29 August 2019

New Zealand Productivity Commission
PO Box 8036
The Terrace
Wellington 6143

Draft report: Local government funding and financing

Meridian is supportive of the Commission's proposals for improving the way councils manage cost pressures and fund their services. We particularly welcome the recommendation that the Government introduce legislative changes to increase the transparency and quality of local government planning and rating decisions.

In our earlier submission on the Commission's issues paper, we noted that Meridian and other electricity generators have high capital value assets and therefore pay extraordinarily high rates, while benefiting from relatively few local government services. When setting a targeted or differential rate, Meridian considers it best practice for a local authority to demonstrate that there is:

- a different level of service; or
- a different share of benefits; or
- the cost of providing the service to one group is different to the cost of providing that same service to others.

Therefore, Meridian is a strong supporter of the Commission's proposal that local government follow, in the first instance, a legislative principle that the burden of rates should be allocated in a way that reflects the level of benefits received by rate payers.

Meridian Energy Limited

Level 2, 55 Lady Elizabeth Lane
PO Box 10-840
Wellington 6143
New Zealand

Phone +64-4 381 1200
Fax +64-4 381 1272
www.meridianenergy.co.nz

The table appended to this submission addresses some of the specific questions from the Commission's draft report. In addition, this cover letter highlights Meridian's key concerns, namely:

- the potential adverse impacts if differentials are removed entirely; and
- the need for greater oversight and accountability for rating decisions.

Adverse impacts if differentials removed entirely

On page 191 of the draft report the Commission notes that rating decisions are often made in a non-transparent manner and the resulting allocation of rates does not clearly reflect the way benefits fall. The Commission concurs with the Shand Report's finding that councils set differentials in non-transparent ways. It consequently echoes the Shand Report's recommendation that rating differentials should be abolished from the suite of tools available to councils. The Commission concludes with the finding that targeted rates are a more transparent way of giving effect to the beneficiary pays principle. The Commission recommends that councils should have 5 years to remove rating differentials.

Meridian shares the Commission's view that councils currently use differentials in a way that is not transparent and often does not allocate the burden of rates to those who benefit from council services. However, Meridian is also of the view that removing differentials entirely without a simultaneous shift to targeted, and principle-based rates could have significant unintended adverse effects. Sometimes rates differentials are applied in a way that reflects the benefits and services received by a rate payer. For example, up until 2013, the Southland District Council used a differential rate in favour of Meridian to recognise the disparity between the high capital value of Meridian's assets against a significantly lower demand for the services provided by the Council. The removal of this differential resulted in a 60% increase in Meridian's rates between the 2012 and 2013 financial years. It is likely that the blanket removal of differentials proposed by the Commission would result in similar adverse impacts elsewhere.

A simultaneous uptake of more targeted rates based on the beneficiary pays principle could alleviate adverse outcomes. However, Meridian considers there to be a real risk that local government would simply remove differentials and leave the adoption of targeted and principle-based rates to a later date (which may never arrive). Meridian considers it far lower risk to allow differentials to remain a rating tool, so long as differentials are applied transparently and in a manner consistent with the overarching beneficiary pays principle.

This would likely require a more granular approach than a blanket residential to business differential.

There is broad discretion for councils to simply remove differentials without a simultaneous adoption of targeted and principle-based rates. There is also limited opportunity for affected parties to challenge such a decision. Meridian is concerned that designing a targeted rating system based on the beneficiary pays principle could be administratively difficult and require more local government resources, therefore local government will have incentives to avoid making this change. In addition, retention of an ability-to-pay principle as a secondary consideration would give councils licence to continue to target large businesses irrespective of the council services enjoyed by those businesses.

Meridian strongly supports a legislative principle that the burden of rates should be allocated in a way that reflects the level of benefits received by rate payers. However, we consider there to be significant risks involved in the removal of rates differentials and that they should remain part of the tool box available to local government. Finally, a legislative ability-to-pay principle is undesirable, increases the risk of inefficient outcomes, and is at odds with the Commission's acknowledgement on page 184 of the draft report that measures to redistribute wealth should be left to central government.

Oversight and accountability for rating decisions

Local authorities frequently make decisions that impact significantly on the community and have significant financial consequences. Meridian agrees with the Commission's comments on the need for robust processes and transparency around those decisions.

In Meridian's earlier submission on the Commission's issues paper, we commented on the limited opportunity in the current system to have an effective voice in long-term planning processes or to challenge rating decisions. We suggested that there should be a right to appeal rating decisions on their merits. In Meridian's view, this would incentivise councils to engage with ratepayers and produce more transparent decisions that are consistent with empowering legislative principles. The Commission acknowledged our concerns but ultimately concluded that the potential drawbacks, such as delaying the adoption of long-term plans ("**LTP**") and strengthening the voice of minority interests, are undesirable. The Commission instead proposes a transparency-based approach to improving the accountability of council decision making.

