Information paper for feedback

Infrastructure Funding and Financing: Development contributions and targeted rates

September 2019

Department of Internal Affairs: Central/Local Government Partnerships Group

Te Tari Taiwhenua
Internal Affairs

Contents

Purpose of this paper **5**
Seeking feedback to inform options development 5
Relationship with the Productivity Commission inquiry 5
Next steps 6
Feedback **7**
How to send us your feedback 7
Further information 7
Official Information Act 1982 7
Summary **8**
Background **9**
The Urban Growth Agenda (UGA) 9
Workstream 3: Effectiveness of existing tools 9
Recent stakeholder feedback about the existing tools 10
Development contributions **11**
Overview of current legislative provisions 11
Issues with the legislation 12
The Crown and development contributions 12
Operating costs related to development contributions 13
Types of infrastructure that can be funded 15
Complexity of the legislation and risk of legal challenge 16
Implementation issues 17
Options to address implementation issues 18
Central guidance resources, advice and support 18
Regional collaboration: Information and resource sharing 19
Compliance checking 20
Targeted rates **21**
Overview of current legislative provisions 21
Issues with the legislation 21
The 30 percent cap on uniform charges/rates 22
Inability to use targeted rates for wastewater on a volumetric basis 24
Postponing growth-related targeted rate collection 25
Reviewing Local Government (Rating) Act Schedules 27
Implementation issues and options 27
The potential of value capture tools? **28**
Introduction 28
Value capture tools: A brief overview 28

Issue summary 29
Some other things to consider 29

Debt servicing benchmark 32
Overview of current legislative provisions 32
The option of removing the benchmark 32

Appendix One: Further Information on recent Productivity Commission reports 34
Using land for housing (2015) 34
Better urban planning (2017) 34
Local government funding and financing (draft 2019 report) 35

Appendix Two: Feedback Questions 36

Purpose of this paper

Seeking feedback to inform options development

This information paper supports a targeted engagement and feedback process about existing infrastructure funding tools (targeted rates and development contributions).

This paper is not a departmental or government policy statement. Any references to potential improvement options are not policy proposals and no decisions have been made about any such options.

This paper is not an exhaustive summary of all the issues that will need to be addressed in future policy work. Rather, it summarises feedback from initial discussions we held with some key stakeholders, provides further information and invites feedback from a wider group of stakeholders on:

- how the existing tools can be utilised more effectively to better recover the cost of infrastructure; and
- how better cost recovery will help with enabling a more responsive supply of infrastructure and appropriate cost allocation.

We encourage you to review the information and to send us feedback indicating:

- whether you agree with the problems described by stakeholders during our initial discussions;
- any additional cost recovery problems you associate with development contributions and targeted rates; and
- any improvement options you would like us to consider.

We are also seeking feedback on the information towards the end of this paper about the possibilities of:

- removing the local authority debt-servicing benchmark from the Local Government (Financial Reporting and Prudence) Regulations 2014; and
- considering legislative changes to establish new value capture tools.

The following section of this document explains how to send us your feedback before **the cut-off date of Wednesday 23 October 2019.**

Relationship with the Productivity Commission inquiry

On 4 July 2019, the Productivity Commission released its draft report '*Local government funding and financing*'. The final report is due in November 2019.

We have initiated this feedback process as a proactive way for us to gather stakeholder views that will help to inform the Government's response to the Commission's final report. We will analyse and consider your feedback alongside that final report in the process of identifying options and formulating recommendations about improving existing tools.

We have already discussed with Commission staff a summary of the feedback from our initial discussions.

For now, we also note that the Commission's draft report includes comments along the following lines:

- the current funding and financing framework is broadly sound;
- better use could be made of existing funding tools, including by applying the 'benefit principle' as the primary basis for deciding who should pay for local government services;
- user charges or targeted rates should be used wherever it is possible and efficient to do so;
- it is preferable to make growth 'pay for itself' by ensuring revenue for new property developments is derived from new residents rather than existing ratepayers, but there are significant barriers to this happening (eg, the long time it takes to recover the costs of development, the risks involved and debt limits).

Appendix One includes some further background information on recent Productivity Commission inquiry reports.

Next steps

After analysing the feedback, we will report to Ministers on possible improvement options and next steps. Depending on the outcome of the analysis, we may also run some targeted stakeholder workshop(s) to test thinking about the nature and design of options.

Thank you very much for your consideration and for any feedback you choose to provide. We look forward to hearing from you and to reviewing your responses.

Feedback

We invite interested parties to send us **written feedback** in the form of responses to the questions posed in this information paper.

How to send us your feedback

You can send us feedback using the feedback template (a Word version of the template accompanied this paper when sent to you by email) and emailing it to: **isaac.ryan@dia.govt.nz.**

We prefer feedback utilising the template. If you cannot do that, you may simply send us an email. To help with our analysis please clearly indicate in the email which questions you are responding to. Appendix Two is a consolidated list of the feedback questions.

To enable us to stay on track with this work, **the cut-off date for sending us your feedback is Wednesday 23 October 2019.**

Further information

Henry Dowler: Mobile +64 27 344 6691 | henry.dowler@dia.govt.nz

or

Isaac Ryan: Mobile +64 27 742 4007 | isaac.ryan@dia.govt.nz

Official Information Act 1982

Feedback we receive is subject to the Official Information Act 1982 (OIA). If you have any objection to any information in your feedback being released under the OIA, please set out clearly which specific information you consider should be withheld, together with the reason(s) for withholding the information.

Grounds for withholding information are outlined in the OIA. Reasons could include that the information is commercially sensitive or that you wish personal information, such as names or contact details, to be withheld. An automatic confidentiality disclaimer from your IT system will not be considered as grounds for withholding information.

We will take your advice on this matter into account when responding to requests under the OIA.

Any personal information you supply in your feedback will be used only in conjunction with the matters covered by this document. Please clearly indicate if you do not wish your name to be included in any summary of feedback that we may publish.

Summary

The Department of Internal Affairs' Central/Local Government Partnership Group is assessing whether the existing local authority targeted rates and development contributions regimes ('existing tools') can be utilised more effectively to better recover the cost of infrastructure. This is a part of the Government's Urban Growth Agenda (UGA) infrastructure funding and financing work programme.

During July/August 2019, we completed initial background research and discussed existing tools with a few key stakeholders to clarify what they saw as problems with the tools.

The specific problems, as described by stakeholders, during those discussions were:

- only being able to use development contributions to recover capital costs which means that funding for significant operating costs[1] directly associated with preparing for growth-related development and/or development contributions must come from other sources;
- statutory exemptions that prevent recovery from certain parties, including the Crown exemptions;
- forecasting and calculation issues including:
  - dealing with significant complexity and uncertainties;
  - a shortage of relevant expertise to complete the work; and
  - the risk of determinations being challenged which leads to conservatism and consequent under-recovery; and
- the inability of some developers and/or ratepayers to pay the full cost at the time it is due (eg, due to inadequate finance or cashflow).
- the statutory cap on uniform targeted rates;
- the inability to use targeted rates to set a volumetric charge for wastewater;
- the statutory limits relating to categories of rateable land and calculating liability for targeted rates[2]; and
- limits on the types of infrastructure that can be funded, including infrastructure funded but not owned by a local authority.

This paper has been developed to support wider engagement and seeks feedback to assist us with developing clear problem definitions and possible improvement options. We are also seeking feedback on the possibilities of removing the local authority debt-servicing benchmark from the Local Government (Financial Reporting and Prudence) Regulations 2014; and whether and how targeted rates might enable new 'value capture' tools.

