Productivity Commission

Local government funding and financing, Draft report (July 2019)

Submission by Dr Kenneth Palmer

Value capture recommendations

1 Introduction

This submission focuses on the recommendations for a value capture provision for councils. In the Draft report (p 182) the **funding and financing growth** recommendations include: "give councils the ability to levy targeted rates on the *increase* in land value as an additional revenue source for high-growth urban councils (the Commission previously recommended this value capture tool in its *Better urban planning* report)".

In the *Better urban planning* report, February 2017, the following recommendation is made:

"R 11.6 A future planning system should include a value-capture tool for councils' optional use to help fund infrastructure projects that benefit broad parts of or the whole of a city. One way of applying value capture that would be feasible, efficient and fair is to enable councils to levy targeted rates on changes in land values. This would require a change in legislation."

2 Value capture at central government level

Under the Income Tax Act 2007, **CB 14** "Disposal: amount from land affected by change and not already in income", provision is continued for a person to be liable for income tax on the disposal of land within 10 years of acquisition, at an increased value, where at least 20% of the excess arises from various listed factors. The factors include the rules in an operative district plan under the RMA, a change in the rules or likelihood of change, a consent granted for development, or likelihood of a consent, or removal of a condition or designation or heritage provision which may affect value. This liability does not apply where the exclusions for a residential property and for farmland apply.

Comment: The extent to which CB 14 is applied in practice, and the level of revenue obtained by the IRD due to the enhancement of land sale values through the operation of the planning system, is a matter on which the IRD could provide information. An assumption is made that the section is not a significant source of revenue, and it would be difficult in most cases to identify that a causal factor in the land price increase was the change in the planning scheme unless there was a specific plan change or a resource consent which could be established as the key factor in increasing the land value. The value could be in a building and not the land.

The revenue under this provision is not shared with local government and would become part of the general revenues of central government. If any provision was made for a local authority to receive revenue from value capture, the system would have two ensure that double

counting or double liability did not arise on the land owner, and that could be a complicated matter which would diminish the efficiency and utility of a value capture provision.

It may be noted that the liability for income tax arises only on the sale or disposition of land within a 10 year period, and that may not occur where the land is retained indefinitely. It can be acknowledged that the liability under CB 14 is a once off liability on disposition, and does not amount to an annual liability for land value increases in the nature of a land tax.

Capital gains tax liability. CP 14 and other provisions of the Income Tax Act 2007, provide for liability on persons whose business is trading or developing land. Outside that area of liability, a capital gains tax recommended in 2018, would have extended liability to all persons disposing of property, not being a principal residence. That capital gains proposal has been ruled out by the present government for the foreseeable future. In principle a proposal by a local authority to receive income from value capture, will duplicate in part the capital gains tax principle, and this is unlikely to receive support from central government.

3 Value capture at local authority level

Under the Town-planning Act 1926, s 29, provision was made for compensation to be paid to a person whose land value was injuriously affected by the operation of the first planning schemes. A claim for compensation would be determined under guidelines in the Public Works Act, and various exclusions were made in respect of such claims.

Under section 30, provision was made for the payment of betterment, being the increase in value of rateable property that "is attributable to the approval of a town planning scheme, or to the carrying out of any work authorised by the scheme". The amount of the betterment increase would be ascertained by a Compensation Court under the Public Works Act. An application by the local authority for betterment determination would be made within 12 months after the completion of work, or within five years after the provisions of the planning scheme coming into effect.

One half of the amount of betterment increase in the value of the rateable property would constitute a debt payable to the local authority, and the recoverable with interest at a rate of 4 ½% per annum by equal instalments over a period of up to 20 years. During the period of payment of the betterment increase in value, the amount would constitute a charge on the property.

Under section 31, all money received by the local authority would be paid into a special fund to call the Betterment Fund. This fund would be applied towards the payment of compensation on other properties which were awarded compensation under section 29, and otherwise for defraying expenses of the local authority in respect of the planning scheme. Pending payments, the moneys in the betterment found could be invested in government securities or bank securities.

