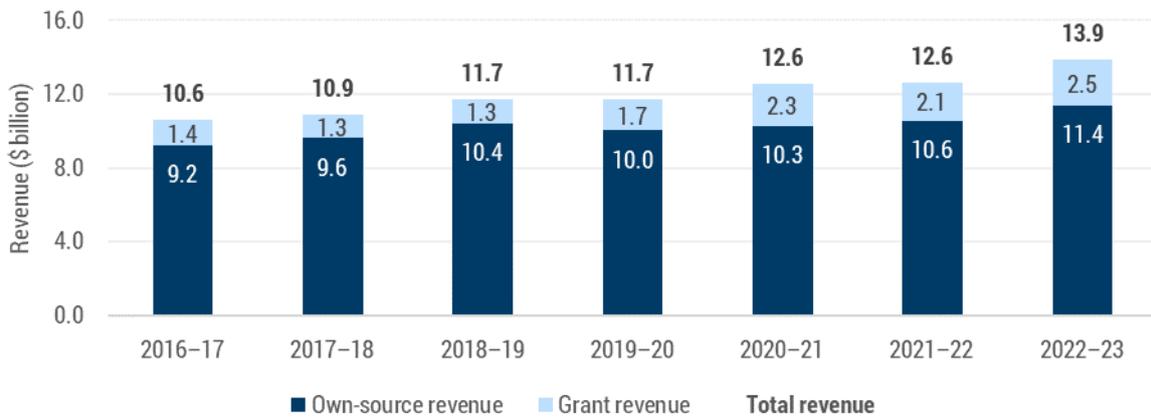


Source: Parliamentary Budget Office.

The *Local Government Act 2020* requires councils to develop a revenue and rating plan every 4 years. The revenue and rating plan outlines how the council will raise revenue, including how the council calculates revenue needed to fund activities and how rates are apportioned.

Own-source revenue currently accounts for around 81.9% of all council revenue, with the remainder from Australian and Victorian government grants.

Figure 19 - Total council revenue



Source: ABS and Parliamentary Budget Office.

Since 2016-17, total revenue has grown by an average of 4.6% per year and reached \$13.9 billion in 2022-23. Own-source and grant revenue have both grown over the same period, but differences in their growth rate has resulted in some changes in the composition of total revenue.

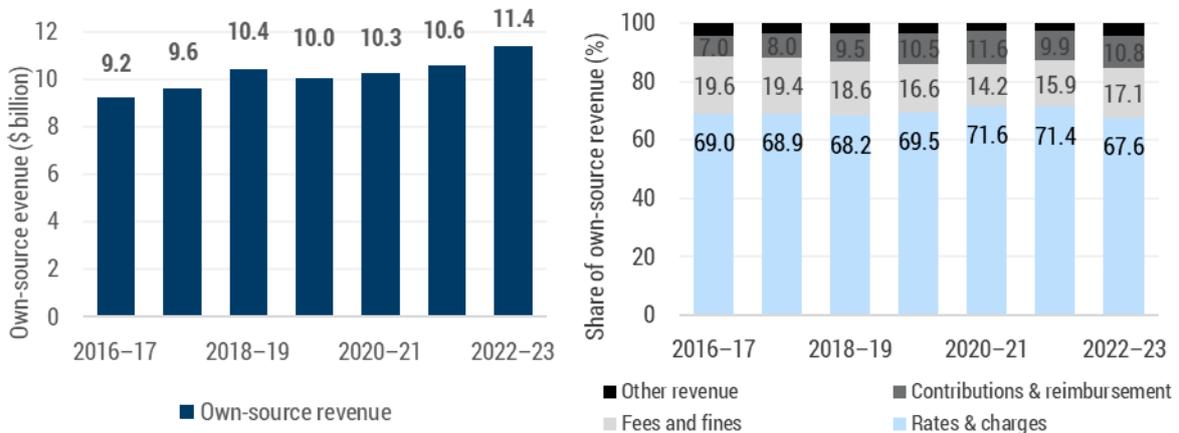
- Own-source revenue grew from \$9.2 billion in 2016-17 to \$11.4 billion in 2022-23, however due to faster growth in grants this represented a fall from 87.2% to 81.9% of total revenue.
- Grant revenue has risen and relatively rapidly. In 2016-17 it was \$1.4 billion or 12.8% of total revenue, by 2022-23 it was \$2.5 billion or 18.1% – an average growth rate of 10.8% per year.

Own-source revenue

Councils generate own-source revenue from:

- rates and municipal charges
- fees and fines
- contributions from developers
- other revenue.

Figure 20 – Own-source revenue



Note: Own-source revenue levels are based on ABS data; shares are based on VLGCC shares.
Source: ABS, VLGCC and Parliamentary Budget Office.

Own-source revenue has grown by an average of 3.5% per year from 2016-17 to 2022-23.

Councils generated around 70% of own-source revenue from rates and charges over the period from 2016-17 to 2022-23.

Of the own-source revenues, contributions and reimbursements has grown the fastest at an average rate of 12.7% per year, rising from 7.0% of own-source revenue in 2016-17 to 10.8% by 2022-23. Contributions and reimbursements can be quite volatile, given the dependence of this revenue stream on larger, longer-term projects. Since 2016-17, this volatility is evident with annual growth rates ranging between -10.3% and 25.0%.

Rates and municipal charges

Under the *Local Government Act 1989*, councils may declare the following rates and charges on liable, or rateable, property:

- general rates
- municipal charges, which are charges that partly cover council administrative costs
- service rates and charges, such as charges for waste and recycling
- special rates and charges, which may be for a specific project and affect some ratepayers only.

Councils issue rates notices to ratepayers on a quarterly basis. Along with rates and charges listed in the notice, councils collect the Fire Service Property Levy on behalf on the Victorian Government.

To determine general rates for properties in its municipality, councils decide on the required budget for the year and how much they will raise from general rates. In doing so they may make decisions about the tax base and the 'rate in the dollar', equivalent to the tax rate.

Base for general rates

The Valuer-General Victoria assesses property values annually, using 3 types of property valuation.

- **Capital improved value** – value of land plus buildings and improvements.
- **Net annual value** – amount a property could reasonably be expected to earn in rent per year.
- **Site value** – land value only.

Councils choose a type of valuation as a base to calculate the total value of property and then distribute general rates throughout the municipality. In 2021-22, 74 of 79 Victorian councils use capital improved value as the basis for rates, while 5 use net annual value. While none currently use site value, it remains an option.

Setting the 'rate in the dollar'

Councils set a 'rate in the dollar', a percentage of property value, which determines property owners' rate liabilities. Councils can apply the 'rate in the dollar' at:

- a uniform rate, meaning there is one rate across all property types
- a differential rate, meaning different property types pay different rates.

Councils develop their own categories of property types for the purpose of setting differential rates. Most properties in Victoria (around 89%) are residential, with a total valuation in 2022–23 of around \$2,421.0 billion. No other property type accounts for more than 6% of properties or 9% of property values.

In addition to setting rates, councils can also apply a municipal charge – a fixed dollar amount per property. This charge can be applied under either the uniform or differential rate approach.

Exemptions, rebates and concessions for general rates

Property owners may be eligible for rebates or concessions on general rates. The Victorian Government provides a 50% deduction on council rates for eligible pensioners, up to a maximum annual amount. Individual councils may also provide additional rate discounts to pensioners or to encourage specific development.

Some types of property are exempt from rates, including:

- Victorian and Australian Government land (crown land), where it is unoccupied or used exclusively for public or municipal purposes
- crown land leased to a rail transport operator
- land used exclusively for charitable purposes
- cultural and recreational land
- mines.

Councils may have alternate rating arrangements in place, including where owners of exempt land pay a contribution to council to fund services. For example, under the *Cultural and Recreational Lands Act 1963*, councils may set a reasonable charge in lieu of rates for eligible recreational land.

Development contributions

Development places increased demand on existing infrastructure, like roads and schools. To recognise this, the Victorian Government and councils collect contributions from developers for the local community.

Developer contributions can be provided as cash, land or construct infrastructure on behalf of public authorities, known as works-in-kind. For example, a developer may set aside a portion of land for a park, or construct a kindergarten centre to fulfill their obligations.

Councils can collect contributions through:

- voluntary agreements, negotiated with developers under section 173 of the *Planning and Environment Act 1987*
- development contributions or public open space contributions, set out in planning schemes.

