SOLGM

Local government funding and financing

The Society of Local Government Managers' contribution to the Productivity Commission Inquiry
Local Government Funding and Financing

leadinglearninglinking

SUMMARY

Rates are a highly visible form of tax that accounts for a majority share of funding for local government. Control of its own source of taxation gives local government a larger degree of autonomy than is the case in many other systems of local government, but this comes with a greater degree of accountability to local communities.

There can be no doubt that changes in rates have decoupled from changes in incomes, and it is this decoupling that has given rise to the Inquiry into funding and financing.

Cost drivers

The price of core services is increasing

Local authorities in this country are largely deliverers of infrastructure. The price of the commodities and services that go into delivering infrastructure are increasing, and have increased faster than the CPI for most of the last twenty years. In some years the rate of increase has been three times the rate of increase in the CPI. The factors driving this increase are many and varied – in our view some investigation of factors driving increases in construction prices would bear fruit.

Population growth and change are key drivers of cost

The Commission has traversed the needs of the growth councils in several of its reports. These councils are challenged to ensure there is a steady flow of shovel ready land, including trunk infrastructure. A grouping of these councils are approaching the limits that they can borrow under their covenants with the local government funding agency. Co-investment in this area is one of the keys to housing affordability.

At the same time parts of New Zealand are static or even experiencing population decline. There are few policy options to reverse decline leaving local authorities in this situation facing demands to deliver services (often to the same standard as others) from a shrinking economic base, knowing that 'right sizing' and decommissioning assets comes with a cost.

At the same time, every local authority in the country is facing the implications of structural aging of the population. Some are close to a demographic tipping point where this factor drives a decrease in population. This creates demands for a different portfolio of services, higher standards of service, from a population where more are moving onto fixed incomes.

But so is economic growth and transformation

One of the interesting results of our research has been to see just how closely movements in GDP and rates track each other. Of course, having the right network infrastructure in place is one of the pre-cursors to economic growth, in the words of the Auditor-General 'it matters where people live and work'. Tourism, dairy and forestry each pose their own funding challenges – be it demand for 'big city' amenity in communities that aren't big cities, or the challenge of managing a level of demand that is at a peak once every 30 years.

Increasing standards are a coming storm

Thanks to the infrastructure strategies we have a good picture of the cost of business as usual. But recent work in the three waters review has given shape to the level of concern that the sector was experiencing. BECA have identified that the sector will face an additional $309-574 million of capital cost as a result of the likely removal of the all steps exemption under drinking water standards – most of which will fall on small communities. In a similar vein GHD and Boffa Miskell have identified some $1.4-2.1 billion in capital costs for the sector to comply with the Freshwater NPS. Often these costs fall on the smaller schemes and communities.

The costs of climate change are starting to gain shape

Work done by LGNZ suggests that some $8 billion worth of local authority assets is exposed to sea level rise of 1.5 metres. While this cost is significant on own these may be dwarfed when the process of managed retreat begins – with no real policy framework in place local authorities may be purchasing property from some and compensating others for regulatory takings.

And these are just the big-ticket items

The above factors are not the only drivers of cost – they are the larger ones. For example, the costs imposed through Treaty settlements are impacting on the regional sector through plan reviews, co-governance etc. Through the operation of *section 100* of the *Local Government Act* depreciation has now become as big an expense as staff salaries.

What should happen?

Central government and local government are in the wellbeing business together – that means national funding for national good

Governments, whether central or local, do not exist for their own sake. Nor do Governments exist as a collection of services that operate on their own. Governments provide the collective means through which the community makes decisions and acts to promote community wellbeing. The *Local Government (Community Wellbeing) Amendment Bill* currently before Parliament will reintroduce a focus on wellbeing to the purpose of local government, and in about a dozen places elsewhere in the *Act*.

The next step in the process of establishing a genuine partnership is to conduct a conversation to establish a clear coherent vision for local government and its role within New Zealand's governance arrangements. This would provide an answer or range of answers to longstanding questions around the appropriate balance between central and local level decision-making and provide for some consistency in approach. Some degree of joining up in this way would also help establish and assess the total cumulative costs and effects of proposed reforms for the sector and for local communities.

The inquiry provides an opportunity for a robust debate as to what constitutes national good, including criteria and methodologies for determining what is "national good" and a strategy for investment in national good infrastructure and services. Some of these criteria might include:

- *the estimated or expected contribution to wellbeing* – no branch of government funds services for their own sake, those services with a higher contribution to wellbeing may have a stronger case for national funding
- *the presence of externalities/spill over benefits* – the sorts of national good are essentially –examples of what economists refer to as "spill over" benefits i.e. a piece of supposedly local infrastructure that generates benefits beyond the district (often referred to as externalities)
- *promotion of equity in outcomes* – a related issue is when the level of service is not completely determined locally, in particular when there are minimum national standards. In this case, local taxpayers may receive more benefits than they would choose (and be prepared to pay for) without the external minima. Good examples of funding that illustrate this criterion in action include funding (on a matching basis) for sewage disposal schemes in small communities and to enable small communities to meet the New Zealand Drinking Water Standards.
- *the size of the local funding base* – this criterion is typically linked with equity in outcomes in that some infrastructure may be necessary for other reasons, but the cost may be beyond the financial capability of the local district to afford. For this reason, funding from central government for infrastructural development is generally either targeted only at

lower income communities (as is the case with sewage and drinking water subsidies) or has some recognition of "ability to pay" (as is the case with most land transport funding).

Applying those criteria and considering the likely areas that a wellbeing strategy would cover probably leads us to the following:

- funding support for three waters infrastructure – especially to meet the impact of the removal of the all practicable steps defence for drinking water treatment and meeting the requirements of the Freshwater NPS
- funding for climate change adaptation
- further support for growth and housing related infrastructure.

Recommendations: Funding for wellbeing objectives

1. That central and local government agree on a joint wellbeing strategy that assigns responsibilities to central and local government.
2. That this strategy set out jointly determined criteria for determining the national good element of funding for local government.

The *Rating Act* could be enhanced

The *Rating Act* is the means for apportioning an amount of funding that policy-makers determine should be raised by tax. As a taxation statute – it's served us well, the issues in this paper go to how much revenue in total is needed.

There are a few arbitrary limits on the use of rating tools that ride roughshod over the disciplines of the *Local Government Act*. Removing these and not buying into the notion that rate-capping is good for the economy in the long-term are both essential.

Rating, especially targeted rates, are heavily reliant on good quality up to date land information. As local authorities move to more use of bases such as separately used or inhabited portions of a rating unit, the limits of the powers to gather information under the *Act* are becoming all too apparent.

And finally, while the terms of reference preclude the Commission from commenting on the rating of Crown land, we draw the Commission's own conclusions about the poor incentives these send and the lack of an underpinning rationale. Removing exemptions in itself will target some areas of need. A high school or a hospital are the size of a small town after all.

Recommendations: Rating tools

3. That the *Rating Act* 3 be amended to remove unnecessary limits on the use of tools in the rating toolkit.
4. That the Commission not pursue proposals to 'cap' rates.
5. That the Commission agree that the *Rating Act* be strengthened to require ratepayer disclosure of all land information relevant to the setting of rates at the time any change occurs.
6. That rates exemptions, including those on Crown and non-Crown land be removed *in toto*.

Investigating alternative tax bases is not a high priority item

The nine previous inquiries into local government funding have concluded either that rates were the best tool for local government, or that there is no clear compelling reason to abandon property tax. We agree. Allowing locally set income tax and GST would come with significant compliance costs for business.

We conclude that this debate quickly goes to nationally set tax with some redistribution. In our view the higher priority needs to be placed on developing the wellbeing strategy and determining what's national good funding.

Recommendation: Alternative tax bases

7. That the Commission take note of the conclusions of the nine previous reviews of local government funding in regards to local income taxes and local expenditure taxes.

Special purpose vehicles could be a useful tool for larger projects

The terms of reference ask the Commission to consider special purpose vehicles (SPV) as a means of project financing. Their cost and complexity make them a viable tool for the larger projects. They will need to demonstrate accountability for the use of public money however its raised. We would have reservations about the entities having powers to tax. The other main regulatory issue we see is the ability to transfer land and assets under the *Public Works Act*.

Recommendations: Special purpose vehicles

8. That the Commission further consider the accountability regime for use of public money provided to, or used by an SPV (including the proposed Urban Development Authority).
9. That the Commission further research the application of the *Public Works Act 1981* to land transferred to and from an SPV.

The effectiveness of development contributions could be enhanced

Development contributions have been something of a political football – with the uncertainty undermining their effectiveness as a funding tool, and the location signals they send. Parliament is about to put back the ability to assess contributions for community infrastructure. This is welcome, but we would also seek to have the cap on reserve contributions removed and that the mechanism applies to Crown developments. We see some degree of future-proofing is required and propose that the power apply to any service where a local authority can demonstrate a nexus with growth, and to projects delivered in partnership where a third party owns the land where the asset will be built.

Recommendations: Development contributions

10. That regional councils be permitted access to development contributions where they can demonstrate a nexus between their services, capital expenditure and growth.
11. That the cap on reserve contributions be abolished.
12. That the law be amended to allow for recovery for development contributions on land that is not owned or controlled by the local authority.
13. That the Crown exemption from paying development contributions be removed.

Tax Increment Financing provides some incentives for growth-related investments, but requires significant regulatory change to work best

Tax Increment Financing (TIF) schemes are a commonly used method of value capture in the United States. They appear to work best where local authorities have access to sales or income tax, but can incentivise investment in growth to the extent that increase economic activity is reflected in property values. Under our present top-down method of setting rates, any additional value in the defined area of benefit is absorbed for the whole.

Recommendation: Tax Increment Financing

14. That the Commission further consider the process through which Tax Increment Financing would operate, including the relationship with the current methodology for setting rates.

Betterment charging does not seem a viable option

Experience with betterment charging both here and overseas is not encouraging. Schemes have generally been short-lived, controversial and not always that effective as a revenue-generator. Our view is that TIF shows more promise.

Recommendation: Betterment charging

15. That the Commission abandon further work on betterment charging.

Environmental taxes send good economic signals that may aid in the pursuit of other objectives

The Tax Working Group has issued a draft report that recommends taxes on pollution and abstraction of water as medium-term priorities. We concur, and add that the pricing signal these would send is a critical means of promoting good demand management, thereby supporting compliance with the Freshwater NPS. Local authorities are well placed to administer such taxes.

Further taxing of automotive energy likewise manages the impact of road use and ought to not be lightly ruled out.

Recommendations: Environmental taxes

16. That the Commission recommend further consideration of taxation of water pollution and water extraction.

17. That the Commission recommend further increases in fuel excise and the extension to other forms of vehicular energy.

A climate change adaptation fund is a must

The costs of climate change, particularly adaptation could become one of the larger drivers of expenditure. New Zealand has no real policy framework for managed retreat whether it be making the decision, funding, liability, insurance etc. This gap must be rectified and supported with an adaptation fund. Some degree of pre-funding will be essential and the fund and the means of generating the funding will need to incentivise responsible action and disincentivise activity that contributes to greenhouse gas emissions.

Recommendation: Climate Change Adaptation Fund

18. That the Commission recommend priority be given to establishing a Climate Change Adaptation Fund.

Some form of taxation of tourism may make a real difference with little real impact on the industry

New Zealand has become an international destination – but many of our most popular tourist places are in communities that are ill-placed to afford them. There are a variety of options for taxing tourists – a levy on accommodation, increasing tax taken at the border, or local taxes (such as the Stewart Island levy). Given we are the last stop on the planet and the distances to travel (and price) are so great we'd need convincing that the elasticity of demand is so high that taxation on a small level would have much of an impact at all.

Recommendations: Taxation of tourism

19. That the Commission recommend an increase in the Visitor Levy.

20. That the Commission recommend local taxation for tourist related purposes subject to the appropriate basis and accountability.

Pricing powers could be brought into the 21st century

Policy work on road pricing has gone around in circles for the last 20 years – it's time that central government recognised the value of an economic signal of the cost of road use. Likewise tolling of new and existing roads should be subject to road controller's discretion. All prices should be set on an actual and reasonable cost basis – including those for statutory functions.

Recommendations: Road tolling

21. That local authorities be permitted to toll any road – new or existing.
22. That such tolling not be subject to Ministerial approval

Recommendation: Road pricing

23. That central government give priority to the introduction of 24/7 road pricing.

Recommendation: Wastewater charging

24. That local authorities be permitted to charge on a volumetric basis for wastewater disposal where the local authority considers it economic to do so.

Recommendation: Fee setting by statute

25. That all remaining instances of statute setting maximum fees be replaced with powers to charge actual and reasonable cost.

There are appropriate models overseas for identifying and resolving unfunded mandates

The Commission's previous inquiries have identified flaws in the way central government makes policy on local government, especially in the regulatory area. Implementation needs go unidentified or unaddressed, costs are not identified, and funding is not often considered. There are overseas approaches that are (or were) used to address these so-called unfunded mandate issues.

The United States federal law the *Unfunded Mandates Reform Act* has several useful checks and balances including cost/benefit analysis, a description of macroeconomic effects, and a summary of concerns from the sub-national government. On first glance adopting a model along these lines would deal with many of our concerns in this area.

Recommendation: Unfunded mandates reform

26. That New Zealand consider an unfunded mandates statute modelled on the American basis, including an obligation to engage with the local government sector in identifying costs and benefits.

Affordability seems to be a factor in the design of most funding systems but it's often not clear how

A majority of local authorities claim they take affordability into account when they set rates. Yet we see some failure to distinguish between this and willingness to pay. There may be a case for making affordability an explicit criterion as part of the funding policy process of *section 101(3)* of the *Local Government Act 2002*.

Recommendation: Affordability

27. That the funding policy process set down in *section 101(3)* of the *Local Government Act 1974* be amended to require explicit consideration of affordability. This would most probably fit in the second step of the process.

There are lessons to be learned from the English experiences with austerity

While local authorities are digitising, implementing shared services, applying demand management and the like our sense is that these tools aren't being systematically used. There are lessons the sector can learn from the experiences of English local authorities during the austerity reforms of 2010-2015. One thing that doesn't help is an over specified and cumbersome requirement to undertake service reviews – we propose stripping out the detail about when and how to undertake a review and leaving the obligation.

Recommendations: Efficiency gains

28. That the Commission note that efficiency and effectiveness are ingrained through the *Local Government Act 2002*.
29. That *section 17A* of the *Local Government Act 2002* be amended to require councils to review cost-effectiveness of services without the specification of options or processes.

The Rates Rebate Scheme needs a first principles review

The *Rates Rebate Act* was written in 1973. It creates a paper-based and administration heavy application process that could benefit from the application of technology. At the same time the scheme is a product of its time – modern land tenure, social practice, and convention have dated the scheme. The more we adapt it to, for example, take account of retirement villages the more it looks like a form of social assistance. The assistance the scheme provides is invaluable, but the scheme itself needs a review.

Recommendation: Rates Rebates Scheme

30. That the Rates Rebate Scheme receive a first principles review including purpose and delivery.

Enhancing the resources available to the public will build public understanding of local government finance

Previous reviews of local government and local government finance have highlighted a paucity of information about local government affairs. Statute makes our processes ever more complex. The public has opportunities to participate in expenditure and funding decisions – yet these are not well understood and not well maintained. We consider that some enhancement would improve the quality of debate and go some way to re-inculcating civic values.

Recommendation: Public education

31. That the Department of Internal Affairs, SOLGM and Local Government New Zealand work to enhance the breadth and availability of the public resources on local government.

Enhancing elected members' financial governance skills and knowledge at induction may enhance decision-making

Elected members govern organisations with large holdings of assets that have a critical impact on the local economy and society. The differences between a local authority and a small business are stark. Financial governance is a must have skill-set, yet the take-up of some (excellent) resources provided by LGNZ is spotty at best. We would like to see more of this woven into induction.

Recommendation: Public education

32. That the Department of Internal Affairs, SOLGM and Local Government New Zealand consider how to most effectively inculcate basic financial skills and knowledge as a part of elected member induction.

INTRODUCTION

The New Zealand Society of Local Government Managers (SOLGM) thanks the Productivity Commission (the Commission) for the opportunity to respond to the issues paper it has prepared as part of the Inquiry into Local Government Funding and Financing (the Inquiry).

SOLGM is a professional society of 700 local government chief executives, senior managers, and council staff.[1] We are an apolitical organisation that can provide a wealth of knowledge of the local government sector and of the technical, practical and managerial implications of legislation and policy.

> Our vision is:
>
> *Professional local government management, leading staff and enabling communities to shape their future.*

Funding issues are at the heart of the relationship between local authorities and their communities. There is an implicit contract between the council and community that sees the community provide a level of funding support in return for a bundle of levels of service. Receipt of a rates assessment, or paying some form of fee or charge to use a council service, is one of the most obvious and frequent forms of direct contact that many residents have with their council. Public views and perceptions of a council's funding policies and practices can make or break an elected council.

The highly visible nature of the rating mechanism and some of the pubic misconceptions about rates make for a higher level of scrutiny and public concern about rates. Yet, recent work by the New Zealand Initiative shows the differences in the order of magnitude between rates and taxes. In the year to June 30, 2017 central government taxes accounted for 29 percent of Gross Domestic Product (GDP), while local government accounted for around 2.1 percent of GDP. Similarly, central government tax per capita in the same year was around $16,600, local government $1214. We are obliged to ask – whose taxes are the more unaffordable?[2]

This paper is presented in three parts that broadly follows the structure of the Commission's terms of reference. The first part deals with the drivers of local government costs – including those matters specifically identified in the terms of reference and the many, many other drivers. Part Two of the submission discusses a set of funding issues and options. In Part Three, we consider that the issues with local government funding and financing will require some action other than additional funding and financing tools or sources – for example a genuine commitment to quantify the costs government requirements impose on local authorities.

Before moving to the main body of the paper we would like to make a few preliminary points about local government funding and financing. These are in the nature of recurrent themes throughout the remainder of the paper.

Rates are a tax, not a user charge. . . .

Rates are a system of tax used to fund local goods and services, in much the same way as income tax and GST are used to fund nationally provided services. However, local authorities have the discretion to tailor rating systems in such a way as to more closely approximate 'user pays'.

1 As at 31 December 2018.
2 New Zealand Initiative (2018), *Fit for Purpose – Are Kiwis Getting the Government They Pay For?* page 15. Approximately 93 percent of all coercive tax is raised by central government.

One need only look at the scheme of the funding parts of the *Local Government Act 2002* to see that rates are not intended to be a user charge. The main section dealing with funding policy (*section 101(3)*) requires local authorities to consider the distribution of benefits among the community, but also to consider:

- the objectives the local authority has in undertaking the activity
- intergenerational equity
- any exacerbators
- the practical implications of funding the activity separately from other activities and
- the impact on wellbeing.

Had Parliament intended that rates were to be solely a user charge it would not have enacted a policy-making requirement that takes in such broad considerations.

The concept of rates as a tax has received judicial recognition on several occasions. The root of this line of jurisprudence is the decision of the Court of Appeal in *Woolworths and Others vs Wellington City (1996)* where the judgement of Richardson P commented that:

" … it is implicit in the scheme of the legislation that the rating system in its diversity remains primarily a taxation system and not a system inherently based on a principle of user pays".

And this line of jurisprudence has continued through *Lovelock and Others vs Waitakere City Council, Visser and Others vs Whangarei District Council, Telecom vs Auckland City Council (No 3)*, and *Luxton and Others vs Waikato Regional Council*.

Finally, any standard economics textbook includes property within its standard definition of tax. Economists refer to the 'tax-like characteristics of rates' which are generally referred to as:

- universality
- coerciveness
- independence from levels of benefit received
- public accountability on the part of the agency levying the tax.

GST on rates is sometimes raised as an argument in support of rates being a user charge. This is something of a 'red herring'. In fact, the reason GST is applied to rates is more to preserve competitive neutrality between providers and to ensure a broad revenue base.

One final note on the tax-like elements of rates. It is frequently claimed that a tax on property is unfair because only landowners pay the tax. This is to confuse the legal incidence of rates and the economic incidence of rates – that is to say it confuses the obligation to pay and where the money actually comes from. Landlords are not generally philanthropists. The claim is simply not correct, especially when housing markets are as active as at present. We would accept however that landlords might not pass on all of a rates increase, and that rentals might adjust more slowly.

Evidence suggests that rates have increased more quickly than household incomes

In a report for the Department of Internal Affairs, Morrison Low (2018) have calculated an estimated level of rates as a percentage of household expenses and as a percentage of household incomes.[3]

Their calculations showed that rates were expected to account for a higher proportion of both household expenses (from around 4 percent to around 4.3 percent) and household incomes (from around 3.65 percent to 4 percent).

3 Morrison Low (2018), Department of Internal Affairs – Costs and Funding of Local Government, pp15-19.

Significantly while the household living cost index has increased by 15.1 percent, while rates have increased by 43.5 percent between 2008 and 2018.

These data, and other indicators assembled by Morrison Low provide prima facie evidence that rates are becoming less affordable – and remember the end of the period they consider is just seven years away.

The 2007 Report of the Independent Inquiry into Local Government Rates ('the Independent Inquiry') held that rates would be unaffordable for an individual ratepayer if they accounted for more than five percent of the ratepayer's gross household income. They did, however note that this was, in their words "a very approximate threshold" and at the time that the average rates bill accounted for around 2.5 percent.

Independence of funding is a strength of our system of local government

New Zealand's system of local government is unusual in its high level of reliance on funding raised through local means. The latest Local Authority Financial Statistics (year ended June 2017) showed that funding from central government accounted for around 12 percent of the sector's operating income.

This is in large part a product of the differing mix of services that local authorities in this country provide. In New Zealand, local authorities are largely providers of services to property (though the picture changes a little for regional councils which serve more of an environmental stewardship role). In other jurisdictions the mix of services is more balanced between services to property and services to people.

In practice, relying on local sources of funding provides local authorities with a significant level of autonomy, and the flexibility to respond to local needs and preferences. This supports local government's constitutional place as an independent arm of government. It should also come as no surprise as it mirrors a basic principle of public finance – that those who levy a tax are accountable to those who pay the tax for the prudent and efficient use of the tax receipts.

To take the counterfactual, consider the place of local government in England. These local authorities are primarily providers of social services (such as aged care). Historically, their financial arrangements were almost the direct opposite of those in New Zealand, with around 80 percent of operating income sourced from Westminster. The so-called austerity regime of 2010-2014 was therefore a significant fiscal blow for English local authorities as

"Government funding for local authorities has fallen by an estimated 49.1% in real terms from 2010–11 to 2017–18. This equates to a 28.6% real-terms reduction in 'spending power' (government funding and council tax)."[4]

The austerity regime has posed a significant challenge for English local authorities. But austerity has also had the benefit of forcing them both to reconsider some of their fundamental assumption about roles and innovate in providing those services that they do deliver.

This is not to say that local government should 'stand alone' – indeed co-investment in identified areas of national good is one of the key policy planks of this paper. Just as local government is accountable to its community, so central government is accountable to the taxpayer. That means that there will be terms or processes so both parties are satisfied an investment represents best value. It is simply not credible under our system of public finance for central government to provide an untied grant. But a balance of autonomy and accountability must be maintained.

4 SOLGM (2018), *Through the Looking Glass – What SOLGM Saw and Learned in England, Scotland and Wales*, page 7.

The issues signalled in this paper go wider than funding tools, and require wider thinking than funding solutions

Some commentators are likely to focus on 'more money' as the solution to all of the issues that have been raised. However, money alone is unlikely to resolve all of the issues.

Part Three of the paper will highlight that public understanding of local government financial matters could be improved. 'More money' is not the solution to this issue – though it may be a short-term palliative. Better education and information to the public about rates and local government funding in general may be the better approach to take. Later sections also highlight some governance and practice issues where education may also be of benefit.

In a similar vein, local authorities are required to implement legislation that is poorly designed or lacks the appropriate recognition of costs. While the right funding tools alleviate these concerns, these are more about the way central government makes policy and the lack of incentives to improve these processes.

And last, but by no means least, local government could make more systematic use of tools such as shared services and digitisation.

PART ONE: COST DRIVERS

In this section we consider the drivers of cost in local authorities. The Inquiry's terms of reference are patchy and inconsistent in their treatment of the drivers of cost. For example, the costs of meeting the needs of a growing and transforming economy are not mentioned at all, yet the costs of treaty settlements are. We consider the following:

- population growth and change (including population growth, population decline and structural components such as the aging population)
- the costs of infrastructure
- economic growth and transformation (which includes a discussion of the costs of tourism and forestry in particular)
- health and environmental standards
- treaty settlements
- climate change and
- other regulatory settings.

Throughout this section we feature case studies of the impact that a particular cost driver has had for a particular local authority. These have been generously provided by each local authority. We asked each local authority to tell their story in their own words – and have edited them only to ensure correct spelling and grammar.

Population growth and change

"Here in Auckland we need to build three new roads per week to keep pace with the demands of growth … "

– Stephen Town, Auckland Council Chief Executive

Servicing the needs of population growth are a significant driver of costs, and a funding challenge for local authorities

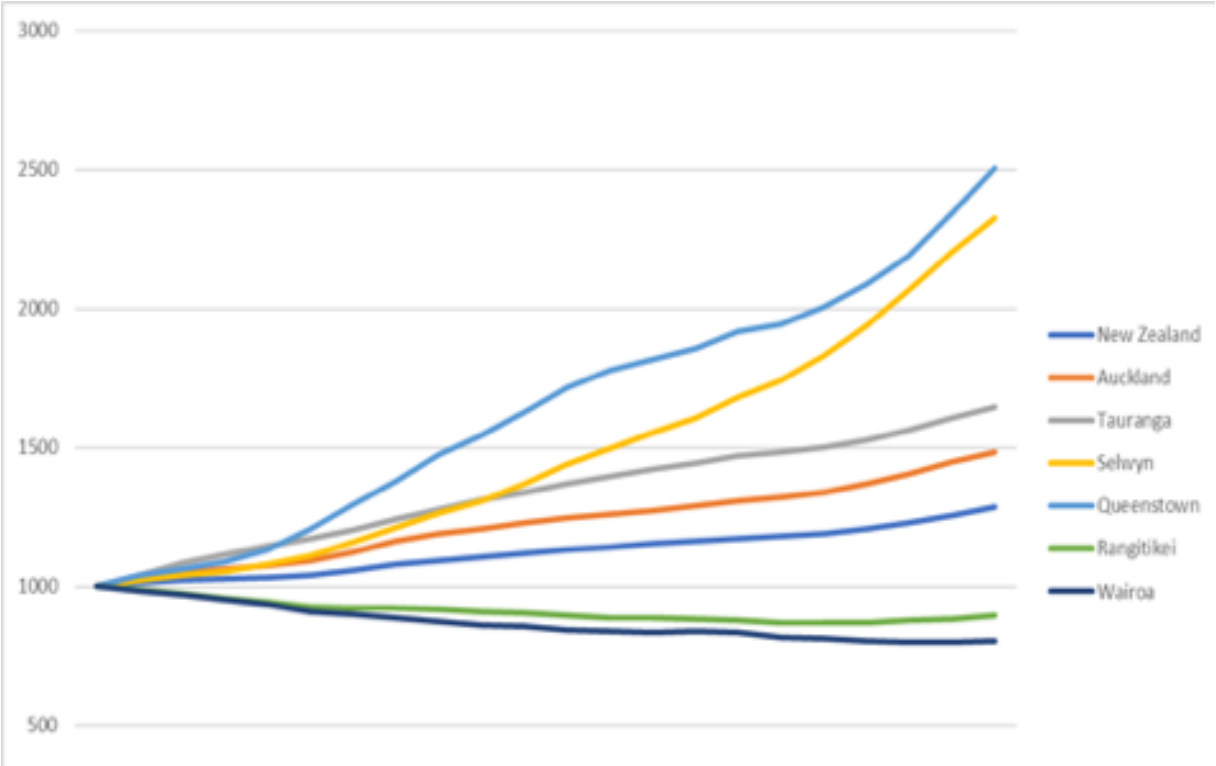
The Commission's previous inquiries, *Housing Affordability* and *Using Land for Housing*, have demonstrated a good understanding of the challenges that growth poses for local authorities.

