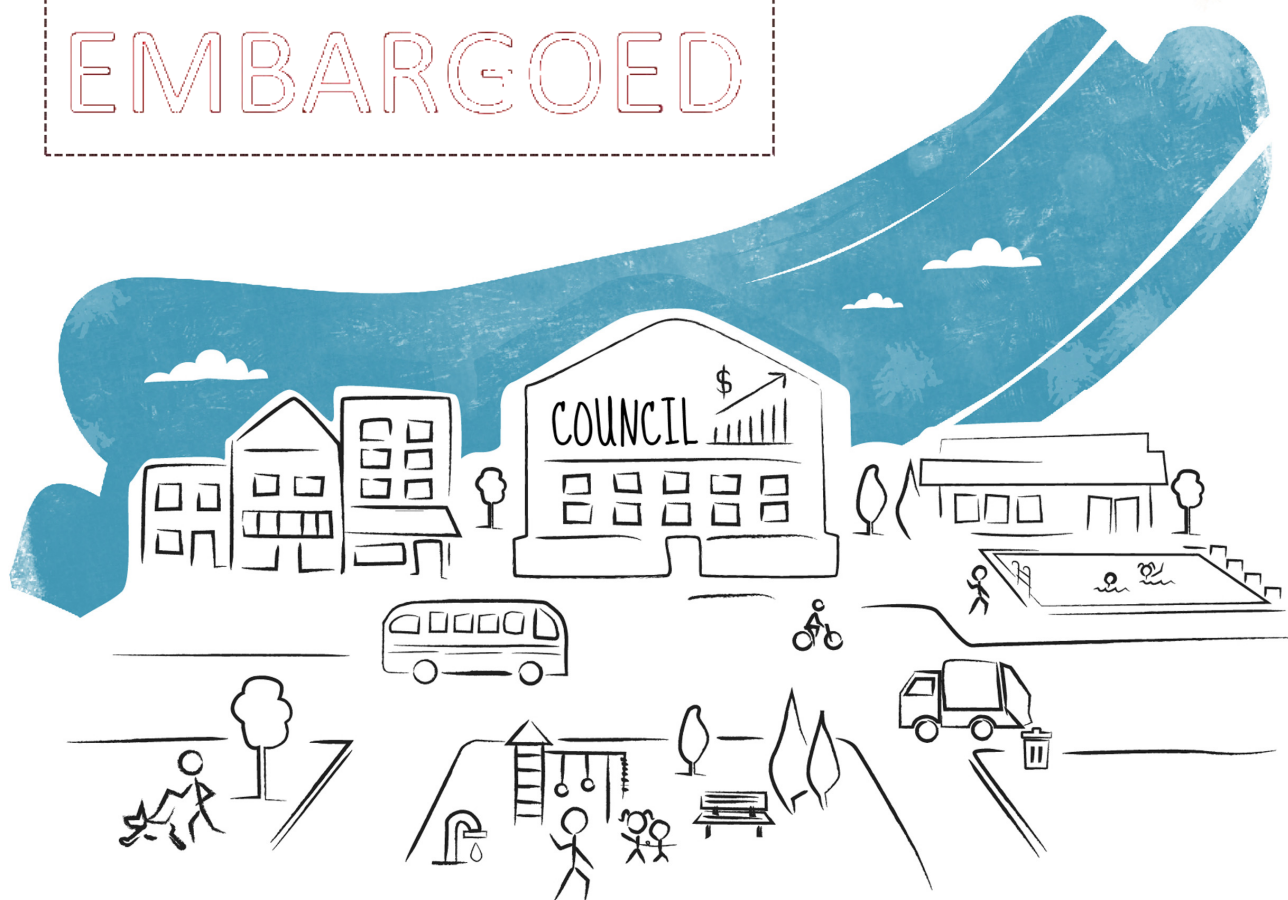




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Local government funding and financing

Draft report

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Draft report

July 2019

The New Zealand Productivity Commission

Te Kōmihana Whai Hua o Aotearoa¹

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NZ Productivity Commission

¹ The Commission that pursues abundance for New Zealand.

Terms of reference

NEW ZEALAND PRODUCTIVITY COMMISSION INQUIRY INTO LOCAL GOVERNMENT FUNDING AND FINANCING

Issued by the Minister of Finance and the Minister for Local Government (the "referring Ministers"). Pursuant to sections 9 and 11 of the New Zealand Productivity Commission Act 2010, we hereby request that the New Zealand Productivity Commission ("the Commission") undertake an inquiry into local government funding and financing.

Context

In 2007, the results of the Local Government Rates Inquiry (the Shand Inquiry) were reported to the Government. Local Government cost pressures have grown significantly since the Shand Inquiry, and local authority rates and payments increases have outpaced increases in the local government cost index.

Local Government plays important roles in New Zealand society. These place-shaping roles enhance and promote local community wellbeing across physical and financial, social, human and environmental capitals. In pursuit of these wellbeing outcomes, Local Government provides essential services, including transport, water and flood protection services, social and community infrastructure services, refuse collection, local planning, regulatory services that assist with public safety, health, environmental protection, biosecurity and economic development and a range of other essential services.

Local Government makes a considerable direct impact on the economy. In June 2016, councils owned \$112 billion worth of fixed assets, employed over 25,000 full-time equivalent staff and had annual operating expenditure of \$9.3 billion and operating income of \$8.9 billion.

The costs and pressures facing local government have increased in recent years, though the circumstances of individual councils vary (e.g. urban and rural communities face differing challenges). Local authority rates increases have outpaced increases in other indices measuring average costs and incomes. In particular, local authority rates and payments increases have significantly outpaced increases in the consumer price index and the independently prepared local government costs index.

Local authorities are capital-intensive businesses. Expenditure on fixed assets has grown significantly in recent years and demand for ongoing capital expenditure is unabated or increasing due to the development, maintenance and replacement of the infrastructure required to support New Zealand's rapidly growing population (including international visitors) and support economic growth.

As a whole, local authority debt has grown steadily since 2006. Some high growth councils are experiencing constraints in their ability to finance further infrastructure investment because they are coming close to covenanted debt limits. At the same time, some local authorities take on very little debt at all.

Major factors that are influencing local authority costs include:

- for fast-growing areas, the need for local authorities to increase the supply of development capacity to address declining housing affordability
- maintaining services in areas with declining populations
- requirements for higher performance, including potentially from fresh water, wastewater, stormwater and flood protection systems to meet environmental and public health standards
- costs of adapting communities and infrastructure to mitigate risks and hazards associated with climate change
- supporting regional development (e.g. growing demand pressures from the tourism industry which may be disproportionate to the number of local residents)

- the need to replace existing infrastructure coming to the end of its useful life.

This mix of factors - rates increases, limits on borrowing, and increased expenditure demands, particularly for infrastructure - creates the need for an independent inquiry into cost pressures, decision making and affordability. Following an objective inquiry into these issues, the Commission is requested to provide an assessment and recommendations of current and alternative funding and financing options for local authorities to maintain and deliver services to their communities into the future.

Scope and aims

In light of the pressures discussed above, and in the context of a decade after the conclusion of the Shand Inquiry, the Government has selected this inquiry topic to examine and report on local government funding and financing arrangements.

Where shortcomings in the current system are identified, the inquiry is to examine options and approaches for improving the system of local authority funding and financing.

Approach to the inquiry

The Inquiry should:

- Have regard to previous reports, inquiries and reviews, but should also look to bring new and innovative thinking to these issues.
- Complement and receive existing work, (e.g. three waters review, and the Urban Growth Agenda) rather than duplicating it.
- Consult with key interest groups and affected parties including (but not limited to) ratepayer organisations, local business and community groups.
- Work closely with Local Government New Zealand, the Local Government Funding Agency, the New Zealand Society of Local Government Managers and the wider local government sector and relevant central government agencies to ensure its findings provide practical ways to improve the funding and financing of local authorities.

Scope

The inquiry would examine the adequacy and efficiency of the existing local government funding and financing framework. Specifically, the inquiry will investigate:

Cost pressures

- The factors (including the mix of services and investment) that drive local authority costs now and in the foreseeable future. This is to include an investigation of the drivers of cost and price escalation, in particular: Whether this is a result of policy, and/or regulatory settings.
 - The role of growth/decline in population (including visitors and other temporary residents).
 - The impacts of Treaty settlement arrangements and costs of climate change on local authorities.
- In addition, the Commission should have regard to current frameworks for capital expenditure decision making, including cost-benefit analysis, incentives and oversight of decision making.

Funding and financing models

- The ability of the current funding and financing model to deliver on community expectations and local authority obligations, now and into the future.
- Rates affordability now and into the future.

- Options for new local authority funding and financing tools to serve demand for investment and services.
- Appraise both current and new or improved approaches considering suitable principles including efficiency, equity, affordability and effectiveness.
- How the transition to any new funding and financing models could be managed.

Regulatory system

- Any constitutional and regulatory issues that may underpin new project financing entities with broader funding powers.
- Whether changes are needed to the regulatory arrangements overseeing local authority funding and financing.

Out of scope

The Government considers that some aspects of local government finance have been well canvassed and further inquiry into them would not assist in achieving sustainable local government financing. Therefore, the following matters are out of scope of the inquiry:

- The particular mechanisms for rating of Maori freehold land and Crown land.
- The valuation system and practices.
- Substantial privatisation.

The Inquiry is not to make recommendations that would directly affect representation or boundary arrangements for Councils.

Report and recommendations

The report should build on previous relevant inquiries undertaken by the Productivity Commission, and use the Shand Inquiry report as context.

The final report should provide findings and recommendations directed at central and local government regarding how to improve funding and financing arrangements.

Consultation

The Commission should engage with a broad range of stakeholders, including industry and non-governmental groups, Iwi, and the public.

Timeframes

The Commission should present the final report to referring Ministers by 30 November 2019.

Hon Grant Robertson

MP for Wellington Central

Minister of Finance

Minister for Sport and Recreation

Associate Minister for Arts, Culture and Heritage



29 APR 2019

Mr Murray Sherwin
Chair
Productivity Commission
PO Box 8036
The Terrace
WELLINGTON 6143

Dear Murray

It has been encouraging to see the Commission's progress with the inquiry into local government funding and financing and the high number of quality submissions and public engagement with the Commission's work.

As you may be aware the Government has received the Final Report of the Tax Working Group.

As part of their work the Group highlighted the challenges of housing affordability in New Zealand and the constraints in the supply of residential land that drive the high cost of housing. To help address this the Group recommended that the Productivity Commission inquiry into local government funding and financing consider a tax on vacant residential land.

The Government agrees with the Tax Working Group and I am therefore writing to ask the Commission to consider this issue as part of its work. The Commission should consider whether a tax on vacant land would be a useful mechanism to improve the supply of available housing for New Zealanders.

The Productivity Commission should have regard to wider work being done to help improve housing affordability. This includes work by the Government to address supply constraints in housing including through reforms to infrastructure financing and the planning system.

In addition, the Government considers that a review of options for taxing land that discourages land-bankers from holding land vacant should be a high priority for inclusion on the Tax Policy Work Programme. As part of its consideration of options for taxes on vacant land the Commission should consult with officials from Inland Revenue and the Treasury.

I look forward to receiving the report of the Commission's inquiry.

Yours sincerely

Hon Grant Robertson
Minister of Finance

About the draft report

This draft report aims to assist individuals and organisations to participate in the inquiry. It outlines the background to the inquiry, the Commission's intended approach, and the matters about which the Commission is seeking comment and information.

This draft report contains the Commission's draft findings and recommendations. It also contains a number of questions to which responses are invited but not required. The Commission welcomes information and comment on any part of this report and on any issues that participants consider relevant to the inquiry's terms of reference.

Key inquiry dates

Submissions due on the draft report	29 August 2019
Final report to the Government	30 November 2019

Why you should register your interest

The Commission seeks your help in gathering ideas, opinions and information to ensure this inquiry is well informed and relevant. The Commission will keep registered participants informed as the inquiry progresses.

You can register for updates at www.productivity.govt.nz/subscribe-to-updates, or by emailing your contact details to info@productivity.govt.nz.

Why you should make a submission

Submissions provide information to the inquiry and help shape the Commission's recommendations in the final report to the Government. Inquiry reports will quote or refer to relevant information from submissions.

How to make a submission

The due date for submissions in response to this report is **29 August 2019**. Late submissions will be accepted, but lateness may limit the Commission's ability to consider them fully.

Anyone can make a submission. Your submission may be written or in electronic or audio format. A submission may range from a short letter on one issue to a substantial response covering multiple issues. Please provide relevant facts, figures, data, examples and documents where possible to support your views. The Commission welcomes all submissions, but multiple, identical submissions will not carry more weight than the merits of your arguments. Your submission may incorporate relevant material provided to other reviews or inquiries.

Your submission should include your name and contact details and the details of any organisation you represent. The Commission will not accept submissions that, in its opinion, contain inappropriate or defamatory content.

Sending in your submission

The Commission appreciates receiving submissions in a searchable PDF format. Please make a submission via www.productivity.govt.nz/make-a-submission.

What the Commission will do with the submissions

The Commission seeks to have as much information as possible on the public record. Submissions will become publicly available documents on the Commission's website. This will occur shortly after receipt, unless your submission is marked "in confidence" or you wish to delay its release for a short time. Please contact the Commission before submitting "in confidence" material, as it can only accept such material under special circumstances.

Other ways you can participate

The Commission welcomes feedback about this inquiry. Please email your feedback to info@productivity.govt.nz or contact the Commission to arrange a meeting with inquiry staff.

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KEY

Q

Question

F

Finding

R

Recommendation

Overview

The Government has asked the Commission to undertake an inquiry into local government funding and financing. The Government wants to understand the factors driving local authorities' costs, now and into the foreseeable future. It also wants to know whether current funding and financing arrangements are efficient, sustainable and affordable. If they are not, what new arrangements would better achieve these ends?

Local government matters a great deal to communities and the wellbeing of New Zealanders. High-performing local government can provide greater access to, and choices of, housing; better protection of New Zealand's natural environment and cultural values; and quality infrastructure at the right time in the right place.

Success in these roles provides the foundation for urban and rural communities that offer a wide range of amenities and are attractive places to live; and where people consume, work, play and create. If councils struggle to deal with rising costs, or have poor incentives for improving performance, this will lead to communities failing to reach their potential.

The funding and financing framework for local government must therefore incentivise good performance and enable local authorities to deliver quality services in line with the preferences and aspirations of their local communities. This requires that local government has the necessary autonomy, responsibility and accountability in delivering these services. This means that local ratepayers should largely pay for local-government services, and that those services must be effective, efficient and affordable.

This draft report sets out the Commission's assessment of the cost pressures faced by local authorities. It presents draft recommendations for new funding tools, where current funding and financing arrangements are insufficient to meet key pressures. It also proposes several improvements to the way councils manage cost pressures, make decisions, and deliver and fund their services.

Box 0.1 Principles for local government funding and financing

The Commission used the following principles to assess the adequacy of the funding and financing options currently available to local government, and the need for additional tools.

- **Appropriate for local government use** – given the role of local government; and the need for local autonomy (flexibility to align with local preferences) and accountability (including transparency).
- **Coherent** with national policy objectives and the wider tax system.
- **Efficient**, in that instruments should minimise harmful incentive effects on resource allocation, investment and innovation, and minimise compliance and administration costs.
- **Equitable and fair** – taking account of who benefits from local government services, including current and future generations.
- **Sustainable**, through minimising avoidance and providing adequate, stable and predictable revenue over time.

In the New Zealand context, the **Treaty of Waitangi** is an important frame when thinking about principles for local government funding and financing. Local government decisions have a strong impact on Māori interests, which are explicitly recognised in legislation. Councils are required to facilitate Māori participation in council processes and decision making. In doing so, councils are giving effect to the Crown's Treaty obligations, for which the Crown retains ultimate responsibility.

Local government in New Zealand

The role and scope of local government

Local authorities play an essential role in New Zealand's system of governance as both a provider of services and an enabler of local democracy.

Compared to most other developed countries, the scope of local government responsibilities in New Zealand is generally narrower. This is partly because many of the functions undertaken at the local level in other countries, such as health services and education, are funded centrally in New Zealand. Here, local government's activities are centred on regulating land use, choosing and funding a set of local amenities, and investing in essential infrastructure for transport and the three waters (drinking water, wastewater and stormwater), with the overall objective of enhancing community wellbeing.

While their roles and responsibilities are relatively narrow, local authorities have a high degree of autonomy in choosing what activities they undertake and how they undertake them in pursuit of these roles and responsibilities. This freedom is provided through the legislative power of general competence, which enables councils to select local goods and services that best align with the preferences and circumstances of their communities. But with such autonomy come strong accountabilities to their own communities, through consultation and transparency requirements.

The current funding and financing options

Local authorities currently have a wide range of funding options to choose from, including general and targeted rates, fees and user charges, and development contributions. Their powers to levy local taxes and charges provide them with a level of fiscal autonomy that is relatively high internationally – in many other countries, a much larger proportion of local government revenues are sourced from central government.

Councils vary widely in how they use the available funding tools, but rates are the largest overall source of local government revenue. While local government expenditure has been steadily rising over time, this has been in line with growth in national population and incomes. As a result, rates have remained stable as a proportion of per capita national and household incomes for many decades, despite widespread concerns to the contrary.

Providing essential infrastructure dominates council spending, and accordingly, the growth in capital expenditure has been driven primarily by roading and the three waters. Growth in capital expenditure has flow-on effects on operating expenditure in the form of increased depreciation and interest expenses. The prices faced by local government have risen more than those faced by consumers, which has contributed to expenditure growth.

Debt is an effective and appropriate way for councils to spread the burden of capital expenditure across generations, so that the people who benefit from infrastructure investments now and in the future contribute to meeting the cost. The Local Government Funding Agency raises debt on behalf of member councils and is the largest lender to local government. Councils may also borrow from banks and other financial institutions, and issue bonds.

Local government debt has risen significantly over the last two decades but, for most councils and the sector as a whole, this does not give cause for concern, given rapid population growth in some areas. Some fast-growing councils face debt constraints which is limiting their ability to supply enough infrastructure to meet the growth in demand for housing and other development. These debt constraints are discussed further below.

A diversity of circumstances

Local authorities span a range of sizes and circumstances, and face different challenges and opportunities. Some urban authorities are experiencing rapid population growth. Other authorities have populations that are very small, and/or are growing slowly or not at all. Some have high rates of deprivation. Physical resources and industry structure vary across the country, driving different infrastructure and service

requirements. The age, quality and condition of essential infrastructure also vary. Tourism is particularly prominent in some areas.

The Commission sought to understand the nature of these differences, through broad engagement across the sector and a series of in-depth case studies of a range of individual councils. The Commission found that these differences result in varying funding pressures across council types and circumstances. This variation had a strong bearing on the Commission's assessment of the current funding and financing framework, and the need for any changes.

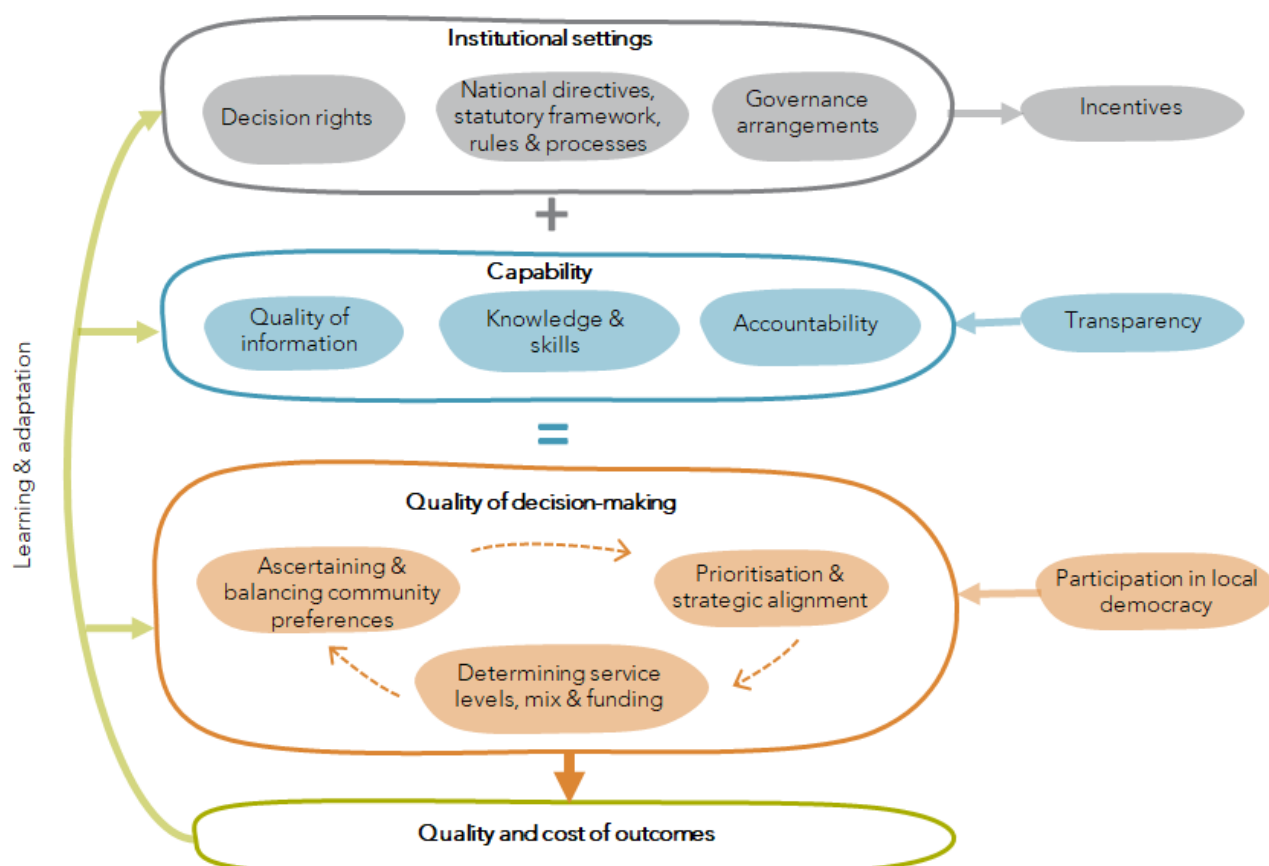
The importance of good quality decision making

The quality of councils' decision making is essential to them making best use of available funding and financing tools, and to ensuring decisions are aligned with the scale and complexity of the local government task. If councils struggle to deal with complex strategic and implementation decisions, and have poor incentives for improving performance, this will put a strain on council funding and risk poor community outcomes.

Councils' decisions about the level of service they provide and about capital investments can have an important bearing on cost pressures, and ultimately on the costs borne by local residents and businesses. The costs of poor decisions can be significant.

Good quality decisions flow from well-designed institutional and statutory arrangements, plus the skills and capability of council decision makers. When the necessary knowledge, incentives and decision rights are all present, local authorities do – and will – make prudent, efficient and effective revenue-raising and spending decisions that reflect the preferences and aspirations of their communities (Figure 0.1). The Commission has assessed the current decision-making arrangements in local government with these features in mind, to identify where improvements are possible.

Figure 0.1 The features of good decision making



The current funding and financing framework measures up well

The current framework is broadly sound...

The current main funding tools of local government in New Zealand measure up well against the principles of appropriateness for local government use, coherence within national policies and institutions, efficiency, enforceability, and the stability and predictability of revenue. The current framework provides councils with considerable flexibility in how they raise revenue, and this is reflected in the diversity of ways in which they do so.

Internationally, no single way of funding local government is clearly better or worse. Compared to alternatives, property taxes are simple and efficient to administer, and wholesale change to a radically different model would be highly costly, disruptive and uncertain. Given the relatively narrow scope of local government in New Zealand, and the benefits of a property tax-based system, rating land and property should continue as the main taxing power of local government. This choice is consistent with the findings of similar previous reviews.

A fit-for-purpose future funding and financing system for local government should be based on the present system, but have some significant new tools to help fund new cost pressures in specific circumstances, and better incentives for improved council performance.

... but there is scope for councils to make better use of existing tools

Councils are complex operations, with numerous business lines. The diversity of community preferences and interests, as well as the triennial election cycle, adds a further layer of complexity. Some councils are navigating this complexity well, with robust decision making and good use of the available funding and financing tools. However, others lack the necessary systems and skill-mix for effective decision making. Good decision making is underpinned by strong and capable leadership, good information to support decision makers, use of independent governance expertise, and effective community engagement.

Significant opportunities exist for many councils to make better use of current funding tools, and to help relieve funding pressures through better organisational performance and decision making. Council decision making and broader performance also need to be more visible to stakeholders, including voters.

Several changes are proposed to bolster governance and increase the transparency of council performance. These include requiring all councils to have an assurance committee that is independently chaired, and encouraging greater uptake of existing performance review and improvement programmes. These proposed changes would be supported by other changes to clarify and streamline the legislative requirements for councils' Long-Term Plans, so they better meet their transparency objectives. In addition, the Commission considers that the performance reporting framework for local government requires fundamental review, with a mind to significantly simplify the required financial and non-financial disclosures and improve their overall coherence and fitness for purpose.

The best way to use the current funding tools

The Commission favours the "benefit principle" as the primary basis for deciding who should pay for local government services. Councils may also use "ability to pay" as a consideration, taking into account central government's primary role in income distribution.

The benefit principle says that those who benefit from, or cause the need for, a service should pay for its costs. This involves determining the extent to which the beneficiaries of a service can be identified and charged. Together with efficiency and consideration of ability to pay, the benefit principle should guide local authorities' use of their funding tools.

The benefit principle implies user charges (where such charges are feasible and efficient) or a targeted rate on a specific group of properties that benefit from a service. It also implies that local ratepayers should fund local services. Some local assets and their associated services could benefit local residents and national interests. In these cases, the benefit principle points to shared funding (with a contribution from central

government). This is illustrated in Figure 0.2. The inclusion of Treaty of Waitangi within the ambit of central government funding recognises that the Crown retains ultimate responsibility for its Treaty obligations.

Figure 0.2 Should local or central government pay for publicly funded local services?

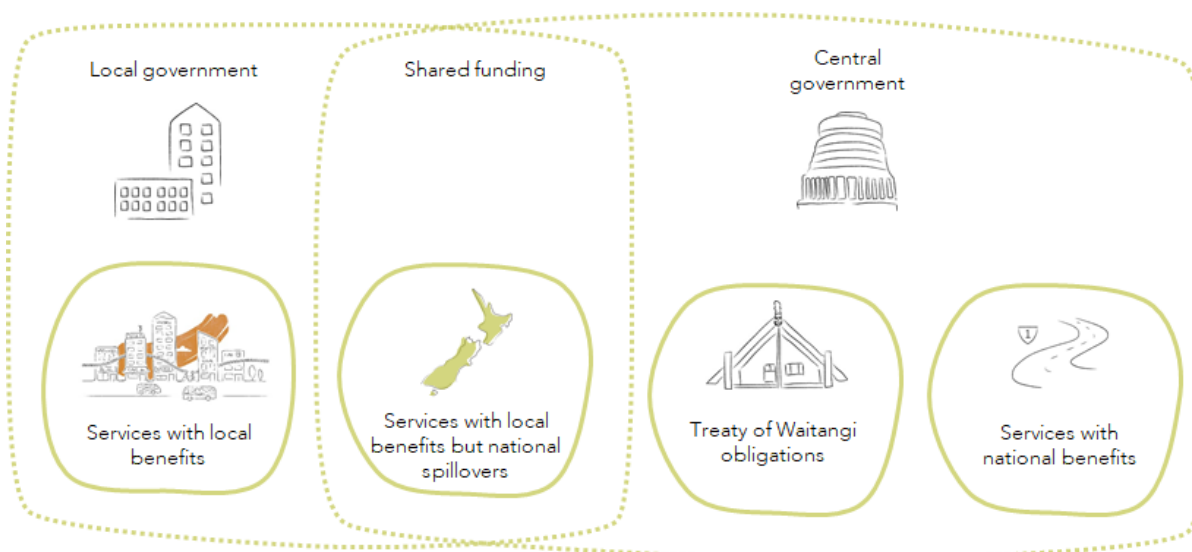
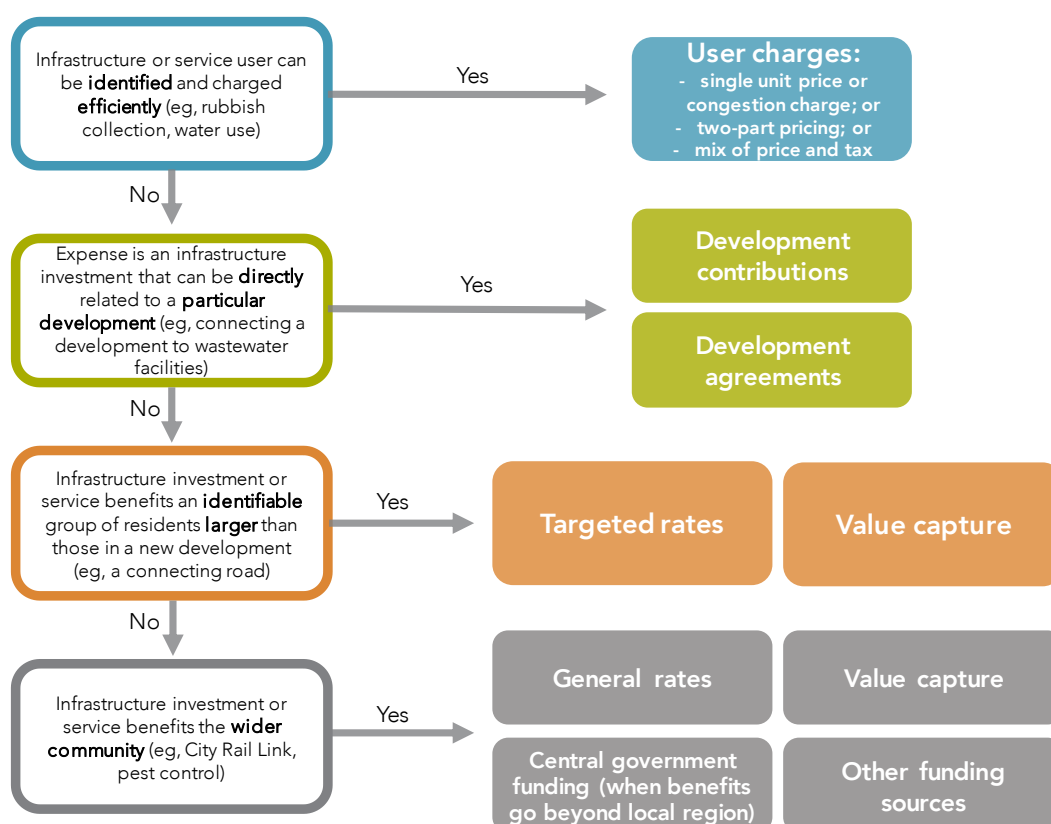


Figure 0.3 sets out a framework for choosing the most appropriate funding tools in line with the benefit principle. The decision framework includes a value capture tool – this is not currently available and its potential is discussed below.

Figure 0.3 Decision-making framework for choosing funding tools for local government services and investments



New funding tools are needed to address key pressures

The Commission has identified four key areas where the existing funding model is insufficient to address cost pressures, and new tools are required:

- supplying enough infrastructure to support rapid urban growth;
- adapting to climate change;
- coping with the growth of tourism; and
- the accumulation of responsibilities placed on local government by central government.

These pressures are highly uneven across councils, due to their differing circumstances. In addition, small rural districts are facing particular challenges in funding essential infrastructure and services.

Local governments had the four community wellbeings (social, economic, environmental and cultural) as part of their legislative purpose from 2002 to 2012. The Commission did not find evidence that these gave rise to significantly increased cost pressures, despite concerns from some quarters. The Commission does not expect the recent re-introduction of the four wellbeings to the legislative purpose of local government to result in a material increase in the scope of local government activities, or its expenditure.

Most Crown land is currently exempt from rates. This includes land occupied by institutions such as schools, universities and hospitals, as well as the conservation estate. In previous inquiries, the Commission has recommended that central government should pay rates on its properties. Doing so would provide additional revenue for councils, and help alleviate funding pressures. The Terms of Reference for the current inquiry direct the Commission to make no recommendations on this topic.

New funding and financing tools for growth-supporting infrastructure

The failure of high-growth councils to supply enough infrastructure to meet demand is a serious social and economic problem. Councils' failure to adequately accommodate growth has been a significant contributor to the undersupply of development capacity for housing in fast-growing urban areas. This in turn has been a major driver of rapid and harmful house price increases in New Zealand since around 2000.

Councils have funding and financing tools to make growth "pay for itself" over time by deriving revenue to fund the infrastructure for new property developments from new residents, rather than burdening existing ratepayers. However, the long time it takes to recover costs, debt limits and the perception that growth does not pay are significant barriers.

Value capture and volumetric charging would help growth "pay for itself"

In its 2017 *Better urban planning* inquiry, the Commission recommended a new "value capture" funding tool for councils. This tool would raise revenue by requiring property owners who enjoy "windfall gains" in their property value as a result of nearby infrastructure investment that is publicly funded to pay a portion of this gain to the council. In turn, revenue raised would help the council fund future growth. The Government has so far not responded to the Commission's recommendation. If value capture is introduced in the way recommended, it will generate additional revenue associated with growth.

The Commission has also recommended in past inquiries that the Government should give councils the power to levy volumetric wastewater charges and road-congestion charges. Combined with the value capture tool, these funding tools would help give councils the means to fund growth without placing a financial burden on existing residents.

Special Purpose Vehicles could help councils nearing their debt limits

Most councils have adequate balance-sheet capacity to finance their infrastructure development. However, a small number of high-growth councils face debt limits that may be impeding much needed investment in growth-supporting infrastructure.

A promising option to assist councils nearing their debt limits is a Special Purpose Vehicle (SPV). To date, Auckland Council, together with Crown Infrastructure Partners, Treasury and developer Fulton Hogan, have established an SPV that has raised nearly \$50 million in long-term finance that will not sit as a debt on the balance sheet of Auckland Council (or the Crown), and therefore not count towards the council's debt limit. The finance is being used to fund five bulk roading and wastewater infrastructure projects to service a large new residential development in Milldale.

The Government and officials are currently investigating how to expand the use of SPVs to finance large brownfield infrastructure investments that will benefit new and existing residents. The Commission supports this work and, if necessary, any enabling legislation to expand the use of SPVs.

A central government payment based on new building work put in place

To address the perception that growth does not pay for itself, the Commission recommends considering a new funding stream from central government to local authorities, based on new building work put in place within an authority's boundary. Such a tool would align well with funding principles, in that it would:

- be largely consistent with local autonomy and accountability;
- link council revenue directly to local growth and development; and
- be transparent and relatively low cost to administer – the revenue would be proportional to a simple estimation of construction and development in a local authority area (eg, based on the value of building consents or new construction measured by floor area).

The direct link between new building work in a jurisdiction and council revenue would incentivise councils to facilitate development and construction – two activities over which they have a considerable influence through land-use planning and infrastructure investment.

A scheme of central government grants to territorial authorities directly linked to new building can be justified under the benefit principle because of the strong national interest in an adequate supply of infrastructure-serviced land and new houses to meet demand.

The level of the payments would be a choice for central government. It would be important that factors determining the size of the payments are clear and stable to maximise the incentive effect on councils. Relatively modest payments (as a percentage of total rates revenues) could have quite strong incentive effects.

The Commission seeks feedback on the advantages and disadvantages of such a payment scheme, how it should be designed, and whether it would be effective.

Considering a tax on vacant land

The Minister of Finance wrote to the Chair of the Productivity Commission on 29 April 2019 asking for the inquiry's Terms of Reference to be expanded to incorporate the recommendations of the 2019 Tax Working Group (TWG) relating to taxing vacant land. The TWG recommended that the Commission's inquiry into local government funding and financing consider whether a tax on vacant residential land would be a useful mechanism to improve the supply of housing for New Zealanders.

The Commission is seeking submissions on this issue and will provide advice to referring Ministers in its final report, due 30 November 2019.

Funding support for tourism hotspots

New Zealand has experienced a large and rapid increase in international visitor numbers in recent years. Domestic tourism has also increased. This has led to sharply increased pressure on several types of services and infrastructure in districts that are popular tourist destinations.

Tourists pay for and cover the costs of many of the goods and services that they consume – either directly or through the businesses they purchase from. An exception is their use of council-provided "mixed-use"

infrastructure and services such as local roads, parking, public toilets, rubbish disposal, and water and wastewater. These are used by both residents and visitors. Tourists make an indirect contribution towards mixed-use infrastructure by buying from businesses that pay business rates, but they do not pay any equivalent of the portion of residential rates that goes towards meeting the costs of these facilities. The strong seasonality of tourism in New Zealand exacerbates this payment shortfall, as infrastructure needs to cater for peak tourist loads.

The best options to directly recover the tourists' share of the costs of mixed-use services are through greater use of user pays, and accommodation levies. These are the only options that target the right group, do not involve an industry subsidy, and meet the other funding principles outlined above.

Government should legislate to enable councils in tourist centres to choose to implement an accommodation levy so those councils can recover the costs of providing local mixed-use services that tourists do not otherwise pay for. Councils in tourist centres should make greater use where possible of user pays for mixed-use facilities.

It is recognised that some small tourist hotspots have a high number of day visitors and councils cannot use either user pays or accommodation levies to reasonably recover the ongoing costs of providing mixed-use services. For these councils, the Government should provide some operational funding from the new international visitor levy.

Adapting to climate change is a significant challenge

A challenging and emerging pressure on local government funding comes from climate change – in particular the threats from sea-level rise and more frequent and extreme weather events (and associated flooding). The most direct threat is the damage that climate change will cause to local government infrastructure such as roads and bridges, and stormwater, wastewater and flood-protection assets.

Moreover, councils are responsible for planning and regulating development on at-risk land, and therefore have an important role in moderating future climate risk exposure and long-run adaptation costs. Councils are also the body closest to exposed communities and will be expected to engage with them on an adaptation strategy. They must manage both pressures from property owners to invest in defences against sea-level-rise and flooding, and retreats from at-risk locations.

Central government leadership is required

To help local governments prepare for climate change, central government should take the lead on providing high-quality and consistent science and data, standard setting and legal and decision-making guidance. Having councils spend resources on these individually would be costly and risks inconsistency.

Institutional and legislative schemes also need to move from their current focus on recovery after an event towards reducing risk before an event. Such schemes need to resist the tendency to continue along current pathways that rely on hard structures to protect new and existing land use, encourage the use of anticipatory and flexible decision tools, and incentivise actions that reduce costs over the long term.

Two broad principles to guide the funding of climate adaptation are minimising costs and risks over the long term, and fairness and justice. The first implies, but is not limited to, discouraging behaviour that leads to increased risk exposure for private gain at others' expense ("moral hazard" behaviour). The second brings into play New Zealand's tradition of societal support and risk sharing, and inter-generational equity.

Assistance for land-transport infrastructure that is at risk

The Government should extend the role of the New Zealand Transport Agency (NZTA) in co-funding local roads to include assistance to councils facing significant threats to the viability of local roads and bridges

from climate change. The amount of assistance should reflect the size of the threat facing each council, its rating capacity and its willingness to take sensible action.

A local government resilience fund for water and river infrastructure

Alongside land transport, the other class of local government-owned infrastructure vulnerable to climate damage is the three waters – particularly wastewater and stormwater systems. The Government is currently reviewing the regulation, governance and delivery of three-waters services.

Whatever approach emerges from the three-waters review, the Commission has concluded that, as with roading, some councils with water assets seriously threatened by damage from climate change require central government assistance. The Commission recommends that the Government creates a climate-resilience agency and associated fund to help at-risk councils redesign, and possibly relocate and rebuild, wastewater, stormwater and flood-protection infrastructure threatened by sea-level rise and more intense flooding due to climate change.

The new entity should also assist regional councils and communities consider the best way to lessen future risk of flooding from rivers. This would include, where appropriate, the potential for using the best-practice model of giving rivers room and developing multiple innovative uses of the wider river corridors.

As with the NZTA model, levels of assistance should be based on each council's level or risk, its rating capacity and its willingness to take appropriate action.

Need to reset the relationship with central government

A key cause of funding pressures on local government is the continued accumulation of functions and responsibilities that central government has passed to councils over the years. These include where central government has introduced or strengthened standards that councils must meet – such as various National Policy Statements, National Environment Standards and higher standards for drinking water.

In these situations, local government should have a means to adequately fund its operations, either through recovering its costs from regulated parties, or, where there are national benefits, a direct funding contribution from central government. Failing to give local government such means results in so-called “unfunded mandates”.

An area of tension relates to the Crown's obligations under the Treaty of Waitangi. The primary obligations under the Treaty lie with the Crown, but local governments often fulfil responsibilities with respect to local iwi. It is vital that central government ensures councils have the ongoing funding and capacity to carry out these responsibilities.

The increasing tasks and responsibilities being placed on local government have now reached a point where the cumulative burden is difficult for many local authorities to manage. A risk is that some councils, particularly small ones, may be unable to continue to comply with all the new responsibilities passed to them. This risk could mean that the policy objectives of central government are not achieved.

A major cause of the problem is the interface and poor state of relations between central and local government. A shift is needed – from treating local government as an agent of central government to a relationship of genuine partnership. This would involve regulatory regimes being co-designed and jointly implemented, with the needs and circumstances of local government kept front of mind.

To make progress, both central and local government need to foster a more open and productive relationship. The Commission sees significant value, and has previously recommended, that central and local government work together to develop a “Partners in Regulation” protocol. The protocol would set out an agreed set of behaviours and expectations when developing and implementing legislation and regulation. More generally, it would promote a constructive interface between central and local government.

Councils with small, static or falling populations must adapt, and will need support

A number of councils have very small, and/or static or falling populations. Some of these communities also have high levels of deprivation, and therefore relatively weak rating bases. These councils must continue to fund services and the supporting infrastructure from a small (and potentially diminishing) rating base. Many of these services, such as drinking water, wastewater and roading, are subject to strong economies of scale in the way they are supplied. This means that the costs of a pipe network or road network, or the fixed costs of a wastewater treatment plant, must be spread over fewer ratepayers. The funding challenges for such councils are compounded by the need to replace ageing assets and meet new higher minimum standards for drinking water and wastewater.

A common strategy to address falling populations and associated funding pressures has been to develop plans and strategies to revitalise the local economy and stimulate population growth. However, evidence on the success of such policies is mixed. Councils in this position therefore need to be realistic about their ability to turn around underlying social and economic trends.

Councils in this situation also need to be open to new scalable technologies and organisational arrangements. A main area of concern is the ability of small councils to fund three-waters services. A way forward on water reform that could deal with the challenges of many small communities struggling to fund safe, cost-effective water services is discussed below.

These councils may require support from central government, to make the necessary investments in essential infrastructure, including water services. Central government policies that subsidise local roads take into account the rating base of territorial authorities in setting the level of subsidy. Similar policies may be required to help councils with relatively weak rating bases meet the costs of climate change adaptation and meet rising standards in the provision of the three waters.

Equity and affordability

Councils address equity and affordability in different, and unclear ways

Councils vary considerably in the way they use rating tools, and use alternative ways of spreading the rates burden across their communities. Councils may base rates on property values, or levy charges that are the same for every rating unit (uniform charges). They can target rates to particular types of properties, to particular locations, or to fund specific services. For both general and targeted rates, they may apply rates “differentials” to different types of properties (eg, “business” or “rural”). They can base targeted rates on a wide range of factors. While the end result can be similar, the rationale that councils use to distribute rates is often unclear and controversial.

To deal with this problem, councils should design their funding policies in two stages. The first stage would apply the benefit principle in a transparent manner. In the second stage, councils may, if they wish, make transparent adjustments to improve ability to pay. Legislative change is needed to require councils to apply the benefit and ability-to-pay principles in separate and distinct steps in their rating decisions.

To further improve transparency in setting rates, the ability to set differentials and uniform annual general charges should be removed, along with the current 30% cap on uniform charges. If they wish, councils can instead use targeted rates to achieve an equivalent distribution of the rating burden.

The Rates Rebate Scheme is inequitable and needs replacing

Little or no evidence is available that shows rates have become less affordable at an aggregate level. Much concern about affordability focuses on low-income homeowners, particularly the households of older people. Yet older people living in their own homes without a mortgage are among the least likely groups to experience material hardship.

The Rates Rebate Scheme (RRS) provides financial support to help homeowners on a low income to pay their rates bills. The Commission’s analysis shows that the RRS is inequitable because renting

households in similar circumstances do not qualify. It is also administratively cumbersome for modest impact (the maximum payment amounts to a little over \$12 a week). The Accommodation Supplement is the Government's principal form of assistance for accommodation costs to low-income households living in private residences. Most recipients of the RRS would not qualify for the Accommodation Supplement because their housing costs are too low.

The Commission considers that a revamped national rates postponement scheme would better fulfil the purposes that the RRS is designed to address. Rates postponement is when a local authority agrees to delay the due date of a rates payment until a specified time or a specific event occurs, such as the sale of the property. The Government should collaborate with local government and suitable financial institutions to design, implement and promote such a scheme. Once a successful national rates postponement scheme is in place, the RRS should be phased out.

Putting it into practice: a case study on three waters

Fundamental reform of the sector is required

Under current arrangements, the provision of safe drinking water and cleanly disposing of wastewater and stormwater are key responsibilities of local government. Some councils have taken the tough decisions to improve their performance, and they should be applauded for doing so. Yet considerable evidence is available that shows poor performance of the three waters sector in many parts of New Zealand, in terms of its impact on human health, the natural environment, productivity and costs to consumers and ratepayers.

Local governments spend a high proportion of their funds on three waters. Achieving better safety and environmental records is expected to create additional funding and financing pressures on local councils, with some small populations potentially incurring very large cost increases. Tackling these pressures requires fundamental reforms that sustainably lift councils' safety and environmental performance as well as their productivity and cost effectiveness.

The current regulatory regime imposes weak disciplines and incentives on council-led water suppliers to meet safety and environmental minimums, and oversight of supplier charges and/or costs is minimal. No prosecutions have been pursued for breaches of health standards and too many suppliers of wastewater are allowed to continue operating with expired consents.

A new regulatory regime to substantially lift performance

The performance of the three-waters sector would be substantially improved through a new approach that both rigorously enforces minimum health and environmental performance standards, and is permissive about how councils meet these standards.

The new regulatory regime would be administered by an existing, credible and independent regulator such as the Commerce Commission, which already regulates similar activities and has a credible "industry watchdog" reputation.

The regime would be permissive and flexible, but a backstop arrangement would be applied to councils that fail by a specified time period to lift their performance sufficiently to meet minimum health and environmental standards. The backstop would take the form of compulsorily merging water businesses, placing them in Council Controlled Organisation structures and requiring them to move to being fully funded directly from water consumers rather than through council rates.

While significant cost efficiencies should be possible for most council-led water services, some small communities will need financial assistance from government to help them make the transition to achieving minimum performance standards.

Bringing it all together

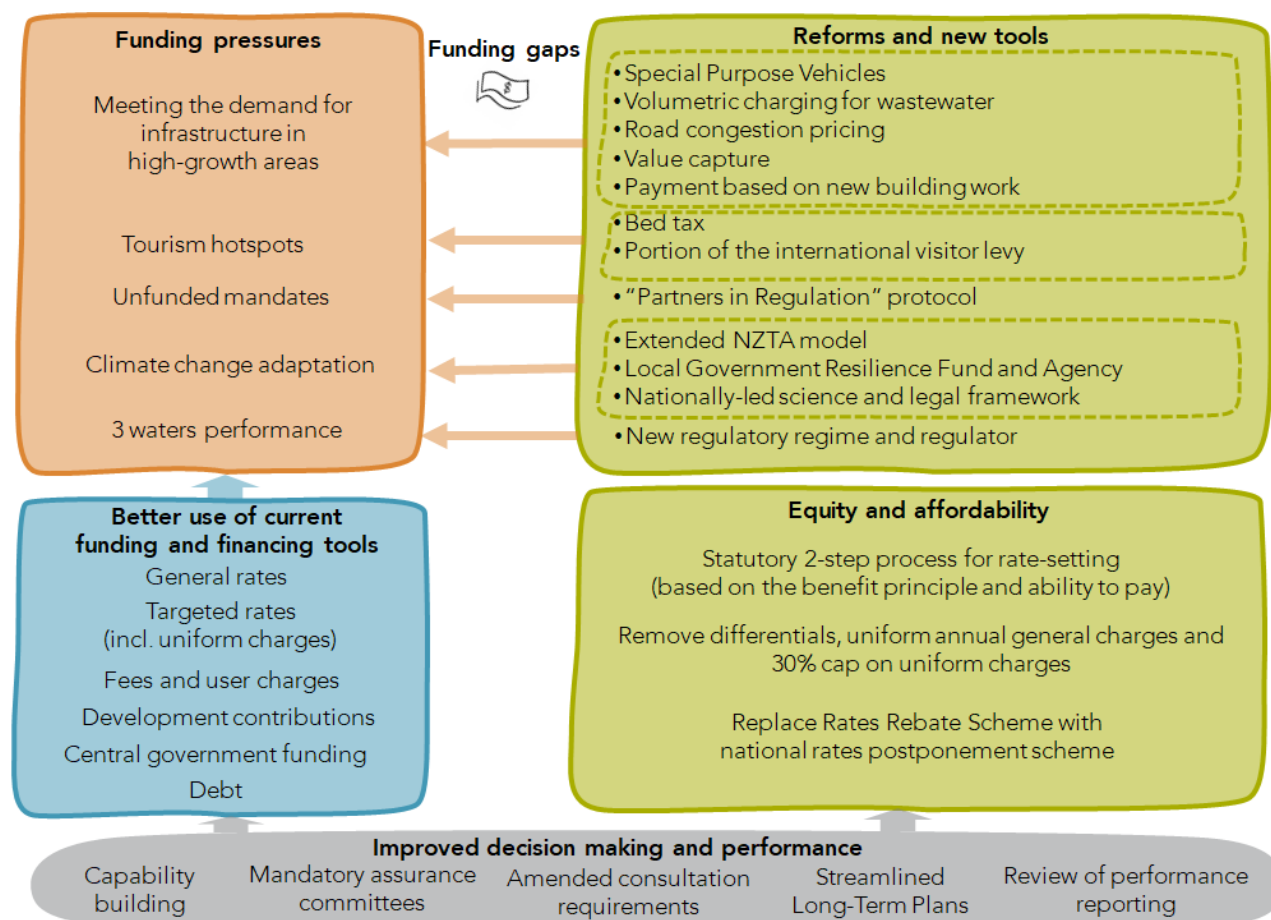
Figure 0.4 is a high-level summary how the funding and financing of local government can be improved. It highlights the key areas of funding pressure on local government, where existing funding and finance arrangements are insufficient. The Commission believes that tackling these funding gaps is the highest

priority for action. Without new funding tools to deal with these significant cost pressures, they will likely worsen over time.

There is also considerable scope for better use of the current funding and financing tools available to local government. This draft report makes a number of recommendations to improve the quality and transparency of councils' decision making and performance. These recommendations will help improve councils' ability to make the best use of the available funding and financing tools, and manage cost pressures.

Legislative changes are also needed to make the current funding system more equitable, including changing rating powers to give more prominence to the benefit principle, phasing out the current RRS, and introducing a national rates postponement scheme.

Figure 0.4 Improving local government funding and financing



1 About this inquiry

Key points

- Local government plays an essential role in New Zealand’s system of government as both a provider of services and a voice for local democracy. High-performing local government matters a great deal to communities and the wellbeing of New Zealanders.
- The Terms of Reference (TOR) for this inquiry identify pressures that are putting a strain on local government costs, now and in the future. The pressures stem from population changes, the need to adapt to climate change, the need for new growth infrastructure, the rapid growth of tourism, and the ever higher and wider service standards expected of local government. The TOR call for an in-depth investigation into the adequacy of local government funding and financing arrangements.
- The Government has asked the Commission to undertake an inquiry into local government funding and financing. It wants to know what is driving the cost of local-government services and whether the current funding and financing arrangements are adequate and efficient. If they are not, the Government wants to know what options and approaches will improve the arrangements.
- The following principles are used to evaluate the adequacy of funding and financing tools currently available to local governments in New Zealand and the need for additional tools:
 - Appropriate for local government use – given the role of local government; and the need for local autonomy (flexibility to align with local preferences) and accountability (including transparency).
 - Coherent with national policy objectives and the wider tax system.
 - Efficient, in that instruments should minimise harmful incentive effects on resource allocation, investment and innovation, and minimise compliance and administration costs.
 - Equitable and fair – taking account of who benefits from local government services, including current and future generations.
 - Sustainable, through minimising avoidance and providing adequate, stable and predictable revenue over time.
- The Commission favours the “benefit principle” as the primary basis for deciding who should pay for local-government services. Councils should consider “ability-to-pay” in a second step, taking into account central government’s primary role in income distribution. When services provided by local government confer national benefits (through contributing to the national interest or national policy objectives), the Commission sees a case for central government to make a funding contribution that reflects such benefits.
- The quality of councils’ decision-making is vital to making best use of available funding and financing tools. This quality flows from well-designed institutional and statutory arrangements, plus the skills and capability of council decision-makers. When knowledge, incentives and decision rights are present together, local governments will make prudent, efficient and effective revenue-raising and spending decisions that reflect the preferences and aspirations of their communities.
- The Commission has identified the three-waters sector (drinking water, wastewater, and stormwater) as an important area for investigation. Local governments spend a high portion of their funds on the three waters and poor-quality water services are common. A case study has been conducted to identify proposals to improve outcomes in the three-waters sector and ease funding pressures.