7 of the growth area or interface councils – Casey, Cardinia, Hume, Melton, Mitchell, Whittlesea and Wyndham – have specific contribution plans in place:

- infrastructure contributions plans, where councils can collect contributions for community or transport infrastructure
- Growth Areas Infrastructure Contribution (GAIC), where the State Revenue Office collects cash contributions, and the Victorian Planning Authority collects land or works in-kind contributions.

The Department of Transport and Planning pools contributions from GAIC into two funds:

- Growth Areas Public Transport Fund, for infrastructure like bus services and interchanges and future transport corridors

- Building New Communities Fund, for infrastructure like primary and secondary government schools, fire stations and ambulance stations.

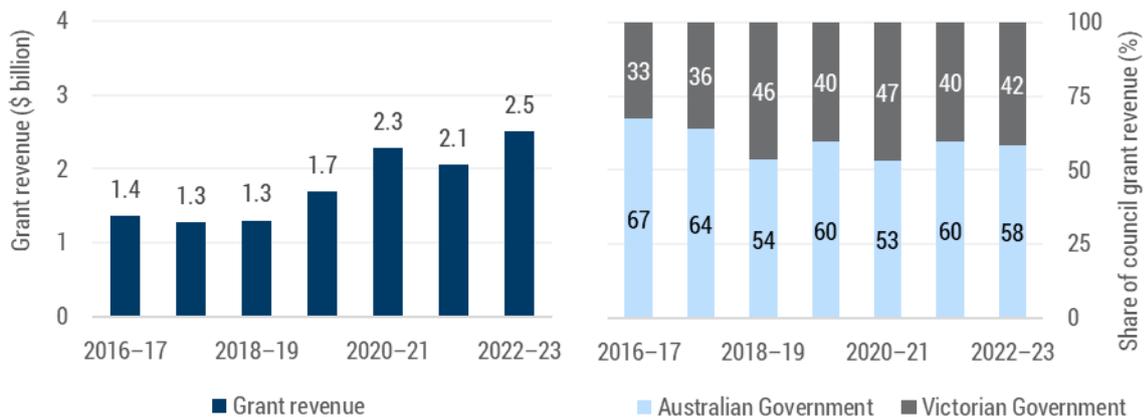
Victorian Government departments and councils in growth areas can then apply for funding for specific projects through annual funding rounds.

Grant revenue

The second largest source of council revenue is grants provided by the Victorian and Australian governments. These grants can be:

- recurring or one-off
- tied or untied – differing by the discretion councils have over the use of the funds
- competitive or non-competitive – councils either apply or government’s nominate them to access funds.

Figure 21 – Victorian council grant revenue



Note: ABS grant revenue used for level chart, VLGGC data used for Australian and Victorian government shares of grants received by Victorian councils.

Source: ABS, VLGGC and Parliamentary Budget Office.

Since 2016-17, grant revenue has grown from \$1.4 billion to \$2.5 billion in 2022-23. This represents an annual average growth rate of 10.8% per year, however growth has not been steady across the period. Considerable volatility over the period has been more than overcome by 2 consecutive years of growth exceeding 30% in 2019-20 and 2020-21.

Victorian Government grants

Since 2016-17, Victorian Government grants have accounted for an average of 40.6% of grant revenue and 7.7% of total council revenue.

In each budget, the Victorian Government outlines specific initiatives and funding for councils. The 2024–25 budget included funding for:

- maternal and child health services
- kindergartens, including the Building Blocks improvement and inclusion grants
- school crossing supervisors

- community infrastructure, including the Growing Suburbs funds
- council flood support and emergency resourcing.

The Victorian Government also transfers funds received from the Australian Government, including the financial assistance grants and disaster recovery funding. Most of the transfers comprise financial assistance grants through Local Government Victoria and the Department of Government Services.

Figure 22 – Victorian Government grants and transfers to councils

| \$ million | 2022–23 revised | 2023–24 revised | 2024–25 budget |
|--|----------------------------|----------------------------|---------------------------|
| Department of Education | 93.2 | 106.8 | 200.7 |
| Department of Energy, Environment and Climate Action | 23.1 | 47.6 | 24.3 |
| Department of Families, Fairness and Housing | 8.2 | 4.2 | 4.2 |
| Department of Government Services | 158.3 | 81.6 | 857.4 |
| Department of Health | 1.3 | 0.2 | 9.8 |
| Department of Jobs, Skills, Industry and Regions | 386.6 | 204.8 | 346.6 |
| Department of Justice and Community Safety | 119.2 | 32.3 | 12.3 |
| Department of Premier and Cabinet | 9.1 | 8.0 | 4.1 |
| Department of Transport and Planning | 119.1 | 128.8 | 194.3 |
| Department of Treasury and Finance | 8.3 | 16.3 | 13.3 |
| Total | 926.4 | 631.0 | 1,667.0 |

Notes: Figures reflect the impact of the machinery of government changes effective from 1 January 2023. Department of Education funding excludes funds provided to local government for service delivery. The Department of Government Services commenced operations on 1 January 2023. As such, the department did not provide grants or transfers to local government in the first half of 2022–23. Department of Justice and Community Safety 2022–23 funding includes funding to the Country Fire Authority. Table may not sum due to rounding.

Source: Department of Treasury and Finance.

The Victorian Government expects to provide \$631.0 million in grants and transfers to councils in 2023–24, which includes Australian Government transfers. This is expected to increase to \$1,667.0 million in 2024–25. The large increase from 2023–24 to 2024–25 reflects the rephasing of financial assistance grants, which were paid in advance and rephased from 2023–24 to 2022–23. The Australian Government may choose to bring forward financial assistance grants from the forward year's estimates and provide the grants to the states and territories in the current year.

Australian Government grants

Since 2016-17, Victorian Government grants have accounted for 59.4% of grant revenue and 11.3% of total council revenue.

The Australian Government provides funding to councils through:

- untied Financial Assistance grants
- tied grants, which are for specific projects.

In the Australian Budget, the Australian Government does not report separately on all funding that goes to councils, some of which is included in funding going through state governments. However, the Australian Government does identify financial assistance grants paid each year, and direct payments to councils.

Financial Assistance grants

Under the *Local Government (Financial Assistance) Act 1995*, the Australian Government provides financial assistance to councils to improve:

- financial capacity
- capacity to provide residents with an equitable level of services
- certainty of funding
- efficiency and effectiveness
- services to Aboriginal and Torres Strait Islander communities.

The financial assistance grants are made up of two components:

- general purpose grants, which are allocated between states and territories based on population share and include natural disaster assistance for some councils
- local roads grants, which are allocated to states and territories based on fixed historical shares.

The Victorian Local Government Grants Commission recommends general purpose grants based on councils' relative expenditure needs and relative capacity to raise revenue. The commission assesses data for each Victorian council, such as their population, dwelling numbers, household income and socio-economic disadvantage.

For local roads grants, the Victorian Local Government Grants Commission recommends grants based on the relative needs of each council for roads expenditure and to preserve its road assets. This includes assessing each council's road length, traffic volumes and several cost modifiers, such as freight loading and climate. While the local roads grants are assessed on roads data, this funding is untied, meaning that councils can spend the grant at its discretion and are not required to spend it on road infrastructure.

In 2023–24, Victorian councils are estimated to receive \$747.4 million in financial assistance grants.

Figure 23 – Victoria's allocation of financial assistance grants

| \$ million | 2017–18 | 2018–19 | 2019–20 | 2020–21 | 2021–22 | 2022–23 | 2023–24 |
|------------------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
| General purpose grants | 414.0 | 434.2 | 453.4 | 469.6 | 487.7 | 524.9 | 550.2 |
| Local roads grants | 155.0 | 154.5 | 160.4 | 164.7 | 173.8 | 187.0 | 197.2 |
| Total | 569.1 | 588.7 | 613.7 | 634.3 | 661.5 | 711.9 | 747.4 |

Notes: 2023–24 figures are the estimated allocation. All other amounts are adjusted allocations, where the Australian Government has adjusted allocations once updated population and inflation data are taken into account.

Source: VLGGC.

