Property Council New Zealand

21 February 2019

Steven Bailey, Inquiry Director
Productivity Commission
Email: info@productivity.govt.nz

Dear Steven Bailey,

**Property Council New Zealand's Submission on the Productivity Commission's Inquiry on Local Government Funding**

## 1. Executive Summary

1.1. Property Council wishes to thank the Productivity Commission for the opportunity to submit on the Local Government Funding and Financing Inquiry Issues Paper.

1.2. We acknowledge that New Zealand is going to be facing significant challenges in the future. The lack of planning and co-ordination is continuing to exacerbate the problems.

1.3. We fundamentally believe the system is broken and that successive governments have endeavoured to rectify on-going issues by amending the Local Government Act 2002 (LGA), but very little changes in practice. This review is an important part, but only a part, of a wider system change that is needed.

1.4. Property Council's key points are:

- Local authorities are unsustainable and yet must produce numerous mandated documents, provide good quality infrastructure and public services, and perform numerous local regulatory functions. Smaller councils are just barely managing these functions.
- Local communities are getting less and less involved and are not interested in the big decisions that councils must make. They are only interested in the smaller issues such as reserves, and things they understand.
- The mandatory requirements set out for local government's decision-making and more important functions are not adequately undertaken, with various examples where these are not met, such as the Mangawhai Wastewater Scheme and the issues with managing water by Environment Canterbury.
- Councils have a vested interest in maintaining the status quo. They are often a key employer in an area. Many councillors have their own self-interests which affect the quality of the wider decision's councils make. There are many highly paid local public servants who also benefit with their broad and complex roles within councils. Therefore, there is no incentive to look at alternatives, such as shared services or amalgamation, or be innovative to be more effective and efficient. The examples where shared services have been investigated, we suggest, are the exception not the rule.
- Local authorities seem incapable of making bigger decisions and tend to focus on activities they understand, like the local communities they represent. Property Council has noted that rather than focussing on the essential infrastructure, 21 councils have allocated capital expenditure for new civic buildings. If a council is managing its finances well at least 30 per cent of its capital expenditure should be focussing on water and waste-water.

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- Councils often believe growth is a bad thing and benefits only a few. Local authorities only have a couple of meaningful ways to collect revenue. They tend to focus on businesses and developers when the wider community and future communities benefit as well. We suggest that good infrastructure benefits all and that the revenue collected should be shared more fairly. Good infrastructure should not be purely funded by the current generation but all generations that receive the benefit through intergenerational funding mechanisms.
- There has been significant under-investment for infrastructure even though better infrastructure is critically needed. There continues to be a heavy reliance on rates, rates differentials and development contributions. This has led to an unfair reliance on only a few paying a lion's share. We believe that everyone benefits and that everyone should pay their share.
- We strongly oppose rating differentials and endorse the Shand report's recommendations that they should be abolished and replaced with targeted rates[1] There is no economic rationale that supports business rates differentials. For example, Tauranga City Council recently introduced a business differential in their recent Long-term Plan, although reducing it to a 1.2differential from their proposed 1.6 differential. Its main rationale is: other councils had differentials; and that it needed to raise more money than they thought they could from residential rate payers. The rationale for greater benefits to the business community was shaky at best.
- The heavy reliance on development contributions is also concerning. Councils often fail to meet their mandatory obligations when developing their policies for development contributions as evidenced by our numerous submissions made over the years. Councils understand only a few are likely to challenge a badly produced policy and as such often push the boundaries of the legality of their development contribution policies. It is the development sector that bears the burden of that, which gets passed on to higher house prices or higher rents for commercial buildings. While economic theory suggests that should not happen, we know from our members' experiences that it does. For example, Hamilton City Council continues to use data and modelling to support their own outcomes to fill funding gaps rather than using realistic data and modelling to provide adequate infrastructure in the right places.
- Many councils have reached their debt and borrowing limits. We note that Standards and Poor's recognises the deficiencies in any funding model that incorporates local decision-making and if it was to be removed, they could receive a higher credit rating and thus borrow more.
- A wholistic approach needs to be considered including how central government plays its part. Previously, when infrastructure was keeping pace with our growth, central government was contributing to key infrastructure. The lack of investment over the previous decades has contributed to the issues being faced today.

1.5. Property Council believes that local government is anything but effective and efficient and amendments to the LGA have only gone so far. At the very least we recommend that more oversight is needed, better reporting requirements, more incentives or mandated requirements for shared services and better financial reporting, particularly more auditing, could be short-term solutions. However, we suggest that a thorough review needs to be undertaken which goes further than the scope of the current inquiry. At the very least the Department of Internal Affairs Three-Waters Review should be incorporated into this inquiry as three-waters infrastructure represents the greatest portion of a council's budget.

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[1] Funding Local Government, Report of the Local Government Rates Inquiry, August 2007

## 2. Property Council Background

2.1. Property Council's goal is the creation and retention of well-designed, functional and sustainably built environments which contribute to New Zealand's overall prosperity. We support legislation that provides a framework to enhance economic growth, development, liveability and growing communities.