1.1 What the Commission has been asked to do

Local government plays an essential role in New Zealand's system of government as both a provider of services and a voice for local democracy. Local government promotes community wellbeing through regulating land use (managing the activities of people and businesses so they do not negatively impact on others or the natural environment), choosing and funding local amenities, and planning and investing in essential infrastructure.

The Government has asked the Commission to undertake an inquiry into local government funding and financing. It wants to know what is driving the cost of local-government services and whether the current funding and financing arrangements are adequate and efficient. And if not, what options and approaches will improve them. The TOR exclude several topics from the inquiry (Box 1.1).

It is important to be clear what is meant by local government *financing and funding*.

- Financing refers to the arrangements put in place to ensure money is available to pay for an investment project or service at the time payment is due. So, for example, a council may finance an infrastructure project through borrowing to ensure that it has the cash on hand to pay the upfront bills.
- Funding refers to the sources of money that the ultimate payers of infrastructure and services provide over time. For example, a council may fund an infrastructure project through sources such as rates or user charges and use this revenue to cover the costs of financing (which would comprise interest and capital repayments in the case of borrowing).

Box 1.1 Matters excluded from this inquiry

The local government funding and financing inquiry excludes the following topics:

- mechanisms for rating Māori freehold land and Crown land;
- the valuation system and practices;
- substantial privatisation; and
- recommendations that would directly affect representation or boundary arrangements for councils.

The inquiry's Terms of Reference do not call for an assessment of, or changes to, the current scope and responsibilities of local government. Any significant change to the scope and responsibilities would require a fresh look at the appropriate range of funding and financing tools.

Source: TOR (pp. i - iii).

On 29 April 2019, the Minister of Finance wrote to Chair of the Productivity Commission asking for the inquiry's TOR to be expanded to incorporate the recommendations of the 2019 Tax Working Group (TWG) relating to taxing vacant land (p. iv). The TWG highlighted the challenges of housing affordability in New Zealand and how constraints on the supply of land for housing contribute to the high cost of housing. The TWG recommended that the Productivity Commission's inquiry into local government funding and financing consider whether a tax on vacant residential land would be a useful mechanism to improve the supply of housing for New Zealanders.

The Commission is seeking submissions on this issue in this draft report and will provide advice to referring Ministers in its final report, due on 30 November 2019.

1.2 Why this inquiry is important

High-performing local government matters a great deal to communities and the wellbeing of New Zealanders. Local government (through its planning and land use regulatory role) can provide greater

access to, and choices of, housing; better protection of New Zealand's natural environment and cultural values; and quality infrastructure at the right time in the right place. Success in these provides the foundation for urban and rural communities that offer a wide range of amenities and are attractive places to live; and where people consume, work, play and create.

If councils struggle to deal with rising costs and have poor incentives for improving performance, then this will lead to poor community outcomes. For example, the inquiry into contaminated drinking water in Havelock North found about 759 000 people in New Zealand (20% of the serviced population) are supplied with water that is not demonstrably safe to drink. Of these, 92 000 people risk getting a bacterial infection, 681 000 risk getting a protozoal infection, and 59 000 risk suffering from the long-term effects of exposure to chemicals (Havelock North Inquiry, 2017, p. 25). In addition, many council wastewater systems are performing poorly. They are degrading freshwater and coastal water quality, and sewage overflows are occurring at a frequency that communities no longer accept.

The funding and financing framework for local government must therefore incentivise good performance and enable local government to deliver quality services when and where needed in line with the preferences and aspirations of the local community. This requires that local government have the necessary autonomy, responsibility and accountability in delivering these services. In turn, this requires that local-government services are largely paid for by local ratepayers, and that the services are effective, efficient and affordable.

1.3 The context of this inquiry

The TOR for this inquiry identify pressures that are putting a strain on local government costs, now and into the future. Accordingly, the TOR call for the Commission to conduct an in-depth investigation into the adequacy of local government funding and financing arrangements to cope with these pressures. Those pressures are:

- for areas with rapid population growth, the need for local authorities to increase the supply of development capacity to tackle declining housing affordability;
- the need to maintain services in areas with declining populations;
- requirements for higher quality standards for fresh water, wastewater, stormwater and flood protection to meet environmental and public health standards;
- the need to adapt to the increasing hazards and rising risks due to climate change;
- the pressures from the rapid growth of tourism, especially where tourist numbers have become large relative to residents; and
- the need to replace existing infrastructure that is coming to the end of its useful life, especially where this has been neglected in recent times.

These pressures vary according to the type of council as well as size, location, demographic and other characteristics. The impact and fiscal adequacy of the funding system in dealing with these and other pressures facing councils are investigated in Chapter 6. Two areas stand out as relatively new and as putting significant additional funding pressure on local government: tourism growth and adapting to climate change.

Previous and current work in this area

Some significant aspects of local government have been the subject of significant investigation and analysis by the Productivity Commission in recent years. In particular, the Commission:

- investigated local government regulatory performance and identified key areas for improvement (*Better local regulation*, 2013);
- examined local government processes for the supply of land for housing in high-growth areas and recommended improvements (*Using land for housing*, 2015); and

- undertook a first-principles review of the urban planning system in New Zealand and set out what a high-performing urban planning system would look like (*Better urban planning*, 2017).

These inquiries examined important issues relevant to this inquiry, such as local government approaches to rating and to funding and financing the infrastructure needed to accommodate population growth.

In addition, existing government work programmes are relevant to this inquiry. In particular, the Ministry of Business, Innovation and Employment is leading the *Urban Growth Agenda* – a programme of work to improve housing affordability underpinned by affordable land. That programme aims to remove undue constraints to land supply, development capacity and infrastructure provision (Ministry for the Environment & Ministry of Business, Innovation and Employment, 2018).

The Department of Internal Affairs is reviewing the organisation and management of drinking water, stormwater and wastewater (the “three waters”). The review has released an initial assessment that considerable evidence exists of under-performance and pressure points within the three-waters sector. The review is undertaking substantial work to develop reform options for improving the three-waters system, including management, service delivery, funding, and regulatory arrangements. This review and the Commission’s inquiry into local government funding and financing will each have implications for the other.

The last comprehensive review of local government funding and financing was the *Report of the Local Government Rates Inquiry* (the so-called “Shand Report”) published in 2007. More than 10 years later, this inquiry presents an opportunity to take another comprehensive look at the funding and financing system across the range of local government functions.

1.4 Gathering evidence

The Commission’s draft findings and recommendations have been informed by a comprehensive engagement with interested and expert parties. The inquiry received 136 submissions on its issues paper (a record number for the Commission) from a diverse range of sector participants; including from councils, business groups, property developers, infrastructure providers, academics and researchers, farming bodies, ratepayer groups, individual ratepayers and government agencies.

The Commission met with a wide variety of interested parties across New Zealand. These included several “cluster meetings” of councils (where a council hosted neighbouring councils) in Dunedin, Christchurch, Palmerston North, Tasman, Porirua, Auckland and Hamilton. The Commission has appreciated the large turn-outs at these cluster meetings. The Commission also met with provincial chambers of commerce members, Federated Farmers members, and property developers.

The Commission undertook four case studies of individual councils, including one regional council. This involved being “on site” and working collaboratively with participating councils. The case-study approach involved a comprehensive document review and semi-structured interviews with elected members and key staff. These “deep-dive” case studies have allowed the Commission to “get below the averages”, providing a detailed understanding of the diversity of issues facing different councils.

The Commission is grateful to the experts who provided advice and input on several technical, data, policy and institutional-design issues. These include Associate Professor Kenneth Palmer (University of Auckland); Professor Ian Ball (Public Sector Performance (NZ) Ltd); Robin Oliver and Mike Shaw (OliverShaw); Fraser Colegrave (Insight Economics); Ashley Milkop, Michael Young, and David Moore (Sapere Research Group); Carl Hansen (Capital Strategic Advisors); and Peter Winder (McGredy Winder & Co).

This evidence has provided a rich picture of the funding and financing pressures facing councils, the adequacy of current funding and financing arrangements, and the need for any additional funding and financing tools.

1.5 The Commission’s approach

Central government plays the major role in macroeconomic-stabilisation and distribution policies, and provides a set of national public goods. Local governments, on the other hand, are focussed on providing

local public goods whose consumption is limited primarily to their community. In this way, local governments can choose the local public goods and services that align with their communities' preferences, taking into account local costs, and other local circumstances.

The Commission has reviewed the taxation and funding literature, past reviews of local government funding and reviews of the national taxation system. From these, it has distilled a set of principles to evaluate the adequacy of the funding and financing tools currently available to local government, and to assess possible new tools (Box 1.2) (Chapter 6). These principles can conflict with each other. The design of a local government funding system needs to make clear which principles prevail and strike a balance between them.

Box 1.2 Principles for funding and financing

The Commission has used the following principles to evaluate the adequacy of the funding and financing tools currently available to local governments in New Zealand and to assess any possible additional tools.

Funding and financing instruments for local government should be:

- appropriate for local government use – given the role of local government; and the need for local autonomy (flexibility to align with local preferences) and accountability (including transparency).
- coherent with national policy objectives and the wider tax system.
- efficient, in that instruments should minimise harmful incentive effects on resource allocation, investment and innovation, and minimise compliance and administration costs.
- equitable and fair – taking account of who benefits from local government services, including current and future generations.
- sustainable, through minimising avoidance and providing adequate, stable and predictable revenue over time.

The Treaty of Waitangi is another important frame to keep in view when thinking about principles for local government funding and financing. This is referred to by Te Rūnanga o Ngāi Tahu in their submission to this inquiry as “Treaty partnership integrity” (sub. 53, pp. 6-7). Different aspects of this principle are discussed in Chapters 2, 4 and 5.

The Commission favours the “benefit principle” as the primary basis for allocating rates (Chapters 6 and 7). This simply means that a council should levy its rates and other charges in rough proportion to the benefit that a property owner receives from the services that the council provides.

The “ability to pay” principle should be a second step in making rating decisions. Ability to pay means that tax is collected in relation to some measure of income or wealth of the property owner. Importantly, any adjustments for ability to pay need to be transparent and take into account central government's primary role in income distribution.

When services provided by local government confer national benefits (through contributing to the national interest or national policy objectives), the Commission sees a case for central government to make a funding contribution that reflects such benefits.

The focus of this inquiry is the adequacy of funding and financing tools that local government needs to carry out its role in providing services for local residents and businesses. However, importantly, the quality of councils' decision making is critical to making best use of available funding and financing tools and resources, and to ensuring decisions align with community needs and preferences.

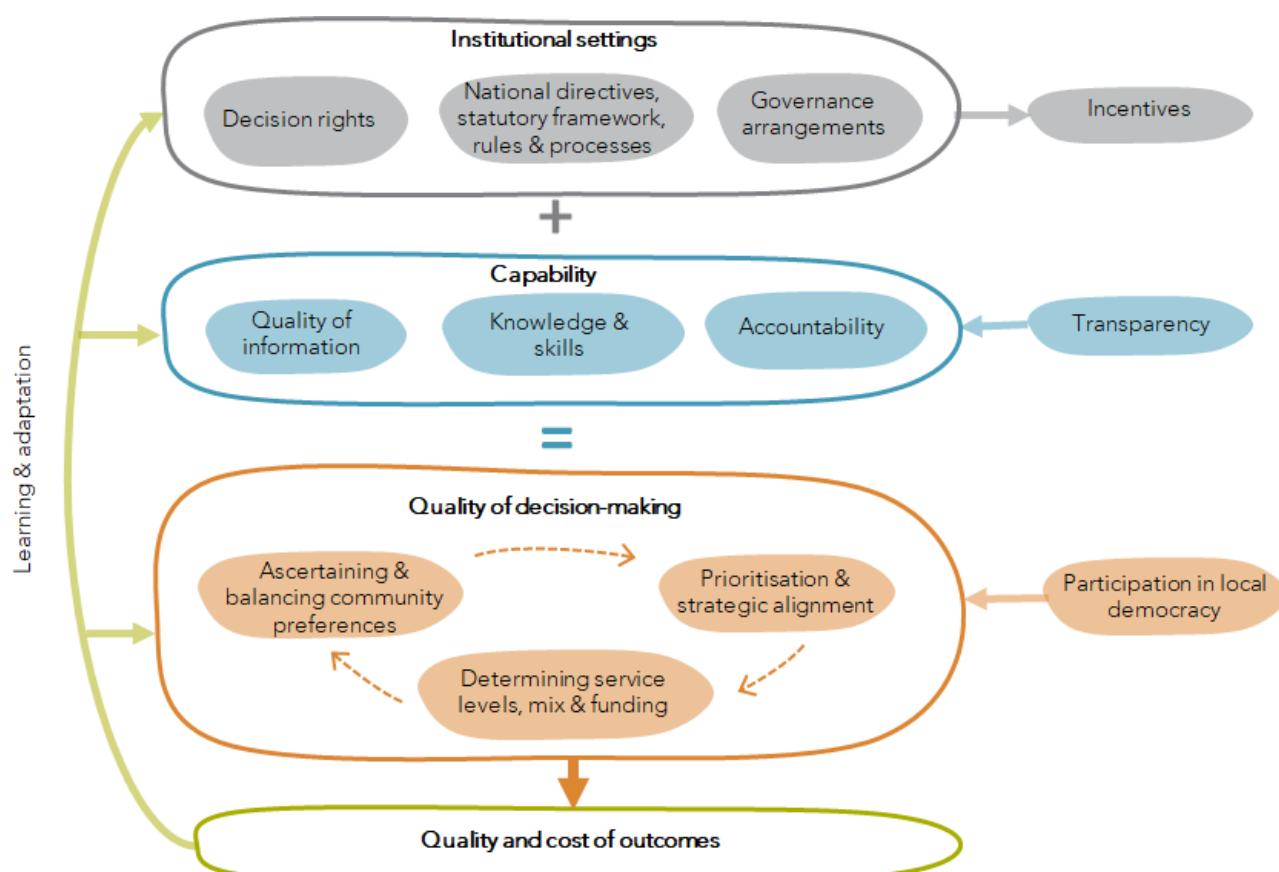
Councils undertake many activities. They make choices about the mix of activities, the levels of service, how each activity is provided and funded and who pays. Councils have many choices about how to fund their activities (Chapter 2). These choices (eg, the mix of general and targeted rates, differentials, and fees and charges), affect the amount different groups of people pay (Chapter 7).

How well councils make use of current funding and financing tools has a material impact on the quality of outcomes. The disciplines and incentives on councils to make good decisions is examined in Chapter 5. The scope for improving the quality of decision making so as to achieve better long-term outcomes is assessed in regard to:

- *institutional settings* (ie, the statutory framework for decision-making, council governance arrangements and where decision-rights sit); and
- *council capability* (ie, the quality of information put to decision-makers, the relevant knowledge and skills of decision makers and those supporting them, and accountability arrangements) (Figure 1.1).

The chapter recommends ways to improve the quality of council decision-making.

Figure 1.1 Key elements of good decision-making



The institutional environment and councils' capability will jointly determine the quality of decisions about levels of service, the mix of services and their funding. They will also influence how well local government decision makers identify and balance community preferences, set strategic objectives and prioritise potential actions in line with them.

The Commission has undertaken a case study by applying the above decision-making framework to the water sector in New Zealand (the so-called "three waters": drinking water, wastewater, and stormwater). Chapter 9 describes this case study. The Commission decided to investigate this area in depth given that local governments spend a high proportion of their funds on the three waters. For example, drinking water and wastewater accounted for nearly 14% of total local government operating expenditure (opex) and 22%

of capital expenditure (capex) in 2018. Local government capex on these activities is projected to be 25% of total capex over 2019–2028, according to their long-term plans. Also, poor-quality water services in New Zealand are common. Achieving higher safety and environmental standards is expected to create additional funding and financing pressures on councils, with some districts with small populations expected to incur very large increases in costs.

Dealing with these pressures will require reforms that can enable a sustainable lift in council performance – in safety, in environmental outcomes, and in productivity and cost effectiveness. Better investment choices are essential to minimise additional costs and harms on communities. The case study identifies a way forward that would substantially improve the performance of the three-waters sector.

A new, challenging and growing pressure on local government funding comes from climate change – the threats from sea-level rise and more frequent and extreme weather events. The most direct threat is climate-induced damage to local government infrastructure such as roads, bridges, and stormwater, wastewater and flood-protection assets. Two broad principles guide the Commissions analysis and advice on funding of climate adaptation: minimising long-run cost; and fairness and justice (Chapter 8). The first implies avoiding moral-hazard behaviour that leads to increased risk exposure for private gain at the expense of others. The second brings into play New Zealand’s strong tradition of societal support and risk sharing, and inter-generational equity.

2 The context

Key points

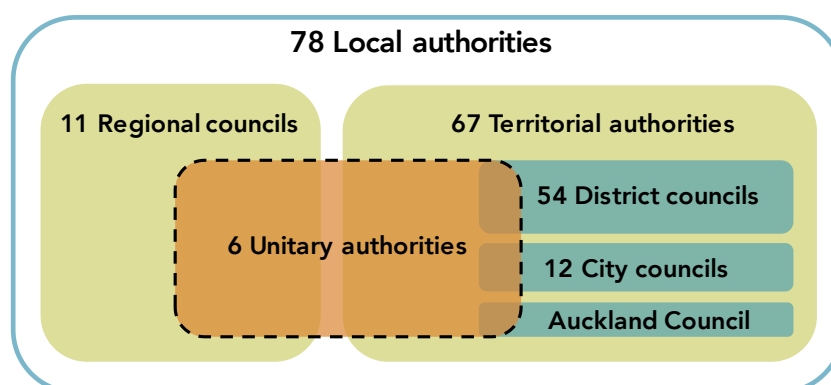
- New Zealand's 78 local authorities are set up under statute to enable democratic local decision making by their communities, to provide local infrastructure and to undertake specified regulatory functions. Under the Local Government Act 2002 (LGA), promoting the four wellbeings of communities (social, economic, environmental and cultural) is a main purpose of local government.
- Local authorities are accountable to and largely funded by their own communities. The LGA provides local authorities with the power of general competence (the ability to choose the activities they undertake to fulfil their statutory role and how they should undertake them subject to public consultation). The LGA and other Acts set out the power of councils, including the power to make local bylaws, the power to raise revenue, and councils' planning and accountability requirements.
- The scope of responsibilities of local government in New Zealand is much narrower than in most other developed countries. Local government in New Zealand makes up a much smaller proportion of total government spending than in most other jurisdictions.
- Local authorities have widely different circumstances that are material to this inquiry. A small number of urban authorities are experiencing rapid population growth. Other authorities are growing slowly in population, or not at all. Physical resources and industry structure vary across the country, driving different infrastructure requirements. Tourism is particularly prominent in some areas.
- Physical infrastructure provision dominates local government operating and capital expenditure, though the details vary greatly across councils. Rates provide the largest source of revenue (just under 50%), with grants and subsidies (particularly from central government for roading and other transport costs) and fees and user charges are also important.
- The Local Government Funding Agency is the largest lender to local government. Other lenders include banks and financial institutions and purchasers of local bonds. Various laws and regulations set out financial reporting and prudential requirements.

This chapter sets out the basis for local government in New Zealand, the activities that it funds and sources of revenue. It identifies the significant variation in circumstances across local authorities that impact their ability to raise revenue to fund activities and to finance their investments.

2.1 Local government in New Zealand

Local government is a term used to collectively describe New Zealand's 78 regional, district, city or unitary councils (Figure 2.1)

Figure 2.1 Types of local government



Notes:

1. The 67 territorial authorities include 54 district councils (four of which are unitary authorities), 12 city councils (one of which is a unitary authority) and Auckland Council (which is a unitary authority).

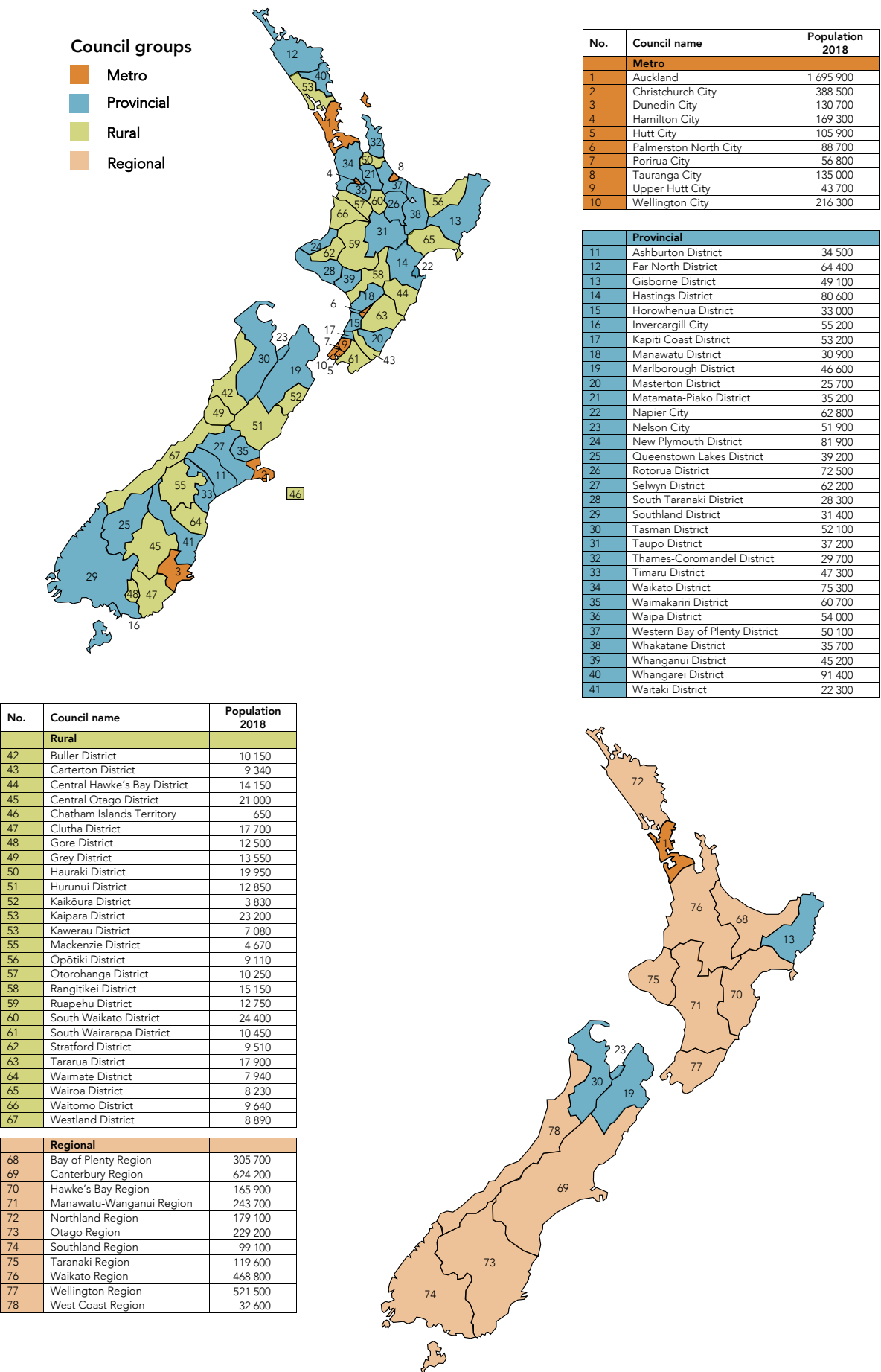
Regional councils are responsible for the physical environment and cross-boundary functions that require an integrated approach, which include regional land transport, flood protection, biosecurity, civil defence and some resource management.² The functions of territorial authorities (city and district councils) are broader, encompassing physical infrastructure such as roads, water supply, wastewater and stormwater, recreation and cultural activities, land-use planning, building standards and some public health and safety functions. A unitary authority is a territorial authority that also has all the responsibilities of a regional council.

The scale of local government is significant. In June 2018, local government owned fixed assets worth \$123 billion, and had a yearly operating expenditure (opex) of \$10.3 billion and an operating income of \$9.9 billion (Stats NZ, 2019c). Local government employed 25 300 staff (full-time equivalent) in June 2017 (Department of Internal Affairs, 2018).

Figure 2.2 shows the location and population of local authorities. It also groups local authorities into sector groups: metropolitan; provincial; rural; and regional. These sector groups are based on Local Government New Zealand (LGNZ) membership.

² Wellington Regional Council is also responsible for bulk water supply through its participation in Wellington Water, a jointly owned Council Controlled Organisation.

Figure 2.2 New Zealand local authorities: population and sector group



Source: Stats NZ, 2018b.

2.2 The purpose and powers of local government

The Local Government Act 2002 (LGA) (s 10) states that the purpose of local government in New Zealand is:

- to enable democratic local decision-making and action by, and on behalf of, communities; and
- to promote the social, economic, environmental, and cultural well-being of communities in the present and for the future.

The powers of local government

Local government is a creature of statute – it is established and empowered by legislation. The main laws that currently govern and empower local government are set out below.

- The LGA provides local authorities with the power of general competence (the ability to choose the activities they undertake in pursuing their statutory role and how they should undertake them, subject to public consultation). It sets out the powers of councils, including the power to make local bylaws, and councils' planning and accountability requirements.
- The Local Government (Rating) Act 2002 (LGRA) sets out the methods by which councils raise revenue through rates.
- The Local Government Act 2002 Amendment Act 2010 prescribes rules for council performance standards for core services of the LGA.
- The Local Electoral Act 2001 sets out the process for council elections.
- The Local Government (Auckland Council) Act 2009 sets out the governance structure for the Auckland Council.
- Local government activities (especially regulatory functions) are governed by a number of statutes, such as the Resource Management Act 1991 (RMA) and the Building Act 2004.

The functions and roles of local government have been frequently restructured and reshaped over the years by central government through legislative change. For example, under the previous legislation (the Local Government Act 1974), before local authorities did anything, they needed to check whether or not they were empowered to do it. The LGA abandoned this prescription and moved towards a power of general competence. However, this does not mean local authorities have a free hand to do whatever they wish. The powers of local authorities are limited by:

- the LGA (eg, local authorities must follow the process set out in the LGA when they make decisions), and local authorities cannot divest themselves of water and wastewater assets;
- other legislation (eg, local authorities cannot levy a poll tax or conduct an election on a different election cycle);
- the requirement that any action must promote the purpose of local government and be consistent with the principles set out in section 14 of the LGA; and
- the needs and wants of the community, as indicated through the decision-making and consultation processes set out in the LGA.

A range of types of powers

The powers invested in local authorities span a spectrum – from the powers that confer substantive discretion and autonomy through to delegated powers to implement regulation with little or no discretion.

Some powers conferred on local authorities are prescriptive and do not permit any discretion on the part of local authorities. The role of local authorities in this context is to deliver services according to national standards. These are often referred to as “delegated” powers. An example is the Building Act 2004, which requires local authorities to issue building consents and undertake building inspections. Local authorities have no role in setting building standards and cannot set higher or lower building standards than the

Building Code. For delegated powers, the performance of local authorities is mainly assessed on their capacity and ability to carry out regulatory functions to nationally determined standards.

Other powers granted to local authorities confer on them substantial discretion and autonomy as to when and how to exercise those powers. These types of powers are often referred to as “devolved powers”, and they give effect to local government’s role as the voice of local democracy. In this context, local authorities operate largely autonomously of central government, and are empowered to choose which activities to undertake and how to pay for them. Their performance will be judged on their ability to consult and reflect community interests and preferences, and to reconcile different community interests and reach a decision. The powers granted under the Resource Management Act and LGA are good examples of devolved powers.

In the middle of the spectrum are regulations that have been conferred on local authorities because local government is considered best placed to tailor regulation to the specific characteristics, needs and preferences of diverse local communities. Different regulations require different types of local input and decision making. For example, the role of local authorities under the Sale and Supply of Alcohol Act 2012 is quite different to their role under the Gambling Act 2003.

Chapter 5 explores the implications of devolved powers on the decision-making processes of local authorities, in particular the role of consultation in determining community preferences, and the importance of transparency in fulfilling the purposes of consultation.

Constitutional relationships with central government

Local authorities are accountable to and largely funded by their own communities.

While local government is a creature of statute, it operates as a largely autonomous provider of services, funded separately by property taxation and held accountable by voters. In the absence of well-defined constitutional or fiscal relationships, local and central government are most accurately regarded as two spheres of a system of collective decision-making, each with revenue-collection powers to fund the implementation of its particular policies and programmes. (Local Futures Research Project, 2006, pp. 13-14)

Local authorities are sometimes characterised as agents of central government, required to implement national priorities and central government’s directions, and accountable to central government. However, in reality, the nature and extent of local authorities’ relationship with central government is context-specific, depending on the particular regulatory framework.

Some regulatory frameworks (such as for building) specifically provide that a local authority is accountable to the relevant minister or government department. However, in the absence of explicit statutory recognition of a line of accountability, a local authority is not accountable to the relevant minister or government department for the exercise of its statutory powers.

Constitutional relationships with Māori

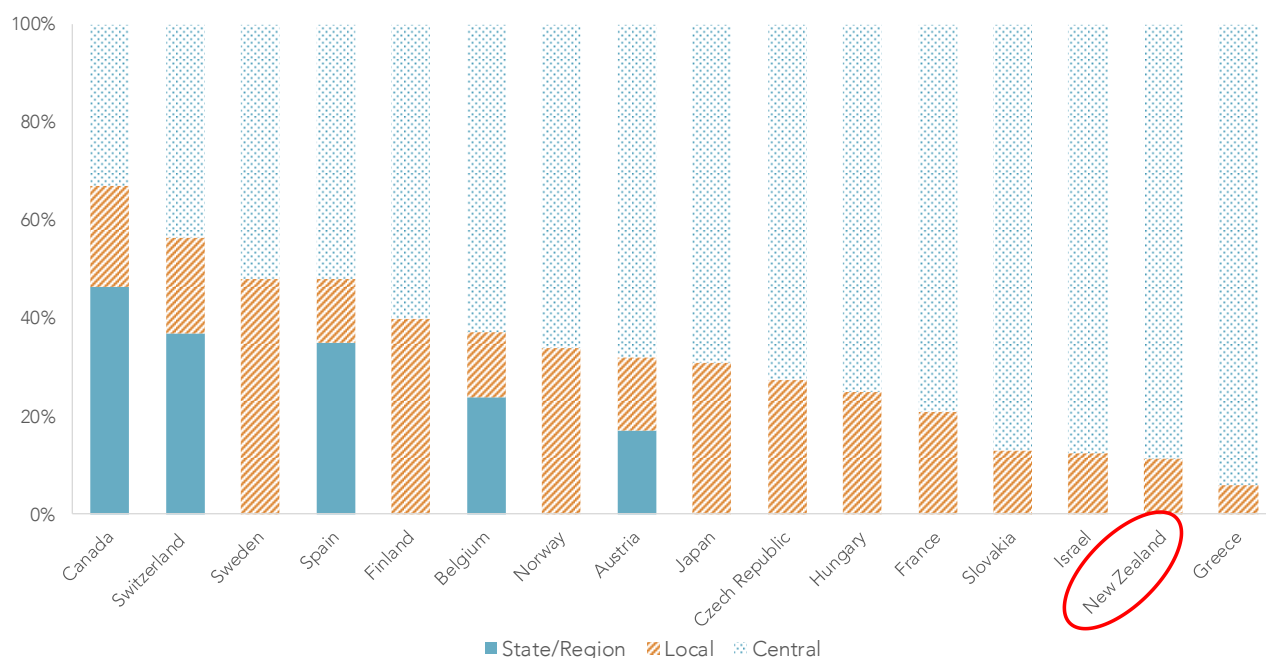
The Local Government Act 2002 includes a specific Treaty of Waitangi clause, which provides that the Crown’s obligations under the Treaty are recognised and respected by placing obligations on local authorities to facilitate participation by Māori in local authority decision-making processes (section 4).

Local iwi have a strong interest in local authority functions. This is especially so for resource management decisions under the RMA. Section 6 of the RMA recognises “the relationship of Māori and their culture and traditions to their ancestral lands, water, sites, waahi tapu, and other taonga” as a matter of national importance. Section 7(a) requires persons exercising functions and powers under the Act to have particular regard to kaitiakitanga, while section 8 requires them to take into account the principles of the Treaty of Waitangi. “[K]aitiakitanga means the exercise of guardianship by the tangata whenua of an area in accordance with tikanga Maori in relation to natural and physical resources; and includes the ethic of stewardship” (s 2).

The scope of local government

Local government in New Zealand currently has a smaller scope of responsibilities than local governments in many other countries, and this is reflected in local government accounting for a small share of total government spending (Figure 2.3). This is in part because many of the functions undertaken at the local level in other countries, such as health services and education, are funded centrally in New Zealand and provided through Crown entities.

Figure 2.3 Spending by level of government, selected OECD countries, 2010



Source: OECD and Korea Institute of Public Finance, 2012.

Notes:

1. Data for New Zealand, Japan and Switzerland correspond to 2009 instead of 2010.

2.3 Differing circumstances across local authorities

Local authorities vary considerably in size and population dispersion

Local authorities vary considerably in population size. Auckland Council, the largest authority, has a population of about 1.7 million, while the smallest mainland authority, Kaikōura District Council, has a population of just under 4 000. All councils are responsible for local roading and the three waters; yet the share of expenditure allocated to different services can vary significantly between councils (section 2.4).

Councils also vary in the dispersion of their population. Some councils have several small population centres and so lack economies of scale in the provision of some infrastructure and services (see eg, Ōpōtiki District Council, sub. 126; Hauraki District Council, sub. 43; Federated Farmers of New Zealand, sub. 75; South Wairarapa District Council, sub. 104).

Population growth and decline across local authorities

New Zealand has experienced significant population growth since the 1990s. As a result, the populations of most local authorities have grown over recent decades; some have grown considerably (Figure 2.4). For instance, Queenstown Lakes district's population more than doubled, partly because of strong growth in its tourism industry. Selwyn district's population also doubled.

In absolute terms, a high proportion of recent population growth has occurred in large urban councils, particularly Auckland, Christchurch, Hamilton, Tauranga and Wellington. The scale of Auckland's population growth is unique (Box 2.1).

Box 2.1 **The unique case of Auckland**

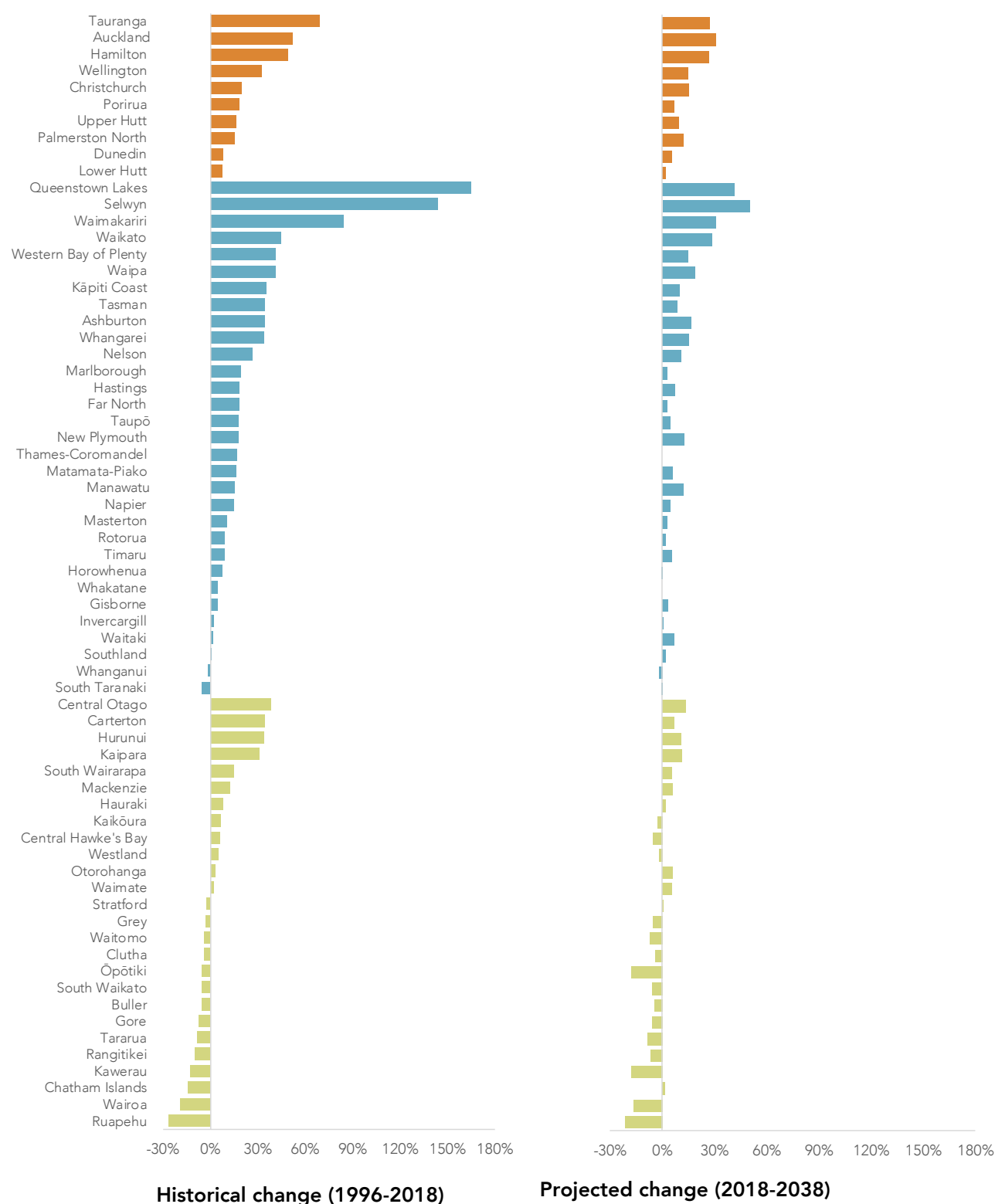
About 35% of New Zealanders live in Auckland. Over the past two decades, Auckland has grown rapidly and its population is projected to increase by over 500 000 people during the next 20 years. That increase is more than three times Hamilton's total population. The size of Auckland, combined with its rapid growth, brings about unique challenges.

- The Council needs financing and funding to deliver significant additional infrastructure to service new developments associated with population growth.
- Population growth has put substantial pressure on the transport network, resulting in increased traffic congestion, particularly at peak periods. It has also demanded large investment in roading infrastructure and public transport (eg, the CityRail link).

Given Auckland's size, failing to effectively tackle these challenges has indirect (and material) effects on the prosperity of the wider New Zealand economy. So, central government is working with Auckland Council to address some growth-related issues; for example, through the Auckland Transport Alignment Project and the Congestion Question project. Also, a recent legislative change enables Auckland Council to implement a regional fuel tax as a new tool to fund transport projects (section 2.5).

Yet, not all local authorities have seen growth – several faced a decline in population between 1996 and 2018. With the exception of Whanganui and South Taranaki, declining councils are smaller rural councils. For example, the population of Ruapehu district reduced by roughly a quarter, from 17 300 to 12 750, between 1996 and 2018. Wairoa district reduced in size by about 20% (Figure 2.4).

These trends reflect a general trend of urbanisation as people move from smaller centres to larger towns and cities. While predicting future population changes is inherently difficult, projections from Stats NZ suggest these trends may continue (Figure 2.4). Specifically, Auckland, Hamilton and Tauranga, commonly referred to as the Golden Triangle, along with Queenstown, Selwyn, Waimakariri and Waikato, are projected to grow the fastest, while 18 provincial and rural local authorities are projected to decline at varying rates. Even so, most of the councils projected to decline have, in fact, had stable or even growing populations in recent years (see eg, Tararua District Council, sub. 18). Domestic migration resulting from a period of unusually high net international immigration and jobs created through the growth of tourism might be some of the reasons. Chapter 4 discusses funding pressures on small councils.

Figure 2.4 Historical and projected population change across local authorities

Source: Stats NZ, 2018b, 2018c.

Notes:

1. Population projections based on 2013 population estimates.

Age structure

The average age of populations in towns and cities has been increasing as a result of historic reductions in birth rates and increasing life expectancy. Across New Zealand as a whole, the median age is projected to increase from 37.5 years to 42.9 years between 2013 and 2043. Projections vary across councils – for example,

the median age in Ashburton district is projected to increase from 39 to 40 in the years to 2043. By contrast, the median age in Porirua city is projected to increase from 35 to 45 (Stats NZ, 2018c). These trends will be discussed in more detail in Chapter 4.

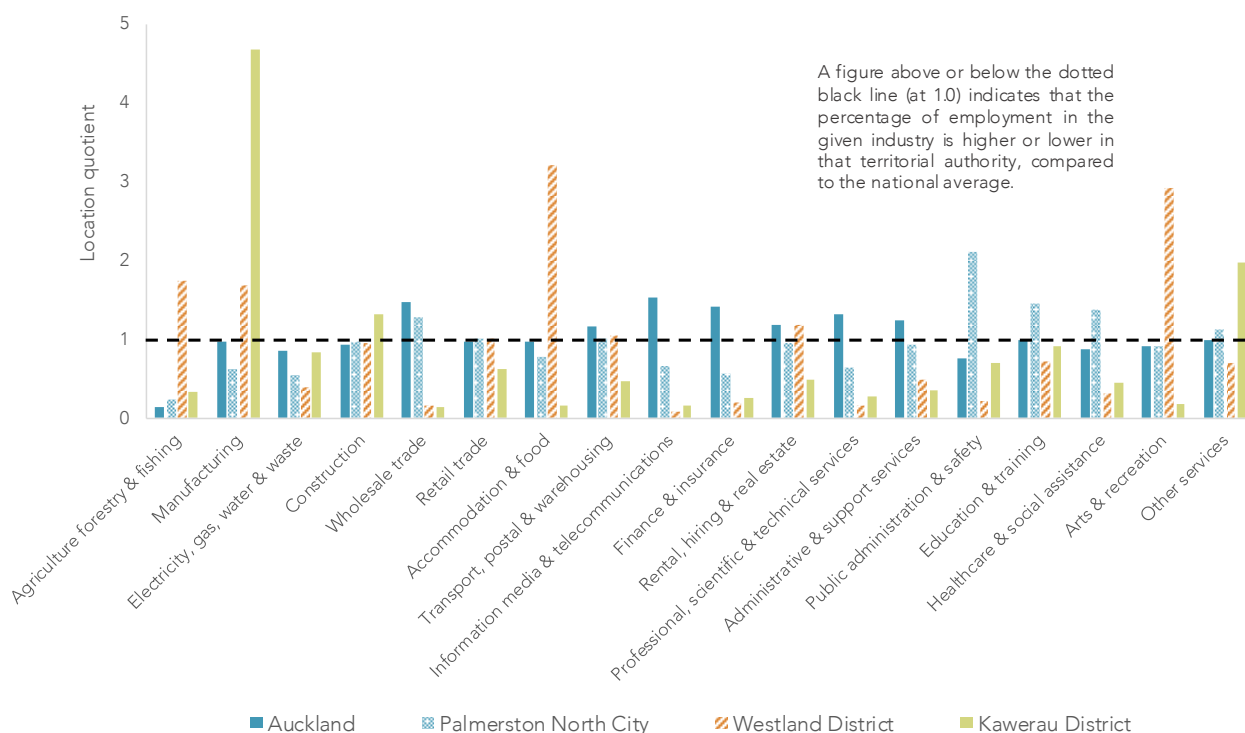
High-growth areas tend to have a younger population than slow-growth areas (NZPC, 2015), although areas attractive for retirees, such as Kāpiti Coast and Tauranga, are exceptions where population growth among older residents has been fast. In towns and cities facing decline, the younger demographic is often the first to leave. This in turn reduces the share of people at reproductive age, which slows the rate of natural increase in population and leads to further slow growth (or decline) over time. The factors driving population decline can be highly challenging (and in some cases impossible) to reverse (NZPC, 2017).

Physical resources and industry structure

Physical resources and industry structure vary across the country, driving different infrastructure requirements and local regulatory needs in different areas. Employment data indicate a pattern of larger “hub” territorial authorities where employment is distributed across a range of industries, while industrial specialisation is greater in smaller territorial authorities (Figure 2.5).

Some areas have very specialised industries. For example, employment in the Kawerau district is heavily concentrated in manufacturing, reflecting the importance of the nearby Norske Skog newsprint mill in the local economy. In the Westland district, employment is most concentrated in accommodation and food, followed by agriculture, forestry, and fishing. Palmerston North has a similar industry structure to the national average, reflecting its position as a regional hub providing goods and services for a wide area. A similar industrial structure is seen in Auckland (Figure 2.5).

Figure 2.5 Industry structure in selected territorial authorities compared to the national average, 2017-18



Source: Productivity Commission estimates using Stats NZ Business Demography Statistics.

Notes:

1. Location quotient refers to the percentage of employment in each industry compared to the percentage of employment in that industry across the country as a whole.
2. Mining, which accounts for a very small share of employment in the selected territorial authorities, is not included.

Other relevant issues

Other differing circumstances relevant to funding and financing local government services include:

- some local authorities (eg, Queenstown Lakes District Council) experience much higher tourism levels than others, placing additional pressure on their local infrastructure network (Chapters 4 and 6);
- the potential impacts of climate change and other environmental issues (eg, deteriorating water quality) differ across councils (Chapters 8 and 9);
- differences in access to income from assets such as ports and airports; and
- a small number of councils, including Christchurch and Wellington City Councils and Kaikōura District Council, face particular funding challenges due to the impacts of severe earthquakes.

Councils also differ in:

- physical terrain and geography (eg, soil types and river catchments) that place differing demands on infrastructure provision (Kāpiti Coast District Council, sub. 12; Western Bay of Plenty District Council, sub. 34; Rangitikei District Council, sub. 115);
- the extent of non-rateable land and of underutilised Māori freehold land (Mackenzie District Council, sub. 27; Ōpōtiki District Council, sub. 126; Upper Hutt City Council, sub. 40; Whangarei District Council, sub. 46);
- the age and quality of their infrastructure, where they are in the infrastructure replacement cycle, the timing and size of past investments and the debt incurred to finance such investments (Selwyn District Council, sub. 84; Western Bay of Plenty District Council, sub. 34);
- community expectations (for instance for the provision of social infrastructure and social services) (The New Zealand Initiative, sub. 96; Local Government New Zealand, sub. 112); and
- their prevailing level of ratepayers' incomes; which in turn affects the affordability of infrastructure and services (Ōpōtiki District Council, sub. 126; Hauraki District Council, sub. 43; Horowhenua Grey Power Assoc., sub. 21).

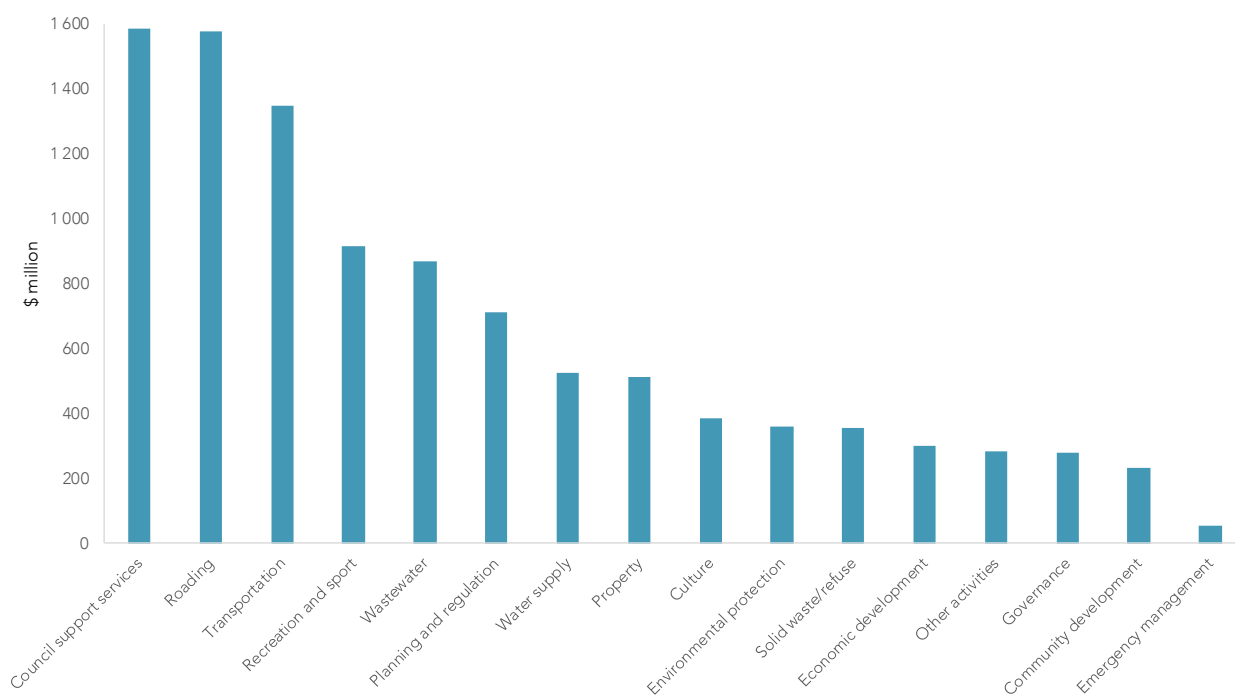
2.4 What do councils currently need to pay for?

Operating expenditure

Councils had a total opex of \$10.3 billion in 2018. Operating expenditure is the ongoing cost of providing day-to-day council services.³ The five largest sources of expenditure account for nearly two-thirds of the total opex (Figure 2.6).

- *Council support services* (which include overheads for local authority administration, finance, IT, and HR functions as well as preparation of reports such as Long-Term Plans (LTPs)) is the largest expenditure area, making up about 15.4% of total expenditure.
- *Roading* (maintenance of gravel and tar-sealed roadways, bridges, cycle lanes, verges, and footpaths) make up the second largest expense (15.3%).
- *Transportation* (bus and all other forms of passenger transport such as rail, trams and ferries, parking, airports, and transport planning) makes up 13.1% of total expenditure.
- *Recreation and sport* (which includes swimming pools, sports facilities, reserves, playgrounds, and bike and walking tracks) make up about 8.9% of total expenditure.
- *Wastewater* makes up 8.4% of total expenditure.

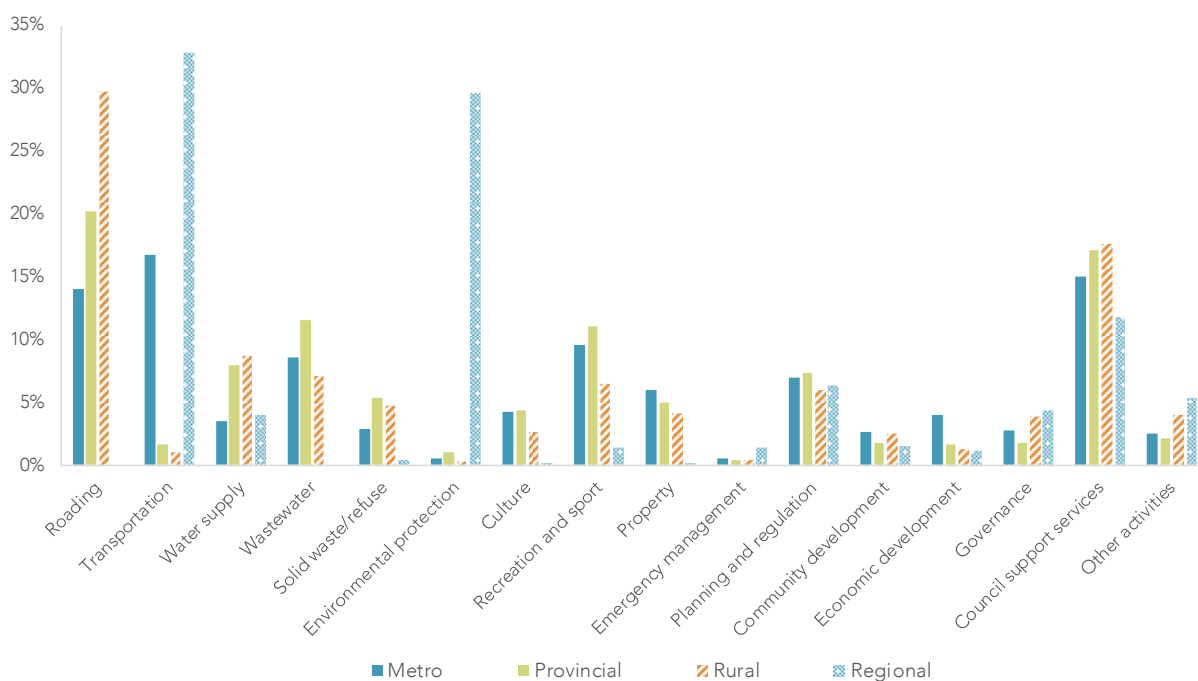
³ A significant and growing component of opex for services involving infrastructure assets is depreciation (see Chapter 3).

Figure 2.6 Total operating expenditure for all councils by activity, 2017-18

Source: Stats NZ, 2019c.

