Absolutely Positively
Wellington City Council
Me Heke Ki Pōneke

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New Zealand Productivity Commission
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SUBMISSION ON LOCAL GOVERNMENT FUNDING AND FINANCING: ISSUES PAPER

Wellington City Council (the Council) welcomes the Productivity Commission's *Inquiry into Local Government Funding and Financing*. The *Inquiry* focuses on the costs of services provided by local government and how they are paid for.

The Inquiry raises a number of complex issues which can be discussed at both a detailed level and at a higher, principle-based level. Increasingly in recent Parliamentary submissions the Council has raised the restrictions on action and limitations of current funding and financing mechanisms.

The changing make-up of our society and greater understanding of the realisation of benefits derived from council provided services, including infrastructure, means payment and charging mechanisms require change to match this newer reality.

We are pleased that the recent reports, inquiries and reviews will be taken into account. In particular, the Council supports the work done by both Local Government New Zealand (LGNZ) and the Society of Local Government Managers (SoLGM) regarding funding and financing and largely supports their submissions to this Inquiry.

In this submission, the Council wishes to raise matters in the following areas:

1. Cost drivers and cost pressures
2. Changing role and expectations of local government
3. New tools and approaches

Overview

Council's funding and financing decisions are impacted by costs pressures, changing central government and community expectations of local government and shows the possibilities and limitations of existing tools and need for new or changed tools and approaches.

Council services are predominantly delivered through infrastructure and people – and inflationary pressures for these are considerably more than CPI. Cost pressure on existing services is only one part of the overall 'cost pressure' issue. Strong community desire to increase service levels and/or for Council to deliver new services, and increasing government regulation that is tasked to local government without any additional revenue sources, also adds significant pressure to the budget line. Population growth and economic growth are also significant cost pressure factors.

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While there is significant and ongoing pressure to expand or increase service levels, there is no community appetite to have significant increases in rates and borrowings, and this consideration – as well as legislative requirements to produce a sustainable budget and take a long-term view – places significant pressure on the planning and budgeting process.

The level of complexity in the above is considerable. These cost pressures and additional functions tend to 'build up' or get added incrementally over many years, and while individually they often don't appear to be significant and are approved through LTP or annual plan processes, over time they collectively add considerably to the rates and borrowing line.

Each council deals with cost pressures in their own way. Some accept more risk; others focus on just delivering basic services, while others do not fully fund depreciation.

While each council deals with these pressures in their own way, there is a growing sense in the sector that current arrangements – which have a significant over-reliance on property taxes to deliver services – are not sustainable in the long-term, and that if local government is to play a broader role in community wellbeing as envisaged by central government, it needs the tools and access to resources to be able to deliver on that objective.

We also encourage wide engagement and a strong consultation process to support this. This role of and views of central government agencies with close links to local government services should also be considered.

1. Cost drivers and cost pressures

Councils are effectively a collective purchasing club of goods or services for those within the clubs catchment. Where a service needs to cross a territorial authority boundary, a property based rates system is not a good mechanism to provide that service. For example – if the provision of water and waste water services is considered a human right then we need a mechanism that allows for an equity approach. Where users of a service do not contribute to rates there is a funding inequity. In high tourist areas the benefits of trade do not seem to translate into income capable of providing the high cost services demanded. We agree with LGNZ that central government is the largest beneficiary of tourism, and local levies are needed. Variations in funding policies and mechanisms have a large impact. Debt funding policies, depreciation approaches, revaluation assumptions and other asset management choices make it very difficult to get apples for apples comparison between Councils.

The Council also wants to note that Treaty Settlements do not only impose costs, there are significant opportunities and benefits that come with these as well, and this should be recognised.

Here, as for each of the areas impacting costs, analysing only costs without considering the benefits is too narrow a view.

The **cost drivers** for the Council are:

- Population Growth – this is driving both green and brownfield development and a requirement for accompanying network infrastructure.

- Economic growth – the Issues Paper does not mention of costs of growing & transforming economy. Wellington is experiencing higher than anticipated population growth which is putting pressure on housing, transport networks and other infrastructure. High construction costs are a large factor.

- Increases in Government regulation, for example resilience, earthquake-prone buildings, drinking water standards etc.

- Funding depreciation – increases are caused by asset revaluations and capital construction cost escalation. This needs to be reviewed.

- Increasing community demand – please see section 3 *Changing role and expectations of local government* below.

- Generational service level increases such as Let's Get Wellington Moving.