In the period since 1996 New Zealand's population increased by some 29 percent – but this is not evenly spread through the country. New Zealanders sometimes (erroneously) equate growth with the so-called 'golden' or 'ATT' triangle or the 'drift to the North'. While the area bounded by Auckland, Tauranga and Taupo is one of the larger growth areas in New Zealand, internal migration is driving significant growth in areas such the peri-urban fringes of Christchurch and the corridor from Queenstown south).[5]

Significant internal migration is far from a new phenomenon – references to a drift northward can be found in media reports from as long ago as 1916.[6] The scale of change is quite different. As Figure One shows, Selwyn and Queenstown-Lakes have more than doubled in size since 1996, while one in five residents of Wairoa in 1996 have left the district since.

5 Source: Statistics New Zealand.
6 *The Press*, 17 November 1916, p. 5. Retrieved 12 January 2018.

Figure One – Rates of Growth, New Zealand and Selected Local Authorities 1996-2017[7]



Of course, when the absolute level of growth (that is the actual number of people) is used as the basis for comparison Auckland continues to dwarf the rest of the country. The latest available Subnational Population Estimates have shown that in the last three years Auckland has added the equivalent of a city the size of present-day Tauranga. While in turn, in 1945 Tauranga was a town the size of the present day Kawerau.

Growth driven expenditure poses some important policy issues for local authorities. Generally, network infrastructure needs to be in place before development occurs – thus the local authority is taking some risk in putting in expenditure in advance of the revenue.

Many of the medium growth local authorities have the potential to borrow and then recoup the expenditure through rates on the properties in the development, although the rating mechanism is a very blunt instrument for this kind of policy.

However, there are a group of local authorities for whom taking on additional debt may not be a long-term option. Auckland, Hamilton, Tauranga, Christchurch and Queenstown-Lakes are all particularly high growth local authorities that have borrowed in amounts that place them at or near the borrowing covenants set on all members of the Local Government Funding Agency. In particular, political pressure to keep rates increases low may act as a revenue constraint and provide a practical limit to the prudential level of debt.

7 Note: Numbers have been indexed (1996=1000) for the purposes of comparison. Source: Statistics New Zealand, Estimated Usually Resident Populations as at 30 June.

There has been some assistance from central government in the form of:

- a Housing Infrastructure Fund – a competitive pool of interest free finance tied to the provision of infrastructure to support housing. It is our understanding that not all of the eligible local authorities have applied for the funding as yet. One potential applicant has described the application process as "not an easy needle to thread"
- the repurposing of Crown Fibre Holdings into a special purpose vehicle tasked with providing infrastructure to support housing development
- the development of a proposal to form an Urban Development Authority to undertake urban development at scale in what we understand will be 12-15 locations around Auckland. The legislation to empower this body will be introduced into Parliament early in 2019.

We present two case studies on the impacts of growth. The first from Greater Christchurch focuses on the implications of the National Policy Statement on Urban Development Capacity, the second from Tauranga City focuses specifically on dovetailing the needs of growth with the other drivers of expenditure.

Case Study: NPS on urban development capacity for Greater Christchurch

The Greater Christchurch Partnership[8] has worked collaboratively for more than a decade on planning and managing urban growth and development in Greater Christchurch to support the long-term needs of people and communities. This includes the development of the Urban Development Strategy (UDS) in 2007, and the crucial role the Partnership and its constituent partners played coordinating and facilitating rebuild and recovery activities after the 2010 and 2011 earthquakes.

The Partnership was in the process of reviewing its UDS when the National Policy Statement on Urban Development Capacity (NPS-UDC) came into effect in December 2016.

The NPS-UDC requires all councils that have part, or all, of a medium or high growth urban area within their district or region to produce a Future Development Strategy. Currently, other areas required to comply are the Auckland[9], Bay of Plenty, Waikato and Queenstown, and with New Plymouth and Whangarei also recently being designated as high growth areas their Future Development Strategy will need to be completed by June 2019. The Future Development Strategy is intended to demonstrate how councils will ensure that there is sufficient, feasible development capacity is available to support future housing and business growth. This includes over the medium (next 10 years) and long term (10 to 30 years) periods. Councils are required to have its first Future Development Strategy completed by the end of 2018, and then undertake reviews every three years.

In undertaking this work, the NPS-UDC requires councils to estimate the sufficiency of development capacity to meet future demand taking into account relevant regional and district plan provisions, actual and likely availability of development infrastructure, the current feasibility and rate of take up of capacity, and the market response in terms of what has been built, where this has occurred and at what price. The NPS-UDC requires two documents to be prepared – a Capacity Assessment and a Future Development Strategy that then must be subject to a comprehensive public consultation process.

The NPS-UDC is very prescriptive in detailing how capacity assessments and future development strategies should be undertaken and presented. For example, the capacity assessment requires every potential development area in the region to be assessed modelling the housing yield, the typology of houses, the various price points for each house typology and the costs of development, as well as a developer margin of 20 percent to assess whether it is feasible and viable to develop in those areas. If not, then other areas must be identified as well as providing up to an additional 20 percent capacity buffer in case some land is not developed. It is an extremely fine-grained assessment that understandably has required numerous assumptions to be made.

Accordingly, there has been a lot of questioning and interpretation of the prescriptive requirements and this has eroded the time available to complete the work and

8 Administratively, Greater Christchurch comprises parts of three territorial authorities: Christchurch City, Selwyn District and Waimakariri District. The Greater Christchurch Partnership has evolved to comprise Christchurch City Council, Selwyn District Council, Waimakariri District Council, Environment Canterbury, Te Rūnanga o Ngāi Tahu, Canterbury District Health Board, New Zealand Transport Agency, Regenerate Christchurch and the Greater Christchurch Group of the Department of the Prime Minister and Cabinet.

9 Auckland Council does not have to comply with the initial NPS-UDC requirements as it was considered that its recent District Plan Review had sufficiently considered the matters.

resulted in frustration and rework. It has required a level of detail and assessment that otherwise would not have been undetaken and has been very resource intensive.

We understand experiences were similar in other areas. For example, in the Waikato it cost $160,000 to complete a capacity assessment. In large part this was because the constant price modelling parameters the Ministry of Business, Innovation and Employment required, understated supply requirements. It took time and energy to get this approach modified.

Rather than continuing with its planned, more holistic review of the UDS the Greater Christchurch councils recognised it needed to set aside that work to focus on the more specific requirements of the NPS-UDC. Currently, experienced policy and planning expertise is difficult to secure. Selwyn and Waimakariri District Councils have resources heavily committed to undertaking a review of their District Plans and Christchurch City Council, while having just completed its District Plan review, is still deeply involved in implementing its District Plan as well as being committed to respond to ongoing demands from the earthquakes. As a result, a significant amount of time and energy of senior local authority staff and consultants has been redirected from these important tasks to meet the timelines and requirements of the NPS-UDC.

The Greater Christchurch councils conservatively estimate they have spent approximately $1.2 million to comply with the requirements of the NPS-UDC to date[10]. Approximately half of that cost is staff time from the various councils, with modelling, consultant, legal and project management costs comprising the balance. Given that the Future Development Strategy sets out developable areas over the next 30 years, and given the number of assumptions involved in developing the Capacity Assessment and Future Development Strategy, it is likely that the conclusions could be subject to judicial review and those costs, which can be very significant, have not been considered in this estimate.

The Greater Christchurch councils are strong advocates of having sufficient planned and available land supply to enable communities to develop and grow with confidence with well supported infrastructure provision, as has been demonstrated from the mid-2000s. As such, they consider that the intent of the NPS-UDC has merit, albeit essentially codifying the good practice urban growth planning that the Greater Christchurch Partnership has been sponsoring for more than a decade.

However, what does concern the councils is both the NPS-UDC specificity and the tight deadlines that the councils have had to meet. This has not allowed councils the time required to understand the requirements, gather the necessary resources without adversely affecting other important work and determine how to combine the NPS requirements with other relevant processes such as required Regional Policy Statement and District Plan changes. It has necessitated employing additional scarce resources to get work completed.

If the NPS had a five-year timeframe for completion it would have allowed councils greater time to understand the requirements and align the required work with the District Plan Review processes being undertaken and the Regional Policy Statement Review planned for 2022. Had engagement surrounding the draft NPS been more effective, the issues concerning timeframes and commitments, as well as the

10 The Greater Christchurch Partnership released its Future Development Strategy for public consultation in October 2018 with hearings and finalisation anticipated in the first quarter of 2019.

complexity and practicality of some of the proposed NPS requirements could have been explored further and may have avoided a lot of the cost and angst that has been incurred.

The exercise has also proceeded on the basis that all of the future land needs can be serviced and funded by each of the councils. This remains a challenging issue when the perception exists that housing affordability issues will be solved largely through councils identifying and servicing more land for housing. In many growth areas councils are unlikely to have the balance sheet capacity to fund all of the future costs.

Hopefully, through the new government's Urban Growth Agenda, a broader approach can be taken.

Case study: Changing nature of local government costs compared to funding and financing – Tauranga City Council

Background

Tauranga City has been one of the highest growth cities in New Zealand over the past decade. Ten year capital expenditure projections have grown from $11 billion in the 2012/22 Long Term Plan to an estimated level of over $2.1 billion in the 2018/28 Long Term Plan. This has led to debt projections of over $1 billion by 2028, increasing from the existing level of $400 million.

Key drivers of the expansion of this capital programme are:

- increases in demand for serviceable land supply both to meet the demands of the market and to meet the requirements of the National Policy Statement
- the recognition of the need to ensure the infrastructure network is resilient and considers the impacts of changes in the environment and climate change
- the need to renew aging infrastructure to a higher standard to meet new environmental / health & safety standards.
- the continued impact of a growing population base on the transport network particularly with the reliance on single vehicle transport
- the impact of changing demographics.

The level of growth has created great opportunities but also comes with its challenges. Among other things from a funding, financing and delivery perspective this includes:

- having sufficient balance sheet capacity to finance the level of expenditure without excessive rates increases
- how to fund this level of growth in an affordable manner
- how to align the interests of key stakeholders to ensure growth is well managed
- how to maximise growth paying for growth, while enabling affordable housing
- how to grow the capacity of council and the contractor market to deliver an expanded capital programme.

Impact on operating costs

In addition since 2000 and looking to the future, the types of expenditure incurred by local government have significantly increased. Increases in base costs, updated infrastructural requirements, changes from central government and changing community expectations have impacted all councils. For growth councils this has been exacerbated by increased growth related costs.

Local government core expenditure cost drivers have often exceeded general inflation due to the nature of goods and services provided.

Level of service requirements have increased for our existing assets. While these changes are beneficial to our residents, they have had significant impacts on cost structures (such as increased staffing levels, investigative research and increased consultation requirements).

Examples include:

- planning for sea level rise (affects consents teams and infrastructure managers (especially stormwater))
- designing for higher rainfall levels and events (impacts on existing infrastructure)
- health and safety legislation (specialist staff, research and traffic management requirements in particular)
- resilience (ensuring existing infrastructure is better able to cope with natural disasters, particularly earthquakes and the effects of liquefaction).

There are two principle impacts of growth on operating expenditure. The first relates to the level of resources required to plan for growth. The costs involved in developing structure plans including resource consents, planning infrastructure requirements and consultation requirements is significant. Local government is unable to recover any of these costs from developers through development contributions.

Additionally there are operational impacts that come with commissioning large pieces of infrastructure. These costs (particularly depreciation) have an immediate impact on costs, but relate to ratepayers that will be catered for in the future.

While there have been significant changes in operating costs, little change has happended in relation to funding. Local government is required to raise enough revenue to fund its operating costs. The major source of this funding is rates revenue.

With little change in revenue sources, this means that rates charges continue to rise significantly above inflation. While the incidence in rates can be changed (the proportion that each group of ratepayers pay) through the use of targetted rates, differentials, revaluations and such, this does not change the overall impact.

Impact on capital costs

Capital Costs have suffered a similar set of increases as compared to operating costs. While the impact of central government/ community expectations has not yet significantly impacted the capital programme, the impact of increased infrastructural requirements has had a significant impact. This is likely to be exacerbated further as the impact of climate change and resilience studies come into effect.

Councils' largest projects within the capital expenditure programme tend to relate to growth assets. These costs have pushed all growth councils to a level of debt where they are at risk of breaching financial limits set by the Local Government Funding Agency. This also removes balance sheet headroom to deal with any unexpected events (such as a natural disaster) that may occur.

The principal basis for recovering growth debt is through Development Contributions (DC). While Tauranga has run a largely successful DC programme, we have only managed to recover about 80 percent of the costs of this debt and the balance will need to be recovered from the ratepayer. This shortfall comes about due to the difficulty with determining appropriate infrastructure requirements for particular areas and estimating future project costs.

While central government have acnowledged the problem with debt for growth councils the efforts to resolve this have had limited effect in that they:

- do not significantly reduce the level of debt
- provide the principal savings to the cost of development (which may or may not be passed on in terms of house prices).

The financial strategy adopted to deliver this expanded capital programme includes:

- adopting a higher level of rating increases particularly over the first five years of the LTP where rates increases averaged 6.5 percent after allowing for growth in the rating base and excluding major level of service changes.
- a recognition that this level of rating increases may not be affordable and therefore signalling an intention to continue to review the long term plan which may result in alterations to these rating levels.
- a recognition that reduction in revenue levels will need to be managed alongside changes to the capital programme and funding and financing arrangements to ensure that council remains within its prudential borrowing limits and delivers necessary capital expenditure.

While council incurs significant increases in operating and capital costs in relation to supporting growth, the current funding systems do not match these costs. Growth provides benefits to residents, visitors, the wider region and central government. Residents gain from the benefits of increased GDP, household income and house prices that tend to accompany growth.

The wider region benefits through greater economic growth, employment and the amenity provided within the city

Central government gains from the increases in taxation that tend to accompany growth. In 2016 we completed a viability assessment for a future growth area to ensure that developers would develop in the event of council completing the required infrastructure. This analysis highlight that the Crown is likely to make a $52 million one-off net gain on the GST relating to land sales. In comparison council would invest over $93 million and even in ideal circumstances only get the same amount back.

This current system suffers from a misalignment between the beneficiaries of growth and the organisations that incur the cost of supporting this growth.

But so is population decline

On the other hand, there are a group of local authorities that are experiencing population decline. Most of these can be found in the central North Island, on the east coast of the North Island and in the west of the South Island.

The link between depopulation and funding pressures should not be underestimated. Simply put, there are significant elements of fixed cost in many local services (i.e. all local authorities have to conduct inspections of premises that sell food, water needs to removed from the ground and treated to certain standards whether the scheme serves 500 people or 50,000, the content of long-term plans is the same for all councils etc) and as population falls the economic base from which to draw revenue falls.

Rangitikei District Council has provided the following case study of the funding pressures facing a local authority that experienced considerable population decline.

Case study: Cost pressures for a declining/static population – Rangitīkei District Council

For the past 10 years, Rangitikei District has recorded a declining or static population, around 15,000 people slightly modified recently (in the southern part of the district) by an influx of Samoan residents, largely due to recruitment by meat processors. For the next decade, high growth projections would see an increase to 15,900 by 2043 – but this is less than the district's population in 1996 so does not impact on the capacity or performance of the council's infrastructure assets. However, while there is minimal need to extend the roading or three waters network, the maintenance of these networks is an ongoing critical need.

Rates revenue for 2007/08 was $13.2 million; for 2017/18 it was $20.5 million. In 2027/28 rates revenue is projected to be $31.2 million. Over this 20-year period, the BERL local government cost index calculates a change of around 158 percent. Rangitikei's rates revenue has thus more than kept pace with increases in costs. However, the index does not measure increases in demand. These increases are driven by government requirements, improved knowledge of the conditions of infrastructure assets, and community expectations. The following table shows trends over the past 10 years and as projected for the next 10 years.

Contribution to annual expenditure[11]

	Actual 2007/08		Actual 2017/18		Projected 2027/28	
	$,000	%	$,000	%	$,000	%
Governance	2,165	9.6%	2,655	9.5%	3,588	10.9%
Roads & bridges	11,145	49.3%	12,205	43.8%	8,423	25.5%
3 waters	4,199	18.6%	6,626	23.8%	10,246	31.1%
Community & leisure services	3,009	13.3%	3,421	12.3%	5,779	17.5%
Solid waste	881	3.9%	1,143	4.1%	2,463	7.5%
Environmental & regulatory	1,209	5.3%	1,838	6.6%	2,498	7.6%

11 For roading, projected costs do not include emergency works (whereas these typically influence the actual expenditure each year). Solid waste costs over 2018-28 are based on council resuming a kerbside collection service in towns, a matter currently out for consultation with all affected households.

Governance costs have risen with the requirements for an audited ten-year plan prepared every three years. The cycle of statutory bylaw and policy making is also a factor as was the initial emphasis over developing and monitoring community outcomes. More recently, the focus on strengthening relationships with iwi, being a catalyst for economic development, and improving communications and outreach to the community (the last being emphasised by the local government excellence programme CouncilMARK™). Until 2017/18, these costs were rated for partly through the uniform annual general charge, partly through the general rate. For 2018-28, the rating mechanism is primarily the general rate, to reduce the burden on low-value properties.

An increase in similar dollar terms (but proportionately much higher) is with Environmental and Regulatory. This reflects the increasing compliance requirements from central government over buildings, food and liquor licensing, as well as increasing community demands for stronger controls over unmanaged dogs, excessive noise and intervention over fly-tipping and abandoned vehicles.

However, the largest increase in expenditure is with the 3 waters, both in the past ten years and in the next ten years. Stricter adherence to the drinking water standards (even before the Havelock North incident), to wastewater discharge compliance (even before the construction of the planned new plants providing for discharge to land rather than water for Ratana and the combined Marton/Bulls facility), to seismic upgrades of reservoirs and treatment plants, and to replacing aging reticulation systems. Assessed water loss is high and there is considerable infiltration and inflow from stormwater into the wastewater system, causing discharges to exceed consented volumes.

In 2007/08 (and for a decade before that), costs for the various water schemes were allocated among users. Recognising that there could be affordability issues, council set an upper limit (or a 'cap') after which the excess amount (or 'spillage') was funded by all ratepayers, whether connected or not. By 2012, this spillage for reticulated urban water exceeded 25 percent, being funded through the general rate. In the 2012-22 Long Term Plan, council scrapped the individual rating schemes and took a district-wide approach, with a proportion being funded as a fixed sum by all ratepayers (rural and urban), the balance by those properties connected to the schemes. In 2018/19, the so-called 'public good' component of rates for the three waters was set at 20-25 percent, totaling $234.90 for each separately used or inhabited part of a rating unit. As these costs increase during the next ten years, there is likely to be resistance to continuing this funding mechanism, particularly as there is not a commensurate increase in funding for the District's roading network (including bridges and footpaths). The roading activity is funded by all ratepayers on a property valuation basis, so rural properties typically pay more than urban properties. There is no urban differential for footpaths.

In the 2015-25 Long Term Plan, council deliberately drew attention to the likely costs for renewing consents for the District's smaller wastewater schemes, such as Mangaweka (where the consent expires in 2021/22) suggesting that alternative (and less expensive) options should be explored. This proposal was strenuously opposed by residents in Mangaweka as downgrading their town and making it a less attractive place for people to live. A conventional upgrade has been included in the 2018-28 Long Term Plan budgets, but the affordability issue will be resolved only if funding assistance is provided from central government – as was the case when the current

plant was built in Mangaweka. This affordability issue for small communities was highlighted in the recently released report by Boffa Miskell/GHD on the upgrades required to community wastewater schemes.

The projected growth in the costs for community and leisure services reflects council's policy to have 'fewer but better' facilities. It is a major challenge. With the exception of the Marton Memorial Hall, the town halls and libraries in the three main towns are at least 90 years old, earthquake-prone and unable to be adapted to present day and future requirements. Renovating or rebuilding these facilities (and the council's administrative offices) are key components in maintaining viable and vibrant town centres which have suffered (like other rural towns) from a dramatic reduction of retail businesses, in favour of larger centres and online marketing. However, council has no certainty about external funding beyond that obtained for Bulls (likely to start construction before the end of 2017) and has budgeted accordingly in the 2018-28 Long Term Plan. Any increase in those costs without external funding would require further borrowing, meaning a higher long-term rates liability and diminished rates affordability. That may not be acceptable.

Given the significance of infrastructure to the Rangitikei, managing these costs is vital. The shared services with Manawatū District, entered into ten years ago, was prompted by an increasing dependency on consultants to maintain these assets because of an inability to recruit and retain sufficient staff. Shared services have reduced that dependency (and the associated costs). A similar philosophy underpins Rangitikei's decision to participate in Archives Central, a collaborative storage facility and database, at a much lower cost than if Rangitīkei had set up its own facility. There has also been close scrutiny to continuing contracted services. In the last three years, council has taken over direct management of parks and reserves and cleaning of council buildings, both on the grounds that levels of service could be improved at similar or reduced costs.

The New Zealand population is ageing, and this has implications both for local services and for local government revenue systems

New Zealand, like most other developed countries, is facing the so-called 'baby boomer bulge' or 'greying' of the population. The latest subnational population projections suggest that by 2032 somewhere between 20 and 22 percent of New Zealanders will be aged 65 or older, compared with 15 percent in 2016. By 2050 this proportion is likely to sit at around 23-25 percent.

No local authority in New Zealand escapes the impact of an ageing population, it is a question of degree. A small number of local authorities have reached the demographic 'tipping point' where the number of people leaving the workforce is greater than the number entering it.

Local government in this country does not have the responsibility for delivering the health and social services that is the case elsewhere. But changes in the age composition of the population will have an impact on the portfolios of assets and services we deliver – different design standards, more demands for community and cultural facilities etc.

Even with changes to the entitlement regimes (such as raising the age of entitlement) more New Zealanders will move onto fixed incomes raising concerns about the affordability of services. There can be a difference between a ratepayer's current income and their current assets – while solutions such as equity release are available, they are not well taken up.

The elderly have traditionally been among the larger participators in engagement processes, and in the democratic process in general. LGNZ's most recent survey of elected members noted that around 41 percent of the respondents were aged 61 or older (and 78 percent aged 51 or older). In a survey of 10 local authorities, Bloomberg (2010) found that 48 percent of submitters on the 2009 long-term plans were aged 60 or older.

Tasman District Council have provided an example of the costs that making one activity a little more age-friendly can create.

Case study: Tasman's ageing population – what it means for transportation services and infrastructure

Tasman's population is ageing

Over the past 20 years, the number of older people (65+) living in Tasman has more than doubled. Based on current demographic trends, the number is projected to keep increasing and to make up more than a third of our population by 2038. By then, one in five Tasman residents is projected to be 75 years or over and we are projected to be one of the oldest populations in New Zealand.

The main drivers of this increase are increasing life expectancy, ageing of the baby boomers, and a trend of mostly older residents moving to our district.

An increasing number of residents with disabilities and health issues

Although disability rates[12] of those aged between 60 and 80 years have declined as life expectancy has increased, the absolute number needing assistance is expected to increase, due to the increasing number of older people.

The 2013 Disability Survey found that 60 percent of older people in Nelson/Tasman/Marlborough/West Coast households identified as having a disability. The most common disability was 'physical' with 47percent of older people reporting mobility and/or agility impairments. Thirty-one percent reported a sensory impairment, which includes hearing and vision impairments.

An increasing need for accessible footpaths and seating

The increasing number of residents with physical and/or sensory impairments has implications for the design and maintenance of our physical environment and transportation network. High quality pedestrian facilities and alternative modes of transport will support older people to continue being mobile and participating fully in society, particularly for those who no longer drive.

Our older residents have asked for safer pedestrian networks, more footpaths, and safer crossings. They would like footpaths to be wider and flatter, without any dips, trip hazards or obstacles. Footpaths also need to be able to accommodate mobility scooters easily.

12 A disability is defined as any limitation in activity resulting from a long-term condition or health problem. Long term is defined as six months or longer.

There is a growing number and range of users and vehicles on footpaths and shared pathways, including pedestrians, skateboards, scooters, mobility scooters, and cyclists, as well as wheelie bins. Some of these users are generally not confident travelling on our roads. The growing congestion and speed of some users on footpaths can have a negative effect on the other users ("journeys not taken").

Seating in public places allows people to stop for a rest during outings and also offer a place to connect socially. Public benches need to have arms and/or central hand rails so that older people can easily get in and out of seats, and should be in pleasant shaded areas. The configuration of seating also has the potential to positively or negatively affect social interaction.

What is Tasman District Council doing to make our district more age-friendly?

We have developed a new Age-Friendly Policy which our community are currently giving us feedback on. The proposed policy will guide council's planning to explicitly take into account Tasman's ageing population and consider the needs of the growing number of older residents. The policy proposes that we focus on areas which align with the purpose of local government but we will also be guided by the World Health Organisation Age-Friendly Checklist. The policy builds on a number of existing and planned services and facilities that provide positive outcomes for older people.

Queen Street upgraded for age-friendliness

We've recently completed a major transformation of Queen St in Richmond, the main street of our largest township, which has resulted in a safe, accessible and beautiful modern street that meets the needs of a rapidly-growing and ageing urban community and provides a pedestrian-focussed public space.

Previously Queen Street was prone to flooding, and with a street design that favoured cars and commuter traffic. While the key driver of the Queen Street Upgrade was to increase flood resilience and stormwater control after serious flood events in 2011 and 2013, this work required the entire street surface to be reshaped so it made sense to look at the way the space was used. Public feedback supported improvements to the street's accessibility for those with limited mobility, slower traffic speeds for public safety and a greater emphasis on pedestrian movement and amenities.

The street is now easier for those in wheelchairs, using walkers or canes, and those pushing prams to navigate, thanks to:

- wider footpaths – 4 metres compared with 2.5 metres previously
- a smooth continuous surface between the road and footpath, with no kerb and channel
- a reshaped road surface to direct surface water away from buildings – the previous upward slope from the footpath also made it difficult for wheelchair users to move off at crossing points
- careful placement of tactiles to signal crossing points for pedestrians with limited sight
- more seating for people to rest, meet up and mingle
- more seating for people to rest, meet up and mingle.

It's safer, thanks to:

- a new 30kmh speed limit
- vehicle calming by narrowing the lanes from 4.5 metres to 3 metres
- an environment that favours pedestrians – a people-dominated space is one in which drivers must take extra care.

