Porirua Economic Development Group
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Pauatahanui
PORIRUA 5381

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Mr Steven Bailey
New Zealand Productivity Commission
Level 15
Fujitsu Tower
141 The Terrace
Wellington 6011

Dear Steven,

Submission on Local Government funding and financing

Introduction

The Porirua Economic Development Group (PEDG) comprises current and former company directors and councillors, a former Government Minister, chief executives, bankers, chartered accountants and economists with an ongoing interest in and the effect of local government on Porirua residents and businesses.

Established in 2011, PEDG has made submissions on Porirua City Council (PCC) annual and long-term plans. We encourage and seek:

- Council operations that comply with principles specified in governing legislation;
- councillors making high-quality decisions and associated allocation of scarce resources through a balanced budget process;
- a focus on essential services, such as core infrastructure, rather than on non-essential services
- limiting the annual increase in rates to manageable levels for all sectors of the community, ideally through productivity gains, but also adjusting service levels accordingly.

We designed terms of reference for and encouraged PCC to employ professional consultants (Grant Thornton), to undertake a Review of Efficiency and Effectiveness within PCC during 2013. The Council took little effective action despite the review discovering up to $6 million potential OPEX savings.

Despite making multiple submissions to PCC over the past seven years, we have failed to get traction. The Council and its officers seem totally uninterested in:

- improving the quality of decision-making;
- living within limited financial means and adjusting service levels accordingly;
- the delivery of any form of efficiency gain.

Context and Background

Notwithstanding your Issues Paper showing that PCC per capita rates increases were, on average, below 2% per annum between 1996 and 2017, we have found that in more recent years actual average residential rates increased as follows[1]:

Porirua Rates increases:		
Year	**Rates inc.**	**Cumulative**
2007-08	3.70%	3.70%
2008-09	4.40%	8.10%
2009-10	2.00%	10.10%
2010-11*	7.10%	17.20%
2011-12	5.20%	22.40%
2012-13	3.00%	25.40%
2013-14	2.70%	28.10%
2014-15	3.90%	32.00%
2015-16	5.03%	37.03%
2016-17	3.30%	40.33%
2018-2019	4.98%	45.31%
*includes effect of GST - actual = 5.7%		

This represents an average increase of 4.12% per annum over the 11 years and the current Long-Term Plan 2018-38 has locked in an expectation of a further 4.98% per annum for the following four years.

During this same period, CPI rose 20.2% and wages inflation was 31.2% (both inclusive of the GST increase in 2010/11).[2]

In summary, the rates increases materially outstrip increases in inflation and wages. This is particularly hard on the sectors of the community that are dependent upon fixed incomes. We suspect that similar patterns may be evidenced at other local authorities.

Productivity in Local Government *(relating to questions 18 - 26)*

The examples cited below demonstrated to us that there was little or no understanding of productivity measures at PCC. And we suspect that few (if any) other local authorities have effective productivity performance measures. KPIs are often used to "measure" soft (non-productivity performance related) targets.

We suggest that:

1. **Productivity** cannot be knowingly improved if it can't be effectively measured.
2. **Measurement** is ineffective unless the subject has been defined: both goods and services should be specified.
3. **Service specification:** A service is normally specified in a "service level agreement" (SLA). But currently there are neither SLAs for what is required of local government nor any real or consistent attempt at describing outcomes and outputs for councils.

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[1] Source: Porirua City Council

[2] Source: Reserve Bank of New Zealand inflation calculator: https://www.rbnz.govt.nz/monetary-policy/inflation-calculator

4. **Meaningful and standardised key performance indicators:** KPIs can be developed only when the above issues have been resolved.
5. **Benchmarking** can only be useful if consistent standards are applied to specification, measurement and reporting across all local authorities in New Zealand over time.

We submit that unless and until the above issues have been addressed, no concrete progress can be made towards improving local government productivity.

Example: employee productivity decline at Porirua City Council.

We identified excessive employee cost growth from a base of $9,998,000 in the year ended June 2000 to $24,190,000 in year ended June 2017: a whopping $14,202,000 or 142%.

This compared with the level increases in superannuation payments of $135.22 per week (66%), making rates increasingly and materially less affordable for super-annuitants among others.

Soaring growth in full time equivalent employee numbers (FTEs) over the same period drove the huge increase in employment costs. The greatest increases took place between 2003/04 to 2011/12, and stopped or eased after 2012. PCC failed to answer our FTE questions satisfactorily, but at least excessive growth in costs and numbers moderated. Our argument was, and remains, that employee productivity suffered severely and was never recovered. (A record of these data and correspondence between PEDG and PCC showing how we arrived at our conclusions but failed to get PCC to provide satisfactory answers or to take corrective measures is attached.)