- *Local government costs vs CPI*

There is little relation between local government cost drives and CPI. Furthermore costs for the basket of goods purchased by local government (salary inflation, contractor inflation, asset value and depreciation) have in recent years increased at significantly greater rates, than those forecast by economists (e.g. BERL). A report from the Office of the Auditor-General states that:

> *'Between 1916 and 2013, almost a century, rates per household have increased by 0.8% per year in excess of general CPI inflation. On a per capita basis, real rates have increased by 1.4% a year. The pace is faster on a per capita basis, as household sizes have shrunk over time, meaning the rates bill is shared across more households.'*[1]

However, as above, the construction sector has changed even in the last few years and we are facing big cost increases as a result. Also, the cost of materials has been a factor in increasing costs for our sector.

Cost pressures

Cost pressures the Council is facing include:

- *Responding to climate change and other natural hazards*

  Some cities, because of where they are located and how they were built need to invest significantly in resilience.

  The Council has been focused on addressing hazards, such as earthquakes and floods, for many years. Addressing climate change and other natural hazards is one of the 5 key priorities in the Council's latest Long Term Plan, 2018-2028:

  > *'Making the city more resilient. In November 2016, we experienced a significant earthquake. Wellington responded well, but there is more work to do. The climate is also changing and we need to find ways of living with a higher frequency of extreme weather events. We also need to factor in*

[1] OAG Water and roads: Funding and management challenges. November 2014: https://www.oag.govt.nz/2014/assets/part3.htm#part3

rising sea levels. In this plan, one of the main priorities is to improve the city's resilience, which is why we're investing more in Council buildings and core infrastructure.'

Key projects over the next 10 years are:

- Security of water supply – additional water storage capacity and network improvement projects throughout the city to support population growth and enhance the city's resilience.

- Wastewater – additional improvements to increase the capacity of the wastewater network to accommodate growth and provide capacity.

- Waste – funding the reduction of our dependence on landfills as our main mode of waste disposal; alternatives to landfill can be very expensive.

- Stormwater – additional investment to increase capacity in key parts of the city to reduce flooding events.

- Building accelerometers – exploring options to install accelerometers in buildings across the city to provide us with better information immediately after an earthquake.

- Resilience of the transport corridor – additional funding to strengthen infrastructure that supports the transport corridor (tunnels, bridges, retaining walls).

- Strengthening buildings – earthquake strengthening a number of Council-owned buildings – including the Town Hall and the St James Theatre and supporting private building owners to meet new regulations.

- Storm clean-up – additional funding to respond to more frequent and severe weather events.

Please see: https://wellington.govt.nz/your-council/plans-policies-and-bylaws/plans-and-reports/long-term-plan/long-term-plan-2018-28 for more detail.

- *Responding to Climate change*

  Central Government's 60 percent underwriting programme is critical to coping with High Impact Low Probability (HILP) events.

  A disproportionate amount of the focus on Sea Level Rise (SLR) is on inundation – when a lot of territorial authorities' infrastructure is underground. Rising groundwater levels will therefore have an impact much sooner. Additional impacts on infrastructure arise from damage caused by twice daily rinsing of pipes with salt water, gravity based drainage that cannot flow at high tide, septic tank drainage fields that won't work in high water tables. These indicators of SLR problems will be seen well before inundation issues arise.

  Millions of dollars of Council infrastructure actually protects billions worth of private assets, for example the road along the coast. Tough conversations and decisions will be needed if a Council is to consider no longer maintaining an asset that provides either protection or access to provide property.

There are very difficult decisions when some councils with high risk are able to invest in resilience options, yet others are struggling to even provide the service on a daily basis.

We therefore support LGNZ's call for central Government support to pay for some of the work as it will be unaffordable for most of the sector.

However, the Council disagrees with LGNZ's description of funding pressures for regional and local council's focus. Both regional and local councils are facing pressures related to changing/higher environmental standards and extreme weather events, not only regional. Increased population and a more disposable and mobile lifestyle has put pressure on our environment, to the point where existing infrastructure has been inadequate to prevent deterioration, in particular, of our waterways.

This Council and many other territorial authorities are doing enormous amounts of work to protect our community from extreme weather events and we do have higher costs when trying to meet higher environmental standards. These are set out in our Long-term plan (link above) and other planning documents.

Central government has recognised the increased pressure on local government funding for infrastructure, and are undertaking an investigation of the three waters, which we expect the Commission will be taking into account.

- *Joint and several liability for issuing building consents and Codes of Compliance*

  Building consents costs are determined on a cost recovery basis. Councils do not collect any extra amount yet councils face significant costs in instances where they bear joint and several liability, for example with leaky buildings. There can be many contributors to a leaky building and the council may or may not be one. Private companies can fold etc. meaning liability can be transferred to councils as the last one standing. We are aware the Government is examining this issue and recommend the Commission take account of that work in this Inquiry.