The project recently won the Best Street category in the 2018 Keep New Zealand Beautiful Awards and some of the new seating was a finalist in our local Age Concern's AgeConnect-Friendly Environment Champion Award for the year.

Over the next 10 years, Tasman District Council has planned to upgrade the main streets for five of our other town centres. The challenge will be balancing community expectations for an improved shared environment, within an agreed budget, and with the competing uses of these main streets, such as parking and state highways.

And as a second example, here's the issues that Westland District identified in its 2018-28 long-term plan.

Case study: The impact of an ageing population in Westland District

Westland District Council developed the 2018-2028 Long Term Plan (LTP) acknowledging that Westland District is predicted to experience an ageing population over the life of the LTP. It is forecast that the number of residents aged over 65 will increase from 19 percent to 26 percent of the resident population (compared to 12 percent nationally in 2016). Westland District Council needs to ensure that the services that are provided meets the needs of one quarter of the population being over the age of 65.

It is predicted that while the population will be ageing, the overall population in Westland District will remain static in size. This will impact not only the type and mode of services that council provides, but also its affordability thresholds as it can be expected that rates will become a higher proportion of average household income. A greater number of ageing residents may hinder economic growth and the appeal of the region to younger citizens who need employment or investment opportunities.

Key issues are that:

- substantial capital expenditure is required on a renewals programme to maintain current levels of service. A number of the district's assets are approaching or past their expected useful economic lives and need to be replaced. A static and ageing population will put pressure on these services
- high tourism growth throughout the district putting extra strain on ageing infrastructure, which will also put pressure on budgeting spending of the rates base.
- a greater number of ratepayers are likely to make applications for rates rebates, which in turn will require central government to refund greater amounts of money to Westland District Council
- a diminishing pool of local volunteers to initiate and support local projects and take on roles in community associations and trusts. This is most likely in areas with static or diminishing population due to fewer employment opportunities. The council will have to work to encourage greater participation from community members over a range of ages. Being able to develop the economy in these areas to encourage population growth would work towards alleviating this issue.
- an increased demand for burials in local cemeteries. There is a trend towards cremation, which would increase the demand for ash plots. Currently the cemetery in Ross is at 80 percent capacity.
- greater pressure on emergency services and civil defence in the event of a natural disaster as an ageing population may be less mobile.

INFR ASTRUCTURE COSTS

"Our roads were built in a time of prosperity in the south about 50 years ago and are coming to the end of their life. The cost of repairing roads has increased dramatically in the past few years and we need to spend $25 million a year to maintain and rebuild our roads at the moment. This cost is going to grow rapidly in the next 10 years and beyond that it only gets worse. The New Zealand Transport Agency has also signalled there will be no extra money from Government."[13]

– Southland District Council

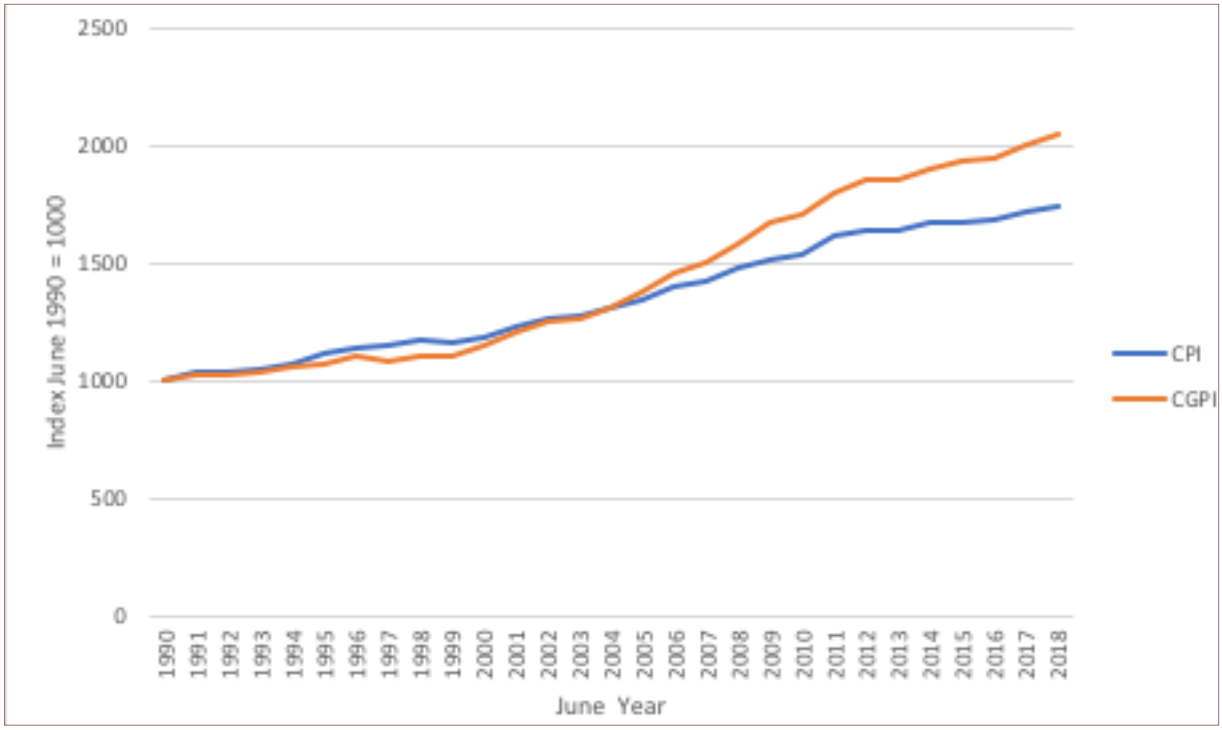
The actual costs of providing infrastructure (i.e. core services) have increased

In addition to the factors that could be described as 'internal' to the local government system and are listed elsewhere in this part of the paper, the actual costs of providing infrastructure have increased.

To demonstrate, Figure Two extends and updates the graphic from the Commission's report Using Land for Housing showing movements in the Consumer's Price Index (CPI) and the Capital Goods Price Index – Civil Construction (CGPI). These statistics are produced independently of SOLGM and the local government and that the Commission chose the point of comparison, not SOLGM.

With the exception of a 'blip' around 2012 the CGPI Civil Construction has been increasing at a faster rate than the CPI since around 2000. In some years, 2005 and 2009 particularly, the rate of increase in the CGPI was more than double the rate of increase in the CPI.

Figure Two: Consumers Price Index vs Capital Goods Price Index – Civil Construction 1990-2018



13 Southland District Council, Roading, last retrieved from https://www.southlanddc.govt.nz/my-southland/roading/ on 16 October 2018.

The implications of these movements is critical to the discussion of local authority funding needs. Territorial authorities especially are primarily in the 'business' of ensuring the infrastructure needs of their communities are met, the above therefore demonstrates that the cost of what might be (provocatively) referred to as core services has increased, and may increase still further.

The factors underpinning movements in construction costs are many and varied. This phenomenon warrants further investigation by the Commission.

The above data demonstrate a symptom or end result of a number of differing factors. We are aware of at least two studies that have considered what the drivers of increasing transport costs might be, the 2006 *Ministerial Advisory Group Report on Road Construction Costs* (MAG) and a 2013 *Construction Industry Study* by NZIER. We are unaware of any such studies having been undertaken for three waters infrastructure.

Some of the commodities that civil construction relies upon are traded on international factor markets (steel and bitumen are good examples). As MAG noted:

"International competition for key resources, such as fuel, steel and skilled staff, has been an uncontrollable factor that is likely to continue as a significant influence on input costs in the foreseeable future."[14]

Local authorities and other infrastructure providers in this country have very little ability to influence prices set internationally.[15] We remind the Commission that almost all capital expenditure and most maintenance work is market-tested in some way – be it through the pricing procedures required by NZTA or through a local authority's own procurement processes. The options open to local authorities and other providers are to reduce their consumption of these materials or to investigate alternative design and procurement options.

The NZIER study is now five years old but we consider it a thorough analysis of the road construction industry and the underpinning cost factors.[16] Many of the observations it makes about the structure of the industry have been known since the mid-1990s. While NZIER was unable to (in its words) *"unpack the contributions of the differing factors to increasing road costs"* it comments that "the causes of the apparent cost increases emerge from a range of complex and at times mutually reinforcing factors:

Factors transport policy makers have little or no influence upon

1. changes in overall demand for civil construction services (broadband, electricity transmission and distribution, irrigation etc.)
2. import cost increases – bitumen price increases.

Factors transport policy makers may influence

3. locally sourced input cost – quarry aggregate[17] and labour cost increases
4. structure and conduct of markets
5. the wider regulatory environment

14 MAG (2007), Report on Road Construction Costs, page 6.
15 Of course, movements in international markets can work both for and against infrastructure providers – one of the reasons for the comparatively lower rate of increase in the CGPI is the fall in the price of oil and products derived from oil (such as bitumen).
16 NZIER (2013), Construction Industry Study: Implications for Cost Escalation in Road Building, Maintenance and Operation, final report to the Ministry of Transport last retrieved from https://www.transport.govt.nz/assets/Uploads/Research/Documents/NZIER-report-2013-construction-industry-performance.pdf on 16 October 2018.
17 The Commission might consider discussion of the current mismatch between the supply and demand for aggregates with the Quarry and Aggregate Association. They have some interesting data and perspectives to share.

Factors within control of the transport policy makers

6. how expenditure on service level improvements is accounted for, leading to apparent cost increases which are actually service additions
7. risk management and productivity incentives
8. standards and guidelines that may improve transport service levels, but increase costs and may at times constrain innovation and productivity."[18]

One other interesting observation that may call some procurement practice into question is that:

"A key additional factor looking forward is the effect that the procurement approach will have on market structure and conduct. There is a risk that reducing the number of contracts and holding those contracts for periods of up to 9 years will create barriers to entry leading to further market concentration. This would create the risk of significant reductions in competition over the long term and consequential increases in prices."

That is to say that local authorities need to ensure that there is a balance between the short-term and long-term in their consideration of costs.[19]

A robust understanding of the factors underpinning movements in construction prices is critical to an overall understanding of the local authority funding and financing issue.

Capital investments in infrastructure have 'echoes' in renewals and maintenance

New Zealand's investment in infrastructure has tended to progress in 'waves' with changes in mandate and the availability of funding being among the key drivers. Analysis undertaken by NZIER for the Office of the Auditor General has found that:

"There are two clearly identifiable surges of investment in 1920-1930 and long boom in investment from 1950-1986 for non-road investments – although with considerable volatility. Investment in roads peaked in around 1965, then trended lower until 1990. Investment in roads trended higher between 1990 and 2013."[20]

While local authorities are becoming increasingly more sophisticated in their understanding of the condition of their assets, the date of construction is still an important factor in renewal cycles.

The Office of the Auditor-General suggests that a renewal and replacement echo will occur within the life of the current set of 30-year infrastructure strategies – specifically:

"Industry experts and practitioners in NZIER's workshop session advised that many roading assets could be approaching second or third renewal cycles, with bridges next approaching a renewal cycle in about 2025. Although the timing for three waters assets is difficult to predict, because councils are more likely to take a "run to-fail" approach to underground assets, our experts advised that a significant renewal cycle of three waters assets is likely to occur during 2040 to 2060."[21]

Competing globally is about place as well as network infrastructure and regulation

We live in a world where barriers to the mobility of skilled labour and investment capital are generally lower than they were in the twentieth century (unless you want to buy a house). More than one in four Kiwis were not born here.

18 NZIER (2013), *Construction Industry Study: Implications for Cost Escalation in Road Building, Maintenance and Operation*, page i.
19 NZIER (2013), *Construction Industry Study: Implications for Cost Escalation in Road Building, Maintenance and Operation*, page i.
20 NZIER (2014), *Local Government Finances – An Historical Perspective*, page 10. Report included in Office of the Auditor-General (2014), *Water and Roads: Funding and Management Challenges.*
21 Office of the Auditor-General (2014), *Water and Roads: Funding and Management Challenges*, page 7.

With digitisation and global markets more jobs can be undertaken from literally anywhere, with the home nation increasingly becoming a concept for tax purposes only. Some countries, such as the United Arab Emirates, are positioning themselves to catch the younger pool of talent (only five percent of Dubai's population are naturalized citizens).

In this world, the quality of place will count more and more in getting the best and the brightest. While New Zealand is quite literally the 'last stop on the planet' it can compete on its environment, on its lifestyle factors and on the business-friendly nature of its regulatory environment. Ironically though we'll compete on a sense of place, as we get more successful at bringing this global talent pool to New Zealand, the harder we'll have to work to inculcate a sense of place once they are here.

The sector has long argued that globalisation makes 'place' an important part of a nation's competitiveness. McKinlay (2006) correctly notes that the place shaping role is likely to be more important for an economy such as New Zealands[22]. New Zealand's labour force, while skilled is also small by international standards. New Zealand lacks some key raw materials particularly domestically produced energy (other than electricity). And, of course, New Zealand is distant from European and North American markets. This line of thinking gives further weight to much of the debate around the notion of New Zealand needing a "world city" to sustain future economic transformation.

This place shaping role and its contribution to economic transformation goes wider than network infrastructure. Communities need to be vibrant, attractive places to live to attract pools of skilled labour. In turn this means that a local authority cannot ignore its stock of community infrastructure (libraries, parks, recreational facilities and the like) and what is sometimes referred to as the "look and feel" of the community.

In short, all investment that supports the ability of a community to compete must be viewed as "core business" – there is no such thing (if indeed there ever was) as a "soft service". Those who look at the 37 percent of projected capital expenditure as an investment in "nice-to-have" services should take note.

22 McKinlay (2006), *Local Government Funding – A Report Prepared for Local Government New Zealand and a Consortium of Councils*, page 9.

ECONOMIC GROWTH AND TRANSFORMATION

"Understand the local economy to plan for the future"[23]

Economic growth and transformation are often overlooked as drivers of local authority costs

Businesses and business groups are among the more trenchant critics of local authority finance, and local government in general. These criticisms overlook that local authorities are providers of:

- three waters and transport infrastructure necessary to support local economies (don't forget that around 65 percent of local authority expenditure supports these services). Ministry of Transport (2016) notes that *"In developed countries where there is already a well-connected transport infrastructure network of a high quality, further investment in that infrastructure will not on its own result in economic growth. However, where the potential for economic growth is present and there are capacity constraints, a lack of transport investment can inhibit potential growth."*[24]
- that support business activity
- community infrastructure that builds the sense of place necessary to compete in a global economy

Table One below shows the movements in rates and nominal Gross Domestic Product (GDP) over the period 1993 to 2017. By and large these data show that the two series appear to move 'in tandem' with rates remaining relatively constant as a percentage of GDP (beyond a small rise during the post-Global Financial Crisis slump).

23 Office of the Auditor-General (2014), *Water and Roads: Funding and Management Challenges*, page 6.
24 Ministry of Transport (2016), *Contribution of Transport to Economic Development – Summary Report,* page 1.

Table One: Local Authority Rates and Nominal Gross Domestic Product 1993-2017

Year	Rates	GDP	Rates as a % of GDP
1993	1600	78309	2.0
1994	1664	84460	2.0
1995	1720	90337	1.9
1996	1770	96325	1.8
1997	1882	101101	1.9
1998	1922	104814	1.8
1999	1993	106827	1.9
2000	2103	113229	1.9
2001	2199	119838	1.8
2002	2305	128712	1.8
2003	2444	135181	1.8
2004	2625	144502	1.8
2005	2785	154558	1.8
2006	3025	162935	1.9
2007	3320	172112	1.9
2008	3585	186846	1.9
2009	3912	189617	2.1
2010	4144	194251	2.1
2011	4350	203434	2.1
2012	4512	213241	2.1
2013	4603	217472	2.1
2014	4764	232719	2.0
2015	5003	242545	2.1
2016	5304	255150	2.1
2017	5531	270604	2.0

The above shouldn't be much of a surprise (though the degree of correlation in movements may). It has long been known that economic growth and transport use move together – though the evidence on any causality in the relationship is inconclusive at best. Correlation has also been shown between economic growth, incomes and demand for water.

Not all local authorities have an appreciation that economic growth can influence the demand for their services. Our reviews of a sample of 30 of 2015-45 infrastructure strategies found that:

"relatively few strategies talked about the non-population drivers of demand. In particular, assumptions about economic growth and its impact on demand have not featured in many strategies. Typically, strategies had either a disclosure that slow growth was expected, or had no assumption at all. This was true even of most strategies that signalled heavy investments in economic development initiatives.

"Some local authorities showed evidence of having thought about economic drivers. Ruapehu District's strategy forecast movement in the number of rating units (though only for the LTP period and not thirty years), number of visitors (ditto), and discusses the impact of agricultural intensification and logging in parts of the district. Hamilton's mentions its role as the regional centre.""[25]

25 SOLGM (2016), *Review of the 2015 Financial and Infrastructure Strategies*, page 15.

SOLGM is reviewing a further sample of the 2018-28 strategies. Based on the few we have completed we suspect that this remains an area for further development.

The impacts of forestry, especially on the road networks are intensive, but sometimes short-lived and difficult to fund equitably

New Zealand has a history of considerable state and private investment in forestry. Forestry was one of the major public works investments during the Great Depression. Forestry has been signalled as a priority by the current government with the so-called 'billion trees' programme.

The demands that forestry places on infrastructure have an unusual profile. For the most part all that is needed to bring a forest into production is a road network – forests aren't generally big consumers of anything else. Unlike a farm where produce might be leaving the farm gate daily – the forest owner will make intensive use of the forest for two periods: planting and then 30-50 years later at harvest. But at harvest time use is extremely intensive – we're advised that a 200-hectare block of forestry will produce about 4000 truck-loads of logs over a two- to three-year period.

The 'billion trees' programme will create infrastructure issues in the areas where large-scale planting occurs starting 30-50 years from now. This is a different example of an investment decision having an infrastructural echo. We would expect that the placement of these plantings would be aligned to initiatives such as the Provincial Growth Fund, the materials we've seen to date could be much more clearly aligned. An example of the costs forestry can create and the issues that the somewhat unusual profile provides can be found on the next page.

Case study: Forestry impacts on local authority roading networks – Whanganui District Council

There are currently 24,000 hectares of plantation forest across 230 properties in the Whanganui District. Many of these forests are located in the district's hinterland on the outskirts of council's roading network.

High volumes of harvestable timber will reach maturity in the 2020–2030 period, with the highest harvest volumes expected in 2024–2029 when more than 50 percent over the district's wood volume reaches maturity.

Transportation of this timber is expected to have a significant impact on roads in our district, with sealed road pavement renewals directly resulting from forestry traffic estimated to cost around $67 million over the next 30 years.

We predicted that the major costs would hit us after 2024 as roads were repaired following the peak harvest, but we are already seeing significant damages occurring on our roading network.

Roading impacts are influenced by forest location, harvest tonnage and vehicle loadings, vehicular movements and distance travelled, as well as other factors such as local geology and susceptibility to storm events. Many of the forests egress onto rural roads in our hinterland which are not designed to accommodate the heavy vehicle traffic involved in forest harvesting operations.

Council has considered a range of options to fund the forestry roading impacts:

- utilising the *Resource Management Act 1991*
- implementing a bylaw under the *Land Transport Act 1998*
- negotiating agreements with forestry owners
- introducing a fee per tonne transported and distance travelled
- implementing targeted rates
- following the Road Controlling Authorities Forum proposed approach based on BERL's report, *Guidelines for Equitable Funding of Pavement Maintenance for Low Volume Roads*.

Having considered legal ramifications and worked through practicalities for each of these options, council's only viable funding option for its Long-Term Plan 2018-2028 was to implement a new targeted rate applicable to forestry exotic (i.e. plantation forestry) properties.

The rate was set at a level that achieved approximately 60 percent recovery of forestry related roading costs for the first six years of the Plan from forestry property owners. The other 40 percent is being funded by general ratepayers.

Council received significant opposition from the forestry sector to the proposed introduction of the new targeted rate in its Long-term Plan 2018-2028. The sector felt unfairly targeted and noted that the issue is a national issue that has been discussed across the country for many years with no solution. They felt that imposing the rate late in the growing cycle was unfair as many had been encouraged into planting forestry decades ago and felt they were now being penalised for this decision. They were concerned about the viability of forestry as a business if costs continued to increase as predicted and they noted that it may affect whether these properties were replanted for another cycle.

Council and the forestry sector are both aware that roading costs are set to increase sharply as the forest harvest peaks and roads need to be repaired, and that the flow on effect of these increased costs to rates will have a significant financial impact. Without additional external funding, council is forced to strike a balance between loading the substantial forestry related roading costs onto 230 forestry property owners or 21,000 general ratepayers in a low socioeconomic district who see little benefit from this activity. Most of the timber is shipped out of the district and there is relatively little value-add production located here to stimulate the local economy.

Whanganui is not the only local authority facing these issues. The Government's One Billion Trees Programme will put further pressure on roading networks in the years ahead, and many of the districts earmarked for additional planting will not have the financial capability to maintain their roading networks at a satisfactory level while providing affordable rates for their residents. A national level approach to finding a solution that is fair to the forestry owners and other ratepayers is essential.

Many tourist centres require 'big city' amenity from a much smaller rating base

Tourism has become one of the major sectors in the New Zealand economy. The Ministry of Tourism's 2017 Brief to the Incoming Minister suggests that tourism accounts for six percent of our GDP and is consistently one of the top two export earners (including the biggest exporter of services). Numbers of international visitors have increased by around 50 percent over the past six years. Current forecasts have the numbers reaching 4.9 million by 2023.

Visitor needs are one of the key drivers of amenity and standards in the tourist destinations, but also in communities along some of the key tourism corridors. Local communities and local authorities are becoming increasingly concerned about the cost of meeting these needs. In a community such as Queenstown there's 39 visitors to every ratepayer.[26]

26 Ministry of Tourism (2017), *Briefing to the Incoming Minister of Tourism*, page 6, accessed at http://www.mbie.govt.nz/about/who-we-are/our-publications/briefings-to-incoming-ministers/2017-bims/tourism.pdf, last retrieved on 11 October 2018.

The New Zealand Pure branding emphasises environmental amenity as one of our key points of distinction, especially to the younger and lower income end of the market, yet some forms of tourism come with environmental impacts of their own – as any community that's a destination for the freedom camper will tell you.

There has been some recognition of the demands that tourism places on communities. The previous Government created the Tourism Infrastructure Fund worth some $25 million per year for four years. That fund was a welcome step to putting appropriate facilities in place in smaller communities – mostly toilets, carparks and the occasional picnic and rest-stop facility. But the scheme is highly targeted in its eligibility criteria, and in its application procedures (not least because the Minister of Tourism has a final veto over any application). In the bigger tourist centres a big city level of amenity is expected – this fund was not designed for these needs.

Meeting the infrastructure needs of primary industry has a cost impact

"Getting New Zealand's main land-based exports to port requires 1.3-1.8 tonne kilometres use of local and regional roads for every 1 tonne kilometre use of state highways."[27]

While we've talked about forestry and tourism, New Zealand is still heavily reliant on agriculture and horticulture for its export earnings. These are heavily infrastructure reliant industries – as the quote above demonstrates these goods need to be moved from the land to the processor, and from the processor to the port. Processing capacity tends to be water-intensive.

Sudden changes in land-use patterns can come with big costs. For example, dairy conversions in rural Southland have seen regional incomes move at a faster rate than the national average – but the greater frequency of heavy traffic creates accelerated depreciation on the roading network, demand for road widening and smoothing for safety reasons and the like.

27 BERL (2014), *The Economic Value of Good Roads – Roads and the Nation's Export Effort*., presentation to the LGNZ Transport Summit, page 3.

HEALTH AND ENVIRONMENTAL STANDARDS

The cost of meeting drinking water standards in full has been well identified

The costs involved in meeting drinking water standards is one of the headline items on the inquiry's terms of reference. This issue is one that has been well canvassed.

In short, the inquiry into the Contamination of the Havelock North Drinking Water Supply found that the approach to compliance with the New Zealand Drinking Water Standards (NZDWS) to be *"so weak as to make compliance with the NZDWS (other than in relation to monitoring) effectively discretionary at the behest of water suppliers.""*[28]

The Inquiry recommended that:

"The secure classification system in section 4.5 of the NZDWS should be abolished forthwith"

and

"The Health Act should be amended to remove the "all practicable steps" test in, at least, ss 69H, 69S, 69V, 69Z and 69ZF, thereby making all duties on water suppliers mandatory"

and

"The defences in s 69ZZS, and all other references to all practicable steps, should be removed so as to make compliance mandatory and to create strict liability offences".[29]

In essence, once these changes are made local authorities will no longer have recourse to a defence of affordability and must comply with NZDWS. Water treatment cannot be upgraded overnight, but at this time it is not clear exactly what kind of transitional period will be put in place.

The Department of Internal Affairs commissioned BECA to estimate the capital and operating costs of removing the all practicable steps test, and of abolishing the secure classification system.

Their report found that the cost of upgrading water treatment facilities would be between $309–574 million in capital costs and an additional $11-21 million in operating costs per annum.[30] Of these costs around 30 percent was attributed to the removal of the secure classification system. BECA were first to note that only those costs directly associated with achieving compliance with the drinking water standards are included. Any other costs such as the upgrading or replacement of an existing asset has been excluded from the estimates.

LGNZ have suggested that when taken in aggregate the amount involved is probably 'manageable' (emphasis supplied). But the impact of drinking water standards does not fall on a sector, it falls on the individual councils and on local communities. Some 653 of the 794 registered schemes serve a population of 5,000 or fewer, and of these BECA considered that some 309 were non-compliant.[31] The total cost per capita of the population is some $315 (capital) and $12 per annum (operating). Of course, when the large supplies are removed the picture changes.

There is lower public tolerance for environmental 'issues' and for service failure in general

Environmental concerns impact on local authorities in two major ways. Firstly, through the direct influence of the public on local authorities (for example, a metropolitan authority undertaking a major upgrade of its sewage system largely because the local community has indicated it will no longer tolerate poorly treated sewage washing up on local beaches).

28 *Report of the Havelock North Drinking Water Inquiry – Phase Two*, page 96.
29 *Report of the Havelock North Drinking Water Inquiry – Phase Two*, pp 221 -227.
30 BECA Limited, *Cost Estimates for Upgrading Water Treatment Plants to Meet Potential Changes to the New Zealand Drinking Water Standards*.
31 One of the interesting features of the BECA analysis is that there are actually fewer medium sized (5,000 to 10,000 people served) plants deemed non-compliant than large sized plants.

This also manifests itself through conditions imposed on resource consents. The MAG report concluded that the mitigation of environmental effects and associated costs have been a significant (but unquantified) driver of roading costs, by widening project scope, especially in urban areas.

"In the future, project costs are expected to rise significantly for mitigating social and environmental effect such as: noise; unwanted visual effects, ecological impacts and pollution. Stormwater treatment is emerging as a major cost factor, especially for highway stormwater retrofits or for new roading developments. Mitigation of heritage issues will also continue to be a significant cost for a number of route options."[32]

Local authorities have cited the cost of compliance with standards set under the National Policy Statement for Freshwater Management (the Freshwater NPS) as one of the bigger ticket items in their infrastructure strategies.

