



16 JUL 2018

Mr Murray Sherwin  
Chair  
Productivity Commission  
PO Box 8036  
The Terrace  
WELLINGTON 6143

Dear Murray

## **TERMS OF REFERENCE FOR AN INQUIRY INTO LOCAL GOVERNMENT FUNDING AND FINANCING**

I am pleased to refer to you the terms of reference for a Productivity Commission inquiry into *Local Government Funding and Financing*.

In the context of a decade after the *Shand* inquiry, and in light of rates increases, limits on borrowing and increased expenditure demands, particularly for infrastructure, the Government has selected this inquiry topic to examine and report on local government funding and financing arrangements.

I wish you all the best as you commence this inquiry and look forward to your results.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'Grant Robertson'.

Hon Grant Robertson  
**Minister of Finance**

## **Terms of Reference: New Zealand Productivity Commission Inquiry into Local Government Funding and Financing**

Issued by the Minister of Finance and the Minister for Local Government (the “referring Ministers”). Pursuant to sections 9 and 11 of the New Zealand Productivity Commission Act 2010, we hereby request that the New Zealand Productivity Commission (“the Commission”) undertake an inquiry into local government funding and financing.

### **Context**

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In 2007, the results of the Local Government Rates Inquiry (the *Shand* Inquiry) were reported to the Government. Local Government cost pressures have grown significantly since the *Shand* Inquiry, and local authority rates and payments increases have outpaced increases in the local government cost index.

Local Government plays important roles in New Zealand society. These place-shaping roles enhance and promote local community wellbeing across physical and financial, social, human and environmental capitals. In pursuit of these wellbeing outcomes, Local Government provides essential services, including transport, water and flood protection services, social and community infrastructure services, refuse collection, local planning, regulatory services that assist with public safety, health, environmental protection, biosecurity and economic development and a range of other essential services.

Local Government makes a considerable direct impact on the economy. In June 2016, councils owned \$112 billion worth of fixed assets, employed over 25,000 full-time equivalent staff and had annual operating expenditure of \$9.3 billion and operating income of \$8.9 billion.

The costs and pressures facing local government have increased in recent years, though the circumstances of individual councils vary (e.g. urban and rural communities face differing challenges). Local authority rates increases have outpaced increases in other indices measuring average costs and incomes. In particular, local authority rates and payments increases have significantly outpaced increases in the consumer price index and the independently prepared local government costs index.

Local authorities are capital-intensive businesses. Expenditure on fixed assets has grown significantly in recent years and demand for ongoing capital expenditure is unabated or increasing due to the development, maintenance and replacement of the infrastructure required to support New Zealand’s rapidly growing population (including international visitors) and support economic growth.

As a whole, local authority debt has grown steadily since 2006. Some high growth councils are experiencing constraints in their ability to finance further infrastructure investment because they are coming close to covenanted debt limits. At the same time, some local authorities take on very little debt at all.

Major factors that are influencing local authority costs include:

- for fast-growing areas, the need for local authorities to increase the supply of development capacity to address declining housing affordability
- maintaining services in areas with declining populations

- requirements for higher performance, including potentially from fresh water, wastewater, stormwater and flood protection systems to meet environmental and public health standards
- costs of adapting communities and infrastructure to mitigate risks and hazards associated with climate change
- supporting regional development (e.g. growing demand pressures from the tourism industry which may be disproportionate to the number of local residents)
- the need to replace existing infrastructure coming to the end of its useful life.

This mix of factors – rates increases, limits on borrowing, and increased expenditure demands, particularly for infrastructure – creates the need for an independent inquiry into cost pressures, decision making and affordability. Following an objective inquiry into these issues, the Commission is requested to provide an assessment and recommendations of current and alternative funding and financing options for local authorities to maintain and deliver services to their communities into the future.

### **Scope and aims:**

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In light of the pressures discussed above, and in the context of a decade after the conclusion of the Shand Inquiry, the Government has selected this inquiry topic to examine and report on local government funding and financing arrangements.

Where shortcomings in the current system are identified, the inquiry is to examine options and approaches for improving the system of local authority funding and financing.

### **Approach to the inquiry**

The Inquiry should:

- Have regard to previous reports, inquiries and reviews, but should also look to bring new and innovative thinking to these issues.
- Complement and receive existing work, (e.g. three waters review, and the Urban Growth Agenda) rather than duplicating it.
- Consult with key interest groups and affected parties including (but not limited to) ratepayer organisations, local business and community groups.
- Work closely with Local Government New Zealand, the Local Government Funding Agency, the New Zealand Society of Local Government Managers and the wider local government sector and relevant central government agencies to ensure its findings provide practical ways to improve the funding and financing of local authorities.

## Scope

The inquiry would examine the adequacy and efficiency of the existing local government funding and financing framework. Specifically, the inquiry will investigate:

### *Cost pressures*

- The factors (including the mix of services and investment) that drive local authority costs now and in the foreseeable future. This is to include an investigation of the drivers of cost and price escalation, in particular:

Whether this is a result of policy, and/or regulatory settings.

- The role of growth/decline in population (including visitors and other temporary residents).
  - The impacts of Treaty settlement arrangements and costs of climate change on local authorities.
- In addition, the Commission should have regard to current frameworks for capital expenditure decision making, including cost-benefit analysis, incentives and oversight of decision making.

### *Funding and Financing models*

- The ability of the current funding and financing model to deliver on community expectations and local authority obligations, now and into the future.
- Rates affordability now and into the future.
- Options for new local authority funding and financing tools to serve demand for investment and services.
- Appraise both current and new or improved approaches considering suitable principles including efficiency, equity, affordability and effectiveness.
- How the transition to any new funding and financing models could be managed.

### *Regulatory system*

- Any constitutional and regulatory issues that may underpin new project financing entities with broader funding powers.
- Whether changes are needed to the regulatory arrangements overseeing local authority funding and financing.

## **Out of scope**

The Government considers that some aspects of local government finance have been well canvassed and further inquiry into them would not assist in achieving sustainable local government financing. Therefore, the following matters are out of scope of the inquiry:

- The particular mechanisms for rating of Maori freehold land and Crown land.
- The valuation system and practices.
- Substantial privatisation.

The Inquiry is not to make recommendations that would directly affect representation or boundary arrangements for Councils.

## **Report and Recommendations**

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The report should build on previous relevant inquiries undertaken by the Productivity Commission, and use the Shand Inquiry report as context.

The final report should provide findings and recommendations directed at central and local government regarding how to improve funding and financing arrangements.

## **Consultation**

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The Commission should engage with a broad range of stakeholders, including industry and non-governmental groups, Iwi, and the public.

## **Timeframe**

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The Commission should present the final report to referring Ministers by 30 November 2019.