2.2. Property Council is a member-led, not-for-profit organisation offering a collective voice for the commercial property industry. The property industry is currently the largest industry in New Zealand with a direct contribution to GDP of $29.8 billion or 13 per cent. In a sense the property sector is a foundation of New Zealand's economy and caters for growth by developing, building and owning the buildings that house businesses.

2.3. Our membership includes some of the largest commercial property holders in New Zealand, including several significant NZX listed companies. Our members include companies that undertake a range of large-scale residential and commercial development projects, including large commercial buildings, industrial parks, and retail precincts.

## 3. Introduction

3.1. Property Council wishes to thank the Productivity Commission for the opportunity to submit on the Local Government Funding and Financing Inquiry. Our members are well aware that the system is broken and the constant under-investment has led to the significant problems that New Zealand is currently facing.

3.2. We would also like to commend you on a well written issues paper. It covers many of the key issues require for consideration. Property Council is happy to offer any further assistance in helping the Productivity Commission on working through these issues.

3.3. We have taken a high-level approach to our submission focussing on the areas that Property Council believes are of key concern and the barriers to change. We have not specifically answered your questions as believe in some cases it's the entire system, not just the funding and financing of local government, that has issues.

3.4. Our membership believes the system is broken and needs a thorough review.

## 4. New Zealand's changing face

4.1. Property Council is aware of the changing face of New Zealand. Our population is continuing to grow, although only in certain areas, such as the bigger urban areas and surrounds. The bulk of our membership operates in these regions and we are acutely aware of the challenges facing these areas.

4.2. Demographic change as a result of immigration and the aging population requires alternative housing models. We suggest not enough thinking, planning and investment for these changes has been undertaken by local authorities.

4.3. There are also areas around New Zealand that are seeing strong levels of decline and suggest very little planning has been undertaken to meet these demands. These areas are stuck in the paradigm that growth is the only solution although are unlikely to see any growth for the foreseeable future. Japan is one of the only countries in the world that is looking at ways to manage declining and aging populations and suggest we could learn from them.

4.4. One of the first steps is recognising these challenges and we suggest this discussion needs to occur at the national level for a co-ordinated response.

## 5. Current Situation

5.1. Property Council believes the current system is broken. We have had twenty years (sometimes much longer) of under-investment and its only getting worse. We recognise that some good initiatives have been undertaken by some councils to make improvements, however we suggest these are isolated.

5.2. Successive governments have amended the Local Government Act 2002 (LGA) to try and get territorial authorities to better manage their funding and finances, although nothing appears to rectify the on-going issues. This shows there is something fundamentally wrong with the system.

5.3. There are local authorities in the South Island as small as Kaikoura District Council (pop 3,830) and McKenzie District Council (pop 4,670), and Kawerau District Council (pop 7,080) the smallest in the North Island, which are unsustainable. The smaller local authorities are grappling with significant issues, such as Kaikoura's earthquake and Kawerau's floods. New Zealand is asking small communities to deal with issues that even larger city councils are struggling with such as Christchurch and its 2009 and 2010 earthquakes.

5.4. Each local authority must at the very least produce a Long-term Plan (LTP), a District Plan, an Annual Report and interim Annual Plans. Further mandated documents are often produced to meet their mandatory requirements, but it could be argued those documents are not meeting the purpose for which they are required to be produced, such as the Thirty-Year Infrastructure Strategies, Financial Strategies, Development Contributions Policies, and the various funding and financing policies. Further to this they must meet mandatory requirements to adequately consult with their communities. These are not insignificant pieces of work being replicated across the country. Some standardisation could assist, particularly the smaller councils that are barely coping.

5.5. Inadequate management is also compounding problems with managing their infrastructure. Councils are struggling with their asset management and very few are likely to have a proper handle on exactly what their assets are and what needs to be done. Many councils are looking at 30 years plus infrastructure and with much of the water and waste-water activities underground it's difficult to assess, and we suggest very little has been done. The LGA makes it very clear that councils are supposed to manage their assets but to what standard is questionable. Many councils do the bare minimum to meet their mandatory requirements and fix issues when they arise.

5.6. This mismanagement and lack of adequate funding is compounding. We provide examples below, but again suggest some standardisation could assist.

5.7. Auckland Council's Urban Land Supply Strategy (FULSS) provides its 30-year programme for releasing 15,000 hectares of rural land for development, as identified in the Unitary Plan. It provides live zoning and aligns its bulk infrastructure with the National Policy Statement on Urban Development Capacity (NPS). It also seeks to provide greater clarity and certainty for landowners, iwi, developers and infrastructure providers when urban land will be ready for future development. In developing the FULSS, Auckland Council recognised its significant barriers to financing and funding all the necessary infrastructure within the timeframes needed to meet projected demand. However, the strategy attempts to help manage these financial issues by sequencing land release over time, it has not resolved how and when the necessary infrastructure investment can be funded.