Different councils face significantly different demands. As an example, Figure 2.7 shows expenditure on different activities as a share of total opex for different types of councils. Small rural councils spend about 30% of their total expenditure on roading while transportation accounted for just 1%. Large urban councils, however, spend 14% of their budget on roading and a larger amount (17%) is spent on transportation.

Transportation and environmental protection are the two major activities of regional councils. In 2018, they spent about a third of their total expenditure on transportation and another 30% on environmental protection.

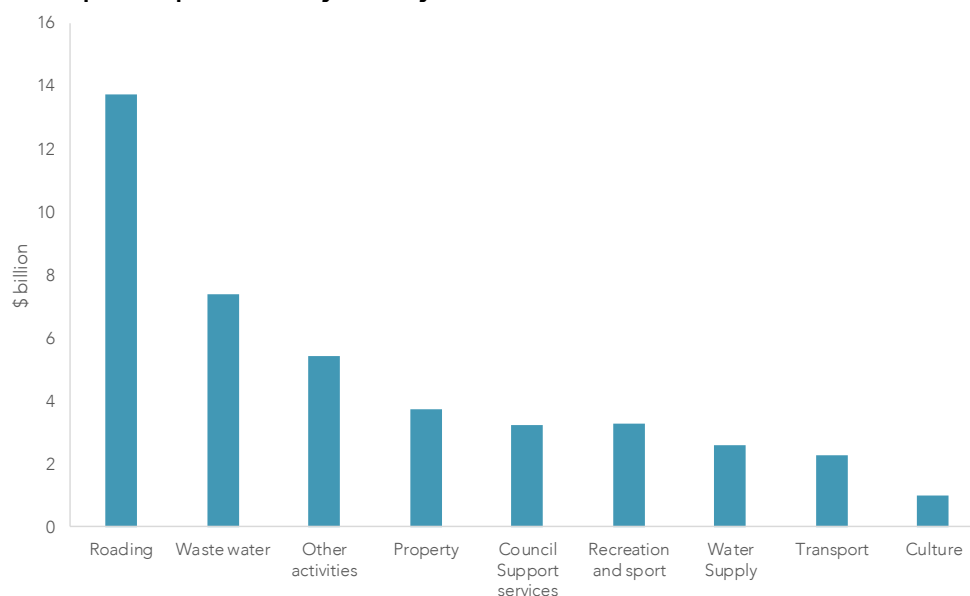
Figure 2.7 Operating expenditure by activity and council type, 2017-18

Source: Stats NZ, 2019c.

Capital expenditure

Local government capital expenditure (capex) in 2018 was \$4.9 billion, up from \$4 billion in 2009⁴ – a real increase of 23% (Stats NZ, 2019c). Capital expenditure pays for building or buying new assets to meet additional demand, replacing existing assets, and improving assets to deliver better levels of service. Roading and wastewater were the two largest areas of capital spending in the last decade (Figure 2.8).

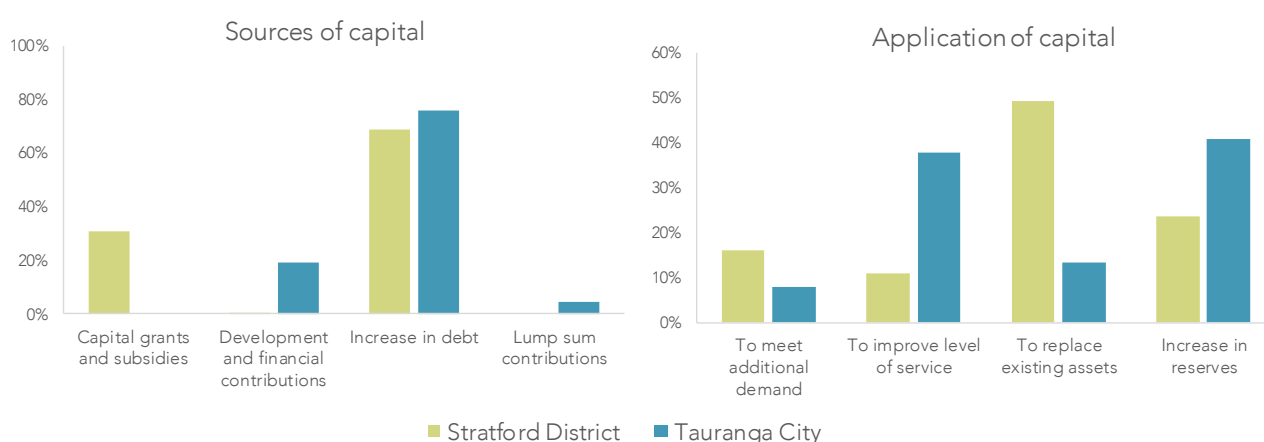
Figure 2.8 Total capital expenditure by activity, all councils, 2009-2018



Source: Department of Internal Affairs, n.d.a.

As with opex, the variability across councils as to where they direct capital spending and how they raise funds for capital projects is significant. For example, Figure 2.9 shows the sources and application of capex for Tauranga City Council and Stratford District Council. Tauranga is a fast-growing city. A relatively large share of its capital in 2018 came from development and financial contributions, and a large share was directed towards improving level of service. Stratford district has a relatively small and stable population. A large share of its capital in 2018 came from grants and subsidies—largely New Zealand Transport Agency (NZTA) contributions—and was directed towards replacing existing assets.

Figure 2.9 Capital expenditure, Stratford district and Tauranga city, 2017-18



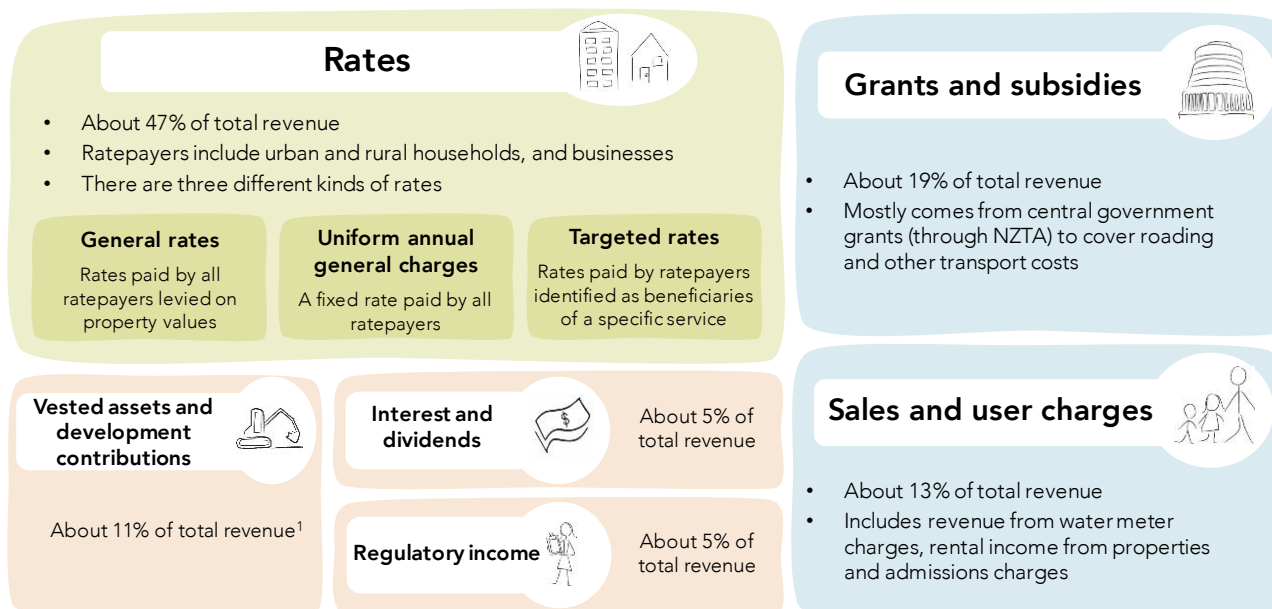
Source: Stratford District Council, 2018; Tauranga City Council, 2018.

⁴ All expenditure and revenue data, unless stated otherwise, are adjusted for inflation using the Consumer Price Index (CPI) and expressed in 2018 dollars.

2.5 What funding sources are available to local government?

Councils can access a variety of sources of revenue to fund infrastructure and other services (Figure 2.10). These can pay for both operating costs and the costs of any debt attached to infrastructure assets. Total revenue across all local authorities in 2018 was about \$12.4 billion. This does not include \$3.8 billion in income generated by valuation changes and other non-operating income.

Figure 2.10 Main sources of funding available to local authorities, 2017-2018



Source: Stats NZ, 2019c.

Notes:

1. Includes financial contributions.
2. Estimates exclude income from valuation changes and other non-operating income.

Rates

Under the LGRA, local authorities may set a general rate for all rateable land within a district. Rates are councils' major revenue source, making up 47% of total revenue in 2018. Rates revenue is used mainly to fund opex, but it can be used in a variety of other ways, including funding new infrastructure assets or the interest costs on debt incurred to finance those assets.

The relationship between property values and rates is frequently misunderstood, with many assuming that increasing property values translates to increased rates. However, this is not correct. By law, councils must decide how much they will spend in the coming year and then set rates to cover those expenses. Property values are used to allocate the burden of rates. The share of general rates paid by an individual household or business depends on the value of their property relative to the value of other ratepayers' properties in the council area. Where property values change differently, then the rating burden will change. One example is if property values in a certain suburb are assessed to have increased more than another suburb. Property owners in the higher-value suburb face a greater proportion of total rates. The total amount of revenue raised does not change just because property values change.

Many councils apply a rating differential to groups of ratepayers, which adjusts the proportion of rates paid by different groups of ratepayers. Differentials are usually expressed as multipliers of the residential rate. For instance, if the residential rate is \$1.00 per \$1 000 of property value and the business rate is \$2.50 per \$1 000 of property value, then the business differential is 2.5 (Colegrave, 2007).

Targeted rates and uniform annual general charges

The LGRA allows councils to set targeted rates to fund infrastructure and services that benefit identifiable taxpayers. Christchurch City Council, for example, has targeted rates for properties near new cycleway

projects, properties that benefit from land drainage and some properties connected to specific water and sewerage schemes.

Local authorities are also able to set a uniform annual general charge, which is a fixed charge per rating unit. Targeted rates may also be uniform.

Chapter 7 provides a more detailed account of how councils set rates and the types of rates, based on work carried out for the Commission (Insight Economics, 2019a).

Fees, user charges and regulatory income

Under the LGRA, councils can set volumetric charges for drinking water. Charges may be calculated as either a constant price per unit of water supplied and consumed, or according to a scale of charges. Councils can also charge for services such as solid waste collection, swimming pools, facilities hire, regulatory services (eg, building consent and liquor licensing fees), and other council-provided services. Such charges help recover operating costs and may contribute to capital costs.

Fuel taxes are also a source of income for local authorities, and recent legislation allows for the collection of regional fuel taxes (Box 2.2).

Box 2.2 Fuel taxes

Under the Local Government Act 1974, local authorities fuel tax is levied on petrol and other fuels, at between 0.33 and 0.66 cents a litre. The tax is collected and distributed to local authorities through 21 designated distribution authorities (MBIE, 2018a: DIA, pers. comm., 5 February 2019).

The Land Transport Management (Regional Fuel Tax) Amendment Act (enacted 26 June 2018) provides a funding tool for Auckland Council to raise revenue to fund transport projects that would otherwise be delayed or not funded. A regional fuel tax of 10 cents a litre (plus GST) applies from 1 July 2018 within the Auckland region. From January 2021, other councils will be able to apply to establish a regional fuel tax. Applications will be subject to a Ministerial approval process (Ministry of Transport, 2018).

Grants or subsidies

Central government provides grants to support council operations, particularly roading and public transport (via the NZTA). Central government funds national roads, while local and central government jointly fund local roads. Overall, central government covers 53% of the cost of local transport (NZTA, 2018).

Interest or dividends

Many local authorities own (or part own) business enterprises such as ports, airports, forests and farms, or have investments in financial assets such as bonds and shares. Income from these sources amounted to 5% of local authorities' total operating income in 2018.

Development and financial contributions

Development contributions are charges levied on developers under the LGA to recover the portion of new infrastructure that is related to growth. Developers can be charged for the capital costs of connections to trunk infrastructure and for needed expansions to bulk infrastructure (water, wastewater, stormwater, roads and other transport), and for community infrastructure (such as neighbourhood halls, reserves, playgrounds and public toilets). They can be charged when a resource consent, building consent or service connection is granted. Councils are required to set out a development contributions policy that explains how contributions are calculated. Chapter 6 provides further details.

Financial contributions are charges set under the RMA that provide councils with resources to avoid, remedy or mitigate adverse environmental effects. Contributions can take the form of money or land and must promote the sustainable management of natural and physical resources. Councils may use those contributions to fund capex on similar assets to development contributions. But councils cannot use them to fund the same expenditure for the same purpose, or to fund operating spending.

Parliament recently legislated the phase-out of financial contributions by 2022. The purpose of the phase-out, according to the previous Government, was to avoid overcharging (on top of development contributions) and simplify the process of recovering infrastructure costs (New Zealand Government, 2015).⁵

Vested assets

When developers provide and pay for water and road infrastructure within a subdivision, this is generally vested in the council upon completion. No development contributions are chargeable where the developer provides the infrastructure. As a rarely used alternative to development contributions, developers also sometimes directly provide trunk infrastructure through development agreements (a form of contract with local authorities). Once completed, the infrastructure is vested in the council. In both these cases, the council does not bear any capital costs for the infrastructure, but needs to meet ongoing operational, maintenance and depreciation costs.

2.6 Sources of finance

Financing refers to how debt, equity or both is raised for the delivery of a project or service when needed. Local authorities can finance projects on a pay-as-you-go basis (eg, through current revenue, grants or accumulated savings) or through borrowing.

With pay-as-you-go financing, councils purchase or construct only those capital assets made possible by financial resources currently at their disposal, such as cash in the capital budget, savings and reserve funds, or other cash on hand. Proponents of pay-as-you-go financing argue that it avoids interest costs, supports local government's fiscal flexibility, and maintains borrowing capacity. However, because pay-as-you-go limits investment essentially to what can be funded from cash in hand, it is likely to lead to large projects being delayed. Given this, pay-as-you-go may not effectively or efficiently fund the infrastructure needed to support a growing population. The approach is also inconsistent with inter-generational equity. If pay-as-you-go is employed for assets with a long lifespan, then only the current generation of users bear the costs. Future generations pay nothing and yet still enjoy the benefits, although they may be required to pay for the next investments in infrastructure that will primarily benefit subsequent generations.

Borrowing enables the matching of an asset's costs with its benefits over its life. This promotes inter-generational equity, since those who benefit from the infrastructure contribute to the cost of that infrastructure. Other benefits of debt finance include:

- councils can deliver infrastructure earlier than they otherwise could have;
- local governments' steady and secure income from rates can be used to meet debt-servicing obligations and to secure debt facilities; and
- it can facilitate institutional investment, such as from superannuation funds, which can bring with it additional rigour and discipline (Ernst & Young, 2012).

Options for raising debt

Local authorities have three main options for raising finance.

- *Banks and other financial institutions* – Since 1996, local authorities have been able to borrow directly from banks (previously, with the approval of the Local Government Loans Board, councils could only borrow by issuing local authority stock (DIA, pers. comm., 5 February 2019)).
- *Bonds* – Local authorities may issue bonds. For example, Auckland Council has issued fixed-rate retail bonds that are listed on the NZX Limited Debt Market (Auckland Council, 2018).
- *The New Zealand Local Government Funding Agency (LGFA)* – The LGFA was established in 2011 to raise debt on behalf of local authorities on more favourable terms to them than if they raised the debt directly (LGFA, 2018). The LGFA is a Council Controlled Organisation (CCO) and is jointly owned by

⁵ The Government has announced that it intends to re-instate various financial contributions which were set to phase out under the 2017 amendments to the RMA.

central government (20% shareholding) and 30 councils (80% shareholding). Other than central government, each shareholder must be a guarantor.

Since its establishment, the LGFA has been the largest lender to local government, accounting for approximately 60% to 85% of all lending to local government. Fifty-six councils are borrowers from the LGFA, with total borrowing at just under \$8 billion. LGFA lent councils just over \$1 billion in the 2017-18 financial year (LGFA, 2018).

2.7 Laws and regulations for funding and financing

Local Government Act

The LGA (and its various amendments) establish processes that shape the provision of infrastructure and other local government spending. The Act also sets out planning requirements for the provision of infrastructure (Table 2.1).

Table 2.1 Local Government Act 2002 planning processes

Requirement	Main purpose
Long-Term Plan	To plan activities and service provision over a timeframe of at least 10 years. As part of Long-Term Plans, local authorities must prepare and adopt a financial strategy. The strategy's purpose is to facilitate prudent financial management, and to provide transparency about the effect of funding and expenditure proposals on rates, debt and investments.
Infrastructure strategy	To set, over at least 30 years, the local authority's approach to the development of new assets and the management of existing assets.
Annual Plan and Annual Report	To set out and report on planned activities, revenue and expenditure for a financial year.

Source: NZPC, 2015; Local Government Act 2002.

The LGA (s 14 (1)(g)) also specifies that a local authority should “plan...effectively for the future management of its assets”. While not required by the LGA, asset management plans help local authorities meet the auditing requirements under the LGA. The LGA requires the Auditor-General to report on “the quality of the information and assumptions underlying the forecast information provided in the [long-term] plan” (LGA s 94(1)(b)).

Financial reporting requirements

Regulations introduced under the LGA in 2014 require every local authority to report in its Annual Plan, Annual Report and LTP on its planned and actual performance against a number of financial prudence benchmarks (Table 2.2). The regulations were introduced to help identify local authorities where further inquiry is needed into their financial management; and to promote prudent financial management by local authorities (Department of Internal Affairs, n.d.-b).

Table 2.2 Local authority prudential benchmarks

Benchmark	A local authority meets the benchmark if:
Rates affordability	<ul style="list-style-type: none"> Actual or planned rates income for the year \leq quantified limits on rates income set by the authority in its financial strategy Actual or planned rates increases for the year \leq quantified limits on rates increases set by the authority in its financial strategy
Debt affordability	Actual or planned borrowing for the year is within the quantified limits on borrowing set by the authority in its financial strategy
Balanced budget	Revenue for the year \geq operating expenses
Essential services	Capital expenditure on network services for the year \geq depreciation on network services
Debt servicing	Yearly borrowing costs \leq 10% of its revenue (15% for high-growth councils)
Debt control	Actual net debt at the end of the year is \leq planned net debt
Operations control	Actual net cashflow from operations for the year \geq planned net cashflow from operations

Source: Local Government (Financial Reporting and Prudence) Regulations 2014.

Local authorities are also required to disclose in their Annual Report certain information about core infrastructure assets (water, wastewater, stormwater, flood protection and roading). The information includes the closing book value, the value of acquisitions made during the financial year, and estimates of replacement costs.

Non-financial performance reporting

Rules made under section 261B of the LGA specify mandatory performance measures for service delivery from core infrastructure. Local authorities must set out their performance targets for these measures in their LTP, and then report on performance against those targets in their Annual Report. The purpose of the Rules under the Act is to “provide standard performance measures that are applicable to local authorities so that the public may compare the level of service provided in relation to a group of activities by different local authorities” (s 261A).

Local Government (Rating) Act 2002

The purpose of the LGRA is to promote the purpose of local government set out in the LGA by

- providing local authorities with flexible powers to set, assess and collect rates to fund local government activities;
- ensuring that rates are set in accordance with decisions that are made in a transparent and consultative manner; and
- providing for processes and information to enable ratepayers to identify their liability for rates (LGRA, s 3).

In particular, Part 1 of the LGRA sets out who is liable to pay rates, what land is rateable, what kinds of rates may be set, and how rates are set. Other parts contain administrative provisions and liability for rates on Māori freehold land.

Land Transport Management Act 2003

The Land Transport Management Act 2003 governs the funding of major transport projects and services, including road policing, public transport, and maintaining and developing the state highway network and local roads.

Through its Government Policy Statement (GPS) on Land Transport, central government sets the overall objectives and long-term results sought over a 10-year period, and expenditure ranges for each class of

transport activity. The NZTA then develops a three-year National Land Transport Programme (NLTP), which gives effect to the GPS and outlines the activities that will receive funding from the National Land Transport Fund (NLTF).

Once the NLTP is confirmed, local authorities can seek funding for activities carried out in their area. They are required to develop a 10-year Regional Land Transport Plan that sets out the region's land transport objectives, policies, and activities where NZTA funding is sought.

The NLTF typically does not cover the full cost of these local activities. It meets an average of 53% of costs across the country. Local authorities contribute the rest, from sources such as rates, development contributions and passenger fares. The exact funding rate varies between 51% and 75% depending on the ability of local authorities to deliver transport outcomes.⁶

⁶ NZTA also uses targeted enhanced funding assistance rates (TEFARs) to support new high-priority activities. TEFARs are currently only applied to support eligible projects in the Safe Networks Programme. TEFAR rates of assistance are higher than normal FARS – they are set halfway between a council's normal FAR rate and 100% (but capped at 90%) (NZTA, 2019).

3 Trends in local government revenue, expenditure, prices and debt

Key points

- Over the longer term and recently, neither local government operating revenue nor rates revenue has been rising as a proportion of gross national income or household incomes. Growth in rates revenue per capita varies greatly across councils, reflecting different circumstances and the timing and size of past investments. High-growth councils are less reliant on rates than other councils.
- Local authority capital expenditure (capex) and operating expenditure (opex) have risen strongly over the last two decades, mostly as a result of population growth and price inflation. Spending on roading and wastewater have been the biggest components of capex since 2009.
- Councils have increased borrowing over the last two decades to finance infrastructure investments and allocate the costs to those who will benefit in the future. Even so, council debt generally remains within accepted prudential limits. Total debt is now \$16.2 billion.
- Growth in capex has flow-on effects on opex. Notably, depreciation and interest have grown as a proportion of local government opex, and now stand at 28% of the total.
- Apart from public transport (which central government substantially subsidises), the activities contributing most to increased opex are roading and council support services. Spending on employee costs and to cover depreciation makes up around 70% of spending on council support services.
- The prices faced by local government have been rising faster than the Consumer Price Index (CPI). Among the drivers of opex, the prices of water, sewerage and drainage services have risen particularly strongly. The prices of the main components of capex, (earthmoving and siteworks; reclamation and river control; and pipelines) have also risen faster than the CPI.
- Excluding depreciation and interest, local government opex per capita grew at an average of 1.2% per year between 2007 and 2017 (after adjusting for inflation using the Commission's preferred price index). Regional and rural council opex per capita grew faster than metro and provincial council opex.
- Long-Term Plans forecast rates revenue continuing to rise at a yearly average of almost 5% over the years to 2028 (after adjusting for expected price inflation). Depreciation and interest are projected to be the fastest-growing costs. Yet projected growth in capex levels off in the 2020s. History suggests that in practice spending plans will be moderated to match rising incomes, but new cost pressures are emerging (as described in Chapter 4).

This chapter sets the scene for later chapters by identifying key funding, expenditure and financing trends for local authorities over recent decades, and looking forward. All expenditure, revenue and debt data, unless stated otherwise, are adjusted for inflation using the Consumer Price Index (CPI) and expressed in 2018 dollars. The CPI best captures the effect of the growth in council revenues on the households who have to pay. In contrast, section 3.4 uses specially constructed local government price indices to adjust for inflation in the prices that local government faces when paying for goods and services.

Section 3.1 compares growth in council revenues with growth in incomes. Section 3.2 looks at trends in capital expenditure (capex) and operating expenditure (opex). The opex data in this section includes depreciation and interest payments. Section 3.3 briefly covers debt trends.

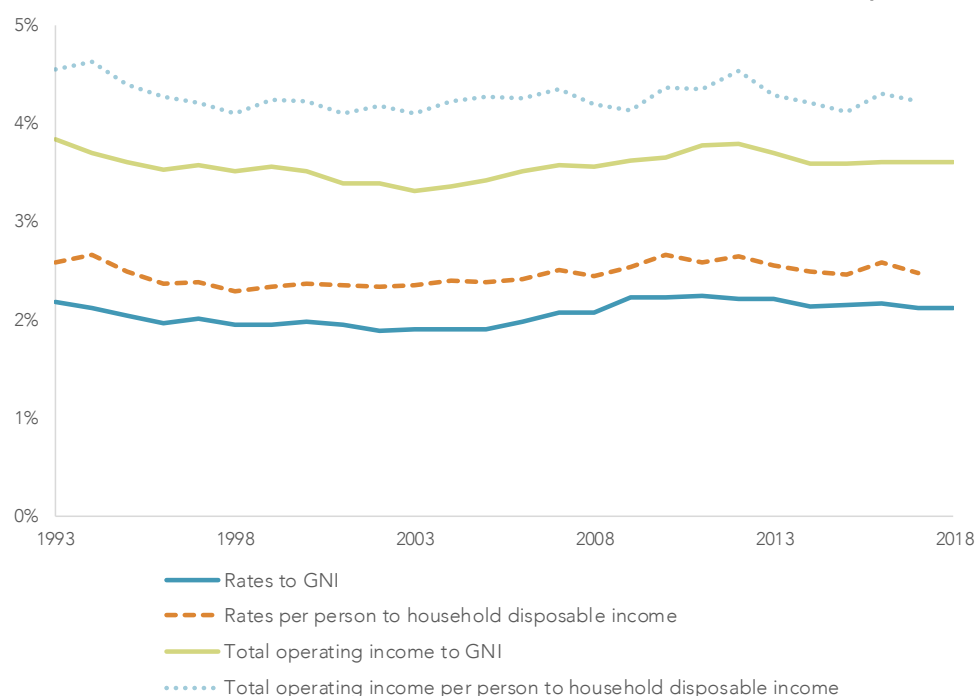
Section 3.4 looks at trends in local government prices adjusted for inflation, using local government price indices constructed for the purpose. Unlike in section 3.2, the measure used for opex in section 3.4 does not include depreciation. Section 3.4 then uses the local government price index to derive the growth rate in real (after inflation) opex per capita, nationally and for different types of councils. Section 3.5 looks at projected revenue and spending trends to 2028.

This chapter distinguishes between high-growth, medium-growth, and low-growth (and declining) councils,⁷ based on population data between 1996 and 2018.

3.1 Trends in council revenue and rates

The inquiry's Terms of Reference (TOR) note concern about the rate of increase in rates revenue in recent years and effects on affordability. Yet, as Figure 3.1 shows, local government operating income and rates revenue have remained in relatively narrow bands as a percentage of Gross National Income (GNI) and household disposable income over the last 25 years. While revenue and rates continued to rise during the Global Financial Crisis (while incomes stagnated), none of the ratios has shown an upward trend over the last five years. Chapter 7 discusses the affordability of council revenue and rates for low-income households.

Figure 3.1 Ratios of council revenue and rates to national and household income, 1993–2018



Source: Perry, 2018a; Stats NZ, 2018b, 2019c.

Notes:

1. Gross National Income (GNI) is all income received by New Zealand residents from participating in a production process (domestic or foreign) or from assets they own.
2. Household disposable income is equivalised disposable income before housing costs as reported in Perry (2018a) and derived from the Stats NZ Household Economic Survey. Disposable income refers to after tax and transfers income; equivalised income is income adjusted for household composition.

F3.1

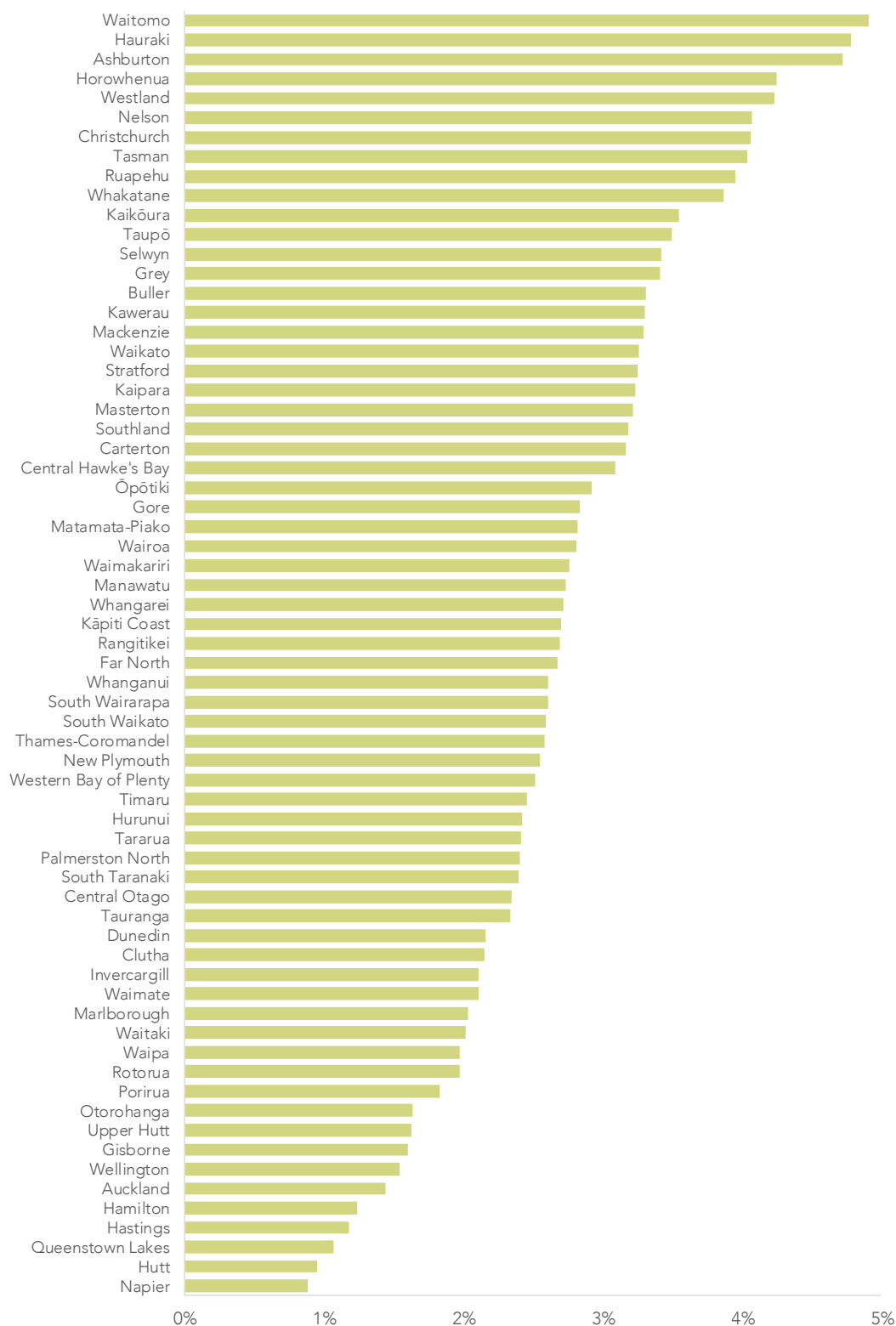
Over long periods of time, and with some variation, increases in local government revenue and rates have roughly matched increases in national and household income.

⁷ High-growth councils (18 in total) are defined as those with population growth greater than 30% between 1996 and 2018. Medium-growth councils (26 in total) are defined as those with growth between 5% and 30% between 1996 and 2018. Low-growth (and declining) councils (23 in total) are defined as those with growth less than 5% between 1996 and 2018.

Rate trends vary greatly across local authorities

Growth in rates per person over the past 20 years has varied greatly across councils. The fastest growth was about 5% a year for Waitomo District Council, and the slowest growth was about 0.8% a year for Napier City Council (Figure 3.2). Yet, fast growth in rates may reflect decisions to upgrade essential infrastructure (such as water supply). As such, growth comparisons across councils in their rates must also consider differences in the quality and age of infrastructure (and the prudence of investment decisions).

Figure 3.2 Average yearly growth in rates per capita across territorial authorities, 2000–2018



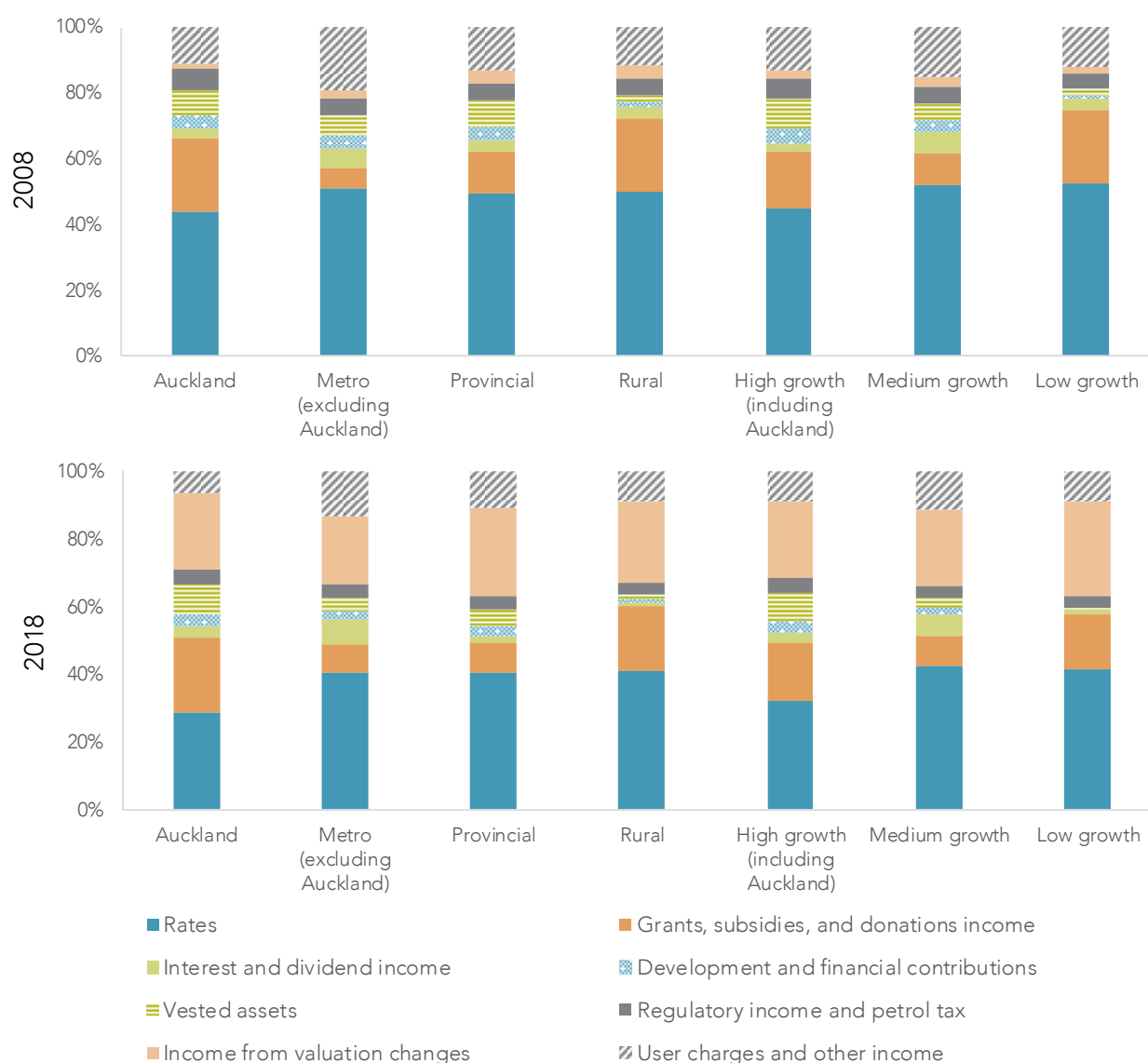
Source: Stats NZ, 2018b, 2019c.

The growth of rates over time shows no clear pattern, though some of the high-growth councils have relatively low growth in rates. Such councils now rely more on development contributions.

The composition of council revenue varies across council types

Rates, at around 60% of operating income, have remained a dominant and relatively stable source of revenue for local authorities over the last two decades. Even so, rates have been declining as a percentage of total income,⁸ partly as a result of the increasing importance of valuation changes in recent years (Figure 3.3). High-growth councils tend to be less reliant on rates than slower-growing councils. Low-growth and rural councils and Auckland Council tend to be more reliant on central government grants and subsidies.

Figure 3.3 Average composition of revenue across different councils, 2008–2018



Source: Stats NZ, 2019c.

Notes:

1. In this figure and later figures in this chapter, data for Auckland includes Auckland Transport and Auckland Tourism, Events and Economic Development; and excludes all other Auckland Council Controlled Organisations (eg, Watercare).

One important change to the composition of revenue since the early 2000s has been the introduction of development contributions and vested assets (Chapter 6). Relative to other revenue sources, development contributions are small for most councils (and some councils do not apply them), but they are a key funding source for some high-growth councils. This helps explain why fast-growing councils are less reliant on rates.

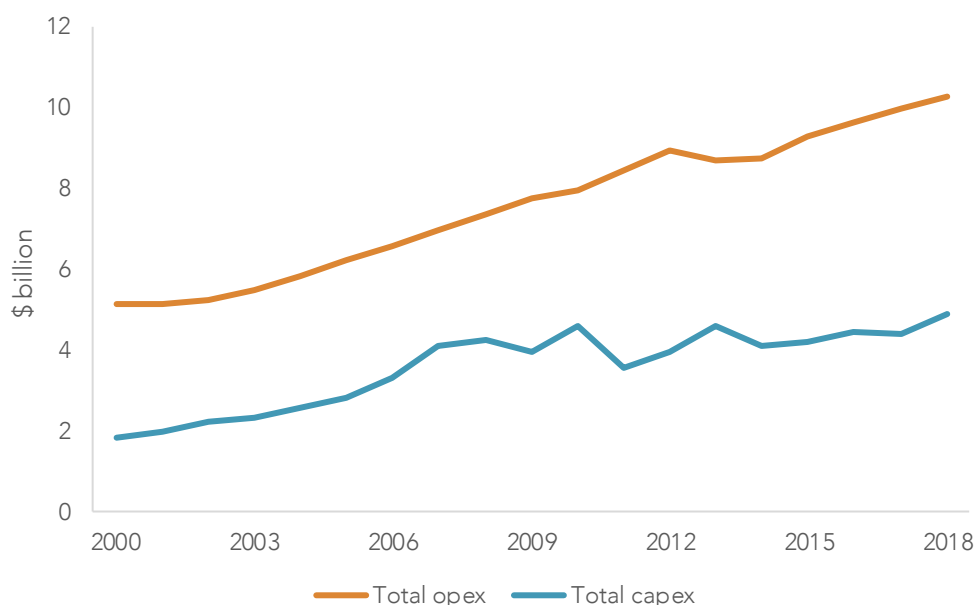
⁸ Total revenue includes operating income plus income from non-operating incomes (such as valuation changes) plus income from capital transactions (such as development and financial contributions and vested assets).

For example, in 2018, development contributions made up about 10% of Selwyn District Council's total revenue, 6% of Waimakariri District Council's revenue, and 7% of Tauranga City Council's revenue.

3.2 Trends in expenditure

Councils adjust their rating policies to meet expenditure plans (Chapter 2). As a result, planned expenditure drives the growth in rates. Local authority opex and capex (after adjusting for inflation) have grown significantly since 2000 (Figure 3.4). Total expenditure (opex and capex) increased from \$7.0 billion to \$15.2 billion between 2000 and 2018. This growth in expenditure pressures was one of the main motivations for this inquiry. This section provides a breakdown of the growth in opex. (Chapter 2 gives a breakdown of capex by activity aggregated over the last 10 years).

Figure 3.4 Local authority spending, 2000–2018



Source: Stats NZ, 2019c.

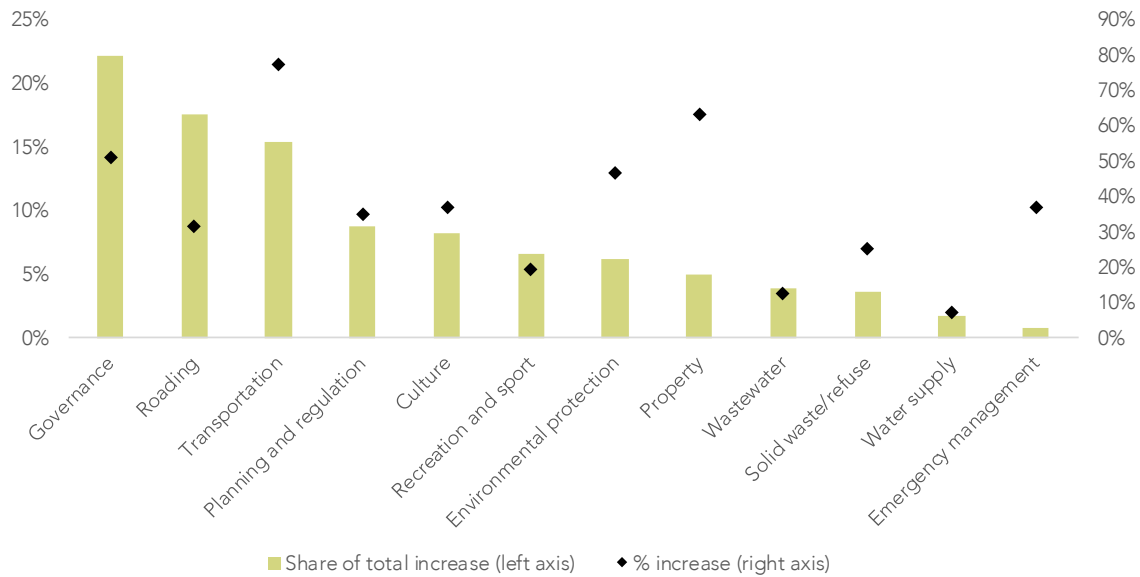
Notes:

1. Capex is estimated as "additions to fixed assets" from council financial statements.

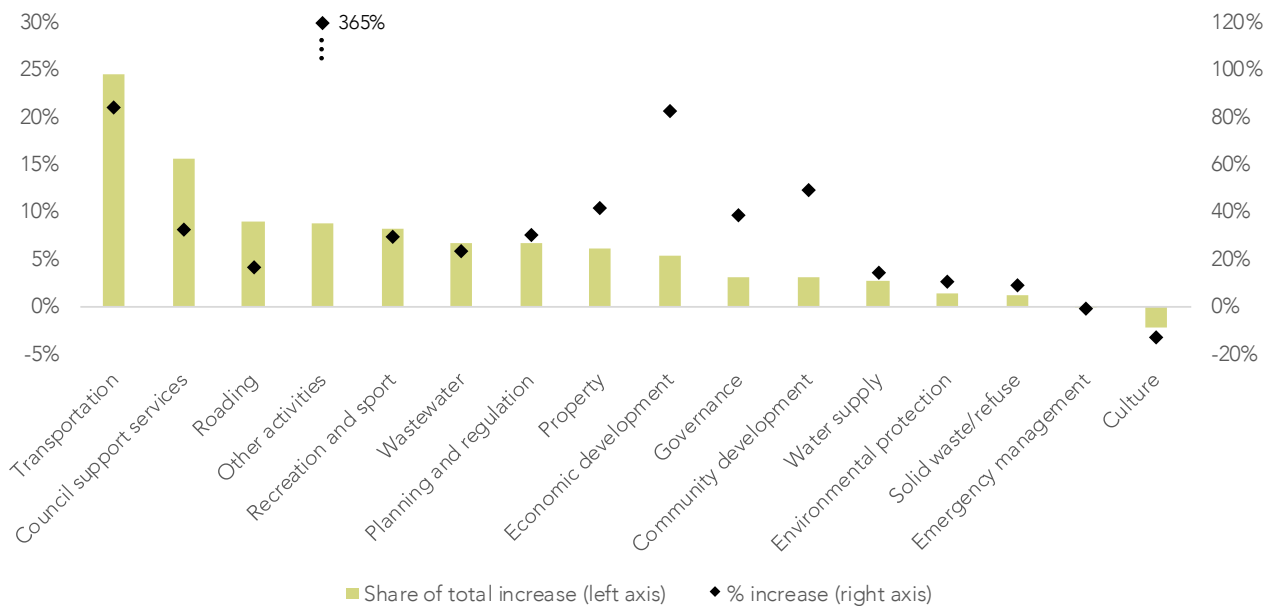
What activities contributed most to the growth in opex?

In 2009 Stats NZ introduced a new way of classifying local authority opex by activity. As a result, valid analysis of detailed expenditure trends for 2003 to 2018 requires breaking the data into two series: 2003 to 2008 and 2009 to 2018. Stats NZ draws its data from a yearly local authority census and from audited annual reports; and therefore relies on councils to classify their opex into broadly defined activities. The consistency of accounting practices to allocate expenditure by activity over time or across councils is unknown.

Local government opex grew by 34% or \$1.9 billion between 2003 and 2008. Figure 3.5 shows the percentage increase in expenditure on each activity, and its share of the total increase. Growth in expenditure on governance, roading, and transportation together made up over half of the total increase. Transportation, in particular, saw rapid growth. Spending on "culture" (libraries and galleries) grew by 37% over the period, making up 8% of the total increase.

Figure 3.5 Growth in local government opex by activity, 2003–2008

Source: Stats NZ, 2019c.

Figure 3.6 Growth in local government opex by activity, 2009–2018

Source: Stats NZ, 2019c.

Notes:

1. "Other activities" includes expenditure not included under other categories and is highly variable from year to year. Some of the largest fluctuations appear to be associated with the early years of the new Auckland Council from 2009; with the Christchurch earthquakes recovery and with Auckland Transport in more recent years. The high apparent growth rate appears to result from a recategorisation of expenditure rather than from a large increase in activity.

Local government opex grew by 32% or \$2.5 billion between 2009 and 2018. Figure 3.6 shows the percentage increase in expenditure on each activity, and its share of the total increase. Growth in expenditure on transportation, council support services and roading together made up more than half of the total increase. Of the expenditure on transportation in 2018, 44% (or \$595 million) was spent on grants and subsidies. Most of this expenditure is funded by central government.

Growth in spending on council support services made up around 15% of all expenditure growth between 2009 and 2018. A comparison of data for 2008 and 2009 suggests that most of the expenditure on "governance" was reclassified as "council support services" in 2009. Council support services cover

[o]verheads for local authority administration, finance, IT, and HR functions as well as report preparation (such as annual reports and long-term council community plans [now Long-term Plans]). (Stats NZ, 2019c)

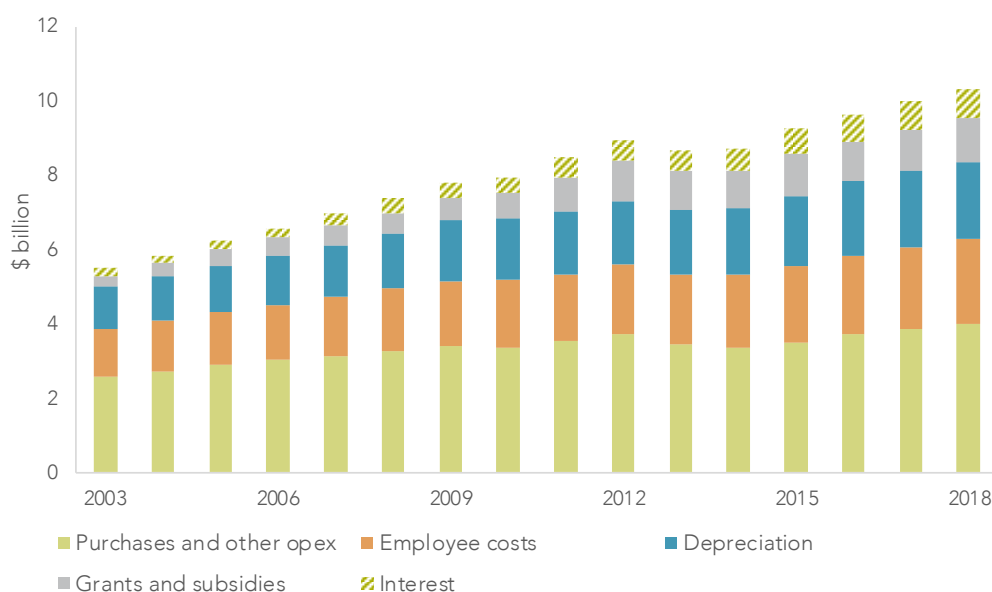
Further analysis of the data shows that around a quarter of spending on council support services in 2018 was on depreciation and interest, while around 45% was on employee costs. This suggests that some councils, at least, may be accounting for some depreciation and employee costs as an overhead rather than under specific activities.

Economic development and community development together made up about 8% of the increase in total expenditure between 2009 and 2018. In 2009 they made up only 4% of all opex, so they could not have made up very much of the total increase in expenditure over the previous period from 2003 to 2008. This in turn suggests (see Chapter 4) that legislative changes to the scope of local government in 2002 that mandated a focus on the “four wellbeings” was not a material driver of increases in local government opex over this period.

What types of cost contributed most to opex?

Figure 3.7 breaks down council opex by type of cost. It shows that three significant drivers of opex are the depreciation of assets, interest payments and grants and subsidies. Depreciation and interest made up 24% of opex in 2003; by 2018 they made up 28% of opex. Central government funds most council spending on grants and subsidies (particularly for public transport). Chapter 6 discusses local government practices in accounting for depreciation.

Figure 3.7 Total opex by type, 2003–2018



Source: Stats NZ, 2019c.

Growth in capex

Capex grew rapidly, by 133%, between 2000 and 2008, but growth has tapered off since then. An absence of historical data that breaks down capex by activity makes it difficult to determine the specific drivers of growth in spending during the earlier period. Chapter 2 shows that spending on roads and wastewater were the main components of capex by activity between 2009 and 2018.

Capex and opex per capita grew more slowly in high-growth councils

Growth in population is an important driver of council expenditure (Chapter 4). New Zealand’s population has been growing relatively quickly since 2013 (compared to the previous decade) as a result of strong net migration from abroad. Growth (including from internal migration) has been concentrated in some centres.

High-growth councils had the lowest growth in capex per capita, and a relatively low growth in opex per capita. Even so, all councils experienced strong growth in both capex and opex per capita.

Table 3.1 Growth in expenditure, 2000–2018

Type of local authority	Total growth	Capex		Opex		
		Annual growth	Annual growth per capita	Total growth	Annual growth	Annual growth per capita
High growth	136%	5.5%	3.4%	115%	4.3%	2.6%
Medium growth	123%	5.1%	4.2%	81%	3.3%	2.6%
Low growth	64%	3.1%	4.6%	61%	2.7%	3.3%

Source: Stats NZ, 2018b, 2019c.

Notes:

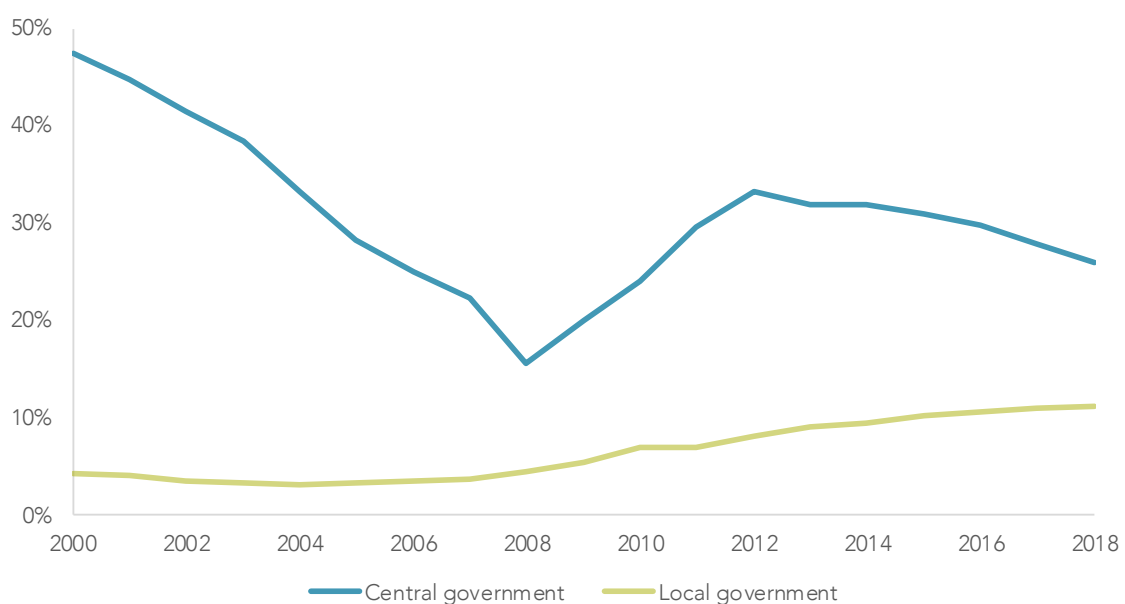
1. Each statistic is the weighted average across all local authorities in each growth category.
2. The total growth in capex refers to the percentage increase in total capex in 2016–2018, compared with 2000–2002. Therefore, total growth in capex presents the increase in capex over 16 years. This is more useful than comparing capex between two single points in time since capex can be highly volatile (as a result of the lumpy nature of infrastructure investments).
3. Regional councils are excluded.
4. The annual growth rates in opex per capita in this table differ from those set out in section 3.4, because this table uses the CPI to adjust for inflation, while section 3.4 uses a local government price index constructed by Sapere (2019). In addition, this table includes depreciation and interest as part of opex; section 3.4 excludes these items.