Other Australian Government grants

The Australian Government provides other grants for services and infrastructure. For example, the Road to Recovery program – a major infrastructure grant for councils – provides funding to councils for road repairs. Under the program, individual councils’ funding is based on the local roads components of the financial assistance grants, to construct and maintain local road assets.

In 2023–24, the Australian Government provided \$300.1 million in payments directly to councils and expects to provide \$199.7 million in 2024–25. The decrease in forecast payments from 2024–25 onwards compared to years prior includes the end of the Local Roads and Community Infrastructure Program, which was a \$3.25 billion investment over 4 years for infrastructure projects across all Australian councils.

Figure 24 – Australian Government payments direct to councils

| \$ million | 2020–21 | 2021–22 | 2022–23 | 2023–24 | 2024–25 | 2025–26 | 2026–27 | 2027–28 |
|----------------------------|---------|---------|---------|---------|---------|---------|---------|---------|
| Payment direct to councils | 328.9 | 308.8 | 312.3 | 300.1 | 199.7 | 213.7 | 193.2 | 203.4 |

Notes: The Australian Budget did not separate out payments direct to local government from its partnership payments before 2020–21. Council receives other funding, which is paid through the state but not separately reported.

Source: Department of the Treasury.

Constraints on revenue generation

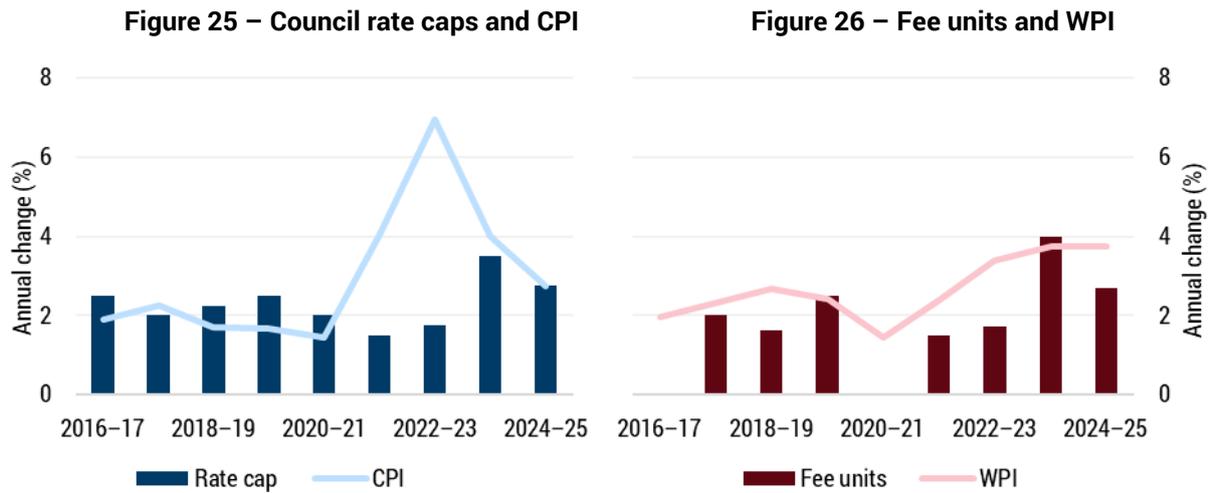
Councils do not have full autonomy in how they raise revenue. The Victorian Government explicitly or effectively limits growth in revenue from rates and fees.

The Victorian Government introduced rate caps from 2016–17 as part of a bill amending the *Local Government Act 1989*. The cap limits the overall increase in rates and municipal charges. The Minister for Local Government sets the rate cap in December each year for the following financial year.

In 2024–25, the cap is 2.75%. In practice, this means that a council which raises \$10.0 million in 2023–24 from rates can only raise \$10.28 million in 2024–25.

The average rate cap between 2016–17 and 2024–25 was 2.3%. In comparison, Melbourne CPI averaged 3.0% over the same period, meaning the change in rate revenue has not kept up with general inflation, particularly in the last few years with higher-than-expected inflation.

Councils can apply for a higher cap through the Essential Services Commission, which monitors the rate cap. Between 2016–17 and 2019–20, 17 councils applied for a variation to the rate cap, and 13 received full or part approval for a higher cap. No higher rate caps are currently in place.



Note: 2023–24 and 2024–25 CPI and WPI figures are based on forecast rates from the Department of Treasury and Finance. There was no indexation on fee units in 2020–21.

Source: Parliamentary Budget Office.

Councils may set pricing for some of their services and use of assets, such as community hall or sporting field hire. To do so, they must consider community expectations, how to equitably allocate costs, as well as the costs of maintaining assets.

Victorian Government legislation and regulations prescribe fees for other services. For example, many planning services, including applications for building permits and subdivisions, attract fees. These fees are set in fee units, which the Treasurer indexes each year. This means councils do not fully control how much they recover from services where fee units apply.

In recent years, wages have grown faster than fee units, averaging 2.8% annually between 2017–18 and 2022–23 compared to an average 2.0% annual change in fee units. This suggests that the cost of administering services is increasing faster than the revenue received for services set in fee units.

Vertical fiscal imbalance

In this section

In this section we discuss:

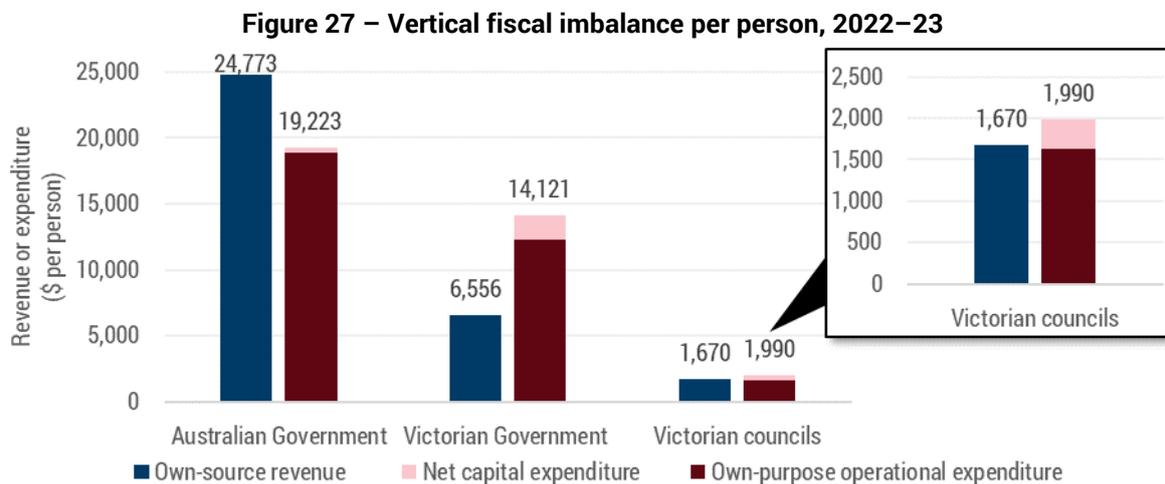
- the vertical fiscal imbalance in Australia
- transfers between levels of government
- Victorian councils' vertical fiscal imbalance over time.

In Australia, each level of government has different expenditure responsibilities and ability to raise revenue. The vertical fiscal imbalance is the difference between the ability of each level of government to generate enough own-source revenue to fund their expenditure responsibilities.

Vertical fiscal imbalance in Australia

The Australian Government is wholly responsible for expenditure in areas such as defence, social security and immigration. The Australian Government has by far the largest sources of revenue – the largest taxes are on personal income, company income, and on goods and services (i.e. the GST).

State and territory governments are responsible for service delivery issues such as policing, justice and public transport, and share responsibilities with the Australian Government for health, education and disaster recovery. State and territory governments generate own-source revenue from taxes, fees and charges, the sale of goods and services, interest and other income. For Victoria, the largest sources of own-source revenue are payroll tax, land transfer duty (also known as stamp duty) and land tax.



Notes: Own-source revenue is total revenue minus grants and subsidies. Own-purpose operating expenditure is total operating expense minus grants and transfers to other levels of government.

Source: ABS and Parliamentary Budget Office.

We consider 2 measures of vertical fiscal imbalance which differ based on the expenditure responsibilities included in the measure:

- **comprehensive vertical fiscal imbalance** – the difference between own-source revenue and the combined funding requirement of operating and net capital expenditure.

- **operating vertical fiscal imbalance** – the difference between own-source revenue and operating expenditure.