- *Insurance*

  The Commission notes (page 35*) 'Rising costs may also be driven by higher insurance premiums and underwriters exiting areas that have recently suffered from earthquakes or other natural disasters'*. We can confirm that higher insurance premiums are a significant factor in rising costs.

  In fact, Wellington premiums have increased massively in recent years and, along with increased flooding caused by climate change a sea level rise, parts of the City face the real prospect of being unable to access or afford insurance.

  Risk management for the Council itself is a significant issue. Particularly local government (and the private sector) obtaining sufficient insurance cover, and at an affordable price.

  In terms of councils' abilities to increase resilience to climate change and natural hazards, it would be unhelpful to force extra insurance costs on the local government sector through arbitrarily changing the insurance ratio of local government assets. Here, spending on improving safety and resilience must be our primary focus. We do however acknowledge that these increasing costs will also be a challenge for both local and central government.

2. Changing role and expectations of local government

The Council agrees with the Commission that community expectations of local government are increasing. With increased visibility and connection through social media people can get in touch with Councils, Mayors and Councillors more easily, about any issue and expect action. A more informed and engaged public is good for our democracy and shaping of the City – especially as we look ahead to local body elections in October 2019.

However, the Council does not agree with the assertion that Councils are moving into areas of 'non-core' expenditure as suggested in Question 11. A broader range of activities, through community well-being, have in various forms been a central part of local government's purpose, and we note the four well-beings are in the process of being reinstated to the Local Government Act 2002.

This Council welcomes the return of the four well-beings and the reinstatement of the purpose statement because it recognises the role of local government, particularly in relation to the role of cities in the 21st century. 'Cities as a whole' are acting to leverage their competitive position to attract skills, talent and business and grow the economy.

These are appropriate matters for local government to be involved in. Councillors are accountable to their ratepayers and residents about decisions made and engage with ratepayers about spending decisions, for example through the Long-term plan process.

- *Community expectations*

  We, like other Councils, are being turned to by community organisations and members of the public to deal with issues such as homelessness, alcohol abuse and associated crime and an increased focus and expectation around accessibility. In some instances the Council is turned to because central Government funding and support has been reduced or removed, creating a gap and a need for an alternative source of support. Sport, recreation and community organisations have increasingly turned to local government for funding as a result of a reduction in funding from central government.

- *Increased level of services*

  Around 50 percent of our capital investment is to improve levels of service. Some is from regulation, such as earthquake strengthening; however the majority results from community expectation for improved resilience of city infrastructure, considered critical rather just a nice to have.

- *Increased responsibilities, for example under the Building Act 2004*

  The Council has, through our regulatory function and in the interests of public safety, had 3 recent instances where we have been directed by the Ministry of Business, Innovation and Employment to obtain information about aspects of buildings: non-ductile columns, targeted building assessments following the November 2016 earthquakes and the investigation into the use of aluminium-composite panels (ACP).

  The Council supports the greater desire to understand the status of buildings and their features in order to protect public safety and to give the public confidence to be in and around those buildings.

However, Councils are not currently funded for additional work they are directed by the Ministry of Business, Innovation and Employment (MBIE) to do and cannot charge for it.
The Building Regulatory system is a 'beneficiary pays' model. The Building Act expanded the Building Levy to cover the costs of the system through a Memorandum Account Mechanism.

Under current system the burden of the costs of recent investigations, and those that will come with these additional investigative powers, rests with the all ratepayers not the beneficiaries of Building Regulatory system. This is inconsistent with the wider "beneficiary pays" policy setting.

Section 60 of the Building Act provides for a Territorial Authority to retain 3 percent of the building levies collected. This is to recognise the administrative cost of collecting that on behalf of MBIE. The Council has proposed in our submission on the Building Amendment Bill 2018 that provisions are included to recognise the Councils' role as co-regulators of the wider building regulatory system and moves the cost model from an administrative function only reflect that of a co-regulator. With an accompanying increase in the percentage of the building levies retained.

This would ensure the funding models are consistent and align the 'beneficiary pays' approach across both levels of Government.

- *Weightless economy*

  The weightless economy is not rated on value or income as they don't own property or small amounts of property (IT, Air BnB, Uber etc.). In today's world property ownership does not determine core business or business success so a rates model based on property is flawed.