3.3 Financing trends

Debt is a good way for councils to spread the burden of capex across generations so that the people who benefit from infrastructure investments contribute to meeting the cost. In this way, and particularly for high-growth councils, debt shifts the cost of development capacity away from existing residents to those who benefit from growth (Chapter 6).

Consistent with this rationale, councils have been, on average, accumulating debt over the last two decades. Between 2000 and 2018, total local authority debt increased from a low base of \$2.7 billion to \$16.2 billion. As a result, the ratios (debt as a share of total assets) of local authorities have been rising (Figure 3.8).

Figure 3.8 Local and central government gearing ratios, 2000–2018



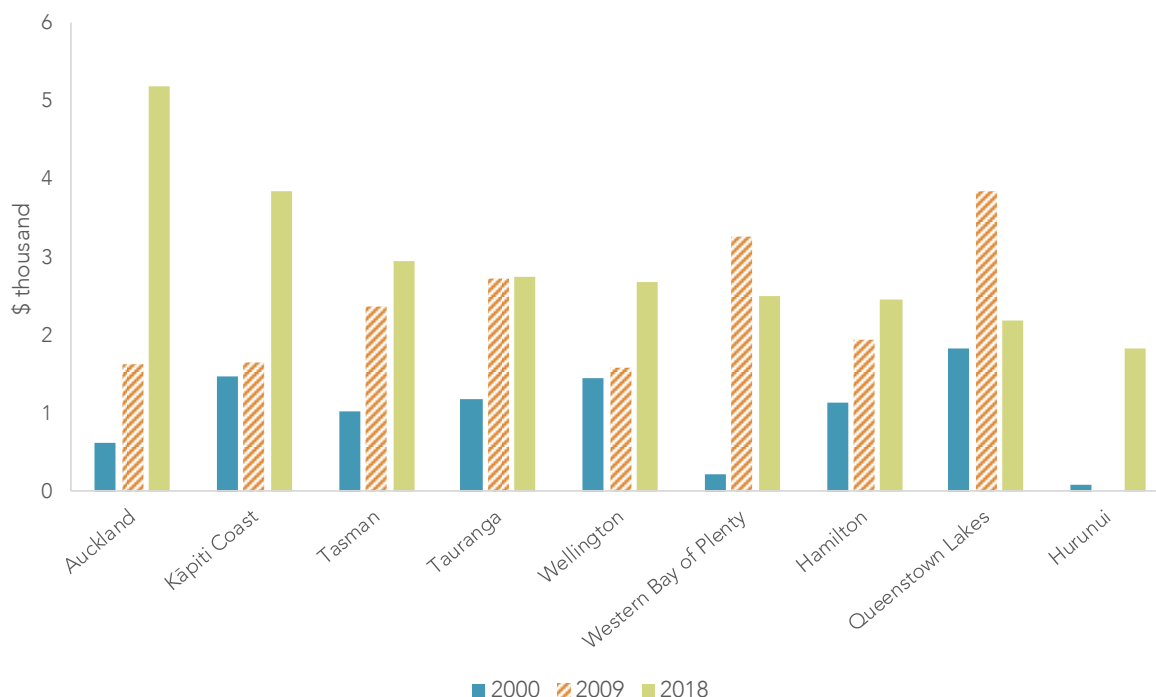
Source: Stats NZ, 2019c; The Treasury, 2018a.

Even so, local government debt remains in aggregate at prudent levels (NZPC, 2015). Gearing ratios of local authorities remain much lower than for central government (Figure 3.8) and large companies in the private sector. A Grant Thornton (2014) study developed a proxy for council financial health using a range of metrics (including debt per head, and debt as a proportion of assets). The study concluded that the overall financial health of all but four councils was “sound” or higher. More recently, the Office of the Auditor-General (2018a) concluded that “overall, local authorities continue to manage their debt prudently” (p. 14).

High-growth councils have increased debt from a low base

High-growth councils have increased their debt per capita, reflecting their need to finance the supply of development capacity (Figure 3.9).

Figure 3.9 Debt per capita across selected high-growth councils



Source: Stats NZ, 2018b, 2019c.

Some councils (eg, Auckland) are now approaching their debt servicing limits imposed by financial agencies (Auckland Council, sub. 120). Chapter 6 analyses the issues for high-growth councils around the financing of development capacity.

3.4 Trends in local government prices

This section presents new local government price indices for capex and opex. It then uses the opex index to assess how much the growth in opex (net of depreciation and interest) is attributable to:

- price increases;
- population growth; and
- growth in the quantity of council services per capita.

Measuring price inflation in local government goods and services

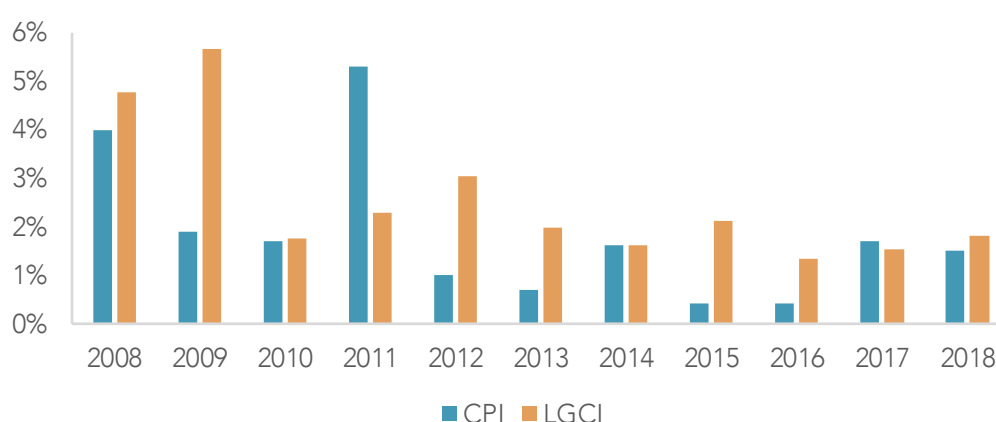
Rising prices for inputs contribute to growth in local authority spending. The Local Government Cost Index (LGCI) is a price index developed by BERL. The LGCI monitors changes in the cost of goods and services for local authorities. Costs include capex on pipelines, earthmoving and site works, and opex such as local government sector salaries and wages.

BERL uses a range of Stats NZ price indices, such as the Capital Goods Price Index (CGPI), Labour Cost Index (LCI) and Producers Price Index (PPI), to estimate the price of expenditure items that comprise the LGCI (BERL, 2010). For example, to estimate the price of capex for roads, BERL uses a mix of the CGPI estimate for roading construction projects and the PPI estimate for inputs into road transport. The LGCI weights these indices to reflect the aggregate expenditure of local authorities on different items.

BERL forecasts price-level changes for local authorities to use in developing their Long-Term Plans (LTPs). Councils commonly set rates by adjusting the previous year's rates by the forecast LGCI, with additional adjustments for anticipated population growth.

The LGCI has generally grown faster than consumer prices (CPI) (see Figure 3.10 below). That the two measures are different is unsurprising, as LGCI measures the prices for a basket of goods and services more relevant to the expenditure of local authorities than the CPI basket, which reflects the expenditure patterns of households.

Figure 3.10 Yearly percentage change in the CPI and LGCI, 2008–2018



Source: Stats NZ; BERL.

An alternative measure of price inflation in local government goods and services

The Commission engaged Sapere Research Group to analyse the drivers of local government costs and prices. Sapere (2019) used the following criteria to assess the LGCI against a range of alternative index methodologies:

- best practice methodology and conceptual soundness;
- practical to implement;
- usefulness (clear and understandable); and
- analytical adequacy (including ability to disaggregate by type of council).

The preferred option from this review was a chain-weighted Laspeyres index.⁹ The preferred index updates expenditure weights each year, and so differs from the LGCI which updates weights every five years. As such, the preferred index accounts for yearly changes in the composition of councils' spending.

The Sapere index uses the same Stats NZ price indices as the LGCI, but adds the PPI output series for water and environmental management. An input index is best used for activities that councils usually undertake themselves, and an output index for work that councils typically outsource. So using a combination of input

⁹ A chain-weighted index takes into account the changes in the composition (mix) of spending over time. It therefore reflects changes in purchasing decisions (primarily purchasers substituting away from goods that have become more expensive and towards goods that have become relatively cheaper). This contrasts to a fixed-weight index which measures price changes based on a fixed composition (or basket) of spending. A conventional Laspeyres price index is a fixed-weight index, which measures changes in the cost of a basket of goods and services over time relative to its cost in the initial base period. A chain-weighted Laspeyres price index is periodically reweighted, in this case each year, using expenditure weights based on purchases in the previous period.

and output indices reflects that councils use a mix of in-house provision and outsourcing for different activities. The Sapere index for all council spending is made up of separate indices for capex and opex.

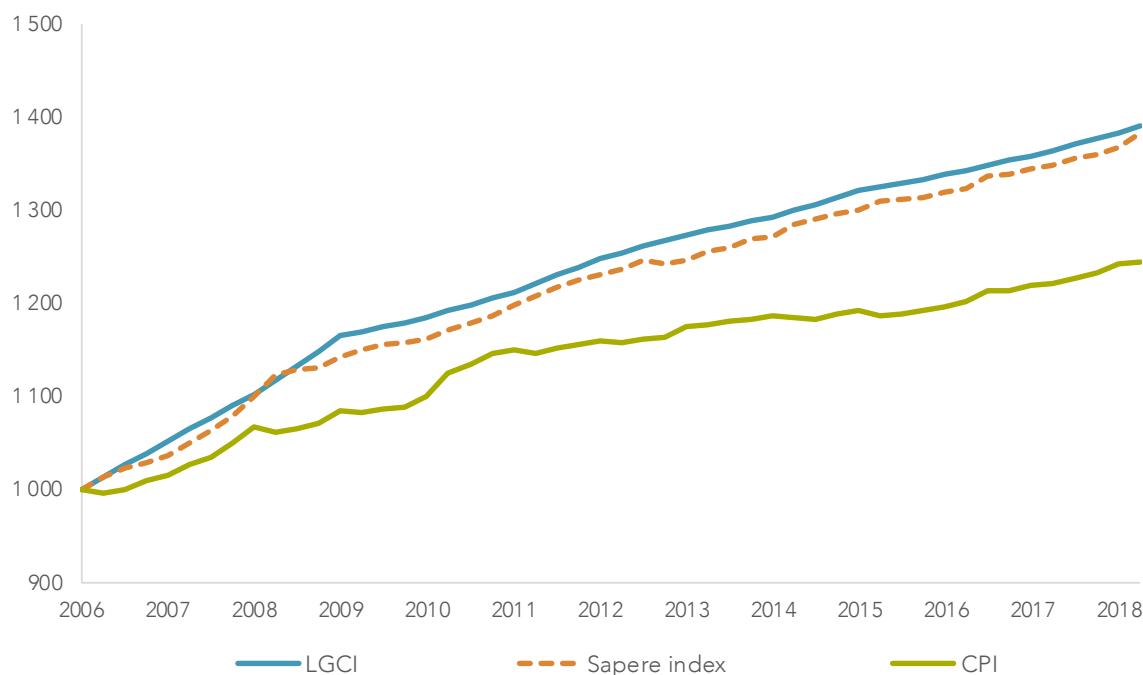
The Sapere index excludes land purchases, as information about the contribution of land prices to council expenditure is limited. The sale of land can also benefit councils, so the net effect of purchases and sales is uncertain.

The Sapere index for opex excludes depreciation from the measure of opex. Sapere's modelling included capex, so including depreciation in the opex would, in effect, result in double-counting of that expenditure. Sapere's preferred index also excluded interest costs, so that it reflects the direct cost of goods and services rather than their financing.

Figure 3.11 compares the LGCI against the alternative index. It shows that between 2007 and 2017¹⁰, Sapere's index was lower than the LGCI in all but one quarter, though total growth over the period was not materially different (32% compared to 31%). Even so, Sapere's adjustments to the LGCI resulted in offsetting movements that were material. The two changes that differ most from the LGCI were:

- around a 3.5% decrease in observed inflation, due to the more frequent reweighting (0.34% on a yearly basis); and
- around a 1.3% increase in inflation due to the inclusion of output series for producer prices (or 0.12% on a yearly basis).

Figure 3.11 Comparison of measures of price inflation in local government goods and services



Source: Stats NZ, 2019c; Sapere, 2019.

Notes:

1. Figures noted in the text refer to the period of analysis (2007–2017); the chart includes the most recent data (up to and including 2018).

Future projections of price inflation in local government goods and services

The Sapere work revealed a number of potential changes to current practice in the way price inflation in local government goods and services is forecast.

¹⁰ Sapere's analysis used data based on calendar years (ie, years ended 31 December), rather than local government financial years (ie, years ended 30 June).

- **More frequent reweighting**, to better reflect the changing composition of actual council expenditure. Sapere concluded that “[i]t would be hard, but not impossible, to forecast changes in weights and consideration could be given to that action if it would result in material changes” (Sapere, 2019, p. 21).
- **Introducing output indices** to the index, in particular the PPI output series for water and environmental management.
- **Disaggregating by council type**, such as the sector groupings of Local Government New Zealand (LGNZ). Price trends by council type are presented below.

Q3.1

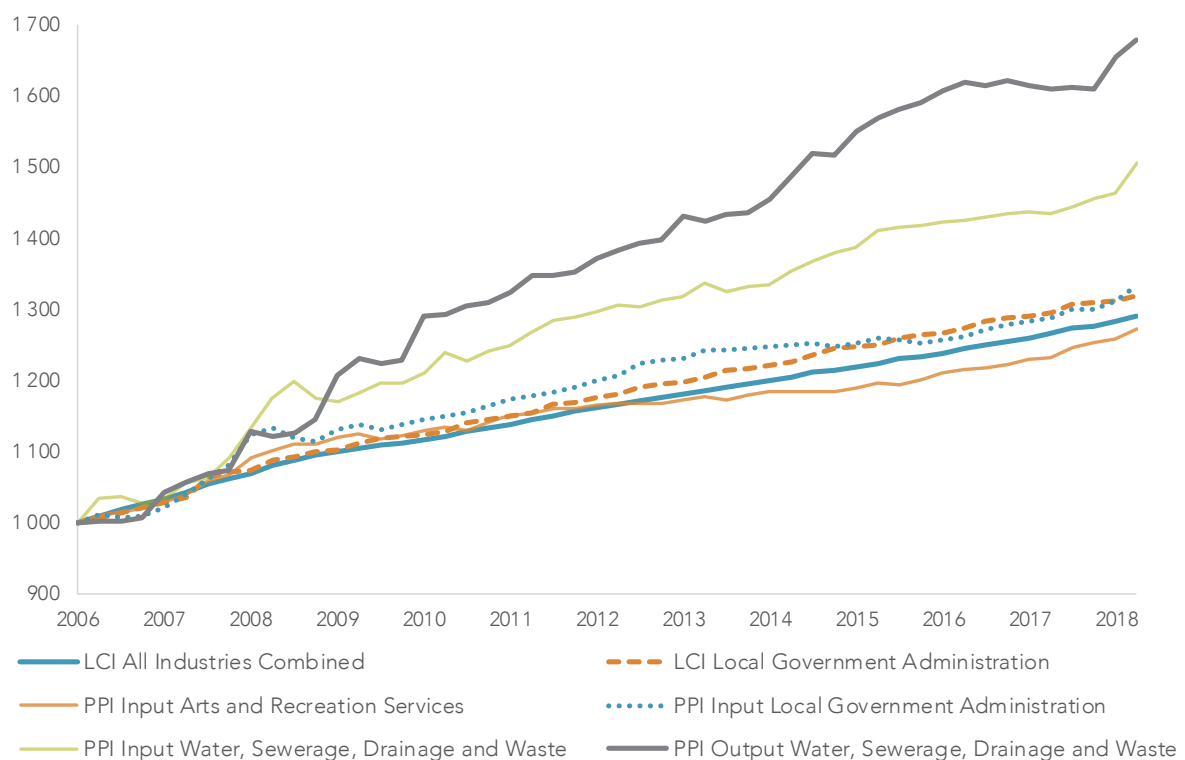
Is the current methodology for preparing the Local Government Cost Index sufficient for forecasting the prices that local authorities are likely to face? If not, should the methodology be improved, such as by one or more of:

- carrying out more frequent reweighting;
- including output indices; and
- disaggregating by council type?

Trends in local government prices

Figure 3.12 and Figure 3.13 show the trends in the individual indices that make up the Sapere index. For opex (Figure 3.12), the input and output series for water, sewerage and drainage services, which rose 38% and 61% respectively over the period, grew fastest. By comparison, labour prices (as measured by the LCI for local government administration) grew by 27%. In terms of capex (Figure 3.13), the biggest increase was in the index for earthmoving and siteworks, which rose by 36% over the period.

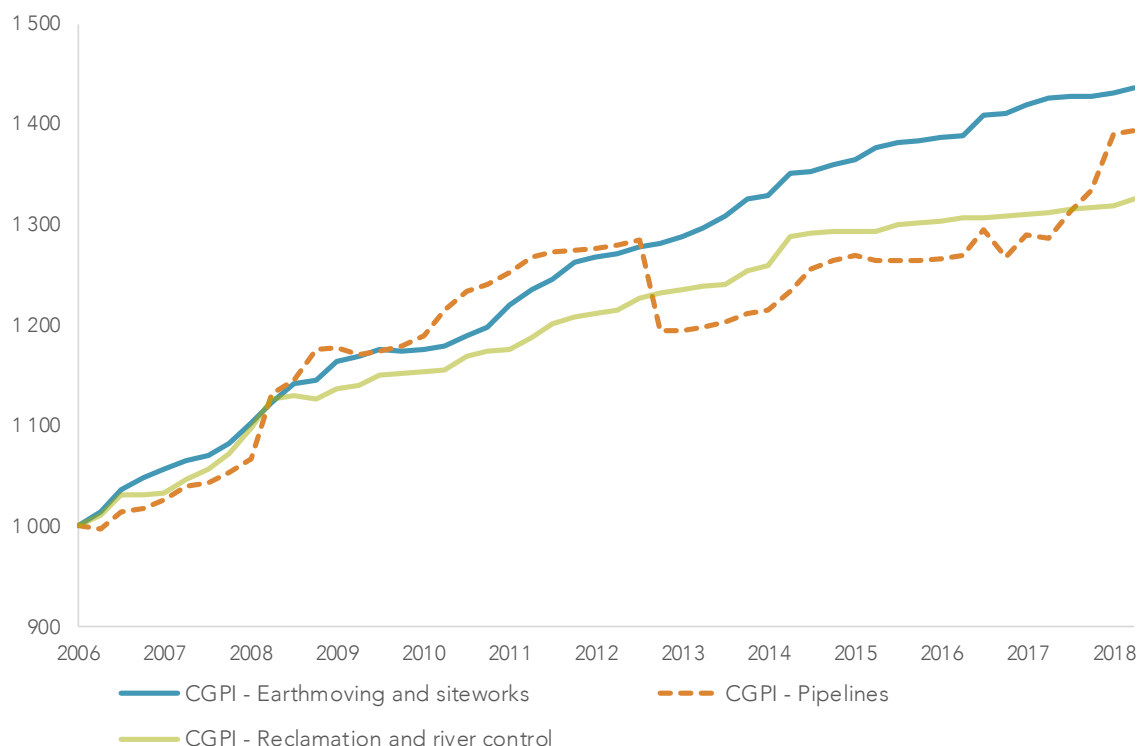
Figure 3.12 Trends in indices that form the opex index



Source: Stats NZ, 2019c; Sapere, 2019.

Notes:

1. The figures in the text refer to the period of analysis (2007–2017); the chart includes the most recent data (up to and including 2018).

Figure 3.13 Trends in indices that form the capex index

Source: Stats NZ, 2019c; Sapere 2019.

Notes:

1. The figures in the text refer to the period of analysis (2007–2017); the chart includes the most recent data (up to and including 2018).

Drivers of local government price inflation

Sapere found that 40% of total price growth from 2007 to 2017 could be attributed to changes in general economic factors.¹¹ Variables with the strongest correlations to local government price inflation were:

- inflation expectations;¹²
- demand pressures in the economy;¹³ and
- world prices of some imported goods into New Zealand, and the exchange rate.

Councils raised the impact of demand pressures in a number of submissions, and in case studies and interviews with local government managers. They identified demand for construction services related to post-earthquake rebuild activity in the South Island as a particular driver of construction capacity constraints. In one case study, a high-growth council commented that competition with the Australian market is providing additional price pressure, as demand there is also strong (this could be a factor where firms or specialist staff are operating in both markets).

For smaller councils, lack of competition in tendering also places pressure on prices. Tararua District Council submitted:

Competition in the construction sector can be low in rural areas.... there is a shortage of both capability and supply of contractors. This has resulted in costs increasing by well above CPI in the last decade (as shown in the BERL LGI [Local Government Cost Index]), and sometimes capital projects have to wait or

¹¹ Attributed in a statistical sense, implying correlation rather than causality.

¹² Firms who provide goods and services to local government are more likely to increase their prices if they think inflation will be higher (as they expect higher input costs).

¹³ As measured by the output gap, which measures the difference between the potential output of an economy and the actual output. It provides an indication of how close an economy is to capacity.

be staged until contractors are available. Generally the Metro Councils have more competition for infrastructure contracts and professional services. (Taranua District Council, sub. 18, p. 3)

This concern was echoed by Ruapehu District Council:

Rural Councils face higher prices for services due to a lack of competition driven by their comparatively small, dispersed populations and somewhat isolated location. In one instance, this resulted in a quote \$100k – 300k above the engineering estimate. (Ruapehu District Council, sub. 85, p. 6)

The lack of tendering competition will affect councils differently, depending on the extent to which they outsource various services.

Councils also referred to difficulty in recruiting staff in specialist areas (including planning, consenting, and water quality science), suggesting that some areas are facing supply constraints. For small rural councils, the general difficulty in attracting and retaining good quality staff compounds the problem. Both difficulties place pressure on the price of specialist labour.

The Commission sees scope for greater demand-side management in the face of these supply constraints, such as through more regional collaboration and use of shared services, and better planning, commissioning and management of capital projects. Ways to improve the decision-making of councils are discussed in Chapter 5. An approach for incentivising more efficient and effective management of three-waters services is explored in Chapter 9.

Councils also identified other New Zealand-specific price pressures, including:

- the scarcity of supply of aggregate (used for construction and roading), which has pushed up its price; and
- increased insurance premiums – as New Zealand insurers exit the market, some local authorities have had to seek out more expensive foreign underwriters.

F3.2

Local governments face higher price inflation than general consumers largely because of the specialised inputs councils use to construct and operate infrastructure. Councils have little direct influence on the prices of many of these inputs, but can adjust their demand and mix of inputs, in response to changes in prices.

F3.3

Modelling of price inflation in local government goods and services using an index that reflects yearly changes in the composition of expenditure produces a slightly lower measure of inflation than the Local Government Cost Index currently used by councils. This suggests that councils do adjust their mix of inputs in response to prices, to some extent.

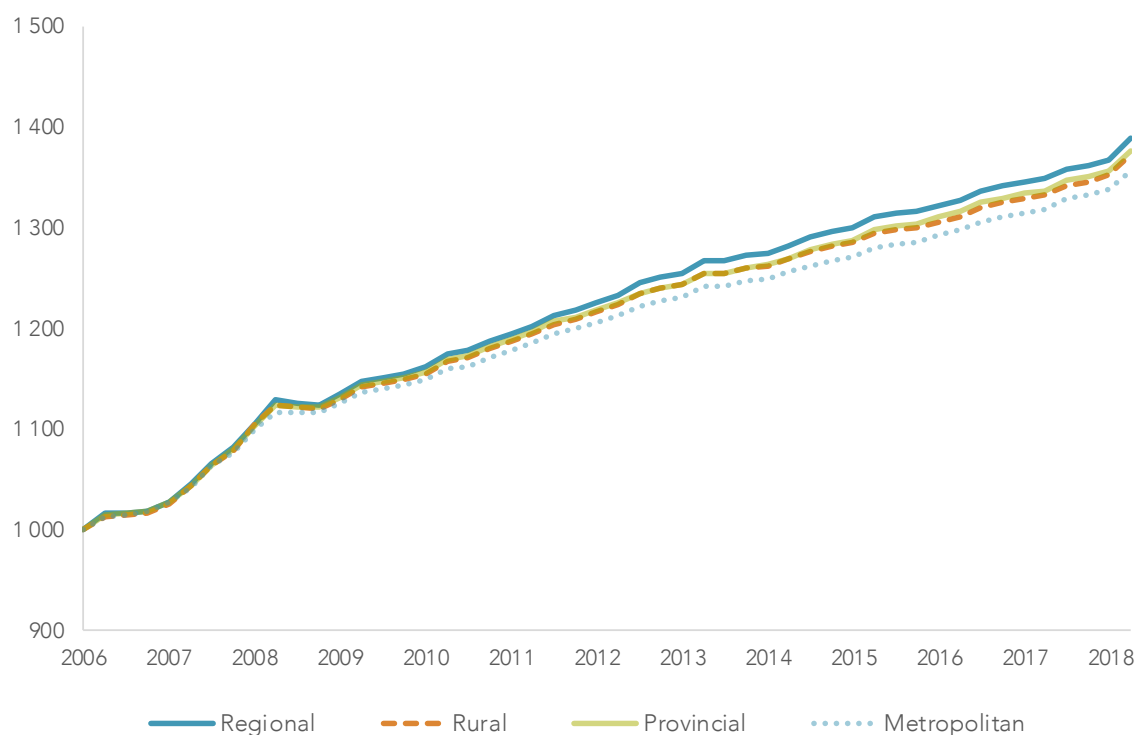
Price trends for different types of council

Every council undertakes a different mix of activities, depending on its role and circumstances and the needs and preferences of its local community (Chapter 2 and section 3.2). For example, regional councils are more heavily focused on regulatory activities. So they have a higher proportion of opex compared to other types of councils. As rural councils tend to have large roading networks, they undertake more roading construction and maintenance. As a proportion, metropolitan councils spend more on community activities (such as libraries, museums and sports facilities). In addition, councils may be at different stages in their asset replacement cycle.

Sapere produced sub-indices of their price index, by LGNZ sector group (metropolitan, provincial, rural and regional). They found that, for opex (excluding interest), regional councils have faced the highest price pressures, largely due to their greater level of spending on water and environmental management (which

includes irrigation and flood control schemes). Metropolitan councils have faced the lowest price growth (see Figure 3.14). However, the differences across council types are small.

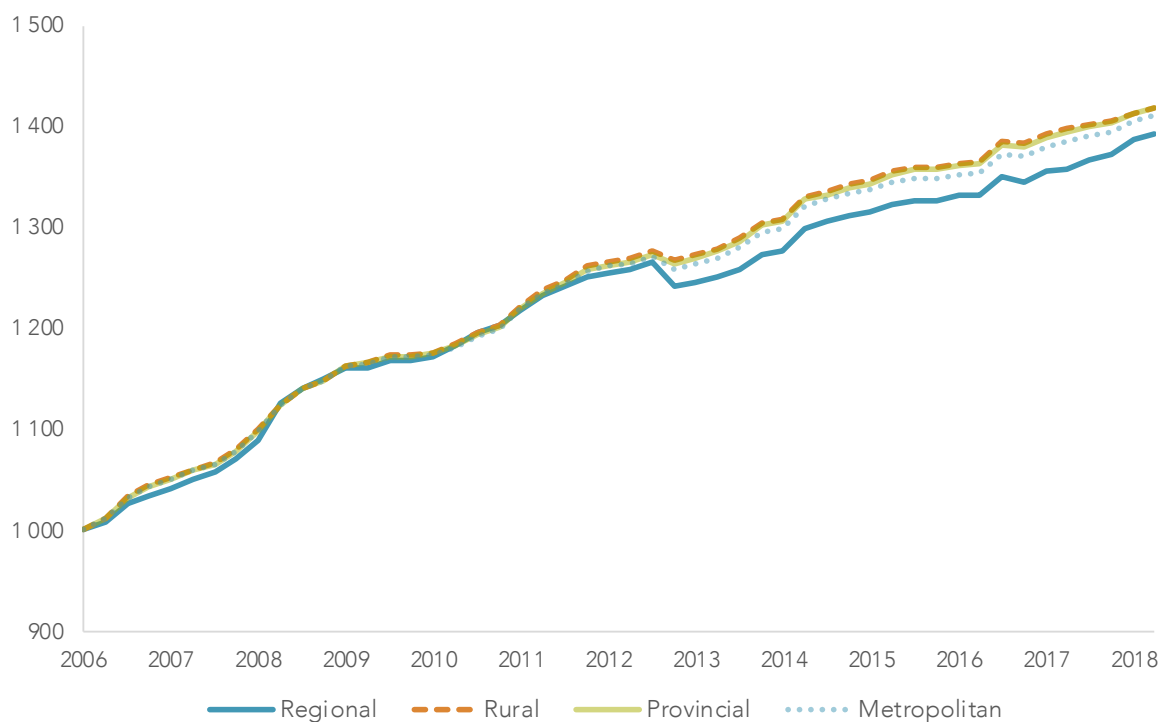
Figure 3.14 Sapere price index by type of council: opex



Source: Stats NZ, 2019c; Sapere, 2019.

For capex, price inflation has also been very similar across the types of councils. It has been lower for regional councils (see Figure 3.15).

Figure 3.15 Sapere price index by type of council: capex



Source: Sapere, 2019; Stats NZ, 2019c.

Analysing the increase in opex

Table 3.2 shows the growth in nominal opex between 2007 and 2017 for the different types of councils and adjusts them for price inflation (using the Sapere index) and for population change. The table aggregates the expenditure values for each council within a category to calculate “weighted averages”. This has the effect of giving larger councils (such as Auckland in the “metro” category), with higher expenditure and larger populations, a higher weighting.

Adjustments for price inflation and population change show the changes in councils’ real expenditure and in real expenditure per capita for each category. The table then shows the compound annual growth rate in real expenditure per capita. The last two lines therefore show the growth in expenditure that is associated with an increase in council activities (ie, the quantity of goods and services purchased by councils), as the effects of prices and population growth have been removed. The pressures underlying this growth in activity are explored in Chapter 4. The data show that real per capita opex growth was strongest for rural and regional councils, averaging 1.7% and 1.5% a year respectively, compared to the national average of 1.2% a year.

Table 3.2 Growth in nominal, real and real per capita opex, 2007–2017

	National aggregate	Metro	Provincial	Rural	Regional
Change in total nominal expenditure	64%	67%	56%	58%	71%
<i>Price inflation (Sapere index)</i>	<i>29%</i>	<i>28%</i>	<i>30%</i>	<i>30%</i>	<i>31%</i>
Change in total real expenditure	27%	30%	20%	22%	31%
<i>Change in population</i>	<i>12%</i>	<i>15%</i>	<i>13%</i>	<i>5%</i>	<i>11%</i>
Change in real per capita expenditure	13%	13%	7%	16%	18%
Compound annual growth rate in real expenditure per capita	1.2%	1.3%	0.7%	1.7%	1.5%

Source: Sapere, 2019; Stats NZ, 2019c.

Notes:

- Figures were calculated by aggregating the values for all councils within a category and then calculating the relevant figures for these.
- The per capita growth rates of opex in Table 3.2 differ from those in Table 3.1 because the latter uses the CPI to adjust for inflation and includes depreciation and interest as components of opex.

F3.4

After adjusting for price inflation using the Commission’s preferred price index, local government operating expenditure (opex) per capita (excluding depreciation and interest) grew at an average of 1.2% a year between 2007 and 2017. The opex per capita of regional and rural councils grew faster than that of metropolitan and provincial councils.

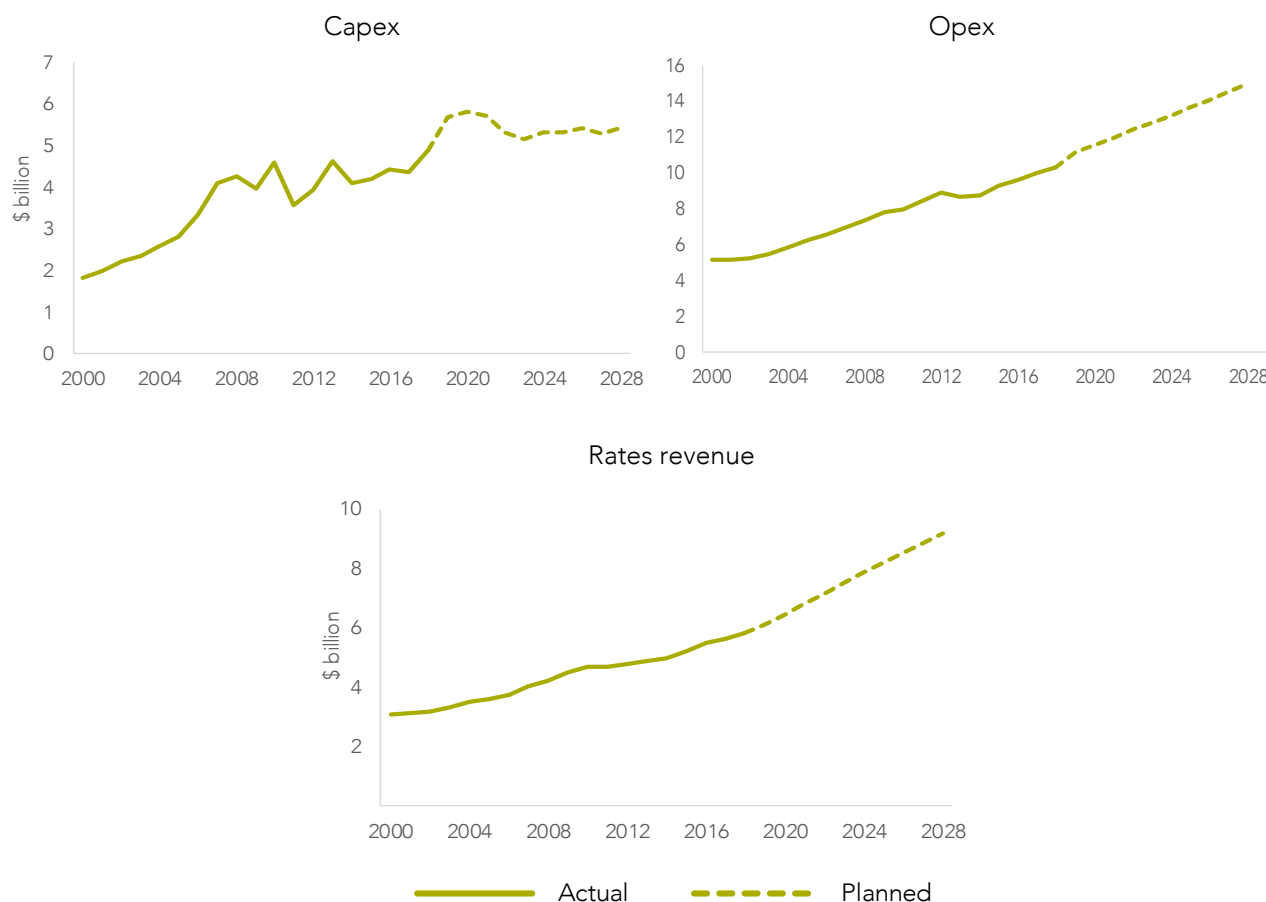
3.5 Projected expenditure and revenue trends

Every three years, local authorities (including regional councils) prepare an LTP that forecasts their revenue and expenditure over the coming decade. Councils may revise future spending plans as the need to fund and finance them becomes pressing, and as priorities change, for instance as a result of unanticipated external events. As a result, the projections are indicative of future trends rather than firm commitments to expenditure and revenue paths.

Figure 3.16 shows the actual capital and opex as well as rates across all councils between 2000 and 2018, and the forecast figures between 2019 and 2028, based on LTP data. The forecast to 2028 shows total rates

revenue across all councils growing at an average of almost 5% a year, as a result of the projected increase in opex.

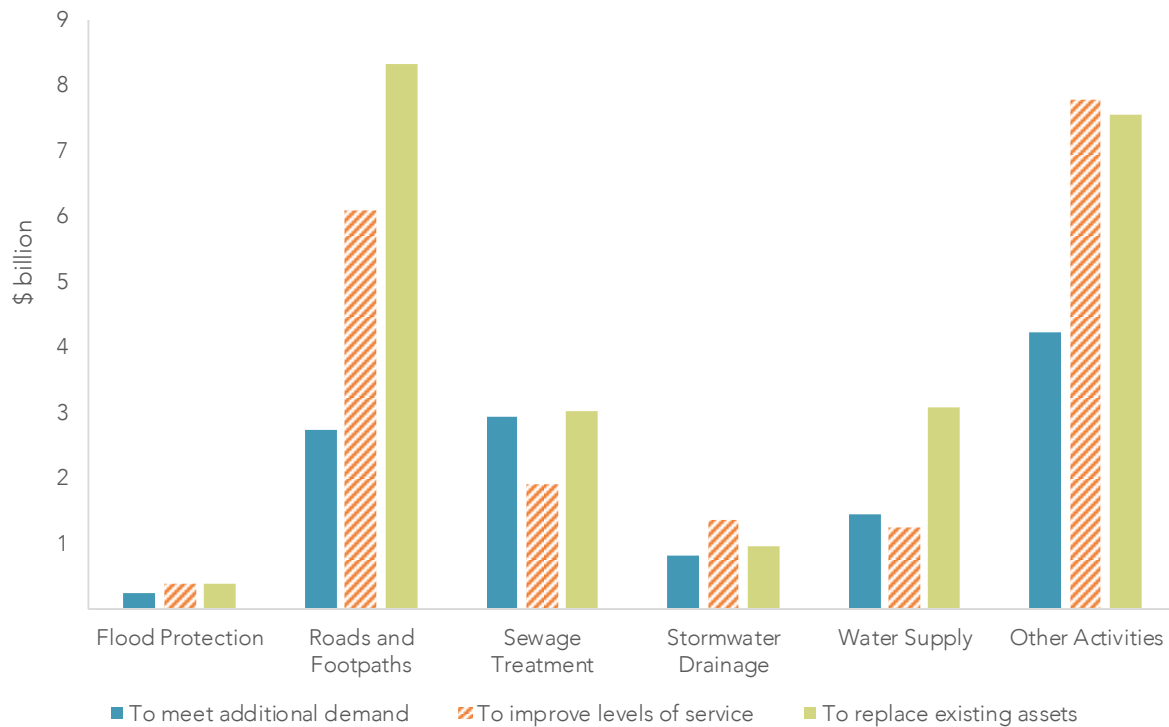
Figure 3.16 Actual and planned revenue and expenditure by councils, 2000–2028



Source: Stats NZ, 2019c; Department of Internal Affairs, 2019c.

Depreciation and interest are projected to grow strongly over the forecast period, with projected growth of 54% and 56% respectively. Rising interest costs are unsurprising given the recent growth in debt; yet it does expose councils to the risk of future adverse movements in interest rates. The Auditor-General notes that a rise in interest rates “could limit some councils’ ability to service their debt and carry out their capital expenditure programmes without making other changes, such as increasing rates or reducing expenditure” (Office of the Auditor-General, 2019b, p. 15).

While projected opex continues to rise, projected capex levels off during the 2020s. Perhaps councils expect their demand for investment to moderate. Alternatively, funding and/or financial pressures on councils may be causing them to scale back investment in capital projects. Of the roughly \$55 billion capex forecast over the next 10 years, just under 43% is to replace existing assets (Figure 3.17). Replacing roads and pathways is the biggest item of capex for councils.

Figure 3.17 Forecast capex (all councils) by purpose and activity, 2019–2028

Source: Department of internal Affairs, 2019c.

The TOR identify new and existing cost pressures facing councils into the future, including pressures arising from fast population growth; the need to adapt to climate change; rising tourism; Treaty settlement arrangements; and rising standards in the supply of drinking water and wastewater services. While submissions and engagement meetings show councils are keenly aware of these pressures, the aggregate data does not clearly show how far councils factor such pressures into their latest LTPs. Chapter 4 describes the pressures in more detail, and subsequent chapters explore ways to address the funding and financing challenges these pressures pose.

3.6 Conclusion

One motivation for this inquiry was a concern that rising local government revenues and especially rates are outstripping the ability of local communities to pay. Yet, over a long period the ratios of revenue (and rates) to national and household income have remained in relatively narrow bands. These ratios show no evidence of any recent upward trend. This suggests that local democratic decision making and the discipline provided by statutory accountabilities, have constrained expenditure growth to match the growth in incomes. Chapter 7 looks further at the effects of rising rates (among other housing costs) on low-income households.

Constraining expenditure to match ability to pay does not necessarily mean that councils' spending choices best match the challenges they and their communities face. Chapter 5 describes improvements to council decision-making processes and the regulatory environment that governs them.

Councils have increased their debt over the last two decades, reflecting a strategy to allocate some of the cost of investments to future generations who will benefit from them. In aggregate, council debt is not excessive, though (as discussed in Chapter 5) individual councils have sometimes gone beyond what their communities can easily manage.

Looking forward, councils, in aggregate, expect expenditure and rates to continue to rise. Past history suggests that in practice spending plans will be moderated to match rising incomes. Even so, the inquiry's TOR identify challenges for councils from specific cost pressures – some relatively longstanding; others newly emerging. Chapter 4 describes these challenges and subsequent chapters consider how to tackle them.

4 Pressures on funding and financing

Key points

- Local authorities face several rising funding pressures, which vary according to the type of council as well as size, location, demographics and other characteristics. While no two councils are quite alike in the pressures they face, there are some common challenges.
- Population changes are creating pressure in many districts. Rapid population growth in some areas means some councils struggle to provide enough new infrastructure, while other areas with small, static or declining populations struggle with high fixed costs compared to their ratepayer base. New Zealand's population is projected to become more geographically concentrated, which will exacerbate these pressures.
- Local demographics can add to this challenge. An ageing population brings increased demand for accessible infrastructure and social services. All regions and districts in New Zealand have ageing populations, although internal and external migration patterns mean some districts will age much more rapidly than others. Districts with a high proportion of residents relying on low fixed-incomes, or with high levels of deprivation, face an additional challenge because residents may struggle to afford rates increases.
- Central government has long tended to pass new responsibilities to local government. It has passed down a steady stream of new standards, regulations and requirements without financial resources to cover their costs – even those that provide national benefits. These “unfunded mandates” have now reached a point where the cumulative impact is difficult for many local authorities to manage.
- Co-management and co-governance arrangements established through Treaty of Waitangi settlements can impose considerable costs on councils, and these costs are not evenly distributed among local authorities. To date, Crown support for such arrangements has fallen short of covering the initial and ongoing costs to councils.
- Many of these challenges are not new, although some are increasing. Yet the cumulative impact of the range of pressures, some of which combine and interact in complex and costly ways (and will do so more in the future), is reaching a point where some councils are finding it difficult to manage. Improved decision making and processes (Chapter 5), more effective use of current funding and financing tools, and more carefully designed central government policy and regulation (Chapter 6) will help to relieve this pressure.
- There are two additional areas, however, where the scale of the cost pressure is significant, and where current funding and financing tools will be inadequate to deal with them:
 - Increased **tourism** is putting pressure on infrastructure in many communities, particularly those with a high visitor-to-resident ratio. Commercial ratepayers in tourism hotspots may receive significant economic benefits from tourism and can pass on the costs of rates to their customers, while residential ratepayers receive limited direct benefits from tourism and cannot pass on the cost of rate increases to support tourism infrastructure.
 - The impacts of **climate change** will create large and growing pressure on local government. This issue is discussed in detail in Chapter 8.

As discussed in Chapter 2, New Zealand's 78 local authorities vary widely in terms of the communities they serve, and the specific circumstances they face. Regional councils, territorial authorities and unitary authorities also have different scopes of responsibilities and therefore the pressures they face can be very

different. Likewise, the handful of councils experiencing rapid population growth face different challenges to the small provincial and rural councils with static, or even declining, populations.

While no two local authorities are quite alike in the specific combination of pressures they face, there are common challenges. This chapter examines the pressures affecting local government funding and financing, and identifies key challenges. It provides context for later chapters about managing cost pressures (Chapter 5), and where, and how, changes to funding and financing may be needed (Chapters 6, 7, 8 and 9).

The first half of the chapter discusses five well-established pressures facing local authorities:

- changing population;
- high rates of deprivation;
- increased functions and responsibilities from central government;
- Treaty of Waitangi obligations and Treaty settlements; and
- scope of local government and rising community expectations.

The second half of the chapter focuses on two significant new pressures:

- increasing tourism; and
- increasing risk from climate change (discussed in detail in Chapter 8).

4.1 Changing population

The two main components to population increase or decrease in any given region or district are: natural increase (births minus deaths); and net migration (arrivals minus departures).

In the last five years, external migration has been the largest component of New Zealand's population growth – contributing about 57 000 migrants in the year ended December 2018, compared to a natural increase of around 25 000 (Stats NZ, 2018d). This national trend is reflected at the sub-national level, with population growth in most regions and districts driven by the combined effect of international and internal net migration. Net migration can be influenced by several factors, including economic or employment opportunities, natural and cultural lifestyle opportunities (including the “sunshine effect”), or access to essential services (Brabyn, 2017).

As noted in Chapter 2, New Zealand's population has grown by about 30% since 1996, but that growth has been unevenly distributed. At a district level, since 1996 it has varied between a 165% increase in Queenstown Lakes District, and a 26% decrease in Ruapehu.¹⁴ Councils in areas experiencing high growth rates, and those with static or declining populations, face different cost pressures.

Councils in areas experiencing high growth

Recent trends of urbanisation have seen a lot of growth occur in large metro centres – including those often referred to as the “Golden Triangle” of Auckland, Hamilton and Tauranga. But while growth in urban areas is large in absolute terms, some smaller districts have also grown rapidly. The three fastest-growing districts are classed as “provincial” – Queenstown Lakes, Selwyn and Waimakariri. The rural districts of Central Otago, Hurunui, Carterton and Kaipara have also shown strong growth.

The drivers for growth vary for metro, provincial and rural districts. Migration to cities is often driven by availability of economic opportunities, and access to services and amenities. High net migration to the Queenstown Lakes District has been buoyed by the booming tourism sector. In Selwyn and Waimakariri districts, both close to Christchurch, migration has been driven in part by people moving following the 2011 earthquake.

Most of the smaller communities experiencing high growth are close to larger centres, with net migration reflecting spillover benefits as workers take advantage of employment opportunities in nearby urban

¹⁴ It is worth noting, however, that Statistics New Zealand estimates that the population in all regions, and all but one territorial authority, grew in the year ending June 2018. See <https://www.stats.govt.nz/news/migration-drives-local-population-growth>

centres, while also benefiting from the natural and cultural lifestyle opportunities those smaller communities offer (Cochrane & Mare, 2017). Auckland, for example, has been at times a net-supplier of population to other areas. Between 2008 and 2013 more New Zealanders migrated from Auckland than to it – many to nearby districts such as Waikato, Thames-Coromandel, and Whangarei (NZPC, 2017, p. 74).

Population growth has many benefits. It fuels economic activity, bringing new businesses and with them more and higher quality jobs for residents. As communities grow, economic and social vibrancy also generally increase, with residents having more choice around jobs as well as amenities like schools, sports and entertainment. As the population increases, councils are also able to spread their costs among more ratepayers and more rateable properties.

Another benefit of growth is that large urban centres are generally more productive than smaller communities. The drivers of this increased productivity are twofold: larger cities are able to attract more productive people and businesses due to the availability of opportunities; and people and businesses are themselves more productive if they locate in larger cities. Bigger cities allow easier matching of skills to jobs, better links between suppliers and industry, and more efficient sharing of ideas that stimulate innovation and productivity growth (NZPC, 2017, p. 26).

But growth also brings challenges. Quality of life for residents can suffer if existing infrastructure fails to keep up with the growing population – roads can become congested, housing less affordable, and amenities can become crowded. To accommodate growth, councils need to keep up with demands for more maintenance, renewal and upgrading of existing infrastructure (such as roading, drinking water and wastewater infrastructure). Many fast-growing communities face high house prices and pressured rental markets as more people enter the community. Councils may also face pressure for investments to cater to more diverse community needs, to improve community wellbeing and keep communities safe.

Relieving the pressure that rapid growth puts on infrastructure and enabling housing development are key challenges for fast-growing councils. Territorial authorities enable housing development through their planning functions, and through provision of infrastructure. Significant population growth can be accommodated by expanding new “greenfield” developments (the creation of new housing areas on the city outskirts), and/or through urban intensification. Both approaches come with significant costs.

Greenfield development requires the construction of significant bulk infrastructure to connect new housing areas to existing council infrastructure. Infrastructure must be in place to “unlock” development. The construction of bulk housing infrastructure is a large up-front cost – for example, bulk housing infrastructure for the Milldale development in Wainui, north of Auckland, is estimated to cost around \$91 million for a development of about 9 000 sections (4 000 in the Milldale development and 5 000 in the surrounding area) (Crown Infrastructure Partners, 2018).

Urban intensification, or “brownfield” development, happens on developed land, so infrastructure is already in place. However, existing infrastructure may need upgrading to accommodate development.

Several previous reports by the Commission have looked at the challenges councils in high-growth areas face to provide growth infrastructure and enable housing development, including *Better urban planning* (NZPC, 2017) and *Using land for housing* (NZPC, 2015). A consistent theme through these inquiries is the perception among some councils that growth does not pay for itself.

Funding growth is expensive, and councils have several options for recovering associated costs, such as:¹⁵

- development contributions;
- targeted rates; and
- general rates revenue.

¹⁵ Auckland Council’s water utility, Watercare, also uses Infrastructure Growth Charges (ICG) to fund new water infrastructure to accommodate growth. Watercare introduced ICGs in 2011. An ICG is levied on new or existing customers who increase their demand on Watercare’s services, in line with the beneficiary pays principle, and varies depending on the costs of the new infrastructure required (Watercare Services Ltd, 2019).

The costs of investments that councils make in infrastructure to accommodate growth are generally large and lumpy – unevenly distributed over time as the population grows. Many councils highlighted in their submissions the lag that exists between a council incurring the capital costs of constructing new or upgraded infrastructure, and when costs are recovered from developers or residents through the tools identified above (eg, Northland Regional Council, sub. 32; Whangarei District Council, sub. 46; and Tauranga City Council, sub. 119).

Because many councils do not have funds available upfront to build growth infrastructure, many will initially borrow to pay for it. This is challenging for some councils either because of ratepayer resistance to debt or because they are close to their debt limits. Being close to the limits constrains the ability of councils to borrow because going beyond those limits would result in a credit-rating downgrade, and make borrowing more expensive. Although this is a challenge for some councils (eg, Auckland and Tauranga City Councils), most operate well within their debt limits.

Using debt to fund growth costs also means that councils will incur debt servicing costs before income is received from either the developers, new ratepayers or service users (Whangarei District Council, sub. 46). In this way, existing ratepayers may bear the burden of growth infrastructure costs before councils can recover the costs (Tauranga City Council, sub. 119). For these and other reasons, ratepayers can be resistant to councils taking on debt to fund growth infrastructure. That resistance creates an additional political challenge for councils. Elected members may fail to understand debt, including how it can be used to support intergenerational equity. This lack of understanding can also inhibit council's use of debt – as discussed in Chapter 5.

In planning for growth, good growth forecasting models and population projections are important, as they provide the basis for future planning. Growth forecasts are used to determine not only the extent of capital works and renewals needed to service growth, but also the number of additional residents and businesses over which costs can be spread (Office of the Auditor-General, 2013b). Councils use different methods to predict growth, but forecasting growth accurately is challenging. And getting it wrong can be costly, as it can be difficult for councils to adjust if the infrastructure they have planned and constructed turns out to be inadequate in the face of higher-than-expected growth (Hauraki District Council, sub. 43), or surplus to requirements when growth is lower than expected.

Regional councils also face some additional costs associated with growth, including costs associated with planning and responding to growth through Regional Policy Statements and other strategies. Regional councils also directly face some infrastructure costs from growth, such as from increased demand for public transport or flood protection.

Councils in small districts, or experiencing low or static growth

While some districts have experienced strong population growth, others have experienced static or even declining populations. Most of these local authorities are located in small rural or provincial districts – between 1996 and 2017 about 19 rural councils and seven provincial councils were located in districts with static or declining populations. The main driver of the declining population in these communities is migration, as residents move to pursue economic and employment opportunities elsewhere. Because it is the young, economically active residents who tend to move to pursue study and job opportunities, population decline also tends to correlate, in most cases, with an ageing population and lower or fixed incomes.

A static or declining population can create significant challenges for local authorities. A declining population means that council costs are spread between a smaller group of ratepayers. Districts with static or declining populations also often have high unemployment and levels of deprivation, as well as low rates of home-ownership, which means affordability issues are exacerbated.

Physical infrastructure dominates the operating and capital expenditure of local government. This is particularly the case in many rural or provincial communities with dispersed populations and a large amount of roading and water infrastructure per capita. The need to maintain and renew infrastructure, often to higher standards required by regulation, means that these councils have high fixed costs and a limited ability to reduce levels of service. This can lead to higher costs per ratepayer if the rating base is not growing.

Small communities often each have their own water treatment plant, wastewater treatment plant, as well as other infrastructure like libraries and other amenities. In Hauraki District, for example, the council provides seven separate wastewater schemes, and several of those schemes service towns with fewer than 1 000 people (sub. 43). Because wastewater treatment is subject to scale economies, this raises per-capita costs.