Please send your feedback using the Word template attached to the email that came with this paper.

---

[1] Sometimes the operating costs for activities such as pre-planning, forecasting and calculating and administration can be very high relative to the revenue generated.

[2] In Schedules 1,2 and 3 of the Local Government (Rating) Act 2002.

Background

The Urban Growth Agenda (UGA)

The success of our cities affects New Zealand's overall economic, social, cultural and environmental performance. As New Zealand moves to a more sustainable, productive and inclusive economy, cities will play an increasingly important role by hosting a large share of the nation's labour market activity, business growth and connections with other countries.

However, our cities are under pressure and are not delivering the benefits we want. We are seeing the symptoms of this in some major cities with rising urban land prices, unaffordable housing, increasing homelessness, worsening traffic congestion, lack of transport choice and flattening productivity.

The Government is looking at how we can shift our urban markets to perform better, by making room for growth and **making sure growth pays for itself** and investing in transport to drive more efficient and liveable urban form.

The UGA is a package of interventions that aims to facilitate these shifts and address fundamentals of land supply, development capacity and infrastructure provision. The UGA recognises that changes are needed to system settings to create the conditions for the market to respond to growth and bring down the high cost of urban land.

Workstream 3: Effectiveness of existing tools

The first of five UGA 'pillars' is focused on **Infrastructure funding and financing**[3] and the problems of local authority debt constraints and the limitations, or limited and/or variable application, of existing funding tools. Opportunities to help resolve these funding and financing problems are being pursued through the following three workstreams.

1. **Workstream 1:** The design, creation and implementation of alternative financing models to be used primarily for investment in local infrastructure including three waters and transport to support housing and urban development.

2. **Workstream 2:** Investigate easing the existing local authority debt constraints with the Local Government Funding Agency.

3. **Workstream 3:** Assess whether the existing targeted rates and development contributions regimes can be utilised more effectively to better recover the cost of infrastructure.

Although the three workstream activities are coordinated, this information paper relates solely to Workstream 3 and the 'existing tools'. We are <u>not</u> seeking feedback through this process on issues or options related to alternative financing or debt constraints.

[3] The other four pillars relate to urban planning, spatial planning, transport pricing and legislative reform.

Recent stakeholder feedback about the existing tools

To inform the development of this paper, during July/August 2019, we met and discussed the existing tools with some peak organisations[4], senior local authority officials primarily from high growth districts around New Zealand, and Watercare (Auckland). We also reviewed past review reports and submissions to the current Productivity Commission inquiry into local government funding and financing.

The stakeholder feedback indicates that existing tools may not always be as effective as they could be for growth-related infrastructure cost recovery because of:

- legal and practical barriers to achieving full or substantial recovery from beneficiaries/exacerbators;
- local community and political resistance to capital raising and debt-servicing costs and limited incentives to counter this resistance; and
- the long timeframes that may be required to recover what are often large upfront costs.

The effectiveness of the existing tools may also be compromised by stakeholder concerns and disputes around local authority decision-making. Stakeholders usually expressed these concerns in terms of a lack of transparency (distrust) about the bases on which local authority decisions are made, inconsistency and, sometimes, a local authority's failure to meet statutory requirements.

Although outside the 'effectiveness of recovery' scope of this workstream, we also noted stakeholder feedback about:

- investment risks faced by local authorities (eg, when developments do not proceed, or proceed in different places or more slowly than anticipated);
- the varying pace of developments and availability of serviced land for building; and
- the inability to capture some of the private value uplift (windfall gains) generated by growth-related public action (eg, through favourable rezoning or infrastructure investment) with associated inefficiencies and unfairness.

[4] Local Government New Zealand, Society of Local Government Managers, Infrastructure NZ, NZ Property Council.

Development contributions

Overview of current legislative provisions

The current Local Government Act 2002 (LGA) development contribution provisions arise from a substantial review in 2012-13, consequent 2014 amendments and further amendments to the LGA in May 2019.[5] Subpart 5 of Part 8 and Schedule 13 of the LGA contain most of the provisions that enable territorial authorities to require development contributions from those undertaking developments.

The basis on which a territorial authority can require a development contribution is set out in section 199, while various other provisions (including sections 101(3), 106, 200 – 204 and schedule 13) are also relevant.

Section 197AA provides that the purpose of development contributions is to "*enable territorial authorities to recover from those persons undertaking development a fair, equitable and proportionate portion of the costs of capital expenditure necessary to service growth*".

Section 197AB sets out the following seven principles in relation to development contributions which must be actively considered:

- development contributions can only be required when the effect of development is to require territorial authorities to have provided, or to provide, new or additional assets or assets of increased capacity;
- development contributions should be determined in a manner that is generally consistent with the capacity life of assets, and in a way that avoids over-recovery of costs allocated to development contributions funding;
- cost allocations used to establish development contributions should be determined according to who benefits (including the community as a whole) as well as who created the need for assets;
- development contributions must be used for or towards the purpose for which they were collected, and for the benefit of the district or part of the district in which they were required;
- enough information should be available to demonstrate what development contributions are being used for and why;
- development contributions should be predictable and consistent with the methodology and schedules in the development contributions policy; and
- when calculating or requiring development contributions, territorial authorities may group developments or categories of land use, provided administrative efficiencies are balanced with fairness and equity, and grouping across entire districts is avoided where practical.

[5] The May 2019 amendments were part of the Local Government (Community Well-being) Amendment Act 2019.

While there is considerable variation between the development contribution policies developed and maintained by local authorities under the LGA, it appears that development contributions are widely used.

Development contributions enable recovery of upfront capital costs. Where there are borrowing constraints, development contributions can be helpful as an enabler of 'debt recycling'.

Issues with the legislation

Few issues have been raised about the legislative provisions related to development contributions. Overall, stakeholders' feedback was that the legislation is fit-for-purpose and the 2014 and 2019 LGA amendments largely resolved historic issues.

Legislation-related issues that did come up in discussions with stakeholders were:

- provisions of section 8 of the LGA which mean the Crown cannot be required to pay development contributions;
- the inability for local authorities to recover development-related operating (eg, pre-planning) and administration costs as part of the development contribution;[6]
- limits on the types of infrastructure that can be funded through development contributions, including the inability to require development contributions for public infrastructure the local authority doesn't own or provide directly; and
- the relatively complex nature of the legislation and the scope for interpretation around the purpose of development contributions and how they are calculated create opportunities for legal challenge (ie, increasing certainty and clarity would be helpful).

The Crown and development contributions

We understand that the issue relates to section 8 of the LGA[7] and is based on the stakeholder view that:

- the Crown should generally have to pay development contributions in the same manner as all others who benefit from new or additional assets or an increase in the capacity of an existing asset provided by a local authority; and
- determination of any development contribution 'exemptions' should be left to local authorities when developing their individual contributions policies.

We also understand this is an extension of the view expressed in feedback to previous local authority rating and funding reviews and the July 2015 proposal by Local Government New Zealand (LGNZ) that mandatory rating exemptions should be removed.[8]

---

[6] Although not raised during recent discussions, we are aware that the inability of Council Controlled Organisations (CCOs) to seek development contributions may also be seen a concern by some stakeholders.

[7] The effect of which is that the Crown is not bound by the LGA regarding development contributions.

[8] LGNZ '*Local Government Funding Review 10-point plan: incentivising economic growth and strong communities*'.

The issue of rating exemptions was addressed in detail in the August 2007 Report of the Local Government Rates Inquiry ('the Shand Inquiry'). Although the Shand Inquiry supported the almost universal view of local authorities that all rating exemptions should be removed, it also concluded that strong cases can be made to:

- exempt Crown land from rates where land involves a nationally important public good, provides clear net national benefits and where a reasonable valuation of land is difficult to establish; and
- retain statutory exemptions for certain categories of Crown land.