5.8. Property Council also notes that Hon Nanaia Mahuta is looking at reviewing the Three-Waters infrastructure and suggest that this review should have been done in conjunction with the local government funding and financing review. The three-waters infrastructure is intrinsically linked to local government funding. If a territorial authority is managing its finances appropriately, at least a third of their budget should be going into replacing or renewing its three-waters infrastructure.

5.9. The Havelock North water supply contamination incident highlighted many of the issues facing, particularly smaller, territorial authorities managing water in their areas. Central government sets the national drinking water standards and expects local government to supply it with very little assistance. This issue has only highlighted the concerns at all levels.

5.10. Councils only have a couple of options to raise funds to pay for its infrastructure, such as rates, rates differentials and development contributions. Other revenue streams do not contribute enough to be effective. These funding streams are very blunt tools all centred around levying property value.

5.11. To lessen the burden on ratepayers many local authorities use rates differentials and development contributions to increase contributions from the business communities. Many councils see these options in a short-sighted usefulness of keeping rates down and making sure they are re-elected because the business communities do not have a vote. These calculations for rates differentials and development contributions are often used with out-of-date or incorrect data to help their arguments to make business communities pay more. We question whether there is any economic rationale behind all or most of the business differentials set in New Zealand. Property Council recommends the Productivity Commission investigate economic literature for any rationale for business differentials.

5.12. Auckland Council recently considered increasing its transport development contribution charges, using data used by Hamilton City Council, which was extremely biased towards an outcome that would have had significant un-intended consequences. Auckland Council has wound back to its 2015 charges at least temporarily. More work needs to be undertaken to ensure they do not continue down the path of increasing their transportation charges exponentially. Hamilton City Council has progressed and are slowly reaping the consequences of their short-sighted decision with development in their city slowly stalling. These decisions require more consideration although councils continue to try a short-sighted approach without due deliberation. We go into more detail below under the funding and financing tools.

5.13. There is also a significant lack of strategic planning undertaken by councils and as such developers are often paying for key infrastructure to support overall developments on top of paying development contributions (in effect councils are “double-dipping”). In some circumstances, the first developer is asked to fund the full infrastructure upgrades (roads, water etc) without taking into consideration other developers in the area and councils’ own responsibility to fund certain infrastructure upgrades. This again is inherently unfair, and the cost of the infrastructure needs to be more equitably split across beneficiaries. This again, is short-sighted and only delays problems into the future.

5.14. Council risk aversion when dealing with any resource management and building consent issues is a significant an mostly unseen cost of the system. That cost is borne by the development sector and results in suboptimal outcomes for both the development itself and the community. The risk aversion manifests with constant stopping of the clock, changing their position, new staff dealing with issues and having to start again, all of which have cost implications that councils do not incorporate into the wider considerations. Councils do offer some discounts to fees due to time delays, however, a $5,000 discount goes nowhere near compensating for $100Ks it costs a developer from its delays.

5.15. A major concern is that local communities do not get involved in the decisions that affect their areas. They are only interested in issues they can see and understand, such as the felling of trees or removing carparks. Communities rarely get involved in local politics evidenced by the very low polling rates in local body elections. As a result, local politicians tend to pander to populist views rather than being brave and making important decisions for their communities, such as infrastructure.

5.16. Local communities are getting less and less involved in the big decisions associated with key infrastructure in their areas. It is difficult for local authorities to get their communities engaged in these processes. Occasionally communities may get upset and engaged if they are looking at significant rates increases. Councils then tend to either shift the increase to the business sector (without any strong economic evidence) or simply delay needed infrastructure investments rather than consider raising rates.

**6. Growth is Bad?**

6.1. Many local authorities also see growth as a bad thing, particularly some of the smaller ones. The argument used by local authorities is that growth should pay for growth, suggesting that growth only benefits the development community. They only see the bad things associated with growth, i.e. needing to renew and improve its infrastructure and a need to find ways to pay for it.

6.2. Currently, there is a heavy reliance on a few to raise the revenue to fund new infrastructure, through differentials and development contributions, lessening the burden on ratepayers. However, the beneficiaries of good infrastructure is everyone and dividing beneficiaries does not create great communities.

6.3. Local authorities are using short-sighted arguments to justify its collection of rates through differentials and increasing its development contributions. However, growth ensures that improvement of infrastructure occurs, keeps New Zealand and its regions competitive, enhances our resilience, facilitates more growth, and improves our living standards and environmental impacts.

6.4. Everybody from the home owner, tenants, tourists, and customers all benefit from good and well-maintained infrastructure that comes from growth. Central and local government sees benefits with increases in its tax and rates revenues. Employers and employees benefit when the businesses grow, and our future generations see improved infrastructure that lasts generations. Adjourning local authorities can also benefit from improved amenity in neighbouring areas, just by proximity.

6.5. Developers are seen by local authorities as those that are the only beneficiaries of growth. Currently, only the developer, the home-owner and business owner that are currently paying for this growth. Developers are happy to pay their fair share, although currently they are paying far more. We believe those that pay needs to be shared more fairly across all those that benefit.