The high per-capita infrastructure costs for small dispersed communities are highlighted in Boffa Miskell's cost estimates for upgrading wastewater infrastructure to meet National Policy Statement for Freshwater Management (NPS-FM) objectives. They estimate that upgrading wastewater treatment plant discharges to meet the NPS-FM requirements will cost between \$1.4 and \$2.1 billion across New Zealand, but that the impact will be largest for small communities. In communities with up to 500 residents, households face a yearly cost impact about three times the average because upgrade costs are spread between fewer households (GHD Limited & Boffa Miskell, 2018, p. i).

According to projections, New Zealand's population will become increasingly concentrated, and fewer territorial authorities will have growing populations (Jackson, 2017). As more councils face a static or declining rating base, and if some small local authorities become even smaller, they are likely to face find it more challenging to meet fixed infrastructure costs.

F4.1

New Zealand's population has grown by about 30% in the last twenty years, but this growth has not been evenly distributed. Councils in high-growth areas are facing pressure from the costs of funding growth infrastructure, while some councils in small districts or districts with declining populations face pressure from high fixed costs distributed between a relatively small number of ratepayers. These challenges are likely to increase as New Zealand's population becomes increasingly concentrated in the future.

An ageing population

New Zealand's population is growing older. In 1970 the median age in New Zealand was 25.6 years. By 2017 it was 37, and in 2043 it is projected to be 43 years. The median ages vary widely between districts, however, with median ages of 32 years in Hamilton city and 51 years in Thames-Coromandel district in 2013. By 2043, the median age is expected to range from 37 years in Palmerston North city to 60 years in Thames-Coromandel district. It is also projected that 12 territorial authorities will have a median age of 50 years or older by 2043, compared to just one in 2013 (Stats NZ, 2018c).

In 2017, about 15% of New Zealand population was at least 65 years old. This proportion is smaller than the OECD average of around 19%, but it is the fastest growing age group nationally. Into the future, all districts are expected to have a greater proportion of people who are at least 65 years old than they do now (see Figure 4.1). Increased life expectancy and the ageing of the "baby boomer" generation are major drivers of this national trend. Yet some districts are ageing more rapidly than others as more older residents move into them, and/or as younger residents move out – known as "age-selective migration" (Jackson & Brabyn, 2017, p. 28).

Several factors can drive age-selective migration. Some districts with the most rapidly ageing populations are "sunshine areas" (eg, Thames-Coromandel and Tasman districts). Many others are within easy reach of larger urban centres with amenities, but which offer cultural or natural lifestyle opportunities (eg, Hauraki, Kāpiti and Central Otago districts).

A rapidly ageing population, and a high proportion of residents who are aged over 65, can create cost pressures for councils. Residents of that age often have different needs, in terms of accessible infrastructure and the types of services they require. For example, elderly residents are often less mobile, and require wider, smoother footpaths and modified street design that can safely accommodate mobility scooters. This can be costly – Hauraki District Council, for example, has allocated \$700 000 over 10 years to widen footpaths to accommodate its ageing population (sub. 43).

Older residents also often want different services from local government. Several councils highlighted in their submissions that ageing populations can lead to demand for a different mix of services, including increased demand for social housing and other social services (Manawatu District Council, sub. 57; Hurunui District Council, sub.110; and Ōpōtiki District Council, sub.126). Communities can expect councils to provide social services for elderly residents if central government or the private sector does not provide these services. Accessible public transport can also be an issue for older residents, many of whom do not drive. Public transport can be important for ensuring older residents can access services, remain self-sufficient and avoid social isolation.

Box 4.1 Impact of an ageing population on Tasman street design

The New Zealand Society of Local Government Managers (SOLGM) provided a useful case study, looking at some of the impacts an ageing population has had on Tasman council street design.

In Tasman, the proportion of the population aged at least 65 has doubled in the last 20 years, and a significant proportion of those residents have a physical disability and/or a sensory impairment.¹⁶ This shifting population profile has led to demand for changes in the way streets and facilities in Tasman region are designed. For example, the council recently undertook a major upgrade of the main street of Richmond, Tasman's largest town, to improve flood resilience, but the improvement was also designed with the needs of elderly and disabled residents in mind. The upgrade included widening footpaths, smoothing out kerbs and channels between the footpath and the road, installing seating for people to rest and mingle, and installing tactile signal crossings.

Similar upgrades will take place in communities around the region over the next 10 years.

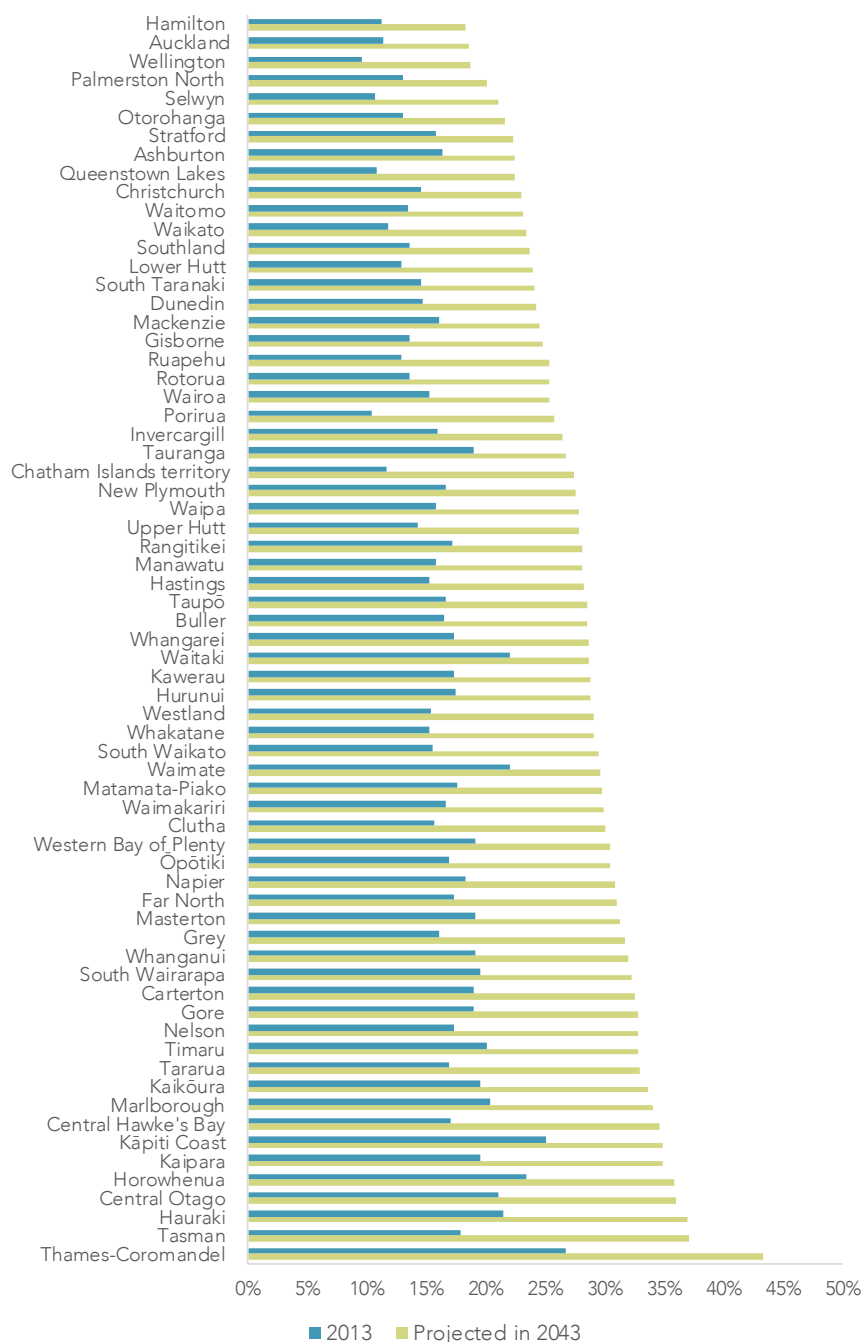
Source: SOLGM submission (sub. 24).

Many submitters also raised the concern that, as populations age, more residents move onto fixed incomes (often low fixed incomes) as they leave the workforce and rely on superannuation and/or savings. This can lead to concerns about affordability, and the ability of residents to pay rising rates (eg, SOLGM, sub. 24; Hauraki District Council, sub. 43; Manawatu District Council, sub. 57; Ruapehu District Council, sub. 85; Environment Canterbury, sub. 111; LGNZ, sub. 112; and Ōpōtiki District Council, sub. 126). There is a perception among many councils that their ability to increase rates can be constrained as the proportion of the population on fixed incomes grows, because those residents may struggle to afford rates.

F4.2

All districts across New Zealand are ageing, and this is happening much more rapidly in some districts. An ageing population creates additional costs for councils as elderly residents require a different mix of accessible infrastructure and services.

¹⁶ The submission cites a 2013 disability survey that found that 47% of residents 65 years or older had a physical disability, and 31% had a sensory impairment.

Figure 4.1 Proportion of population 65 years or older – 2013 and projected in 2043

Source: Stats NZ, 2018c.

4.2 High rates of deprivation

Some participants submitted that high rates of deprivation in their populations put pressure on revenue-raising and on their councils' ability to provide infrastructure and services to expected standards (Horowhenua Grey Power Assoc., sub. 21; Hauraki District Council, sub. 43; Ōpōtiki District Council, sub. 126). Also, as explained later in this chapter (section 4.3) such councils often feel pressed to provide services to disadvantaged members of their communities, to compensate for the lack of, or withdrawal of, central government social services.

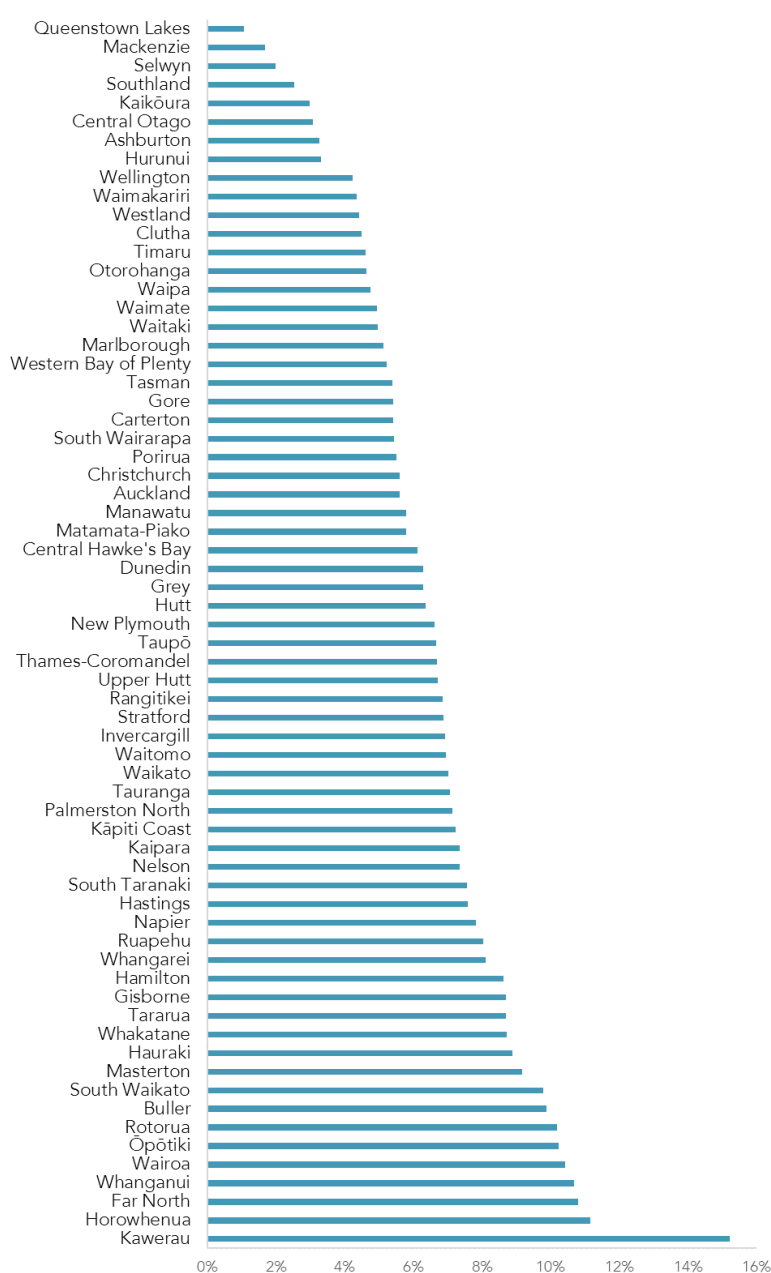
The previous section identified pressure from ageing populations, including concern that elderly residents on fixed-incomes may struggle to afford rates. Yet, as explained in Chapter 7, older people living in their own homes without a mortgage are a group that is among the least likely to be experiencing material hardship. This is because their housing costs are usually low relative to other low-income households who rent their homes or are paying off a mortgage. After housing costs are paid, young low-income families, particularly sole parents, are much more likely to be experiencing hardship (Chapter 7). While such families

do not usually pay rates directly, they effectively pay them through their rental payments – because landlords generally pass on the costs of rates to their tenants.

Receipt of the central government's Accommodation Supplement (AS) payments is a good indicator of experiencing difficulty in meeting housing costs (Chapter 7). Rural districts, often with high proportions of Māori residents, and mostly in the North Island, are likely to have relatively higher proportions of households dependent on the AS to meet their housing costs. These districts sometimes face additional challenges, because multiply-owned Māori land is often relatively unproductive, and councils find it difficult to raise rates from such land.

Figure 4.2 shows AS recipients as a percentage of the local population, across territorial authorities. Rural districts, often with high proportions of Māori residents, and mostly in the North Island, are likely to have relatively higher proportions of households dependent on the AS to meet their housing costs. These districts sometimes face additional challenges, because multiply-owned Māori land is often relatively unproductive, and councils find it difficult to raise rates from such land.

Figure 4.2 Accommodation supplement recipients as a percentage of the population, 2018



Source: Ministry of Social Development; Stats NZ, 2018b.¹⁷

¹⁷ Accommodation Supplement data is for December 2018; population data is for June 2018.

Central government policies that subsidise local roads take account of the rating base of territorial authorities in setting the level of subsidy (Chapter 6). Similar policies may be required to help councils with relatively weak rating bases to meet the costs of climate change adaptation (Chapter 8), and to meet rising standards in the provision of the three waters (Chapter 9).

4.3 Increasing responsibilities

As noted in Chapter 2, local government has a range of responsibilities and functions, which vary depending on the type of council (regional council, territorial authority or unitary authority). During engagement and through submissions, many councils expressed concern that central government has shifted responsibilities to local government, without adequate funding provision, and this is creating cost pressure. The process of expanding local government responsibilities without commensurate funding is sometimes referred to as “cost shifting”, and the resulting responsibilities or functions as “unfunded mandates”.

Concerns around unfunded mandates are not new. Local Government New Zealand (LGNZ) has conducted three local government surveys to gauge the extent of central government cost shifting, covering periods beginning in 1989.¹⁸ Each of these surveys identified a broad range of legislation and regulation transferring responsibilities to local government with limited financial support. Most recently, LGNZ released a report in 2012 looking at the extent of costs imposed on local government by legislation and regulation since 2006 (LGNZ, 2012).

For some new functions and responsibilities, councils have the ability to recover costs from the regulated party. Also, some new regulation applies across the economy, not just to councils – such as health and safety regulation.

The examples of new responsibilities and unfunded mandates identified in these surveys vary widely in terms of their cost impacts on councils. Likewise, the examples highlighted to the Commission in submissions, and during discussions with councils around the country, are very diverse in form and scale. Broadly, unfunded mandates can be broken down into four types, outlined in Figure 4.3.

Figure 4.3 New responsibilities passed from central to local government

Type of unfunded mandate	Examples	Example costs
New standards councils must meet, or strengthening of existing standards – without commensurate funding	<ul style="list-style-type: none"> New National Environmental Standards (NES) New National Policy Statements (NPS) Strengthened drinking water standards Health and safety regulations 	<ul style="list-style-type: none"> Training staff on new standards Monitoring and reporting, including science and data costs Large infrastructure costs for some councils, to update infrastructure to meet new standards
New responsibilities, functions or processes that councils must adhere to – without commensurate funding	<ul style="list-style-type: none"> Food and liquor licensing LTP provisions in LGA (2002) Earthquake Prone Buildings measures 	<ul style="list-style-type: none"> Training staff on new regulations or procedures Preparing and consulting on policies Monitoring and enforcing compliance LTP audit costs
Reduction, cessation or removal of central government funding, or of government funded programmes and services within the community	<ul style="list-style-type: none"> Changes to NZTA FARs Removal of funding for community services, such as health and aged services 	<ul style="list-style-type: none"> Increased roading and infrastructure costs for some councils Councils face decision of whether to take over costs of a service, or lose it
Restricting councils' ability to set adequate fees for services or functions	<ul style="list-style-type: none"> Problem-gambling levies under the Gambling Act 	<ul style="list-style-type: none"> Unable to recoup total costs associated with delivering a service

¹⁸ The three LGNZ surveys cover the periods: 1989-2000; 2000-2006; and 2006-2012.

New standards, or strengthening of existing standards

The introduction of new standards, or the strengthening of existing standards, is the most significant form of cost shifting for many councils. Many councils have raised the impact of the introduction of National Environmental Standards (NESs) and National Policy Statements (NPSs) under the Resource Management Act (RMA) as a particular concern.

All five NPSs have come into effect during the last ten years, so the costs of “giving effect to” NPSs is a reasonably new pressure for councils. Similarly, the first of the current six NESs came into effect in 2004, so the costs of amending plans and rules to bring them in line with NES provisions, and of meeting and monitoring the standards, are relatively recent. Currently two new NPSs and three new NESs are being developed.

SOLGM refers to increasing standards as the “coming storm” (sub. 24, p. 3). As LGNZ noted in their 2012 review of cost shifting, national standards have different impacts on different councils, depending on the degree of change required to bring plans, processes, policy settings and infrastructure in line (LGNZ, 2012).

The cost impacts of giving effect to the NPS-FM were noted by several councils in their submissions. For example, South Wairarapa District Council stated that to comply with the NPS-FM they need to construct three wastewater systems, which will be a \$30 million project over 4 000 connections. The project will unfold over 30 years as the council does not have the funds to accelerate it (sub. 103, p. 4). Hauraki District Council has forecast that the NPS-FM will require them to spend \$38 million to upgrade wastewater infrastructure, resulting in a cost of \$6 975 for each connected property (sub. 43, p. 7).

Boffa Miskell has estimated that, across New Zealand, the total capital costs associated with upgrading wastewater treatment plant discharges to meet the NPS requirements is \$1.4 to \$2.1 billion (GHD Limited & Boffa Miskell, 2018). They also estimated an additional \$39-\$59 million of operating costs each year. The report notes that these costs will not be spread evenly. Not all wastewater treatment plants will require upgrading to meet the NPS-FM, but a large proportion of those that do require upgrading serve small populations, meaning fewer connections over which to spread the cost.

Beyond the significant infrastructure costs falling on district councils, regional councils also noted other costs associated with giving effect to the NPS-FM. These include the costs of making changes to regional and sub-regional plans, costs for increased monitoring, reporting, associated science, consultation, hearings and appeal processes, as well as mātauranga Māori requirements (Environment Canterbury. sub. 111, p. 4; Northland Regional Council. sub. 32, pp. 3-4; and Greater Wellington Regional Council, sub. 68, p. 5). While hard to quantify, such operational costs are also incurred for other NPSs and NESs, as councils amend regional and district plans and policy statements to implement the standards, policies and objectives contained in the national direction.

The strengthening of drinking water standards, which are currently under review following the Havelock North Drinking Water Inquiry, will also create significant cost pressure for some councils. Potential changes being considered include:

- making compliance to minimum standards mandatory, by removing a current provision that allows councils not to meet them if they have taken “all practicable steps” to do so; and/or
- abolishing the secure groundwater classification, which currently places reduced requirements on groundwater considered at low risk of infiltration by pathogenic bacteria, protozoa and viruses (Ministry of Health, 2008).

In a recent report prepared for the Department of Internal Affairs (DIA), Beca estimated that the costs of upgrading *council owned* water treatment plants to meet both requirements would be \$384 million, with an increase in operational costs of \$13 million a year. The cost of upgrading the additional 181 *non-council*

owned plants¹⁹ is estimated at \$57 million, with an increase in yearly operating costs of \$3 million (Beca, 2018).

As with the costs of upgrading wastewater treatment infrastructure, these costs are not distributed evenly. The three regions facing the largest total capital costs would be Canterbury (\$102-\$190 million), Otago (\$66-\$123 million) and Waikato (\$30-\$56 million). Per capita, however, the highest capital costs would be faced by Otago, Tasman and West Coast.

Table 4.1 Estimated costs of meeting the NPS-FM and proposed drinking-water standards

	Capital costs	Annual ongoing costs
NPS-Freshwater Management	\$1.4 - \$2.1 billion	\$39 - \$59 million
Drinking water standards: council owned	\$384 million	\$13 million
Drinking water standards: non-council owned	\$57 million	\$3 million

Source: GHD Limited and Boffa Miskell, 2018; Beca, 2018.

In some cases, increasing national standards (for example, freshwater or drinking water standards) can require councils to raise the level of service beyond that for which local ratepayers would otherwise be prepared to pay. LGNZ refers to this as *raising the bar*. For example, Beca estimated that across New Zealand about 497 non-compliant water treatment plants currently serve a combined population of 866 000. About two-thirds of these plants are council owned, and many serve small populations (Beca, 2018, pp. 14-18). As noted above, the costs of upgrading these plants to meet drinking water standards is significant; without the new standard, councils might prioritise the spending in a different way to better meet the needs and preferences of their local population. As Tararua District Council noted in their submission, “the choice of appropriate standards and timing of upgrades has been removed from local residents” (sub. 18, p. 2).

This tension was also highlighted in a survey of local authorities conducted as part of the Commission’s 2013 inquiry into local regulation. Around half of the survey respondents agreed or strongly agreed that local political pressures conflict with the regulatory objectives of central government regulations (NZPC, 2013, p. 114).

At least one council submitted that, despite the considerable costs of complying with new standards, little real benefit would result from that investment. With respect to the NPS-FM, Hauraki District Council stated that:

[n]ot only will this require a huge investment, but it will result in very little environmental benefit. Modelling shows that the risk of illness from our treated wastewater in one of our rivers is already lower than the upper catchment of that river. Treatment plant improvements will result in the environmental benefits to receiving waterways being very limited. (sub. 43. p. 7)

Regional councils already face costs associated with monitoring and protecting biodiversity, and this may increase when the NPS on Indigenous Biodiversity is introduced. Currently, councils have a role under the RMA (1991) for maintaining indigenous biodiversity, and the proposed NPS will provide national direction and guidance for improving biodiversity management. The draft NPS will be released for consultation later in 2019, but based on an early draft the NPS is likely to require councils to assess the ecological significance of all areas of indigenous vegetation and fauna habitat, to identify and map “significant natural areas” and protect the ecological integrity of those areas by managing a number of effects (Biodiversity Collaborative Group, 2018).

Regional councils also have some biosecurity responsibilities with respect to weed and pest management. Under the Biosecurity Act 1993, the Ministry for Primary Industries (MPI) is the lead agency nationally for biosecurity, with a focus on reducing the risk of new pests (plants, animals and diseases) entering New Zealand. Once new pests become established, however, regional councils have a long-term pest

¹⁹ Non-council owned plants that supply communities are generally owned by community organisations, although some are owned by private companies (Beca, 2018).

management role (including monitoring, surveillance and control) under the Act through their regional pest management plans. Several councils indicated during engagement meetings that they currently focus only on high-priority pests, and that they lack the capacity and resources to manage all established pests. With climate change and increased movement of people (through tourism and migration), pest incursions will likely increase. This may put increased pressure on the pest management activities of regional councils.

Many councils also noted they are experiencing higher costs from strengthened health and safety regulations under the Health and Safety at Work Act 2015, both in higher direct costs for councils and in higher costs for council contractors.

Box 4.2 National Policy Statements and National Environment Standards

National Policy Statements

National Policy Statements (NPSs) are instruments issued under section 52(2) of the Resource Management Act 1991 (RMA). They state objectives and policies for “matters of national significance” relevant to achieving the purpose of the RMA, and guide decision making under the RMA at the national, regional and district levels. Regional policy statements, regional plans, and district plans are required to “give effect” to NPSs.²⁰ When a new NPS is introduced, or an NPS is updated, councils need to amend policy statements and plans to give effect to the objectives or policies contained in the NPS. Also, consenting authorities must have regard to relevant policy statements when considering applications for resource consent.

Five NPSs are currently in effect, and two are being developed:

- NPS on Urban Development Capacity (2016)
- NPS for Freshwater Management (2014, with amendments that took effect in 2017)
- NPS for Renewable Electricity Generation (2011)
- New Zealand Coastal Policy Statement (2010 – replaced the New Zealand Coastal Policy Statement 1994)
- NPS on Electricity Transmission (2008)
- NPS on Indigenous Biodiversity (being developed)
- NPS on Versatile Land and High-Class Soils (being developed)

National Environment Standards

National Environment Standards (NESs) are regulations made under the RMA, which set out technical standards, methods or requirements relating to matters under the RMA. NESs provide consistent rules nationwide by setting planning requirements for certain specified activities. An NES may set minimum standards, and can also prescribe technical standards, methods or requirements for monitoring. When a new NES is introduced, or an NES is updated, councils must amend their regional and district plans if a plan rule conflicts with an NES provision. NESs can also lead to compliance and enforcement costs for councils, although councils can recover some of these costs from the regulated parties. Consenting authorities must have regard to relevant NESs when considering an application for a resource consent. An NES will not apply to a pre-existing resource consent, but will apply at the time any review of permit conditions or designations takes place.

Six NESs are currently in effect, and three are being developed:

- NES for Plantation Forestry (2018)
- NES for Telecommunication Facilities (2017)
- NES for Assessing and Managing Contaminants in Soil to Protect Human Health (2012)

²⁰ Under sections 62(3), 67(3) and 75(3) of the RMA 1991.

- NES for Electricity Transmission Activities (2010)
- NES for Sources of Drinking Water (2008)
- NES for Air Quality (2004)
- NES on Ecological Flows and Water Levels (being developed)
- NES for Marine Aquaculture (being developed)
- NES for the Outdoor Storage of Tyres (being developed)

Source: Ministry for the Environment, and the New Zealand Environment Guide.

New responsibilities, functions or processes that councils must adhere to

The passing of new responsibilities and functions from central to local government is not new. However, many councils have pointed to an “incremental expansion of local government responsibilities” (Ōpōtiki District Council, sub. 126, p. 6), the cumulative impact of which can create significant cost pressure. Quantifying the costs of new responsibilities and functions imposed on local government is hard, but many councils noted that they are facing pressure from a steady expansion of their responsibilities, requiring increases in staff or consultant resources (eg, Tararua District Council, sub. 18, p. 3).

The Commission’s 2013 inquiry into local government regulation found that there had been a steady stream of new statutes over the preceding decade, each affecting local government regulatory activities to varying degrees (NZPC, 2013). The inquiry also noted, however, that not all new statutes entail significant new costs for councils, as some require little change to existing regulatory processes.

That inquiry identified about 50 pieces of legislation (primary and secondary legislation) that required local government to undertake significant regulatory activities. Since the Commission published the report from that inquiry, several new pieces of legislation with significant impact on local government have been passed, including the Food Act 2014, Health and Safety at Work Act 2015, the Building (Pools) Amendment Management Act 2016, and the Building (Earthquake-prone Buildings) Amendment Act 2016.

The costs councils might incur as a result of this central government legislation vary, and can include costs associated with training staff, preparing and consulting on policies, developing implementation systems and processes, monitoring, reporting and compliance, as well as enforcement costs. Many councils noted that they face increased cost pressure from this new legislation, although the impact is hard to quantify. For example, several councils noted increased compliance and monitoring requirements for food and liquor licensing, buildings and swimming pools (eg, Timaru District Council, sub. 25, p. 25; Mackenzie District Council, sub. 27, p. 10; Whangarei District Council, sub. 46, p. 4; and Hurunui District Council, sub. 110, p. 3). However, councils can collect a fee or charge to cover all or some of the costs of issuing licences and consents, and for compliance and monitoring requirements, in relation to those functions.

The costs of compliance with the Long-Term Plan (LTP) provisions in the Local Government Act (LGA) 2002 have been raised in submissions by many councils as a cost pressure, and also featured prominently in LGNZ’s 2012 report. Councils often raised the costs associated with developing, preparing, consulting about, and auditing LTPs. However, it is hard to identify how much these costs differ from business as usual under best practice. Chapter 5 discusses the LTP process, and potential improvements, in more detail.

Some councils, particularly small ones, are clearly finding it difficult to manage the expansion of responsibilities and functions. A risk is that such councils may be unable to comply with all the new responsibilities and functions being passed to them. This would ultimately lead to the objectives of central government legislation not being achieved.

Ōpōtiki District Council, for example, noted that their small team is responsible for administering many different pieces of legislation or functions, and that:

[k]eeping up with the ongoing changes to legislation is an ongoing battle. Government needs to be more aware that the number of changes being made and the timing of those changes can have real deliverability issues at the coal face, particularly in small councils where even delivering the status quo can be a challenge. (sub. 126)

Ruapehu District Council raised similar concerns:

Without additional and adequate support, an expansion of responsibilities results in an increased workload for Councils as well as pressure on budgets. Additional responsibilities place particular pressure on those Councils already at capacity in terms of staff budgets. This is especially true for small Councils, as although Councils must perform the same functions, meet the same levels of services, and meet statutory requirements, small authorities do this with less resources both financial and human. (sub. 85, p. 5)

F4.3

If some councils are not able to comply with all the responsibilities and functions being passed to them, then the objectives of central government legislation will ultimately not be achieved.

Reducing, ceasing or removing central government funding

When central government removes or reduces funding for a role, function or service, local governments often face additional costs. A commonly cited example of this form of cost shifting is changing funding assistance rates (FARs) from the New Zealand Transport Agency (NZTA). The FARs set the share of central government funding for road construction and improvements in different districts around the country. NZTA completed a review of the FARs in 2014, and is phasing in adjustments to the FARs between 2015 and 2021. For most councils, FARs are increasing or will remain the same. However, for about 20 councils the FAR will reduce. This will have implications for their roading costs (NZTA, 2014).

Councils can find themselves under pressure to take on new roles or take over certain services when communities demand these roles and services continue but the funding for them from elsewhere has ceased. This pressure can take several forms, such as:

- withdrawal of central government staff from the community (eg, withdrawal of Work and Income, immigration or other services from a community);
- withdrawal or cessation of central funding for a programme or service (eg, reduction in funding for the Enviroschools programme, reduction in funding to local road-safety programmes, reduction to CreativeNZ funding for cultural organisations and events); or
- withdrawal of services or funding previously provided by other organisations or businesses (eg, withdrawal of funding for St John Ambulance, homeless shelters, or of other sporting, social or aged services).

This form of cost shifting differs in that the pressure does not stem from new responsibilities or functions being passed down to local government. Rather, councils have found that their communities are increasingly turning to them to deal with social and other issues, and to fill the gaps left as central government and other service providers withdraw. Ōpōtiki District Council summarised this challenge in their submission:

[W]e have witnessed over the last few years a systematic withdrawal of government responsibilities from our district. In this situation we are faced with a decision of whether to subsidise the service or lose it entirely making Ōpōtiki District Council an organisation of last resort. In many scenarios, ratepayers do not appreciate the difference between central and local government, government and non-government organisations. They just see a decline in the availability of services and we are the organisation they turn to, complain to, ask to advocate on their behalf, or to seek funding to continue providing the service. For this reason we end up involved in services that are well outside of the traditional remit or mandate of local government, but in the absence of anyone or anything else, we fill the void. (sub. 126, p. 8)

Wellington City Council also noted this challenge:

Council is increasingly being turned to by community organisations and the public to deal with issues like homelessness, alcohol abuse and associated crime...In some cases council is turned to because central govt funding and support has been reduced or removed... (sub. 61, p. 6)

Restricting the ability of councils to set adequate fees for services or functions

Some of the regulatory powers and functions passed down to local government incur direct costs for processing applications, issuing permits or licences and enforcement. Setting fees for these types of services allows councils to recover these costs from the users of services of those subject to regulation rather than from general rates – in line with the benefit principle (discussed in Chapter 6).

For some services, councils can exercise some discretion over the fees they charge. For example, councils have flexibility in what they charge for consents issued under the RMA and the Building Act, and for fire permits. Where such discretion is allowed, councils can generally recover “reasonable” or “actual” costs of performing the function. Due to this discretion, councils differ in how much they charge for services. Often councils recover direct costs (eg, the costs of receiving applications, processing and issuing permits) through fees and charges, but other associated costs such as developing policies, consultation, and other overheads are sometimes funded through general rates.

For some other services, regulations constrain councils in how much they can charge users to deliver that service. For example, the Sale and Supply of Alcohol (Fees) Regulations 2013 set maximum fees that councils can charge for licence applications, special licences and manager certificates (SOLGM, 2017b, p. 14). The fees that councils can charge for “amusement device” permits are also set in the Amusement Devices Regulations 1978.

Only a few regulations that contain this level of prescription remain, but those that do can create costs for councils. Fees or maximum penalties in legislation tend to become outdated, and no longer reflect the costs councils incur to provide the service or function.

F4.4

When central government passes new responsibilities to local government, without providing adequate funding, this creates cost pressure for councils. Unfunded mandates fall broadly into four categories:

- new or stronger standards that councils must meet – without commensurate funding;
- new responsibilities, functions or processes that councils must undertake – without commensurate funding;
- reduction, cessation or removal of central government funding, or of government-funded programmes and services within the community; and
- restrictions on the ability of councils to set cost-recovery fees for services or functions.

F4.5

Central government’s passing of new responsibilities and functions on to local government is not new. However, this process has continued, and some councils are finding the cumulative impact increasingly difficult to manage.

Good regulatory design

When central government considers policy changes that may make, change or repeal an Act or regulation, it must provide a Regulatory Impact Statement (RIS) to Cabinet, summarising the problem being addressed and potential options to address it. A RIS must also include a cost–benefit analysis of each option. The quality of this process is important because, as noted in the Commission’s 2013 inquiry *Towards better local*

regulation, good regulatory design is founded on rigorous analysis of the problem definition and options for response (NZPC, 2013, p. 68).

During that inquiry, the Commission found that, for a number of years, officials and others had highlighted the need for the government to undertake a more thorough analysis of impacts on local government. The Commission also found that councils strongly perceived that central government agencies did not have a good understanding of the costs and impacts of new regulations on local government (NZPC, 2013, p. 69).

As noted above, a steady stream of new legislation with significant implications for local government has been passed since that inquiry, including two new NPSs, two new NESs and several other Acts. Councils continue to believe that central government does not adequately consider costs and funding implications for local government when designing such legislation. Hurunui District Council, for example, point to a “one size fits all” approach to central government regulation that can lead to disproportionate costs on small rural communities (sub. 110, p. 6). Other councils noted concerns in their submissions; for example:

The government needs to have a better awareness around the expectations associated with new/amended legislation that then has to be picked up by territorial authorities. Government (RIS) first look is superficial and do not take into account all costs and funding requirements, nor the unintended consequences associated with such. (Ōpōtiki District Council, sub. 126, p. 23)

We also consider that central government should put more effort into understanding the cost implications of policy initiatives / new law for local government and identify these in thorough cost / benefit assessments or regulatory impact statements. (Northland Regional Council, sub. 32, p. 5)

[I]dentifying costs, where they fall and consequent funding implications, should be done when the policies are being developed, not as an afterthought. In doing so, local government experts should be genuinely involved, not just consulted and asked to provide information. (Western Bay of Plenty District Council, sub. 34, p. 4)

Consideration should be given to placing a statutory obligation on Central Government policy development to better identify costs and effects of their decisions on local government. (Palmerston North City Council, sub. 124, p. 6)

F4.6

Central government is sometimes passing new responsibilities to local government without adequate analysis, including consideration of the range of council circumstances. This can result in regulation that is “one size fits all”, making it unfit for purpose, or particularly costly to implement, in some localities.

4.4 Treaty of Waitangi settlements and other Treaty obligations

The principles contained in the Treaty of Waitangi (the Treaty) are the foundation of the relationship between the Crown and Māori. The Treaty partnership is fundamental, and all legislation is enacted against the backdrop of the Treaty and its principles. The three main statutes underpinning local governance – the RMA, the Local Government Act 2002 (LGA) and the Land Transport Management Act 2003 (LTMA) – include recognition and active protection of Māori customary rights, taking into account the values and interests of Māori, and providing ways and means for Māori interests to be represented in the development of plans and decisions (NZPC, 2017, p. 177). These Acts place obligations and requirements on local government with respect to iwi. Requirements included in the LGA are discussed in more detail in Chapter 5.

Under the RMA, for example, local authorities are required to consult with iwi authorities when preparing or changing policy statements, regional and district plans, and to engage with tangata whenua in other resource management decisions. The LGA requires councils to establish and maintain processes for Māori to contribute to decision making, and to foster the capacity of Māori to contribute to those processes.²¹ The LTMA also requires consultation with Māori about proposed activities.²²

²¹ LGA (2002), sections 14); 81(1)(a); and clause 8 of Schedule 10.

²² LTMA (2003), section 18g(1)(c).

The legislation noted above requires councils to act in a way that gives effect to the Crown's responsibility under the Treaty. However, the Treaty obligations and responsibilities themselves remain with the Crown. As the Commission noted in 2013, it is generally accepted that the Crown cannot transfer its obligations and responsibilities under the Treaty (NZPC, 2013, p. 176).

Local government decisions and services closely involve iwi and hapū interests. Regulation of the use of natural resources and land is especially significant. Te Rūnanga o Ngāi Tahu emphasised this in their submission, stating that "the Treaty partnership is central in interactions between local authorities and Papatipu Rūnanga within Ngāi Tahu takiwā" (sub. 53, p. 6).

Changes to the RMA in 2017 placed new responsibilities on councils to facilitate Māori participation in resource management processes and decisions. The responsibilities require councils to engage with iwi, and consider and report on iwi authority advice. Iwi authorities can invite regional or district councils to form a Mana Whakahono ā Rohe – a binding statutory arrangement that provides for a more structured relationship between the iwi and the local authority under the RMA.

The purpose of a Mana Whakahono ā Rohe is "to provide a mechanism for iwi authorities and local authorities to discuss, agree, and record ways in which tangata whenua may, through their iwi authorities, participate in resource management and decision-making processes under this Act".²³ Upon receiving an invitation to form a Mana Whakahono ā Rohe, councils are required to begin a process of engagement and negotiation with the requesting iwi, and any resulting Mana Whakahono ā Rohe arrangements must be completed within 18 months.

Councils and mana whenua have a choice of mechanisms and processes to facilitate Māori participation in local government decision making (NZPC, 2017). Like other local authority decisions, the choice is a local one and reflects local circumstances and preferences. These are likely to evolve over time as both parties work out what is effective, efficient and practicable. Different mechanisms will involve different costs to either or both parties, and it is in everyone's interest, including the Crown's, to search for the best way to meet statutory obligations.

Māori are a significant community of interest for local authorities, and one to whom there are specific statutory obligations to include in decision making. This creates expectations for councils in terms of engagement and relationship management, as well as from them administering iwi arrangements under the relevant legislation. Councils may reasonably be expected to bear these costs, to the extent that they incur them as part of their usual business in serving their community. Yet, to the extent that councils incur these costs to meet the Crown's Treaty obligations, an ongoing contribution from the Crown may also be reasonable.

Q4.1

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?

Treaty settlements

The Crown is committed to settling historic breaches of the Treaty through Treaty settlements. One outcome of many recent Treaty settlements has been the creation of co-governance and co-management arrangements over significant natural resources and reserve lands. Co-governance and co-management arrangements vary, but can include independent statutory bodies, statutory boards, or joint council committees, with different mixtures of council, iwi and other participants.

As the regulatory authority for natural resources and land, councils – particularly regional councils – play a critical role in implementing these arrangements. They establish the various co-governance entities required in the settlements, and support their ongoing functioning and effectiveness once established. In this way,

²³ RMA (1991), section 58 M(a).

while the Crown settles historical breaches of the Treaty with iwi, under these arrangements local authorities essentially become the co-governance and co-management partner with Treaty settlement groups (LGNZ, 2018d).

The impact of Treaty settlement arrangements is not evenly distributed across the country. Some councils have several different arrangements in place, while others have none. This is partly due to large differences in the size and distribution of iwi and hapū groups around the country and across council boundaries, and partly a reflection of how the Treaty settlement process has unfolded and evolved over time.

Waikato Regional Council, for example, currently has one co-management agreement and five joint management agreements with iwi partners: the co-management agreement for the Waikato river; and five joint committees under joint management agreement.²⁴ Bay of Plenty Regional Council has three arrangements in place, and anticipates more will be established in the near future (Bay of Plenty Regional Council, sub. 95).

Treaty partnership between local government and iwi, as well as Treaty settlements and the co-governance and co-management arrangements they establish, provide opportunities for local authorities and iwi to develop relationships that provide many benefits for their communities, as well as for the environment and natural resource management. Te Rūnanga o Ngāi Tahu emphasised this point in their submission:

While the focus is on costs to local authorities, the benefits of working with iwi and hapū as primary partners need to be acknowledged. Te Rūnanga each bring resources to the table to enable the Treaty partnership and support positive outcomes for environmental management. (sub. 53, p. 6)

Many councils also noted during engagement meetings, and in their submissions, the benefits from their relationships with iwi, including through Treaty settlement arrangements. Wellington City Council noted that Treaty settlements create “significant opportunities and benefits...that should be recognised” (sub. 61, p. 2). Bay of Plenty Regional Council also noted that “co-governance and co-management arrangements provide invaluable connectivity with iwi and an opportune platform for council to assist in building iwi capacity and capability” (sub. 95, p. 3).

Yet many councils also emphasised the large costs they can incur as a result of Treaty settlement arrangements, and the challenges this can create. In their recent report on Treaty settlement costs for local government, LGNZ noted a range of ongoing costs on councils from settlement arrangements, including:

- administrative support, democratic and other council staff services required to ensure the exercise of powers and functions of the co-governance entities;
- specialist technical staff time spent developing and implementing co-governance entity plans, documents and joint management agreements, including legal, scientific, policy, planning and resource consenting advice;
- assistance to build iwi capacity so they can participate in Treaty settlement arrangements; and
- additional RMA policy development activities required under a Treaty settlement.

Central government has made one-off contributions towards local government costs for some Treaty settlements. Yet Crown contributions have varied greatly – ranging from no contribution for the establishment of some joint arrangements to about \$800 000 towards arrangements under the Te Hiku Claims Settlement Act 2015 to support Northland Regional Council (LGNZ, 2018d, pp. 25-28). Some councils have raised this inconsistency as a serious issue that “risks reinforcing inequality between settlements, iwi, and regions” (Bay of Plenty Regional Council, sub. 95, p. 3).

Where the Crown has provided one-off contributions, they have often been insufficient to cover council costs. For example, Waikato Regional Council estimated total Treaty settlement costs of more than \$13.18 million to date for the six arrangements it has in place, while one-off Crown contributions for the settlements provided about \$1.3 million (sub. 125, p. 8).²⁵ Although one-off contributions can cover most establishment

²⁴ The four joint management agreements are with the Raukawa Settlement Trust, the Te Arawa River Iwi Trust, the Waikato Raupatu Trust, the Maniapoto Māori Trust Board and three district councils (Waitomo, Waikato and Waipa), and the Tuwharetoa Māori Trust Board.

²⁵ This figure includes plan development and plan-change process costs, development and establishment of the co-governance and joint-management entities, and ongoing administration and implementation costs (sub. 125, Appendix A).

costs for some arrangements, ongoing costs can also be significant. For example, the Crown made a one-off contribution to Auckland Council of \$400 000 towards establishing the Maunga Authority. The council has since estimated that \$400 000 was spent during the establishment phase, but that ongoing costs associated with the Authority are about \$634 000 each year (LGNZ, 2018d, p. 26).

In the absence of adequate Crown funding to support Treaty settlement arrangements, councils need to use ratepayer funds to meet the funding shortfall. In their submission, Bay of Plenty Regional Council noted that “the lack of resourcing from central government places significant financial and staff resource burdens which have to be met from ratepayer and other council funding sources” (sub. 96, p. 3). Other councils also noted this point, including Greater Wellington Regional Council:

Settlements are an opportunity for the Crown to settle long standing grievances with iwi. Once agreed and signed, the responsibility for implementation of settlements shifts to agencies including local government. The Crown’s policy is to provide one-off establishment costs for the implementation of Treaty Settlement outcomes. These contributions are welcomed; however, councils nationally are engaging in discussions on the true cost to implement settlements and note that the Crown’s contributions are often not reflective of the true costs of implementation. We also note that the ongoing financial costs to implement settlements (through the current mechanisms of funding) have shifted from the Crown and become the responsibility of ratepayers. This means that, in regions where there are multiple settled iwi, there are also multiple ongoing costs. (sub. 68, p. 6)

It is also important to note that iwi can also find the implementation of co-management and co-governance agreements very costly. The costs in time and other resources are significant. Te Rūnanga o Ngāi Tahu emphasised this point in their submission by stating “it is important to note that for every new responsibility that must be met by council, there will be a corresponding resource implication for Ngāi Tahu” (sub. 53, p. 6). Bay of Plenty Regional Council also highlighted this challenge:

There are also costs borne by iwi particularly in relation to capacity and capability. While Councils generally have the staff to support the administration of these entities, iwi are not equipped to deal with many of the technical (and potentially highly political) aspects arising from these groups. Iwi participants in most cases have to take time off work, are not supported by staff who are able to respond to complex matters, and have other issues to address that also compete for their time. (sub. 95, p. 3)

In implementing Treaty settlement arrangements, local government plays an important role. However, a key concern is that the limited financial support provided by central government to implement those agreements jeopardises councils’ ability to implement them in a robust and enduring way, and some councils are questioning how much longer they can fully deliver on those arrangements. Waikato Regional Council stated that funding challenges mean the council is now “actively considering the extent to which it continues to deliver on Treaty settlement obligations” (sub. 125, p. 7). Bay of Plenty Regional Council also submitted that “Treaty settlements impose real new costs and without increased and consistent funding for co-governance implementation, the durability and effectiveness of these settlements will be undermined” (sub. 95, p. 2).

The Office of the Auditor-General also noted this challenge, and the risks involved:

Over the last few years, the Office has actively considered examples of co-governance and co-management. We have found that the commitment required to establish relationships, to establish processes and to build and maintain a shared understanding of what everyone is trying to achieve is significant and is often underestimated. An underestimation of resources (both time and financial commitment) can undermine the effectiveness of the arrangements, resulting in more costs in the long run. (sub. 70, p. 5).

Many councils have highlighted a funding gap with respect to implementing Treaty settlement arrangements, but to date there has been no comprehensive and in-depth analysis of the associated costs – either to councils or iwi. In the absence of such analysis, it is not possible to identify the additional resources councils have to deploy to carry out this role. It is clear, however, that the initial and ongoing costs of establishing and supporting such arrangements are considerable, and that central government support has, to date, fallen far short of covering these costs.

Given that the requirements and responsibilities passed to councils through Treaty settlement agreements derive from the Crown's obligations under the Treaty, and given the primacy of the Treaty partnership, adequate resourcing from the Crown to support settlement arrangements should have high priority.

F4.7

To date there has been no comprehensive and independent in-depth analysis of costs associated with implementing Treaty settlement arrangements – either to councils or iwi. Such analysis would be valuable to clearly identify the additional resources councils must deploy to carry out this role.

F4.8

Co-governance and co-management arrangements established through Treaty settlement agreements between the Crown and Māori can impose considerable costs on local authorities. So far, central government support has been ad hoc, and fallen short of covering the initial and ongoing costs to councils.

F4.9

Some councils are struggling to meet the costs of implementing Treaty settlement arrangements. The durability and effectiveness of some Treaty settlement arrangements may be at risk if funding issues remain unresolved.

4.5 Scope of local government and community expectations

The scope of local government in legislation

Actual operating expenditure by local government rose by 95% between 2000 and 2017; and grew at a faster yearly rate between 2003 and 2012 than between 2012 and 2017 (Chapter 2). Some commentators, including the Local Government Business Forum (sub. 52) have suggested that legislative changes to the scope and powers of local government in 2002 may have contributed to these increased operational costs. Some of these changes were repealed in 2012, giving more weight to this suggestion.

Yet the analysis of expenditure trends in Chapter 3 strongly suggests that the main drivers of increased expenditure over this period were activities, such as roading and transport, that have long been the central responsibilities of local government. The same drivers are largely responsible for the faster rate of expenditure growth in the period 2003 to 2012. Analysis of the relevant legislative changes in 2002 and 2012 suggests that their effect on the scope of local government was limited, and so reinforces this conclusion.

First, on its enactment in 2002, the LGA gave local authorities powers of general competence for local government (LGA (2002) (s 12 (2)(a)(b)). Under these provisions, local authorities have “full capacity to carry on or undertake any activity or business, do any act, or enter into any transaction” and “full rights, powers and privileges” in performing their role. Yet the intention of these powers was to give local authorities greater flexibility in carrying out their role rather than to expand that role. The amendment achieved this by replacing a large volume of specialist local government law with the general law applying to local government (Lee, 2001).

Second, the LGA introduced “[promoting] the social, economic, environmental and cultural wellbeing of communities, in the present and in the future” as part of the purpose of local government ((LGA (2002) (s 10 (1)(b) as enacted in 2002). In 2012 these provisions were replaced by a new purpose: “to meet the current and future needs of communities for good-quality local infrastructure, local public services, and performance of regulatory functions in a way that is most cost-effective for households and businesses” (LGA, s 10(1)(b)).

Even so, the 2002 change to the purpose of local government was more about increased focus than an extension of scope. The 1974 LGA (s 598(1)) already enabled councils to provide such services they thought necessary to promote the wellbeing of the public. Shand notes that the 2007 Rates Inquiry, which he led, “found no evidence that the provisions of the Local Government Act 2002 had been a significant driver of

rates increases” (Shand, 2019, p. 7) Similarly, LGNZ submitted that “[t]here is no evidence of major shifts in the nature of the services and activities that local governments fund” (sub. 112, p. 11).

Legal analysis of the 2012 amendments reinforces these conclusions. Knight (2015) assessed how New Zealand courts would likely interpret the changes considering their wording and contextual material. He concluded that, largely because of imprecise wording, the amendments did not introduce substantial changes in the scope of local government. Rather, he concluded that they unhelpfully introduced doubt and uncertainty around the mandate of local government. Parliament reintroduced promoting the four wellbeings as a purpose of local government in May 2019 (in the Local Government (Community Well-being) Amendment Act).

Many council participants in the inquiry told the Commission that the 2012 changes made little or no difference to the scope and extent of their services, as they responded primarily to the expectations of their communities (as discussed later in this section). Yet some councils submitted that re-introducing the wellbeings might increase costs. Manawatu District Council, for example, noted that “expectations and demand for cultural and recreational facilities may increase with the reintroduction of the four wellbeings to the purpose of local government” (sub. 57. p. 3).

Expanding services beyond the “core”?

Related to concerns about an expanding scope of local government, several inquiry participants expressed concern about increasing council expenditure on “non-core” functions and services as a cost pressure. Other participants doubted that the concept of “core services” was appropriate for local government. As LGNZ noted in their submission, “attempting to define activities as core or not is always problematic” given the broad range of services that have been funded historically and the impact of changing circumstances on what communities want” (sub. 112. p. 11).

The LGA definition of core services was repealed in the Local Government (Community Well-being) Amendment Act 2019, which was passed in April 2019. Previously, core services were defined in the Act:

In performing its role, a local authority must have particular regard to the contribution that the following core services make to its communities:

- (a) network infrastructure:
- (b) public transport services:
- (c) solid waste collection and disposal:
- (d) the avoidance or mitigation of natural hazards:
- (e) libraries, museums, reserves, and other recreational facilities and community amenities. (s 11A)

This definition of core services was broad in scope, and did not prevent councils offering other services (Knight, 2015), therefore its repeal is unlikely to affect the types of services councils provide.

The LGA also mandates one purpose of local government as enabling “democratic local decision-making and action by, and on behalf of, communities” (s 10 (1)(a)). This emphasises the role of community expectations in shaping what services councils provide.

Views at the local level will always differ about what councils should or should not provide (as many submissions show). Even so, the statutory democratic and decision-making processes provide for communities to collectively identify preferences, and make decisions about funding different services, as discussed further in Chapter 5.

Rising community expectations

Many councils submitted on the pressure they feel from their communities to increase levels of service in many areas.