The Shand Inquiry acknowledged that removal of exemptions would be a major policy change with financial implications for the Government (eg, creating the need to increase funding for government institutions) and uncertainty and potential costs for other parties. Shand also found that there are clear grounds for some exemptions for Crown land and local authorities can recover some costs from the Crown through other means (eg, targeted rates for water supply).

The exemption issue relates to the entirety of rating and goes well beyond the scope of this existing tools 'effectiveness of recovery' assessment. We note that that the Productivity Commission did not make any recommendations on the issue in its draft report on local government funding and financing. Further consideration may be given to this issue if the final report of the Productivity Commission (due in November 2019) includes a relevant recommendation.

Operating costs related to development contributions

Section 197AA of the LGA is clear that the purpose of development contributions is to enable recovery of capital expenditure. We note that the LGA definition of a "capital project" is the same as that in section 117A of the LGRA, namely:

> ***capital project****—*
>
> *(a) means a project or work the expenditure for which is not recognised by generally accepted accounting practice as being operating expenditure; and*
>
> *(b) includes a loan in relation to a project or work.*

Local authorities have advised us that, in addition to capital expenditure, they incur significant operating expenditure in planning and preparing to open areas for growth and administering the development contribution regime.

We were advised that:

- this operating expenditure includes the costs of procuring and paying external advisors as well as internal staff time and overheads; and
- as operating expenditure cannot be recovered through development contributions, they are usually funded out of rates revenue with the cost generally falling to existing ratepayers, rather than those who benefit directly from the growth.

We expect that, in calculating and setting development contributions, local authorities will apply generally accepted accounting practice (GAAP) to distinguish between capital and operating expenditures.

If legislation were to be changed to enable recovery of operating expenditure through development contributions, amendments may need to be made to LGA provisions relating to matters such as the development contributions purpose, principles, policies and methodology.

The complexity of the legislation may increase as amended provisions would need to be drafted in a way that ensures such operating costs are:

- directly related to developments that require a local authority to provide new or additional assets or to increase in the capacity of an existing asset;
- limited to operational activities that are essential elements of the process of planning and preparing for a development and administering the development contributions directly related to the development (ie, as distinct from ongoing infrastructure operating costs); and
- otherwise legally constrained to ensure the costs are reasonable and over-recovery is avoided.

Policy decisions would also need to be made about whether and how to provide in legislation what flexibility local authorities would have in their determinations around the inclusion, or otherwise, of operating expenditures in development contributions.

We also note that:

- local authorities do already have the option of using a targeted rate to recover relevant operating expenditures from those who benefit directly from the growth (ie, rather than the existing ratepayers who do not); and
- it is likely that inclusion of additional costs in development contributions would increase the amount of contributions, reduce incentives to develop and/or increase the cost of post-development land.

On the other hand, if inclusion of operating costs meant the funding/recovery system became more sustainable, the supply of infrastructure may be more responsive and better support more competitive urban land markets.

Question One:

Please tell us whether you support the idea of amendments to enable inclusion of some operating costs in development contributions, or whether you prefer to retain the current focus on capital expenditure. Please explain the reasons for your answer.

If you support the amendment idea, please include in your answer information about:

- ***how this would enable more effective cost recovery and why this is preferable to using targeted rates;***
- ***how you consider such costs should be determined; and***
- ***what, if any, implications higher development contributions will have on growth?***

Types of infrastructure that can be funded

Recent legislative changes

Some local authorities referred to the 2014 LGA amendments that narrowed the scope of development contributions. For example, those amendments meant that development contributions could no longer be required as a contribution towards ‘community infrastructure’, such as swimming pools, that have community-wide benefits.

This concern was also referred to by LGNZ in its July 2015 ‘10-point plan’ which proposed that the 2014 scope limitation be reconsidered to “…*give growing communities the flexibility to ensure continued economic development without unfairly burdening existing residents*”.

The proposed reconsideration has occurred. In May 2019 amendments to the LGA restored local authorities' power to collect development contributions for any public infrastructure needed because of development and for reserves from non-residential development.

The development contributions principles in section 197AB and other LGA provisions that existed prior to the 2014 amendments still require a ‘causal nexus’ approach to development contributions. This helps to ensure that, as far as practicable, everyone who benefits from new infrastructure contributes to its cost. The distinction is between the private good nature of local infrastructure (where those who use it are relatively easy to define, and there is little or no use of the infrastructure by people from outside the development area) and the public good nature of infrastructure that is regularly accessed and used by the wider community.

Infrastructure funded but not directly provided by a local authority

At least one local authority mentioned the inability to require development contributions for public infrastructure the local authority doesn’t own or provide directly, but for which it has agreed to contribute funding through a partnership or one of many other possible formal ownership and control arrangements. Examples might be facilities jointly provided with a local school, or a sportsground owned by the relevant sporting body.

This issue was also raised by several local authority submitters on the Bill that led to the May 2019 amendments to the LGA. In summary, submitters considered that, provided such arrangements deliver growth-related infrastructure that complies with the LGA in all other respects, it would be reasonable for at least some of the relevant local authority capital expenditure to be recovered through development contributions.

Although the submissions did not lead to changes to the Bill, consideration of the issue did highlight:

- the merits of such joint arrangements; and
- potential for local authorities to structure the arrangements so that their expenditure is classified as capital expenditure and recoverable through development contributions (ie, without amendments to the LGA).

This potential arises from the definition of ‘community infrastructure’ in s.197 of the LGA, which refers to local authority <u>control</u> as well as ownership. Examples of this potential are:

- where a council has a long-term lease of land for the provision of a facility, it could reasonably be said that the council controls the land, even if it does not own the land; and
- where a council-controlled organisation provides a facility or service on behalf of the council, it is arguable that the facility is controlled by the council (albeit indirectly).

Risks associated with enabling the use of development contributions in such circumstances include:

- potential for increased pressure on local authorities to meet the capital cost of amenities that have traditionally been met from other sources (eg, private fundraising or the Crown);
- increasing complexity/confusion about funding allocations when considering whether and to what extent the development being charged has caused the need for the joint infrastructure; and
- difficulties with maintaining transparency around the cost of the infrastructure and the proportion of local authority funding being contributed.

If consideration were to be given to extending the legislative provisions to provide greater flexibility around joint provision of community infrastructure, it would still be a requirement for expenditure to be limited to that which is necessary to service growth. There would also need to be protections against the additional risks of:

- the funding system being gamed by the local authority's infrastructure partners (ie, at the expense of developers); and
- subsidisation of one private enterprise by another.

Question Two:

Given the potential already provided by the 'control' reference in the LGA definition of community infrastructure, do you consider that there is any need to consider further amendments? Please explain the reasons for your answer.

If you support further amendments, please include in your answer an explanation of:

- ***how the amendments would enable more effective cost recovery; and***
- ***how you consider the risks identified in this paper could be effectively managed.***

Complexity of the legislation and risk of legal challenge

Although the general complexity of the legislation was referred to by several stakeholders in terms of the work it involves to comply, no specific concerns about legal challenge risks were noted. Where concerns were raised, they usually related to how the law was being applied by an individual local authority, or a particular scenario or context.

While it appears that some local authority stakeholders would value some further guidance and advice, most indicated that they could work with developers and others to navigate and apply the legislation appropriately.

Question Three:

Please indicate any specific legislative provisions related to development contributions you consider are not clear, what changes you would suggest to improve clarity and how the changes would enable more effective cost recovery.