There are substantial comprehensive and operating vertical fiscal imbalances between the Australian Government and the Victorian Government. The Australian Government generates substantially more revenue than its own-purpose expenditure, while the Victorian Government has broad expenditure responsibilities and a relatively narrow state government tax base.

Victorian councils in aggregate generate enough own-source revenue to fund their operating expenditure responsibilities, but not their operating and net capital expenditure combined. In 2022–23, Victorian councils were subject to a:

- **comprehensive vertical fiscal imbalance** of \$2,181 million or \$320 per person, equivalent to 19.2% of own-source revenue
- but not an **operating vertical fiscal imbalance** with a surplus of \$245 million or \$36 per person.

Comprehensive vs operating vertical fiscal imbalance

If a level of government is subject to a **comprehensive vertical fiscal imbalance**, this indicates it requires grants from other levels of government, or borrowings, to fund its overall expenditure responsibilities.

If a level of government is subject to an **operating vertical fiscal imbalance**, this indicates it would require grants or borrowings to fund its expenditure responsibilities, net of its capital works program.

It is useful to consider both indicators of underlying financial sustainability because:

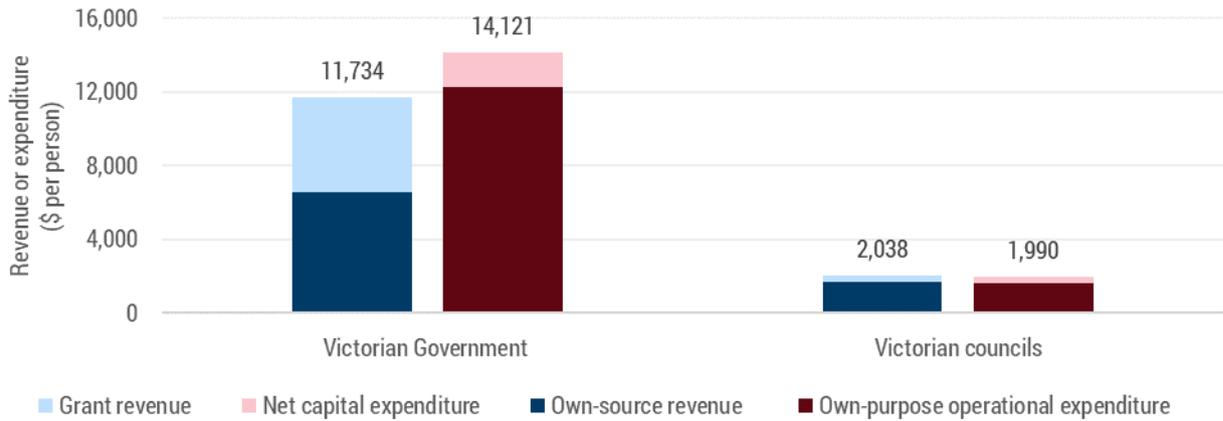
- net capital expenditure and operating expenditure have different balance sheet implications – both require funds from a mix of revenue and borrowing, but net capital expenditure builds net worth with non-financial assets, while operating expenditure does not
- some net capital expenditure is more discretionary than operating expenditure – for example, constructing a new library to service a growing population may be more discretionary than ongoing funding for waste collection services.

Transfers between levels of government

The Victorian Government and Victorian councils both rely on grants from other levels of government to fund their overall expenditure responsibilities. Based on ABS data, in 2022-23:

- the Victorian Government received 44.1% of its total revenue as grants – the vast majority from the Australian Government
- councils received 18.1% of their funding in grants from the Australian and Victorian government.

Figure 28 – Total revenue and expenditure for state government and councils, 2022–23



Notes: Own-source revenue is total revenue minus grants and subsidies. Own-purpose operating expenditure is total operating expense minus grants and transfers to other levels of government.

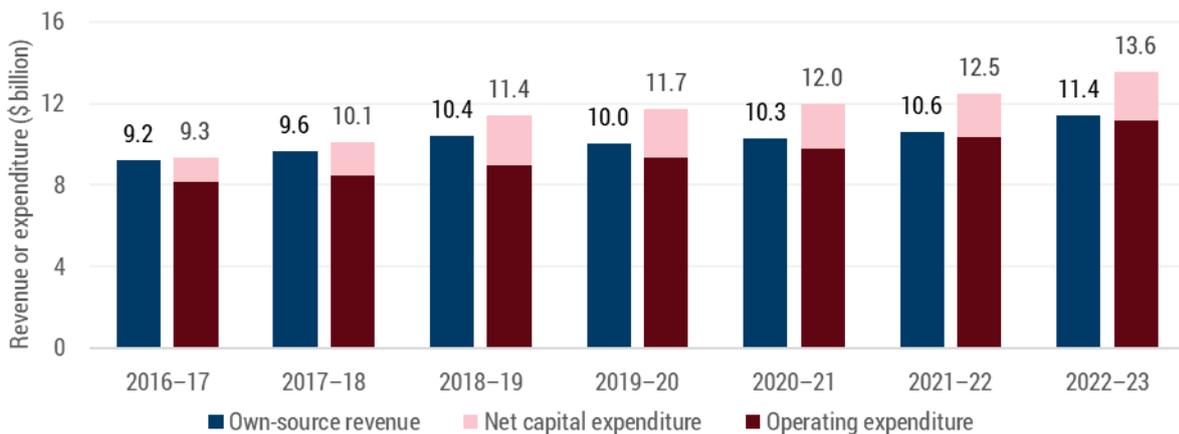
Source: ABS and Parliamentary Budget Office.

Once we include transfers from other levels of government in the form of grants, Victorian councils have sufficient revenue to fund their total expenditure responsibilities, however the Victorian government does not. It is more sustainable for the Victorian government to run this shortfall (referred to as a net borrowing position) as it can access finance on a more preferential basis than councils.

Vertical fiscal imbalance over time

In aggregate, Victorian councils have been subject to a comprehensive vertical fiscal imbalance since at least 2016-17.

Figure 29 – Victorian council vertical fiscal imbalance over time



Source: ABS and Parliamentary Budget Office.

The imbalance has grown over time – from \$0.1 billion in 2016-17 to \$2.2 billion in 2022-23. This is reflected in councils’ increased reliance on grants, which rose from 12.8% of council revenue in 2016-17 to 18.1% in 2022–23.

Funding sources for specific services

The source of funding for each council service varies, with some primarily funded from own-source revenue, and others mainly funded from Australian and Victorian government grants.

Figure 30 – Share of total revenue sources by function, 2022–23



Notes: Data includes revenue source where this is linked to a service in the VLGGC data. Revenue includes recurring and non-recurring Victorian and Australian Government grants, and excludes rates revenue and Financial Assistance Grants from the Australian Government.

Source: VLGGC and Parliamentary Budget Office.

All council functions are at least partially self-funded, and all receive some Australian and Victorian government grants.

- Councils primarily use own-source revenue to fund core functions, such as governance, waste management, and traffic and street management.
- Victorian Government grants provide most of the funding for family and community, and environment services.
- Australian Government grants provide most funding for aged and disabled services, and local roads and bridges.

Horizontal fiscal imbalance

In this section

In this section we discuss:

- horizontal fiscal imbalance across council types
- differences between expenditure across council types
- differences between revenue raised across Victorian council types.