6.6. The system is broken with decades of under-investment and something needs to happen to improve the situation quickly. We suggest the government needs to be looking at a system approach to fix a system problem.

**7. Capability**

7.1. Property Council suggests that councils are unskilled in managing the complexities of local government. They are responsible for billion-dollar budgets with little to no aptitude to undertake this work. We understand the need for local democracy, but we suggest we need to give these local politicians the tools to adequately manage these billion-dollar budgets.

7.2. Many enter local politics with the sole agenda of ensuring that rates are kept low and do not increase. This is often their platform and they spend their entire time ensuring that rates do not increase. This has in part led to some of the significant under-investment across New Zealand that we are now facing. Keeping rates so low has not kept pace with the infrastructure requirements. However, we agree that the true rates' increases required for the proper levels of maintenance and improvements would have likely been unsustainable by most communities.

7.3. Very few local politicians have a finance background and even fewer understand public finances. It takes time to understand public finances and how they should function. The three-year cycle is too short to adequately get a full understanding.

7.4. The use of debt for inter-generational equity is often beyond the understanding of many councillors and takes a significant period to truly understand its complexities. They have often come in hoping to manage the council finances like their own. They want to ensure there is no debt or that it should be reduced. They also wish to ensure that rates are maintained at the lowest levels possible.

7.5. Local Government New Zealand (LGNZ) does offer training courses for new councillors, although you cannot make these newly elected officials attend these. If they do attend it still takes time to build up a public finance understanding.

7.6. The three-year election cycle is far too short to ensure that newly elected members understand all the issues. They are elected and are then quickly into the long-term planning decisions.

7.7. A newly elected politician arrives in October, receives potentially some training in November, attends their first introductory Council meeting prior to Christmas and then it's their summer break. The first meeting of the year might occur in February and potentially by July, at the latest, they need to start understanding the LTP decisions and its multi-billion-dollar budget. A council that has been planning well in advance for the next LTP may start these discussions earlier but that just means a newly elected member needs to come to terms with these important discussions even earlier.

7.8. Newly elected councillors, even those with some prior experience, cannot be as actively engaged in the LTP discussions as they are required to be. Some struggle to even understand the full weight of these discussions and what their responsibilities are. Many fail to understand that if they get it wrong what the implications are for themselves under the LGA.

7.9. Following the introduction of the LTP the next elections follow quickly the following year and the cycle repeats. No local politician wishes to be engaged in controversial decisions leading up to an election. The three-year cycle is just too short to have fully trained and engaged local politicians.

7.10. Property Council suggests it might be the time to be considering a longer election term, potentially at least for local body elections. We also suggest more tools and training needs to be given to newly elected local politicians and that this be made mandatory.

**8. Decision making**

8.1. The LGA sets out the mandatory requirements for decision-making. There are various examples where these mandatory requirements are clearly not met.

8.2. The Mangawhai Wastewater Scheme and the issues with managing water by Environment Canterbury were so serious that Local Government Commissioners were required to replace the locally elected decision-makers. However, most issues go under the radar and local authorities stumble through their decision-making by deliberating issues over and over and rarely getting to a resolution.

8.3. Larger decisions that require more understanding such as water and wastewater are often over-looked for more immediate issues that communities show an interest in. These activities and services that are given the greatest attention such as community halls, reserves and carparks. This is not an issue only associated with smaller territorial authorities as evidenced by the national news articles recently associated with trees being felled in Auckland.

8.4. The more complicated a decision the less likely local politicians are fully engaged in the discussions and deliberations associated with those decisions. They spend most of their energy on the smaller inconsequential decisions rather than focussing on the bigger issues facing their communities that are complicated and require more debate, such as the three-waters infrastructure.

8.5. Similarly, the advice given to councillors is often not as free and frank as it could be. The advice is often drafted in a manner to seek an outcome already predetermined, i.e. the end justifies the means.

8.6. We also suggest very few local authorities have been adequately considering all potential options. We recommend that the Productivity Commission review some council decision-making processes to better understand how they adequately or inadequately consider all options. The 2014 LGA amendment again mandated that local authorities must, when making a decision, consider all the options to make prudent financial decisions and again suggest this is not adequately undertaken.

8.7. Property Council suggests there is no oversight of local authorities and they make decisions with impunity. Many assume that LGNZ is the organisation that holds a similar role to the State Services Commission (SSC), although they only represent the interests of local government and ensuring the status quo is maintained. LGNZ is an advocacy organisation representing the views of elected members.

8.8. The Local Government Commission that could be seen as having a similar role to the SSC, has a very finite role under the LGA and very few staff. They are heavily reliant on local government policing themselves unless it rises to level of a Mangawhai waste-water treatment plant issue and becomes so public it cannot be ignored.

8.9. There has also been a serious lack of integrated strategic planning across boundaries by local authorities. A more strategic planning process across regions could lead to more effective and efficient decisions being made, similar to the Auckland Plan.