To the best of my knowledge, due to problems in determining betterment values, no claims were made by any local authority under section 30 for betterment increase between 1926 and 1953, and section 30 was repealed by the Town and Country Planning Act 1953.

4 Town and Country Planning Acts 1953 and 1977

The provision for land betterment liability and payment was not included in either the 1953 or 1977 Acts. However the provision for payment of compensation to a property owner whose land was adversely affected by rules in the district scheme or plan was continued under the Town and Country Planning Act 1953, section 44, and the Town and Country Planning Act 1977, section 126. Under these statutes, only a handful of claims were made against local authorities for the effects of rules in reducing land values.

Both statutes allowed existing activities and buildings to remain and continue under existing use rights, and the potential to claim for loss of value was circumscribed by various conditions. The reported decisions indicated that claims based on zoning were unlikely to succeed due to the qualifications in the legislation.[1] That outcome was advantageous for local authorities who were able to plan for the zoning and development of areas with confidence and without the risk of claims for compensation being made due to the constraints under the planning rules. In any event the council was allowed a month to change the rule and avoid liability. In practice, most councils were aware of the general principle that the rules should be reasonable in effect, and the rights of appeal to the Planning Tribunal (now the Environment Court) were a safeguard against unreasonable rules.

5 Resource Management Act 1991

Under the Resource Management Act, the provision for payment of compensation for property values injuriously affected is not continued. A new provision RMA section 85, formerly headed "compensation not payable", provided an option for owners who claimed the rules made the land "incapable of reasonable use", and in addition placed "an unfair and unreasonable burden" on the owner, to apply to the Environment Court, for an alteration to the rules to avoid the burden on the owner. An amendment 2017, allowed a further remedy to request the Court to make an order that the local authority purchase the land at market value to enable the owner to relocate where the local authority did not wish to change a restrictive rule.

Two examples can be given of the satisfactory operation of section 85. In the *Steven* decision the owner of a heritage cottage which could not be demolished due to a heritage listing, was able to get an order that the listing should be cancelled, to enable her to make reasonable use of the property by way of disposal at a market price.[2] Another recent decision has involved the owner of a golf course at Matarangi, seeking to have an open space zoning changed to a residential zoning. The particular case failed before the Environment Court on the grounds that the owner had not established that there was no continuing reasonable use of the land as a golf course, or that the value of the land and financial returns placed an unfair and unreasonable burden on the owner.[3]

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[1] *Allison v Piako County* [1957] NZLR 1214 (no claim for rural zoning preventing sporadic housing). *Mackay v Stratford Borough* [1957] NZLR 96 (designation preventing shop rebuilding). See Kenneth Palmer, *Planning and Development Law in New Zealand* (Law book Co 1984), vol 2, 735-745.

[2] *Steven v Christchurch City Council* [1998] NZRMA 289 (cancellatioin of heritage listing).

[3] *Golf (2012) Ltd v Thames-Coromandel District Council* [2019] NZEnvC 112.

These decisions indicate that the effect of a planning scheme, may be one of swings and roundabouts or "windfalls for wipeouts", as noted by an American author Professor Hagman.[4]

If a proposal is made to introduce a value capture regime, it should be borne in mind that as a matter of equity, where a property diminishes in value due to a restriction or rule in a district or regional plan or public work, there could be a role for the local authority to pay compensation to that owner. For example, new rules in the Auckland Unitary Plan 2016 allowing an increase in heights of buildings in residential zones may result in many owners losing sea and landscape views, and the value of their properties being diminished. To reintroduce a system of compensation, would be legally complex, and could undermine the efficiency and effectiveness of any approved plan, and negate the public consultation process and appeal rights in establishing the plan. A return to the former law introduced under the first Town-planning Act 1926 would be a hugely backward step and is not recommended.

6 Road improvement betterment claims

The Local Government Act 1974, section 326, remains in force today and continues a provision for a council to make a claim for betterment where the council forms a new road in the district or widens any existing road or part of the road, and takes or purchases part of the land which has frontage to the road. Further, that by reason of the widening of the road or formation, the value of the remaining part of the land not taken is increased by an amount that exceeds the amount of compensation payable. In these circumstances, the owner is required to pay the excess of the land value by way of betterment to the council. The amount of liability can be paid in one amount or spread over a period of up to 14 years, and the liability will form a charge on the land. The amount received by the council in betterment is to be firstly expended in paying the cost of the land acquired and road formation or upgrade. Any excess balance is to be applied in respect of the widening of other roads in the district.