The Freshwater NPS directs regional councils to set objectives for the state of freshwater bodies in their regions and to set limits on resource use to meet those objectives. The Freshwater NPS must be implemented in full by 2025 (there are limited circumstances where the deadline is extended to 2030).[33]

During 2017 the Freshwater NPS was amended and national targets for improved water quality for swimming were introduced. The target is **currently** 90 percent swimmable water by 2040 (we say currently because the incumbent Minister for the Environment announced his intention to have a new Freshwater NPS and a National Environmental Standard in place by 2020).

The Department of Internal Affairs commissioned Boffa Miskell and GHD (we use the acronym BMG to connote the combination of both firms) to scope the overall compliance costs that meeting the current NPS water quality criteria would impose on local authority wastewater treatment plants. We are advised that there are some 152 plants that are discharging to freshwater (around 47 percent of the total number of plants).

The BMG report[34] assumed that each plant would be expected to comply with NPS Freshwater B attribute states for E. coli, nitrates and ammonia in receiving waters.[35] BMG have concluded that the capital cost for meeting the Freshwater B attributes lies somewhere between $1.4 and $2.1 billion. The average annual capital cost is some $1,138 per household.[36] On top of the capital cost an anticipated additional operating cost of between $39 and $59 million per annum would be incurred.

Significantly these costs do not fall evenly. We understand that more than 80 percent of the schemes that would require an upgrade serve less than 5001 people. With these works having a high fixed cost element and small populations the estimated average annual capital costs rise to some $3,576 per household in schemes serving less than 501 people. It is our understanding that BMG consider that their analysis could be further enhanced by further analysis of costs around wet weather overflows, and consideration of rules around the management of phosphorus discharge.

32 MAG (2007), *Report on Roading Costs*, page 20.
33 Hon David Parker (2018), *Taking Action to Improve Water Quality*, press release last retrieved from https://www.beehive.govt.nz/release/taking-action-improve-water-quality on 16 October 2018.
34 Boffa Miskell and GHD (2018), *Cost Estimates for Upgrading Wastewater Treatment Plants to Meet the Objectives of the NPS Freshwater*. Downloaded on 24 October 2018 from https://www.dia.govt.nz/diawebsite.nsf/Files/Three-waters-documents/$file/Costs-of-wastewater-upgrades-GHD-Boffa-Miskel-Final-report-Oct-2018.docx
35 BMG describes this assumption as providing a consistent approach across the study and target that has an element of the aspirational.
36 Based on an annual interest rate of 6 percent over a loan repayment period of 25 years.

Bringing it down to local level here are two case studies – from Hauraki District Council and from Waimakariri District Council

Case study: The degree to which the regulatory settings of the NPS Freshwater are driving our costs – Hauraki District Council

We are facing major upgrades of our six wastewater plants over the next 15 years to comply with government direction to clean up our waterways. We will have to invest $38 million in capital with very little environmental return on this investment. We agree that our waterways need to be improved but we think that there are more effective ways of doing that.

The Hauraki District is home to a number of small and dispersed settlements. Seven of these receive wastewater collection and treatment services (a total of 6,150 properties). Because of their location, we provide this service through seven separate wastewater schemes.

The National Policy Statement on Freshwater (the NPS) is driving significant changes to the quality of water discharges to water bodies. This includes both wastewater and storm water discharges. It seeks the progressive reduction in the quantity of contaminants into waterways over a number of years. Regional councils are required to ensure that the intent of the NPSFW is implemented when issuing resource consents for how much and what quality can be discharged. Wastewater discharge standards will no longer be effects based, but will require improvement regardless of the standards already being delivered.

We already treat our wastewater to a high quality before disposal into the Waitakaruru, Ohinemuri, Waihou and Piako Rivers which flow through the Hauraki District (one of our treatment plants discharges to land). The resource consents for our wastewater treatment plants are coming up for review. Indications are that the conditions of consent for our schemes will be in accordance with the NPSFW and seek to reduce the amount of nitrogen and phosphorus discharged into waterways, irrespective of whether this provides a tangible environmental benefit.

This revised approach would require major upgrades to six of our wastewater treatment plants. While the plants are generally providing discharges of high standard, they will not be able to meet the reduced nutrient loadings under the expected conditions of consent. This work will need to start in 2024 and will continue through to 2032.

These new regulations will also mean that we will no longer have the capacity to provide for our growing population and industry. Our current performance is well within our current consented discharge requirements, leaving capacity for future growth. By limiting future discharge standards to what is now being achieved by the treatment plants this additional capacity is removed.

The cost of meeting these increased standards

We've looked at our options. Our existing treatment plants are based on cost effective and appropriate wastewater pond technology. We'd need to replace our existing ponds with treatment processes that can treat wastewater to a tertiary level. It would involve disinfecting wastewater (to remove pathogens) and reducing the number

of contaminants to 75 percent of current loads. We have forecast that this will cost about $38 million in capital spend over 15 years. This is significant.

The spend will affect our debt levels and rates funding requirements. Our wastewater debt levels will increase from $8 million to $38 million over the next fifteen years. We believe that this increase in debt levels will put significant constraints on our ability to respond to new and as yet unforecast spend in the years ahead, whether they be driven by regulatory change or community need.

In total, the wastewater upgrades will cost each connected property $6,975. Our wastewater rates funding will increase by 80 percent. This equates to an increase in the average annual property wastewater rate from $640 in the current year, to $1,150 by 2028 alone. This will require a huge investment, and not only will this place more financial pressure on our highly deprived communities, but it will result in very little environmental benefit.

The effectiveness of this approach

We agree that our waterways need to be improved but we think that there are more effective ways of doing that.

Modelling shows that in the case of one major river, the risk of illness from our treated wastewater is already lower than the upper catchment of that river. There is a large proportion of land within the catchment of one of our treatment plants that is likely to be contributing towards existing nutrient concentrations in the river, and our treatment plant's contribution to nutrient and E.coli concentrations is likely to be small. The effect of treatment plant improvements on the receiving waterways is then very limited.

We believe there are other options that have the potential to achieve a much better environmental outcome and cost-benefit to our communities, but they may require amendments to the NPSFW. We'd like the option to consider the establishment of a central fund to do major projects that would improve the receiving environment would be valuable. This could include for example, establishing wetlands at each point of discharge and retiring existing farms.

More requirements ahead

We'll expect that we'll have to look at treating the storm water we collect and dispose of too, but we don't yet know what the cost will be. We're currently looking at options for retrospectively installing storm water treatment devices as it is expected that we will require these when new discharge consents are granted between 2021-23.

Case study: The impact of the National Policy Statement for Freshwater Management on local government rates – Waimakariri District Council

The 2014 changes to the National Policy Statement for Freshwater Management (NPS-FM) introduced the National Objectives Framework (NOF) with the objective of achieving a more concerted nation-wide approach to managing freshwater. The NOF included the identification of a number of national values, two of which are compulsory, that is, that must be incorporated into plans at Regional level. The national values are accompanied by "attributes", that is, the matters that are to be monitored and reported under the NPS-FM.

For each attribute the NPS-FM sets a national bottom line and a series of thresholds above this. These thresholds are important as the main plank of the amendments to the Policy Statement, below which water quality is to be "maintained or improved". This meant that in managing the quality of water in a lake, river or aquifer those involved must ensure that its quality does not decline below its current status for each of the attributes.

In response to these amendments to the NPS-FM, the Canterbury Regional Council (Ecan) amended the Canterbury Land and Water Regional Plan (Plan Change 4) and, amongst other things, required operators of reticulated stormwater systems to manage the quality of stormwater entering the reticulated network. In Canterbury, most operators of reticulated stormwater systems are Territorial Authorities.

In Canterbury, several Territorial Authorities submitted against the proposed PC4 to the Canterbury Land and Water Regional Plan, and specifically on the management of reticulated stormwater systems contained in the proposed Policy 4.16A. Territorial Authorities (TAs) were concerned about the requirement for operators of reticulated stormwater systems to manage the quality and quantity of all storm water directed to its system and discharges from its system from 1 January 2025. Their concerns related to the requirement for TAs to be responsible for the storm water discharges from the high-risk sites such as contaminated sites, construction-phase storm water, and dewatering operations, which were at the time consented by Ecan. TAs argued to the hearing panel that it is appropriate for Ecan to continue to be responsible for consenting the discharges from these sites, as it has the specialists in this sphere

There also was some tension between the new Policy 4.16A and the new rules covering construction-phase storm water. Prior to 2025 TAs considered that they should be able to require an Ecan consent to accompany any application to discharge construction-phase storm water into its stormwater system, rather than being expected to rely on the applicant's assessment that it meets Ecan permitted activity status. Despite the proposed Policy 4.16A, TAs argued that this arrangement should continue, as otherwise TAs would be being asked to carry an unacceptable risk, in a situation where its power to enforce standards is more limited than that of the Regional Council.

The Waimakariri District Council, at the time that PC4 was notified, regulated access to its stormwater system through its Stormwater Bylaw 2011, and maintained the view, that the arrangements that see high-risk activities remain responsible for their discharges in accordance with the bylaw, were satisfactory. The council urged Environment Canterbury to maintain a system that provides for the high-risk enterprises to be required to have their discharges consented by the Regional Council. If that situation was allowed to continue, any breaches of consent conditions by these enterprises would be subject to enforcement proceedings by the Regional Council, who have far greater monitoring, compliance and enforcement resources than Territorial Authorities. Following PC4 becoming operative on 11 March 2017, council would be attempting to take enforcement action under its Stormwater Bylaw or find that the council itself is subject to enforcement action by Environment Canterbury under the *Resource Management Act 1991*.

In any event, the Waimakariri District Council undertook an extensive review of its *Stormwater Bylaw 2011*, and after a Special Consultative Procedure and hearings process, adopted the *Stormwater Drainage and Watercourse Protection Bylaw 2018* on 14 May 2018 with the express objective of managing contaminants to reticulated urban stormwater systems. *Section 259* of the *Local Government Act 2002,* however, limits the breaches of bylaws that are infringement offences, and a Territorial Authority would have to go through an expensive prosecution process through the courts to enforce a contaminant entering a water course through a reticulated stormwater system. All of this has an impact on rates, and none of these costs are born by central government.

So central government set the national direction through the NPS- FM, passed the responsibility to regional councils who were required to amend Regional Plans (at no cost to central government so the cost of the amended Regional Plans was born by ratepayers), and in Canterbury at least, this responsibility was shifted to territorial authorities, who in turn strengthened their power of general competence and passed a tougher bylaw (at no cost to central government but in response to a national direction). Bylaw enforcement by Territorial Authorities however is limited by central government's prescription of bylaws that can be enforced by infringement notices (under S 259), thereby putting inordinate financial pressure on ratepayers to prosecute breaches of the bylaw through the courts (again at no cost to central government but in response to a national direction).

This situation still is current, despite the Productivity Commission's *Inquiry into Local Government Regulation* in 2015 finding that the impost on local government from Central Government policy direction and regulation was significant.

TREATY OF WAITANGI SETTLEMENTS[37]

ThThe terms of reference for the inquiry ask the Commission to consider the impact of Treaty of Waitangi settlements on local authorities.

Creating co-governance or co-management arrangements has become a common feature of Treaty Settlement agreements. The implementation of these arrangements can create direct impacts on local authorities – such as the creation of new co-governance entities or development of new plans or policies or amendments to an existing plan or policy specifically to meet some requirement in the deed of settlement.

"Some examples include:

- administrative support, democratic services and other council staff services required for the provision of the exercise of powers and functions for the co-governance entities, boards or committees
- RMA policy development activities that are not planned or anticipated but are required by a Treaty settlement within a specified timeframe
- specialist technical staff time on the development and implementation of co-governance entity plans, documents and joint management agreements or other such agreements as required
- assistance with building iwi capacity to participate in the Treaty settlement arrangements. For example, councils contracting independent advisors for the Tangata Whenua representatives who sit on the Hawke's Bay Regional Planning Committee and the establishment of two senior Treaty advisors to support the Rangitāiki River Forum, Kaituna River Authority Te Maru o Kaituna and the forthcoming Tauranga Harbour Governance Group in the Bay of Plenty."[38]

Depending on the nature of the cost item, these can run from say the low six figures (which might be the operating cost for a committee for a year) to as high as the tens of millions (where an *RMA* plan has to change). The amount that has been to develop the Healthy Rivers/Wai Ora Proposed Waikato Regional Plan change has been conservatively estimated as some $13 million.

We are advised that Crown policy is to make a one-off financial contribution for the implementation of Treaty settlement outcomes. The level of the contribution is at the discretion of Cabinet and is based on a number of factors, which may include the:

- complexity of arrangements included in a settlement
- capacity of the local authority to implement the arrangement
- capacity of the iwi to implement the arrangement
- extent of current Crown assistance to the local authority
- level of existing commitments by the local authority for involving the iwi in natural resource management
- potential for efficiencies arising from the arrangement.[39]

We note that the above is prefaced by a statement that Crown policy is to provide a modest one-off payment. And modest they are indeed. For example, the Hawkes Bay Regional Planning Committee received an $100,000 one-off grant on establishment in 2010. We are advised that for the period 2010-2016 the Committee cost an average annual $131,000 to operate.

37 SOLGM gratefully acknowledges the assistance of Local Government New Zealand in preparing this section.
38 Local Government New Zealand, *Whakataunga Tiriti – The Case for Increased Financial Contribution to Local Government for Implementing Treaty Settlement Arrangements*, page 8.
39 Office of Treaty Settlements (2013), *Crown Contributions to the Costs of Local Authorities and Iwi Arising From Treaty Settlements*, page 1.

CLIMATE CHANGE

The impacts of climate change will create costs for local authorities, and the cost of adaptation will be an order of magnitude higher

"It would be easier not to have to think about what's ahead for our district, but the council doesn't have that luxury. We are better to debate these issues now and plan accordingly, rather than turn a blind eye and just hope for the best. No-one will thank us in 30 or 50 years' time for doing that."[40]

Few serious scientists now doubt the existence of climate change and the largely anthropogenic nature of the cause. Climate change has been described as *"an unparalled slow-motion natural disaster, but also one that is destined to intensify as the century progresses"*.[41] The anticipated impacts of climate change include:

- rising sea levels
- more frequent, and more severe adverse weather events (at both ends of the scale – that is to say droughts and rainfall events)
- new biosecurity risks and
- an accelerated loss of biodiversity.

No part of New Zealand is more than 130km from the coast. The recent publication *Coastal Hazards and Climate Change: Guidance for Local Government* provided decadal estimates of projected sea level rise across four scenarios. The estimated sea level rise from base level was sea level rise of:

- • between 23 and 37 centimetres by 2050 (i.e. just two years from the end of the current set of infrastructure strategies)
- between 32 and 61 centimetres by 2070 (i.e. just over 50 years from now)
- between 46 and 105 centimetres by 2100 and
- between 69 and 188 centimetres by 2150[42]

Boston and Lawrence (2018) note that there are no comprehensive estimates of the cost of sea-level rise for New Zealand over the coming century.[43] They cite a study undertaken by Bell, Paulik and Wadwha for the Parliamentary Commissioner for the Environment that found that there are at least 43,683 homes and 1,448 commercial properties within 1.5 metres of the average spring high tide. These properties have a replacement value of around $20 billion (in 2011 dollars!) – though we are first to acknowledge that exposure and cost are not necessarily the same thing.[44]

More extreme rainfall events can be expected, with the overall rainfall trend being that the north and west will be drier and the south and east wetter.

Local Government New Zealand recently commissioned Tonkin and Taylor to quantify the level of risk exposure created by sea level rise. The research had just been released as we finalised this submission. The report concludes that at a mean sea level rise of 1.5 metres some 6000km of pipe is exposed, as well as more than 2000km of roads and almost 2000 buildings or facilities. The estimated replacement cost of this infrastructure is around $7.8 billion. At the 3 metre increment the estimated replacement cost is some $13.4 billion.[45]

As we know, any risks are unlikely to materialise for some time, so the true cost of replacement is likely to be higher.

40 Pat Dougherty, former Chief Executive of the Kāpiti Coast District Council, as quoted in 'Kāpiti Erosion: Head to Head', *Dominion Post*, 12 March 2013.
41 Boston and Lawrence (2018), Funding 'Climate Change Adaptation – the Case for a New Policy Framework', *Policy Quarterly*, Volume 14 Issue 2.
42 Ministry for the Environment (2017), Coastal Hazards and Climate Change: Guidance for Local Government, page 106.
43 Boston and Lawrence (2018), *Funding Climate Change Adaptation – the Case for a New Policy Framework*, pp 41 - 42.
44 Bell, Paulik and Wadwha (2015), *National and Regional Risk Exposure in Low-lying Coastal Areas*.
45 See Simonson and Hall (2019), *Vulnerable – The Quantum of Local Government Infrastructure Exposed to Sea Level Rise.*

We are currently reviewing a sample of 20 of the most recent infrastructure strategies. We are typically finding that local authorities are making the following investments that are related to the impact of climate change:

- investments intended to protect communities from the increased risks of adverse rainfall and storm events – greater capacity in stormwater and wastewater disposal, flood protection and river control assets, coastal defences
- investments designed to cope with increased demand for services especially water
- investments in measures designed to improve water security – reservoirs, dams and other measures designed to add to the capacity to store and distribute water, investigations of alternative sources
- reviews of planning frameworks, documents and related regulatory practices – reviews of district plans, development and investigation of options for threatened communities etc..

The increasing risks arising from climate change will be accompanied by a corresponding inability to rely on traditional means of managing risk, or an increased cost to accessing these mechanisms. In particular, one of the first consequences of a community being identified as at risk from sea-level rise is that the ability to insure assets in that area is greatly reduced and/or comes at an increased premium.

New Zealand needs a rational policy framework for managed retreat

The above costs reflect the costs of building resilience into the specific infrastructure networks. As we have already observed, network infrastructure enables a community but does not make a community. There are entire communities that are at risk of coastal erosion, coastal inundation or higher levels of flood risk – including parts of almost all of our major cities. Historically the response to these situations has been to defend the impact area with engineering solutions (such as stopbanks, seawalls, groynes etc).

Increasingly local authorities will move to making use of managed retreat as a (or perhaps the) policy option. Managed retreat involves the conscious decision by policy-makers and the affected community to limit the use of land in response to the environmental risk or threat, or to remove the land from use altogether. The movement of Otago community of Kelso in the 1980s is one such example, smaller scale examples can be found all around the country.

There has always been some public expectation that their council has a moral obligation to compensate property owners affected by a decision to withdraw protection, or not to defend an area. This expectation may be reinforced by the decision to compensate property owners in the so-called 'red zoned' areas affected by the Canterbury earthquakes, although the factual circumstances are a little different than would be common in most retreat circumstances. Expectation may also have been created by historic cases of managed retreat where the areas affected were typically small, and compensation by property acquisition an economically feasible option.

Added to this, amendments to the *Resource Management Act* during 2015 have probably added some degree of legal obligation to the moral obligation. *Section 85* of the *Resource Management Act* now allows the Environment Court to order a local authority that has made rules in a District Plan that render land 'incapable of reasonable use' to either amend the rules or acquire the land under the *Public Works Act*.

A number of local authorities have started retreat conversations with smaller communities where perhaps the small number of properties may make acquisition a feasible option. These will not be the only such conversation required over the next 30 years – other communities in the Eastern Bay of Plenty and the West Coast of the South Island will be moving significant numbers of people over this timeframe.

Other regulatory settings

The balanced budget test may muddle financial accounting standards and asset management needs

Local authorities have been required to adhere to a variant of a balanced budget requirement since 1998.[46] The formulation of this test for a local authority is quite different than that which applies in central government. Central government need only balance the budget, on average, over a reasonable period of time (though there is a requirement to run a surplus where debt is not at prudent levels).

By comparison, a local authority is required to set operating revenues at least equal to operating expenses each year unless it resolves that it is prudent not to having had regard to the following statutory factors:

"(a) the estimated expenses of achieving and maintaining the predicted levels of service provision set out in the long-term plan, including the estimated expenses associated with maintaining the service capacity and integrity of assets throughout their useful life; and
(b) the projected revenue available to fund the estimated expenses associated with maintaining the service capacity and integrity of assets throughout their useful life; and
(c) the equitable allocation of responsibility for funding the provision and maintenance of assets and facilities throughout their useful life; and
(d) the funding and financial policies adopted under section 102."[47]

Local authorities do make use of these provisions to run an unbalanced budget. Some of the most common examples involve:

- the conscious decision to realise a financial reserve
- not funding a portion of the depreciation on roads on the assumption that NZTA will meet a share of maintenance and renewal costs
- not depreciating assets where a conscious decision has been made to run down a level of service (such as halls in declining rural areas).

Nevertheless, even a cursory examination of the long-term operating expenditure data shows the impact this requirement has had on operating budgets. The level of depreciation and amortisation expense has quadrupled in real-terms since 1996 and now stands at some $2.03 billion or around 21 percent of operating expenditure.[48] By comparison in the last full year before local authorities implemented the change the level of reported depreciation expense was some $404 million, around 12 percent of operating expenses.

The Office of the Auditor-General considers, and we agree, that the requirement to run a balanced budget is subordinate to the obligation to manage dealings prudently and in the current and future interests in the community. The *Act* creates a rebuttable presumption that a small surplus is prudent. We have come across instances where a local authority that was proposing to run 10 years' worth operating surpluses received an adverse opinion[49] and more than one local authority with 10 years of deficits regarded as prudent. These judgements are fact-specific and from time to time may take on the appearance of a judgement on the merits of the policy content.

46 The legislation requiring the shift in policy was enacted in 1996 but local authorities were given a two-year transitional period to adjust their revenue levels in a staged fashion.
47 *Section 100(2), Local Government Act 2002.*
48 To place this amount in context, the level of employee costs in the most recent year was some $2.18 billion.
49 Office of the Auditor-General (2006). Matters Arising from the Audits of 2006-16 Long-Term Plans, pp 82-83 contain examples and useful explanations of both circumstances. These are dated in terms of the local authorities and their circumstances, but serve as good illustrations of the principles of the balanced budget requirement and how these interact with the test of prudence.

In a similar vein, there is a much-used rule of thumb that, over the long term, the level of renewal expenditure a local authority undertakes should, in the round, be at least equal to the level of depreciation. That is to say, that a prudent local authority would broadly be replacing assets as close to the rate as it is using them up. This is often measured by use of a capital expenditure to depreciation ratio (but growth-related capex or major level of service increases can distort this), or a renewals to depreciation ratio.

In their review of the 2015-25 Long Term Plans, the Office of the Auditor-General noted that, after an initial 'blip' in renewal spending, the office expected that the renewal spend would return to historic levels when compared to depreciation expense.[50] Typically the amount spent on renewals sits between 64 and 67 percent of depreciation expense.

"In the previous LTPs, many local authorities proposed a "just in time" approach to renewals as a way of reducing overall spending on infrastructure. The latest LTPs have an increasingly realistic approach to the need to spend money on renewing infrastructure assets. Several local authorities presented plans to address what they now acknowledge as a "backlog" of renewals spending" [51]

While legislation and benchmarks can provide useful guidance, places to start analysis, and indicators of potential issues they can never be determinative. The important thing is that local authorities are properly accounting for asset needs and can demonstrate that clearly. While the spur that the balanced budget requirement provided was a useful one, and not before time, it is a definite example of a regulatory setting that is a driver of costs. It's also a good example of a driver that would 'fly beneath the radar' with the general public.

50 The Office attributed the 'blip' in renewals to replacement works undertaken in Christchurch.
51 Office of the Auditor-General (2016). *Matters Arising from the Audits of 2015-25 Long-Term Plans*

PART TWO: FUNDING ISSUES AND TOOLS

In this section we consider the set of funding tools and powers that are currently available to local government

Funding for wellbeing objectives

"A shared understanding of objectives (wellbeing) is a good start. But, a clear recognition and admission from all stakeholders that the local government funding model is neither sustainable nor fit for purpose would be major progress in terms of our ability to tackle these burning platforms. With that recognition, meaningful reform of local government funding could follow. Such funding reform would enable a strong foundation for both central and local arms of government to together pursue the economic, environmental, social, and cultural wellbeing of present and future communities of Aotearoa."

– Ganesh Nana, Principal Economist, BERL [52]

Central and local government are, or should be, partners in promoting the wellbeing of New Zealanders

Managing for the Big Issues, SOLGMs Brief to the Incoming Minister and Associate Minister of Local Government, opened by noting that:

"Governments, whether central or local, do not exist for their own sake. Nor do Governments exist as a collection of services that operate on their own. Governments provide the collective means through which the community makes decisions and acts to promote community wellbeing.

Local government's role in contributing to community wellbeing has evolved over the years. Today, we can best summarise local government's main contribution to wellbeing as:

- *a supporter and developer of strong, resilient communities*
- *• an advocate on behalf of the community – for example, to central government for resources such as more police, to current and potential employers in the district and so on*
- *a provider of the network infrastructure that sustains life and supports economic growth and transformation; and of the community infrastructure that shapes our communities as places*
- *a manager of the nation's natural resources and*
- *a regulator of community safety and environmental sustainability.*

The many and varied roles of local authorities mean that there is a considerable intersection and interdependence between central and local government. An issue such as affordable housing has many facets (social assistance, the provision of infrastructure, land supply, the availability of skilled labour and materials etc). Of these facets, local authorities can influence only the provision of infrastructure and land supply. Central government has more of a handle on the levers for social development and skilled labour, as well as having a role in infrastructure provision.

Successful resolution of the challenges of the 21st century requires a shared commitment from both parties to join up the thinking and act as a collective. In the final analysis, both central and local government are in the 'business' of promoting the wellbeing of the community."[53]

52 Nana (2018), *Focus on wellbeing welcome, but LG funding model remains elephant in room*, downloaded from https://www.solgm.org.nz/Article?Action=View&Article_id=98, last retrieved on 6 October 2018.
53 SOLGM (2017), *Managing for the Big Issues* – Briefing for the Incoming Minister and Associate Minister of Local Government, page 10.

In concluding that discussion we observed that a government that believed in the principle of partnership would consider the functionalist statement of purpose in the *Local Government Act* an impediment to a genuine relationship. We recommended the repeal of the present *section 10* and its replacement with a statement of purpose that recognised the sector's role in the promoting of the current and future social, economic, environmental and cultural wellbeing of communities.

Mission accomplished, but there is more to do

We are pleased to report that the *Local Government (Community Wellbeing) Amendment Bill* currently before Parliament will do precisely this.[54] If enacted the *Bill* will reintroduce a focus on wellbeing to the purpose of local government, and in about a dozen places elsewhere in the *Act*.

The next step in the process of establishing a genuine partnership is to conduct a conversation to establish a clear coherent vision for local government and its role within New Zealand's governance arrangements. This would provide an answer or range of answers to longstanding questions around the appropriate balance between central and local level decision-making and provide for some consistency in approach. Some degree of joining up in this way would also help establish and assess the total cumulative costs and effects of proposed reforms for the sector and for local communities.

Principles such as subsidiarity, community of interest, the presence of spillover effects, and location of capability and information should all play a role in determining who should take responsibility for what. These should not be new to the Commission, most have come from your report on your inquiry into *Local Government Regulation*.