Implementation issues

From our readings and direct discussions with stakeholders, it seems that some of the development contribution implementation issues may be more significant and of greater concern than the legislation itself.

The implementation issues that came up during our stakeholder discussions are:

- different (inconsistent) approaches to how local authorities develop, present and implement development contribution policies, including within the same region;
- in some cases, concerns about a lack of transparency and/or precision around the content of policies or specific development contribution calculations and/or failures to strictly comply with legislative requirements;
- difficulties local authorities experience in accurately forecasting development requirements and calculating development contributions, with brownfield and commercial developments being the most challenging;
- financial risks to local authorities if development is delayed and/or most growth occurs in locations other than was anticipated;
- a shortage of expertise for assessment work and to develop the evidential base that supports cost attribution and the quantum of the development contribution; and
- the extent that developers can afford to pay, upfront, large development contributions.

From those discussions, we understand that the implementation issues arise largely from:

- independent decision-making by each local authority in highly variable community contexts and development environments;
- complexities, uncertainties, trade-offs, differing risk appetites, community and political priorities and/or varying financial capacities that inevitably complicate local authority decision-making about future developments and proportionate cost allocations; and
- the differing capabilities and capacities of local authorities and developers to consider and address wide-ranging issues in highly variable circumstances.

Options to address implementation issues

Stakeholder discussions indicated that options to address implementation issues might include some more:

- central development and provision of guidance resources, advice and support;
- regional collaboration and information and resource sharing; and
- formal, independent compliance checking.

We discuss each of these options briefly below and seek further feedback to assist future, more detailed consideration of the merits of these suggestions.

Central guidance resources, advice and support

Local authorities and other stakeholders take advice and use guidance resources from a range of internal and external sources. External/central sources include peak organisations such as the Society of Local Government Managers and Local Government New Zealand and information published from time-to-time by the Department of Internal Affairs.

We are seeking feedback to enable us to assess whether stakeholders consider there is already enough central guidance, advice and support about existing tools and which guidance and advisory support is currently most valued.

If any stakeholders consider that new, improved or additional central guidance resources or advisory support is necessary, we also seek feedback on:

- what else is needed;
- why it is needed (ie, how it would improve the current situation);
- how it should be provided and by whom; and
- who should pay for the development and provision of the new/additional guidance resources, advice and support.

We note that the Productivity Commission's draft 2019 report includes the following recommendation (R6.1):

> *"The Government, Local Government New Zealand and the New Zealand Society of Local Government Managers should work together to develop standardised templates both for the development contribution (DC) policies of councils and council assessments of DC charges for individual property developments. Councils should be required to use the standardised templates."*

From our recent discussions with stakeholders, we expect that central and local government organisations working together to develop standardised templates may be viewed positively. However, because local authorities must respond to a variety of issues with differing local circumstances and community preferences, we are uncertain about the merits of making the use of templates a 'requirement'. We would welcome stakeholder feedback on this point.

In the cost recovery context, we invite stakeholders to consider whether and how central advisory and support services could be improved. For example, in terms of centralised expert capability and capacity and its current availability to local authorities to:

- provide clarifying support, advice and some basic compliance checking (short of legal advice); and

- collate and publish helpful case studies and other information to assist local authorities to identify options for:
    - dealing with forecasting and cost calculation challenges and associated litigation risks;
    - managing financial and other growth-related risks, including cross-subsidisation from rates or other funding sources where cost estimates are too conservative;
    - accessing data and specialist expertise to support decision-making; and
    - working constructively with developers of varying capability and capacity.

Question Four:

<u>With cost recovery effectiveness in mind</u>, please tell us:

- ***which existing guidance resources and advisory support arrangements you value most highly and why;***
- ***whether you consider central guidance resources and advisory support could be improved and, if so:***
    - ***what specific improvements are needed and why;***
    - ***who should lead and contribute to the improvement work; and***
    - ***who should pay for the improvements and any ongoing delivery costs and why they should pay.***
- ***your view of the standardised template recommendation in the draft Productivity Commission report and the idea that the use of such templates should be a 'requirement'.***

Regional collaboration: Information and resource sharing

Stakeholder discussions confirmed that inter-district and regional collaboration and information and resource sharing already occurs to varying degrees in terms of scope and formality. However, we were told that, even in regions where there is relatively close collaboration, independent decision-making at the district level means that some generally desirable regional alignments of local authority development contribution policies and processes cannot always be achieved.

Alignment in this context doesn't necessarily mean identical, or absolute consistency. Rather the aim would be to achieve consistency insofar as local circumstances and community preferences allow. The extent that community preferences can or should be influenced by the regional approach will also need to be determined at the regional level.

As the ultimate independence of each local authority is currently a 'given', approaches to inter-district and wider regional collaboration around development contributions involve local authorities that are adjacent, or within a region, determining themselves whether and how to collaborate and/or share information and resources.

Like the discussion above about central guidance, advice and support, we are seeking feedback to enable us to assess whether and how regional collaboration and information and resource sharing can be improved for the benefit of all concerned.

Question Five:

<u>With cost recovery effectiveness in mind</u>, please tell us:

- ***which existing regional collaboration arrangements you value most highly and why;***
- ***whether you consider regional collaboration could be improved and, if so, what specific improvements are needed and why.***

Compliance checking

Developer representatives and some of the local authorities we spoke with suggested that there should be more formal, independent checking and reporting on local authority compliance with legislative requirements around development contributions. As they described it, this would be central, regulatory oversight and public accountability measures additional to and independent of the advisory functions referred to earlier in this section.

In general, we consider it reasonable to assume that:

- local authorities genuinely strive to comply with all relevant laws and will be prudent in seeking legal advice in carrying out their functions;
- guidance and advice provided to local authorities by their own legal advisors and others (eg, SOLGM) is fit-for-purpose and helps to ensure compliance;
- non-compliance by a local authority will generally be due to an oversight or misinterpretation of the law (rather than deliberate action or omission); and
- where non-compliance is brought to the local authority's attention (eg, by an adversely affected party) a suitable remedy will be applied by the local authority with due haste.

That said, there are examples of local authorities' interpretation and application of the law and/or development contribution policies being challenged and found to be wrong. While it is preferable that such situations are avoided, issues may not always be clear-cut and an authoritative determination (eg, by Development Contribution Commissioners or the Courts) can help to clarify and confirm how the law/policies should be applied generally, or at least in the circumstances of a specific case or type of situation.

We welcome feedback from stakeholders about this compliance checking suggestion.

Question Six

Do you consider compliance checking powers beyond current provisions (eg, the powers of Development Contribution Commissioners) would improve the effectiveness of cost recovery? Please explain your answer.

If you do consider there is a need for new or additional compliance checking powers to improve the effectiveness of cost recovery:

- ***what would those powers be;***
- ***how would you see them working in practice; and***
- ***how should the exercise of such powers be funded?***

Targeted rates

Overview of current legislative provisions

The Local Government (Rating) Act 2002 (LGRA) enables local authorities to raise revenue through different types of rates from the community generally, specified groups or categories of ratepayers, and those who use or generate the need for particular services or amenities. Sections 16-19 of the LGRA specifically provide for targeted rates as summarised below.

Targeted rates may be set for an activity or groups of activities identified in the local authority's funding impact statement (FIS), including a targeted rate for the quantity of water supplied.

Targeted rates can be set for all rateable land in the district or for different categories of land identified in the FIS and defined in terms of 1 or more of the matters listed in Schedule 2 of the LGRA, which include: land use, area, service availability, situation and value (annual, capital or land value).