Horizontal fiscal imbalance is the difference between the ability of individual councils, or types of councils, to generate sufficient revenue to fund their expenditure responsibilities. There are 2 main drivers of horizontal fiscal imbalance:

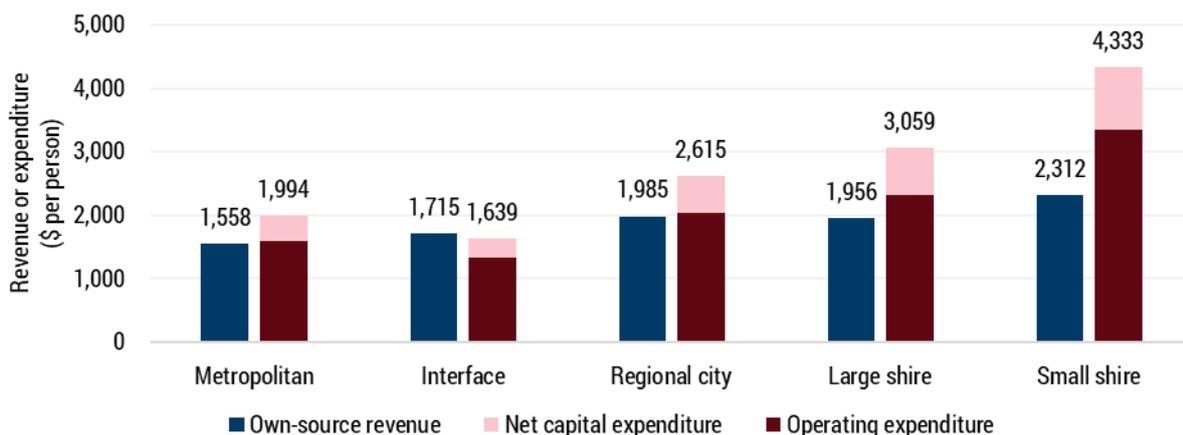
- expenditure needs – regional councils generally face higher costs than metropolitan councils to deliver the services and infrastructure needed by their communities
- revenue base – all councils levy rates on properties, but metropolitan, high socio-economic areas tend to have higher property values than regional areas, and therefore a larger revenue base.

Horizontal fiscal imbalance across council types

To assess the magnitude of the horizontal fiscal imbalance across types of Victorian councils, we compare the:

- shortfalls in own-source revenue to fund total expenditure – combined operating and net capital expenditure
- reliance on Australian and state government grants to make up these shortfalls.

Figure 311 – Horizontal fiscal imbalance, 2022–23

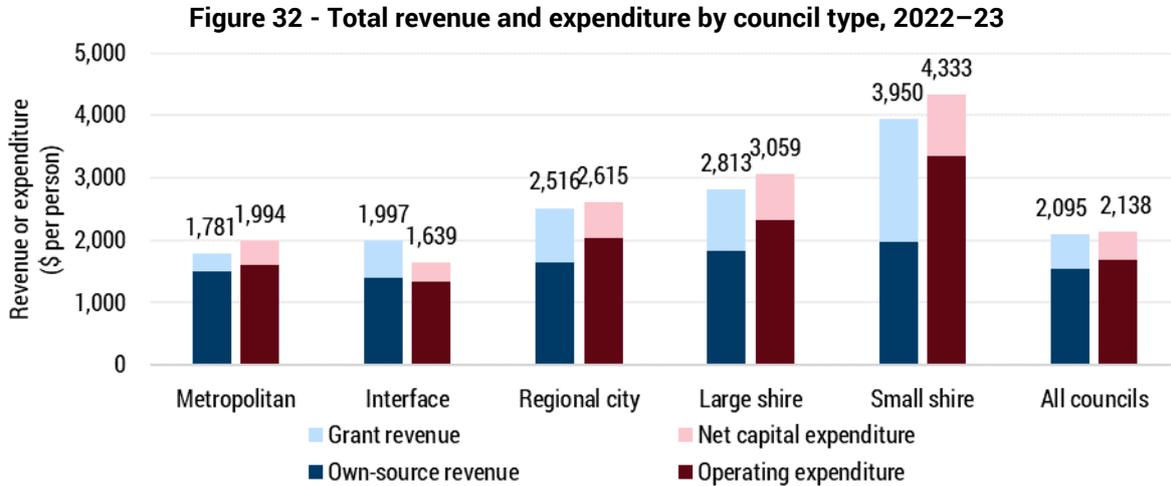


Note: Own-source revenue is total revenue minus grants and subsidies. Operational expenditure and own-source revenue include non-recurrent items reported separately to the VLGGC.

Source: VLGGC and Parliamentary Budget Office.

In 2022-23, all types of Victorian councils other than interface experienced a negative imbalance between their own-source revenue and their total expenditure:

- Metropolitan councils experienced the smallest negative imbalance, with average own-source revenue of \$1,558 per person, equivalent to 78.1% of total expenditure (\$1,994 per person).
- Small shire councils experienced the largest imbalance, with average own-source revenue of \$2,312 per person, equivalent to 53.4% of total expenditure (\$4,333 per person).



Note: The figure presents total revenue and total expenditure for each council type based on VLGGC data for 2022–23. The difference between revenue and expenditure is broadly indicative of council type’s net lending or borrowing position, but it is not an exact measure. Own-source revenue is total revenue minus grants and subsidies.

Source: VLGGC and Parliamentary Budget Office.

Victorian councils rely on grants from other levels of government to fund shortfalls in their own-source revenue. Based on VLGGC data, in 2022-23:

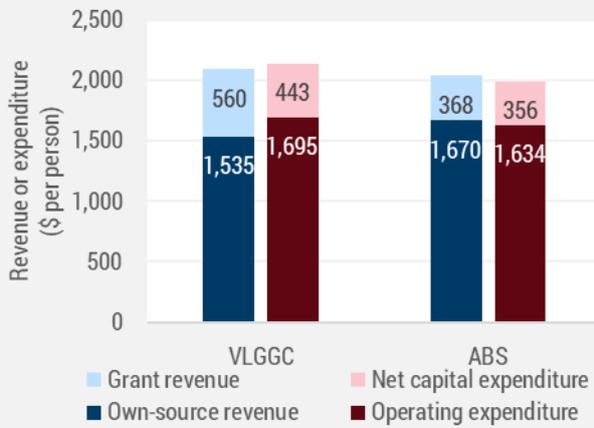
- metropolitan councils received the smallest proportion of their total revenue in Australian Government and Victorian Government grants (12.5%)
- small shire councils received the largest proportion of their total revenue in Australian Government and Victorian Government grants (41.5%).

Comparability with vertical fiscal imbalance

The Australian Bureau of Statistics (ABS) does not publish data at a sufficiently granular level to assess horizontal fiscal imbalance across council types. We rely on data from the Victorian Local Government Grants Commission (VLGGC), which is slightly methodologically different.

Comparability with vertical fiscal imbalance

Figure 33- Council revenue and expenditure



Source: ABS, PBO and VLGGC.

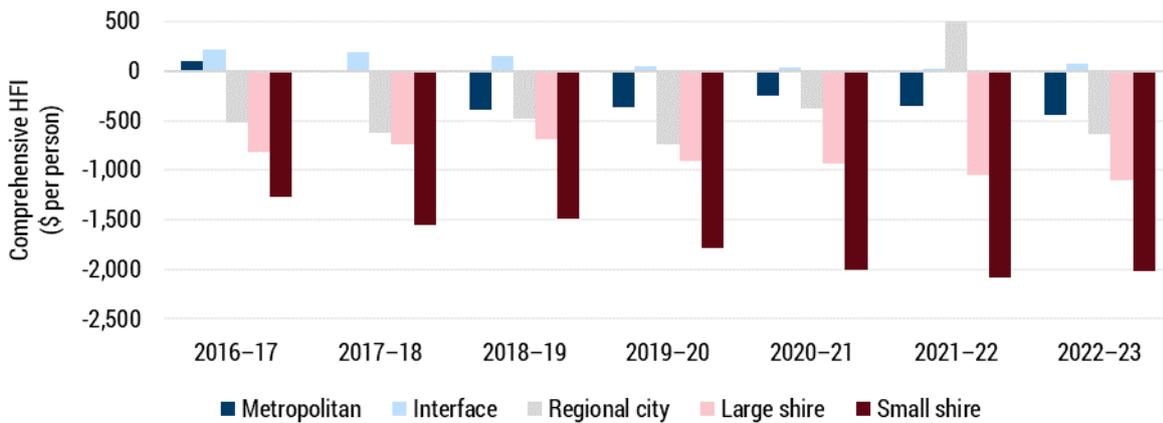
Compared to ABS data, the VLGGC indicates:

- higher total revenue
 - driven by higher grant revenue
 - but moderated by lower own-source revenue
- higher total expenditure driven by higher operating and net capital expenditure
- larger vertical fiscal imbalance
- net borrowing position (total expenditure greater than total revenue) rather than a net lending position.

Horizontal fiscal balance over time

Over time, regional and rural councils have continued to experience a horizontal fiscal imbalance relative to their urban counterparts.

Figure 34 - Comprehensive horizontal fiscal imbalance over time, per person



Source: VLGGC and Parliamentary Budget Office.