Mission Creep *(related to questions 6, 11, 12 and 13)*

We note that "The inquiry *Terms of Reference do not call for assessment of, or changes to, the current scope and responsibilities of local government"* (page 2). But because decisions on taxes are intensely political, and rates are often seen by voters as an unavoidable hidden cost, central government is incentivised to shift costs/obligations to local government. In terms of what is expected of this sector. The specification in section 11A of the Local Government Act 2002 (as inserted in 2010) of core services to be considered by a local authority in performing its role is far too vague:

> " *…must have particular regard to the contribution that the following core services make to its communities:*
>
> - *network infrastructure;*
> - *public transport services;*
> - *solid waste collection and disposal;*
> - *the avoidance and mitigation of natural hazards; and*
> - *libraries, museums, reserves, and other recreational facilities and community amenities"*

We believe that, without detailed guidance, such a wide scope of services for local authorities to provide has led to "mission creep" whereby local government keeps increasing commitments with insufficient regard for all of the purposes and principles stated in sections 10 and 14 of the Act, including cost and community equity.

For measurement purposes, Table 5.3 in the Issues Paper (quoted below from page 37) provides a superior guide for categories of OPEX:

Table 5.3 Local government operating expenditure categories

Category[1]	Activities included	% of total opex, 2017	% growth, 2009 – 2017 (nominal)
Core infrastructure	Roading, transport, water supply, wastewater, solid waste/refuse	46%	45%
Core services	Environmental protection, property, emergency management, planning and regulation, governance	18%	40%
'Non-core'	Culture, recreation and sport, community development, economic development	17%	35%
Council support	Council support services	16%	48%
Other	Other activities	3%	470%

Source: Stats NZ (2018c).

Notes:

1 Expenditure categories were established subjectively.

Local government operating expenditure (OPEX)
Using table 5.3 as a guide, percentage growth in OPEX clearly illustrates levels of local government costs that cause ratepayers significant financial stress. We suspect that capital expenditure (CAPEX) (which Porirua City Council seems to focus on in its planning) would show similar trends.

Local government capital expenditure (CAPEX)
It is interesting to note that both councillors and officers appear to regard CAPEX as easily funded through debt capital, conveniently overlooking that those loans will be serviced through OPEX as will annual depreciation. They also appear to fail to recognise the financial risks associated with the currently very low interest rates which financial commentators expect to significantly increase in the short to medium term. This has the potential to lead to a vicious upswing in OPEX that appears to be absent from long-term financial planning.

Comparative wage and other inflation measures
Over the same period (8 years from 2009 to 2017), wages in New Zealand increased by 22%; CPI increased by 12.8%; and transport costs by only 5.1%[3]. Accordingly (and in general) rates charged by local government to recover these costs have grown far above wage inflation and therefore beyond fairness or what is reasonable for wage earners and super-annuitants. (Unless the rating base has grown faster than costs, which could be the case in a few locations.)

Household and population growth
This must also be factored into the increased local government costs, but New Zealand population growth has not exceeded 2% p.a. (circa 17% total in 8 years) over the period while household growth has been circa only 1% p.a. (circa 8% total in 8 years)[4].

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[3] Reserve Bank of New Zealand inflation calculator: https://www.rbnz.govt.nz/monetary-policy/inflation-calculator

[4] Statistics New Zealand

Given these statistics (inflation and growth), local government "percentage growth" costs look excessive. (Add either wage inflation *OR* CPI to population *OR* household growth together = something between 17% (minimum) and 39% (maximum) could be expected.)
We believe that there are several aspects of local government that need to be addressed in order to enhance productivity.
We suspect much of the excessive extra costs (exceeding inflation and growth combined) has come from what the military call "mission creep". Whereby the original purpose of local government has been expanded beyond the original "mission" to provide certain basic services to residents. Encouraged by central government (eager to limit its own costs) and some constituents who are happy to receive "free" facilities and services without paying for them.

Restoring Fiscal Order to Local Government

(relates to questions 2,7,8, and 49)

There is a requirement to develop a hierarchy of needs/importance to guide local government, perhaps based on your Table 5.3 above. Given that the Productivity Commission's terms of reference preclude comments on the scope of local government services, then the issue of how each of the services are funded could be addressed in your recommendations. For example

Funding hierarchy:

1. **Core infrastructure:** funded from rates revenue (this can easily be measured and monitored against benchmarks);
2. **Core services:** funded from a mixture of central government (e.g. environmental protection, emergency management), user-pays fees (e.g. planning and regulation), and rates (governance). These are not so easy to measure in detail or monitor against benchmarks;
3. **Non-core services:** funded from user pays (culture, recreation and sport, economic development) or government (community development). These are difficult to measure in detail and/or monitor against benchmarks;
4. **Council support:** funded from rates. These can easily be measured and monitored against benchmarks; and
5. **Other:** funded from user pays and/or central government as appropriate and prohibit the use of ratepayer funds on these activities.