8.10. Property Council recommends that central government needs to play a far stronger role in assisting local government to make better decisions. At the very least we suggest that more oversight is required and more integrated-strategic planning. The bigger decisions also need to be ring-fenced so they cannot be beholden to the changes of the election cycle. We also suggest more financial tools in the toolbox are needed.

**9. Activities and Services**

9.1. The 2014 LGA amendment tried to focus local authorities on the more important activities such as the three-waters and transportation. While well intentioned councils were still not able to manage and fund even those core services. Property Council suggests a more thorough and perhaps radical rethink about what services councils should provide should be undertaken.

9.2. The LGA amendment also introduced mandatory performance measures to show how different territorial authorities are performing in these areas. If a council does not meet its performance measures, there is currently no accountability and therefore no incentive to meet them. We also suggest very few councils use these performance measures to help with their decision-making or even subsequently use these performance measures to improve their services.

9.3. Communities are only becoming fully engaged in local discussions when something goes horribly wrong. They are only interested that when they turn on their taps,good clean water comes out. Some individuals already believe most of what local authorities are supposed to deliver is done by central government.

9.4. Water and waste-water should have a lion's share (often up to 40 per cent of their entire budget let alone their capital expenditure portion) of the any council's budget. Reviews of councils' LTPs shows (and are happy to share this information) that many are struggling to have even 30 per cent of their capital expenditure dedicated to water and waste-water infrastructure. Kawerau District Council has 64 per cent, however, they were the exception not the rule. Some councils reduced into the negative percentages, clearly showing they need to undertake the work but have not allocated any capital expenditure for it to be completed in the next 10 years. We agree with your assumptions that councils might be deferring replacing out-dated assets. We also agree that the over-depreciation implications are likely to be causing current generations to pay more for infrastructure that is not being replaced.

9.5. Property Council has also noted that rather than focussing on the essential infrastructure, 21 councils have allocated funding for new civic buildings. Over the next 10 years Tauranga City Council appears to have allocated $39 million of capital expenditure on new buildings and some councils are looking at between $15-17 million. We suggest insufficient discussion has occurred within these councils to make robust decisions. We also suggest new buildings should not be the priority and other options should be considered.

9.6. A standard option considered by central government for new buildings is leasing. Many of our members are in the business of supplying these buildings. This is a prudent method of managing the public purse. The maintenance and on-going renewals of buildings is maintained by the building owner and when the new lease is negotiated, buildings are improved to meet the latest requirements that the government tenant requires.

9.7. Regarding the performance measurements of essential activities, we also noted through the review of the council LTPs and Annual Reports that there is no consistency across territorial authorities for their reporting. Councils combine their activities and services differently and there is no consistency across authorities. This makes reviewing their financial reporting very difficult. It also shows a lack of any transparency. Three councils, Hurunui District Council, Kaikoura District Council and West Coast Regional Council had not even adopted their Annual Reports at the time of our review. Clearly not meeting the mandatory requirement of adopting by the 1 October.

9.8. Property Council suggests that local government is not as efficient and effective as it should be. This is even reflected in LGNZs own research which shows that 'local government does not have a strong reputation with business and the public'[2].

9.9. Auditing of council financial management and reporting also does not go far enough. Audits are carried out only to ensure that a local authority can produce their mandated requirements. More auditing is needed. There are examples of Council's LTPs not meeting the mandated requirements although the audits have just highlighted these deficiencies and suggested they can be fixed either the following year through its Annual Plan, or an amendment to the LTP be prepared. The auditing companies are aware of the implications of not adopting the LTP by 1 July and do everything to assist a council to adopt it. This does not give anybody any confidence in the capabilities of local authorities or their ability to adequately manage these billion-dollar budgets.

9.10. Property Council recommends more oversight and auditing requirements, including more auditing enforcement powers, are required, and at the very least more consistency and standardisation of reporting be introduced. Again, at the very least we suggest that more guidance is required to ensure that councils focus on the essentials rather than activities that are nice to have.

## 10. Protectionism

10.1. The 2014 LGA amendment tried to introduce requirements for territorial authorities to consider alternatives for efficiency and effectiveness. However, as councils are often a key employer within an area, particularly smaller areas, they tend to try and safeguard that the status quo is maintained.

10.2. Councils are made up of local politicians with a vested interest in maintaining their political position. Similarly, very well-paid local public officials that often hold the decision-making powers in local communities have vested interests in keeping their positions. The officials have a clearer understanding of the bigger decisions and hold sway over elected members. They are there longer and have a vested interest in ensuring that their advice is not always as robust as it should be.

10.3. Elected members' remuneration is set by the Remuneration Authority with some guiding criteria and there is consistency across local authorities. However, there is no consistency across local authorities for CEOs total packages and the leadership teams about how much they should be paid and is not related to any criteria or ability.