  This has an impact of rates on affordability. For example in the retail sector, the increased use of online shopping has in some cases led to a downsizing of retail space required, increased lease turnover and more vacant spots. All contribute to reduced rates income for local councils.

3. New tools and approaches

- *Problems with relying on rates*

  In general the Council agrees with LGNZ about the problems of relying on rating as the major source of funding. The issue of equity also needs to be considered regarding income. Whilst there is some evidence that those with higher value houses have the best ability to pay, those on fixed incomes are more limited. Another reason for seeking sources of revenue other than property rates is the change in home ownership rates results in a lower proportion of the population being directly charged rates.

  While rates increases may be partly captured through higher rent costs, the relationship is not strong enough to ensure that local government funds the services the community wants.

  Furthermore, in Wellington the property and rental market are quite different. Passing on increasing rates costs also has the potential to put more pressure on those renting. Such a change also means that there is a loss of connection between residents and the council services they receive and those who pay for them.

New tools are needed to align costs of growth with beneficiaries of it, for example cost-sharing models. Any proposals for higher costs are consulted on in LTPs, so costs may rise but they are transparent and agreed.

The Council notes the wide range of possible tools, including those listed by LGNZ and SoLGM. All new tools and approaches will require more detail and an assessment of each on the merits. Prior to introduction any will require public consultation. Principles to assess them should include assessing both environmental and economic sustainability.

The Council also recommends investigating the following:

- *The need to review outdated classifications of non-rateable land*

  An example is university accommodation property, where a commercial business is run on non-rateable land.

- *The need for a structured approach to diversify local government funding streams*

  Clarity of and certainty about local government funding streams are needed. Uncertainty about the Government's approach or likelihood of change adds to the pressure. Options for further consideration include investigating both returning GST on rates to the sector, and sales and excise taxes. Any changes would need to take into account any impact on credit worthiness of territorial authorities having more uncertain income or variable income than the current rating system. The certainty of income (modifiable income) provided by local councils through control of their income through rates, is valued and rated highly by credit rating agencies. It is worth maintaining that certainty. If we include mechanisms outside of property taxes they need to be structurally sustainable.

  For example, if the GST on rates was returned to Councils, in order to plan and ensure the Council has a sustainable stream of income to invest in our communities, it is desirable to have certainty, and that it would not be changed, say with a change of government. Options that do work include petrol taxes and excise duties. The level of income from these fluctuates, but the mechanism remains.

  To provide clarity and certainty, there needs to be a change to the current 'ad hoc' funding transfers from Government to local government, for example the Regional Development Fund, Growth Councils in the Housing Infrastructure Fund, off -balance-sheet vehicles, individual funding from deals for one-off long-term assets etc.

- *Incentives to invest in productive infrastructure*

  Incentives to invest for growth and mechanisms for central government funding should both be investigated further, particularly where central government standards, and associated requirements and costs, are higher than the local authority would have agreed themselves. Without this, higher costs would likely be passed on to ratepayers.

- *Value capture*

  The Council noted the Commission's 2015 recommendation for legislative change to enable value capture to be used in New Zealand to help fund the infrastructure needed to support Growth. The Council recommends local councils receive some of the gain where economic or property value gains have been made from local government funded projects to private gain.

- *Development contributions*

  The Council recommends re-examining the funding of new network infrastructure with a focus on the effectiveness of the model.

  The Development Contribution model and process is very costly and resource intensive to administer and implement. Local councils do not recover very much from brownfield developments, as they are largely upgrades of existing infrastructure and developments can utilise existing capacity. Greenfield developments cost more and have higher contributions. Is this equitable?

- *Procurement approaches*

  The Council supports, and is a member of, models such as the Local Government Funding Agency. We are interested in co-ordinated models of procurement across both local and central government, which also support social, economic, and environmental outcomes. Investigation into a local government risk agency is supported.

- *Earthquake strengthening support for private landowners*

  Council continues to advocate for central government support for property owners whose buildings require earthquake strengthening. This includes the ability to claim GST on strengthening costs and consideration of funding and financing support for earthquake residential property owners.

- *Other new tools*

  The Council supports the Commission's 2015 recommendation that councils should be allowed to price the use of existing local roads where it would enable more efficient use of the road network. We also recommend that the effectiveness of the Auckland Regional Fuel Tax is assessed to inform future consideration of such options for the rest of the sector.

  In the area of public transport, the issue fare box recovery needs to be considered by central government as well as regional councils around the country to ensure that users are paying a fair proportion of the cost.

  The issue of equity between different transport modes should also be addressed so that public transport is treated equitably with roading.