A targeted rate may be set on a uniform basis for all rateable land, or differentially for different categories of rateable land.

Factors which can be used for calculating targeted rates are specified in Schedule 3 of the LGRA and include value (land, improvement, capital, or annual value), total land area, area of land paved, sealed or built on, area of land protected, area of floor space of buildings, number of connections, number of water closets and urinals, number of separately used/inhabited parts, and extent of provision of services.

Targeted rates are usually paid incrementally over a longer period and typically require a local authority to borrow to finance the upfront capital costs.

Targeting rates towards those ratepayers who benefit from an investment is seen as a fair way of allocating this burden. Targeted rates can be used "*where a council decides that the cost of a service or function should be met by a particular group of ratepayers (possibly even all ratepayers) on a basis different from that of its general rate*".[9]

Issues with the legislation

Overall, stakeholders' feedback was that the legislation around targeted rates is also largely fit-for-purpose. We were told that the provisions are flexible and provide local authorities with considerable choice in how and where targeted rates are used. Some local authorities told us that they use a lot of targeted rates to ensure that those who benefit pay and to increase transparency about where and why the costs fall to some ratepayers and not to others.

---

[9] Local Government Rates Inquiry, 2007, p. 44).

Legislation-related issues that came up in discussions with stakeholders about targeted rates were:

- the option of removing the 30 percent cap on uniform charges/rates;
- the inability to use targeted rates for wastewater on a volumetric basis;
- the option of enabling collection of a growth-related targeted rate to be postponed until a property is sold (ie, postponed rates paid by the purchaser), with this recorded on the land title;
- the option of reviewing and updating LGRA Schedules; and
- inability to use targeted rates based on changes in the value of property over a specific timeframe ('value capture').

The 30 percent cap on uniform charges/rates

Where any targeted rate is calculated as a fixed amount per rating unit, the provisions of section 21 of the LGRA mean that a council cannot collect more than 30 percent of its total rates revenue by way of a combination of those targeted rates and uniform annual general charges (excluding targeted rates that are set solely for water supply or sewage disposal).

The intent of the cap is to limit the regressive impact of uniform/undifferentiated rates (ie, rates that take a larger percentage of a low-level income and a smaller percentage of a higher income). As such, the cap is seen as an 'affordability' intervention which:

- recognises that the cost of basic, universal local authority services is often a larger percentage of the expenditure of the lower income population;[10] and
- limits local authorities' ability to fully apply the 'beneficiary pays principle' when setting uniform targeted rates.

Stakeholder feedback suggests that the cap achieves some of its intended effect, however the water and sewage rate exceptions and the ability to use rating differentials to stay below the cap can substantially reduce its effectiveness.

As the following 'real world' example for a New Zealand residential property with a capital value of $63,000 illustrates, application of the cap to total rates revenue doesn't necessarily protect individual ratepayers from regressive impacts. No rate remissions apply to this property.

Description of rate type	Amount of rate ($)
General rate (capital charge)	95.95
Solid waste management (uniform)	175.00
Uniform annual general charge (uniform)	703.00
Stormwater rural (uniform)	15.00
Water supply (uniform)	1,103.00

[10] As rates are primarily an issue for landowners, this is often raised in the context of elderly ratepayers who may be relatively asset rich (eg, own a debt-free home after a lifetime of work) but who have a low income (eg, rely largely on national superannuation).

Sewerage (uniform)	1,028.00
Targeted services rural (uniform)	32.00
Trade waste contribution (uniform)	40.00
District roading (capital charge)	105.40
District wide benefit water (uniform)	44.00
District wide benefit sewerage (uniform)	56.00
Total rates payable for the property	**3,397.35**

In this example the uniform charges make up $3,196.00 (94%) of the total rates and the exemptions for the significant uniform targeted rates for water supply and sewerage are a significant factor in reducing the progressive effect of the cap for this individual ratepayer.

The Productivity Commission's draft 2019 report recommends that the LGRA should be amended to remove the cap. The Commission considers that *"…the cap has no clear rationale and unnecessarily restricts the discretion of councils to use rates to reflect the benefits of services and amenities. Currently, few councils are close to the cap."*

While the intention of limiting the regressive impact of uniform/undifferentiated rates is at odds with the Commission's finding that "*the cap has no clear rationale*", we do understand how it can be seen as an incongruous restriction on local authorities' otherwise broad capacity "*to use rates to reflect the benefits of services and amenities*". During our recent discussions, at least one stakeholder commented that the cap can limit a local authority's ability to invest and set rates for community-wide assets.

Determining a preferred option (eg, maintaining, altering or removing the current cap provisions) involves considering matters such as:

- taxation principles that should guide decision-making about the use, or not, of uniform charges generally and targeted rates specifically;
- how effective the cap has been in limiting the regressive impact of uniform/undifferentiated rates; and
- other possible ways of intervening to address issues of affordability (eg, through local rates remission or postponement policies and/or through the central government redistribution function, including reform or replacement of the existing rebate scheme).

Question Seven:

Please tell us your preferred option regarding the cap on uniform rates (eg, maintaining, altering or removing the cap) and the rationale for your preference, including how it will help to improve the effectiveness of cost recovery.

Inability to use targeted rates for wastewater on a volumetric basis

Currently, the legislation enables local authorities, or their subsidiary infrastructure providers, to use targeted rates to charge volumetrically for water supply, but not for wastewater. The Productivity Commission's draft 2019 report notes that the Commission has recommended in past inquiries that local authorities should also have the power to levy volumetric wastewater charges.[11]

Although local authorities could develop and use a service contracting approach under current legislative settings (eg, like the approach Watercare has taken in Auckland[12]), we were told by some local authorities that the time, effort and costs to establish and maintain new contracting systems and processes would likely be much higher than setting a new targeted rate. We are also aware that the introduction of metering and volumetric user charges can be controversial in and of itself.

Measurement of wastewater volumes discharged from individual properties is more difficult and complex than measuring the volume of water supplied. Until the difficulty is resolved, any volumetric charges for wastewater could be derived from measurements of reticulated water supplied to the property and, where relevant, the contribution of any alternative water sources on the property to wastewater discharges.

Inevitably there will be instances where volumes of water supplied to a property have little or no relationship to wastewater volumes from the property (eg, where the water is almost all used for on-site irrigation or is otherwise consumed without generating wastewater).

Also, if actual wastewater volumes are measured, there may also be a need to consider how this could influence ratepayer behaviour (both positively and negatively) and what, if any, additional measures may be needed to encourage good behaviour and discourage bad behaviour.

An example of good behaviour might be properly designed and approved on-site water management systems that enable appropriate capture and re-use of some wastewater (eg, separate collection of relatively clean 'grey-water' for irrigation in more arid locations). A bad behaviour would be deliberate, unconsented diversion of sewage to land or to some other inappropriate outfall (eg, to stormwater or a natural watercourse). As existing public health and environmental protection laws already enable enforcement action in such cases, it may be that no additional measures are necessary.

This all creates very complex practical and legal challenges for lawmakers and for the local authorities that implement the law, for example in determining how best to:

- assess and determine a fair volumetric wastewater charge in highly variable, site-specific and ratepayer circumstances; and

---

[11] The purpose of a targeted rate is effective and appropriate cost recovery. However, it is recognised that efficient cost recovery can send price signals that help to reduce service and infrastructure costs and environmental externalities.

[12] Watercare has a volumetric charge for wastewater incorporated in its service contract with all properties with a water meter and a wastewater connection. Those properties pay a wastewater charge that is usually based on 78.5 percent of the water volume coming in to the property, as measured by the water meter. For apartments, the charge is usually based on 95 percent.