10.4. Again, a review of all the councils' Annual Reports (again we are happy to share this information) shows that local government CEOs are paid anywhere between, the highest at $447,733 (Hamilton City Council) and about $188K for Waimate District Council and Chatman Islands[3] The leadership teams can be paid anywhere between the maximum of $3.8 million (Christchurch City Council) and $707K (Otorohanga District Council)[3]. The CEOs earn on average

[2] Local Government NZ, *Building a Stronger Local Government for New Zealand – a survey of New Zealanders' perceptions of local government 2015*.
[3] Excludes Auckland Council.

$310K, and the combined leadership teams of an average $1.4 million. This is a real incentive by local public servants to maintain the status quo and to keep councils in business.

10.5. There is also no incentive for local councils to consider other alternatives such as shared services or amalgamation. They undertake many activities and services that could be shared across boundaries. Obvious activities like IT, accounts and human resources are never considered in any real depth for sharing consideration across boundaries. Property Council agrees with the Productivity Commission that shared services across boundaries could be a more effective and efficient way forward for local authorities. However, unless the core issues with local government are looked at in any real depth or this is made a mandatory consideration, changes are unlikely.

10.6. The Waikato Three-Waters Shared Services Review has been looking at water services for across Hamilton City, Waipa and Waikato Districts, but we suggest this is an exception not the rule. The Waikato Three-Waters review also highlights the issues with local decision-making and the short election cycle. Each of the councils involved at one time or other has decided to exit. This does not endorse confidence in their decision-making processes.

10.7. Property Council suggests that unless the fundamental issues with local government are looked at there is no real incentive for change. However, at the very least we recommend some guidance needs to be in place for consistency of local public servants similar to the SSC guidance for central government. We also suggest that big infrastructure decisions need to be ring-fenced and out-side of local politics and the election cycles. This could ensure that longer-term decision-making could be made.

**11. Innovation**

11.1. Due to the inherent need to protect local government and the status quo, there is very little incentive to be innovative. Logical innovations that even central government might implement quite quickly are likely to take decades within local government. We suggest the examples noted in your Issues Paper of innovations are again the exception not the norm.

11.2. Innovative solutions to local government activities used by one council are unlikely to be introduced in others. Introducing further innovations from central government is also unlikely. Local authorities tend to constantly reinvent the wheel and deliberate issues repeatedly. Property Council suggests that the territorial authority belief that they are totally unique from other areas, inherently stops them from considering alternatives tried by other councils.

11.3. Property Council suggests some form of mandated requirement be introduced that local authorities consider innovative technologies implemented in other councils before going to market for efficiency. Or at the very least consider sharing innovative technologies and activities across local authority boundaries.

**12. Funding and Financing Tools**

12.1. Funds raised should be for better infrastructure and currently with the significant under-investment infrastructure is critically needed.

12.2. There continues to be a heavy reliance on rates, rates differentials and development contributions which has led to an unfair reliance on only a few paying a lion's share of revenue. We believe that everyone benefits and that everyone should pay their share.

12.3. Property Council suggests that the direct beneficiaries should pay their apportionment of a benefit, although everyone who benefits should pay their fair share too. The deeply held belief of local authorities that those "that create the growth should pay for growth" ensures that only a few that benefit pay that largest amount. We suggest everyone benefits from growth.

*Rates differentials*

12.4. We strongly oppose rating differentials as a means of revenue gathering. Business differentials are contrary to the 2007 Local Government Rates Inquiry (also known as the Shand report) which recommended that in the interest of transparency business differentials should be abolished and replaced with targeted rates[4]. There is no economic literature which provides an economic rationale in support of business rates differentials. However, business rating differentials despite strong evidence supporting their removal, are used across New Zealand. Where councils have agreed to reduce their differentials, it is also often a long and arduous process as councils do not wish to lose any revenue.

12.5. Wellington City Council continues to have a heavy reliance on business differentials, a political decision that appeals to the largest number of individual votes. Businesses are paying about 14 per cent of their rental incomes in rates which is ultimately passed onto tenants. However, residents, are paying only about 2.8 per cent of their income on rates. This is inherently unfair and disproportionally burdens the commercial sector.

12.6. They are punishing developers and the business community by over-rating those providing jobs in local areas. They do not take a bigger picture approach that when rates go too high businesses may move and eventually reduce their rating base. We suggest rating differentials goes against productivity.

12.7. We suggest the Local Government (Rating) Act 2002 needs amending and needs to consider a cost benefit analysis approach, including the ability to pay, when establishing rates. The LGA system of councils setting their budget first and then adjusting the level of rates to collect the money needed is perverse and opposite to how households, business and central government budget to stay within their means. We also suggest that the need to strike the rate every year fails to take a longer-term view particularly for the bigger capital expenditure items.

12.8. Tauranga City Council endeavoured to introduce a significant business rates differential initially obtaining evidence to justify its implementation from Wellington City Council which was also flawed. It took significant influence on behalf of our organisation and our members in the region to highlight their flawed arguments and the un-intended consequences of its introduction. They finally decided to reduce the business rates differential from 1.6 to 1.2 but again refused to accept that fundamentally rates differentials are flawed.