That conversation is likely to identify a genuine set of priorities for joint action and an agreement as to which party is to do what to promote the plan. These discussions occur at the Central/Local Government Forum and the Central/Local Government Chief Executives Forum but these almost always:

- dentify an issue (the four current are climate change, transport, water and housing)
- list all of the review, programmes or initiatives that central government has underway to address the issue
- end with a statement committing to work together without a clear work programme or way forward to address the issue.

The development of a Living Standards Framework will bring a broader focus to identifying what is important using an evaluative framework that is broader than the impact on GDP. While there are a few rough edges we note that there is a great deal of alignment with the four wellbeings. One of New Zealand's leading economists has encouraged the sector to think of the four capitals as focussed on inputs

"our wellbeing is determined by the extent to which we invest in protecting, nurturing and/or improving the 4 capitals. Together the 4 capitals generate wellbeing (outcomes)".[55]

Central and local government therefore need to work together on a joined-up strategy for promoting national wellbeing. This would be more than a 'parenthood and apple pie' discussion or even the vague 'we will work on these issues' that we get from the Central/Local Government Forum. To be sure there would be objectives, but the strategy would state desired end objectives, and most importantly which party is primarily responsible for what (as the old saying goes, what gets measured, gets done).

54 At the time of writing, this *Bill* was awaiting a second reading. We anticipate that the remaining Parliamentary stages could be protracted.
55 Nana (2018), *The Four Wellbeings – The Second Coming*, Presentation to the 2018 SOLGM Community Plan Conference

And there is a funding dimension to this discussion

We note and welcome the Government's announcements that the 2019 Budget will be a wellbeing focused budget. What we would say is that the investment priorities for a wellbeing budget need to be based around what we'll term national good principles

The inquiry provides an opportunity for a robust debate as to what constitutes national good, including criteria and methodologies for determining what is "national good" and a strategy for investment in national good infrastructure and services. Some of these criteria might include:

- *the estimated or expected contribution to wellbeing* – no branch of government funds services for their own sake
- *the presence of externalities/spill over benefits* – these sorts of national good generate what economists refer to as "spill over" benefits i.e. a piece of supposedly local infrastructure that generates benefits beyond the district. A simple test of this argument is: who would be worse off if a particular piece of infrastructure were absent? If the only losers were local users, there are no externalities; if other significant losers can be identified beyond the locality, then externalities exist
- *promotion of equity in outcomes* – a related issue is when the level of service is not completely determined locally, in particular when there are minimum national standards. In this case, local taxpayers may receive more benefits than they would choose (and be prepared to pay for) without the external minima. Typically, there may be some externalities generating such external minima, e.g. costs which would be imposed on taxpayers outside the locality. Such externalities do not necessarily have to result from actual external costs. They may also result from people's preferences, in particular that people in high-benefit areas would prefer to see other areas enjoying a similar level of benefits, to the extent that they might be prepared to make some contribution to them. Good examples of funding that illustrate this criterion in action include funding (on a matching basis) for sewage disposal schemes in small communities and to enable small communities to meet the New Zealand Drinking Water Standards.
- *the size of the local funding base* – this criterion is typically linked with equity in outcomes in that some infrastructure may be necessary for other reasons, but the cost may be beyond the financial capability of the local district to afford. For this reason, funding from central government for infrastructural development is generally either targeted only at lower income communities (as is the case with sewage and drinking water subsidies) or has some recognition of "ability to pay" (as is the case with most land transport funding).

Applying those criteria and considering the likely areas that a wellbeing strategy would cover probably leads us to the following:

- funding support for three waters infrastructure – especially to meet the impact of the removal of the all practicable steps defence for drinking water treatment and meeting the requirements of the Freshwater NPS
- funding for climate change adaptation
- further support for housing related infrastructure.

Recommendations: Funding for wellbeing objectives

1. That central and local government agree on a joint wellbeing strategy that assigns responsibilities to central and local government
2. That this strategy joint set of criteria for determining the national good element of funding.

Rating powers and issues

There is more flexibility in the rating system than is commonly understood or applied

The basic approach to the 2002 rewrite of the *Rating Act* was to *"provid(e) local authorities with flexible powers to set, assess, and collect rates to fund local government activities"*[56]

By and large, the *Rating Act* has achieved these objectives well. Almost all the statutory restrictions on the use of rating tools have now been removed (such as the maximum rate). We have relatively few recommendations for change to the set of rating tools per se.

The flexibility afforded by the *Act* means there is a much higher policy component to the setting and assessing of rates than was the case pre-2002 (simply because there is a great deal choice).

A local authority that wishes to treat its rates as more of a tax has the option of selecting a value-based general rate as the mainstay of its rating system. A local authority that wants to treat its rates as being more akin to a charge for services might load up the rating system with fixed charges, water metering or some of the proxies from *schedule 3* of the *Act*. Both, and all points between, are perfectly valid policy choices provided they are justified to the community.

As we shall see the rating mechanism is a device for allocating the burden of rates. This as a tool can be used to solve many issues and concerns,[57] but in the end we observe that

"The targeted rating mechanism is potentially a very powerful tool that can be used to solve a variety of rating issues. However, targeted rates are, for the most part, a means of allocating the incidence of rates in a manner that the council deems to be more equitable, as a general rule targeted rates are not a means for 'tapping' previously unexplored pockets of rating potential."[58]

But it is time to remove the last restriction

In 1976 local government was given the powers to make two types of rate that do not change as property value changes. These are:

- the uniform annual general charge (UAGC) – a fixed dollar charge per property, or separately used part of a property, with the proceeds being available for any lawful purpose;
- targeted fixed rates - fixed dollar charges per property, or separately used part of a property, with the proceeds only available for specified purposes.

However, the ability to use these charges is statutorily limited to no more than 30 percent of the local authority's *total rates revenue*. The *Act* is very specific and limiting in its terminology and what may fall inside or outside the cap can turn in some quite narrow and specific factual circumstances.[59]

The existence of the cap devalues the regime of accountability and community choice promoted in the *Local Government Act*. Local authorities must work through a rigorous and transparent process of considering certain principles (efficiency, equity etc) when making funding decisions, having the cap rides roughshod over these disciplines. The cap is also inconsistent with the purposes of the *Rating Act* (one of which was to provide local authorities with flexible powers to set and assess rates).

56 *Section 3, Local Government Rating Act 2002.*
57 SOLGM and LGNZ (2013), *Rating Knowhow – the Guide to the Local Government Rating Act*, pp30 -33 set out a number of common rating policy issues and shows how they can be resolved with judicious use of the tools.
58 SOLGM and LGNZ (2013), Rating Knowhow – the Guide to the *Local Government Rating Act*, page 34.
59 Page 29 of SOLGM and LGNZ (2013) shows just how narrow the facts need to be before something gets put beyond the legal coverage of the cap.

The way rates are determined has a mix of good and not so good incentives

One of the oft-held misconceptions of the rating system is that *"my property value has increased so I'll be paying more rates"*. That's not necessarily true. Whether this fictitious property actually gets an increase will depend on two things – whether the total amount collected from rates increases and the movement in value of this fictitious is higher or lower than the district average. If it's higher than the ratepayer's share of the rates increases, if it's lower than the ratepayer's share of the rates decreases and all things being equal the ratepayer may pay a lower amount of rates.

The way our rating system operates also means that, all things being equal, there is no bracket creep in the rating system. Local authorities set one rate in the dollar of property value.[60]

Local authorities can only set and assess having first adopted either a long-term plan or an annual plan, including a budget for the coming financial year. All local authority rates have to be reset annually. That is to say, local authorities begin the rating process by determining what their expenditure needs are, including engaging the community on the expenditure priorities and a proposed method for funding.[61] Then and only then can a local authority set the rates of tax and create the legal obligation to pay the tax.

While local authorities are not obliged to approach each year's budget from a zero-base, in practice there is a degree of re-litigation of spending priorities each year. There are local authorities that adopt a long-term plan in one year, and then effectively redo the work the following year.[62]

This top-down, public approach to setting rates provides strong incentives on local authorities to manage their costs.

On the other hand, the incentives to make growth-producing or generating investments are not strong. The *Using Land for Housing Report* noted that *"Where an infrastructure investment increases the rateable value of newly serviced land, this only causes the total rating burden to be re-allocated among ratepayers. No new revenue is actually generated unless a council also increases its forecast expenditure."*[63]

Infrastructure New Zealand have been even more direct in their assessment

"A culture of cost minimisation prevails over a desire for value creation. Leadership, vision, cooperation and integrated long-term, planning and investment are undermined. Siloed decision-making and politicisation of projects are major issues."[64]

While we might not agree with all of the sentiment that Infrastructure New Zealand expresses, we do agree that the way New Zealand approaches the setting of rates could be aligned to better capture value uplift.

As we understand it, England and some jurisdictions in the United States do not require the annual resetting of rates. If the tax base (in this case the total value of property in the local authority) increases local authorities receive a dividend in the form of an increase in revenue. This is not to say that local authorities don't provide an annual budget – far from it. And nor does it suggest that the model is perfect – indeed even Infrastructure New Zealand has noted that there has been historic issues with underinvestment in maintenance in the American cities it visited.

60 Local authorities can use property value as the basis for constructing a differential. However, the local authorities that use this charge each property a single rate in the dollar across every dollar of property value.
61 Refer *sections 93A* and *95* of the *Local Government Act 2002* for descriptions of the content of the information that supports the public engagement on a long-term or annual plan.
62 One year the mayor of this local authority voted for adoption of a long-term plan, and then noted that *"council will have to work hard to bring next year's increase down"*. (Why adopt the plan in the first place?)
63 Productivity Commission (2015), *Using Land for Housing*, page 227.
64 Infrastructure New Zealand (2018), *Enabling City Growth: Lessons from the USA*, page 4

Set against this, however, is the fact that some New Zealand cities have experienced rapid increases in property values in recent years, and that this appears disconnected from any investments that local authorities might have made in their communities. For example, one city advised us their rating base has increased more than 40 percent in the last three years.

Rate-capping is the long-run enemy of sustainability of service

We have no doubt that the Commission will receive submissions or advice in favour of setting some form of limit on rates increases over any given period of time. For convenience we'll use the term rate-capping to describe these initiatives regardless of form (New South Wales and IPART,[65] California and Proposition 13 etc).

Although we do not wish to give these initiatives undue credence, a few observations about rate-capping and its impacts are in order.

Although we do not wish to give these initiatives undue credence, a few observations about rate-capping and its impacts are in order.

Most caps are constructed around some measure of consumer prices, sometimes with a growth factor added. These are usually specified as the maximum allowable increase. A local authority that does not elect to go for the maximum allowable increase in one year is not usually able to make up the increase in a subsequent year – so a *"if we don't take it, it's gone"* mentality can prevail.

Legislators focus on the taxation component of the revenue system. While this might be a reasonable stance to take given that this is the coercive element of revenue system, such a policy stance overlooks that there are other revenue sources. What can happen is that local authorities look to make up any deficiencies in revenue through increasing the levels of the non-regulated services (mostly fees and charges).

For example, the so-called proposition 13 in California was meant to constrain local authority revenue growth by limiting property tax. The net result is that local authorities in California shifted their revenue-raising efforts to sales taxes. In a 2008 study of American local government Kousser, McCubbins and Moule found that a majority of US states had raised fees and charges following the implementation of property tax limitations.[66] In a more dated (1999) pair of studies Shedbegian (29 states) and Skidmore (49 states) each found that local authorities had each substituted property tax with funds raised under 'miscellaneous revenues'.

One unintended consequence of rate-capping initiatives is that they can provide fertile ground for so-called 'blame shifting' that is to say, local authorities making their financial affairs the business of the next level of government up. *The Economist* magazine argued in 2011 that *"for all its small government pretensions, Proposition 13 ended up centralizing California's finances, shifting them from local to state government."*[67]

It has been argued that rate-capping will force efficiencies in local government. There is actually little evidence to support this proposition (or, for that matter to refute it). A very limited study by Dollery comparing the (rate-capped) New South Wales and the uncapped South Australia calculated expenditure per household over four years finding that *"in each of the four years under analysis the efficiency of New South Wales councils was well below that of their South Australian counterparts"*.[68]

65 The Independent Pricing and Regulatory Tribunal (IPART) sets the limit on rates – while not a wonderful proposition, it is an enhancement on the situation pre-2009 where the cap was set by the NSW Minister of Local Government.
66 Kousser, McCubbins and Moule, For Whom the Tel Tolls: Can State Tax and Expenditure Limits Effectively Reduce Spending, State Politics and Policy Quarterly Winter 2008, pp 331-361.
67 'The Perils of Extreme Democracy', *The Economist*. 2011-04-20
68 Dollery (2017) *An Empirical Assessment of the Impact of Rate-Pegging on South Australian Local Government*, page 15.

Finally, it's worth remembering that local authorities in New Zealand do set their own limits on rates and debt as part of their financial strategies.[69] These are self-set but are not toothless. Local authorities are required to disclose their performance against their limits as part of their reporting under the *Local Government (Financial Reporting and Prudence) Regulations 2015*, and also in their pre-election reports. A local authority that is consistently breaching its caps might find that its asked questions about the prudence of its financial management, and have to face the voters having to explain breaches of its own limits.

As an aside, when done well, the caps on rates can become a device for setting and communicating priorities – Hamilton City Council's 2012 planning process is held up as an exemplar. The Commission might consider this as an example of the positive incentives from a long-term plan process.

Rating, especially targeted rating, is heavily reliant on quality information

The Commission asked specifically about the use of the targeted rating powers under the *Act*. We've already suggested that these are a potentially powerful tool for those councils that wish to incorporate elements that are proxies for user charging or beneficiary pays into their rating systems.

An examination of *schedules 2* and *3* shows just how much flexibility exists in differentiating categories of property and in the selection of bases to calculate liability. The degree of flexibility is further added to as local authorities are not limited to selecting only one factor from *schedule 3* for targeted rates. For example, a local authority could:

- differentiate and use a different factor for each category or
- a combination of factors such as say, 50 percent land value and 50 percent land area.

But this flexibility has to be traded off against compliance costs. One of the major aspects of compliance cost is the generation and maintenance of information necessary to set and assess the rate.

Not all of the factors in *schedule 3* are collected by the valuers as part of the revaluation process. In particular, the valuers take little role in determining the number of separately used or inhabited portions of a property (or SUIPs). While this is appropriate as different local authorities, quite legitimately, have different definitions of SUIP and some can turn on narrow distinctions of fact, this is one of the most common bases for setting targeted rates.

Establishing what is and isn't a SUIP is reliant on having reliable, up to date, information. Parts of a property move into and out of SUIP status all the time. In similar vein properties or parts of properties change use for differential purposes all the time. Yet all this information is reliant on the ratepayer to disclose the information that is relevant for the calculation of their rating liability. At the present time the ratepayer is required to disclose only when properties are sold or some other circumstance that is relevant to determining who the ratepayer is. Other circumstances relevant to the calculation of rates are not well captured under these provisions.

Any serious look at funding would include consideration of rates exemptions

We realise that the Government put the "particular mechanisms for the rating of Crown land" outside the terms of reference for the Inquiry. We note that the Government was keen to put its own land, but not other exempt land beyond scope. We cannot however represent our members without making at least a passing comment on rates exemptions.

69 *Section 101A Local Government Act*. The strategy also has to contain an explanation of how the limits cohere with the local authority's ability to meet the levels of service set elsewhere in the plan, and accommodate any new requests.

Schedule 1 of the *Rating Act 2002* exempts 22 different categories of land from paying most rates.[70] Some apply only to one or two properties, but others are significant (for example National Parks, the education sector, and the road network). The only rates these properties pay are targeted rates for water supply, sewage disposal, and refuse collection.

Your own report, *Using Land for Housing,* concluded that *"the rating exemption on core Crown land does not appear to have a principled justification".*[71] We agree that most of the arguments advanced in favour of exemptions are highly suspect.

For example, it is often argued that many of the non –rateable properties are held for public good purposes (i.e. are meeting some purpose that is deemed to be a national good) or that non-rateable properties provide benefits to the local community that may not otherwise have been generated. For example, it is claimed some national parks generate tourist visits which in turn provide centres such as Ohakune with economic benefits they might not have captured otherwise. Others claim that some exempt land receives little benefit from local authority services.

Each of these is superficially attractive, but fails on closer analysis. The national good argument is, in reality, an argument for national funding of the rates on these properties. To do otherwise effectively expects the local ratepayers in Westland or Dunedin to subsidise the benefits of others. Other properties provide benefits to local communities (for example in some towns the pulp and paper mill, or the freezing works are virtually the sole employer) yet these properties are fully rateable.

Rates exemptions provide, and are intended to provide, a ratepayer funded subsidy on the provision of the exempt service. Any standard economics textbook will set out how subsidising an activity distorts the decision-making processes (in particular it provides an incentive to overproduce the subsidised service). Again, your own *Using Land for Housing Report* was very clear on this point (in the context of freeing up land for housing):

"Rating crown land would encourage agencies to use land more efficiently, and release land that is not required. The Crown, in principle should face the incentives as the private sector to hold land . . . ."[72]

Again, we can only agree and add that exemptions can also distort competitive neutrality. For example, universities are exempt, and are well known occupiers of office space throughout many of the major cities. Yet many private training establishments are not exempt.[73]

On occasion we have heard officials express concern that local authorities would view newly rateable properties as a 'cash cow', with the treatment of newly rateable electricity generation assets in the late 1980s being cited as an example. We suggest that Courts overruled what we agree were extreme decisions by two local authorities, and that their approaches would have even less authority under today's legislation.[74]

Local Government New Zealand has estimated that removing rates exemptions would cost the Crown about $180 million. The sector would be willing to discuss arrangements for transition towards the removal of exemptions, and would be willing to help contribute to resolving some of the issues this might raise (such as valuation methods for land where there is no active market). We would also be willing to discuss options for a regime of Crown contributions in lieu of rates.

70 There are a few rates exemptions for individual properties or landowners elsewhere in legislation.
71 Productivity Commission (2015), *Using Land for Housing*, page 90
72 Productivity Commission, *Using Land for Housing*, page 90.
73 This line of reasoning is sometimes offered by operators of ports, airports and the rail corridor as an argument for retaining exemptions e.g. if roads are exempt and these others are not then road users receive a major subsidy. Actually, around 90 percent of the road network (by length) is local roads which are not generally competing with air, rail etc (as far as we are aware there is no air service to Karori), though we do accept that the State Highway network does compete with rail, air and sea transport.
74 See SOLGM and LGNZ (2013), *Rating Knowhow – the Guide to the Local Government Rating Act*, page 23 for a discussion of Electricity Corporation of New Zealand vs Mackenzie District Council (1991). This remains one of the leading cases on tax, administrative law, and the common law test of unreasonableness.

Recommendations: Rating tools

3. That the *Rating Act* be amended to remove unnecessary limits on the use of tools in the rating toolkit.
4. That the Commission not pursue proposals to 'cap' rates.
5. That the Commission agree that the *Rating Act* be strengthened to require ratepayer disclosure of all information relevant to the setting of rates at the time any change occurs.
6. That rates exemptions, including those on Crown and non-Crown land be removed *in toto*.

Alternative tax bases

The Commission has asked specifically for views on the pros and cons of local income and expenditure taxes.

There have been nine previous reviews of local authority funding that have considered the merits of alternative tax bases for local government.[75] All have considered local income and local expenditure against a fairly standard set of principles such as efficiency, equity and the like. All have concluded that at a minimum there was no compelling argument for abandoning rates, most have gone further and concluded rates are the best means for funding local government.

Basing a tax on incomes has some attractiveness in terms of ability to pay. However, wealthy individuals and the business sector are more likely to make use of means for tax avoidance (and in the case of businesses, a switch to income tax may also create a shift in the incidence of local government funding needs)

We've seen calls for locally set variants of income and expenditure taxes as a means of creating tax competition. In our view these oversimplify the compliance issues involved in the economy as a whole arranging its affairs to pay different rates of tax in different local jurisdictions. As an example, take the recent introduction of a regional component to fuel excise in one city-region of the country and the publicity around transport firms telling their drivers when and where to fill-up.[76] In practice debate around local variants of income and expenditure taxes quickly collapse to central government distributing part of the revenues it collects.

In our view the greater priority should be to have the conversation on funding national good, and the question of from whence these funds come should be left as a matter for central government to determine.

Recommendation

7. That the Commission take note of the conclusions of the nine previous reviews of local government funding in regards local income taxes and local expenditure taxes.

75 The Independent inquiry into Rates lists seven previous inquiries on page 49 of its final report, when adding the 2004-6 Local Government Funding Project and the Inquiry itself that makes nine such inquiries.

76 Of course, we accept that what makes for a good media headline and what actually happens on the ground may not necessarily be the same thing.

Special purpose vehicles

Special purpose vehicles could be a useful tool for some of the larger projects …

The Commission has been asked to consider whether there would be any benefit to importing some of the project financing approaches in use overseas into local government here.

Chief among those are the so-called special purpose vehicles (or SPVs). As we understand it a special purpose vehicle is an entity that is established off a parent entities balance sheet. Most SPV models involve some variant of the SPV accepting or attracting finance from a third party entity, constructing or acquiring an asset (say a road). We observe that the international ratings agencies (such as Standard and Poors) provide their rating based on the financial health of the parent and group – including anything 'off-balance sheet'.

An SPV is therefore one variant of a public-private partnership (PPP) arrangement.

Unlike the 'typical' PPP there isn't the necessary expectation that ownership of the asset will transfer to the local authority at the end of an agreed period of time. The SPV might retain ownership indefinitely – as former Minister of Local Government Anne Tolley observed:

"Councils will have the option of buying back the infrastructure at some point in the future, but won't have to commit to doing so. This is all about introducing outside capital to build this infrastructure, so current ratepayers don't get burdened with all the costs of growth."[77]

Of course, there is nothing new in the SPV approach. In concept it is very similar to the re-purposing of Crown Fibre Holdings into Crown Infrastructure Partners and widening its brief to the provision of housing related infrastructure. The proposed Urban Development Authority is another variant on the SPV model and comes with many of the same caveats.

An SPV will need scale and some guaranteed revenue streams

The SPV model will not make sense for all projects in all circumstances. The historic view in New Zealand has been that there is a 'rule of thumb' for a minimum project size of around $50 million for a successful PPP. Our understanding is that thinking now points to a project or related group of around $30 million as being the minimum economic size.

At the start of the transaction the SPV accesses finance from a third party which will be expecting a return on its capital. The SPV will need enough financial strength to give third party providers sufficient confidence of a return, and more fundamentally recovery. A mechanism such as a local authority guarantee might well be treated as a contingent liability and defeat the purpose of establishing the SPV. As we understand it this is one of the reasons that the then Government chose to use Crown Fibre Holdings as the base for Crown Infrastructure Partners.

The SPV will only make a return if it has guaranteed revenue streams. In some cases, such as roads and drinking/waste water infrastructure, direct user charging may be economically feasible (though potentially politically contentious). Local authorities might also elect to guarantee a revenue stream for an SPV either to 'top up' a revenue stream from user charges or (in extreme) to replace user revenues altogether.

There may be constitutional and regulatory issues but we doubt these are insurmountable

The Commission was specifically asked to consider *"any constitutional and regulatory issues that may underpin* (sic) *new project financing entities with broader financing powers"*.

77 Corner (2017), Crown Fibre Holdings Morphs into Crown Infrastructure Partners, from Computerworld, last retrieved from https://www.computerworld.co.nz/article/625163/crown-fibre-holdings-morphs-into-crown-infrastructure-partners/ on 15 October 2018.

We have considered whether an SPV or SPV-like vehicle delivering water services could potentially be captured by the requirements of *sections 130* and *136* of the *Local Government Act*. These place local authorities under an obligation to deliver water services where it was on commencement of the *Act* (unless the community votes otherwise) and places a 35 year limit on any contracting out. Our view is that an entirely new asset built from scratch and entirely funded directly from the user, by a user charge, would not fall within these provisions. A major upgrade of an existing facility operated by a local authority would fall within the scope of *section 130* and potentially *section 136*.

Probably the issue of more pressing concern from a constitutional standpoint would arise where these entities had powers to tax. We too, would be concerned if these entities had independent powers to tax or set charges. But these questions are no different from those faced by the other project financing entity that the Government is planning to establish – the Urban Development Authority. The key is to develop a regime of accountability for the revenues raised which in concept need be no more than:

- a plan setting out what any public money will be used for
- an audited report setting out what public money was actually used for and that the SPV remains a going concern
- legislative confirmation that an SPV is bound to any regulatory standards that apply to the parent local authority e.g. New Zealand Drinking Water Standards are the obvious example.

Alternatively, the *Local Government (Auckland Council) Act 2009* may provide a solution. The substantive council controlled organisation Auckland Transport cannot access development contributions for growth related infrastructure. However, the parent, Auckland Council, may (and does) include allowances for development contributions for transport in its own policy. The amounts it raises are then passed to Auckland Transport. Both bodies are publicly accountable for the funds.

The other regulatory issue that may be most difficult to resolve in practice lies in powers under the *Public Works Act*. The very off-balance sheet nature of an SPV that makes it attractive as a means of controlling debt, may also act as a limitation on its powers to acquire land under the *Public Works Act*.

In a similar vein we can readily conceive of local authorities attempting to transfer land to an SPV and encountering claims that the land should have been offered back. Similarly, the SPV might encounter claims if and when it attempts to transfer an asset or land to the local authority – especially if the asset has, or may have income generating potential.

In short, the SPV vehicle is a useful tool in a range of limited circumstances that would heavily favour the larger local authorities and the construction of new capital projects. This tool is more likely to succeed where there is an ability to directly charge for a service – roads and drinking/waste water appear to lend themselves most readily.

Recommendations: Special purpose vehicles

8. That the Commission further consider the accountability regime for use of public money provided to, or used by an SPV (including the proposed Urban Development Authority).
9. That the Commission further research the application of the *Public Works Act 1981* to land transferred to and from an SPV.

Development contributions

"The Commission's review of infrastructure charges in its Housing Affordability inquiry found that properly structured and administered infrastructure charges help manage overall infrastructure costs by signalling to developers the cost of building in different locations. The Commission concluded that 'the case for development contributions is strong. Linking payment made for some types of additional infrastructure to the benefits received helps ensure that investment reflects its opportunity cost and that locational decisions are efficient."[78]

Section 198 of the *LGA* provides territorial authorities with the power to require development contributions to recoup the incremental costs that development poses for:

- network infrastructure (roads and footpaths and the three waters infrastructure), and
- a (very) limited range of community infrastructure.[79]

Councils have chosen to apply development contributions because they consider that new developments should be required to pay for the new or upgraded infrastructure that councils must invest in, in order to meet the needs of that new development. The alternative would be for the whole community to bear the cost through higher rates (whether in upfront payments or to repay debt). Many local authorities do not consider it reasonable that current (or future) ratepayers should bear the full burden of funding infrastructure that is required to service growth.

Development contributions have, unfortunately, been something of a political football

We endorse the Commission's findings on development contributions as being in line with economic theory and the practical requirements on meeting growth needs. Not all policy-makers in central government and local government share this view – with some considering that they are one of the root causes of our present housing affordability issues.