Community expectations of both the scope and standard of council services are constantly growing. In addition to core infrastructure, regulatory and community services, the community expectation is now that council will routinely deliver economic development, events and marketing and community

development activities. Year on year, expectations for the level of Council services also increase. Public halls need to have video and sound systems, the swimming pool needs a splash pad for children, the library should deliver more adult programmes and so on. These activities require new and additional funding. (Kawerau District Council, sub. 97, p. 3)

Residents want big-city amenities. Dunedin has observed demand for longer opening at community pools, and demand for more activities in public spaces to accompany major events. (Dunedin City Council, sub. 17, p. 1)

[A]s population changes with more people moving from larger towns and cities into rural areas, expectation changes. Communities are more likely to expect similar facilities that are provided in larger towns such as squash courts, swimming pools, dedicated cricket and rugby grounds, better quality playgrounds and dog parks, all of which are community facilities passed to Councils to maintain. (Hurunui District Council, sub. 110, p. 6)

As our nation, district, and communities change and evolve, so too does the demand for Council services. This change in demand relates to both 'what' Councils deliver but also 'how', 'how much' and 'how fast'. As a general observation, demand for Council services has matured over time. Core services are now a basic expectation albeit with increasing pressures on costs and levels of service that will provide a substantial hurdle going forward. Councils are also place-makers, broadly responsible for advancing quality-of-life for their communities. (Whakatane District Council, sub. 121, pp. 7-8)

Community expectations will inevitably shift over time. As discussed elsewhere in this chapter, causes may include factors such as:

- changing perceptions of risks (eg, from climate change, poor-quality water supply or discharges into waterways);
- expectations of increased standards of service (including by people who have moved from or have visited wealthier communities); and
- changes in the age composition of the local population, and rising incomes (which makes it easier for people to meet the cost of better quality and additional services).

The mix and quality of central government services changes over time in response to the same sorts of factors. The key issue for councils experiencing this pressure is that rising community expectations are not necessarily accompanied by the community's willingness to pay. Chapter 5 assesses how councils determine priorities and investments in response to community preferences and through ongoing engagement with the community.

F4.10

Evidence reveals no major shifts over the last several decades in the range of services that local government generally provides. The Local Government Act 2002 defines the purpose of local government as to "enable democratic local decision-making and action by, and on behalf of, communities". The nature, quality and extent of services provided by councils is reliant on the quality of their democratic decision-making.

F4.11

Community expectations for levels of service from local (and central) government are rising over time in response to factors such as:

- changing perceptions of risk from climate change;
- drinking water quality and impacts of discharges into waterways;
- changes in the age mix of local populations; and
- rising incomes (which makes it easier for people to meet the cost of better quality and additional services).

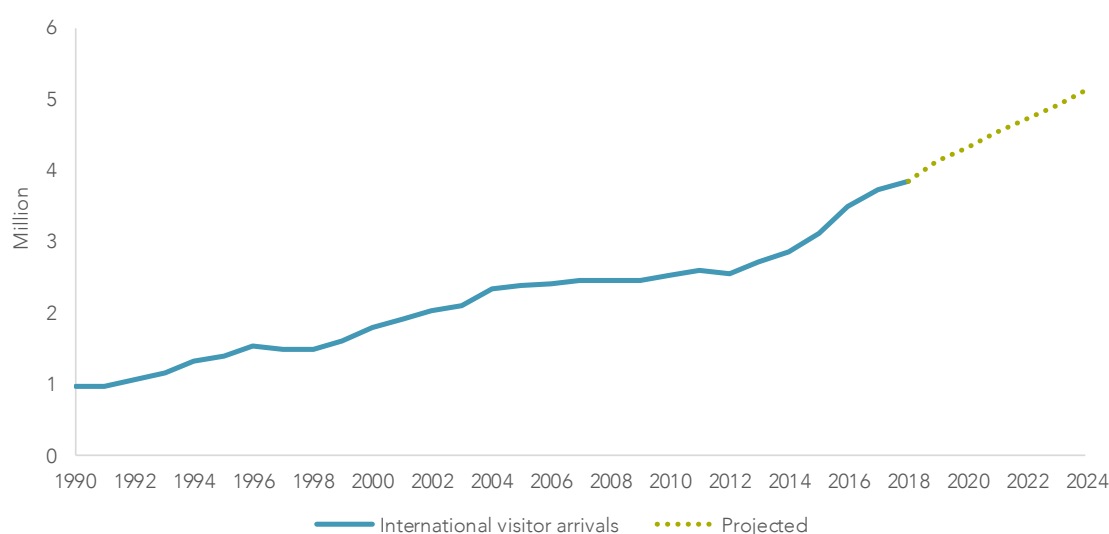
4.6 Tourism

New Zealand has a long history as a tourist destination, but over recent years has experienced a rapid and significant increase in international visitor arrivals. In 1990 there were almost one million international visitors to New Zealand; by 2018 this number had increased to 3.8 million. International arrivals are projected to continue growing at between 4% and 5% each year, and reach five million visitors in 2024 (Figure 4.4) (MBIE, 2018b).

Although their numbers have been increasing, international tourists still make up less than half of New Zealand's total "tourism load". Yet their share is growing. Over the last decade, domestic guest nights have grown by 21%, but international guest nights have grown by 29%.

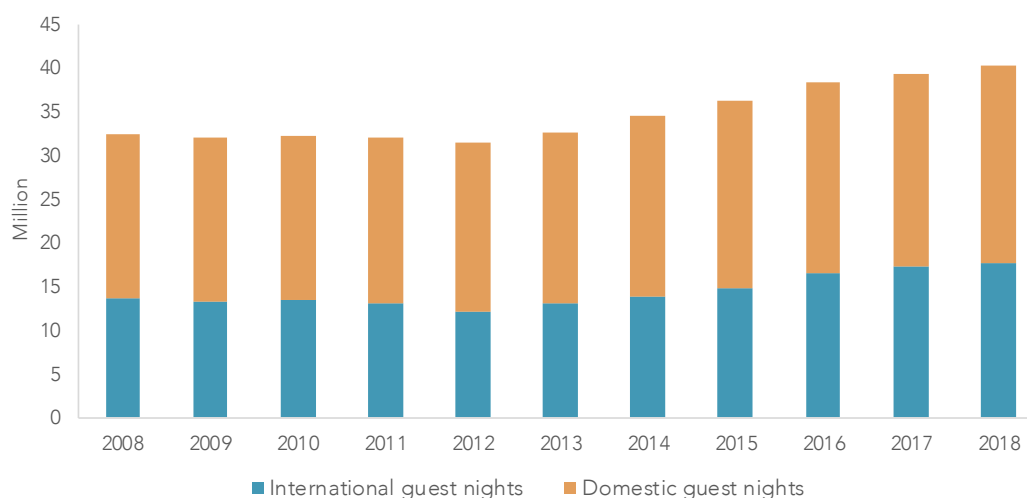
This more rapid growth means that international visitors made up 42% of total guest nights in 2008, but reached 44% in 2018 (Figure 4.5). In 2018, domestic and international visitors together spent about 40 million guest nights in communities throughout New Zealand.²⁶

Figure 4.4 International visitor arrivals



Source: StatsNZ; MBIE Tourism Forecasts.

Figure 4.5 Domestic and international guest nights (commercial accommodation)



Source: Stats NZ, 2019b.

²⁶ These figures only account for guest-nights spent in commercial accommodation (hotels, motels, backpackers and holidays parks). Visitors staying in informal accommodation (such as Airbnb, Bookabach, freedom camping or staying with family and friends), or those staying in homestays or Bed and Breakfasts, are not captured in these figures.

For the communities hosting these visitors, tourism can bring many benefits. A strong tourism industry supports a range of businesses – accommodation providers, tourism providers, as well as restaurants and retail. In the year ending March 2018, for example, domestic and international tourists in New Zealand collectively spent almost \$39.1 billion (including GST) on products including retail sales (\$12 billion), food and beverage services (\$4 billion), and accommodation services (\$3 billion) (Stats NZ, 2018e).

The influence that tourism has on commercial activity in a region can be good for councils, as businesses that generate revenue from tourism in turn contribute to local government revenues through business rates. Businesses will likely pass on the cost of rates to their customers. Businesses catering to tourists also provide jobs, and local residents enjoy some benefit from the expanded employment opportunities that tourism brings to a community (NZIER & McKinlay Douglas, 2001). In 2018, about 216 000 people around New Zealand were directly employed in tourism – including in the accommodation, food and beverage services, retail and transport industries (Stats NZ, 2018e). Tourism can also bring less-tangible benefits to some communities, such as increased vibrancy and cultural vitality.

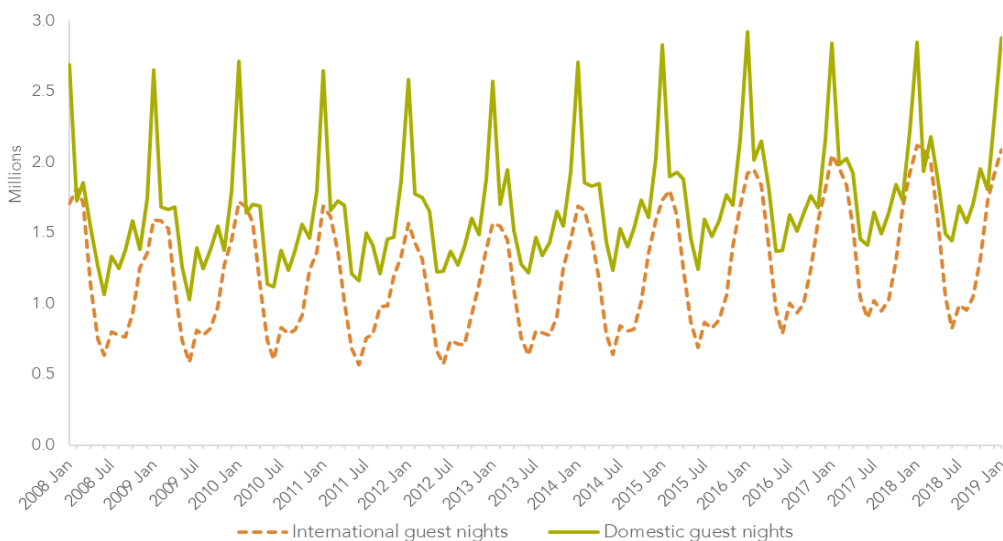
Tourism puts pressure on local infrastructure

Tourists use a wide range of public and private infrastructure, including airports, roads, visitor accommodation, water and sewage systems, public toilets and car parks. Of relevance to this inquiry is tourists' use of local, publicly funded infrastructure – such as roads, three waters infrastructure, waste management and other amenities. In general, this is the same infrastructure that residents use and depend on. In the context of tourism, this type of infrastructure is often referred to as local mixed-use infrastructure.

The importance of local mixed-use infrastructure for the tourism sector is well understood. In 2016 a report commissioned by major tourism businesses in New Zealand²⁷ noted that gaps or lack of capacity in such infrastructure can have negative impacts on the experiences of tourists and residents (Tourism sector leaders, 2016). It can diminish residents' quality of life if their ability to access infrastructure is affected – for example, by road congestion, lack of parking, or crowding of local amenities. Similarly, it can diminish the visitor experience if local infrastructure is unable to accommodate visitor flows, which risks undermining a location's reputation as a tourist destination.

Tourism in New Zealand is very seasonal, which creates challenges for local infrastructure. Most domestic and international tourists travel throughout New Zealand in January and February. As a whole, almost twice as many guest nights in New Zealand occur in January than in June (Stats NZ, 2019b).²⁸ These peaks are problematic because local mixed-use infrastructure needs to be able to accommodate use (including by visitors) at peak times, even if high visitor volumes only last for a few weeks or months.

Figure 4.6 Number of commercial guest nights, by month



Source: StatsNZ, 2019b.

²⁷ Auckland Airport, Christchurch Airport, Air New Zealand and Tourism Holdings.

²⁸ Guest nights are likely to be a significant underestimate of actual visitor numbers, as the Accommodation Survey does not capture informal accommodation.

Deloitte undertook a nationwide assessment of tourism infrastructure in 2017. The assessment identified seven priorities for investment to support tourism. Although infrastructure priorities vary from place to place, four of the priorities identified were different forms of local mixed-use infrastructure: car parking; water and wastewater systems, public toilets, and road transport (Deloitte, 2018b). Similarly, the *Tourism sector leaders' report* estimated that an “initial and immediate” \$100 million of funding is required for local mixed-use infrastructure across 20 priority councils currently under pressure from tourism growth (Tourism sector leaders, 2016).

This type of infrastructure is largely funded from local rates. Therefore, a key issue for many councils under pressure from tourism is the disconnect between who pays for local mixed-use infrastructure to accommodate tourism growth and peaks, and where the benefits from tourism accrue. Many commercial ratepayers derive some direct benefit from tourism, and are generally expected to pass on the costs of rates to their customers. However, residents typically receive only indirect benefit from tourism growth (eg, employment), and cannot pass on the cost of rates rises. Ratepayers may therefore resist rate increases to pay for upgrades to infrastructure required to accommodate peak tourist numbers, or tourism growth. Councils have the discretion to apply targeted rates and rating differentials to business ratepayers so as to reduce rate rises on residents and keep in line with the benefit principle.

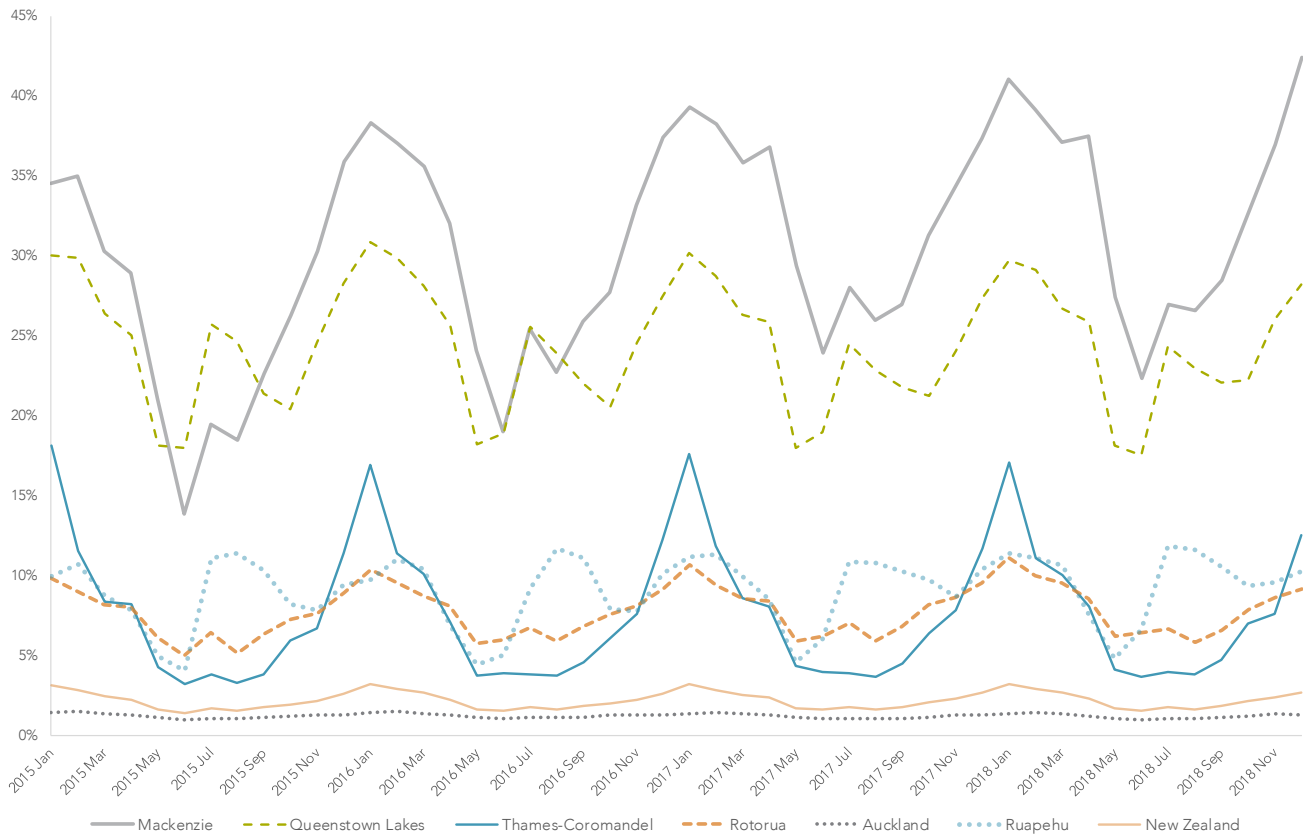
Meanwhile, as with other industries, many of the tax revenues generated by tourism accrue to central government. Deloitte estimate that in the year ending March 2018 central government collected about \$1 billion in income tax, \$353 million in company tax and \$264 million in motor vehicle taxes, attributable to international tourism (Deloitte, 2018a). But unlike other export industries, tourism also directly contributes a large amount of GST to central government revenue. In 2017–18, international tourists generated \$1.7 billion in GST (Stats NZ, 2018e). Many councils perceive a disconnect between council costs from tourism and central government benefit from tourism (eg, Mackenzie District Council, sub. 27; Kaikōura District Council, sub. 101; Wellington City Council, sub. 61; and Northland Regional Council, sub. 32).

As well as putting pressure on local mixed-use infrastructure, tourism growth can also affect housing affordability. As tourism increases, and more local businesses move in to support tourism growth, more people are needed to work in those businesses, leading to higher growth of the local resident population alongside tourist numbers – as noticed in Queenstown Lakes District in particular. Housing affordability issues associated with this rapid growth can be exacerbated because many of the jobs currently created through tourism are relatively low-wage (eg, jobs in accommodation, hospitality, and retail). Some councils have also noted that diversion of private accommodation away from the long-term rental market to short-term visitor accommodation is also having an impact on housing affordability (Mackenzie District Council, sub. 27, p. 1; Ruapehu District Council, sub. 85, p. 4).

A distinctive feature of tourism as an industry is that it involves large volumes of people who can put considerable pressure on local public infrastructure as they travel, and who can also change the character of the places they visit. Some of these effects can be positive, but others can be negative. In particular, the natural capital that many tourists come to New Zealand to enjoy can become degraded if the volume of visitors exceeds the carrying capacity of the locations they visit.

New Zealand's recent, rapid tourism growth has not been evenly distributed, and different local authorities face different pressures from tourism. Some communities are tourism hotspots, while others still receive relatively few visitors. The resident-to-visitor ratio can give an indication of how much pressure tourism puts on different communities, and their local mixed-use infrastructure. Because communities that receive a lot of visitors have very different resident populations, the visitor-to-resident ratio varies hugely even among the tourism hot-spots. In communities with a large local population compared to the number of visitors they receive (and therefore a low visitor-to-resident ratio), residents use that infrastructure much more than visitors – even during the peak summer period for tourists.²⁹ In these communities, the costs each additional tourist puts on local infrastructure is spread among more ratepayers than for communities with high visitor-to-resident ratios.

²⁹ However, in some cases the tourist peak period may still push infrastructure beyond the capacity needed only for residents.

Figure 4.7 Proportion of people locally who are visitors, by month (visitor-resident ratio)

Source: Stats NZ (population estimates: by territorial authority areas, years ended June; Accommodation survey: guest nights by regional tourism organisations (RTOs)). 2018 population estimates used for July-December 2018. Queenstown Lakes district guest night figures combine Queenstown and Wanaka Regional Tourism Organisations.

The figure above illustrates the wide variation in visitor-to-resident ratios between selected tourism hotspots. Yet, it is difficult to get an accurate picture of the visitor-to-resident ratio using only commercial accommodation data. These figures are likely to be a significant underestimate because the Accommodation Survey does not capture informal accommodation, although a significant proportion of tourists use it (informal accommodation includes online platforms like Airbnb and Bookabach, as well as freedom camping and staying with friends and family).³⁰

StatsNZ recently estimated that accommodation-sharing platforms like Airbnb could have contributed around an additional 8.8 million guest nights in the year ended March 2018, potentially making up about 18% of total guest nights across the country (Stats NZ, 2019a). Some councils also have their own estimates. Mackenzie District Council, for example, estimate that online platforms and informal accommodation add between 20% and 30% to their official guest night figures (sub. 27), and Queenstown Lakes District Council estimate that, on a peak day, more visitors stay in informal accommodation than in commercial accommodation (sub. 67; pers. comm., 14 June 2019).³¹

Also, the guest night figures do not capture visitors who may be visiting or passing through one district, but staying in another district. Mackenzie, Buller and Matamata-Piako are examples of districts where the number of visitors passing through to visit popular tourist sites (eg, Church of the Good Shepherd in Tekapo, the Punakaiki rocks on the West Coast, and the Hobbiton movie set in Matamata) is likely to far exceed the number of visitors staying one or more nights. Yet day visitors also put pressure on local infrastructure, including roads, car parks and public toilets.

³⁰ Monthly averages will also not reflect variation within the month. For example, in many tourism hotspots the visitor-to-resident ratio is likely to be significantly higher during the first few days of January (new-year period) than in late January.

³¹ Based on a comparison of Accommodation Survey data and visitor data included in Queenstown Lakes District Council's submission (sub.67, p.4).

There are also large differences, between tourism hotspots, in terms of where tourists come from. In Queenstown Lakes District, for example, international tourists make up about 70% of guest nights. In contrast, in Thames-Coromandel district international visitors only make up about 30% of guest nights.

Not all tourists bring the same level of economic activity to the regions they visit. During engagement meetings some councils raised concerns about “freedom campers” creating the need for new regulations and putting pressure on local infrastructure – including creating demand for new infrastructure like public toilets. Some councils voiced concern that freedom campers put pressure on infrastructure yet spend less on goods and services than other tourists and therefore contribute less to the local economy. In 2017 and 2018 international visitors who did some freedom camping during their time in New Zealand spent, on average, about half as much a day as the visitor average (\$99 a day compared to \$195). However, their total spend was higher than the average, mainly because they stayed in the country longer – almost three times longer than visitors who did not freedom camp (MBIE, 2019).

The level of economic activity tourists generate not only varies depending on whether or not they are freedom campers. Some international visitors spend considerably more than others.³² Different groups of tourists also have different expectations of the destinations they visit. Kaikōura District Council and Queenstown Lakes District Council noted in their submissions the challenge of meeting the high expectations of some visitors:

Visitor needs are one of the key drivers of amenity and standards in the tourist destinations, but also in communities along some of the key tourism corridors and premier tourism destinations. Our Council is increasingly concerned about the cost of meeting these needs with a small ratepayer base. (Kaikōura District Council, sub. 101, p. 2)

[V]isitors to the district have high expectations of cleanliness and amenities in New Zealand’s premier tourism destination. As such, our operational expenses and levels of service are high, in keeping with our responsibilities around manaakitanga and kaitiakitanga. (Queenstown Lakes District Council, sub. 67, p. 2)

F4.12

Tourists use the same local infrastructure as residents. The seasonal nature of tourism in New Zealand creates the need for this local mixed-use infrastructure to be able to accommodate peak visitor numbers, even if that peak only lasts for a few weeks or months. Some communities have a high visitor-to-resident ratio during peak tourist season, which can create significant cost pressure.

Funding and financing tourism infrastructure

The rapid growth of tourism is putting greater funding pressure on some local governments. International visitor arrivals have increased faster than predicted over recent years, yet councils have little control over where and when tourists travel, and the tax benefits from tourism growth accrue mainly to central government. Meanwhile, local governments in tourism hotspots (and their ratepayers) fund the construction and maintenance of significant parts of the infrastructure that tourists use, largely through general rates revenue.

Deloitte (2018a) recently looked at three case studies to examine the income and expenditure related to international tourism – in Auckland, Nelson and Southland. Deloitte noted examples of different approaches to funding some tourism-related costs. Southland District Council levies \$5 on each person who visits Stewart Island. Nelson charges visitors to the district who access museums and attractions, and Auckland has introduced a targeted rate on accommodation providers. Southland charges for access to some public toilets. Southland regional council (Environment Southland) also charges a levy on cruise ships.³³

³² For example, in 2017 Korean tourists spent 2.2 times more in an average transaction than tourists from Australia, and 2.6 times more than tourists from Japan (Visa Public, 2017).

³³ The funds from this levy are used by the regional council to cover the cost of coastal management, including work undertaken on coastal science, coastal policy, aquaculture management, harbour management and coastal compliance (Environment Southland, 2012).

Several councils also have tourism-related targeted rates on commercial accommodation providers – including Queenstown Lakes District, and Tauranga City councils. However, the funds from those targeted rates generally are spent on destination marketing through Regional Tourism Organisations (RTOs), rather than on tourism infrastructure or destination management.

These examples highlight the range of tools currently available to councils to fund tourism-related costs (including user chargers, visitor levies, and targeted rates), but central government funding also contributes. In addition to NZTA funding for land transport, the central government funds tourism infrastructure through the Tourism Infrastructure Fund (TIF) and the Provincial Growth Fund (PGF). The new International Visitor Conservation and Tourism Levy (IVL), coming into force later in 2019, will provide additional funding (Table 4.2).

Table 4.2 Existing central government funding for tourism infrastructure

Fund	Details
Tourism Infrastructure Fund (TIF)	<p>Launched in May 2017, the TIF is a \$100 million contestable fund that provides up to \$25 million a year for tourism-related infrastructure. The two rounds of funding through the TIF to date have allocated a total of \$33.84 million to 76 different projects. Round three is currently under way.</p> <p>Toilets and car parking facilities are the most common types of projects funded, although several large wastewater systems have also been funded, as well as many small grants for councils to conduct feasibility studies. To date, funding has focused on capital expenditure.</p>
Provincial Growth Fund (PGF)	<p>The PGF is a \$3 billion fund, providing \$1 billion a year over three years to projects that will “lift the productivity potential of the regions”. The PGF funds a combination of “bottom-up” initiatives prioritised by the regions, and “top-down” initiatives prioritised by the Government to address social and infrastructure deficits at a regional level.</p> <p>The PGF has funded a wide range of projects, but a significant number have been for tourism-related infrastructure. These include funding to develop or upgrade many local attractions (funding provided both to councils and other bodies). To date, funding has focused on capital expenditure.</p>
Responsible Camping Initiative	<p>A \$8 million fund distributed to 28 councils to help them manage freedom camping during the 2018–19 season. Funds were provided for initiatives including facilities, monitoring and enforcement. In May 2019 the government announced an additional \$8 million for the 2019/20 season.</p>
International Visitor Conservation and Tourism Levy (IVL)	<p>A \$35 per visitor levy will start in the second half of 2019. The IVL will apply to all international visitors applying for visa waivers through the new Electronic Travel Authority process, and all international visitors entering New Zealand on short-term entry visas (12 months or less), with several exceptions, including Australian and Pacific Island forum country citizens.</p> <p>The levy is expected to raise around \$80 million a year, and revenue from the levy will be split 50-50 between conservation (DOC) and tourism (MBIE) activities. The exact nature of the spending is still being developed.</p>

Source: MBIE.

While many councils have benefited from existing central government funds, many submitters voiced concern about lack of certainty around tourism funding, highlighting that “such ‘discretionary’ funding cannot be relied upon for future investment by local government on an ongoing basis” (Northland Regional Council, sub. 32, p. 3). Regional Tourism New Zealand also emphasised this point by stating that, “[w]hile these schemes are welcome...they are relatively small, short term and interventionist solutions. If the tourism market is to achieve its potential, more sustainable forms of funding that allow local communities to share in the financial benefits need to be established” (sub. 58, p. 3).

Smaller councils also emphasised the challenges they face in accessing these funds. Kaikōura, for example, stressed that “without dedicated resources of larger councils it is difficult to effectively compete with larger councils for contestable funds” (Kaikōura District Council, sub. 101, p. 3).

Many councils also noted that even when assistance is provided towards upfront capital costs of tourism infrastructure, ongoing operational and maintenance costs are considerable, and remain largely funded by local ratepayers. Hauraki District Council noted that they spend \$700 000 each year operating public toilets and reserves for travelers, and \$620 000 each year on their cycleway, which is used mainly by visitors (sub. 43, p. 7). Mackenzie District Council (which has about 4 600 residents) also noted this challenge in their submission.

Our Council has incurred increased costs in capital expenditure such as public toilets (the district has gone from having 6 public toilets in 2015 to now having 15 as at January 2019), and increases in operational expenditure such as cleaning and maintenance, increased rubbish volumes, and additional enforcement of bylaws and regulations...The Council will also face increased expenditure on infrastructure renewals as usage increases and capacity is more quickly taken up ...While some capex may be co-funded (for example through the Tourism Infrastructure Fund or the NZTA subsidy), there is still a ratepayer contribution for those capital works, as well as ongoing operational costs that must be fully funded by the ratepayer. (sub. 27, p. 4)

As discussed above, several options already exist for councils to fund tourism infrastructure that different local authorities use to varying degrees. Scope exists to use these tools more effectively to relieve funding pressure. For example, user-charges for public toilets remain uncommon, and many councils do not charge visitors for access to museums or other amenities.

Councils' use of targeted rates to fund tourism costs has been limited largely to funding destination marketing and tourism promotion. For communities under pressure from “over tourism”, councils can use targeted rates to fund destination management and tourism infrastructure.³⁴ Tauranga City Council, for example, provides \$991 000 of funding a year to Tourism Bay of Plenty, through an economic development targeted rate on commercial ratepayers. The council recently approved \$621 000 of additional funding for Tourism Bay of Plenty, specifically for destination management. This may come from the economic development targeted rate, starting in 2020 (Tauranga City Council, 2017, p. 13).

F4.13

Local authorities have access to a range of tools to address pressure from tourism. Councils appear to under-use some of these tools, including user charges and targeted rates. Yet, even with more effective use of existing tools, a funding gap remains because tourists do not fully pay for the costs of the local mixed-use infrastructure and services they use.

4.7 Climate change and natural hazards

Due to its geology and position in the South Pacific, natural hazards have always been part of life in New Zealand. Floods, storms, earthquakes, landslides, droughts and cyclones have been an ever-present risk throughout the country's history.

Planning for, and responding to, natural hazards has been an important role for both central and local government for a long time. The risks associated with natural hazards are varied, and some impacts are more predictable than others. Further, anthropogenic climate change is affecting the nature, severity and predictability of extreme events – including flooding, storms, landslides and droughts – and the level of risk that communities face.

³⁴ Destination management involves trying to influence where and when tourists travel, with a focus on dispersing visitor flows more evenly throughout the year, and throughout a district (eg, organising and promoting events during shoulder seasons).

Adaptation to climate change

Climate impacts create a significant cost pressure for local government on several fronts. For instance:

- councils are the owners of a large amount of the infrastructure directly at risk from the impacts of climate change;
- councils are the authorities responsible for planning and development on at-risk land, and therefore have an important role in minimising future risk exposure and long-run costs; and
- councils are the governing body closest to communities, and have a clear role in supporting community wellbeing in the face of adverse climate impacts.

The Commission has identified planning for and adapting to climate change as a major increasing cost pressure on local government. Given the complexities and scale of the challenge, adaptation to climate change is discussed in a Chapter 8.

Climate mitigation

New Zealand has committed to transition to a low-emissions economy. The government is currently in the process of enshrining in law an emissions reduction target through the Climate Change Response (Zero Carbon) Amendment Bill. Once passed, the legislation will set a target of reducing carbon dioxide and nitrous oxide emissions to net zero by 2050. It will also set a target for reducing gross emissions of biological methane (from livestock agriculture) to within the range of between 24% and 47% below 2017 levels by 2050. This represents a significant increase in ambition from previous emissions reduction targets.

Transitioning to a low-emissions economy will require significant action across all sectors of the economy, and has significant implications for local authorities. Reducing emissions in the transport sector, for example, will likely require significant investments from regional councils in public transport infrastructure, and investments from many territorial authorities to encourage “mode-shifting” away from cars and to cycling and walking.

Reducing New Zealand’s emissions may also result in major pressure for some communities that are currently reliant on fossil-fuel intensive or extractive industries; for example, communities in Taranaki with large oil-and-gas-processing industries. Councils will also incur some direct costs associated with mitigation, including Emissions Trading Scheme (ETS) costs associated with operating landfills, as well as other costs passed through the ETS. Ruapehu District Council noted in their submission that its ETS costs have quadrupled in the last four years (sub. 85, p. 5); this trend is likely to increase significantly as the carbon price rises.

Pressure from new forestry

One of the largest costs for local government in some areas, however, will be the impact from increased forestry. As described in the Commission’s 2018 *Low emissions economy* report, a low emissions transition will require a significant amount of land-use change. In particular, modelling undertaken for that report estimated that between 1.3 million and 2.8 million hectares of new forestry could be required – up to a third of this would be permanent native forest, and the remainder exotic plantation forest (NZPC, 2018). This represents a significant amount of new forestry, given that New Zealand currently has about 1.7 million hectares of land in plantation forest (Ministry for Primary Industries, 2018).

Increased amounts of forested land will have an impact on councils in several ways. In some areas the change from pastoral agriculture land into forestry will be significant, and will represent an economic transformation that will inevitably affect some communities in terms of the local workforce and culture. The biggest cost impact for councils, however, is likely to come after 25 or 30 years, at harvest time, when forestry puts pressure on local roading infrastructure.

As SOLGM noted in their submission, forestry puts very specific demands on local infrastructure, as the forestry cycle requires intensive use of the forest for only two periods: planting; and harvest about 30 years later. SOLGM describe this as “an investment decision having an infrastructural echo” (sub. 24, p. 37). The impacts of forestry on local roads are significant, particularly during harvesting when a large amount of heavy machinery and timber is transported. Although the specific impacts vary depending on certain conditions,

such as the types of roads and vehicle tonnage, this leads to considerable wear and tear on roads. This results in roads needing more frequent maintenance and renewal.

Whanganui is already experiencing cost pressure from forestry in their district, with 24 000 hectares of plantation forest across 230 properties (SOLGM, sub. 24, p. 38). Much of this timber will reach harvestable age in the period between 2020 and 2030. In their submission, Whanganui District Council noted the large cost impact this is expected to have in the district.

Within the Whanganui District, the transportation of timber has, and will continue to have, a significant impact on our roads. Over the next thirty years, renewing sealed roads directly resulting from forestry traffic is estimated to cost around \$67M with a peak between 2024 and 2029. While the Council's modelling predicts that the major costs will impact Council after 2024, as roads are repaired following peak harvest, Council is already experiencing significant damage on our roading network. (sub. 93. p. 2)

The council has attempted to deal with this anticipated cost impact by introducing a new targeted rate on plantation forest owners. That rate aims to recover 60% of the council's forest-related roading costs, with the remaining 40% funded from general rates. This approach has faced opposition from the forestry sector, for creating a new and unanticipated cost late in the forestry cycle. The council, at the same time, has attempted to "strike a balance between loading the substantial forestry related roading costs onto 230 forestry property owners or 21 000 general ratepayers in a low socioeconomic district who see little benefit from this activity" (SOLGM, sub. 24. p. 39).

As rates of afforestation increase to support New Zealand's transition to a low-emissions economy, more councils will face similar challenges. Councils will need to ensure that they plan and account for the future infrastructure costs associated with this large-scale afforestation, much of which will occur on marginal farmland often in districts that are relatively socioeconomically deprived.

In New Zealand all road users directly contribute towards road construction and maintenance. Most light-vehicle drivers pay through levies on vehicle fuel, but heavy vehicles pay a Road User Charge (RUC). RUCs are calculated based on dollars per thousand kilometres travelled, and vary depending on the size and class of the vehicle to reflect the impact they have on roading infrastructure. All funds collected through RUCs go to the National Land Transport Fund (NLTF), which the NZTA uses to fund road maintenance and improvements.

As with other industries, forestry companies therefore already contribute to road maintenance costs through RUCs. The challenges that councils like Whanganui District are facing from forest sector activity may therefore indicate a need to re-examine how RUC funds are distributed.

F4.14

Rates of afforestation will increase as New Zealand transitions to a low-emissions economy. This increase in forested land will result in considerable new pressure on many local roads, particularly at harvest time. This will, in turn, lead to a need for more frequent maintenance and replacement of roads, resulting in increased costs. The cost pressure this creates for some councils may indicate a need to re-examine how funds from Road User Charges are distributed.

4.8 Three-waters infrastructure

As noted earlier in this chapter, physical infrastructure dominates local government operating and capital expenditure, including three-waters infrastructure: drinking water, wastewater, and stormwater. Small and dispersed communities with a large amount of water infrastructure per capita face a particular challenge in funding and financing its maintenance and renewal. This pressure is compounded by requirements to meet strengthened safety and environmental regulations.

The government is currently considering extensive reforms to the three-waters sector, including to regulatory standards and the regulatory regime (including how the regime is funded and delivered). Within this context, the Commission has identified three-waters infrastructure as a major cost pressure on local government, and developed a useful case study of how altering current arrangements may improve

performance and lift productivity. Chapter 9 provides an analysis of the issues and challenges with the current three-waters system, and discusses a range of potential changes to improve its sustained performance, environmental and safety outcomes, while easing cost pressures.

4.9 Conclusion

Local government faces a broad range of cost pressures, which vary between regions and districts. Looking to the future, many of these pressures will increase as:

- New Zealand's population becomes more concentrated;
- the population ages;
- more regulation is passed down from central government;
- international tourism continues to increase; and
- the impacts of climate change are increasingly felt.

It is also important to note that none of the individual pressures described in this chapter happens in isolation. Some challenges will combine and interact with each other in complex and costly ways. For example, ageing water infrastructure will need upgrading to meet strengthened environmental and safety standards while also adapting to the impacts of climate change and a changing population.

Many challenges identified in this chapter are not new. Some pressures, such as increasing responsibilities from central government, have been growing for a long time and appear to be reaching a point where the cumulative impacts of incremental change are having a significant impact.

However, while such challenges may result in cost pressure on local authorities, the cause of that pressure is not necessarily lack of funding or financing by itself. Rather, cost pressure often flows from other causes – such as:

- poor prioritisation or decision making by councils, poor business models and processes that stymie innovation and the adoption of more efficient technologies (Chapter 5); or
- poorly designed central government policies and regulation that do not take adequate account of council costs (Chapter 6).

There are two areas, however, where the scale of the cost pressure is very significant, and where current funding and financing tools are inadequate: tourism infrastructure and adaptation to climate change. In both areas, pressures fall unevenly across local authorities. And in both areas, the scale of the investments required go beyond what local authorities can reasonably manage with the current funding and financing tools available to them. Potential options for tackling tourism issues are explored in Chapter 6, and planning for and adapting to the impacts of climate change are discussed in Chapter 8.

5 Improving decision making

Key points

- The focus of this inquiry is the funding and financing tools that local government needs to carry out its role in providing services for local residents and businesses. However, the quality of councils' decision making is essential to making best use of the available funding and financing tools, and to ensuring decisions are aligned with the scale and complexity of the local government task.
- Local authorities make numerous decisions that are significant in monetary terms, and in their impact on people's day-to-day lives. Councils' decisions about the level of service they provide and about capital investments can have an important bearing on cost pressures, and ultimately on the costs borne by local residents and businesses. The costs of poor decisions can be significant.
- Councils are complex operations, with numerous business lines. The diversity of community preferences and interests, as well as the triennial election cycle, adds a further layer of complexity. Some councils are navigating this complexity well; however, others lack the necessary systems and skill-mix for effective decision making.
- Success factors underpinning good decision making include strong and capable leadership, good information to support decision makers, use of independent governance expertise, and effective community engagement.
- There is scope to improve the use of the existing funding and financing framework, and enhance decision making more generally, through improving councillors' governance skills and financial literacy.
- All local authorities should be required to establish an assurance committee such as an Audit and Risk Committee. Consistent with good practice, such committees should have an independent Chair and ideally at least one other independent member, to ensure they span the range of requisite skills.
- Local authorities are primarily accountable to their local communities. The effectiveness of decision making by local government therefore largely depends on the public understanding, and taking part in, local democratic processes – both of which are notoriously low. Council decision making and broader performance need to be more visible to stakeholders, including voters.
- The current performance reporting requirements on local authorities, including the financial information disclosures, are excessively detailed, inappropriately focused and not fit-for-purpose. The framework requires fundamental review, with a mind to significantly simplifying the required disclosures, and improving their overall coherence and fitness-for-purpose.
- Councils' Long-Term Plans (LTPs) are long, complex and contain duplication. This is partly a feature of the legislative requirements, which are disjointed and require an unnecessary level of detail. The Commission recommends that the requirements are streamlined so that LTPs become more accessible documents which can better fulfil their transparency objectives.

5.1 The importance of good decision making

Local authorities make numerous decisions that are significant in monetary terms, and in their impact on people's day-to-day lives. Councils' decisions about the level of service they provide, and about capital investments, can also have an important bearing on managing cost pressures. Decisions to invest in large new capital assets (eg, transport infrastructure or sports stadia) have the potential to add significant costs that ultimately must be recovered – largely from local residents and businesses. There are also indirect costs of decisions to build or not build (eg, congestion, health impacts, disruption).

The costs of poor decisions can be significant, as the story in Box 5.1 below illustrates. On the flip side, sound and timely decision making supports the efficient allocation and use of resources, and delivery of good, quality outcomes. It is therefore essential that councillors have the necessary skills and expertise to ensure good decision making, including a good grasp of governance principles and financial management concepts. Where these skills are lacking, suitable supports (such as professional development and external expertise) should be available, as well as checks and balances to help incentivise good decisions and avoid poor decisions.

An important aspect of councils' decision making is how it promotes innovation and learning. Continuous improvement, including adoption of new technologies, and disciplined learning and adaptation, is an important driver of good outcomes.

Firms operating in a competitive market face incentives to continually innovate. They experiment with ways to better attract and satisfy customers, and to reduce their costs of supply. They also learn and adapt to the changing needs and preferences of their current and future customers. Successful innovation is fostered by plurality (having a number of competing firms) and customer choice.

The incentives on councils are different. As a single supplier for most of its services, the incentives on a council to continually improve its use of resources, and better match consumer preferences, are more muted. And as a democratically elected body, a council is governed by elected members (rather than a professional board of directors), accountable to its wider community (rather than shareholders) and subject to a triennial electoral cycle. Community preferences are diverse and the interests of different parts of the community may conflict. The need to make trade-offs across these preferences, as well as the election cycle, add a layer of complexity to councils' decision making. Having robust processes around these decisions then becomes particularly important, as does transparently demonstrating to the community how and why councils have made these decisions.

Councils undertake a large number of activities. They make choices about the mix of activities, the levels of service provided, how each activity is provided, how they are funded and who pays. As explained in Chapter 2, councils have a range of choices for how they fund their activities. The way in which these funding tools are used (eg, the mix of general and targeted rates, differentials, and fees and charges), affects the amount different groups of people pay.

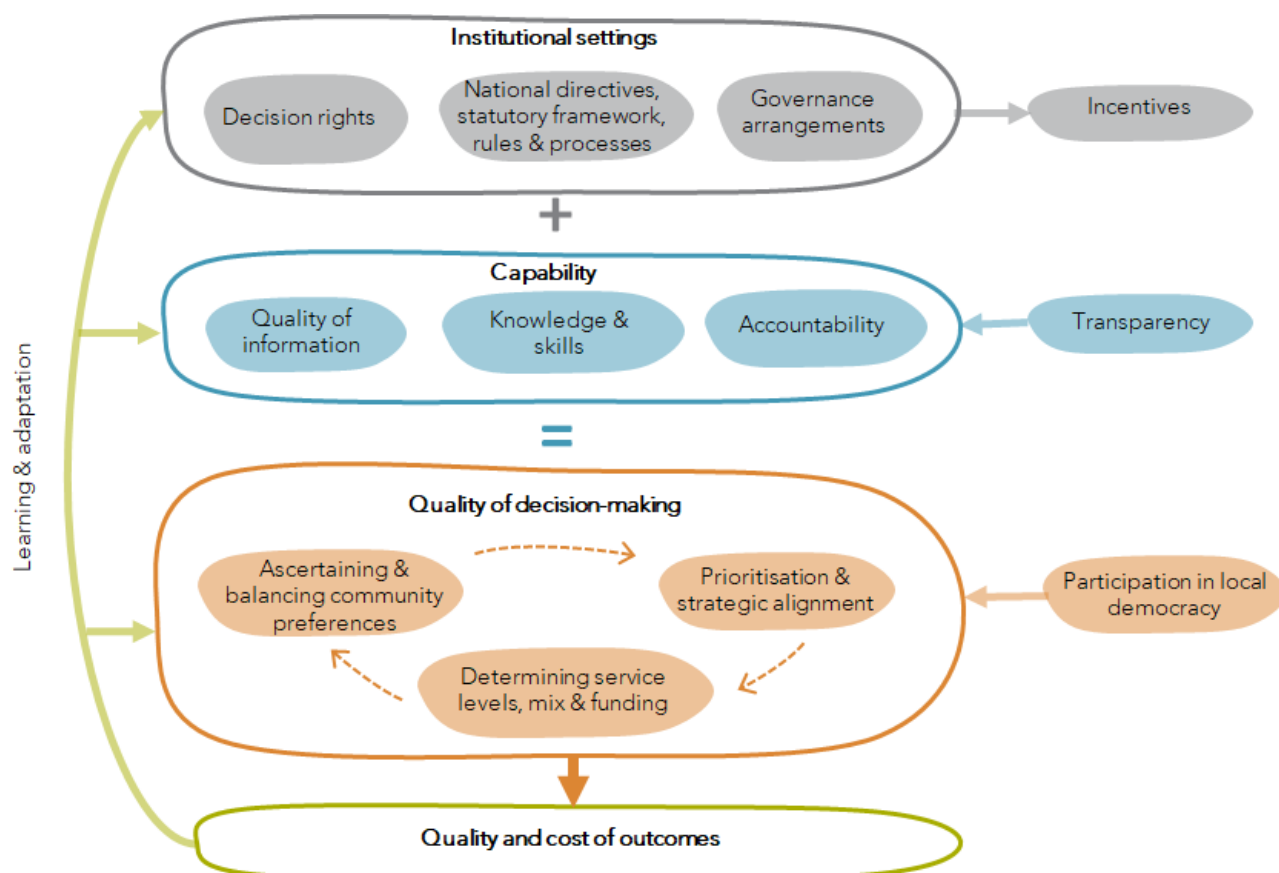
How well councils are making use of the current funding and financing framework has a material impact on the quality of outcomes. This chapter explores the disciplines and incentives on councils to make good decisions. It assesses the scope for strengthening the quality of decision making so as to achieve better long-term outcomes. The appropriate use of funding tools is explored further in Chapter 6, and challenges with determining who should pay are discussed in Chapter 7.

To assess the scope for improving councils' decision making, this chapter examines the following dimensions (illustrated in Figure 0.1).

- The **institutional environment**. This includes where the decision rights sit, the statutory rules and national policy directives around decision making, and councils' governance arrangements (discussed in section 0).
- Councils' **capability** for sound decision making (section 5.3). This includes:
 - the quality of information put to decision makers; and

- the relevant knowledge and skills of decision makers, and those supporting them.
- The **incentives** to make good decisions. This includes the accountability mechanisms (section 5.4). In the local government context, these are underpinned by the **transparency** of decision making (section 5.5).
- The **quality of decisions** about service levels, mix and funding. This includes how community preferences are identified and balanced, and how potential actions are prioritised and aligned with strategic objectives (sections 5.6 and 0).
- Community participation in **local democratic processes**. This includes long-term planning engagement and consultation processes, and local body elections (section 5.7).

Figure 5.1 The features of good decision making



Box 5.1 **The costs of poor decision making**

Kaipara District Council (KDC)'s management of the Mangawhai wastewater scheme is often cited as an example of the costs of poor decision making. It also illustrates the importance of good governance.

Between 1996 and 2012, KDC oversaw the development of a reticulated wastewater disposal scheme in Mangawhai, a small coastal community south of Whangarei. The history of the project is long and complex. It was plagued by numerous problems, including significant cost escalation, and culminated in ministerial intervention to appoint a Commission to manage the council, and to postpone the local body election. The likely cost for the scheme as presented to the community in a 2006 consultation document was \$35.6 million. The final cost is unknown, but estimated to be around \$63.3 million, most of which was debt-funded. This significant increase in costs occurred in the absence of any further public consultation.

In 2012, KDC asked the Auditor-General to undertake an inquiry into its decision making, financial, and contract management processes for the scheme. The Terms of Reference for the inquiry also included some of the work done on behalf of the Auditor-General through the course of the project, which did not identify audit risks with the scheme. The inquiry concluded that KDC failed to attend to its fundamental legal and accountability obligations and the council effectively lost control of a major infrastructure project. The underlying causes of this included poor governance, management and record-keeping by KDC. The issues of most concern were "the lack of attention that KDC gave to its legal obligations and to its obligation to be able to account to the community for its decisions and actions" (Office of the Auditor-General, 2013a, p. 16). Legal requirements that KDC failed to meet included how it sets rates, the need for it to take decisions at formal Council meetings (or people with delegated authority to take decisions), and its record-keeping requirements.

The inquiry reported that one of the key lessons from the "woeful saga" was the importance of governance, including the need for members of a governing body "to have the courage to keep asking questions until they understand what they are deciding" (Office of the Auditor-General, 2013a, p. 13).

The appointed Commissioners took significant measures to rebuild the organisation. They:

- brought activities back in-house;
- rebuilt organisational capacity, capability and systems, including for core council functions such as consenting, rate-setting and asset management;
- put in place basic business systems and policies that were inadequate or absent, including records keeping and management, financial reporting and financial delegations;
- introduced policy frameworks to guide decision making; and
- established an Audit and Risk Committee, along with a risk management framework and a Chief Executive Performance Review Committee (Kaipara District Council Commission, 2016; Robertson, 2016).

In his outgoing letter to the Minister of Local Government, the Chair of the Commission identified a number of lessons from the experience. These included:

- the need for elected members to be aware of their purpose and roles as established in legislation;
- the importance of strict legislative compliance, and strict legal oversight of processes such as rate-setting;
- the need for councils to have an Audit and Risk Committee, with an independent member; and
- the need for an independent panel of experts to peer review large project proposals.

The council has now returned to a fully elected council, with a new Mayor and Chief Executive, and a restructured senior leadership team. The council is in a sound financial position, having paid down debt, and is a member of the Local Government Funding Agency (LGFA). By 2018, KDC had completed its first LTP overseen by elected members (and adopted within statutory timeframes) since 2009, and published its first annual report from a full year of an elected council, since 2011 (Kaipara District Council, 2018).

Source: Kaipara District Council, 2018; Kaipara District Council Commission, 2016; Office of the Auditor-General, 2013a; Robertson, 2016.

5.2 Decision rights and decision-making rules

Decision rights

Elected members agree to council strategies, plans, policies and their associated budgets. The Chief Executive is the only staff member appointed by a council. The Chief Executive is the principal advisor to the council, and employs all other staff on behalf of the council. They are responsible for implementing council decisions, with delegated authority for operational decisions.

Within these parameters, councils have discretion as to how they assign decision-making responsibilities. Most councils have either a number of standing committees or a portfolio system. Standing committees consider particular issues, such as planning, finance or regulation. Some have delegated decision-making authority while others are advisory. A portfolio system involves individual councillors taking a leadership role on specific policy matters (LGNZ, 2017a).

Councils may also have sub-municipal bodies (such as community boards) and/or some services in Council Controlled Organisations (CCOs). A CCO is an entity in which one or more local authorities control 50% or more of the voting rights, or appoint 50% or more of the members of the governing body. A CCO can be a company, trust, partnership, incorporated society, joint venture or other profit-sharing arrangement (Office of the Auditor-General, 2015b, p. 6). A CCO's constitution sets out what things the CCO's directors can decide, and what they must refer back to the local authority. While a CCO makes decisions at arm's length, it effectively makes decisions on behalf of the council and is accountable to the council. The council is, in turn, ultimately accountable to its community for the CCO's activities and outcomes (Office of the Auditor-General, 2015b).

Council staff provide input to decision making, preparing supporting analysis and advice for consideration by councillors (including around options, costs and benefits), and drafting documents such as the LTP, for council approval. The Chief Executive delegates day-to-day decisions, on operational matters such as regulatory compliance and enforcement, and asset management, to staff. These decisions must be consistent with (and give effect to) the strategic direction and policies, and within the budgets, as approved by council.

Statutory principles

Local authorities are required to manage their resources prudently, and to ensure efficient and effective use of resources. This is made clear in section 14(1) of the Local Government Act 2002 (LGA), which emphasises the requirement for efficiency.

In performing its role, a local authority must act in accordance with the following principles:

- a) a local authority should—
 - (i) conduct its business in an open, transparent, and democratically accountable manner; and
 - (ii) give effect to its identified priorities and desired outcomes in an **efficient and effective** manner:

- b) a local authority should make itself aware of, and should have regard to, the views of all of its communities
....
- e) a local authority should actively seek to collaborate and co-operate with other local authorities and bodies to improve the **effectiveness and efficiency** with which it achieves its identified priorities and desired outcomes
....
- g) a local authority should ensure **prudent stewardship** and the **efficient and effective** use of its resources in the interests of its district or region, including by planning effectively for the future management of its assets (emphasis added).

The focus on prudence is further emphasised in the balanced budget requirement of section 100, and the financial prudence regulations (described in Chapter 2).

The LGA sets out specific principles for decision making. Section 77 requires councils to consider “all reasonably practicable options” for achieving its objectives, and “assess the options in terms of their advantages and disadvantages”. Section 79 specifies that the extent of options analysis, including the degree to which costs and benefits are quantified, should be commensurate with the significance of the decision; and councils have discretion in both developing and applying their significance and engagement policy (required to be adopted under section 76AA).