12.9. We have also been a supporter of user-pays rating systems as fairer. Property Council has also previously preferred targeted rates over other forms of revenue gathering. This ensures that those that directly benefit pay. We also believe that there should not be any double-dipping and that we should not have to pay more than once. Developers are rate-payers, as well as tax payers and contribute to GST collection. Making developers pay development contributions again on top of everything else, and sometimes even business rate differentials, this is inherently unfair.

[4] Funding Local Government, Report of the Local Government Rates Inquiry, August 2007

12.10. Property Council also agrees with the Productivity Commission's suggestion that councils over-estimate future demand and bare this risk. However, we suggest a more integrated strategic planning approach may mitigate some of these problems. We also suggest having central government more involved in this planning as they have more expertise and could assist.

*Development Contributions*

12.11. As mentioned earlier, our members are happy to pay their fair share. However, currently they are paying a disproportionate amount compared to everyone that benefits. There is a heavy reliance on development contributions which are often used to supplement rates, rather than undertaking the due analysis required to collect them.

12.12. It is the development sector that bears the burden of that, which gets passed on to higher house prices or higher rents for commercial buildings. While economic theory suggests that should not happen, we know from our members' experiences that it does.

12.13. Property Council has significant concerns with the analysis that councils use to justify the use and proportionality of development contributions. Regularly our organisation is having to reiterate council's responsibilities under the LGA when establishing development contributions (and have included our previous submissions on these issues).

12.14. We are also constantly questioning council's analysis regarding the causal nexus between projects and who specifically benefits. We're also having to note the requirements of the *Neil Construction Limited v North Shore City Council*[5] that established that the causal nexus can only be established at the project level and not in generalities such as at a catchment level. Council's continue to inadequately identify the legitimate beneficiaries of projects and establish the causal nexus between the demand on infrastructure and how councils intend to meet that demand. We suggest the guidance established to assist councils continues to be ignored.

12.15. Hamilton City Council continues to use data and modelling to support their own outcomes and to supplement rates. They use development contributions to fill funding gaps rather than using realistic data and modelling. We have continued to question their accuracy of their growth projections and assumptions. They proposed inequitable charges and a 57 per cent to pay for their schedule of assets. They refused to accept our arguments that their new development contribution policy was likely to have un-intended consequences and progressed with their recommendations. Consequently, they are now seeing a slowing of development within their area.

12.16. The market is elastic and adaptable, and we agree that if it is in equilibrium, which is rare, this should be the case. However, when demand outstrips supply, ie population growth is greater than the new build supply, the end user will absorb the increased costs of development. If demand falls (net emigration) and the supply is highly elastic, which generally it is, and developers can only break even, they will not develop. Therefore, there is not the reciprocal drop in end-user pricing, merely a shortage of development occurs, and the supply imbalance continues, and prices continue to rise.

[5] *Neil Construction Limited v North Shore City Council* [2008] NZRMA 275 (HC), at [61].

12.17. Auckland Council also, as mentioned above, using some of Hamilton's flawed analysis followed suit. Auckland Council eventually saw some sense and agreed that some of their proposals were likely to see some un-intended consequences of stalling development across the region. However, this is not over and there is considerably more work that needs to be done.

12.18. It is well-known amongst councils that there are very few, other than the development community, that are concerned with development contribution policies. Therefore, they understand they are unlikely to be judicially reviewed and will push the boundaries on what they think they can get away with. This is clearly evidenced by the number of submissions we need to make highlighting their responsibilities under the LGA and the Neil Group case.

12.19. Property Council supported the Department of Internal Affairs Guidance for councils on development contributions. However, if councils continue to refuse to follow their mandatory responsibilities we can 't expect them to follow voluntary guidance.

*Credit ratings*

12.20. Property Council notes that many councils have reached their debt and borrowing limits, including Auckland, that is hindering their ability to erect sorely needed infrastructure. However, we note that Standards and Poor's (S&P) recognises deficiencies in any funding model that incorporates local decision-making and rates local government accordingly. If local decision-making is removed from the management of any utility an organisation can receive a higher credit rating and thus borrow more.

> "The governance structure will be credit-neutral so long as there seems to be the ability for management to operate the utility as an ongoing, viable enterprise, largely independent from politics, with professionals who are capably engaged in risk oversight and can balance interests appropriately."[6]

12.21. Similarly, Council-Controlled Organisations (CCOs) are rated the same as the governing body as it will ultimately have the final decision-making authority, i.e. S&P will still rate a CCO the same as the Governing Body because they will ultimately step in if something goes wrong. S&P rates a privately held utility higher due to the better and more structured a private company's decision-making is versus public management. If political influence is removed a far better, more long-term strategic decision can therefore be made.

*Central Government's role*

12.22. Central government has long removed assistance in helping local government construct needed infrastructure. Apart from 50 per cent of roading infrastructure from NZTA and the occasional assistance for drinking water and tourism infrastructure, central government has continued to not help with infrastructure needed to meet our growing economy. It is time that central government provides more and pays its NPV (net present value). Previously, when infrastructure was keeping pace with our growth, central government was paying about a third towards needed infrastructure. This lack of input has led to less revenue being collected and less infrastructure being built.