Your own Housing Affordability inquiry found the development contributions varied considerably from local authority to local authority and could be as little as 1.5 percent of the median section price in the district to as much as 9.7 percent in others. At that time the Commission could not *"draw a general conclusion about how much development contributions increase housing prices and reduce affordability: they vary considerably across New Zealand and the extent to which they are passed on probably varies"*.[80]

As we write this, Parliament is debating legislation that will increase the range of community infrastructure that can be funded in this way (or to be accurate, restore the situation as it applied on original enactment).

Development and the servicing of development each have long lead times and require some degree of certainty. We doubt that it is in the interests of the development community, the local authority and the remainder of the community to have this sudden degree of change in policy frameworks.

Regional councils should have access to these powers where they can demonstrate a causal nexus

Under the law as it stands only territorial authorities and unitary councils can access development contributions powers.

78 Productivity Commission (2015), *Using Land for Housing*, page 216.
79 Under the *Local Government Act* as it currently stands *community infrastructure* means the following assets when owned, operated, or controlled by a territorial authority: community centres or halls for the use of a local community or neighbourhood, and the land on which they are or will be situated: play equipment that is located on a neighbourhood reserve: toilets for use by the public.
80 Productivity Commission (2012) , *Housing Affordability*, pp135-136.

The *Act* envisages that activities could be transferred between territorial and regional councils (and vice versa), indeed local authorities are actively encouraged to join forces to identify these opportunities. The lines between regional and territorial activity may "blur" in future. There is no difference between regional and territorial authorities with respect to the ability to own assets, including infrastructure.

Section 103(2) of the *Act* identifies a number of sources of funding that are available to local authorities, including rates, fees and charges, borrowing, interest and dividends, proceeds from the sale of assets, etc. "Development contributions" are the only funding source in this list not available to regional councils. All other sources are available to both regional and territorial authorities.

Regional councils currently have powers to levy financial contributions under the *Resource Management Act*. The 2017 amendments to that *Act* would remove these powers from 18 April 2022 (though the current Government has announced plans to reverse those amendments). Some regional councils (for example those with responsibilities for flood control) are able to make use of these powers to fund some of their capital expenditure. However, the powers are not sufficiently broad or relevant to be able to be used by regional councils to fund their growth related capital expenditure.

Extending powers in this way would assist regional councils to meet their responsibilities under the financial management provisions of the *LGA* (*section 101*). These responsibilities require local authorities to have regard to a range of factors including the distribution of benefits between the community as a whole and any identifiable part of the community; and the extent to which the actions or the inactions of groups (or individuals) contribute to the need to undertake the activity. The absence of a power to charge development contributions prevents regional councils from considering whether new development should pay for a fair share of the new regional infrastructure (such passenger transport) required to service that development.

The cap on reserve contributions should be abolished

Section 199 of the *LGA* allows councils to levy developers for a contribution for the purposes of a reserve. *Section 203* sets a maximum contribution of 7.5 percent of the value of allotments created by a subdivision, of the value equivalent of 20 square metres of land for each additional household unit.

Some local authorities consider that the artificial maximum set in *Section 203(1)* does not enable them to collect sufficient reserve contributions to provide for the active and passive reserve needs of new residents into the future. The option offered in the *Act* does not work when there is a development that has no subdivision; then part (a) cannot apply or likewise with (b) it is not necessarily known at a subdivision stage how many household units would be constructed. Therefore, the option of "the greater of" cannot apply in practice.

There is no reason in principle why councils should be able to determine (in consultation with their communities) appropriate contribution levels and levels of service for community infrastructure but not for reserves. Both activities are aimed at providing for social, environmental and cultural wellbeing.

The 7.5 percent/20m2 formula in *section 203(1)* has historically had the advantage of certainty, allowing developers to factor contribution levels into project costings. This certainty would still be maintained through development contributions for reserves, calculated in accordance with the *schedule 13* methodology, being specified in the schedule of development contributions under *section 203 (1)*.

Removal of the cap would be consistent with the *schedule 13* approach for other growth-related infrastructure.

The law must reflect the increasing reliance on partnerships to provide public amenity

Parliament is considering restoring the broader definition of community infrastructure in the *Local Government (Community Wellbeing) Amendment Bill*.

The definition of community infrastructure in *clause 11* of this *Bill* expressly includes only that *" . . . land and development assets on land,* ***owned or controlled by the territorial authority*** *. . ."* (emphasis supplied).

The definition of community infrastructure that applied 2014 has been carried into this *Bill*. While that is appropriate for most purposes the definition overlooks more modern partnership approaches to developing community infrastructure. For example, co-funding a new hall or indoor sports facility on Ministry of Education provided school land.

This is a cost-effective way of providing new community infrastructure that is very much in keeping with the principles of local government that we traversed earlier (especially around collaboration), and with the collaborative ethos that underpins the community well-being *section* of this *Bill*. These partnerships ought not be discouraged by limiting access to a legitimate funding source.

The sector has made submissions on this matter in the Select Committee hearings on the *Local Government (Community Wellbeing) Amendment Bill*. We are hopeful that Parliament will address this matter in the last stages of the Parliamentary process.

And the Crown should pay its way

Section 8 of the *Local Government Act* establishes which obligations of that *Act* bind the Crown. The obligation to pay development contributions has been omitted from the list of binding obligations meaning that the Crown has given itself an exemption from any obligation to pay a development contribution.

Crown developments such as new schools, tertiary education, prisons, social housing developments and the like require council provided infrastructure to function. In some cases this requires the provision of a peak capacity – for example school sewage disposal needs to be built for a thrice daily peak demand.

Some developments, such as tertiary establishments, high schools and some of the planned housing developments are/will be the size of small communities. Our comments on rates exemptions noted that an exemption of this nature sends extremely poor signals around the use of land.

Development contributions are not a tax – they are more of a targeted charge for a service. The (specious) rationale that the Crown does not pay tax is not available in this case – making this one of the more blatant examples of expectation that the ratepayer subsidise the Crown. This should be removed forthwith.

Recommendations: Development contribution

10. That regional councils be permitted access to development contributions where they can demonstrate a nexus between their services, capital expenditure and growth.
11. That the cap on reserve contributions be abolished.
12. That the law be amended to allow for recovery of development contributions on land that is not owned or controlled by the local authority.
13. That the Crown exemption from paying development contributions be removed.

Value capture

Value capture is a type of public financing that recovers some or all of the value that public infrastructure generates for private landowners. These are often based on a normative judgement that the increases in value are the unearned result of public investments to which the landowner has made only a marginal contribution.

Tax Increment Financing provides some incentives for growth related investment but would require significant regulatory change to work best

From time to time, some development or commercial groups, and the occasional local authority propose tax increment financing (TIF) as an additional tool. While TIF schemes take a variety of forms, most are variants on the following basic structure:

1. a proposed project or piece of expenditure is identified. This might be a piece of infrastructure or a development programme
2. the local authority then defines an area of benefit for the project (known as the TIF district), and sets out the proposal including the rates of tax etc. In some jurisdictions where TIF are used primarily as a regeneration tool, there has to be a finding of 'blight' or 'decline', Significantly the TIF district is generally a legal entity in its own right whether 'ringfenced' within the local authority or a standalone entity
3. the local authority determines the base value for the TIF district. Values are frozen at that point for TIF purposes – the TIF is collected only from the new value in the TIF district
4. the local authority borrows the funds necessary to undertake the development project – often this is done through the issue of 'TIF bonds', that is to say debt securities that entitle the bondholder to a 'share' of TIF revenues
5. each year the revenue collected via the TIF scheme is used to repay the loan. All revenue off 'new value' goes to the TIF district and not to the local authority.

TIFs have similar objectives to a targeted rate in that those that are deemed to benefit from a particular expenditure pay for that expenditure. The difference is that a targeted rate is allocated across all value in the area of benefit, a TIF only over new value.

In a system that is reliant on property tax, it is something of a fact of life that spending on say an economic development initiative, is more likely to stimulate growth in central government's revenue base (increased GST etc). Our understanding is that TIFs seem to work best in the United States because this is a jurisdiction where local authorities have access to sales taxes.

Nevertheless, economic theory tells us that, in the long run, an asset's value reflects the income stream derived from ownership. There should be some uplift in property value that corresponds

with an increase in economic activity. To that extent the TIF model provides an incentive to undertake growth expenditure even where tax is based on property value.

As we've seen though value uplift does not necessarily mean an increase in rates revenue. In its report, Using Land for Housing, the Commission noted that some types of development project do not in themselves guarantee additional rates revenue. As the Commission notes:

"Rates are calculated in a top-down method; with a council first agreeing a LTP and a financial impact statement, then allocating the financial burden between ratepayers (as noted in s 23 of the Local Government (Rating) Act 2002). Where an infrastructure investment increases the rateable value of newly serviced land, this only causes the total rating burden to be reallocated among ratepayers. No new revenue is actually generated unless a council also increases its forecast expenditure. Nor is it possible to forecast what the rate take from a new development will be in the future, because it depends entirely on the council's expenditure plan (which is subject to change)."[81]

It can be difficult to establish a 'nexus' between the development, any uplift in value and the TIF. On one level there is what might be termed the 'but for' argument – that is to say 'but for' the TIF would the development or project have occurred. On a second level. lies the difficulty in establishing that the value uplift has been generated by the project, programme etc. It is for this reason that TIFs have been abandoned in some jurisdictions due to the frequency of litigation around TIFs.

Benefits and costs, particular economic benefits and costs are not constrained by lines on a map. They 'spill over', and where benefits do spill over, the taxpayers in the TIF district effectively subsidise the free-riding of those outside the district. This is particularly true of a project such as a sports stadium, where a TIF district might be drawn to reflect the businesses in the area immediately around a stadium, not recognising the increase in business those near regional transport nodes might receive.

As a funding mechanism a TIF is worthy of further consideration but would work best in a situation where they were not set in the same top down manner as rates.

Recommendation: Tax increment financing

14. That the Commission further consider the process through which Tax Increment Financing would operate, including the relationship with the current methodology for setting rates.

Betterment schemes tend to lack durability

A typical betterment charge is set as a fixed percentage of the increase in value in the affected area or areas. Our understanding is there is typically no great 'science' in determining the lift in values – its measured as the increase in value between the assessment point and the point at which the work started or the policy shift occurred.

The charge is generally assessed on sale or development of the land in question. Charging at the point of the work or decision is sometimes referred to as charging on 'paper profits'. More importantly in the New Zealand context, charging at this point can create a demand for cash at a time when developers may be struggling with cash flows.

81 Productivity Commission (2015), *Using Land for Housing* – draft report, page 190.

New Zealand has previously and unsuccessfully experimented with betterment charging. The *Town and Country Planning Act 1926* permitted the establishment of betterment funds in each local authority funded by a charge of half any demonstrated value uplift. It appears no betterment levy was ever collected due to difficulties in the calculation and collection of such a levy, and the provision was repealed in 1953.[82]

Betterment is a taxation mechanism that might seem elegant and intuitively attractive. However, a betterment mechanism that works in the long-term has generally proved elusive.

The major practical impediment to betterment charging lies in the difficulties in separating increases in property value that have arisen from a policy shift or project from other factors. For example, the lack of agility in many planning systems tends to mean that intentions are well signposted, and there is often some form of speculation in advance of a scheme. It is difficult for a betterment system to recognise and reflect market trends and extraneous factors – in the Auckland context something as unrelated as a change in a school zone might potentially have an impact. It appears no robust formulae or rationale has been developed for decomposing the components of changes in value and the tax ends based on 'before' and 'after' values in their entirety.

All of the schemes we have been able to locate have assessed the tax at the point where property is sold, otherwise alienated, or developed.[83] The existence of what then becomes a tax on this activity might then provide, at the margin, some disincentive to sale or development. Britain and Colombia in particular provide evidence that this holding of land from development or sale is a real phenomenon.[84] This is sometimes presented as an argument in favour of betterment tax as a means of discouraging speculative development. It is unlikely that these incentives would sit well in the current policy environment where housing supply is a major policy and political concern.

A third issue with betterment tax lies in the setting of the rate of 'tax'. We have not come across any attempts to apply good taxation principles to the selection of a rate of tax. The rates appear very much set according to the values and mindset of the tax-setter. For example, the scheme introduced in Britain in 1947 had the rate set at 100 percent, reflecting the then Government's intent to 'nationalise development'. On the other hand, much of the discussion around the abortive Planning Gain Scheme centred on a rate around 20 percent, seen as 'a modest rate to capture a portion of the land value uplift created by the planning process'.[85] That is to say that there is little transparency in the setting and collection of the tax.

Critics of betterment tax note that there is an implicit value judgement that any gain in value for a private property owner is something that should be accessible to the state. On occasion the converse can happen, that is to say that a land use decision or infrastructure project can depress property values. For example, the opponents of developments that will be used for so-called affordable housing are often motivated by perception property values will fall. Unsurprisingly, few public officials are ever keen on compensating property owners for what is sometimes referred to as 'worsenment'.

Overseas experience with betterment charging has not been encouraging. The United Kingdom has introduced betterment tax four times since 1909 (1909, 1947, 1965 and 1975).[86] With the exception of the first, none of these schemes has lasted longer than ten years. The tax has varied from 100 percent (described as a nationalisation of all development-created value) to 40 percent. The Australian Capital Territory has a form of betterment charging in place, which appears to generate only a marginal amount of revenue. Columbia and Ecuador also have implemented

82 Productivity Commission (2015) *A History of Town Planning*, a research note, page 6
83 While in theory a betterment tax could be set based on movements in property values regardless of sale or development, if the increment is dramatic (as it may be in the case of land opened for development) that is likely to create major equity issues.
84 The British experience has been attributed in part to the short lives of many of the previous incarnations of betterment charging.
85 UK Government (2007), *Planning Gain Supplement*, para 1.9.
86 A 2006 review recommended that a betterment levy be introduced. As of the time of writing this *Planning Gain Supplement* has been supplanted by a Community Infrastructure Levy (a mechanism similar to what we would recognise as a development contribution).

betterment charging – in the former case since 1921. Our review suggests that recovery of betterment through planning changes appears more common than for what might be termed public expenditures.

Recommendation: Betterment charging

15. That the Commission abandon further work on betterment charging.

Environmental taxes

"Another way of ensuring appropriate incentives to protect against environmental degradation is to green the tax system (i.e. tax polluting activities more). New Zealand has room for improvement in this domain: environment-related taxes have fallen more since 2002 as a share of GDP than in the rest of the OECD . . . ."[87]

The Commission's terms of reference ask it to complement and receive relevant work being undertaken in other areas. SOLGM considers that changes to the funding and financing arrangements for local government cannot realistically be considered in isolation from the work of the Tax Review Group.

We would like to draw the Commission's attention to the interim conclusions that the Working Group has drawn around environmental taxation and the so-called corrective taxes. The Working Group has concluded that *"there is significant scope for the tax system to play a greater role on sustaining and enhancing New Zealand's natural capital."*[88]

We particularly draw the Commission's attention to the Working Group's draft framework for taxing negative environmental externalities and the draft principles for taxing natural resource use.[89]

These taxes will have, and are designed to have, significant impacts on personal behaviour and on the macroeconomy. These effects are relevant considerations when developing transitional arrangements, but are not reasons to avoid introducing taxes in themselves.

The Tax Working Group suggests that the taxation of water abstraction and water pollution are both medium term options. We agree that an introduction of taxing of water (and other resource use for that matter) will also require the addressing of Māori rights and concerns.

There would be significant technical challenges measuring pollution and ascribing causation. While we agree that some degree of local variation would send the best pricing signals, we suspect that too fine-grained an approach would only get public acceptance with a robust evidence base.

In the short-medium term it may be that some form of assessed levy on permits to discharge to water under the *Resource Management Act* would provide at least some signal of the cost of environmental degradation. Local authorities administer the consenting system and therefore hold much of the information necessary to administer such a levy. It would be important to set the levy at such a level that sends a realistic pricing signal – but not so high to incentivise non-compliance. We would caution against the revenues being regarded as a source of general revenue and suggest that revenues be hypothecated to projects that 'clean-up' pollution or prevent/reduce pollutants entering waterways.

87 OECD (2017), OECD *Economic Surveys: New Zealand*, page 67.
88 Tax Working Group (2018), *Future of Tax: Interim Report*, page 7.
89 Tax Working 2018), *Future of Tax: Interim Report*, pp 63 - 64.

In a similar vein, it's local authorities that issue the permits to take freshwater and have the information necessary to administer any tax or resource rental. Equity would dictate that local authorities would need to meet some charge for abstraction and pollution, and this may be one of the bigger challenges the sector would face.

We concur with the Working Group's views on the short-term potential for expanding the waste disposal levy and that the Emissions Trading Scheme should be strengthened as a first preference to a carbon tax. In the former case hypothecation to projects designed to incentivise reuse or recycling would appear to sit well with the environmental logic underpinning the tax.

We turn now to the taxation of vehicle energy. In practice, taxation of vehicle energy in this country has relied upon taxation of petrol, and diesel vehicles have been charged through road user charges. The reason for the distinction between the two types of energy is that approximately 40 percent of diesel is used "off road".

The key advantage of a vehicle energy tax is that it is extremely difficult to evade (cars need energy to run) and that the price elasticity of demand for fuel is quite low (i.e. demand does not respond much to price).[90] In short, energy tax is currently a cost-effective means of raising revenue.

We deliberately emphasised the word 'currently' in the preceding sentence. Developments in technology – in particular the greater take-up of hybrid technology, increasing fuel efficiency, hydrogen powered vehicles etc will all mean that standards on the existing petroleum-based technology are likely to undermine the demand for petrol in the medium to long-term. Any boosting of fuel taxes will be of short-term benefit and decreasing benefit in the long-term.

Recommendations: Environmental taxes

16. That the Commission recommend further consideration of taxation of water pollution and water extraction.
17. That the Commission recommend further increases in fuel excise and the extension to other forms of vehicular energy.

Climate Change Adaptation Fund

We have previously seen that all climate change adaptation occurs at local level – though there are aspects of national good to this policy problem. The cost implications could dwarf any of the other items we discussed in Part One, yet we do not have a clear sense as yet that central government has undertaken any structured thinking about the funding of climate change adaptation.

New Zealand may not have undertaken the degree of integrated thinking that has occurred elsewhere

We could not help but be struck by the contrast with the European Union, We are advised that under their Multiannual Financial Framework, the Union will ensure that at least 20 percent of the European budget will be climate related by 2020.[91]

90 A 2001 MDL/NZIER report quoted research which found that the price elasticity of petrol consumption was between 0.1 and 0.2 in the short run and 0.3 to 0.6 in the long run. This means that a 10 percent increase in the price of petrol would lead to a reduction in consumption of between 1 percent and 2 percent in the short run, and up to 6 percent in the long-run.

91 This is not to say that we advocate setting what looks almost like a target – we'd rather concentrate on quality of spend, but the commitment of resource to climate-related spend is striking.

The five so-called European Structural and Investment Funds each have 'climate change adaptation, risk prevention and management' as one of 11 cross-cutting themes.[92]

While these things are easy to say – we don't get the same sense that New Zealand has invested the same level of thinking about climate change adaptation into the design of some of the contestable pools of funding the New Zealand government administers. For example, while some of the priority areas (particularly food and beverage and forestry mention 'environmental sustainability') climate change adaptation is mentioned nowhere in the statement of objectives for the Provincial Growth Fund.

A climate change adaptation fund is a vital step to supporting a 'future-proof' local government funding and financing system

SOLGM has been supporting the work that Boston and Lawrence have been doing through Victoria University.[93] They have concluded that there are *"no (current) mechanisms to ensure that the costs of climate change adaptation are shared equitably, whether intergenerationally or intragenerationally"*.[94]

It appears that the funding of climate change adaptation is every bit the public policy challenge that is posed by say, the funding of national superannuation and the other costs of an aging population. There is the same need to incentivise good decision-making (for example, ensuring there is no new development in areas that are at risk of sea level rise, coastal erosion etc) while taking account of the decisions that have gone before.

Boston and Lawrence suggest (and we agree) that any future climate change adaptation mechanisms would be designed in such a way as to minimise the long-run costs of adaptation and would include incentives to avoid activity that would add to these costs.

They go further and suggest that funding should be consistent with *"widely accepted principles of social equity (or distributive justice)"*. [95] This includes the so-called fair opportunity requirement – that people should not be unduly disadvantaged for those things that they have little control over. In addition, like should be treated alike, that includes consideration of need, ability to pay, and responsibility.

There is a strong economic case to support some degree of pre-funding the costs of adaptation. First, the notion of exacerbator pays suggests that those responsible for harm or damage (in this case the emission of gases that have created climate change) should contribute towards the cost of adaptation.

Second, with the right design, the mechanism for contribution could be used to send at least some signal about the cost of activities that gave rise to climate change or avoid locating in areas at risk etc. Further tax on automotive energy and/or other fossil fuel use would be one example. "Pricing" in this way should avoid sending disincentives for actions that support adaptation or internalise some cost, for example funding by a levy on insurance would be as good an example what not to do.

Funds raised in this way might then be invested for future use once the heavy-duty adaptation expense begins – in much the same way as the present day New Zealand Superannuation Fund operates.

92 To take an example the European Regional Development Funds has as one of its objectives: promoting climate change adaptation, risk prevention and management by:
(a) supporting investment for adaptation to climate change, including ecosystem-based approaches;
(b) promoting investment to address specific risks, ensuring disaster resilience and developing disaster management systems.

93 For example, see Boston and Lawrence (2017), *The Case for New Climate Change Adaptation Funding instruments*.

94 Boston and Lawrence (2018), 'Funding Climate Change Adaptation – The Case for a New Policy Framework', *Policy Quarterly*, May 2018, page 43.

95 Boston and Lawrence (2018), Funding Climate Change Adaptation – The Case for a New Policy Framework, Policy Quarterly, May 2018, page 44.

We would add a third principle, that any adaptation funding should be applied only to those options that offer the best long-term benefits. For example, a defensive option, such as a sea-wall that offers protection for say thirty years, might well be of lower long-term benefit than retreat, The design of funding arrangements should not encourage short-termism.

Many, but not all of the areas that are at the forefront of adaptations issues are in areas that have particularly limited capacity to raise revenue. South Dunedin is one of New Zealand's poorest metropolitan communities, and many parts of the Eastern Bay of Plenty, Northland and the West Coast of the South Island fall into the category. This may reduce local authority capacity to build up their own funds in advance.

We accept that this conversation cannot only be a conversation about funding. If the sector expects central government to play a role in funding adaptation decisions, then it will need to let central government into the conversation around planning and investment in those areas.

Recommendation: Climate Change Adaptation Fund

18. That the Commission recommend priority be given to establishing a Climate Change Adaptation Fund.

Taxation of tourism

We have seen the demands that tourism can create both in demands for specific facilities in out of the way areas, and in demands for "big city" levels of service in centres where tourists stay the night.

Local authorities have investigated means of sheeting home an appropriate share of costs to those businesses that are deemed to benefit from tourism, or to finance schemes promoting tourism – primarily commercial accommodation. We have seen local authorities introduce target commercial accommodation through applications of a differential on a general rate, or more recently the introduction of targeted rates on commercial accommodation.

These rates have typically been controversial in the lead up to and at introduction – Auckland came close to being sued for introducing its targeted rate. Typical objections include that taxation based on the value and other characteristics of land is not suited to rating an occupancy based business (though what other business is rated based on the level of unused capacity!). More cogently it argued that not all providers pay the tax (this has become especially prevalent with activity such as Airbnb).

From time to time the notion of a 'bed tax' is brought forward. These are often, though not always levied as an additional flat amount on or a percentage of, the nightly tariff (or less frequently the total bill). On first glance it appears that the appropriate means for collecting such a tax may already exist – for example through the same mechanisms as GST at national level. What is not present is an existing mechanism for distributing the tax revenues.

In 2018 the Government announced it was introducing an International Visitor and Tourism levy of $35 on visitors entering New Zealand for less than twelve months (other than Australians and most Pacific Island Forum countries).[96] The levy will be collected through visa applications and the new Electronic Travel Authority and is expected to collect around $80 million per annum. The levy will be hypothecated to tourism and conservation.

96 Davis (2018), Visitor levy to raise $80 million to future proof tourism, media release at https://www.beehive.govt.nz/release/visitor-levy-raise-80-million-future-proof-tourism, last retrieved on 13 October 2018.

That is welcome though we suspect that the market could well have borne a higher charge without undue damage.[97]

Local Government New Zealand has this to say about tourist tax

"The concept of a local tax to fund disproportionate costs borne by a specific community has been tested and proven in Stewart Island. The conditions which need to be satisfied for efficient local selective tax can be isolated and described so that other communities which meet those requirements might have the option to introduce their own tax. These conditions might involve a reasonably close relationship between the expenditure being taxed and the activity being funded (eg visitors and tourist related infrastructure), a tax design which involves little distortion to regional economic activity by minimising the incentives to shift production across regions simply because of the local tax, and comparatively low compliance and enforcement costs (eg Stewart Island can collect the levy at points of entry)."[98]

We agree. The Stewart Island levy required local legislation[99] and took almost two years to pass through Parliament (it was a *Private Members' Bill*).

We consider that powers to set coercive taxes should not be issued holus-bolus. However, the process could be streamlined by passing a single enabling *Act* that would allow access to these forms of taxes with approval of:

- the Minister of Local Government (and/or the Minister of Finance), or
- the Governor-General in Executive Council.

Some basics features or safeguards that might be part of an enabling *Act* include the following:

- a set of conditions or criteria for a local tax including any limitations (e.g. central government would probably wish to reserve income tax and consumption taxes for itself)
- an identifiable or measurable unit of liability, including a means for verifying or appealing measurement of a unit of liability
- appropriate linkages to the accountability framework of the *Local Government Act* (especially the long-term/annual plan and the funding impact statement provisions).

Recommendations: Taxation of tourism

19. That the Commission recommend an increase in the Visitor Levy.
20. That the Commission recommend local taxation for tourist related purposes subject to the appropriate basis and accountability.

Pricing powers

Local authorities make far more use of pricing mechanisms than is commonly supposed. The last release of Local Authority Financial Statistics (for the year ended June 2017) showed that local government received around 17 percent of its operating income from sales of goods and services.[100]

97 On the day we wrote this part of the paper $35 was between 1.4 and 1.8 percent of a return airfare between Auckland and Shanghai. When accommodation and other spending is factored in, we have to say that concerns this will disincentivise tourism seem somewhat melodramatic.
98 Local Government New Zealand (2015), *Local Government Funding Review – 10 Point Plan: Incentivising Economic Growth and Strong Local Communities*, page 15.
99 *The Southland District Council (Stewart Island/ Rakiura Visitor Levy) Empowering Act. 2012* (the *Act*) was passed into law on 26 March 2012.
100 We understand that sales in this context includes revenue from water metering levied under the authority of the *Rating Act*. In classifying water by meter Statistics New Zealand has relied on the economic form of the transaction, rather than the legal authority for the tax.

At around $1.1 billion this amount is broadly equivalent with the level of operating grants that local authorities receive from central government. Trend data from the Local Authority Financial Statistics suggests that the share that 'sales' income takes of operating income has declined over time (though admittedly this is more to do with the rate of growth in other sources of income).

The value of pricing to local authorities is two-fold. First, and most obviously, it is a tool for raising revenue. Potentially of more importance moving forward is the economic signal that a properly set price can send.