National policy directives and rules

Central government also imposes requirements that affect local government funding and decision making, through national policy directives. For example, financial assistance for roading is available through the National Land Transport Fund, which is administered by the New Zealand Transport Agency. Territorial authorities can seek funding for roading activities in their area, but a suite of planning and procedural requirements must first be met in order to apply. Once funding is approved, councils must then comply with a suite of rules and obligations around the use of this funding.

Other national policy directives include National Policy Statements (NPSs), such as those for Urban Development Capacity and Freshwater Management. NPSs, and the obligations they impose on councils, are explained further in Chapter 4.

Governance arrangements

Section 39 of the LGA sets out the following governance principles.

A local authority must act in accordance with the following principles in relation to its governance:

- a) a local authority should ensure that the role of democratic governance of the community, and the expected conduct of elected members, is clear and understood by elected members and the community; and
- b) a local authority should ensure that the governance structures and processes are effective, open, and transparent; and
- c) a local authority should ensure that, so far as is practicable, responsibility and processes for decision-making in relation to regulatory responsibilities is separated from responsibility and processes for decision-making for non-regulatory responsibilities; and
- d) a local authority should be a good employer; and
- e) a local authority should ensure that the relationship between elected members and management of the local authority is effective and understood.

Point (e) is particularly important, as it emphasises the distinction between the governing body (political decision makers) and the management (executive arm) of the council. The Office of the Auditor-General (OAG) has described this distinction.

Generally, the roles are for:

- the governing body to set direction and policy, make important decisions, report to the public, and oversee the functioning and health of the organisation including its long-term capability and sustainability, and its compliance with the law; and
- management to focus on putting policies and decisions into effect, carrying out the organisation's functions, and providing information and advice to the governing body (Office of the Auditor-General, 2014a, p. 10).

The OAG has also explained the need for this distinction:

Good governance requires a clear distinction between the role of governance and the role of management. Governance involves ensuring that systems and processes are in place that shape, enable, and oversee the management of an organisation. Management is concerned with carrying out the day-to-day operations of the organisation. There is a need to guard against the risk of governors becoming involved in operational decisions because it limits their ability to then hold management to account (Office of the Auditor-General, 2016, p. 11).

The Chief Executive is appointed by the local authority and therefore accountable to elected members. Elected members are "responsible and democratically accountable for the decision making of the local authority" (s 41(3) of the LGA).

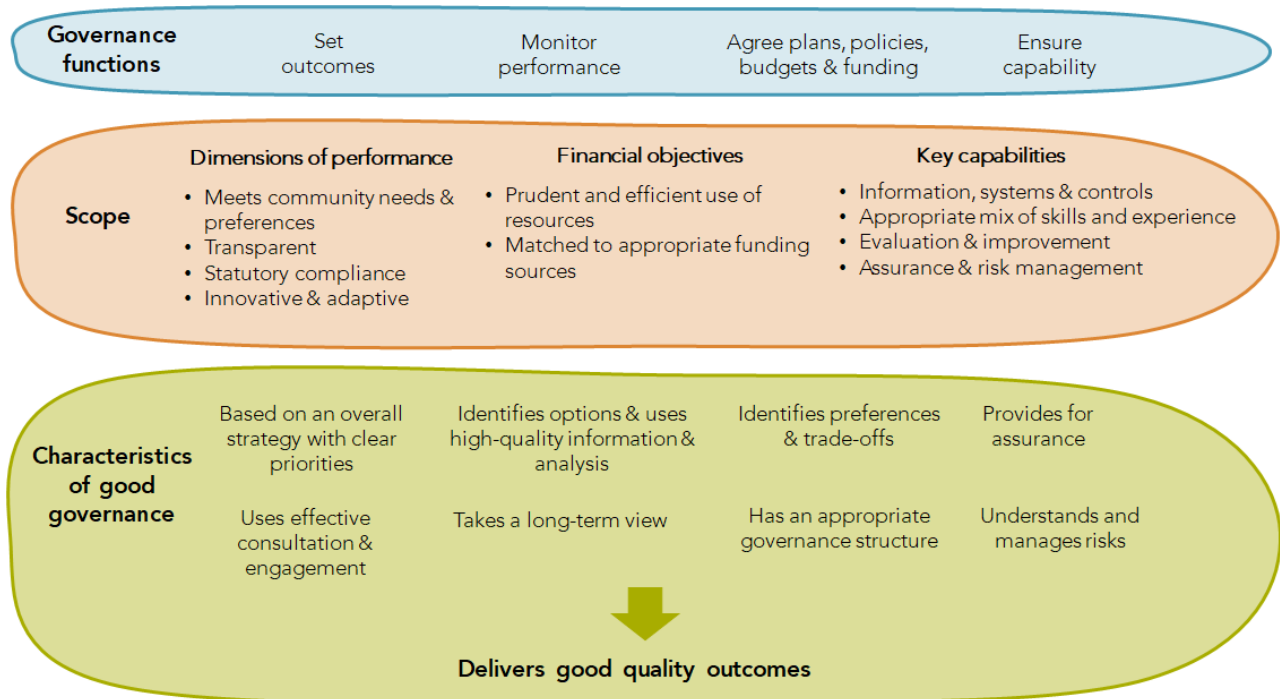
5.3 Decision-making capability

A framework for effective governance

The OAG (2016) has set out eight generic elements essential for effective governance.

1. Set a clear purpose and stay focused on it.
2. Have clear roles and responsibilities that separate governance and management.
3. Lead by setting a constructive tone.
4. Involve the right people.
5. Invest in effective relationships built on trust and respect.
6. Be clear about accountabilities and transparent about performance against them.
7. Manage risks effectively.
8. Ensure that you have good information, systems and controls (Office of the Auditor-General, 2016).

A 2017 report by MartinJenkins presented a governance framework tailored to the area of water asset management (MartinJenkins, 2017). The diagram below is an adapted version of this framework. The Commission has broadened it to encompass the range of council responsibilities and draw on advice from the OAG. A key challenge for councils is ensuring that decisions take a long-term view, in light of the political incentives imposed by the triennial election cycle (which can encourage a short-term focus).

Figure 5.2 Framework for effective governance

Adapted from: MartinJenkins, 2017.

Councils often lack the range of necessary governance skills

MartinJenkins (2017) examined the water asset governance practices across 12 councils (including Auckland and Wellington where the water services are delivered via CCOs³⁵). The authors found that, across the 10 councils where water assets are governed by elected members, councillors typically lacked understanding of what is involved in good governance of water assets. The report notes:

The elected member governance model relies on elected community representatives having the skills required for governing a complex set of assets and engineering systems, and there is no way to provide assurance of that if no external expertise is sought to complement elected member governance. (MartinJenkins, 2017, p. 9)

While it is possible that some elected members on a council will have some of the skills and experience required, it is unlikely in practice that a council will have them to the full range and extent appropriate. They may also not have the right focus given the varied interests and priorities among members. (MartinJenkins, 2017, p. 17)

The report concludes that there is a lack of assurance that governance will be robust, and a number of indications show that governance is not consistently at the appropriate level (p. 15). The report sets out a range of options for improving governance, including:

- stronger governance guidelines and peer support for asset governance;
- incentivising shared service arrangements and the development of external governance groups; and
- establishing CCOs (pp. 15-16).

The authors expressed a preference for incentivisation rather than mandating such arrangements, on the basis that a “coalition of the willing” was most likely to be effective. The Commission agrees that mandating CCO structures (eg, for particular council activities) is unlikely to be the most effective way of improving governance in all situations. The potential for greater use of CCOs in general is discussed further in Box 5.2, below. Chapter 9 discusses the scope for better outcomes and efficiency improvements in the provision of

³⁵ Wellington Water delivers three waters services (drinking water, wastewater and storm water). In Auckland, Watercare delivers two of the waters (drinking water and wastewater), with storm water delivered by Auckland Council.

the three waters (drinking water, wastewater and stormwater), including how to incentivise councils to aggregate suppliers, where it makes economic sense to do so, and place these in CCOs.

The incentives on councils to consider shared services arrangements is explored in Box 5.3. The rest of this section considers councils' governance skills, and ways to build this capability.

Box 5.2 The potential for greater use of CCOs

In its *Using land for housing* inquiry, the Commission explored the use of CCOs for governing transport and water infrastructure. It found the advantages of establishing arm's length entities to carry out public tasks include the ability to specialise and access skills (including commercial know-how), independence from political pressures and greater transparency. Yet establishing such entities also has disadvantages. These can include loss of coordination, lack of responsiveness to the owner, higher overhead costs and lower community accountability (NZPC, 2015, p. 253).

Submitters raised the potential loss of coordination as a key concern. The Commission concluded that the CCO model has significant potential, and that it warranted further consideration by councils, while avoiding potential coordination failures. For example, councils should set specific performance objectives to ensure that CCOs are aligned with council plans. It recommended that councils should consider the CCO model when reviewing their service delivery arrangements (as required under section 17A of the LGA) (NZPC, 2015, p. 255).

However, the inquiry noted that CCOs may not be the optimal approach for every council. In particular, for councils serving small communities, creating multiple small-scale separate entities for different infrastructure services may not be efficient. A cost-benefit analysis is needed before deciding on a CCO approach (NZPC, 2015, p. 255).

Guidance by the OAG outlines the considerations in determining whether a CCO is the best option. That guidance includes whether a CCO would be a cost-effective and sustainable way of achieving the objective the local authority is trying to achieve, and whether the council has the capacity and capability to manage a relationship with a CCO as well as monitor its performance. The guidance notes there is no "perfect model" for the form of a CCO, but that councils need to set clear objectives, appoint the right people to govern, monitor performance and be clear about their appetite for risk. Formal accountability documents negotiated with the local authority include a Statement of Intent and a Constitution for the CCO. These, and non-statutory measures such as a Letter of Expectations, play an important role in ensuring that the decisions made by a CCO are aligned with the council's objectives for the organisation, as well as the council's wider aims (Office of the Auditor-General, 2015b).

CouncilMARK™ assessments explore governance and financial decision making across the gamut of council responsibilities. They have found that councils have a generally sound approach to financial management, noting that some have come from a background of poor practices, and are in the process of building more robust systems and processes. However, they have frequently noted that councillors lack financial literacy. This limits councils' ability to make robust decisions around debt, rates increases, consumption and investment, with some resorting instead to "intuition".

As shown in Chapter 2, a number of councils have low or no debt. The Commission learned through its engagement and submissions, and review of council documents, that many councillors are concerned with the political optics of taking on debt, and focused on keeping debt low. This appears to be driven by a lack of understanding of local government debt and its implications for inter-generational equity, both among elected members and the general public. The implication is that some councils may be deferring necessary investment (eg, in infrastructure renewals or upgrades). This may delay inevitable rates increases. The Property Council New Zealand submitted:

Many enter local politics with the sole agenda of ensuring that rates are kept low and do not increase. This is often their platform and they spend their entire time ensuring that rates do not increase. This has in part led to some of the significant under-investment across New Zealand that we are now facing.

Keeping rates so low has not kept pace with the infrastructure requirements. However, we agree that the true rates' increases required for the proper levels of maintenance and improvements would have likely been unsustainable by most communities....

The use of debt for inter-generational equity is often beyond the understanding of many councillors and takes a significant period to truly understand its complexities. They have often come in hoping to manage the council finances like their own. They want to ensure there is no debt or that it should be reduced. They also wish to ensure that rates are maintained at the lowest levels possible. (Property Council New Zealand, sub. 117, p. 7)

Councillors' knowledge of governance principles was another weakness identified through CouncilMARK™ assessments, as was understanding of risk management. A common recommendation was for councils to have additional, independent and suitably qualified members on their Audit and Risk Committees. Many reports also point to the need for training and capability development in finance and governance.

Some submitters commented that councils tend to be risk averse in their decision making. Environment Canterbury explained the implications of this for innovation in local government.

Local government is often risk averse (not least because of the limitations of its sources of funding and its obligations to consult) and thus innovative change can be slow. Innovation requires adequate funding mechanisms to underwrite and being prepared to fail. The appetite for local government initiative failure is arguably lower than in the private sector (where one is often risking one's own money and earning returns that reflect that risk) and coupled with limited capacity to sustain failure from a financial perspective, means the costs of this can be perceived to be too great. (Environment Canterbury, sub. 111, pp. 8-9)

This mirrors the Commission's inquiry into *Improving state sector productivity*, which found that closed and risk-averse cultures in many core public service agencies are stifling innovation.

Based on this evidence, the Commission has concluded that the elected member governance model does not consistently deliver a mix of councillors that collectively possesses the full range of skills required for effective governance, and many councils lack the necessary expertise for effective decision making.

A lack of skills among elected members can be ameliorated by having a capable Chief Executive who is able to provide sound advice and guidance to council. This means that appointing a well-qualified and suitably experienced Chief Executive is one of the most important decisions a council will make. A combination of a capable Mayor and Chief Executive, who work well together, is a recipe for success. Having neither risks poor decision-making and potentially adverse consequences.

The discussion below explores ways of improving council capability. This is followed by an examination of the checks and balances to help incentivise good decisions and militate against poor decisions.

F5.1

The elected member governance model does not consistently deliver a mix of councillors that collectively possesses the full range of skills required for effective governance, and evidence shows that many councils lack the necessary expertise for effective decision making. A lack of skilled councillors can be ameliorated by having a well-qualified and suitably experienced Chief Executive.

Improving governance and financial capability

It is essential that councillors receive appropriate induction, as well as ongoing training and support. External expertise is also likely to be required. The Commission has considered two main ways to improve councils' financial governance and decision making. These are:

- strengthening councils' understanding and use of assurance and risk management, through the use of Audit and Risk Committees and co-opting of relevant experts; and
- building the governance and financial skills of elected members.

Strengthening the use of Audit and Risk Committees

Audit and Risk Committees play a valuable role in improving the governance, performance and accountability of an organisation. The OAG states that such committees can be

a powerful advisory group to help the entity manage its risk. By applying external, independent perspectives to the risks, issues, and challenges facing an entity, the committee can help the entity to manage the variability of its delivery of its outputs, impacts and outcomes. (Office of the Auditor-General, nd)

No centralised information is held about the number of councils that have some type of assurance committee. The New Zealand Society of Local Government Managers (SOLGM) undertook a survey of all territorial authorities, asking them whether they had an Audit and Risk Committee, and, if so, whether it had independent members and a Chair. Sixty-three councils responded to this survey; information for the remaining 15 councils was sourced from their websites.

Fifty-nine councils have a committee or other governance body explicitly set up to perform audit and risk functions. A further 13 identify audit and risk in the title of a committee with a wider brief (such as “Finance, Audit and Risk”). Six councils have neither, though assurance functions may be undertaken within the remit of another committee, such as a Finance committee. Of the 72 council committees with an explicit audit and risk function, 58 have one or more independent members (8 have two or more), and 30 of these have an independent Chair. The committee of one other council has an independent advisor with no voting rights.

CouncilMARK™ assessments show that many of these committees have been established recently (in the last year or two), while some are longstanding (for example Waimakariri District Council’s Audit and Risk Committee has been operating for 20 years). Some appear to have been established (in one case reinstated) since the council received its CouncilMARK™ assessment.

The Commission considers that an Audit and Risk Committee should be a mandatory requirement for all councils. This is consistent with guidance published by Local Government New Zealand (LGNZ), which states that such committees are a necessary part of ensuring a council has effective controls in place to meet its legislative requirements (including for prudent stewardship) and community expectations (Jones, n.d., p. 1).

Audit and Risk Committees should follow the good practice guidance around scope, membership and practices, including for risk management. This includes having an independent Chair and, ideally, at least one other independent member, to help ensure its membership spans the full range of requisite skills and experience, and acts independently and objectively. The Commission notes a range of existing resources are available to support such committees, including that provided by the OAG, the Institute of Directors, LGNZ and Deloitte (much of which is freely available), and recommends that councils draw on this when developing and running their committees.

Building the governance and financial skills of elected members

A wide range of resources, and training and development opportunities, are already available to local authorities, including through LGNZ and SOLGM, and provided by agencies such as the OAG. Support for governance and financial capability of elected members includes induction and other courses run by Equip (LGNZ’s Centre of Excellence), and governance training by the Institute of Directors (including a module on financial governance, and a short course on Audit and Risk Committees).

Some councils actively support the induction and professional development of their councillors. For example, Hauraki District Council holds a thorough induction programme, including a three-day retreat for its elected members and Executive Leadership Team immediately following local body elections, and ongoing training for elected members (CouncilMARK, 2019a). And New Plymouth District Council provides training and mentoring of councillors, as well as encouraging membership and participation in the Institute of Directors (CouncilMARK, 2019b).

However, a general theme from the CouncilMARK™ assessments, submissions and the Commission’s case studies is that the uptake of training and supports across councils is patchy. This echoes a finding in the report of the Shand Review, which reported that “it appears many elected members do not utilise training opportunities” and recommended a more comprehensive and formal training programme (Shand Report,

2007, pp. 257-258). The Commission was told, via submissions and case studies, that disincentives to taking part in professional development include:

- reluctance to travel (including the opportunity cost of time away);
- dissatisfaction with training received in the past;
- the scrutiny on travel and training expenses; and
- lack of personal awareness of the need for such training.

SOLGM's submission suggested that online courses, or enabling delivery by local authority staff (including an element of "training the trainers"), could help overcome these barriers (SOLGM, sub. 24, p. 96). The Commission agrees that greater use of alternative delivery platforms are worth exploring, including the likes of webinars and online collaboration tools. Other models of capability development could also be considered, such as institutional links between councils ("sister council" arrangements), through which one council mentors and supports another.

There may also be scope to improve the content of existing training. SOLGM submitted that the induction training for new Mayors and Regional Council Chairs run by Equip focuses "largely on the rating system, and that there is little on the basics of financial governance" (SOLGM, sub. 24, p. 95).

The Commission notes the importance of ongoing monitoring and evaluation of training and development to ensure both are fit for purpose and meeting their objectives. In addition to identifying any gaps in the available training, it would be helpful for such evaluation to also canvas the views of councillors who do not take up professional development supports, and to explore the reasons for this (eg, identify any gaps or shortcomings in content or delivery methods).

F5.2

A wide range of training, resources and supports are available for elected members. However, the uptake of these is patchy. Reported barriers include reluctance to travel, public scrutiny of travel and training expenses, dissatisfaction with training provided, and lack of personal awareness of the need for capability development.

R5.1

The Department of Internal Affairs, Local Government New Zealand (LGNZ) and the New Zealand Society of Local Government Managers should work together to improve basic governance, including financial governance, skills and knowledge across elected members. In undertaking this work, they should consider:

- a range of mechanisms, such as formal training; peer support, mentoring (eg, via "sister council" links), and networking; and sharing of resources and best practice; and
- a variety of delivery platforms, including online media and collaboration tools.

LGNZ should ensure that resources and initiatives are well evaluated.

R5.2

Local Government New Zealand should work to achieve greater participation in ongoing professional development by elected members, including new and existing members, to ensure skills and knowledge are built and periodically refreshed.

R5.3

The Local Government Act 2002 should be amended to require all local authorities to have an Audit and Risk Committee (or equivalent assurance committee).

- Audit and Risk Committees should have an independent Chair, and ideally include at least one other external expert, to ensure they span the full range of necessary skills and experience.
- Independent members should be appropriately skilled and qualified.
- Councils should draw on the good practice guidance and resources that are available to develop and run their committees.

Decision support

CouncilMARK™ assessments have found that the quality of information provided to councillors is varied in terms of comprehensiveness, structure and appropriate level of detail. A common theme was the lack of a consistent use of business cases to inform major investment decisions. Where these are done, they typically lack analytical rigour. A bottom-up engineering perspective often dominates, with financial analysis inadequate or absent.

A common recommendation in these assessments was for councils to stress test their underlying assumptions (particularly around population growth) and to undertake sensitivity analysis (eg, high and low scenarios). Projections around economic structure and land-use change are also important.

An important part of assumption testing is interrogation by councillors. The OAG (2016) explained the importance of governance members asking powerful questions.

The governing body's questioning of management needs to be constructive and testing. Effective governors use their combined experience and skills to query information, to probe, and to challenge so they can make informed decisions. Governing bodies need to keep asking questions until they understand what they are being asked to approve. Sometimes decisions need to be deferred until further information is supplied.

It helps if governors ask powerful questions. (Office of the Auditor-General, 2016, p. 15)

To do this, they need to know what questions to ask. As discussed above, failure to ask the right questions was a key problem with the management of the Mangawhai wastewater scheme. A range of guidance and support exists to help councillors. For example, the OAG publishes reports and guidance on governance for public sector entities, including local authorities. It also convenes a Public Sector Audit Committees group.

A strong theme from submissions, and the Commission's engagement and case studies, is that councils of all sizes are struggling to attract and retain the necessary capacity and capability across the range of necessary skills, including the expertise required to provide high-quality advice to decision makers. For example, many councils lack the internal resource and capability to prepare adequate business cases.

The Terms of Reference for this inquiry preclude the Commission from recommending council amalgamations. Yet it is clear that the small size of many councils makes it difficult to recruit and retain the range and quality of skills, experience and expertise required to perform to a suitable standard. With such competition for analytical resources, combined with lack of scale, the Commission recommends greater use of capability and resource sharing (eg, via shared services arrangements, centres of excellence, and collaborative knowledge sharing and problem-solving).

Box 5.3 Incentivising the use of shared services

Shared services arrangements can offer councils access to a wider range of skills and resources, as well as cost savings through economies of scale. Appropriate use of shared services can therefore provide councils with a way of better managing cost pressures, within the existing funding and financing framework.

The LGA provides councils with considerable freedom to participate in shared services arrangements, through a variety of structures including CCOs. CouncilMARK™ assessments show that some councils are making good use of alternative and innovative service delivery models, including regional collaborations and shared services. Regional collaborations include the Bay of Plenty and the Waikato Local Authority Shared Services, which are both incorporated as CCOs.

A primary barrier to the use of shared services is resistance within councils. At the councillor level, this includes the political desire to protect local autonomy. Within the executive, it includes the desire to protect individual careers and staff numbers. Another barrier is friction among councils, due to differing personalities, conditions, characteristics, priorities and objectives (Aulich et al., 2011; Drew, 2011).

Section 17A of the LGA requires councils to regularly review the cost-effectiveness of its service delivery arrangements. These reviews must consider “options for the governance, funding, and delivery of infrastructure, services and regulatory functions”. CouncilMARK™ assessments have found that, while s 17A reviews are being done in many councils, these reviews typically lack good quality analysis. This suggests a lack of genuine and robust consideration of alternative service delivery arrangements.

Experience from overseas and New Zealand has shown that significant adoption of shared services arrangements has been slow in the absence of mandating or strong incentives, such as the threat of forced amalgamation or funding reductions (Aulich et al., 2011; Drew, 2011). Chapter 9 discusses how to incentivise councils to aggregate provision for three waters services, where this makes economic sense, via CCOs. This includes having independent directors, rather than councillors, as CCO board members – both to ensure the necessary skills and to take the political dimension out of decision making.

Shared services arrangements do not necessarily deliver cost savings. Overseas experience has shown “significant success stories” as well as initiatives that have been “spectacularly unsuccessful” (Aulich et al., 2011, p. 21). This is consistent with the evidence presented to the Commission through submissions and case studies, which illustrated mixed experiences with shared services.

Councils should consider the use of alternative delivery arrangements such as shared services to achieve cost savings and access scarce skills. But they should analyse the costs and benefits of options prior to entering such arrangements, and monitor the realisation of these over time.

5.4 Incentives and accountability

Accountability mechanisms

Accountability describes the complementary checks and balances that exist in a system to incentivise the making and implementation of good decisions and to highlight weaknesses or failure.

Local authorities have responsibilities to a range of stakeholders, including local residents and businesses, the courts, central government institutions and ministers, and Parliament. Under the LGA and Resource Management Act 1991 (RMA), councils also have specific responsibilities to local iwi, including obligations to facilitate and support Māori participation in decision making.

The two main types of formal mechanisms available for communities to hold local authorities to account for their expenditure and funding decisions are:

- **Local democracy** – through local body elections, and the consultation requirements set out in the LGA; and
- **Decision review** – judicial review and decision appeal rights.

The LTP and annual plan consultation processes are the main mechanisms for ratepayers to express their views on council proposals for expenditure, and the associated funding and financing, including the implications for rates. Ultimately, councillors are held to account through the local election process.

Underpinning the effectiveness of these formal accountability mechanisms are **transparency** (including reporting) and **effective participation** in democratic processes.

Models of local democracy

Chapter 2 explained that local authorities have a range of powers with varying degrees of autonomy, discretion and input of local preferences and characteristics. The spectrum of local government powers – ranging from devolved to delegated powers – has implications for the nature of democratic processes. Chapter 2 noted that devolved powers, such as those granted under the LGA, entail requirements on local authorities to consult with their communities. The purpose of this consultation is to ascertain local interests and preferences about what activities to undertake and how to fund them. An important part of their decision making is then reconciling the diverse range of preferences that is gleaned through these consultation processes.

The consultation processes required for devolved powers are heavily prescribed in the statutes granting these powers. The consultation processes required under the LGA are discussed below in section 5.6. They require substantial public engagement at various stages of council planning and decision making, including in the preparation of LTPs. The extensive consultation required can be characterised as **participatory democracy**. It exists as an important accountability mechanism to accompany these highly devolved powers, where councils have significant latitude in deciding what they do, at what cost, and who pays.

Delegated powers, on the other hand, involve little discretion on the part of councils. Councils' decision making around delegated functions is therefore likely to be more around service delivery and resourcing options. Decision making at this end of the spectrum is therefore more in the realm of **representative democracy**, in which elected members make decisions on behalf of their local community.

Figure 5.3 illustrates the spectrum of local government powers and the associated implications for the model of democracy.

Figure 5.3 The spectrum of local authorities' powers and the implications for democratic participation



Decision review

The LGA provides the power to object to the assessed amount of a development contribution (s 199C), which must be reviewed by independent commissioners. And under the Rating Valuations Act 1998, ratepayers may object to the assessment of rateable value. The valuation is referred to a registered valuer for review (s 33-34), and the Land Valuation Tribunal hears any objections to the review outcome.

Otherwise, apart from the RMA (which has relatively broad decision review and appeal rights), the options to review council planning and funding decisions are mostly limited to judicial review. The scope for judicial review is limited to matters such as failure to follow statutory procedures and processes, and the reasonableness of decisions – with a very high threshold for what can constitute “unreasonable”. Courts rarely intervene in political decision making, as overriding the decisions of elected representatives would risk undermining local democracy.

An Ombudsman can investigate decisions made by a committee or employee of a local authority, relating to matters of administration (s 13(1) of the Ombudsmen Act 1975). The New Zealand Police is responsible for investigating possible criminal offences and the Serious Fraud Office is responsible for investigating serious or complex fraud.

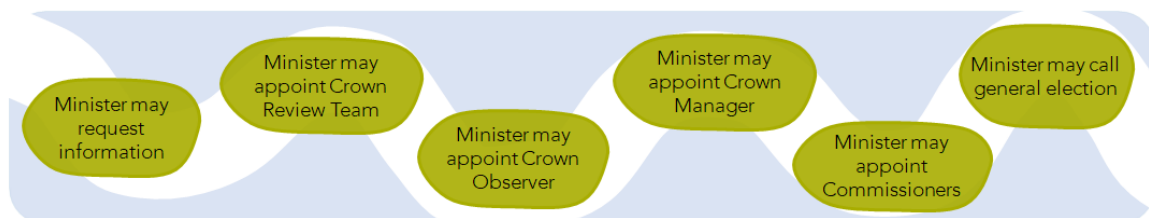
Legislation provides a spectrum of options for central government to intervene when there is a “significant problem” in relation to a local authority. “Problem” is defined broadly in the LGA and includes failure by the local authority to demonstrate prudent management of its finances. “Significant” is defined to mean that the problem will have actual or probable adverse consequences for residents and ratepayers.

The range of ministerial powers to intervene is set out in Part 10 of the LGA, and illustrated in Figure 5.4, below. Section 254(4) of the Act explains that these options are *not* a hierarchy that must be employed sequentially.

The Minister may request information from the local authority on the nature and extent of the problem, and how it is addressing it, so they can assess whether further action is required. The Minister can appoint a Crown Review Team to investigate a problem. That Team can make recommendations for addressing the problem, including whether or not to appoint a Ministerial body (Crown Observer, Crown Manager or Commissioners).

The role of a Crown Observer is to *assist* the local authority in addressing the problem, and monitoring its progress. A Crown Manager *directs* the local authority to act. And Commissioners *perform the functions* of a local authority, with the accompanying powers to set, collect and spend rates and charges.

Figure 5.4 Power of a Minister to act in relation to local authorities



Source: Part 10 of the Local Government Act.

Notes:

1. “General election” is a general election of the local authority.

Examples of how these tools have been used include the following.

- A Commissioner was appointed to Rodney District Council in 2000, to “re-build community trust in local democracy by providing an effective form of decision making and resolving the issues that led to the dysfunction” of the Council (Minister of Local Government (Sandra Lee), 2000).
- Commissioners were appointed to Environment Canterbury in 2010 to address problems with the council’s freshwater management.
- As discussed in Box 5.1, Commissioners were appointed to Kaipara District Council in 2012 following its management of a wastewater reticulation scheme. This was followed by the appointment of a Crown Observer to assist with transition and a Crown Manager to address outstanding issues around rates litigation.

- In 2013, a Crown Manager was appointed to Christchurch City Council to address serious problems with the council's building consents performance, following the withdrawal of its International Accreditation New Zealand and Building Consent Authority accreditation.
- More recently, the Minister of Local Government requested information from Westland District Council, following a March 2019 report by the OAG into its procurement of work to construct a stopbank. The report found "numerous examples of poor decision-making and poor procurement practices", prompting the Department of Internal Affairs (DIA) to recommend Ministerial intervention (Department of Internal Affairs, 2019a; Office of the Auditor-General, 2019a, p. 5).

The LGA gives the Minister significant discretion as to when and how to intervene. There is no check on the exercise of that discretion by, for example, an independent agency. However, the Act requires that the intervention must ensure, as far as is practicable, that a local authority's existing organisational capacity is not diminished. As obliged by the Act, the Minister has published in the *New Zealand Gazette* a list of matters that will be relevant to the use of the intervention powers (Minister of Local Government, 2018). That list identifies guiding principles to which the Minister must have regard when determining what action, if any, to take. The guiding principles are:

- Ministerial action should be informed by the purpose of local government and the role of, and principles relating to, local authorities, as set out in Subparts 1 and 2 of Part 2 of the Act;
- local authorities' accountabilities are to their ratepayers and residents;
- elections are the primary mechanism for communities to express satisfaction or dissatisfaction with elected representatives;
- Ministerial assistance or intervention should have regard to:
 - what the local authority has done, is doing, or plans to do about the problem; and
 - the costs of benefits of assistance or intervention;
 - Ministerial assistance or intervention should be proportionate to:
 - the nature and magnitude of the problem;
 - its potential consequences; and
 - its duration to date and its likely duration if not addressed;
- Ministerial assistance or intervention should endure for only as long as necessary to resolve the problem and provide for a transition back to normal democratic processes; and
- Ministerial decisions regarding assistance or intervention should be transparent.

The list also identifies the matters or circumstances relating to management or governance of local authorities that the Minister considers are likely to detract from the ability of local authorities to give effect to the purpose of local government within their districts or regions. These matters are:

- financial mismanagement; and/or
- a significant failure in service delivery; and/or
- dysfunctional governance, which includes:
 - failure or breakdown of key relationships; and/or
 - serious capability deficiencies of elected members or the chief executive, of the local authority.

Oversight

No single agency is responsible for oversight of all the work of local authorities. This is consistent with the constitutional status of local government. However, a number of agencies have some role in providing scrutiny of local authorities' activities and financial management.

DIA is responsible for administering the legislation governing local authorities, including providing policy advice to the Minister of Local Government and leading central government's relationship with local government.

Some regulatory frameworks specifically provide that a local authority is accountable for its operational performance to the relevant minister or government department, directly or indirectly. For example, under the building regulatory framework, the Minister for Building and Construction has powers of intervention if the Minister believes that the territorial authority is not fulfilling its statutory functions (s 277 of the Building Act 2004). The Chief Executive of the Ministry of Business, Innovation and Employment also has powers to review the performance of local authorities in exercising their statutory functions and powers under the Building Act (s 204 and 276 of the Building Act 2004). However, in the absence of explicit statutory recognition of a line of accountability, a local authority is not accountable to the relevant minister or department for the exercise of its statutory powers.

The OAG is responsible for auditing all local authorities. LTPs must include a report from the Auditor-General, providing an opinion on whether the plan provides a reasonable basis for fulfilling its legislative purpose (as described in s 93(6) of the LGA) and whether the information and assumptions underlying the forecasts are reasonable (s 94 of the LGA). The LTP must also provide an opinion on whether the disclosures made are complete (to fulfil the requirements of the financial prudence regulations). The audit opinion does not guarantee the accuracy of the information, nor does it take a view on the merits of any policy content.

The Auditor-General also has the discretion to carry out other work, including performance audits to consider matters of effectiveness and efficiency, probity and waste; as well as inquiries into any other matter concerning a public agency's use of its resources. Examples of such inquiries include the 2013 inquiry into the Mangawhai wastewater scheme overseen by Kaipara District Council, and (as mentioned above) a 2019 inquiry into the procurement of work by Westland District Council to construct a stopbank.

The OAG has undertaken reviews of councils' LTP consultation documents (discussed below) and of councils' approaches to infrastructure asset management (Office of the Auditor-General, 2014b). The OAG also issues guidance on matters such as governance and reporting.

A number of councils also choose to apply for an independent credit rating or to be a member of the LGFA. Councils that do so are subject to scrutiny as part of their application. For example, the LGFA undertakes a credit analysis of councils who apply to be members. Any local authority that borrows from a bank will also be under scrutiny and will have banking covenants that it will need to comply with.

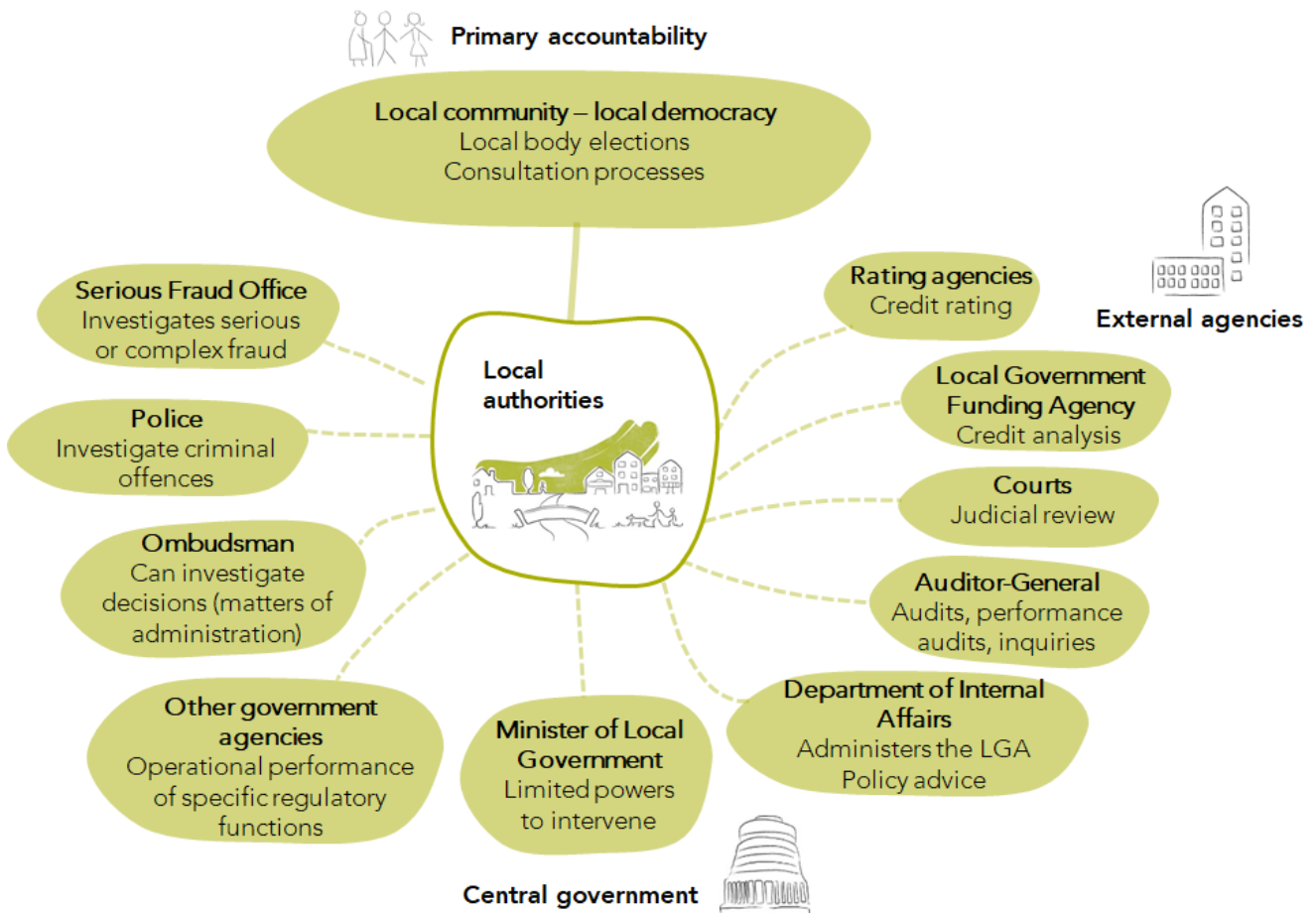
Appeal rights

The appeal rights in relation to councils' rating and long-term planning decisions (primarily judicial review, and investigations by the Ombudsmen) are limited. Meridian's submission made this point, raising the option of creating appeal rights in respect of LTPs (Meridian, sub. 73, p. 7).

Strengthening the appeal rights on decisions relating to councils' long-term planning and rating decisions could help improve the incentives on councils to undertake good quality engagement and be transparent in their decision making. Yet it could also have drawbacks similar to those raised by submitters to the *Housing affordability* inquiry. These include the potential to hold up the adoption of LTPs (and therefore rating) and strengthen the voice of minority interests. And as noted earlier, the courts are generally reluctant to intervene in what are essentially political decisions – it would be a radical move to change this and would substantially undermine local government autonomy. For these reasons, and those outlined above, the Commission favours a transparency-based approach to improving the accountability of council decision making.

Figure 5.5, below, summarises the range of oversight and accountability mechanisms that apply to local authorities.

Figure 5.5 Local government oversight and accountability mechanisms



5.5 Transparency of decision making

The importance of transparency in local government

Transparency is the means by which decision makers can be held to account. In the local government context, transparency includes information made available to the community about how council rates and charges are set, revenues spent, spending decisions made (including trade-offs), and value and outcomes delivered.

Public accountability enables citizens to see how their taxes and rates have been used. It should also provide an insight into what has been achieved by the public sector. Those responsible for governance need to be accountable for the decisions they make and the basis on which they are made. Their decision-making processes need to be legitimate and be seen to be so. (Office of the Auditor-General, 2016, p. 6)

Transparency is particularly important for enabling effective participatory democratic processes, and ensuring local authorities are held accountable for their use of devolved powers, by their communities.

To meet its accountability purpose, information on options for council activities needs to be readily available and easily understood. The importance of transparency in local government is amplified because some of the key accountability mechanisms are weakened by lack of public understanding and participation.

- There is widespread public misunderstanding of how rates are set. Many people assume that increasing property values translate to increased rates. But, as explained in Chapter 2, this is not correct.

- More generally, the public lacks an understanding of local government roles and decision-making processes, and participation in local government consultation processes is low. This is discussed further below.
- Councils are ultimately held to account via the election process. However, as discussed later in this chapter, public participation in local government elections is much lower than for general elections. Participation is also non-representative of the wider community.

The combination of these factors makes it difficult for councils to assess the range of community preferences, and limits the extent to which they can view feedback from formal accountability processes (such as submissions) as an accurate indicator of community sentiment. This suggests the accountability of local government is instead highly reliant on the transparency of its processes, decision making, and performance.

F5.3

The accountability of local government to local communities is highly reliant on the transparency of its processes, decision making, and performance.

Measuring and reporting service delivery and financial performance

Local authorities in New Zealand are not currently subject to mandatory performance benchmarking. However, councils' annual reports must include an audited statement that compares service levels for groups of activities against the associated performance target or targets, explaining the reasons for any variation between the actual and intended level of service. Mandatory performance measures for service delivery from core infrastructure are specified in a rule made under s 261B of the LGA. The performance framework is summarised in the following table by the OAG.

Table 5.1 The Local Government Act's service delivery performance framework requirements

Requirement	Description
Community outcomes	The outcomes the council wants to achieve
Groups of activities	Activities in each group of activities are clearly defined
Rationale for activities	How the groups of activities contribute to wellbeing/outcomes and to the council's strategic objectives and duties
Significant negative effects	Any significant effects that an activity might have on the community
Service levels	Including intended levels of service delivery; any intended changes to the level of service provided in the year before the first year covered by the plan and the reasons for the changes; and the reason for any material change in the cost of a service
Performance measures (for service delivery)	The specific criteria or means used to objectively measure performance (in detail for years 4–10). They include the mandatory performance measures specified under a rule made under section 261B
Targets	The level of performance sought (supported by quality information) on forecast expenditure, assets, resources (capability, capacity) and robust assumptions

Source: Office of the Auditor-General, 2019b, p. 11.

As described in Chapter 2, local authorities are required to report their financial performance against a set of benchmarks specified in the Local Government (Financial Reporting and Prudence) Regulations 2014. In addition, the LGA requires councils to set their own quantified limits on rates increases and borrowing as part of their Financial Strategy.

Voluntary performance assessment and benchmarking

While performance benchmarking is not mandatory, a number of councils participate in voluntary performance assessment or benchmarking initiatives, as part of their efforts to continually improve.

The CouncilMARK™ programme is a voluntary initiative that is part of LGNZ's Local Government Excellence Programme. It is designed to "improve the public's knowledge of the work councils are doing in their communities and to support individual councils to further improve the value they provide to all New Zealanders" (LGNZ, 2018b). The programme is intended to be part of a continuous improvement cycle, rather than a one-off assessment.

The programme includes an independent assessment system that is overseen by an independent assessment board and delivered by a small team of independent assessors. Assessors provide gradings against four priority areas as well as an overall grading, along with commentary and advice for improvement, in a published report. The four areas are:

- excellence in governance, leadership and strategy;
- excellence and transparency in financial decision making;
- excellence in service delivery and asset management; and
- strong engagement with the public and businesses.

The assessments consider the processes and capability a council has in place to deliver customer value, as well as the outcomes being achieved. Aspects assessed include, for example, infrastructure service performance, financial performance, customer satisfaction, and the effectiveness of stakeholder relationships (including with iwi).

The reports from the assessment are published online, providing transparency to the general public about the assessment and its results. However, it is not a benchmarking scheme and it not designed to enable the public to compare council performance across quantitative metrics (eg, of efficiency).

At the time of writing, assessment reports had been published for 26 councils, with a further four due for release. Overall grades to date range from CCC (Wairoa District) to AA (Greater Wellington Regional and Waimakariri District) (the lowest available grade is C and the highest AAA).

Some councils participate in voluntary benchmarking through the Australasian Local Government Performance Excellence Program. This Program is run by SOLGM's sister organisation Local Government Professionals Australia (LG Professionals, NSW). It comprises an annual survey that collects, compares and benchmarks information from over 100 councils across Australia and New Zealand. Unlike CouncilMARK™, reports are confidential to each participating council, though councils may choose to distribute their own report. Aggregated results are available only to SOLGM and LG Professionals, NSW and council survey participants. This initiative therefore does not primarily serve as an accountability mechanism, but rather as an organisational performance measurement and improvement tool.

Another voluntary benchmarking initiative is the National Performance Review (NPR), which has been conducted by Water New Zealand since 2008 (Water New Zealand is the principal industry organisation for water services in New Zealand). The NPR is an annual exercise that collates performance metrics drinking water, wastewater and stormwater service provision. Forty-six councils and two CCOs participated in the 2017-2018 review (Water New Zealand, 2019). In *Using land for housing*, the Commission recognised the NPR as good practice and recommended that LGNZ support it by encouraging all councils to participate and working with councils to improve their data quality (NZPC, 2015, p. 266).

A number of councils also participate in other voluntary initiatives. For example, Waikato Regional Council submitted that in addition to the above two programmes, it undertakes benchmarking with Environment Canterbury and Bay of Plenty Regional Council about trends in human resource and financial metrics, and is a member of the Regional Human Resources Special Interest Group that gathers human resource metrics across regional and unitary authorities (Waikato Regional Council, sub. 125, p. 13).

Problems with the existing performance reporting framework

A number of submitters were of the view that the current accountability framework should be further strengthened, with some calling for greater monitoring and oversight of local authorities.

The current mix of rating and voting systems creates strong incentives for councils to push costs onto sectors that are poorly represented at the ballot box.... Central government has adopted institutions and frameworks which provide appropriate checks and balances against the powers vested in Government.... Local Government has none of these checks and balances. Some ongoing independent monitoring of the sector would provide impetus for performance improvement and enhance local government accountability. (Foodstuffs NZ, sub. 23, p. 4)

In its recent audits of the 2018–2028 LTPs, the OAG raised concerns about the effectiveness of the mandatory financial disclosures. An area of particular difficulty is the expression of the limits to rates increases, which differs across councils and can:

- exclude growth in the rating base;
- exclude both rating units and valuation movement impacts; or
- be restricted to reflecting increases in general rates rather than all rates.

In its submission, Federated Farmers of New Zealand expressed similar concern about the explanation and comparability of rating policies in LTP consultation processes.

As experienced submitters we are finding the coverage [in LTP consultation processes] of rating impacts, rating policy and sources of funding has declined in quality in recent years.... A re-vamp of the consultation provisions in the Local Government Act overall is needed to strengthen accountability and set requirements on transparency as to the allocation of rates to various property owner groups. (Federated Farmers of New Zealand, sub. 75, pp. 21-22)

The variation in approaches restricts both the transparency and comparability of this measure across councils.

The Commission engaged Professor Ian Ball (Public Sector Performance (NZ) Ltd) to provide expert review of and advice on the financial and non-financial performance disclosure requirements on local authorities (Public Sector Performance (NZ) Ltd, 2019). Ball assessed the reporting regime against the statutory principles (as noted in 0) and the following criteria:

- relevance to needs of report users;
- quantity and complexity of reporting;
- consistency of reporting; and
- cost of reporting.

With respect to the first criterion, Ball distinguished between the information needs of two types of users:

- *owners*, who are interested in matters such as financial performance, efficiency of asset use and investment funding requirements; and
- *customers*, who are interested in information on outputs or services delivered, such as quantity, quality, and cost, as well as the outcomes to which the outputs contribute.

He found both gaps and overlaps in the reporting requirements from these two perspectives. For instance, the Funding Impact Statement (FIS) lacks information needed from the ownership perspective, while the service performance benchmarks lack information on the full cost of services.

In relation to the financial disclosure requirements (including the financial prudence benchmarks and the Funding Impact Statement), Ball concluded that these are not fit-for-purpose:

The present financial disclosure regime has certain elements which are excessively detailed, have an inappropriate focus, or are confusing in the context of the wider reporting framework. The FIS component of the disclosure regime suffers from all three of these limitations.

At the whole of council level, it is very difficult to see the presence of both the FIS and the Cash Flow Statement as anything other than highly confusing.

The disclosure regime in relation to groups of activities is somewhat incoherent, not being based on a recognition of the different perspectives of “performance” – “ownership” and “customer” – that would assist in structuring information requirements to better meet user needs. (Public Sector Performance (NZ) Ltd, 2019, p. 21)

In relation to the non-financial benchmarks, he queried the appropriateness of a number of the measures. For instance, some councils’ level of borrowing is so far below the debt servicing benchmark, that reporting on this metric is of limited use to decision makers.

Ball advised that the reporting regime could be significantly improved and simplified by having a single authoritative source for service performance reporting, which includes financial and non-financial information related to groups of activities, and which reflects the two perspectives on performance. He recommended that the local government performance reporting framework be subject to a fundamental, first principles review.

F5.4

The current performance reporting requirements on local authorities, including the financial and non-financial information disclosures, are excessively detailed, inappropriately focused and not fit-for-purpose.

Improving the transparency of council performance

Successive reforms since 2002 have sought to improve transparency and accountability by using more plain English for financial reporting. They have also sought to use standardised financial reporting and non-financial performance measures to improve inter-council comparability.

The OAG recently reiterated its previous caution against further prescription of the disclosure requirements for financial strategies, as this “could lead the sector to address the requirements in a mechanistic way” (Office of the Auditor-General, 2019b, p. 28). Similarly, the Local Government Think Tank³⁶ observed that

[t]he main developments since the Shand report have been additional fine tuning of council reporting and accountability requirements, often increasing the complexity and lack of transparency needed to build trust and understanding. (Local Government Think Tank, sub. 105, p. 3)

Based on this experience, and the advice from Professor Ball, the Commission is of the view that the local government performance reporting framework requires fundamental review, with a mind to significantly simplifying the required disclosures, and improving their overall coherence and fitness-for-purpose.

Ball suggested such a review consider the potential for new forms of external reporting, including integrated reporting, to shape changes in the reporting framework. Integrated reporting is one of the developments taking place internationally in corporate reporting. It emphasises concise communication of the factors contributing to an organisation’s value.

One of the advantages of integrated reporting is that it encourages organisations to use a very open framework to consider how best they can “tell their story”, making for better communication and transparency. (Public Sector Performance (NZ) Ltd, 2019, pp. 37-38)

Such an approach would also avoid the perverse incentives created by the increasingly prescriptive reporting requirements that have been imposed on local government.

Given the growing participation in existing performance review and improvement programmes, the Commission does not see a case for creating new programmes or initiatives. The Commission therefore

³⁶ The Local Government Think Tank is “a small group of councils seeking to understand and apply new approaches to the role and function of local government including innovation in how councils work with their communities” (sub. 105, p. 1).

recommends building on the existing performance review and improvement mechanisms, such as CouncilMARK™ and industry-run benchmarking programmes. With respect to CouncilMARK™, the Commission notes the assessment framework is continuing to evolve. As with any such initiative, it should be subject to ongoing monitoring and evaluation, of both the framework and the independent review processes.

The Commission favours a voluntary approach to increasing participation, to help ensure that councils participate because they see value in performance review, and focus on learning for continuous improvement, rather than taking a compliance-based approach.

F5.5

Successive legislative reforms aimed at increasing the transparency of council performance through prescriptive reporting requirements have been counterproductive. The local government performance reporting framework requires fundamental review, with a mind to significantly simplifying the required disclosures, and improving their overall coherence and fitness-for-purpose.

R5.4

The local government reporting framework (including the financial disclosures, Funding Impact Statement and performance measures for service delivery) should be subject to a fundamental, first principles review. This review would:

- identify financial disclosures of low value to users of financial statements;
- examine the mix of financial and non-financial disclosures, and recommend a revised framework that provides the most efficient, coherent and accessible way of reporting the range of information sought by both types of users;
- consider the potential for new forms of external reporting, including integrated reporting, to shape changes in the reporting framework; and
- be undertaken by a working group comprising the Department of Internal Affairs, the External Reporting Board and representatives of the local government sector and information users. The Office of the Auditor-General would be consulted.

R5.5

The Department of Internal Affairs, Local Government New Zealand and the New Zealand Society of Local Government Managers should continue to work together to promote and encourage councils' participation in existing performance review and improvement initiatives, such as CouncilMARK™ and the Australasian Local Government Performance Excellence Program. The emphasis should be on learning for continuous improvement, rather than a one-off exercise. This work should include efforts to boost public awareness of initiatives such as CouncilMARK™ to increase demand for their use.

5.6 Ascertaining and balancing community preferences

Consultation requirements

Both the RMA and LGA place a heavy weight on public consultation (NZPC, 2015). J. Krupp (2016) underscored the importance of transparency and good quality information in local government consultation processes.

If the level of local government accountability is to be meaningfully improved, communities need to know what options are available to them, the trade-offs associated with each, and the consequences of their choices. (J. Krupp, 2016, p. 45)

The LGA imposes general obligations on councils to consider the views of all their communities, reflecting the RMA's goal of promoting "the accountability of local authorities to their communities" (s 3(c)). Section 78 of the LGA requires councils to consider the views and preferences of people likely to be affected by, or to have an interest in, the decisions being made. Guidance published by the DIA explains that full consultative and analytical processes are only expected for significant decisions. These decisions are defined as being highly important to community wellbeing, or to the people likely to be affected by a decision; or that affect the ability of the council to perform its role and the costs of doing so (Department of Internal Affairs, 2011).

As described in Chapter 2, each council must develop their own **significance and engagement policy**. That policy sets out the council's approach to determining significance and includes a list of assets that it considers is of strategic importance. The purpose of that policy is to provide the community with clarity about when and how they can expect to be engaged in decisions on particular matters. Councils are required to consult on certain matters regardless of their significance policy. These include the LTP and the annual plan, and adopting or amending funding and financial policies.

Consultation on decisions must follow statutory principles (s 82), provide opportunities for Māori to contribute to decision-making processes (s 14) and establish and maintain processes for Māori to contribute to decision making (s 81(1)(a)).