The imbalance between own-source revenue and total expenditure exceeding has generally worsened for councils over this period, and the disparity between metropolitan and regional councils has generally widened.

Differences in expenditure across councils

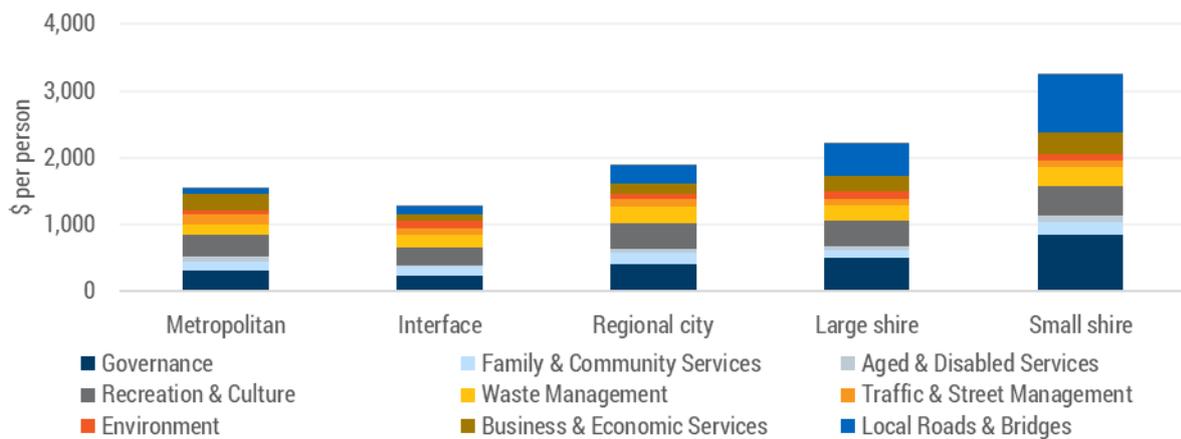
Each council has different population, demographic and socio-economic factors which affect demand for services. Differences in expenditure requirements are key drivers of the horizontal fiscal imbalance between councils.

Regional councils generally face higher costs than metropolitan councils to deliver the services and infrastructure their communities need. These higher costs can reflect increased need for certain kinds of services and infrastructure, and higher costs associated with delivering them in more remote geographic locations. Regional councils spend more on roads as they have responsibility for a greater length of roads per person and tend to spend more on governance services than more urban councils.

Operating expenditure

Operating expenditure by function of local government varies substantially across council types. We consider expenditure on a per person basis to compare across councils.

Figure 35 – Operating expenditure by function, 2022-23



Note: This figure does not include non-recurrent expenditure, which is not available by function in VLGGC data.
Source: VLGGC and Parliamentary Budget Office.

In 2022-23, small shire councils’ operating expenditure averaged \$3,266 per person, which was around two-and-a-half times that of interface councils (\$1,270 per person).

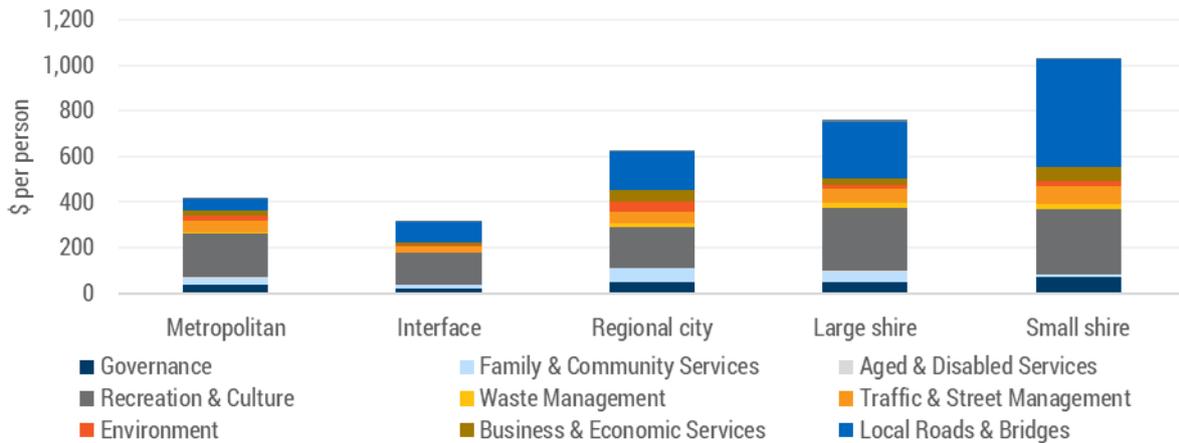
The 2 largest contributors to this difference were local roads and bridges, and governance. Small shire councils operating expenditure on:

- local road and bridges was \$865 per person – around 7 times higher than interface councils (\$118 per person), and 9 times higher than metropolitan councils (\$93 per person).
- governance was \$845 per person – around 3 times higher than metropolitan councils (\$317 per person) and interface councils (\$245 per person).

Net capital expenditure

Net capital expenditure by function of local government also varies substantially across council types.

Figure 36 – Net capital expenditure by function, 2022-23



Source: VLGGC and Parliamentary Budget Office.

In 2022-23, small shire councils’ asset expenditure averaged \$1,028 on per person, which was around 3 times as much as interface councils (\$313.3 per person).

The largest contributor to this difference was local roads and bridges. Small shire councils’ average asset expenditure on local roads and bridges was \$476 per person – around 5 times higher than interface councils (\$313 per person) and 9 times higher than metropolitan councils (\$51 per person).

Parliamentary inquiry into rural and regional councils

In 2018, the Victorian Parliament completed an *Inquiry into the sustainability and operational challenges of Victoria’s rural and regional councils*. The inquiry highlighted factors which particularly impact spending needs in regional and rural (large and small shire) councils, such as:

- risks of climate change, which impacts asset investment including in mitigation infrastructure
- market failures, which result in councils providing services like day care or medical services, which private enterprises would deliver in metropolitan council areas
- the impact of tourism, where non-ratepayers use but do not contribute to services or asset maintenance
- the challenges of attracting staff.

Differences in revenue raising capacity across councils

Aside from expenditure requirements, the other key driver of the horizontal fiscal imbalance between councils is the capacity to raise revenue.

Regional councils generally have a smaller revenue base than metropolitan councils, reflecting lower socio-economic status and average property values. They therefore have a lower capacity to raise revenue.

However, as regional councils generally have higher expenditure requirements, they tend to set much higher rates than metropolitan councils. Even with these high rates, they remain more reliant on Australian and Victorian government grants.

Potential own-source revenue

Councils’ potential to raise own-source revenue is largely driven by rates. Councils determine their rates funding needs, they then set a rate in the dollar accordingly, subject to Victorian Government restrictions.

In setting revenue targets councils face two limiting factors that reflect local circumstances, specifically the council:

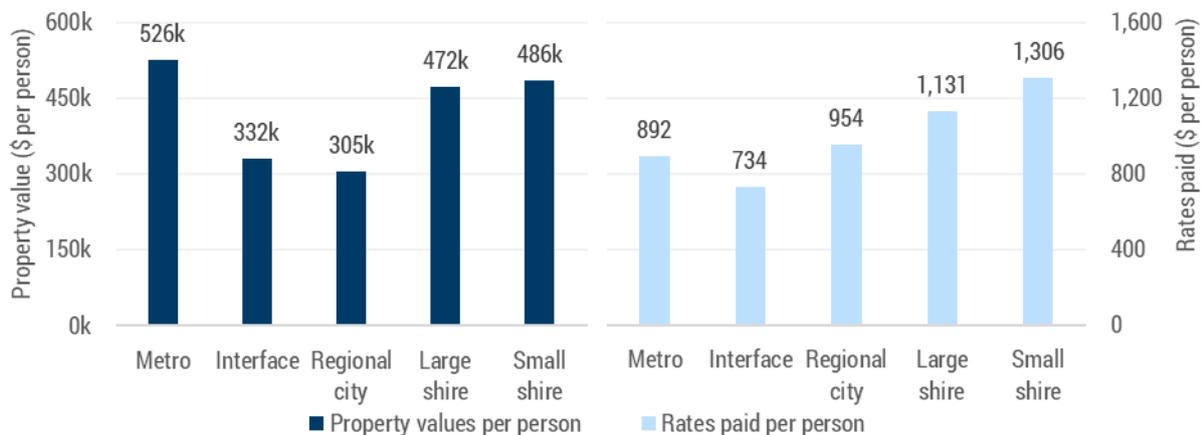
- **rate base** – the value of properties in the council
- **socio-economic status** – the wellbeing of councils residents, their need for services and capacity to provide council revenue.