- ensure adequate protections and recourse for ratepayers where excessive, unfair or otherwise inappropriate volumetric cost recovery situations arise.[13]

We are seeking stakeholder feedback to assist us with assessing whether there are practicable options available to overcome the complex legal challenges that have, until now, prevented targeted rates from being used to charge volumetrically for wastewater.

Question Eight:

Please tell us whether you consider that:

- ***enabling targeted rates to be used to charge volumetrically for wastewater would improve the effectiveness of cost recovery;***
- ***if this was enabled, how you would expect ratepayers to be legally protected from excessive, unfair or otherwise inappropriate volumetric cost recovery situations;***

Please also describe:

- ***what you see as the main barriers to volumetric wastewater charges and how they might be overcome; and***
- ***data sources you would recommend to help understand the water in/water out ratio in different contexts (ie, where direct measurement of wastewater flows is not practicable).***

Postponing growth-related targeted rate collection

During stakeholder discussions we noted a suggestion that consideration could be given to a new rates postponement provision whereby collection of growth-related targeted rates is permanently postponed until a property is sold. The suggestion was that the postponed rates would be payable by the purchaser rather than the seller and a record of the postponement be placed on the land title to help ensure potential purchasers were aware of the rates owed.

As it was explained to us, we understand this suggestion is intended to:

- give existing landowners/ratepayers, including developers who are holding land pending its sale, relief from additional, growth-related costs;
- recognise that it is the subsequent purchasers/landowners who are the primary beneficiaries of the new infrastructure the targeted rates apply to; and
- ensure prospective purchasers can easily discover the postponement and the financial liability associated with it (ie, through a land title search).

[13] Noting that local authority ratepayers would not have access to statutory consumer protections (eg, the Fair Trading Act), which do apply, for example, to Watercare customers.

Section 102(3)(b) of the LGA already enables local authorities to adopt a rates postponement policy and section 110 sets out requirements for such a policy. Section 87 of the LGRA is also relevant where a postponement policy has been adopted.

Many councils have a rates postponement policy for residential properties, and these vary considerably. Generally, the policies allow certain people (eg, older persons) with equity in their homes and who meet some other criteria to choose to defer the payment of their rates, sometimes for years. There is usually an administration fee and some level of interest to pay on the sum owed.

Accordingly, it appears that the stakeholder suggestion could be largely met by local authorities adopting or amending a rates postponement policy to enable postponement of growth-related targeted rates. For the reasons outlined in the paragraphs below, we question whether there is any need for new legislative provisions requiring postponed rates to be paid by a purchaser or recording rates postponements on the land title.

Section 38 of the LGRA already provides for the inspection of rates records for a rating unit. Although rates arrears, remissions and postponements are not able to be made available to the general public, all the rates record can be inspected by:

- a person who is authorised by the ratepayer to do so:
- a solicitor, a person (not being a lawyer) who provides conveyancing services, a real estate agent, or any other person, who—
    - is a party to (or acting as an agent for a party to) a transaction relating to the rating unit; and
    - reasonably requires the information in the rates record for the purposes of the transaction.

Examining rates records is standard due diligence and conveyancing practice and rates owing on a property are normally part of the settlement calculation, so, in the ordinary course of events, purchaser awareness should not be an issue. Adding and maintaining information on the land title is likely to be more complex and expensive, with little additional benefit.

If the due diligence checks reveal that the amount of any postponed rates is significant, it will likely influence the sale price of the rating unit, regardless of who pays. If, as is usually/presently the case in residential sale and purchase agreements, the seller is liable to pay then the seller is motivated to recover some of the cost in the sale price. If a purchaser were to become liable, then the reverse would apply (ie, the purchaser would seek a corresponding reduction in the price).

We also note the risk that postponement may further incentivise developers to hold land rather than develop it, and delay the time at which a local authority receives revenue to pay back the money borrowed to fund the development infrastructure.

Question Nine

With effectiveness of cost recovery in mind, do you consider that existing statutory provisions are already adequate to enable:

- ***postponement of growth-related targeted rates until a property is sold; and***
- ***prospective purchasers to make effective due diligence checks about postponed rates?***

If not, please explain what changes you consider are necessary.

Reviewing Local Government (Rating) Act Schedules

One local authority we met with suggested that the LGRA Schedules relating to categories of rateable land and calculating liability for targeted rates (Schedules 1, 2 and 3 to the Act) could be reviewed to ensure they are up-to-date and are not unduly constraining in the present environment. No specific change suggestions were proposed by that authority.

To assist us with considering whether the Schedules need to be reviewed and what, if any, amendments may be appropriate we invite your feedback on this review suggestion.

Question Ten:

If you consider that any changes are needed to Schedules 1, 2 or 3 of the LGRA to enable more effective cost recovery, please describe the changes and explain why the changes are needed.

Implementation issues and options

Stakeholder feedback related to targeted rates indicated that the main options for addressing implementation issues are like those referred to when discussing development contributions, namely:

- centrally developed guidance resources, advice and support; and
- regional collaboration and information and resource sharing.

Accordingly, please refer to the earlier discussion about implementation issues in the development contributions section of this paper.

The potential of value capture tools?

Introduction

Public infrastructure investments funded in traditional ways can increase adjacent land values and result in a cost-free profit (windfall gain) for the owners of the land. In this context, the term 'value capture' refers to conversion of at least some of that windfall gain into public revenue.

Value capture is not a cost recovery tool like development contributions or targeted rates in their current form. Whether and how any value capture options could generate revenue more efficiently and fairly than existing tools in New Zealand remains to be determined. However, we are taking this opportunity to also seek stakeholder feedback to help inform future consideration of the targeted rates regime; and whether there may be merit in changes that would enable a value capture approach. This is not a value capture proposal.

Other government agencies, such as the Ministry of Transport and Ministry of Housing and Urban Development, are also considering the potential of value capture options for transport and housing infrastructure developments. We are in regular communication with these agencies and may share some of the feedback we receive to assist their complementary work on this topic.

Value capture tools: A brief overview

Much has been written about value capture theory and implementation, particularly around the value created by new transport infrastructure. There are also cases where private developers contribute significant funding so they can share in the value capture, often in association with new infrastructure (eg, railway stations) and high density commercial and residential developments.

Two examples of value capture tools most often referred to in our initial discussions with stakeholders were:

- ***Tax increment financing*** (TIF): A 'TIF zone' is established in the area where property values are expected to rise and sets base property values and tax revenue for the zone. When property value increases in the TIF zone tax revenue above the base rate is directed to re-paying loans used to finance the infrastructure investment.[14]
- ***Betterment tax***: Usually based on land value and paid by the property owners identified as direct beneficiaries of a zoning change or infrastructure investment. This tool requires attribution of the value increase to the change or investment (ie, as distinct from general land price increases at the local level).

[14] New Zealand local authority rates are a very different system to the property tax systems in countries where the TIF approach has been used. New Zealand rates revenue is budget driven (cost-based), whereas overseas tax rates are fixed and revenue fluctuates according to changes in the property values.

> We note that local government legislation currently in force enables a local authority to require, in certain circumstances, a landowner to pay a betterment charge where land value increases as a result of the creation or widening of a road. [15]

Please note that this workstream is not considering other value capture tools such as transaction taxes.[16]

Issue summary

Local authorities are required to take a cost-based approach to long-term planning and setting rates. Stakeholders have told us that, although there may be some increase in revenue where there is an increase in the number or rating units, the cost-based approach can prevent revenue from increasing to match significant, unanticipated growth pressures.