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[6] Standards and Poor's Ratings, "*U.S. Public Finance Waterworks, Sanitary Sewer, And Drainage Utility Systems: Methodology and Assumptions*", December, 2014, https://www.spratings.com/documents/20184/908554/US_PF_Event_RFCRndTblsJan2015_Article1/30d125eb-1066-4730-8ab1-f2cd6a6d6f9a.

12.23. Your paper also mentions local government's concerns regarding central government placing more and more cost pressures and regulatory responsibilities on councils, and we agree. However, we do believe that at the very least their reporting and monitoring requirements are a must, and some councils even fail to meet those. We question some of the monitoring of district plans. The district plan monitoring if undertaken could help formulate their reviews of their district plans.

12.24. A wholistic approach needs to be considered including how central government plays its part.

*GST*

12.25. Significant discussion has been given to the GST amounts, particularly in tourist areas, collected in an area going back to where it was collected. Although this is what many local authorities would like to see we suggest this is only a short-term solution and more needs to be done as outlined above.

12.26. The major issues are not with the revenue gathering but how it is shared and how local authorities make their decisions and manage their infrastructure.

*Tourism Sector*

12.27. Your issues paper discusses other options such as visitor levies and bed taxes. Property Council has previously questioned Auckland Council's Accommodation Provider Targeted Rate, as it levies one sector against another, and could potentially reduce the value of hotels and other accommodation property. Although we support targeted rates how the hotel industry is managed means building owners are unfairly targeted as there is no direct or apparent benefit to property owners in the provision of tourism services and events, particularly where those property owners are unable to pass on the rate.

12.28. Often accommodation providers operate their businesses from a mixed-use property containing other tenants, such as restaurants, cafes, shops or offices providers and it is unlikely a property owner will be able to pass this cost on. This creates a perverse outcome in the context of mixed-use property, whereby the property owner would be unable to recoup the cost from its multiple tenants, some of which are not accommodation providers. This could cause significant issues in how a landlord imposes rental charges, which could further impact on the property owner's ability to lease part of a property for accommodation purposes.

12.29. However, we believe a nationally established visitor levy could alleviate some issues, particularly for smaller areas with low rating bases, such as Queenstown Lakes. Many countries have introduced visitor levies or bed taxes to alleviate the costs caused by visitors, and these have been acceptable to visitors who understand the need to manage infrastructure. If this were to be introduced, we suggest it will need to ring-fenced back into the communities in which they have been collected to be effective.

*Cost indices*

12.30. Rising prices is also always a concern. Your issues paper notes that local government uses the Local Government Cost Index (LGCI) to monitor its costs of goods and services. This index is a means to better understand the constraints of local government's capital expenditure. Local government needs to have wide ranging cost indicators that are over and above the consumer price indicators. If it is currently not meeting the needs of local government, we suggest a thorough review of the LGCI be undertaken and amended more in line with current costs.

12.31. There are numerous funding tools and a fairer system needs to be considered with significantly more oversight. Property Council suggests a range of revenue models needs to be considered. The heavy reliance on just a few is again inherently unfair. You will see that some could be useful in the New Zealand context and others may not. A thorough analysis of all the possible options is required. Property Council is happy to work with the Productivity Commission to consider what might work best for New Zealand.

12.32. We suggest better governance and clearer oversight are required at the very least. At a bare minimum clearer and more transparent financial reporting should also again be mandated. Having reviewed all the annual reports, it was often quite difficult to find some of the information contained within. Poorly made decisions at the local authority level have been leading to the problems we are facing now. Longer-term decisions on revenue, that are potentially ring-fenced, could counter some of the short-sightedness from locally elected councillors, and could be spent in the right places.

## 13. Conclusion

13.1. Property Council suggests the whole system is broken and that all options need to be considered. Our members are happy to work with the Productivity Commission and the Government to look at innovative ways to pay for the infrastructure that is so sorely needed.

13.2. Local government is anything but effective and efficient and amendments to the LGA have only tweaked the edges. At the very least more oversight is required. However, better reporting requirements, more incentives or mandated requirements for shared services and better financial reporting could be short-term solutions.

13.3. We also suggest this review should have been undertaken in conjunction with the Three-Waters review. Any decision made on the three-waters infrastructure will have a direct bearing on any decision regarding local government funding. The lion's share of any local authority's budget should be three-waters infrastructure.

13.4. Property Council again wishes to thank the Productivity Commission for the opportunity to provide feedback on your inquiry into local government funding and finances. We are happy to engage further the Productivity Commission on any further assistance required and to discuss our submission.

13.5. Any further queries do not hesitate to contact Jane Budge, Senior Advocacy Advisor, email: jane@propertynz.co.nz or cell (021) 863-015.

Yours sincerely,

Leonie Freeman, Chief Executive
Property Council New Zealand