Section 326 has been the subject of several court decisions. The most significant case is *Waitakere City Council v Khouri*, regarding a dispute over liability to pay betterment value.[5] Various landowners agreed to the construction of a public road and agreed on the amount of contribution. A proposal to charge an adjoining owner for betterment was contested. The Court construed the liability section as not applicable to an owner who received a betterment where none of their land was taken for the work. The section was criticised for its lack of clarity and lack of consistency. Tipping J in the Court of Appeal made various statements including: "All this points to yet another anomaly in a betterment regime which is riddled with anomalies". A later statement is made "While there is no great logic in confining payment of betterment to cases where compensation in accordance with the Public Works Act is payable, there is little logic in the various other distinctions which are implicit in the statutory betterment regime". [No amendments have been made to s 126 following this decision.]

By way of comment, the provision for payment of betterment in respect of road construction or improvements, provides a caution against relying upon betterment assessments as a

[4] Donald J Hagman, Dean J Misczgaski, *Windfalls for Wipeouts: Land Value Capture and Compensation* (Amer Planning Assoc 1977). Available Amazon.

[5] *Waitakere City Council v Khouri* [1999] 1 NZLR 415, [1999] NZRMA 353 (CA). See Kenneth Palmer, *Local Authorities Law in New Zealand* (Brookers 2012), ch 4.2.5.

source of revenue, where property owners benefiting are not in agreement over a works project and their contributions. The section may have very limited application in practice, and the interpretation limits its application to a person who would have a claim for compensation against the council for loss of land, where the balance land value is enhanced by the work to a greater value.

7 Conclusion

An ultimate example of a value capture law is the former Community Land Act 1975 (UK) enacted by the UK Labour government. The CLA was intended to nationalise land values at a specified date, and all sales of land after that date would be channelled through the local authority. At least 90% of any increase in value in the sale of the land would be payable under a capital gains tax. In practice, large areas of land were withheld by owners and land bankers from disposal or sale to avoid the liability, and the opposition Conservative party pledged to repeal the law when restored to government. Local authorities were funded to purchase the land by central government, and in several notable instances the councils ended up purchasing unsuitable land at inflated land values from owners who were pleased to dispose of land, and the councils made substantial losses on the holdings. The Community Land Act was repealed in 1980, and has not been reintroduced. In the UK the more general capital gains tax liability, provides an appropriate value capture tax which is paid to central government.

Regarding the history of attempts to claim betterment in 1926 in New Zealand, the failure of that system due to problems in establishing that the increase in value could be attributable to the planning schemes, and not a consequence of loss of monetary value and general inflation, and the related issue of providing compensation for property owners whose values diminish, provides a challenging situation for any proposed legislation. For example, a landowner holding a multitude of properties, could be in a position where some properties increase in value and others diminish. By way of comparison with rental properties, the general taxation system allows for gains and losses to be offset. A value capture system for local government would need to take account of that possibility. No encouragement should be given to property owners to challenge the present district and regional plans other than through the existing appeal structure.

For the reasons set out, proposals to establish a value capture system are not supported. The present powers of a local authority to establish a targeted rate to provide for annual payments by property owners who benefit from an existing or proposed work or services, to finance or repay the cost of that work or service, are adequate, fair and reasonable.[6]

Any increase in the values of the properties within a targeted rate area, could result in the owners of the properties with increased values paying a proportionately larger sum under the targeted rate. Other properties in the area which do not increase in value or may diminish the value, such as apartments, may pay less. This system largely achieves the objectives of a

[6] *Kidd v Southland District Council* [2019] NZHC 1947 (targeted toilet rate in residential complex held to be lawful and reasonable).

value capture system, without the complications, inefficiencies and costs of a further system, which is not considered to be necessary or legally practicable.

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