The current LGRA provisions do not enable local authorities to use targeted rates based on changes in the value of property over a specific timeframe. This prevents local authorities from using targeted rates to capture some of the uplift in property values generated by infrastructure investment.

In a series of recent reports, the Productivity Commission has recommended that value capture tools be established to enable local authorities to generate funding for infrastructure projects that would otherwise be difficult to initiate, while allocating the financial burden more fairly towards those enjoy a direct windfall benefit.

The Commission sees merit in implementing value capture by allowing local authorities to levy a targeted rate on the uplift in land values within a defined area (ie, where the increase in value is sufficiently greater than the general property inflation in the wider district). When consideration is given to the Commission's recommendation it is likely that the utility of tax increment financing or betterment tax options will be assessed.

Some stakeholders have also suggested that local authorities should be able to set a value capture targeted rate at any time (ie, outside the annual planning and rate-setting cycle) and for multiple years. They consider that this would better enable the timely capture of property value increases due to a zoning change or infrastructure investment. This suggestion recognises that some significant value increases can occur relatively quickly in anticipation of, or shortly after, an announcement about the local authority action (eg, a zoning change or planned infrastructure investment).

However, we note that there would be accountability challenges associated with local authorities potentially being able to set rates outside of the annual planning cycle.

Some other things to consider

Value capture tools are conceptually attractive when focusing on a 'beneficiary pays' approach. The targeted approach enabled by such tools should ensure that those who benefit most from proximity to infrastructure via higher property values, added commerce, or use of the infrastructure, help to pay for it.

---

[15] Section 326 of the Local Government Act 1974.

[16] For example, transaction taxes may apply to the difference in the price of a property and the price received when it is sold (ie, capital gains tax) and tax on the purchase of certain assets such as property (eg, stamp duty).

However, overseas experiences indicate that legislative design and implementation would need to be undertaken carefully to ensure that associated risks are minimised.

A 2018 research report on TIFs published by the US Lincoln Institute of Land Policy '*Improving Tax Increment Financing (TIF) for Economic Development*' comments that "*The basic design of TIF has significant virtues, but decades of experience and research from around the United States show that often TIF is flawed in practice. This report argues that, if used properly, TIF can be an important tool to nurture economic development in the public interest.*"

Implementing a TIF or betterment tax does not guarantee additional revenue. Because there are many factors that influence property values, a zoning change or investments in infrastructure on their own may not always cause prices to rise.

The attribution challenge of a betterment tax was also summarised in a May 2010 Australian report '*Australia's future tax system*' which noted that "…*in practice, betterment taxes can increase the uncertainty associated with land development. To operate effectively, betterment taxes need to isolate the increase in value attributable to the zoning decision or the building of infrastructure from general land price increases at the local level. This is often difficult since the value of land will move in anticipation of a change in re-zoning. Sometimes this can occur many years before the re-zoning.*"

In its December 2016 publication '*Capturing Value: Advice on making value capture work in Australia*, Infrastructure Australia also observed that estimating value uplift is complex. The publication noted that "*Analysis of property data around recent Australian infrastructure projects shows that the impact of these investments is difficult to isolate from other factors determining property prices. Broader property market forces typically dominate price trends in the areas around projects, and there is often a high degree of price fluctuation across the period of project delivery*".

In our discussions with Infrastructure New Zealand we also heard expressions of concern about the complexity of property-related taxes and associated revenue forecasting difficulties which have potential to make value capture taxes unfair and economically inefficient. Infrastructure New Zealand suggested that it would be preferable to shift rates to a 'pricing-based' approach as that creates incentives on all parties to be efficient and minimise costs.

Infrastructure New Zealand also referred to overseas experiences where value capture is achieved through government ownership of the land prior to the zoning change or infrastructure development – most often transport-related. Clearly this would require detailed, long-term strategic planning and, most likely, the exercise of powers well beyond the scope of a targeted rate regime.

Other risks associated with betterment taxes referred to in the May 2010 Australian report were:

- the taxes may be applied on an ad hoc basis;
- a lack of transparency where tax rates are determined through discussions between developers and government as part of the planning approval processes;

- delays; as setting the tax conditions can create lengthy disputes about how to share the 'economic rent';[17]
- governments may be incentivised to create economic rent through additional zoning restrictions or delays in land release, in order to raise more revenue (which is likely to stop land being devoted to its most productive use — at least in the short run).

If value capture approaches like the special tax bonds used in the USA were to be enabled here that would involve significant changes to New Zealand legislation. The policy and legislative design process would need to consider matters such as voter approval of a long-term pledged special taxes; issuance of special tax bonds the tax is pledged to repaying; pledging the moneys raised to a special public service; and prohibiting the use of council's general revenues to repay those bonds, enabling them to be independently credit rated.

Question Eleven:

Do you support the idea of legislative changes to establish new value capture tools for local authorities to use to generate funding for infrastructure projects? Please explain your answer.

If you support the idea and have a preferred value capture option, please describe that option and explain the reasons for your preference.

[17] Economic rent is the extra amount earned by the land by virtue of its present use.

Debt servicing benchmark

Overview of current legislative provisions

The Local Government (Financial Reporting and Prudence) Regulations 2014 do not set hard limits but do require local authorities to report their actual and planned performance against several financial prudence benchmarks, including a debt-servicing benchmark (regulation 21).

The debt servicing benchmark, focused on sustainability (including capacity to deal with unexpected events/shocks), is a ratio of the borrowing costs against revenue (excluding development contributions, financial contributions, vested assets, gains on derivative financial instruments, and revaluations of property, plant, or equipment).

A local authority meets the debt servicing benchmark for a year if it's borrowing costs for the year equal or are less than 10 percent of its revenue for the year. However, a high-growth local authority meets the debt servicing benchmark for a year if it's borrowing costs for the year equal or are less than 15 percent of its revenue.[18]

We note advice in a June 2018 Treasury Report[19] that all high growth local authorities, apart from Auckland, could double their borrowing and still not breach the 15 percent debt servicing benchmark (assuming no change in interest rates).

The option of removing the benchmark

The utility of the debt servicing benchmark has been questioned. During our discussions with local authority stakeholders there were no expressions of concern about the option of removing the debt servicing benchmark. The feedback suggested that local authorities largely view reporting against the benchmark as a compliance issue.

The baseline covenants of the Local Government Funding Agency and credit rating agency criteria (see below) are clearly more impactive and relevant to local authorities than the debt servicing benchmark.

We note that the three main credit-rating agencies[20] rate local authorities, with each having their own methodologies for making credit-rating assessments.

Naturally, local authorities are motivated to maintain credit ratings that help to minimise borrowing costs. Signals from rating agencies, and internal assessments by local authorities[21], indicate that there may be flow on effects/increased debt costs where a rating

---

[18] A high-growth local authority is a local authority whose population is expected to grow at or above the national population growth rate.

[19] https://treasury.govt.nz/sites/default/files/2019-02/oia-20180278.pdf

[20] Standard & Poor's (S&P), Moody's and Fitch Group.

[21] Specialist finance staff at Auckland City Council and the LGFA told the Productivity Commission that if Auckland suffered a credit downgrade it would likely lead to an increase in the cost of new debt of 0.1% to 0.15% (10 to 15 basis points) or $1 million to $1.5 million a year on a loan of $1 billion.

agency downgrades the credit rating of a local authority and/or the LGFA which may ultimately lead to a rise in the cost of borrowing for all local authorities in New Zealand.

As well as the desire to retain strong credit ratings (which assists in minimising the cost of borrowing), self-imposed borrowing limits and associated ratepayer preferences for low debt and low rates may mean that some local authorities are unwilling to increase their debt levels.