Effective management of infrastructure usually involves an element of managing user demand for the service, either to make optimum use of an existing asset, or to manage the use of scarce resource. Local authorities can and do use a variety of non-pricing strategies – for example rationing or other physical limits on use (such as prohibiting sprinkler use during dry periods).

Road tolling

We have seen that developments in fuel efficiency are likely to undermine the viability of fuel excise as a funding source for land transport (and for any other purpose by the way).

It is therefore quite disappointing that New Zealand has only recently begun to explore the potential of road-tolling. At the time of writing there are three toll roads in operation in New Zealand: the Northern Gateway Toll Road north of Auckland, the Tauranga Eastern Link Toll Road and the Takitimu Drive Toll Road. Historic use of tolling has been confined almost exclusively to bridges and has been characterised by excessive levels of political interference.[101]

Section 46 of the *Land Transport Management Act 2003* provides for road-tolling schemes on issuance of an order-in-council by the Governor-General (on the recommendation of the Minister of Transport). This means that road-controlling authorities can only toll a road if central government agrees to the proposal to toll.

The Minister is expressly authorised to decline proposals, amend proposals or place any condition on a proposal – as the Minister sees fit. Tolling is only permitted on new roads – and is expressly prohibited in most other circumstances.[102] For example, a local authority could not toll to fund a capacity extension on an existing road. The Minister must be satisfied there is a feasible alternate route to the tolled road.

This is obviously a fairly stringent set of criteria to meet, coming on top of public consultation. It is no surprise that no local authority has ever managed to complete the process, and indeed we aren't aware of any local authority outside of Wellington that has ever submitted one. Given that these schemes can easily become politicised even after operating for some years they can be a fiscal risk.

Tolling of new and existing roads could be a useful intermediate step to full road pricing as both a revenue raising tool and a demand management tool. The main barrier to tolling an existing road is public acceptance – concerns that the road user has "already paid for the road" do not recognise either the full-life cycle of the roading asset or the full economic costs of road use. The recent Review of International Road Pricing Schemes, Previous Reports and Technologies undertaken for the Ministry of Transport concluded that clarity on use of revenues is critical to public acceptance.[103] A publicly accepted plan will overcome many of the public objections to tolling.

101 For example, the toll on Tauranga Harbour Bridge was removed as part of negotiations following the 2005 general election as the one of the conditions of a confidence and supply

102 *Section 46* of the *Land Transport Management Act* allows tolling of an existing road only where the Minister is satisfied that the existing road or part is located near, and is physically or operationally integral to, the new road in respect of which the tolling revenue will be applied

103 D'Artganan Consulting (2018), *Review of International Road Pricing Schemes, Previous Reports and Technologies* – review undertaken for the Ministry of Transport, page 131.

Even with road pricing some variants of tolling might be worth retaining. For example, cordon-tolling of the form used in cities such as London might be a better option in cities with only a limited number of access routes (such as Wellington).

Recommendations: Road tolling

21. That local authorities be permitted to toll any road – new or existing.
22. That such tolling not be subject to Ministerial approval.

Road pricing

Much of the local government sector has long supported the introduction of road pricing both as a means of generating funding for the land transport network and, just as importantly, as a demand management tool.[104] As long ago as 1993 the then Local Government Association and representatives from the Automobile Association and the Road Transport Forum supported the introduction of 24/7 road pricing.

Even at that time there was a recognition that this would rely on having the technology in place as the necessary pricing signals would see charging dependent on time of day, location and the nature of the vehicle.

The technology is available, and has been tested and proven reliable for road pricing purposes in overseas jurisdictions and also as the basis for tolling on the three toll roads in this country. The D'Artagnan Consulting report concluded that *"Automatic Number Plate Recognition (ANPR) technology has lowered in cost and become much more reliable"*.[105] Further it notes that Global Navigation Satellite System (GNSS) technology has matured to the point where it is being trialled for use to administer a time, location and distance based pricing in Singapore from 2020 and potentially in London soon after that.

We agree that the introduction of road pricing will raise very challenging policy questions. For example, at the present time it appears road pricing is only under serious consideration as a tool for managing demand in Auckland, but is there a case for introducing the tool elsewhere either on a limited basis (for example, Wellington and Tauranga) or more generally. What does it imply for existing governance, funding and ownership arrangements for New Zealand's roads and public transport networks?

Policy work on these matters has gone around in circles. Road pricing and tolling sat on policy agendas twenty years ago.[106] are aware of at least four published studies on road pricing in the last 15 years, not counting the recent Review described earlier which has been commissioned to inform ongoing policy work on Auckland Transport.

We accept that true 24/7 road pricing will have, and is intended to have a major impact on the microeconomy of road transport and through that impacts on modal choice and land use (both urban and rural). We were surprised to learn recently that the New Zealand Transport Agency is contemplating yet another study on the impact of road pricing.

It seems that the introduction of road pricing has been subject to a case of paralysis by analysis. It is time to remove this policy 'blockage' and bring this work to a conclusion.

104 See for example. Local Government New Zealand et al (1993) *Land Transport Funding A Submission to Government*.
105 D'Artganan Consulting (2018), page 99.
106 The original New Zealand Land Transport Pricing Study was a four-report study that was released over the course of 1996.

Recommendation: Road pricing

23. That central government give priority to the introduction of 24/7 road pricing.

Pricing mechanisms under the *Rating Act*

Rating legislation has long empowered local authorities to set a price for one particular service. *Section 19* of the current legislation empowers the setting of a rate based on the quantity of water provided by a local authority – commonly called either water metering or (less frequently) volumetric charging.[107] Metering is far from universal, but it is not uncommon for local authorities where metering is in to receive as much as one dollar in five from this source.

There is a substantial body of international evidence that shows the effect that the introduction of pricing can have on demand, especially for water. To take a local example, Kāpiti Coast District Council was able to encourage the fixing of an estimated 97 percent of leaks and reduce overall consumption by 26 percent in the year after moving to metering.

Our recollection is that the inclusion of this mechanism was one of the very last policy decisions taken and that, among others, the Treasury opposed inclusion of a pricing power in what is a taxation statute. Consequently, there are a few technical and procedural inconsistencies and barriers to water metering in each of the *Rating Act* and the *Local Government Act*. To take some examples:

- the *Rating Act* is silent on what happens where there are multiple properties and a single outflow. There is no provision to apportion rates on these grounds
- tampering with water meters is not treated as a criminal offence (indeed at least one anti-metering campaigner made her name by showing people how to disconnect meters).

Some local authorities have expressed an interest in borrowing from overseas jurisdictions and volumetrically charging for sewage disposal. Developments in technology now mean that it is possible for a provider to:

- charge using a proxy – the commonly used benchmark in overseas jurisdictions is to charge for sewage on the basis of 80 percent of winter water use
- charge by metering the volume of wastewater disposed directly.

Such a charge would act as a further incentive to customers to install water saving technology such dual-flush toilets or consider onsite treatment and disposal solutions. It's also consistent with the notion of managing drinking water and wastewater as an integrated whole.

Recommendation: Wastewater charging

24. That local authorities be permitted to charge on a volumetric basis for wastewater disposal, where the local authority considers it economic to do so.

107 Local authorities also have the option of entering into supply contracts under the authority of *section 12* of the *Local Government Act*. While some local authorities use this tool for exceptionally large volume individual customers, we are aware of only one local authority that has ever tried to use this provision on a large scale (the former Rodney District Council). It seems local authorities value the availability of the enforcement tools under the *Rating Act* to a higher degree than the flexibility to charge.

Fee-setting in statute

"Cost recovery reduces the call on taxation revenue to fund regulators, and so decreases the cost of tax administration and compliance".[108]

The Commission's report on the *Regulatory Institutions and Practices* provides an elegant summary of the case for full cost recovery in that:

- building the full cost of production (including the administrative costs of regulation into the cost of regulatory services encourages users of regulatory services to adjust their use of services in line with their willingness to pay for them
- the responses of those who pay for regulatory services to "buy" those services signals to regulators which services are in demand
- appropriately structured charges can motivate regulators to look for better ways to provide services
- those who have to pay for regulatory services may be motivated to monitor regulator's performance so as to constrain their cost and
- cost recovery reduces the call on taxation revenue to fund regulators, and so decreases the cost of tax administration and compliance..[109]

One of the core roles of a local authority is as a provider of local regulation. The Commission's own report on Local Government Regulation identified some 40 different statutes that empowered local authorities to exercise a regulatory power, plus secondary legislation, and the occasional *Local Act*. The efficient and effective performance of regulatory functions is one of the key aspects that local communities use as a barometer of the performance of their local authority.

The Commission has taken an in-depth look at the funding of regulatory activities in central government, its report on local regulation did not subject funding of local regulation to the same depth of scrutiny. The comments that open this section apply equally to those regulatory functions that local government performs on behalf of central government.

Historically, legislation was extremely prescriptive in its approach to fee-setting powers (often to the point of specifying a maximum charge for each particular activity). It is not clear that legislators have access to the right information, or the right incentives to be able to set a price that bears relationship to the cost of a service. This is especially true when the service is delivered by local government as opposed to central government.

There are still some regulatory regimes that operate in this way. The obvious result is that the maxima become dated and over time bear less and less relationship to the cost of the activity. An often-repeated anecdote is that of the official who made a round trip of four hours to inspect an amusement device, for which *clause 11* of the *Amusement Devices Regulations 1978* limited the council to recovering $12.[110]

The following is a list of those regulatory regimes that have this level of prescription:

- *Sale and Supply of Alcohol Act 2012* and *regulations*
- *Amusement Devices Regulations 1978*
- *Heavy Motor Vehicle Regulations*
- Towage fees under the *Land Transport Act 1962* (though we accept that there may be a case these are more in the nature of a fine).

108 Australian Productivity Commission
109 Productivity Commission of New Zealand (2014), *Regulatory Institutions and Practices*, page 332
110 This example was first brought to our attention in 1998, and the amount the council could now recover is still $12 (or around $8 in 2018 dollars).

More recently enacted legislation tends to have more flexible charging powers. However, these powers generally tend to allow for recovery of the cost of processing applications, undertaking inspections and the like. Few, if any, actually allow for recovery of the cost of developing policies yet these can create significant costs even with the amendments made to legislation in 2014. Even fewer treat risk/contingency management costs (such as liability insurance) as a reasonable cost.

If pricing powers do not allow for recovery of full costs, then local authorities are left with no alternative other than to fund from the general rate. Some have sought to defend this on the grounds that regulation protects the public and thus there is a public good element to these services which local taxation should meet. On the other hand, judgements about the public and private good elements of services are made through the processes under the *Local Government Act 2002* and statutory prohibitions of this type ride roughshod over these disciplines.

Recommendation: Fee setting by statute

25. That all remaining instances of statute setting maximum fees be replaced with powers to charge actual and reasonable cost.

PART THREE: OTHER ISSUES AND OPTIONS

One of the first points we made in this paper was that the issues and challenges involved in future-proofing the local government funding system go further than sources of funding. In this part of the paper we consider issues and options that go beyond the kit of funding tools (although there is some degree of intersection between the two). Specifically, we consider::

- unfunded mandates reform
- affordability in the making of funding policy
- efficiency gains and the incentives to seek them
- the Rates Rebate Scheme
- public education and
- financial governance, decision-making and advice.

Unfunded mandates reform

One of the often repeated claims about local government funding is that unfunded mandates are drivers of cost in the local government sector. An unfunded mandate is a piece of legislation or regulation that imposes a duty or obligation without funding to meet the requirements.

It is true that local authorities have roles and responsibilities under more than (at last count) 160 pieces of legislation (not counting local *Acts*). But many of those are obligations that are imposed across the economy such as the *Health and Safety of Work Act 2015*, the administration of the *Goods and Services Tax Act 1986* etc. Others depend on the policy choices councils make for themselves, such as the *Companies Act 1993* and the formation of corporate forms of CCOs.

It is also fair to say that some of the examples that appear on the sector's list of 'unfunded mandates' actually came from policy ideas promoted by the sector. Examples include:

- the regulation of commercial sex premises (the *Prostitution Reform Act 2003*) – this came from a request from the sector to allow for district plans to set stronger controls on the location of brothels
- local alcohol policies under the *Sale and Supply of Alcohol Act 2012*
- development of class four gaming policies under the *Gaming Act,* and
- the National Environmental Standards for Air Quality – this came from a request from the regional sector for more national direction on air quality.

Nevertheless, there are plenty of real life examples of obligations that have been imposed without funding or with only partial funding. We've already considered the costs involved in ensuring there is a supply of 'shovel-ready' land under the National Policy Statement on Urban Development Capacity. While successive Governments might argue that the Housing Infrastructure Fund is a response, it is targeted towards the needs of the six highest growth councils. In a similar vein there has been no sign as yet of any funding to meet the requirements of the National Policy Statement on Freshwater and the move to making rivers and lakes 'swimmable' (however that's measured and whenever the target date is).[111]

Central government's record of consideration of the cost of such policy initiatives on local government is patchy at best. In the words of the Funding Project Team:

"We have found that the consideration of costs to local government in policy work and regulatory impact statements is often incomplete, or on occasion is not included at all."[112]

111 In fairness we should note that some of the cost imposition here is actually local authorities imposing costs on each other.
112 Joint Central/Local Government Funding Project Team (2005), *Local Government Funding Issues*, page 21.

In the Commission's report on Local Government Regulation you quoted a passage from our submission to the effect that:

". . . much of the debate about the performance of local authorities in their regulatory roles in New Zealand hinges on this accountability disconnect around the design of the regulatory frameworks. The incentives for central government to ensure that the legislated regulatory processes it designs are cost-effective and proportionate, are significantly weakened where it knows that the costs of administering the system will be collected through a fee levied by a local authority or through local rates because it knows that the public will see the local authority as the agency responsible for the level of those costs."[113]

The unfunded mandate debate has been had at one time or another in practically every democratic society. Overseas jurisdictions have taken various approaches to the issue:

- England historically sought to provide full compensation for the cost of additional functions to local government. We understand there were issues as to the robustness of the formula for determining compensation. It also appears that this approach was one of the first casualties of the austerity reforms of the Cameron government
- representatives of Australian federal, state and local government signed an Inter Governmental Agreement to guide Relations Between the States and Territories, the Australian Government and Local Government which contains a clause that provides a non-binding statement that central government should consider the financial implications of devolution are taken into account). It reads:
  "Where the Commonwealth or a State or Territory intends to impose a legislative or regulatory requirement specifically on local government for the provision of a service or function, subject to exceptional circumstances, it shall consult with the relevant peak local government representative body and ensure the financial implications and other impacts for local government are taken into account."
- The United States has a Federal law – the *Unfunded Mandates Reform Act 1995*. Where legislation or regulations contain a rule that could result in expenditure by state or local governments of $100 million or more in any given year, the rule must be accompanied by a statement that includes the legal authority for the rule, a cost-benefit assessment, a description of the macroeconomic effects that the mandate will likely have, and a summary of concerns from the state and local government and how they were addressed.[114] The responsible agency must choose the least-costly option that achieves the objective of the mandate, and must consult with elected officials of state and local governments. A 2015 *Act* – the *Unfunded Mandates and Information Transparency Act,* further requires that the Congressional Budget Office independently cost each such unfunded mandate and compare the cost to the authorised level of funding.[115]

Evidence on the effectiveness of these initiatives is spotty but there are aspects of the *Unfunded Mandates Reform Act* that may go some way to improving the quality of regulation and the funding of local authorities. While this legislation codifies much of what we would expect to see in a regulatory impact statement, the advantage of legislation is that it cannot be set aside if a Minister does not agree with the costing, or rushed because a Minister wants to make an announcement.

113 SOLGM (2012), *Submission to the Productivity Commission to Local Government Regulation*, page 7 quoted in Productivity Commission (2013), *Local Government Regulation*, page 68.
114 Aspects of this appear similar to a regulatory impact statement – we'd give anything to have the statement of our concerns and how they were addressed in.
115 Our understanding is this amendment forms part of the *Congressional Budget Act 1974* – broadly speaking the United States Federal equivalent of the *Public Finance Act*.

Recommendation: Unfunded mandates reform

26. That the Commission consider an unfunded mandates statute modelled on the American basis, including an obligation to engage with the local government sector in identifying costs and options.

Affordability

Affordability is often confused with other aspects of funding system design

"(Our) rates are unpopular rather than unaffordable"

– Anonymous regional council policy manager[116]

Affordability is one of the regular staples of talkback radio (and not just with rates but electricity, public transport fares etc). But what does it really mean?

For an individual ratepayer, rates are affordable if that ratepayer is able to meet the financial impost of the rates they have been assessed and have enough income to meet critical personal or household needs. As we shall see later, this means that affordability is not just about the level of rates, but also about the level of income (and wealth or at least those components of wealth that are related to income).

We suspect that often the general public refer to rates being unaffordable when what they are really referring to is their willingness to pay (that is to say 'don't want to pay' as opposed to 'can't pay'). The quote that opens this section is a good example of the distinction between the two.

Ratepayer willingness to pay is also likely to reflect on their perceptions of the value for money that they get from rates, this in turn is closely linked to ratepayer perceptions of levels of service. Some sectors of the community (such as the farming community) also hold views that they receive little for the rates they pay and that they effectively subsidise the benefits that others receive. The Independent Inquiry into Rates suggested that many local authorities could do more to counter perceptions that rates are poor value for money.

Affordability has two dimensions – which we term the global (i.e. system or local authority wide affordability issues) or the distributional (affordability for individuals or groups). Previous inquiries have concluded that affordability issues, where they exist, are confined to groups within the community.

The Independent Inquiry into Rates drew on analysis from BERL that (unsurprisingly) concluded that the groups most likely to experience an affordability issue were:

- single person households
- one parent households
- households where the primary source of income is superannuation, or
- were in the lowest 40 percent of incomes.

BERL estimated that between 7 and 14 percent of New Zealand households fitted into those categories.[117]

116 Quoted in Joint Central/Local Government Funding Project Team (2005), *Local Government Funding Issues – Report of the Joint Central/Local Government Funding Project Team,* page 12. Note: at the time this manager spoke the rates on the median value residential property in his region came to around $300.

117 Independent Inquiry into Rates (2007), *Funding Local Government*, page 188. This estimate assumed that rates would be unaffordable in an individual household if they were higher than 5 percent of the household's gross income.

Local authorities have a variety of policy choices available to them to respond to, or take account of, affordability issues. These include the following:

- *reducing or deferring planned expenditure*
- *using rating tools to adjust the incidence of rates* – a local authority could use differential rates to shift the incidence of rates from one group of ratepayers to another perceived as having a higher ability to pay. Equally a local authority might decrease its use of fixed rates to shift the incidence from lower valued to higher valued properties
- *adopt a remission or postponement policy to provide assistance to low income ratepayers* – local authorities are able to remit (forego payment of) or postpone (defer payment of rates until a specified time or specified circumstance) rates on any rating unit, in any amount, for any reason. In 2016 SOLGM reviewed a sample of 28 rates remission and postponement policies and found that most of the postponement policies in place allowed for postponement in cases of extreme financial hardship. On the other hand, remission is used more to simplify the administration of the rating system, ameliorate the impact of sudden change in incidence or support cultural, recreational, heritage or charitable endeavours[118]
- *additional promotion and proactive referral of low income ratepayers to the Rates Rebate Scheme*.

There is no explicit statutory requirement to consider affordability when making funding policy

Sections 101, 102 and *103* set the statutory framework by which local authorities make funding policy. *Section 101* (especially *section 101(3))* sets out the 'rules' around process and *sections 102* and *103* set out the rules around engagement and the documentation of the results of *section 101* analysis.

Section 101(3) is often referred to as the 'two step funding process'. At step one of the process local authorities identify each of their activities and must consider the following for each activity:

"(i) the community outcomes to which the activity primarily contributes; and
(ii) the distribution of benefits between the community as a whole, any identifiable part of the community, and individuals; and
(iii) the period in or over which those benefits are expected to occur; and
(iv) the extent to which the actions or inaction of particular individuals or a group contribute to the need to undertake the activity; and
(v) the costs and benefits, including consequences for transparency and accountability, of funding the activity distinctly from other activities".

Having completed the analysis for each activity, at the second step the local authority then aggregates the results of the step one analysis and considers the impact of the results of the step one analysis on the social, economic, environmental and cultural wellbeing of the community. It is after this step that local authorities make a final selection of funding tool.

It therefore can be seen that there is no direct reference to affordability or even ability to pay in *section 101(3)* – and nor is there any reference to willingness to pay come to that. Those local authorities that claim to have considered affordability in the design of their funding systems tend to rely on the reference to the four wellbeings in their policies without explaining why. There's a clear link between affordability and economic wellbeing. The link to the other wellbeings is less direct (and more arguable), essentially local authorities provide services for their contribution to wellbeing which is reduced if some members of the community are precluded from accessing a service or facility on affordability grounds.

118 SOLGM (2016), What's Up With Waiver Policies – A Presentation to the 2016 SOLGM Funding and Rating Forum

Affordability seems to be a factor in most policies, often it's not clear how

SOLGM has recently completed a review of a random sample of twenty of the 2018 crop of revenue and financing policies. We found a reference or references to affordability in 13 of these policies.

There were a group of local authorities that claimed they applied affordability as one of a set of underpinning principles. The remainder wove it into their step two analysis. We concluded that there were few local authorities that documented their step two analysis clearly. For example, one local authority stated that they considered the impact on the four wellbeings including the affordability of services.

On the other hand, this passage from the Tararua District Council's policy is a neat summation of the drivers and some of the choices:

"Alongside the increasing levels of service are the affordability issues that many residents face. These affordability issues occur across the urban, rural and commercial / industrial sectors and are often driven by the many factors outside council control or knowledge. These factors include employment, climate, world demand for farm products and family situations. On average the urban sector has more of an affordability issue, with lower median household incomes when compared to the rural sector. Many of the infrastructure upgrade costs will be borne by urban residents only. Council is fully aware of these affordability issues and is focusing on designing infrastructure that balances function, longevity and affordability. Council is also actively working to gain external grant funding where possible and practical."[119]

Likewise Bay of Plenty Regional Council noted (with a focus more on affordability for groups):

"Council has applied the above preferences for the use of funding sources to each activity in its Funding Needs Analysis.

Following section 101(3)(a) assessment council has considered its funding mix against the overall impact of any allocation of liability for revenue needs on the community as required by section 101(3)(b).

The Long Term Plan Financial Principle which guides council in assessing the funding mix is Principle 2: council achieves the right mix to fund its activities, and keeps rates, fees and charges, affordable, fair and equitable.

Examples of how the council has balanced its approach to funding its activities include:

- *aligning the Policy on Remission and Postponement of Rates with the local authorities. This ensures the council's ratepayers have access to the same affordability tools, such as considering financial hardship, options for reverse equity of properties*
- *consistent application of criteria for rates on Māori freehold land and remissions of rates for social/cultural purposes such as recreational facilities, as they do for their local authority rates seeking alternative funding sources outside the region where wider interests exist (for example, Central Government funding for contaminated site remediation)*
- *using general funds and reserves to spread the costs of services throughout the region to reduce the burden on small communities of interest, and when council services proved wider and indirect benefits across different elements of well-being*
- *considering inter-generational equity when funding depreciation and capital projects so current and future ratepayers pay their fair share."*[120]

119 Tararua District Council (2018), Long-Term Plan 2018 -28, page 175.
120 Bay of Plenty Regional Council (2018), Long Term Plan 2018 – 2028, page 160.

While these policy choices are, for the most part, things that many other local authorities make, drawing them together in a single place represents a clear statement that councils are considering affordability and the steps they take as a result.

There is a case for local authorities to make their consideration of affordability and any steps they have taken more explicit. Incorporating affordability as one of the considerations in the step *101(3*) process would encourage local authorities to be more transparent. We consider that affordability is something that should be considered 'globally' and therefore is more appropriately addressed in the second step of the process. This is not to say that a local authority would not identify concerns with the affordability of an individual service – but that judgements that a user charge should be trimmed here, or increased there, have global impacts (for example on the general rate).

This is not a case for a mandatory definition of affordability, or a statutorily set approach to assessing affordability. As with the other matters listed in *s101(3)* these are policy judgements for elected members to make based on advice. SOLGM has commissioned PwC to provide some advice on an analytical framework that councils could use to assess affordability and expects to release this around March.

Recommendation: Affordability

27. That the funding policy process set down in *section 101(3)* of the *Local Government Act 1974* be amended to require explicit consideration of affordability. This would most probably fit in the second step of the process.

Efficiency gains

"You never let a serious crisis go to waste. And what I mean by that it's an opportunity to do things you think you could not do before."

– Rahm Emanuel, Mayor of Chicago

We expect that the Commission will receive submissions suggesting that the terms of reference for the review are misguided, and that all could be solved if only local government were more efficient. In this section we look at the incentives towards efficiency that our local authorities face, and on the lessons our sector might apply from the burning platform that the austerity reforms created for English councils.

Efficiency and effectiveness are woven through the fabric of the *Local Government Act 2002*

Local authorities use public money and therefore must be accountable for its effective and efficient use. Incentives to effectiveness and efficiency are woven through the *Act* as a whole, probably inextricably.

In fact, the effectiveness of local government is one of the headline concepts in the very purpose of the *Act* itself. *Section 3* of the *Act* establishes that: *"The purpose of this Act is to provide for democratic and effective local government that recognises the diversity of New Zealand communities. . . "*

Effectiveness and efficiency are also woven into the principles of *section 14* of the *Act*. The principles form the very bedrock of the expected behaviours of a local authority in that local authorities must act in accordance with the principles.

These include:

- *s14(1)(a)(i)* – a local authority should give effect to its identified priorities and desired outcomes in an ***efficient and effective manner . . .*** *(emphasis supplied)*
- *s14(1)(e)* – a local authority should actively seek to collaborate and co-operate with other local authorities and bodies to improve the ***effectiveness and efficiency*** with which it achieves its identified priorities and desired outcomes (emphasis supplied)
- *s14(1)(f)* – a local authority should undertake any commercial transactions in accordance with sound business practices (we doubt anyone would disagree that this encapsulates a drive to effectiveness and efficiency)
- *s14(1)(g)* – a local authority should ensure prudent stewardship and the efficient and effective use of its resources in the interests of its district or region, including by planning ***effectively*** for the future management of its assets.

Section 17A requires local authorities to periodically assess the cost-effectiveness of their methods of delivery for their good quality local infrastructure, local public services and local regulation. In effect this is a directive to regularly consider the cost-effectiveness of different options (in-house, contracted out, council-controlled organisation etc).

And last, but not least, ensuring effectiveness and efficiency are part of the responsibilities of the chief executive. *Section 42* is the statutory part of the job description for a chief executive and establishes he or she is responsible for "ensuring the effective and efficient management of the activities of the local authority".

Most local authorities are involved in various shared capability initiatives. For example, South Taranaki District Council told us:

"For some time now, local governments have recognised the benefits of sharing services with other councils. Such arrangements can result in significant cost savings and efficiencies in service delivery or buying power, avoid duplication and make the best use of scarce resources or technical skills. Close collaboration and sharing of expertise and experience among councils on core business ensures that councils learn from each other and continuously improve the delivery of services, making their operations more effective and efficient. The four councils in Taranaki already have a considerable degree of shared services and collaboration between them (approximately 50 examples) and further cooperation is being explored."