- *Landfill levy/waste management charges*

  This is an issue the Council particularly wants to highlight as a new approach is required to be effective. The Waste Minimisation Act 2008 established a levy per tonne payable by disposal facility operators on waste disposed of to a disposal facility. As the Council is the owner and operator of a disposal facility, it pays the levy fee on the waste disposed to the Southern Landfill. The purpose of the levy is to raise revenue for promoting and achieving waste minimisation; and to increase the cost of waste disposal to recognise that disposal imposes costs on the environment, society, and the economy.

  The $10 per tonne levy has no impact on waste minimisation behaviour. National advice suggests it would have to be in the region of $90-100 per tonne to start having a noticeable impact on waste minimisation. Across the region, the 3 landfills "compete" for waste by keeping their gate fees and 'bulk fees' competitive, that is, driving costs down. The levy could also be extended to landfills (class 2-4) that are not currently captured due to the technical description in the Waste Minimisation Act.

The Council's waste activity, which includes landfill operations, kerbside rubbish & recycling collection, waste minimisation and education initiatives, is self-funding – i.e. any surpluses made from the landfill and rubbish bag sales & any other revenue we make pays for recycling and waste min & diversion. In short, we need to have waste to landfill to be able to meet our funding policy. The more we sustain our waste levels which earn us landfill revenue, the more we are able to continue to self-fund the waste diversion.

This is counter to the environmental objectives in the Waste Management and Minimisation Plan to reduce total waste to landfill. If the Council is too successful at reducing total waste to landfill, yes its levy payment obligation decreases but then so does the overall income stream. Increasing the levy would likely lead to behaviour change and enable Councils to pay for additional supporting infrastructure. However, this would need to be considered alongside 'fee avoidance'.

Targeted rates and user charges are effective when they are not also incentives for behaviour change in relation to environmental objectives. Local authorities either require alternative revenue streams to replace those generated from environmental activities or for Central Government to introduce national charges to fund environmental initiatives.

- *Fines and penalties*

  An updated approach to infringement fees and penalties is required.

  Local government has been criticised by some for having ineffective bylaws due to a lack of enforcement abilities and/or a nominal amount of an infringement fee. Councils are limited by legislation about the level of infringement fee that can be charged. Many are outdated, and like the landfill levy above, the amounts are not significant enough to encourage behaviour change.

  The Council further recommends that section 242 of the Local Government Act 2002 be amended to include meaningful penalty amounts. Currently, prosecution to recover these amounts is not a viable option because the costs of a prosecution would often be several times the amount recoverable. This reduces the effectiveness of local government as a regulator.

  The Council recommends that statutes, regulations, rules etc. setting infringement and penalties be reviewed and amended to include meaningful penalties.

- *Long-term Plan Consultation*

  The Commission has asked about the appropriateness of Long-term Plan (LTP) consultation process for aligning decisions about capital investments and service levels with the preferences, and willingness and ability to pay, of residents, businesses and other local organisations

  The LTP is a strategic budgeting tool and key capital investments will often have been discussed with the community – sometimes on multiple occasions – well ahead of it being included in the LTP for consideration. Because there is a good understanding of city issues through various pre-engagement exercises and research, there is strong alignment between our capital programme and community *preferences*. It would be very rare to have a substantive capital investment included in the LTP without prior discussions with the community.

Willingness to pay is tested through the LTP consultation process itself – and because many councils carry out pre-engagement to include people early in the decision-making process, there is traditionally strong support for most investments proposed in LTPs. For example, Council's most recent LTP (2018) had very high engagement levels and nearly three quarters of all submitters were in support with the LTP direction and initiatives.

In terms of *ability* to pay, this is researched ahead of developing an LTP and a consideration in setting the Financial Strategy (rates and borrowing targets and limits) and various financial policies including the Revenue and Financing Policy, and the rates Postponement Policy. Through spatial mapping (GIS) we can match household income data and a meshblock level (off census data) to rates expenditure, to test affordability, fairness and taxation progression.

While at the high level, the LTP provides a good mechanism whereby the community is engaged on levels of service and rates and borrowing levels, the breadth of issues, information, and policies and strategies included in the LTP often means that community focus and feedback is on specific projects rather than broader financial picture.

We also note the changing interpretation of auditors of Local Government Act requirements are increasing the volume and complexity of information in consultation documents which is reducing overall transparency and the effectiveness of engagement.

Conclusion

Thank you for the opportunity to contribute at this early stage. Councillors would welcome an opportunity to discuss the Inquiry and these points with the Commission.

We look forward to hearing from you in the near future.

Yours sincerely,

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Mayor