Question Twelve:

Do you support the option of removing the debt servicing benchmark from the Local Government (Financial Reporting and Prudence) Regulations 2014? Please explain the reasons for your answer.

Appendix One: Further Information on recent Productivity Commission reports

Using land for housing (2015)

The Productivity Commission's 2015 report noted that the pressure to not increase rates, debt levels and/or development contributions is directly associated with many councillors using "reduce debt" as one of their election platforms in local government elections.

A different interpretation might be that local authorities are prioritising the current and future interests of their existing residents who, unsurprisingly, are reluctant to pay for investment from which they see no benefit. We were also told that trade-offs must sometimes be made, such as choosing to invest in improvements to existing assets rather than new assets to meet growth demands.

Better urban planning (2017)

The Productivity Commission's 2017 report included a recommended decision framework for funding infrastructure. The Commission concluded that local authorities should use targeted rates for the following three main purposes.

- As an alternative to development contributions for infrastructure that serves a new development, where developers and residents prefer to spread the upfront cost over time rather than pay it upfront, and where the council can extend its debt to enable this.
- To fund broader community infrastructure that benefits a wider group of ratepayers than those within a new development. Development contributions would not be appropriate in cases such as this because they target only developers (and the customers of developers). This case also assumes that user charges to recover full costs would be either not practical or not efficient.
- To form part of an efficient scheme of non-linear pricing for infrastructure services. All service consumers could pay the targeted rate in addition to the unit charges they face (based on marginal cost). The rate could proxy the uniform daily charges used by private utility operators and help councils to recover full costs from users.

The report also noted that "*Ensuring that those benefiting from the additional infrastructure bear the financial cost also reduces the burden that infrastructure expenses place on general rates. Targeted rates can be an effective way to recover from beneficiaries the costs neither practically nor efficiently recoverable through user charges. For example, people who never use a community facility may benefit from it. Retailers might benefit from a community centre or library that attracts people to their area, even if the retailer never uses the facility.*"

Responses to a survey referenced in this report indicated that the problem of funding urban infrastructure could be addressed, at least in part, through more extensive use of user charges.

The report also notes that:

- political pressures may be responsible, at least partly, in influencing the decisions a local authority makes regarding the provision, or not, of infrastructure and infrastructure related investments;
- pressure from existing residents, who are fearful that growth and development will impact them in negative ways (eg, rate rises and higher debt burdens), is a potent influence on council politics and decision making;
- what often appears to be overlooked, or at least discounted, is that new residents, however, add to general rates because growth leads to an increased number of rateable properties.

Local government funding and financing (draft 2019 report)

The existing tools workstream is in regular contact, and closely coordinated, with the DIA Central/Local Government Partnership Group's wider programme of work, including the Group's consideration of outcomes from the current Productivity Commission inquiry into local government funding and financing.

The Productivity Commission's final report is due in November 2019. However, the Commission's July 2019 draft report suggests that:

- a fit-for-purpose future funding and financing system for local government would look substantially like the present system but with some significant new tools and improved council performance; and
- the appropriate use of rates (including targeted rates), along with user charges, development contributions and connection charges is efficient and can also yield fair outcomes in the sense of satisfying the benefit principle – that those who benefit from a service or cause the need to prevent or mitigate a harm should pay.

Recommendations in the Commission's draft report directly relevant to this workstream are to:

- give councils the ability to levy targeted rates on the *increase* in land value as an additional revenue source for high-growth urban councils (ie, the 'value capture' concept); and
- enhance councils' ability to charge for congestion and wastewater (by volume).

Appendix Two: Feedback Questions

Question One: Operating costs related to development contributions

Please tell us whether you support the idea of amendments to enable inclusion of some operating costs in development contributions, or whether you prefer to retain the current focus on capital expenditure. Please explain the reasons for your answer.

If you support the amendment idea, please include in your answer information about:

- how this would enable more effective cost recovery and why this is preferable to using targeted rates;
- how you consider such costs should be determined; and
- what, if any, implications higher development contributions will have on growth?

Question Two: Types of infrastructure that can be funded

Given the potential already provided by the 'control' reference in the LGA definition of community infrastructure, do you consider that there is any need to consider further amendments? Please explain the reasons for your answer.

If you support further amendments, please include in your answer an explanation of:

- how the amendments would enable more effective cost recovery; and
- how you consider the risks identified in this paper could be effectively managed.

Question Three: Complexity of the legislation and risk of legal challenge

Please indicate any specific legislative provisions related to development contributions you consider are not clear, what changes you would suggest to improve clarity and how the changes would enable more effective cost recovery.

Question Four: Central guidance resources, advice and support

<u>With cost recovery effectiveness in mind</u>, please tell us:

- which existing guidance resources and advisory support arrangements you value most highly and why;
- whether you consider central guidance resources and advisory support could be improved and, if so:
  - what specific improvements are needed and why;
  - who should lead and contribute to the improvement work; and
  - who should pay for the improvements and any ongoing delivery costs and why they should pay.

- your view of the standardised template recommendation in the draft Productivity Commission report and the idea that the use of such templates should be a 'requirement'.

Question Five: Regional collaboration, information and resource sharing

With cost recovery effectiveness in mind, please tell us:

- which existing regional collaboration arrangements you value most highly and why;
- whether you consider regional collaboration could be improved and, if so, what specific improvements are needed and why.

Question Six: Compliance checking

Do you consider compliance checking powers beyond current provisions (eg, the powers of Development Contribution Commissioners) would improve the effectiveness of cost recovery? Please explain your answer.

If you do consider there is a need for new or additional compliance checking powers to improve the effectiveness of cost recovery:

- what would those powers be;
- how would you see them working in practice; and
- how should the exercise of such powers be funded?

Question Seven: The 30 percent cap on uniform charges/rates

Please tell us your preferred option regarding the cap on uniform rates (eg, maintaining, altering or removing the cap) and the rationale for your preference, including how it will help to improve the effectiveness of cost recovery.

Question Eight: Targeted rates for wastewater on a volumetric basis

Please tell us whether you consider that:

- enabling targeted rates to be used to charge volumetrically for wastewater would improve the effectiveness of cost recovery;
- if this was enabled, how you would expect ratepayers to be legally protected from excessive, unfair or otherwise inappropriate volumetric cost recovery situations;

Please also describe:

- what you see as the main barriers to volumetric wastewater charges and how they might be overcome; and
- data sources you would recommend to help understand the water in/water out ratio in different contexts (ie, where direct measurement of wastewater flows is not practicable).

Question Nine: Postponing growth-related targeted rate collection

With effectiveness of cost recovery in mind, do you consider that existing statutory provisions are already adequate to enable:

- postponement of growth-related targeted rates until a property is sold; and
- prospective purchasers to make effective due diligence checks about postponed rates?

If not, please explain what changes you consider are necessary.

Question Ten: Reviewing Local Government (Rating) Act Schedules

If you consider that any changes are needed to Schedules 1, 2 or 3 of the LGRA to enable more effective cost recovery, please describe the changes and explain why the changes are needed.

Question Eleven: Value capture considerations

Do you support the idea of legislative changes to establish new value capture tools for local authorities to use to generate funding for infrastructure projects? Please explain your answer.

If you support the idea and have a preferred value capture option, please describe that option and explain the reasons for your preference.

Question Twelve: Debt servicing benchmark

Do you support the option of removing the debt servicing benchmark from the Local Government (Financial Reporting and Prudence) Regulations 2014? Please explain the reasons for your answer.