

FACT SHEET

Latest discount rate for use in local development contributions plans

February 2016

Our Technical Paper *Modelling local development contributions in a present value framework*¹ recommends that councils adopt a specific method to calculate the discount rate for use in any net present value (NPV) modelling of contributions plans. This Fact Sheet uses the methodology in that paper to update the discount rate based on historical data to the end of January 2016.

The methodology 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) and adding our estimate of the debt margin.

Calculating the debt margin

The debt margin is defined in two parts. First, we take half of the rate spread between the 10-year Commonwealth bond and non-financial corporate A-rated 10-year debt. Secondly, we add a small margin of 12.5 basis points to allow for the cost of raising debt.

Converting from a nominal to a real discount rate

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 in order to derive a real discount rate. Our inflation measure is the average of the Reserve Bank of Australia's inflation forecast for the next year and nine years of the midpoint of its target inflation range.

Current discount rate

Since the publication of our last Fact Sheet in September 2015, the nominal and real discount rates have increased by around 10 basis points.

¹ IPART, *Modelling local development contributions in a present value framework – Technical Paper*, February 2016, available on our website.

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

Table 1 Calculating nominal and real discount rates – IPART method

Averaging relevant rates	Commonwealth 10-yr bond yield	Corporate A-rated 10-yr yield	Spread
Average 10 years	4.605	6.664	
Average 2 months	2.794	5.362	
Midpoint	3.700	6.013	2.314
Calculating the discount rates			
Commonwealth 10-year bond yield	3.700		
+ Half of spread	1.157		
+ Debt-raising costs	0.125		
= Nominal discount rate	4.982		
Inflation forecast	2.500		
Real discount rate	2.421		
Nominal discount rate (rounded to 1 decimal place)	5.0		
Real discount rate (rounded to 1 decimal place)	2.4		

Note: The periods over which the averages are calculated are to January 2016.

Source: Bloomberg (10 year bond rates); Reserve Bank of Australia, Statistical Tables F3 (corporate yields).

IPART will release the next update of the discount rate for local government development contribution plans in August 2016.