Rate base

Council types have very different rate bases. Strictly speaking, the rate base is the aggregate value of property within each council. The rate base is also affected by the types of properties present – councils apply different rates in the dollar depending on property type.

Metropolitan councils have the largest rate base per person, with average property values of around \$526,000 per person. This is substantially higher than interface and regional city councils, with average values of \$332,000 and \$305,000 respectively.

Figure 37 - Council rate base and rates paid



Source: Parliamentary Budget Office.

The amount of rates revenue raised generally reflects two factors:

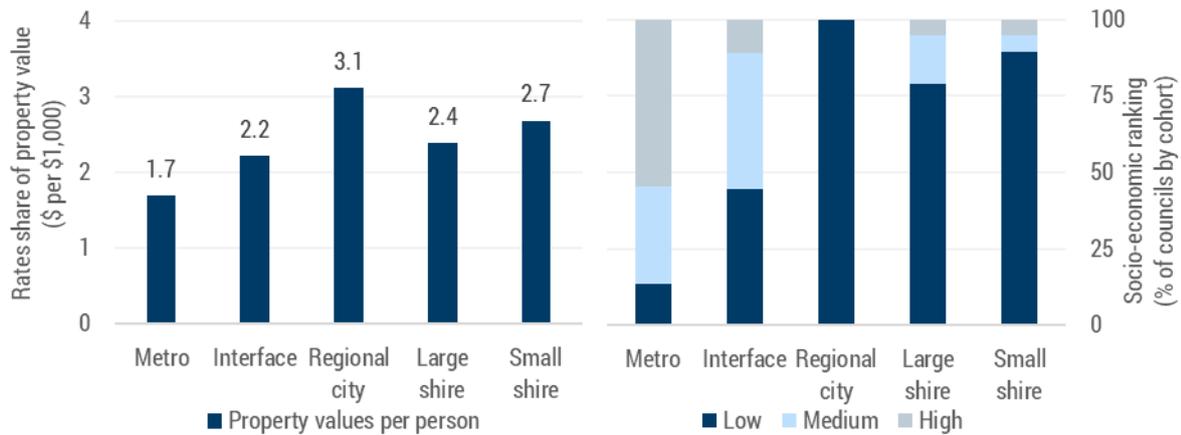
- the size of the rates base
- the ‘rate in the dollar’ that each council sets for different property types.

Metropolitan councils generate the second lowest rate revenue per person, as they charge lower rates across their relatively large potential rate base. Regional city councils raised the median income across councils, despite having the smallest rate base, implying a relatively high average rate on the dollar.

Rate burden

Comparing councils rate revenue to their potential base can be illustrative of the burden rates place on ratepayers. Residents of regional councils that collected higher rates faced larger burdens relative to metropolitan councils – and particularly regional city councils, which had the smallest potential base.

Figure 38 - Rate burden and socio-economic status



Source: ABS and Parliamentary Budget Office.

The ABS Index of Relative Socio-Economic Disadvantage (IRSD) provides a broad assessment of the socio-economic status in a region. A low score on this index indicates higher socio-economic disadvantage. Using the ABS index we have ranked councils into either low, medium or high socio-economic status based on their deviation from the average Victorian score across all councils.

Metropolitan and interface councils had the smallest proportions of low socio-economic councils – where their score was significantly below the state-wide average. The councils collecting the highest rates per dollar of property were all majority low socio-economic councils – regional city councils all returned a low ranking, and so did nearly 80% of large shire councils and 90% of small shire councils. This indicates that the councils paying the proportionally highest rates may be least able to afford them.

Total revenue raised

Rates revenue represents around half of total council revenue, although this varies by council type. Councils’ other source of revenue are:

- other own-source revenue such as fees and fines, and development contributions
- Australian Government and Victorian Government grants.

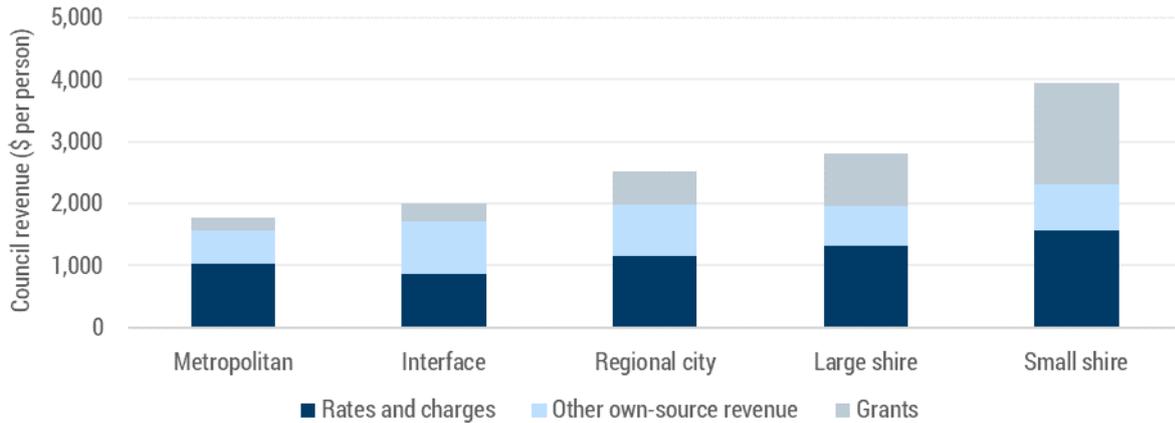
Figure 39 – Total revenue by council type



Source: VLGGC and Parliamentary Budget Office.

Metropolitan councils collectively report the highest revenue, \$5,640.0 million in 2022–23. This is more than the total revenue for regional city, large shire and small shire councils combined. However Metropolitan councils also account for 46.5% of Victoria’s population compared to 24.9% for the combined regional city, large shire and small shire councils.

Figure 40 – Revenue per person by council type



Source: VLGGC and Parliamentary Budget Office.

Own-source revenue per person other than rates is broadly consistent across council types. The variation in revenue per person is attributable to:

- Rates – small shire councils raise the most rates revenue per person of all the council types (\$1,557 per person), despite their relatively small revenue base. Interface councils raised the smallest amount of rates per person (\$853 per person).
- Grants – regional councils receive more revenue than metropolitan and interface councils by a significant margin. Small shire councils have the highest grants revenue (\$1,638 per person), more than 7 times metropolitan councils (\$223 per person).

Attachment A – Terms

In this advice, we use the following terms.

| Term | Definition |
|---|--|
| Operating expenditure | Expenditure on ongoing costs to councils, including employee costs |
| Net capital expenditure | Expenditure on non-financial assets, including new assets, and asset renewal, upgrades and expansions |
| Net capital expenditure | Expenditure on non-financial assets minus sales of non-financial assets |
| Own-source revenue | Total revenue minus grants and subsidies |
| Own-purpose expenditure | Total operating expenses minus grants and transfers to other levels of government |
| Operating vertical fiscal imbalance | <p>A vertical fiscal imbalance refers to the difference between revenue raising and fiscal responsibilities between levels of government.</p> <p>We measure this as the gap between own-source revenue and own-purpose expenditure.</p> |
| Comprehensive vertical fiscal imbalance | <p>We expand on the measure of vertical fiscal imbalance noting that governments also have net capital expenditure responsibilities.</p> <p>This measure is own-source revenue minus own-purpose expenditure minus net capital expenditure, across levels of government</p> |
| Operating horizontal fiscal imbalance | <p>A horizontal fiscal imbalance refers to the difference between revenue raising capacity and fiscal responsibilities at the same level of government.</p> <p>We measure this as the gap between own-source revenue and operating expenditure, across types of councils</p> |
| Comprehensive horizontal fiscal imbalance | <p>We expand on the measure of horizontal fiscal imbalance noting that councils also have net capital expenditure responsibilities.</p> <p>This measure is own-source revenue minus operating expenditure minus net capital expenditure.</p> |