Some commentators appear fixated on shared services, and formal structures as the only means of sharing capability. In fact, there are a wide range of options available short of forming a CCO. To take some examples:

- Palmerston North City Council runs the after-hours call centre for approximately 30 councils (at last count)
- the Waikato councils have used the centre of excellence model – where one council takes the lead responsibility for delivery of a certain activity or group
- councils offer consent processing for others either in times of emergency or peak demand, for example Hastings assisted Christchurch with consent processing after the earthquake events.

Legislating processes for finding efficiencies is self-defeating

The 2012 report of the Local Government Efficiency Taskforce noted that the incentives to local government sharing innovation and collaborating were weak. It further commented that the *Local Government Act "appears to contain no provisions which would help build or encourage a local government culture in which innovation was an important or integral element".*[121]

121 Local Government Efficiency Taskforce (2012), *Report of the Local Government Efficiency Taskforce*, page 86.

The Government of the day responded to this by inserting a statutory requirement for local authorities to periodically review the cost-effectiveness of current arrangements for meeting the needs of communities within its district or region for good-quality local infrastructure, local public services, and performance of regulatory functions. Local authorities were given three years to complete their first set of what are commonly referred to as *section 17A* reviews.

Section 17A is quite detailed in its specification of when a review must be carried out, and what options must be considered in such a review. The review includes consideration of the governance, funding and delivery of each option. Reviews have a maximum shelf-life of six years, and must be conducted whenever a contract comes within two years of expiry or whenever there is a significant change to levels of service. Local authorities need not conduct reviews where they are satisfied the cost of undertaking a review outweighs the benefits, or where a service delivery arrangement cannot reasonably be changed within two years.

Looking at the specified list of options in *section 17A(4)* of the *Act* it becomes readily apparent that local authorities cannot undertake a sensible *17A* review in isolation from other local authorities. It would seem somewhat odd to a ratepayer in say, Kawerau, if their council and Whakatane District are each working separately on a review that includes options for their working together, especially if they come to different conclusions! Doing a *section 17A* review properly is therefore a major undertaking.

We do not disagree that local authorities should be looking for opportunities to collaborate for the effective achievement outcomes, and that local authorities should look for efficiencies. As the experiences cited below demonstrate its healthy to challenge the status quo occasionally. We have seen that the notion of efficiency and effectiveness is ingrained elsewhere in the *Act*.

In legislating a requirement to review services and specifying the detail of when and what options to consider, Parliament has unwittingly encouraged reviews that are perfunctory or take a tick-box approach. A genuine investigation of these opportunities can be time and resource intensive, especially where opportunities might lie in cross council collaboration and there is more than one authorising environment operating.

There have been few changes from the first round of *section 17A* reviews, though we are aware that some useful discussions have taken place, and that further work on opportunities is ongoing in some areas. We are doubtful that these required a legislative 'spur'.

We are far from certain that legislating for efficiency is any more successful than legislating to control inflation. It may be that stripping out the prescriptive detail from *section 17A* around options that must be considered and how, and allowing local authorities to look for opportunities in a sensible fashion and limiting themselves to those options that are sensible might generate a better overall result.

New Zealand local governance is not inefficient but could learn more from overseas experience

"Local government has been engaged in what is starting to feel like a phoney war against its budget cuts. Municipal budget reductions have been deep and remorseless, but so far most services in most parts of the country have held up remarkably well. Central government support for councils will fall something like 40 percent in real terms by the end of this parliament, yet only a third of the public has noticed the difference.

On the other hand the cuts have acted as a spur to innovation."[122]

122 Parker (2014), *The Council and the Common – Local Government in 2020*, report commissioned for the New Local Government Network, page 5.

The quote that opens this discussion is from a think piece that an English local government focussed think-tank commissioned in 2014. Through its English sister organisation, SOLACE, SOLGM has invested some energy investigating what their sector has learned as it responded to the so-called austerity reforms, and the extent to which this learning is transferable to New Zealand.

It's worth remembering that New Zealand has historically had quite a strong culture of 'contracting out' – especially since the transport reforms of 1989 established the competitive procurement procedure. It is a rare local authority that undertakes a capital project using in-house resources, likewise maintenance is also not undertaken in-house any more. Few local authorities do anything more than professional services (such as design and investigation) in-house. That is to say that the overriding majority of asset related activity is 'market-tested'.

Nevertheless, our reports, *Austerity: Creating Service Resilience*[123] and *Through The Looking Glass*[124] have identified strategies that could be applied or where the application of the strategy could be extended.

Economic growth and regeneration

The English rating system incentivises councils to undertake coordinated investments in promoting economic growth in their localities. Coordinated investment in housing, especially social housing has been one consistent theme. The so-called devolution deals have created both a set of coordinated investments in infrastructure and the regional coordination and support the necessary infrastructure to undertake them.

Demunicipalisation and Reductions in Levels of Service

"In leisure, as in so many areas, the role of the local authority is shifting from being a provider of even a commissioner of services, into a partner which subsidises and facilitates social businesses."[125]

Another common theme from the English literature has been what is referred to as demunicipalisation, which Parker refers to as "effectively withdrawing from some areas of service provision". In short, the term is a euphemism for reducing levels of service. Spending on the arts, cultural and community facilities and environmental services have been particularly affected. Some of the strategies used that fall under this heading include:

- *community based budgeting* – where a community is allocated a notional budget and then the elected members work with local people to decide what stays and what goes. For example, a council might decide to reduce the frequency of mowing of council parks in favour of retaining or adding to the library budget
- *transferral to arms-length structures or to the community* – English councils have transferred services such as libraries and parks into structures such as not for profit trusts, some local parks have been handed back to the community with provision of an absolute minimal level of service
- *co-production* - our own report, *Austerity Creating Resilience,* refers to co-production as a process in which a community or individuals are involved with delivering the outcomes of a service. In effect the council moves from being solely an organisation that provides services to the community to an organisation that starts to produce services alongside the community[126]
- *and, yes, cuts in funding for some activities* and cuts of levels of service – leisure centres, parks and other community infrastructure, have been particularly hit.

123 Available at https://www.solgm.org.nz/Attachment?Action=Download&Attachment_id=966
124 Available at https://12233-console.memberconnex.com/Attachment?Action=Download&Attachment_id=1515
125 Parker (2014), page 15.
126 SOLGM (2015), *Austerity: Creating Service Resilience*, page 11.

There are currently some 252 council-controlled organisations in existence in New Zealand. CCOs, and their forerunners the Local Authority Trading Enterprises had been in existence since 1989 (and in some cases well before that). CCOs take a variety of organisational forms but most operate either as a corporate or a trust. They cover a variety of interests from road contracting to libraries to health services to maintaining various parks and reserves.

Most local authorities have ownership or purchase interests in one or more of these, it would however be a stretch to suggest demunicipalisation has been anything other than piecemeal. In Through the Looking Glass we concluded that *"New Zealand local authorities have not been forced to look at devolving activities and assets to communities or simply ceasing activities"*.[127]

In truth, while local authorities regularly trim budgets to fit within a fiscal envelope actual deliberate cuts in levels of service are much less frequent. As we've seen, expectations in the core infrastructural area are increasing and dragging levels of service with them.

There are a few instances of community based budgeting of the form described above. The processes for funding and accountability of the Auckland Local Boards probably represent the closest parallel in New Zealand. The Boards and the Governing Body of Auckland Council agree on an allocation of funding to each board, and within the parameters of an agreement that specifies matters for the Governing Body to determine, and what are local matters, it is left to the boards and local communities to determine levels of service and funding.

Digitisation

"We're looking at closing the call centre completely and moving to assisted digital support. The call centre won't be an option in the future. We want to keep people away from human voices and hands."[128]

English local authorities are primarily providers of services to people. There has been heavy investment in:

- digitisation of service delivery (redesigning services to automate processes and enable customers to access services from websites and self-service technologies) and
- investment in data analytics as a tool for focussing investment in the areas that will be most effective for the community.

New Zealand local authorities are generally more focussed on services to property or the provision of public goods such as environmental regulation. There has been considerable investment in digitising services in regulatory areas (for example, the winner of SOLGM's 2015 Excellence Award was Selwyn District Council's online end-to-end building consent system), some community services (such a library services), and of course, payments.

Through the Looking Glass suggested that the scale of New Zealand local authorities may well mitigate against the investment in skills, software, hardware and systems that enable them to achieve higher levels of digital maturity. Collaboration in shared IT services is an opportunity meriting further work by NZ local authorities. SOLGM is one of the partners in the recently established Local Government Digital partnership that will progress a more joined up and strategic approach to investment in ICT and the development of a sector digital strategy.

The use of data analytics as a tool for extracting meaning from big datasets is very much in infancy in New Zealand.

127 SOLGM (2018), *Through the Looking Glass*, page 49.
128 An unidentified English local authority Chief Executive quoted on Parker (2014), page 15.

The SOLGM/ALGIM report, *Fit for the Digital Future*, concluded that some of the uses of big data and data analytics could include:

- *transport planning* – big data can add richness to a council's understanding of how, when and where people are travelling
- *regulatory services* – big data is a tool for detecting correlation and could be used for predictive analysis
- *asset management* – big data can marry asset condition and location data to gain an understanding of which areas need the investment, when. Information from resource and building consents might also be linked to asset information to enhance demand forecasts.[129]

Demand management

The digitisation discussion highlighted one means by which English local authorities are managing demand for their services. English local authorities are also investing more in early intervention as a demand management tool, that is to say, detecting and acting to resolve concerns before they become larger ones. For example, using truancy as an indicator of later social issues or concerns. While local authorities in this country are not generally large providers of services to people, demand management is a tool that is of general value in infrastructure management. The early intervention approach may have some value in the regulatory area.

Concluding Comments: Efficiencies

It is however worth noting that the 'Commons' report also comments that:

"It is hard to avoid feeling a little depressed by the findings set out herein. There is simply no way that local government can reach 2018, let alone 2020, while still delivering the full range and quality of services currently on offer". [130]

In short, do not place much credence in claims that all local government in New Zealand need do is adopt the same strategies as those in England. There are lessons to be learned, but they are a small part of a much bigger picture. Many are in use in New Zealand, though the application of these strategies have been applied piecemeal and not with the same spur that English local authorities have had.

Recommendations: Efficiency gains

28. That the Commission note that efficiency and effectiveness are ingrained through the *Local Government Act 2002*.

29. That *section 17A* of the *Local Government Act 2002* be amended to require councils to review cost-effectiveness of services without the specification of options.

129 SOLGM and ALGIM (2015), *Fit for the Digital Future*, pp 81-82.
130 Parker (2014), page 6.

Rates Rebates Scheme

Affordability is not just a question of the level of rates and charges, it's also about the level of rates and charges relative to the income available to meet them, and the other calls on that income. We've become aware that budget advisory services typically advise penurious ratepayers to pay the rates last (as the penalties are typically lower than say a loan from a payday loan specialist and it takes at least 12 months to get a rating sale going).

The Rates Rebates Scheme is a central government scheme authorised under the *Rates Rebate Act 1974* to provide assistance to low income residential ratepayers who wish to stay in their homes through providing assistance with property rates. The bulk of the administration is undertaken by local authorities, the applicant submits their paperwork (we'll come back to that shortly) to the local authority who processes it and then sends to the Department of Internal Affairs for final approval.

Depending on the household income and the number of dependents ratepayers can receive a rebate of (in the current year) up to $630 towards their rates. Many, but not all, recipients of the scheme are superannuitants. In the most recent year for which statistics are available (2016/17) almost 98,000 claimants were paid a combined total of some $54.6 million (an average rebate of some $558.[131]

In 11 of the last 12 financial years, the Department has successfully put up a budget bid for funding to adjust the maximum rebate and the abatement thresholds in line with movements in the CPI. The one year there was no adjustment coincided with a movement in the CPI of less than 0.5 percent.

Before embarking on a further discussion of the scheme and the issues with the scheme we would like to make it clear that the assistance that the scheme provides makes a real difference for nearly 100,000 ratepayers. However, we also note that even 100,000 ratepayers represents a take-up of less than one third of the estimated number of eligible households.[132]

The scheme, and particularly the legislation, may no longer reflect life in New Zealand

The *Act* is now quite dated. As a statute it is starting to take on something of a patched look that will make it increasingly difficult to interpret and apply. Some of the provisions appear outdated. For example, *section 5(2)* of the *Act* prohibits regional councils from processing applications for the scheme. The five regional councils that collect their own rates, must have any applications processed by their constituent territorials.

In recent years we've become increasingly aware that the *Act* may no longer reflect modern tenure arrangements, and that this creates a perception of anomalies and 'unfairness' For example, local authorities commonly encounter ratepayer objection and resistance to the notion that people who occupy a property on a 'life interest' arrangement and who pay rates under this arrangement cannot qualify for the scheme as they are not owners.

To take another recent example, late in 2017 Parliament enacted the *Rates Rebates (Residents of Retirement Villages) Amendment Act*. This *Act* fixed a perceived anomaly whereby residents of retirement villages that hold licences to occupy pay the rates through their licensing fees but are not the ratepayer for the purpose of the *Rating Act* and cannot claim a rates rebate. At the time when the principal *Act* was passed, there were not many retirement villages in existence. This type of arrangement and tenure grew as populations changed.

131 Source: Rates Rebates Statistics, downloaded from www.localcouncils.govt.nz/lgip.nsf/Files/Excel/$file/rates_rebates_statistics.xlsx, data last retrieved on 25 November 2018. As an aside, the fact that the average rebate paid is 90 percent of the legal maximum seems to suggest the scheme criteria are relatively effective at targeting the low income. .

132 The (approximately) 98,000 recipients of the scheme is still is around 4,000 lower than the peak take-up of the scheme (which we understand occurred in 1977).

Soon after the *Amendment Act* was passed, we learned of a variant on the 'typical' retirement village scenario that necessitated a 'patch on a patch' – which is being progressed through the *Local Government Regulatory Systems Bill* currently before Parliament.

Similar issues occur in the case of owners of papakāinga, who are required to pay rates but cannot apply for a rates rebate because of the multiple occupation of communally owned land. We understand that this issue may be covered in upcoming reforms to the rating of Māori land.

And finally, as we write this paper, the Government is considering proposals to change the way that so-called three waters infrastructure is delivered. Some of the possible models include the removal of these services from local government and their placement at 'arm's length' from political control. One of the more likely options is the establishment of CCOs (such as Watercare) which will be expected to fund a large degree of their costs internally (for example by metering water). One of the lessons from the Auckland reorganisation is that CCO charges are not legally regarded as rates and are therefore excluded from the coverage of the Rates Rebate Scheme. In other words, a metered water charge levied under the *Rating Act* and payable to a council is covered by the scheme, the same charge levied by a CCO is not.

The scheme is not well attuned to developments in technology

The *Rates Rebate Act* was first enacted in 1973. It therefore reflects the analogue realities of its time and is almost entirely paper-based. One council, Tauranga City Council, advised us that the cost to administer the *Rates Rebate Act* is around $200,000 per annum, representing many millions of ratepayer dollars over all New Zealand local authorities. Central government agencies such as DIA and Inland Revenue also resource the process.

We've seen that online/digital delivery of services is an expectation of the local communities. We are aware that the Service Innovation Lab (DIA), Tauranga City Council and other stakeholders have successfully piloted an online pilot rates rebates application. The collaborative project was to make the process simpler for customers, reduce paperwork, remove duplicate handling, build verifiable audit capability, reduce administration costs and create greater public awareness of the rates rebate scheme.

We understand the pilot scheme for online applications in Tauranga has been a resounding success, and the councils intend to extend the pilot scheme to all 55,000 rating units in August and September 2018. Other councils, including Auckland Council, are commencing pilot trials this year.

The true cost includes the time, and transportation that our citizen's use to come into council offices in our town or city centres. The single biggest negative comment from citizens who applied for a rates rebate on line was that the requirement to come into council to verify a signature was nonsensical. This mirrors the comments from applicants, many of whom are elderly, who need to travel into council offices to make a declaration witnessed by a council officer.

The enactment of the *Contract and Commercial Law Act 2017* sets out a standard for the electronic signature and verification of the signature. The online identification tool RealMe also provides another option for online verification of identity.

In short there are many opportunities to move the scheme away from paper-based processes.

Local authorities may not be the most appropriate front desk for the scheme

In the period 2005-06 the Government undertook a major restoration of the levels of assistance and the levels at which assistance abates. Unsurprisingly this had the support of the sector as a whole, both LGNZ and several of its member local authorities having lobbied for the change. Many of these representations overlooked that one of the consequences of the restoration of the volume of applications to the scheme.

The scheme has elements of 'handling' by local authorities and the Department i.e.

(i) local authorities act as the front desk for the scheme receiving the application forms
(ii) forms are transferred to DIA which undertakes further processing and makes the final decision on eligibility with further back office processing
(iii) DIA then transfers funds back to the local authority to credit against the successful applicants' rates accounts.

The *Report of the Independent Inquiry into Rates* reported that:

"A key issue raised in public meetings, in meetings with the local government sector, and in submissions was the appropriateness of requiring applications to be made to the territorial authority. Submissions from territorial authorities generally supported the rates rebate scheme with some indicating that they were happy to continue to administer the scheme. However, a majority of councils, as well as submitters, considered that the Ministry of Social Development's Work and Income Service should administer the scheme because that agency holds personal and household income data. In addition, it was felt that the confidentiality of the applicant's income data was more likely to be protected through that or a similar central government agency. An alternative agency suggested by some submitters was the Inland Revenue Department. This could better present the scheme as a rebate designed to adjust the incidence of tax rather than a form of social welfare payment."[133]

When combined with the paper-based process it seems to us that there is ample opportunity to improve the way the scheme is administered for the benefit of the applicants, the taxpayer, and (of course) local authorities.

The role of the scheme is becoming increasingly blurred

The recent changes to bring certain residents in retirement villages into the coverage of the scheme serve to highlight some blurring of the role of the scheme. The Independent Inquiry were quite correct to say that the scheme was designed to adjust the incidence of a tax. The retirement villages amendment and the above discussion about CCO charges each move the scheme away from that purpose. In the case of the retirement villages the scheme is now being used as a partial subsidy for rent, in the case of CCO charges the advocates of this change appear to be advocating for a subsidy to living costs. Effectively, in each case the scheme would be providing a form of income support. Yet groups such as Greypower would view the scheme as an entitlement as opposed to income support.

It may be time to take a first principles look at the purpose and operation of the Rates Rebate Scheme.

133 Independent Inquiry into Rates (2007), pp 200-201.

Recommendation: Rates Rebates Scheme

30. That the Rates Rebate Scheme receive a first principles review including purpose and delivery.

Public education

". . . every exaction of money for an act is a discouragement to the extent of the payment required, but that which in its immediacy is a discouragement may be part of an encouragement when seen in its organic connection with the whole. Taxes are what we pay for civilized society. . . ."

– Oliver Wendell Holmes, American jurist

Rates are a highly visible means of taxation

Rates operate in quite a different manner from the taxes that central government relies on. PAYE is deducted at source – the only time most income earners see their tax bill is if they need to make an adjustment and/or file a return. In a similar vein GST is simply factored into the price on the shop shelf – with a legal presumption that if in doubt the price is GST inclusive. Despite the generally higher quantum central government taxes tend to go unnoticed.

By contrast the rating system is, and was designed to be, highly visible.[134] A local authority cannot set its rates until it has completed a process of public consultation on either a long-term plan or an annual plan which includes a detailed list of the rates and the basis on which they are set and some models of the impact of the rating proposals.[135] A local authority must issue an assessment that tells each ratepayer how much they will pay and at high level what these will fund.[136] And finally, the local authority must issue a rates invoice for each instalment.

Factors that seem to most influence perceptions of rates include:

- how much they pay and whether they can afford to pay (ratepayers measure this relative to their income rather than relative to their assets)
- comparisons with other local authorities and with rates the ratepayer might be liable for on other property
- media reports on council spending and on the general operation of the council (perceptions of 'waste' tend to dominate, and 'disputes' around the council table tend to influence ratepayer judgements)
- the method of calculation (this seems to be a more prevalent factor in rural communities and amongst the business sector).

Better understanding of local government would help counteract some of the negative perceptions about local authority finance

Throughout this paper we've met and countered some of the common misconceptions about local government rates and local government finance in general. For example, that if an individual ratepayer's property value goes up, there's an automatic increase in rates (the answer – depends on the movement relative to the rest of the district), or that local government is heavily indebted (not true of the sector as a whole though is true a small number are approaching covenanted limits).

134 *Section 3* of the *Rating Act* establishes that two of the three purposes of the *Rating Act* are 'ensuring that rates are set in accordance with decisions that are made in a transparent and consultative manner' and *'providing for processes and information to enable ratepayers to identify and understand their liability for rates'*.

135 By comparison central government issues a budget policy statement – and while this gets referred to the Finance and Expenditure Select Committee it would be stretching a point to call this consultation.

136 It is the issuance of the assessment that gives rise to the legal liability to pay rates.

Local government processes are increasingly complex – and it sometimes seems that every attempt to 'streamline' processes seems to make them more so.

A survey undertaken after the 2013 local elections revealed that one in five of the non-voters considered that voting would make no difference to them and one in seven considered local government is not relevant to them. When coupled with the estimated million eligible voters that did not vote in the general election, it is apparent that a significant proportion of voters have 'disengaged' from government. We suggest that this is, or should be, a matter of equal concern for both central and local government, the two spheres of government need to work together.

This points to a need for better voter education. Although (somewhat dated) international research indicates that New Zealand students had a higher than average degree of 'civic literacy', we suspect that this is largely a legacy of the high degree of civic awareness of previous generations. There is no subject called civics in the New Zealand curriculum, and while the civic ethos is woven into subjects such as social studies, very little of this has any local government theme. An understanding of local government, including finance needs to be inculcated at an early age. We are aware that the incumbent Minister of Local Government wants to increase the civics component of the curriculum – we agree with these sentiments.

Previous reviews of local government finance have also pointed to a paucity of information about local government and local government finance in places such as the Department of Internal Affairs website. The Shand Inquiry concluded that::

"The quantity and quality of the information provided about local government on the DIA website could be enhanced. A 2004 guide to local government provides useful guidance about the LGA 2002 and more general civic education encompassing the role of local government. This type of guide needs to be produced and updated ***on a regular basis and made widely available to community groups. Audio-visual materials also need to be produced*** *(emphasis supplied)."*[137]

Recommendation: Public education

31. That the Department of Internal Affairs, SOLGM and Local Government New Zealand work to enhance the breadth and availability of the public resources on local government.

Financial governance, decision-making and advice

"The role of a governing body is to test and challenge the advice it is given to satisfy itself that the proposed decisions are appropriate . . . If the information provided is overly technical, is incomplete, or simply cannot be easily understood, elected members are entitled to question it and ask for more. It is better for a member to "ask the dumb question" and ensure that they understand what they are deciding than to assume that the technical advice must be appropriate"[138]

The above quote is from an inquiry into what was a systemic failure of governance and management across many of the areas that are the focus of the inquiry. The way in which local authorities go about making decisions and the advice that they receive influences what investments are made, when.

Evidence based decision making is critical

Local authorities own and manage substantial infrastructural facilities and networks. Making the right asset management decisions can have significant financial consequences.

137 Independent Inquiry Into Rates (2007), *Local Government Funding,* page 258.
138 Office of the Auditor-General (2013), *Inquiry into the Mangawhai Community Wastewater Scheme,* page 277.

The Auditor-General has highlighted the importance of evidence-based decision-making in asset management. We concur that decisions that manage risk and make trade-offs between financial and non-financial consequences must be based on robust data on asset condition and performance.

There are sector leaders in practice. For example, Wellington City Council has invested heavily in upgrading its collection of data, the systems to manage this data, and the analytical tools to extract meaning from the mass of data. Having accurate information on the actual condition of assets rather than relying on asset 'birth dates' and statistical models enables this local authority to better manage its maintenance and renewal programmes. The council has married asset and economic data to get an evidence-based picture of current and future affordability.

An analysis of the 2015-45 infrastructure strategies showed that almost all local authorities needed to improve their understanding of the condition of their networks. Eighteen of the 30 councils disclosed plans to improve their asset information. Our (partially completed) review of 2018-48 strategies leaves us in some doubt as to whether these plans have been acted upon.

Investments in information do not come cheap and can be difficult to justify in the short-term. This is another area where investments in better guidance and support for the sector would pay dividends.

Most local authorities would also benefit by applying the same evidence based decision-making to their community infrastructure. Last year Auckland Council won the (SOLGM run) Minister of Local Government's award for innovation in asset management for its Community Facilities Asset Management Excellence programme for doing precisely that.

Training and resources are available but take-up and retention is spotty

There is a wealth of resources and training opportunities available for local authorities. Through its There is a wealth of resources and training opportunities available for local authorities. Through its training arm Equip, LGNZ offers courses in financial governance, decision-making and other disciplines relevant to financial management, as well as a number of other topics of relevance to governing bodies.

Elected members come from all walks of life. While some have a small-business background (including farming) many do not. And the differences between local government finance and a small business are stark – accrual accounting, different standards, a completely different regulatory frameworks, and finance based largely on a tax. All would benefit from knowledge of the basics of financial governance.

Each triennium Equip invests considerable resource in running induction courses for newly elected members – including one specifically aimed at new mayors and regional council chairs. Historically SOLGM participated in the delivery of these courses and based on these experiences we observe that the focus on finance is largely on the rating system, and that there is little on the basics of financial governance.

Elected members who want to sit on *RMA* hearing panels need to complete the so-called Making Good Decisions programme developed by the Ministry for the Environment. A greater understanding of basic financial governance would appear to be useful to all elected members, when exercising literally any governance duty, and that extent may be a high priority for investment.

The issue is that, understandably, there is a reluctance on the part of many elected members to travel. In part there is the personal inconvenience of leaving the community, but still more there is the scrutiny that comes with disclosure of travel expenses. It seems to us that a course in basic financial governance could be delivered online, or that such a course be developed in

such a way that local authority staff deliver it (which of necessity would include an element of 'training the trainers').

Turning to our own offerings SOLGM has suites of guidance available on the long-term plan, financial management and a general introductory course for managers and staff new to local government (which has recently been converted to an online e-learning resource).[139] We also offer annual networking and practice-sharing events targeted at Finance Managers and staff, and an event that is specifically targeted at staff with a policy or practice interest in funding (mostly rates).

Our observation is that training and professional development can often be the 'first thing to go' when finances are tight (and let's face it, it's not often that they aren't). Yet not keeping up with practice or with evolving issues is the classic false economy.

Recommendation: Financial governance

32. That the Department of Internal Affairs, SOLGM and Local Government New Zealand consider how to most cost-effectively inculcate basic financial governance skills and knowledge as part of elected member induction.

139 We have attached copies of the so-called Dollars and Sense and Jigsaw guides on long-term planning; our guide on doing a rating review, and the Knowhow Guide to the Rating Act (the latter was jointly developed with LGNZ). The Commission's inquiry into Local Government Regulation reviewed Your Side of the Deal, the companion guidance on performance management concluding that it was clear and practical. These guides are written to reflect the same philosophy of learning.

SOLGM

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