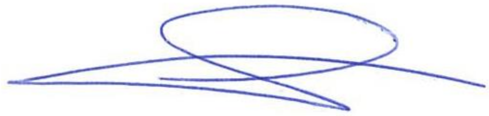
The Commission has proposed that the legislative information requirements for local government consultation and audit processes be clarified and amended. The Commission recommends that LTP consultation documents provide more detailed information on the implications of options and that councils implement robust quality assurance procedures for LTPs, for example using independent expert review for significant decisions. Meridian supports these proposals.

However, Meridian still considers there to be a need for additional checks and balances. Meridian's experiences have demonstrated that even when presented with evidence regarding the beneficiaries of local government services – councils may still allocate costs to those they consider more able to pay. Making a rating decision contrary to the advice of an expert reviewer would be no different. Even in these cases, judicial review of rating decisions offers extremely limited opportunity to review rating decisions given the breadth of local government rating powers and the lack of firm legislative guidance. To the extent that the proposed legislative principles are conflicting and there is no clear prioritisation, judicial review processes will remain inadequate.

An alternative to merit appeals would be an increased role for central government to review rating decisions and test the reasonableness of these decisions against the legislative principles proposed. The powers to intervene in Part 10 of the Local Government Act are more tailored to intervention in cases of systemic failure, rather than for review of individual decisions. While we acknowledge the importance of local government autonomy, Meridian considers greater central government or judicial oversight on the merits of rating decisions would increase the accountability and transparency of rating decisions.

Meridian representatives would welcome any opportunity to discuss this submission in person. Otherwise, please contact me if you have any queries regarding this submission.

Yours sincerely



Sam Fleming
Regulatory Counsel

Appendix

	Question	Comment
3.1	Is the current methodology for preparing the Local Government Cost Index sufficient for forecasting the prices that local authorities are likely to face? If not, should the methodology be improved, such as by one or more of: (a) carrying out more frequent reweighting; (b) including output indices; and (c) disaggregating by council type?	No comment.
4.1	To what extent are the Treaty-related costs associated with fulfilling the obligations and requirements under local government statutes "business as usual" for councils? And to what extent should they be considered costs incurred to fulfil obligations on behalf of the Crown under the Treaty of Waitangi?	No comment.
5.1	The Commission is seeking more information on the advantages and disadvantages of reducing the frequency of Long-Term Plan (LTP) reviews, while retaining the requirement for annual plans. What would be the benefits, costs and risks of reducing the frequency of LTPs, from every three years to every five? What if five years were a minimum, and local authorities were free to prepare LTPs more frequently if they wished?	Meridian sees considerable benefit in decoupling LTP processes from the political cycle. We think this will increase the likelihood of principled rating decisions. Less frequent LTP reviews would also lower the burden for stakeholders to engage (especially for organisations with a presence throughout New Zealand). However, less frequent LTP reviews would also further limit the ability of rate payers to influence rating decisions. Meridian already considers there to be minimal opportunity to be heard when it comes to rating decisions and less frequent reviews would exacerbate this problem. Meridian would be less concerned about this effect if we had confidence in the principled nature of rating decisions. A longer LTP review cycle that went together with steps to prescribe a principled approach to rating and increased the accountability of local government, would provide significant benefits.
5.2	Is it appropriate for local authorities to include an adjustment for anticipated price inflation when they set rates each	Meridian does not consider it appropriate for local authorities to include anticipated price inflation in their

	year? If not, what disciplines could be applied to the rate-setting process, to encourage local authorities to seek to manage cost and price pressures through productivity improvements? What would be the benefits and drawbacks of such an approach?	budgeting process. Receiving an automatic increase in baseline funding each year assumes consistent increases in costs but does not necessarily relate to any actual increases. As noted by the Commission, central government does not include provision for inflation in its budgeting and agencies are expected to manage within their baselines through reprioritisation and productivity improvements. Meridian sees merit in applying a similar discipline to local authorities to encourage a greater focus on productivity improvements.
5.3	Would establishing a capital charge for local authorities be an effective way of incentivising good asset management? What would be the advantages and disadvantages? Are there other, more effective ways of encouraging better asset management practices in local government?	No comment.
6.1	How desirable and useful would a tax on vacant residential land be as a mechanism to improve the supply of housing for New Zealanders? How would such a tax measure up against the principles of a good system of local government funding and financing?	An alternative way to deter residential land banking would be to apply rates based on land value rather than capital value of a property – increasing the rates liability of vacant land and avoiding disincentivising more productive uses of land.
6.2	What would be the advantages and disadvantages of a system of payments to territorial authorities based on new building work put in place in each territorial local authority? What would be the best design for such a mechanism? Would it be effective in incentivising councils to keep the supply of consented land (greenfield and brownfield) and local infrastructure responsive to growth pressures?	No comment.
8.1	What legal options exist for placing a condition on land-use consents that would make a voluntary assumption of risk by a current owner (and any person or entity who later becomes the owner) enforceable in all future circumstances?	No comment.