Attachment B – Reconciliation against the request

| Requested submission | Addressed in submission |
|---|--|
| Council functions and expenditure | |
| Victorian council responsibilities for service delivery | Council responsibilities (pp. 11-12) |
| Costs of delivering these services | Council expenditure (pp. 13-18) |
| Council revenue | |
| How councils are funded, including: | Council revenue (pp. 19-27) |
| <ul style="list-style-type: none"> ▪ own-source revenue ▪ Australian government grants ▪ Victorian government grants | <ul style="list-style-type: none"> ▪ Own-source revenue (pp. 20-26) ▪ Grant revenue (pp.23-26) ▪ Grant revenue (pp.23-26) |
| Vertical fiscal imbalance | |
| Vertical fiscal imbalance, including: overall imbalance between council revenue and expenditure | Vertical fiscal imbalance (pp. 28-31) <ul style="list-style-type: none"> ▪ Vertical fiscal imbalance in Australia (pp. 28-29) ▪ Vertical fiscal balance over time (p. 30) |
| Breakdown of vertical fiscal imbalance by: | |
| <ul style="list-style-type: none"> ▪ services ▪ council type (if relevant) | <ul style="list-style-type: none"> ▪ Funding sources for specific services (p. 31) ▪ Horizontal fiscal imbalance across council types (pp. 32-34) |
| Horizontal fiscal imbalance | |
| Horizontal fiscal imbalance | Horizontal fiscal imbalance (pp.32-39) |
| Comparison across council types of: | |
| <ul style="list-style-type: none"> ▪ expenditure (per person) ▪ revenue raising capacity of councils ▪ rates and actual revenue (per person) | <ul style="list-style-type: none"> ▪ Differences in expenditure across councils (pp. 34-36) ▪ Potential own-source revenue (pp. 37-38) ▪ Total revenue raised (pp. 38-39) |

Attachment C – Data sources

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Attachment D – Council profiles in 2023

| Council | Area (km ²) | Population | Population density (persons/km ²) |
|--------------------------------|-------------------------|------------|---|
| Metropolitan | | | |
| Banyule City Council | 62.5 | 129,602 | 2,074 |
| Bayside City Council | 37.2 | 104,272 | 2,803 |
| Boroondara City Council | 60.2 | 174,537 | 2,899 |
| Brimbank City Council | 123.4 | 196,046 | 1,589 |
| Darebin City Council | 53.5 | 155,683 | 2,910 |
| Frankston City Council | 129.6 | 142,826 | 1,102 |
| Glen Eira City Council | 38.7 | 156,837 | 4,053 |
| Greater Dandenong City Council | 129.5 | 163,792 | 1,265 |
| Hobsons Bay City Council | 64.2 | 93,738 | 1,460 |
| Kingston City Council | 91.4 | 163,724 | 1,791 |
| Knox City Council | 113.9 | 161,766 | 1,420 |
| Manningham City Council | 113.3 | 129,514 | 1,143 |
| Maribyrnong City Council | 31.2 | 91,762 | 2,941 |
| Maroondah City Council | 61.4 | 117,434 | 1,913 |
| Melbourne City Council | 37.5 | 177,396 | 4,731 |
| Monash City Council | 81.5 | 203,560 | 2,498 |
| Moonee Valley City Council | 43.1 | 126,486 | 2,935 |
| Merri-bek City Council | 51.0 | 181,223 | 3,553 |
| Port Phillip City Council | 20.6 | 109,515 | 5,316 |
| Stonnington City Council | 25.7 | 111,335 | 4,332 |
| Whitehorse City Council | 64.3 | 178,639 | 2,778 |
| Yarra City Council | 19.5 | 97,448 | 4,997 |
| Interface | | | |
| Cardinia Shire Council | 1,282.6 | 126,960 | 99 |
| Casey City Council | 409.4 | 392,110 | 958 |
| Hume City Council | 503.8 | 262,764 | 522 |
| Melton City Council | 527.5 | 206,070 | 391 |

| Council | Area (km²) | Population | Population density (persons/km²) |
|------------------------------------|------------------------------|-------------------|--|
| Mornington Peninsula Shire Council | 724.0 | 170,243 | 235 |
| Nillumbik Shire Council | 432.3 | 63,264 | 146 |
| Whittlesea City Council | 489.7 | 245,029 | 500 |
| Wyndham City Council | 542.1 | 324,087 | 598 |
| Yarra Ranges Shire Council | 2,468.2 | 158,694 | 64 |
| Regional city | | | |
| Ballarat City Council | 739.0 | 118,137 | 160 |
| Greater Bendigo City Council | 3,000.0 | 124,174 | 41 |
| Greater Geelong City Council | 1,248.0 | 282,809 | 227 |
| Greater Shepparton City Council | 2,421.9 | 69,135 | 29 |
| Horsham Rural City Council | 4,266.8 | 20,315 | 5 |
| Latrobe City Council | 1,425.6 | 78,154 | 55 |
| Mildura Rural City Council | 22,081.9 | 57,554 | 3 |
| Wangaratta Rural City Council | 3,645.1 | 30,002 | 8 |
| Warrnambool City Council | 120.9 | 35,907 | 297 |
| Wodonga City Council | 433.0 | 44,276 | 102 |
| Large shire | | | |
| Bass Coast Shire Council | 865.8 | 42,729 | 49 |
| Baw Baw Shire Council | 4,027.6 | 60,644 | 15 |
| Campaspe Shire Council | 4,519.1 | 38,299 | 8 |
| Colac Otway Shire Council | 3,437.5 | 22,273 | 6 |
| Corangamite Shire Council | 4,407.5 | 15,948 | 4 |
| East Gippsland Shire Council | 20,939.5 | 49,179 | 2 |
| Glenelg Shire Council | 6,218.8 | 20,022 | 3 |
| Golden Plains Shire Council | 2,703.4 | 25,818 | 10 |
| Macedon Ranges Shire Council | 1,748.3 | 52,920 | 30 |
| Mitchell Shire Council | 2,862.1 | 53,723 | 19 |
| Moira Shire Council | 4,045.9 | 30,775 | 8 |
| Moorabool Shire Council | 2,110.6 | 39,092 | 19 |
| Mount Alexander Shire Council | 1,529.6 | 20,576 | 13 |
| Moyne Shire Council | 5,481.7 | 17,610 | 3 |

| Council | Area (km ²) | Population | Population density (persons/km ²) |
|----------------------------------|-------------------------|------------|---|
| South Gippsland Shire Council | 3,296.3 | 30,823 | 9 |
| Southern Grampians Shire Council | 6,654.0 | 16,470 | 2 |
| Surf Coast Shire Council | 1,552.9 | 39,292 | 25 |
| Swan Hill Rural City Council | 6,115.5 | 21,212 | 3 |
| Wellington Shire Council | 10,817.4 | 46,124 | 4 |
| Small shire | | | |
| Alpine Shire Council | 4,788.2 | 13,182 | 3 |
| Ararat Rural City Council | 4,211.1 | 11,683 | 3 |
| Benalla Rural City Council | 2,352.6 | 14,529 | 6 |
| Borough of Queenscliffe | 8.6 | 3,238 | 377 |
| Buloke Shire Council | 7,998.2 | 6,040 | 1 |
| Central Goldfields Shire Council | 1,532.8 | 13,574 | 9 |
| Gannawarra Shire Council | 3,737.6 | 10,420 | 3 |
| Hepburn Shire Council | 1,473.0 | 16,670 | 11 |
| Hindmarsh Shire Council | 7,524.2 | 5,559 | 1 |
| Indigo Shire Council | 2,040.5 | 17,662 | 9 |
| Loddon Shire Council | 6,696.4 | 7,747 | 1 |
| Mansfield Shire Council | 3,843.9 | 10,546 | 3 |
| Murrindindi Shire Council | 3,879.8 | 15,482 | 4 |
| Northern Grampians Shire Council | 5,729.9 | 11,879 | 2 |
| Pyrenees Shire Council | 3,434.6 | 7,786 | 2 |
| Strathbogie Shire Council | 3,303.3 | 11,578 | 4 |
| Towong Shire Council | 6,675.2 | 6,243 | 1 |
| West Wimmera Shire Council | 9,108.7 | 3,933 | 0 |
| Yarriambiack Shire Council | 7,325.8 | 6,389 | 1 |

Source: ABS, Parliamentary Budget Office.