We are convinced that the use of mechanisms, such as user-pays, will bring better quality and focused expenditure where services are not so easily measured.

Sadly, as alluded to above, local government politicians (at least in Porirua) seem to have little understanding of the impact that CAPEX has on operating expenditure OPEX. PCC continues to recklessly invest in non-essential CAPEX: e.g. building a "splash-pad" costing in excess of $1 million, while pleading the need to radically increase rates to support a gradual move towards a balanced budget over several future years.

Measures to improve productivity, funding and financing:

1. Ring-fence and monitor ratepayer funds to ensure councils cannot use them to fund activities not specifically allocated to funding by rates income.
2. Create Service Delivery Agreements for all core infrastructure, core services and council support services so that these can be measured and compared like-for-like across New Zealand.

3. Develop key performance indicators for common use and publication by all local government.

Key performance indicators:

Break all expenditure into fixed and variable. For example, “water supply and wastewater” costs are infrastructure (pipelines) and processing (e.g. treatment, etc.), with

- Infrastructure costs measured as cost per kilometre;
- Processing/treatment measured as cost per litre (or multiples thereof).

  Infrastructure costs are influenced by number of households, whereas treatment costs are impacted by population, making it possible to compare local governments more fairly.

Roading, transport and waste can be addressed in similar ways. (e.g. waste disposal is almost entirely influenced by household numbers rather than population.)

Capital expenditure:

The issue of financing capital expenditure is complex as local government does not generally have access to either new equity capital or retained profits to fund such expenditure. It relies almost entirely on debt capital. There is a real problem as financial commentators are projecting significant rises in interest rates over the next few years. The effect will be that debt servicing costs will increase significantly and, no doubt, be borne by the ratepayer. With rates increases already out of control, such a change could have catastrophic consequences for service levels in many areas.

Theoretically the renewal or enhancement of infrastructure assets could be partially funded through depreciation. However, the Commission has already observed (page 23) that “*there was 28 local authorities whose renewals expenditure was less than 60% of depreciation*” and that “*funds accumulated from depreciation was being spent on other items*”. Unfortunately, the more reckless and short-sighted councillors may see this as a pot-of-gold for non-essential investment.

Perhaps our comments above on Restoring Order to Local Government offer a solution.

Conclusions

PEDG has consistently attempted to influence Porirua City Council to:

- improve financial transparency;
- operate to the letter and spirit of its governing legislation;
- provide ratepayers with better value of money through:
    - improved decision making
    - release of efficiency gains

- guide councillors to undertake their governance role effectively;
- for officers to serve councillors in the manner officials serve central government Ministers; and
- be fair to all members of the rate-paying community.

Sadly, we have been unsuccessful and have concluded that the only way to get value for money for the ratepayers is through central intervention. We are certain that local government is the only major sector of the NZ economy that has not be subject to effective and efficiency reforms over the past 35 years. Looking at the reform of core government from the 1980s, major changes were instituted in terms of what services state sector entities did or didn't provide with tangible evidence of realising better value for money and reducing the associated fiscal impact. Change in the local government sector is long overdue.

The democratic model that underpins local government legislation is fine in theory but does not work in practice. Low voter turnouts and the generally poor quality of candidates at the local elections is indicative of voter apathy, which must be reversed if the current democratic model, as currently embodied in legislation, is to work effectively.

There is a fine line to be drawn between effective central intervention and an undermining of the independence of local government. Nevertheless, we are certain that the future should include the following:

- an effective and independent monitoring regime that carries real sanctions;
- a monitoring body independently owned but with line access to the Minister;
- a differentiation of roles for councillors and officers, with the former centred on governance and the latter on service delivery, albeit within the parameters set by councillors;
- compensation from central government for regulatory mission creep; and
- an enforced hierarchy of expenditure with strict penalties enforceable where discretionary expenditure displaces essential expenditure such as on core services.

Thank you for the opportunity to contribute to your critically important review. We trust that your report will be the springboard from which a sector reform of local government can be launched.

We wish you every success and would be pleased to provide you any further information that may be relevant to this submission. We would welcome the opportunity to discuss this submission with you and ask you to note that whilst we have used PCC as a specific example, we believe that many of the issues are generic to the entire local body sector.

We ask you to note that we would be pleased to make further submissions in respect of a number of the questions raised in your discussion document, such as the issue of effective monitoring. We would also welcome the opportunity to discuss this submission with you, should you so desire.

Andrew Weeks

Chairman

Attachments: FTE spreadsheet, email exchanges and PCC response (pdf)