

# Local government discount rate

24 August 2023

## 1 August 2023 update

As at the end of July 2023, the nominal local government discount rate is 3.2% and the real discount rate is 0.6%.

We recommend councils apply the local government discount rate when calculating local infrastructure contributions using a net present value (NPV) approach.

We calculate an updated discount rate every 6 months. Our approach to calculating the discount rate is:

- consistent with IPART's WACC method (in determining the cost of debt for utilities)
- market based (based on an assumed credit rating for the sector)
- relatively simple to administer
- based on historical data on the relevant debt margin.

This approach is explained in more detail in our August 2018 Technical Paper, [Modelling local infrastructure contributions in a present value framework](#). We have also included the calculation of the local government discount rate in the WACC model spreadsheet, available on our website [here](#).

Our method for calculating the discount rate uses a market-based estimate of the cost of debt for the local government sector. We calculate this by taking the risk-free rate (10-year Commonwealth bond yield), adding half of a debt margin spread (for 10-year non-financial corporate A-rated debt) and debt-raising costs of 12.5 basis points.

Councils have the flexibility to model contributions rates using either nominal or real values. If councils use real values, they should use a real discount rate. We adjust the nominal discount rate for inflation to derive a real discount rate. Our inflation estimate is the average of the RBA's inflation forecast for the next year, and 4 years of the midpoint of its target inflation range.

IPART will next publish the local government discount rate in February 2024.

## 2 August 2023 update calculations

Since the publication of our last Fact Sheet in February 2023, the nominal discount rate has increased from 3.1% to 3.2%. The real discount rate has increased from 0.4% to 0.6%.

Table 1 shows the nominal and real discount rates and the various components that make up the rates.

Table 1 Calculating nominal and real discount rates – IPART method

Relevant rates	Commonwealth 10-yr bond yield (%) <sup>b</sup>	Corporate A-rated 10-yr yield (%) <sup>b</sup>	Spread (%)
Current cost of debt <sup>a</sup>	2.20 <sup>d</sup>	3.60 <sup>d</sup>	
Historic cost of debt <sup>a</sup>	2.50 <sup>d</sup>	3.90 <sup>d</sup>	
Midpoint	2.35	3.75	1.40
<b>Calculating the discount rate</b>			
Commonwealth 10-year bond yield (midpoint)	2.35		
+ half of the spread	0.70		
+ debt raising costs	0.125		
<b>= Nominal discount rate</b>	<b>3.175</b>		
Inflation forecast <sup>c</sup>	2.60		
<b>Real discount rate</b>	<b>0.56</b>		
<b>Nominal discount rate</b> (rounded to 1 decimal place)	<b>3.2</b>		
<b>Real discount rate</b> (rounded to 1 decimal place)	<b>0.6</b>		

**a** We use a trailing average to calculate the historic and current cost of debt. The historic cost of debt consists of 10 equal tranches of debt for a 10-year period and the current cost of debt consists of 5 equal tranches of debt for a 5-year period.

**b** For each tranche of debt, the Commonwealth 10-year bond yield is based on 40 trading days of data and the non-financial corporate A-rated 10-year yield is based on 2 months of data.

**c** The inflation forecast is based on the current 1-year forecast based on quarterly data from the RBA's Statement of Monetary Policy, and the remaining 4 years is based on midpoint of the RBA's target band of inflation of 2.5%

**d** The bond yield values are all rounded to 1 decimal place to be consistent with the corresponding inputs in the primary WACC calculation.

**Note:** The periods over which the trailing averages are calculated are to 31 July 2023.

**Source:** Reserve Bank of Australia, Statistical Tables F2 (Commonwealth 10-year bond yield), F3 (non-financial corporate A-rated 10-year yield) and Statement of Monetary Policy (inflation).