The LGA lays down particular requirements for consultation on LTPs, including the preparation of a public **consultation document**. Section 93B explains the purpose of this document.

The purpose of the consultation document is to provide an effective basis for public participation in local authority decision-making processes relating to the content of a long-term plan by—

- a) providing a fair representation of the matters that are proposed for inclusion in the long-term plan, and presenting these in a way that—
 - i. explains the overall objectives of the proposals, and how rates, debt, and levels of service might be affected; and
 - ii. can be readily understood by interested or affected people; and
- b) identifying and explaining to the people of the district or region, significant and other important issues and choices facing the local authority and district or region, and the consequences of those choices; and
- c) informing discussions between the local authority and its communities about the matters in paragraphs (a) and (b).

Section 93C explains the required content, which includes, for each of the key issues identified:

- the principal options for addressing the issue;
- the financial and non-financial implications of each of these options;
- the local authority's proposal for addressing the issue (ie, preferred option), if they have one; and
- the likely consequences of proceeding with the proposal on rates, debt and level of service.

With respect to the consultation document for the annual plan, this must identify "significant or material differences between the proposed annual plan and the content of the long-term plan" (s 95A).

The requirement to prepare a consultation document before adopting their LTP was introduced in 2014. As LTPs are prepared every three years, consultation documents have so far been prepared in 2015 and 2018. The OAG has published reviews of its observations on the two tranches of consultation documents prepared to date. While both reviews found examples of good practice, they also identified room for improvement. For example, the 2015 review found that many councils missed an opportunity for effective engagement. Shortcomings in consultation documents included poor discussion of the infrastructure and financial strategies, and poorly drafted consultation questions (Office of the Auditor-General, 2015a, p. 4).

Box 5.4 Concerns with LTP consultation processes

The Commission received a number of submissions, particularly from business organisations, that expressed similar concerns with councils' consultation processes, including the presentation of alternative options, the framing of consultation questions and the quality of supporting information.

Millennium & Copthorne Hotels New Zealand Ltd

Our experience across New Zealand also shows that consultation by local authorities has become a simplistic tick box exercise. (sub. 26, p. 7)

The Employers and Manufacturers Association

The surveys and consultation processes are set-up in such a way as to provide a pre-determined outcome.... The LTP process is just a rubber stamp. (sub. 94, p. 5)

BusinessNZ

[I]n most cases the LTP process arrives at a foregone conclusion, there being little time for robust debate either orally or through the formal submission processes. In BusinessNZ's experience, it is very much a rubber stamp process with marginal tweaks here and there and therefore likely to deter groups from spending time and effort making submissions. (sub. 54, p. 19)

Foodstuffs NZ

Public consultation processes do not always present all the relevant information on which to base an objective decision. (sub. 23, p. 4)

Wellington Chamber of Commerce and Business Central

Trade-offs are not clearly articulated, and counterfactual scenarios are not laid out for stakeholders to consider. (sub. 72, p. 7)

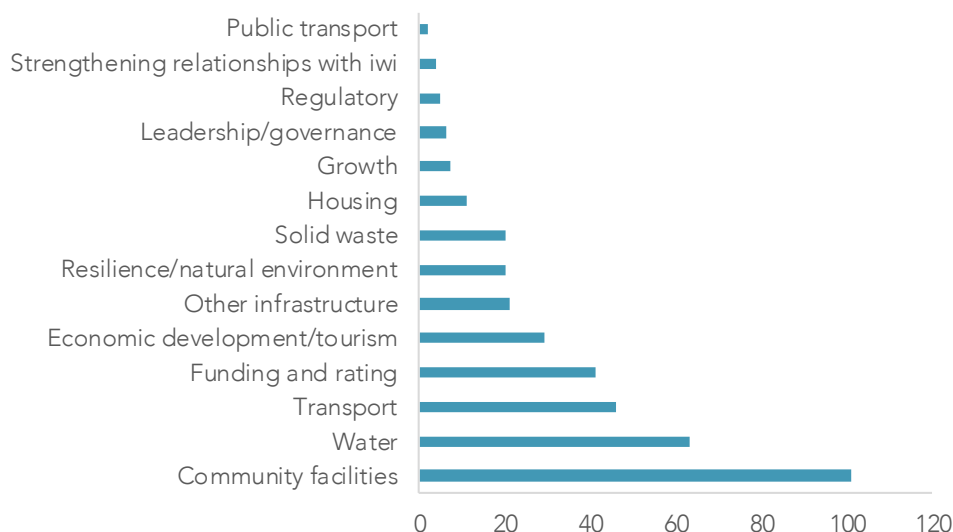
The New Zealand Initiative

Too often Councils do not support resource decisions with competent assessments of their net benefits to affected members of the community.... Nor do current complex consultation processes adequately facilitate community oversight of public expenses. (sub. 96, p. 17)

The OAG's 2018 review reiterated many of the findings of its first review. It also found that information about funding and financial strategies, including the council's approach to debt and the rates implications for an individual ratepayer, was often difficult to understand or even find in the documents (Office of the Auditor-General, 2018b, p. 11).

The OAG's 2018 report reviewed the types of issues presented for consultation. As illustrated in the chart below, the most common issues related to "community facilities", with most of these concerned with proposals to enhance existing amenities. Funding and rating issues mostly related to affordability.

Figure 5.6 Number of issues presented to communities in the 2018–2028 consultation documents, by category



Source: Office of the Auditor-General, 2018b, p. 26.

Māori engagement in the decision making of local authorities

The LGA recognises the Crown's obligations under the Treaty of Waitangi by placing obligations on local authorities to facilitate participation by Māori in the decision-making processes of local authorities. The LGA includes requirements for each council to:

- provide opportunities for Māori to contribute to decision-making processes (s 14);
- establish and maintain processes for Māori to contribute to decision making (s 81(1)(a));
- consider ways in which they can foster the development of Māori capacity to contribute to decision-making processes (s 81(1)(b));
- provide relevant information to Māori (s 81(1)(c));
- set out in their LTP the steps that the local authority intends to take to foster the development of Māori capacity to contribute to decision-making processes (cl 8 of Schedule 10); and
- identify in their annual report the activities undertaken to foster that development (cl 35 of Schedule 10).

The RMA also imposes obligations of consultation with tangata whenua.

Local authorities currently use a range of mechanisms to engage Māori in decision making, including:

- Māori committees and Māori representation on council committees;
- joint management and co-governance arrangements;
- statutory consultation; and
- iwi management plans.

As an alternative to Māori representation on Auckland Council, the Local Government (Auckland Council) Act 2009 established the Independent Māori Statutory Board (IMSB). Section 81 of that Act charges the IMSB with assisting Auckland Council to make decisions, perform functions and exercise power by promoting issues of significance to Māori in Tāmaki Makaurau and ensuring the council complies with statutory provisions referring to the Treaty of Waitangi. The Commission's *Better urban planning* inquiry found the IMSB model was suited to some regions, particularly those with a large number of mana whenua groups (NZPC, 2017).

The Commission's *Towards better local regulation* inquiry found that effectively involving Māori in local decision making requires meshing two systems of governance: the tikanga of local iwi; and local representative democracy. It recommended that local authorities aim to support Māori who are involved in decision making with sufficient inclusion of tikanga Māori in plans, and appropriate legal backstops and safeguards to be able to meaningfully adjudicate whether or not particular proposals align with tikanga Māori (NZPC, 2013).

The *Better urban planning* inquiry found that while many inquiry participants supported the broad framework for Māori engagement and participation in planning, many were disappointed by poor practice and weak commitment to effective engagement in some areas. Many argued for the need for additional measures to address uneven practice and capabilities, including around building the capability of councils and of mana whenua groups. The Commission recommended the development of guidance, including around the possibilities for co-governance and joint management arrangements (NZPC, 2017).

Te Runanga o Ngāi Tahu's submission to this inquiry emphasised the significance of long-term planning between local authorities and iwi and hapū in enabling ahi kā.

Opportunities exist for long term planning between councils and iwi that helps identify Treaty partnership priorities. For example, many traditional areas of Māori settlement have suffered from low levels of council expenditure and support. New papakainga provisions being introduced into local planning instruments are providing for improved ways to utilise Māori lands and enable iwi and hapū to invest in these areas. This enables growth where there has been stagnation and facilitates potential for return of whanau to lands of cultural significance. (Te Runanga o Ngāi Tahu, sub. 53, p. 6)

CouncilMARK™ assessments show councils' relationships with iwi are at various stages of development and maturity. Awareness of Māori priorities/issues has improved, but some councils still have some way to go to establish meaningful engagement. A common finding of the assessments was the need to further strengthen working relationships. While relationships with iwi are often strong at the Mayor and Chief Executive level, assessors found that some councils need to build understanding and knowledge of Māori tikanga at the senior management and staff levels. A number of councils have staff development programmes in place.

A variety of engagement structures are used, including Māori seats, appointment of Māori councillors and a Māori Consultative or Advisory Committee. Wairoa District Council's Māori Standing Committee was reported as having been used as a model for other councils (CouncilMARK, 2017b, p. 13). Also, Ruapehu District Council's longstanding Ruapehu District Māori Council was described as an effective way of providing a way for local iwi to engage in council governance (CouncilMARK, 2017a, p. 14).

Facilitating effective community engagement

Some councils submitted that greater flexibility in statute would help councils achieve meaningful and more representative community participation in long-term planning:

We agree participation in Annual/Long Term planning processes can be low and lack representation from all sectors of society. We consider more flexibility in these processes is required, which would enable councils to design the consultation (and supporting documents) to be fit for local circumstances. (Northland Regional Council, sub. 32, p. 9)

There is no one right answer to how councils can better interact and connect with their communities through the LTP process. The issues facing councils are varied because their geography, infrastructure, natural and physical resources, growth profiles and communities of interest are very different. This diversity of environmental, social, economic and cultural context means councils need legislative flexibility that promotes innovative and creative approaches to achieve meaningful connection and engagement with their communities through the LTP process. (Palmerston North City Council, sub. 124, p. 4)

While the purpose and content of LTP consultation documents is specified in legislation, its form and manner are not. Some councils submitted that the legislation is too restrictive, in that it precludes the full draft LTP being within or attached to the consultation document (s 93C(3)(b)). However, other councils manage this restriction by providing detailed information and supporting documents on their website. For example, in its 2018-2018 LTP consultation document, Buller District Council provided a URL to the full draft LTP on its website (Buller District Council, 2018).

Further, councils face no legislative impediment to undertaking a wide variety of additional engagement techniques and tools, such as pop-up Q&A shops/drop-in sessions, community barbecues, roadshows, hui at local marae, interacting via social media, and other web-based tools (such as apps and surveys), and indeed many do so. As Hurunui District Council submitted:

Engaging with the community is important and in the Hurunui District we have pre engagement sessions with the community ahead of preparing budgets. Whilst this requires a significant increase in preparatory work it results in better engagement through the LTP process (Hurunui District Council, sub. 110, p. 8)

Examples of good practice consultation documents and engagement techniques also exist. The OAG's 2018 review of consultation documents highlighted those from Hauraki, Waimate, Gisborne and Horowhenua District Councils as particularly effective, in terms of their use of plain English and presentation style. They also observed a number of other councils using a variety of approaches (in addition to the formal consultation document), to help make the process more accessible and improve community participation in the LTP process. These included using videos, online rates calculators, informal meetings, and advertising campaigns to raise awareness and encourage feedback.

In addition, pre-engagement processes, including the questions asked, are not constrained, and some councils are undertaking innovative and open-ended engagement before preparing their consultation document.

Horowhenua District Council elected to prepare a 20-year LTP (rather than the required minimum of 10 years) in light of expected strong future growth in the district. The pre-engagement process for this involved seeking community feedback on the desired future focus. Mayor Michael Feyen explained that "[b]efore the plan can be written, we first need to find out from everyone what is important to them, what should be included in the plan, and if our vision is right or needs altering" (Horowhenua District Council, 2017).

Horowhenua District Council's pre-engagement saw 2 680 people engaging in various ways, including sending in postcards, completing surveys, attending meetings, interacting via social media, talking to council staff and elected members, and playing the "LTP Priorities Game" (Horowhenua District Council, 2018).

Gisborne's early engagement campaign – "WTF Tairāwhiti" (What's the Future Tairāwhiti) involved a roadshow of 35 events including hui at a local marae, an interactive website, bilingual radio advertising, digital and newspaper advertising and social media. The campaign won the Excellence in Public Sector Engagement category of the Deloitte IPANZ Public Sector Excellence Awards 2018 and was also a finalist in the 2018 LGNZ EXCELLENCE Award for Community Engagement. LGNZ reported the feedback from the judges for their award.



Judges praised the project for its innovative, edgy engagement, widening the participation from different communities and demographics, including youth and Māori.

Judges said "This project showed innovative, edgy engagement for consultation of the Council's Long Term Plan reaching new community segments. The project widened the participation from different communities and demographics, including youth and Māori, resulting in increased face to face engagement by 700 per cent". (LGNZ, 2018a)

While attracting face-to-face interactions, alternative engagement techniques do not necessarily translate into formal written submissions. For example, while the Tairāwhiti campaign engaged with around 2 800 people, the council received 347 formal submissions on its LTP consultation document, compared to 308 for the previous LTP (an increase of 13%). This is not surprising, given that the campaign aimed to garner feedback from a wider range of people than typically engage in formal consultation processes. In addition, guidance from SOLGM explains that:

[c]hanges to the special consultative procedure have deemphasised the formal reliance on a “written submission and hearing” approach to engagement. In particular, written submissions are no longer the only means for making feedback....

Your local authority cannot rely solely on written comments or submissions. The practical implication is that thought must be given to engagement method or methods, and the practicalities of engaging in those ways, at an early point in the process. (SOLGM, 2016c, pp. 24-25)

It is therefore important that community feedback from all engagement methods is incorporated into the decision-making process (eg, included in the summary material presented to councillors for their LTP deliberations).

Box 5.5 A wide range of community engagement techniques

In addition to traditional consultation methods, local authorities can use a wide range of other techniques to elicit the views of their communities and gain their input into decision making.

- **Polling and surveys** canvas views on issues. The various methods to implement these include postal, online, telephone and face to face (eg, door to door or in public places such as on the street or in shopping malls). Under the Local Electoral Act 2001, a local authority can hold **referenda** (a type of polling) on any of its existing or potential services, policies or proposals (s 9). These referenda can be binding or non-binding.
- **Citizen juries** involve a randomly selected and demographically balanced group of citizens meeting over several days to provide structured deliberation on a specific issue. Members are presented with impartial background information and expert speakers, and participate in facilitated discussions and voting to arrive at recommendations (Jefferson Centre, 2019). Citizen juries can provide insights into the public appetite for various solutions, and can be useful for issues that lack political consensus (Department of Prime Minister and Cabinet, 2017a).
- Other ways of debating specific issues include “town hall” meetings, and physical and online debates and discussion forums (Department of Prime Minister and Cabinet, 2017b).
- **Public participation** involves the public helping to design and develop policies and services. Methods include co-design/human-centred design (where end users are directly involved in the design of services), and participatory budgeting (a process in which citizens are directly involved in deciding how public money should be spent).

Below are examples of how these methods are used in New Zealand.

- **Local referenda** have been held by various New Zealand councils on issues such as water fluoridation and the development of recreational facilities. Whanganui District Council ran yearly referenda from 2005 to 2010 on the council’s proposed spending and its rates implications, to inform the LTP process. LGNZ reports that “[o]ne of the strengths of this scheme was that it confronted the public with the costs of their decisions” (LGNZ and the NZ Initiative, 2019, p. 13).
- **Participatory techniques** have been used in the Christchurch recovery and regeneration programme. From 2011 to 2016 the Christchurch Community Forum provided advice to the Canterbury Earthquake Recovery Authority and the Minister for Canterbury Earthquake recovery. Since then, Regenerate Christchurch has provided advice to Christchurch City Council and the Minister supporting Greater Christchurch Regeneration. It has used methods ranging from traditional consultation techniques, to “design jams” (Department of Prime Minister and Cabinet, 2017b).
- **The Auckland Co-design Lab** is a collaboration between Auckland Council and eight central government agencies. The Lab provides a neutral space for multi-agency teams to collaborate and work alongside citizens to apply co-design principles and a systems lens to explore complex social issues. Projects have included topics such as increasing the number of young people with driver

licences, raising visibility of the factors influencing family violence, and investigating how to accelerate the advancement of Pacific people in the workforce.

The benefits of more participatory methods of community engagement can include more effective design of services (through accessing local resident/user knowledge), more representative engagement and better buy-in to decisions. Participatory budgeting techniques have been shown to also increase citizen understanding of, and confidence and engagement in, local political processes (Williams et al., 2017). However, participatory methods can require significant time input from community participants, which may militate against representative participation.

The Commission's assessment is that local authorities are not unduly constrained by the legislative requirements surrounding LTP consultation documents and engagement processes. The problems that submitters raised are more to do with how councils are implementing the requirements. In relation to this, and to submitters' concerns about the quality of information on the impacts of the identified options, the Commission notes that SOLGM offers guidance on this matter, which includes examples of good practice. This guidance advises councils that if they lack the necessary capabilities in-house, then they may need to bring in external expertise to prepare their consultation document (SOLGM, 2016c).

However, inconsistency is apparent across the LGA in relation to the level and type of analysis councils must undertake, and then present in consultation documents. This is reflected in the varying quality of consultation documents across councils.

- Section 82A(2)(b) requires consultation processes to make publicly available an analysis of the *reasonably practicable* options, while s 93C(2)(b)(i) requires LTP consultation documents to describe the *principal* options.
- Section 82A(2)(a) states that consultation information must include "the proposal and reasons for the proposal", while 93C(2)(b)(ii) requires LTP consultation documents to describe "the local authority's proposal, *if any*, for addressing the issue".
- Section 77 requires local authorities to assess the reasonably practicable options "in terms of their advantages and disadvantages", while s 93C(2)(b)(i) requires LTP consultation documents to describe "the implications (including financial implications)" of each of the principal options, and the "likely consequences of proceeding with the proposal on the local authority's rates, debt, and levels of service". In addition, s 101(3) on funding sources requires consideration of the "*costs and benefits*" of funding each activity distinctly from other activities, and distribution of benefits and the period over which benefits are expected to occur.

The Commission recommends that the terminology and requirements around LTP consultation documents are clarified and made consistent across the LGA. In particular, the Commission recommends that LTP documents are required to include information on the implications for rates and future service levels associated with each of the identified options. The legislation implies that such analysis should be done anyway, but councils vary as to whether they include it in their consultation documents.

The benefits of including this information in consultation documents would be:

- Information on the service levels associated with the alternative options will help the community understand the marginal benefits they offer, beyond the status quo.
- Information on the financial implications of options will help people assess their willingness to pay for different options. The community's demands for activities may change when confronted with the costs of their choices – for example, they may prefer to accept the lower levels of service of a cheaper option. This in turn could assist councils in their prioritisation process.

Information on the financial and service level implications of alternative options needs to be communicated simply and at a high-level, to ensure it is readily understandable by the community. Some councils are already doing this well (see examples in Figure 5.7 and Figure 5.8).

Figure 5.7 Presenting options in the LTP consultation document: Horowhenua District Council

Options

1 Status Quo
This option involves retaining all the Community Halls. The impact on debt would be \$2,296,184 to earthquake strengthen and maintain. The impact on rates would be \$1.07 for every \$10,000 land value.

2 Retain halls available for public hire but not leased properties
This option would see the halls that are available for public hire retained as Council property but not the leased properties (Coronation Hall and Courthouse Museum). The impact on debt would be \$1,407,990 to earthquake strengthen and maintain. The impact on rates would be \$0.56 for every \$10,000 land value.

3 Retain leased properties but not halls available for public hire
This option would see the leased properties retained as Council property but not the halls available for public hire (being the memorial halls in Levin, Foxton and Shannon). The impact on debt would be \$888,194 to earthquake strengthen and maintain. The impact on rates would be \$0.22 for every \$10,000 land value.

4 None of the Community Halls are retained as Council property and are disposed of
This option would see none of the Community Halls retained as Council property and Council start a disposal process. This option would mean \$2,296,184 is not added to our debt and in terms of rates there would be a saving of \$0.88 for every \$10,000 land value.

Preferred Option

In light of the declining use and the significant remediation costs Council's preferred option is **Option 4**.

This will reduce potential debt and rates over the term of the LTP. There is a limited impact on Level of Service as the loss of these halls for hire and lease would be compensated by other available facilities. Our desire would be to see the buildings repurposed as important features of the urban townscape and potentially provide additional commercial space in town centres to assist in meeting projected growth demand. However, if selling them proves unsuccessful in some cases there may be no other option but to demolish derelict buildings.

Note: the cost of maintenance for the Community Halls has been factored into the draft financials, due to the uncertainty around when they might be sold.



Source: Horowhenua District Council, 2018, p. 15.

Figure 5.8 Presenting options in the LTP consultation document: Gisborne District Council

DrainWise

Putanga Wai

The challenge for DrainWise

Illegal spouting connections, surface flooding into gully traps and leaky lateral pipes on residential properties is the main source of water getting into the wastewater network during heavy rain. When that happens, some people can't flush toilets in their homes, sewage can flow back up pipes onto their properties and can spill out of manholes onto roads which is a high risk to public health. So to avoid this, we have to open emergency wastewater valves to release it into our city's waterways.

Homeowners are responsible for making sure rainwater is drained to the right place. For the last three years we've been completing inspections in the worst-affected neighbourhoods to identify where there are issues and working with homeowners to get their drainage fixed. Council has focused largely on improving both its ageing wastewater network and the capacity of its stormwater network, but the reduction in overflows is not at a level we all want.

Requirements in our Freshwater Plan, the impact on water quality in our waterways and the health of people, means tackling the issue to prevent discharges is hugely important to all of us.

Stop raw sewage being released into the rivers
— Toni
56 3

Focus on public, enforce private

We'll replace 54km of old wastewater pipes in the public network, staged over the next 30 years. In the next ten years that'll mean an investment of \$15m for renewals. We'll also increase network performance with \$4m for additional jetting maintenance and surveillance for blockages to help the system to cope with extra water (and help prevent overflows in dry weather too).

As private property flooding is the main reason for sewage overflows, we propose to invest \$6m (40% of the estimated total cost) over ten years to reduce flooding on private properties. This investment would be limited only to properties that are the worst contributors. We'll take on debt to fund the work each year, and increase rates to pay it back over time. And, we'll also look for alternative funding of \$7.8m to do more.

We'll continue inspections in the worst affected areas, assisting homeowners where we can. This option means we'll continue to rely on homeowners to make and pay for repairs. While this option is a lower cost to ratepayers, it means it could take longer to achieve any substantial reductions in overflows.

Our Preferred option
Rates increase **3.0%** over ten years
\$19m for public pipe renewals and maintenance
\$6m for stormwater on private properties funded by debt and rates

Pay for private

This option is to fix and fund more private property issues with money from rates. There are significant environmental, cultural and public health benefits and so the community may want to fund more than the \$6m budgeted, up to a total estimated cost of \$14.6m.

We would still do all of the work to replace and maintain the public pipe network. But we could invest a greater portion of council funds to fix more private property issues. This means we would take on more debt to fund the work each year, and increase rates to pay it back over time.

This option is more expensive for ratepayers, but provides greater confidence in reducing the amount of sewage overflows.

Another option
Rates increase **3.4-4%** over ten years
\$19m over ten years for public pipe renewals and maintenance
\$9.4-\$14.6m for stormwater on private properties funded by debt and rates

Source: Gisborne District Council, 2018, p. 21.

F5.6

While the purpose and content of Long-Term Plan consultation documents are prescribed in legislation, the form and manner of engagement are not. Councils are free to undertake early engagement to ask open-ended questions, and use a wide range of techniques tailored to their local communities. Some are doing this effectively.

R5.6

The legislated information requirements for the consultation processes of local authorities should be amended to:

- make the terminology around the required analysis of alternative options consistent across relevant sections of the Local Government Act 2002;
- clarify that Long-Term Plan (LTP) consultation documents must describe the reasonably practicable alternative options for addressing each identified issue; and
- explicitly require that LTP consultation documents include high-level information on the implications for rates and future service levels associated with each of the identified options.

Balancing preferences and making trade-offs

The public has longstanding concerns about the level of rigour and transparency around how councils consider community views when planning and making decisions. In its 1998 report on public consultation and decision making by local government, the OAG found a common perception that consultation processes are a “sham”. It cited concerns that councils are unwilling to listen, do not provide feedback about final decisions, have vested interests and avoid making decisions. It also reported concerns expressed by both councils and the public that particular interest groups can dominate or capture public consultation processes, leading to a reluctance to voice opinions and the “squeaky wheel syndrome” (The Controller and Auditor-General, 1998, p. 9). This was echoed in the 2007 report of the Shand Review, which found that “those who make submissions or participate in other consultative processes often feel that their views are ignored” as they do not receive meaningful feedback about their input (Shand Report, 2007, p. 247).

The OAG’s 2018 review of consultation documents noted the challenge for councils in giving due consideration to all community feedback, received from different parts of the community and via different approaches. The report states that “[c]ouncils have processes to ensure that elected members are aware of the channels through which feedback has been provided and this information assists elected members to evaluate the relative weight of community opinion” (p. 23). However, it acknowledges concerns raised by Grey Power Auckland that “it can be difficult for the community to understand the value placed on their feedback by the elected members during their deliberations” (p. 23).

Lack of transparency around the weighting of community views was again a common theme in submissions to this inquiry. Hospitality New Zealand submitted:

On occasion our members have felt that genuine consultation was not undertaken but rather council appeared to be paying lip-service to any consultation.

Once the consultation process was completed, in many instances it was not evident from subsequent documents produced by councils as to whether points in the submissions made had even been actually, or fairly, considered.

In our view, the Long-Term planning process needs to be made easy for the average person to understand.... Councils should undertake proper consultation with those who will be affected by their decisions and be transparent in their decision-making. (Hospitality New Zealand, sub. 78, pp. 11-12)

And Grey Power New Zealand Federation Inc. submitted:

The current LTP process is opaque so far as most citizens are concerned. It is also largely a ‘mock consultation’ since the ability of either public submission or councillor opinion to effect more than minor changes is very limited. Attempts to improve citizen engagement by singling out specific items of

expenditure together with costs and rating implications, whilst welcome, often merely diverts attention to projects several orders of magnitude smaller in cost terms than the business as usual expenditure and financing associated with major infrastructure. (Grey Power New Zealand Federation Inc., sub. 113, p. 4)

The Commission also heard concerns from business that submissions to council from peak bodies and umbrella agencies, representing numerous entities and often addressing systemic issues, are given the same weight as submissions from individual ratepayers, about very localised matters (eg, suburban amenities).

These concerns reflect the incentives on councils as a sole supplier of many local services, including essential infrastructure such as the three waters and roading. A key difference between a situation with multiple suppliers and a single supplier is the power of customer choice. In the absence of customer choice, the voice of local residents and businesses is an important feedback mechanism about preferences.

A problem with relying on voice is that it favours groups of well-educated, middle-class people and their interests at the expense of groups of people who are not as well-educated and on lower incomes. In contrast, with choice, all customers are valued³⁷ (competing suppliers want to attract and retain customers). This bias in voice is reflected in the demographics of those who participate in local democratic processes (discussed below).

The following table compares the different impacts that customer choice and customer voice have on supplier incentives. For example, the concerns around the weighting of submissions reflect the discretion of councils in how they aggregate views from across their local communities.

Table 5.2 The disciplining power of choice over voice

Customer choice	Customer voice
Consumers have no reason to misrepresent their views in the hope of private advantage	Consumers may have incentives to misrepresent their views (called “gaming”), and their responses can depend on how survey questions are framed
The intensity of customer views is revealed	Difficult to truthfully measure intensity of customer views
Views are easily aggregated as they show up in the form of “lost business”, and are measured financially	Often multiple options exist for aggregating views that, in turn, produce different headline results
Accounting processes automatically record and report customer choices to decision makers	Bespoke processes are often adopted for recording and reporting feedback; the timing and veracity of reports to decision makers can be manipulated
Significant financial consequences tend to attract the attention of senior managers and boards	The implications for customer value are inferred and not explicit. This makes it easier for boards and senior managers to defer action as the financial position of their firm is not greatly affected
The financial consequences of customer choice often provide a helpful counterfactual for building a business case for taking costly action	Difficult for management to motivate a business case for action. The costs of action are highly visible, but the benefits are largely intangible to the firm

Source: CSA, 2019.

The Commission reviewed a sample of minutes from LTP deliberations and found wide variation in how the nature of debate was formally recorded. The minutes of some councils’ deliberations on their LTP detailed the issues raised (and by whom); others only recorded the final decisions, and sometimes voting patterns. Where the discussion was recorded, this showed that councillors are very conscious of the impact of their spending decisions on total (average) rates increases and of the need to be fiscally prudent. However, there tended to be a focus on incremental spending proposals (typically charismatic, discretionary projects), and a lack of explicit policy rationale around individual projects.

Minutes showed that it was often unclear how feedback from submitters was weighted in the decision making. Discussion of the impact of funding and rating decisions on the various financial prudence

³⁷ Some exceptions do exist, such as customers with bad debts, or who pay late.

benchmarks (against which councils must report) was minimal. Debate mostly focused on the level of rate increases that councillors thought the community would tolerate. This is consistent with the findings of the Shand review, and with feedback received by the Commission through submissions and engagement meetings for this inquiry. It suggests that political economy is a primary discipline on rate-setting.

Councils that successfully balance preferences and achieve community buy-in to decisions and trade-offs do so in a variety of ways. The Commission heard through its engagement meetings and case studies that communities tend to accept targeted rates well because of their transparency (ie, appearing as separate line items in rates invoices). Early engagement, and engagement that links options to their costs and funding implications, can assist community conversations about priorities and trade-offs. In engagement meetings, one council told the Commission that having a clear fiscal envelope helps them say “no” to some discretionary funding proposals. Another council explained that having a clear strategic vision and set of priorities assists them when selecting and staging investments.

CouncilMARK™ reviews have identified some examples of good practice in eliciting and balancing community preferences, including those below.

- Upper Hutt City has invested heavily in understanding the needs and preferences of the community. They received strong community engagement on the LTP and have produced a “realistic” plan.
- In Central Hawke’s Bay the residents’ survey was identified as providing a comprehensive representation of community preferences, which the council has analysed and prioritised.
- Ruapehu District sought community input on major infrastructure issues at an early stage, allowing better informed and prioritised decision making. The review identified that the council communicates well with its community about the trade-offs between expenditure and environmental impact; and around agreeing on service levels.

While there are examples of well documented and transparent decision processes (such as comprehensive minutes that record the detail of debate, as well as feedback to the community), the level of documentation and transparency is not even across the sector.

F5.7

There is scope for greater transparency across councils, in how they have considered and balanced the range of community views in their decision making.

Strategic planning and prioritisation

Concerns about the required content of Long-Term Plans

A primary purpose of the LTP is to provide “integrated decision-making and coordination across the resources of the local authority” (s 93(6)(c) of the LGA). Another purpose is to “describe the community outcomes of the local authority’s district or region” (s 93(6)(b)). The second purpose was merged into the LTP in the 2010 reforms, having previously been a separate required process. Part of the intent of this and other legislative changes was to give LTPs a more strategic focus; to focus on the community outcomes sought by the council, and provide clearer links between these outcomes and how the council proposes to achieve and pay for them (Minister of Local Government (Hon. Rodney Hide), 2010).

In its recent audits of the 2018–2028 LTPs, the OAG raised concerns about the content of LTPs.

LTPs, and the strategies they contain, remain long and complex. It is timely for the Department of Internal Affairs and the local government sector to discuss and review the required content for LTPs to ensure that they remain fit for purpose as planning and accountability documents. (Office of the Auditor-General, 2019b, p. 5)

Particularly, we recommend that any review consider whether all the content required for LTPs is actually needed, such as some of the mandatory disclosures in the financial strategies and the duplication in the Act in the area of assumptions. (p. 9)

The OAG noted that they have “not yet seen a financial strategy that we consider to be an overall good example” (p. 29). They challenged councils to “present a financial strategy in a clear and concise way, in no more than five pages”, in their next LTPs (p. 29).

Level of prescription contributing to the expense of long-term planning

LTPs cover a rolling ten-year period, and are required to be reviewed every three years. A strong theme from submissions, case studies and the Commission’s engagement with the sector was that the LTP review process is time-consuming, expensive and resource-intensive. Yet some councils do consider the process valuable.

The long term plan process provides a thorough decision-making process for councils to work through to identify what cost pressures it is facing, how it will manage them and keep council services affordable.... It enabled our Council to have a clear conversation with our communities about the trade-offs between costs and services and the results of this have been a clear directive to the subsequent annual planning process, as legislation intended. (Hauraki District Council, sub. 43, p. 13)

Overall, the Long Term plan is a good process to address the issues and to have a strategic look at what has happened in the previous three years and the following three years as well as looking forward to the next ten years. (Hurunui District Council, sub. 110, p. 7)

However, many feel it is inefficient and ineffective, with the level of prescription acting to constrain effectiveness.

The long term plan consultation process every three years creates a huge expense in both time and money. Council has to ask the community about every decision we make. Very prescriptive compliance removes our ability to be flexible. (Manawatu District Council, sub. 57, p. 10)

Consultation Documents on Long Term Plans are generally effective, but the legislative constraint around limiting content to consultation matters makes it harder for local authorities to provide a coherent explanation of their plans to their communities.... Flexibility of content to reflect local issues, local language, and local personalities would help engagement. (Selwyn District Council, sub. 84, pp. 2-3)

The LTP process is long and tortuous, and should be reviewed for effectiveness. Small local authorities struggle to resource the LTP and it does take valuable resource away from day to day business. Our LTP costs in the order of 2% of our rates to prepare and have audited, and that is without the internal staff costs. (South Wairarapa District Council, sub. 104, p. 6)

Several councils submitted on the associated cost of audits (of LTP consultation documents, annual reports and LTPs), which they consider to be excessive (Mackenzie District Council, sub. 27; Ashburton District Council, sub. 92; Hurunui District Council, sub. 110; Tauranga City Council, sub. 119; and Ōpōtiki District Council, sub. 126).

Scope to streamline the required content

Successive reforms to the LTP requirements have sought to streamline the planning process. For example, legislative changes in 2010 aimed to simplify LTPs and reduce compliance costs for councils by (among other things):

- focusing long-term planning on major issues;
- enabling councils to decide for themselves how and when to obtain the views of affected persons;
- reducing the need for audited amendments by removing some required information from LTPs;
- removing a number of operational policies from the LTP; and
- merging the community outcomes process into the LTP process, thereby eliminating the costs of a second LTP process (Minister of Local Government (Hon. Rodney Hide), 2010).

The Commission reviewed a sample of LTPs and found them to be very long and detailed, with much duplicate information. The duplication in LTPs is partly a feature of the current legislated requirements, which are disjointed and still require a level of detail that works against the strategic intent on LTPs.

The Commission sees scope to further streamline the required content, to help reduce duplication and therefore the length of LTPs, and encourage a more integrated approach. This could present a problem for councils who choose to publish components of the LTP separately as self-contained documents (such as the Financial Strategy, Infrastructure Strategy and so on). One option is for councils to have greater flexibility in how they present the required content in their LTP.

F5.8

Long-Term Plans (LTPs) are long, complex and contain duplication. This is partly a function of the legislative requirements, which are disjointed and require an unnecessary level of detail. This works against the strategic intent of LTPs.

R5.7

The Local Government Act 2002 should be revised to clarify and streamline the required content of Long-Term Plans so as to reduce duplication, ease the compliance costs on councils, and help make them more accessible documents.

Value in retaining current audit requirements

In relation to audit costs, one of the Cabinet Committee papers for the 2010 LGA reforms noted that:

[t]he only way to significantly lower the cost of auditing LTCCPs [Long-Term Council Community Plan (now called Long-Term Plan)] would be to abandon the audit. However, this year 13 of the 85 draft LTCCPs received a non-standard audit opinion. In addition there were councils that amended their original proposals before publication to achieve an unqualified opinion. Overall, the performance of the sector has not reached a level where the benefits of the audit process are outweighed by the cost. (Minister of Local Government, 2009, p. 10)

The audit results from later years show that the number of non-standard audit reports has declined over time. However, a number of changes have occurred over this period, including changes to the requirements for audited documents and the matters on which the OAG provides opinion. This makes it hard to infer too much from this trend. In addition, a positive final opinion may partly reflect work undertaken by auditors through the process, to help a council meet the requirements.

In an engagement meeting, one council suggested an “audit-lite” track, on which councils meeting certain requirements (such as a history of unqualified audits) would only have to undertake the full audit process every three years. The aim of this track would be to reduce audit costs for those councils who are low risk and performing well, and provide an incentive for others to lift their game. However, an independent expert advised the Commission that reducing the frequency of audits would not necessarily reduce either audit fees or council staff time and resources. The same amount of work would be required to provide the necessary assurances (indeed possibly more, given the time between audits).

The Commission believes that the current prospective audit requirements provide an important discipline on planning and funding processes. However, it is important that audit processes are not taken as a substitute for internal quality assurance, and peer and expert review. These are fundamental aspects of good organisational practice, and particularly important when making significant decisions. SOLGM guidance on long-term planning states:

Quality assurance is a vital part of developing an LTP and needs to be incorporated formally into your process.... Quality assurance is an on-going process, and not just a task that gets done towards the end....

The external audit process can sometimes become a de facto quality assurance process. This will add to the time and cost it takes to produce your LTP and should be avoided. (SOLGM, 2016b, pp. 27-28)

In addition to the scrutiny of individual LTPs and their associated consultation documents, the Commission also sees value in the reports prepared by the OAG that summarise the findings from the OAG’s reviews across all councils. These review reports include recommendations for improving current practice, and examples of good practice. They provide a useful resource for councils themselves, and transparency for wider stakeholders, including ratepayers, and central government.

LGNZ submitted that the audit requirements are an important part of the accountability framework for local government funding and financing, which is “internationally regarded and works well”. Its submission stated:

The audit of annual reports and OAG’s annual report to parliament is not only a mechanism for highlighting individual councils that may be facing financial risks, but highly symbolic. (LGNZ, sub. 112, p. 26)

The Commission is therefore not convinced that a net benefit would result from reducing the current LTP audit requirements. Further, given the findings of the latest round of auditing on consultation documents (as discussed above), there is a risk that relaxing the audit requirements could lead to a decline in the quality of LTPs.

F5.9

The benefits associated with auditing Long-Term Plans and their consultation documents currently exceed the costs. These benefits include assurance and transparency for the general public, as well as recommendations and advice for councils about good practice.

R5.8

The scrutiny on long-term planning provided by the audit requirements should not be considered a substitute for internal quality assurance processes. Councils should have robust quality assurance procedures across their Long-Term Plan process, including the use of expert review where appropriate (such as for significant decisions).

Long-term planning processes are part of continually improving performance

Several submissions suggested that the LTP process be reduced, from every three years to every five or even ten years (Paul Elwell-Sutton, sub. 48; Manawatu District Council, sub. 57; Ruapehu District Council, sub. 85; Southland District Council, sub. 106; and Environment Canterbury, sub. 111). Environment Canterbury submitted:

The investment timescales and rate of change from local government strategy can be very long term, thus re-litigating strategies every 3 years can lead to sub-optimal delivery and short-term focus as benefits of strategies and investment may not be realised for 6, 9 or more years.... The cycle of consultation and planning essentially means up to 40-50% of resource time can be spent in managing this process, rather than delivering on initiatives and outcomes. Further, given such planning cycles are aligned with the political cycle, there is greater opportunity for variability and change in policy direction and investment priority and focus, again diluting and compromising medium to long term investment decisions. (Environment Canterbury, sub. 111, p. 9)

Long-term planning is part of a wider performance management cycle. SOLGM guidance explains that performance management is an ongoing cycle that includes the disclosures in the LTP, as well as monitoring of other performance measures, to maintain and continuously improve performance over time (SOLGM, 2016d). This is consistent with the notion of adaptive management, which supports innovation through ongoing experimentation, learning and adaptation.

The SOLGM guidance cites the performance management framework for state and local government developed by the US National Performance Management Advisory Commission, which describes performance management as a dynamic and continuous process. Planning is an integral part of this framework, alongside budgeting, operational management and evaluation. Planning may be medium or long-term (covering two, three, five or more years), while budgeting is shorter term (yearly or every two years) (National Performance Management Advisory Commission, 2010, p. 21).

While auditing processes provide assurance around probity and legislative compliance, performance management is focused on the internal systems and culture for delivering improved results.

Traditional government processes and practices have too often emphasized a process-compliance definition of results rather than an outcomes-based definition. Compliance with prescribed processes

may help to assure fairness, fiscal probity, or adherence to the law, but often results in less emphasis on achieving actual substantive benefits for the public. Performance management principles and practices work to assure that the organization's strategies, processes, and the culture itself are aligned with the results the organization aims to achieve, while still ensuring fairness, proper stewardship, and adherence to the law. (National Performance Management Advisory Commission, 2010, pp. 8-9)

The timing of the current cycle of LTPs was structured around the three-year election cycle, allowing time for a new council to come up to speed, before they prepare and adopt their LTP. The benefits of reducing the frequency of LTPs could include reduced costs for councils, in terms of consultation processes, LTP development and audit fees. Reducing the frequency could also help depoliticise the LTP process, by de-linking it from the local election cycle. However, drawbacks could include reduced community engagement and loss of in-house expertise in preparing LTPs. Reducing the frequency could also lead to more substantive changes between LTPs, due to changing circumstances. In addition, a frequency other than three-yearly (or six-yearly) would mean that the revised LTP cycle would eventually coincide with an election year.

Some information in LTPs is required to be presented in detail for the first three years; and in summary form for the remaining years of the plan. This timeframe would need amending to align with a revised LTP cycle.

An alternative option would be to give councils flexibility around how frequently they update their LTP; for example, five years could be a minimum, but councils could be free to prepare them more often if they wished. The OAG advised the Commission that this would help spread the auditing burden over time. It would require them to keep track of when individual councils were due, but this would not be problematic to monitor. A risk of providing flexibility would be public confusion as to why councils were consulting on their LTP at different times.

The Commission has considered the equivalent requirements on central government agencies. Of particular relevance are the requirements on investment-intensive state services agencies. These agencies are required to have a Long-Term Investment Plan that covers a period of at least 10 years, and to update these at least once every three years (Department of Prime Minister and Cabinet, 2015).

The Commission's preliminary view is to keep the current requirement to review LTPs every three years, as ongoing planning is a normal part of good business practice and should be considered in the context of broader performance management. However, the Commission is keen to receive feedback on the advantages and disadvantages of reducing the frequency, to maybe every five years.

Q5.1

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?

Prioritisation and strategic alignment

CouncilMARK™ assessments have identified a need for more careful and deliberate prioritisation in resource allocation, in some councils. This can be hindered by a lack of integration between the strategy (embodied in the LTP) and the suite of planning and accountability documents, and with the council's decision making. As discussed above, some councils have achieved good strategic integration; however, CouncilMARK™ assessments have found that others lack a clear strategy and vision to guide policies and actions. In addition, several councils lack a regulatory enforcement strategy to guide the prioritisation and targeting of enforcement resources, meaning compliance monitoring and enforcement occurs without a sound basis for assessing risks, outcomes or alternative approaches. This has implications for both the efficiency and effectiveness of regulatory enforcement activity.

While the legislative requirements do impose parameters around the content of LTPs, they do not preclude the preparation of a strategic framework, and alignment of the LTP and other accountability and planning documents within this. A number of councils have done this successfully.

For example, Palmerston North City Council was the 2018 winner of the LGNZ EXCELLENCE Award for Best Practice in Governance, Leadership and Strategy, for its strategic framework development “Framing the Big Picture”. Councillors led the development of a strategic framework to inform the preparation of the LTP.

Judges said the project “showed a clear vision and strategy operationalised by measurable success indicators and was able to be endorsed by external organisations. It also demonstrates strong links between the Council’s strategy, financial decisions and public engagement...”

Overall the judges felt that the strongest entries demonstrated a strong strategic focus, clear outcomes, measured results, cost benefit analysis and engagement with external organisations – particularly a collaborative approach with stakeholders, and meaningful engagement with iwi and Māori.” (LGNZ, 2018c)

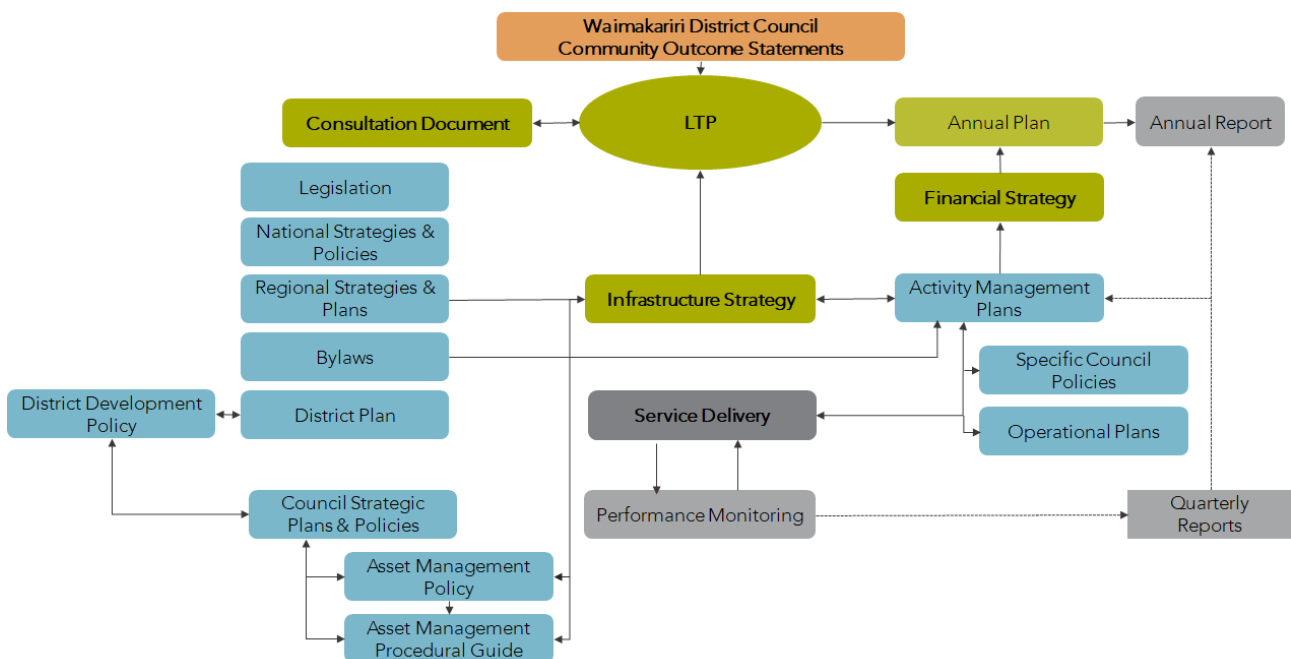
CouncilMARK™ assessors praised Hauraki District Council for its coherent strategic framework, in which its strategies and plans are closely aligned with its vision and goals, and reflected in the Chief Executive’s performance agreement. The review report commented that “[t]he Council formally reviews its vision, goals and other strategic documents every three years, and effectively allocates resources on the basis of urgency and importance, taking care to balance effective governance, management and administration/compliance” (CouncilMARK, 2019a, p. 6).

Also, Waimakariri District Council has illustrated how its infrastructure strategy aligns with its suite of planning and accountability documents and its strategic vision (“community outcome statements”) (see Figure 5.9). This is cited in SOLGM’s guidance on long-term planning, as an example of a “wiring diagram” (SOLGM, 2016a, p. 26).

As a matter of best practice, all local authorities should have a strategic framework that:

- sets out their vision and goals;
- provides clear links between the strategic goals and desired community outcomes, the planned activities to deliver the goals and outcomes, and measures of results against these outcomes;
- aligns all supporting strategies, plans and policies within the strategic framework; and
- is actively used to guide prioritisation and decision making.

Figure 5.9 Links between strategies and plans



Reproduced from: (Waimakariri District Council, 2018, p. 8).

F5.10

A clear strategic framework is an important mechanism for guiding councils' prioritisation and resource-allocation decisions. While the current legislative requirements impose parameters around the content of Long-Term Plans (LTPs), they do not preclude the preparation of a strategic framework, and alignment of the LTPs and other accountability and planning documents within this. A number of councils have done this successfully; others lack a coherent framework to guide their strategic planning.

Incentives to manage cost pressures through productivity improvements

Chapter 3 explored trends and drivers in the prices faced by local government. It explained that councils commonly set rates by adjusting the previous year's rates by the forecast Local Government Cost Index, with additional adjustments for anticipated population growth.

This raises the question as to whether it is appropriate for councils to include anticipated price inflation in their budgeting process. Central government does not include provision for inflation in its budgeting. In fact, the government's fiscal strategy has involved fixed nominal baselines since 2003. This means that government agencies do not receive an automatic increase each year in their baseline funding to account for inflation (exceptions do exist – such as funding for services that are price-indexed and demand-driven, such as welfare payments). The annual budget allocation for new spending is tightly focused on the government's key priorities. Agencies are expected to manage within their baselines through reprioritisation and productivity improvements (The Treasury, 2018b).

A similar discipline could be applied to local authorities, to encourage a focus on productivity improvements in the first instance (rather than rates increases), to meet cost and price pressures. The Commission is interested in views as to whether and how such a discipline could be implemented, and the benefits and drawbacks of doing so.

Q5.2

Is it appropriate for local authorities to include an adjustment for anticipated price inflation when they set rates each 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?

The importance of good asset management practices

Managing, maintaining and investing in infrastructure assets dominates local government's activities and expenditure. Effective asset management is therefore critical to ensuring efficient use of funds, making good decisions about how services are delivered and any trade-offs to be made, and achieving good quality outcomes.

The National Infrastructure Unit (NIU) identified three key areas for improvement in asset management:

- **appropriate institutional incentives** – in particular, alignment between strategic asset management functions and financial management functions;
- **effective use of asset management capability** (given the limited pool of specialist expertise in New Zealand); and
- **collecting the right kind of data using shared data standards**, so that infrastructure condition and performance can be meaningfully compared and benchmarked across infrastructure providers (National Infrastructure Unit, 2015, p. 48).

The OAG has emphasised the need for alignment between asset and financial management, and the importance of good quality data:

Overall, 30-year [infrastructure] strategies will be a useful planning tool for local authorities only if they are supported by robust information about asset performance.... Local authorities will need to match their revenue and financing policies, and their choice of funding tools, to their asset management and service intentions. Linking the infrastructure policy to the financial strategy is therefore critical (Office of the Auditor-General, 2014b, p. 9).

To help ensure the collection of consistent and comparable data across infrastructure providers, Land Information New Zealand (LINZ) is leading work on developing metadata standards for three asset types (roads, water infrastructure and built assets). The standards for water infrastructure were released in August 2017.³⁸

Maintaining drinking water, wastewater and stormwater assets comprises a significant proportion of local government expenditure. However, there is a lack of comprehensive data on the performance and condition of councils' water assets and services, and LGNZ is leading a project to address this lack of information. The first part of this project was a National Information Survey, which was conducted in 2014 and gathered data from 70 councils. It found that "large sections of the three waters networks remain ungraded... [and] some councils have entire networks that have not been graded by their condition" (LGNZ, 2014, p. 14). Future work aims to develop a common set of key performance indicators for water service providers and benchmark relative performance levels.

Regional collaboration is important for making more effective use of limited asset management expertise. Ways to incentivise greater collaboration between councils in the management of water infrastructure are explored in Chapter 9.

The management and delivery of capital projects was a common area for development identified in CouncilMARK™ assessments, with several councils experiencing low completion rates and therefore underspends. Issues identified in assessment reports include planning and prioritisation, project management, reporting and governance. This suggests that better project management and governance are important aspects of improving the efficiency of asset management, and ensuring investment decisions are aligned with strategic priorities.

Another mechanism for assisting better asset management is the capital charge. The capital charge is a way of recognising the opportunity cost of investments in assets. In central government, the charge is levied on the net worth (assets minus liabilities) of departments and some Crown entities. It has a dual purpose:

- it means the cost of services generated through the use of assets fully reflects the real resource cost of their production; and
- it creates an incentive to asset managers to optimise the use of assets in the production of services (Public Sector Performance (NZ) Ltd, 2019, p. 29).

In his advice on local government financial management and accounting issues, Professor Ian Ball concluded that:

The absence of a capital charge in local government results in an understatement of the cost of services. Even where interest-bearing internal loans are used to finance activities, the full cost of services is not normally reported.

In addition to understating the cost of services, the absence of a cost being attributed to the use of capital weakens the incentives for good asset management. (Public Sector Performance (NZ) Ltd, 2019, p. 30).

Ball recommended that DIA establish a working group to consider the means by which some form of capital charge be introduced into the local government sector. The Commission is keen to hear views on the merits of a capital charge for local authorities.

³⁸ The standards are available at: <https://standards.meta-connect.com/>.

Q5.3

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?

The value of a spatial approach to long-term planning

“Spatial planning” can be defined in various ways. In its *Better urban planning* inquiry, the Commission saw value in regional-level spatial plans. These would be high-level, strategic and direction-setting documents that lay out a vision for development over time. They would:

- be led by regional councils yet owned by all councils in a region;
- focus on issues closely related to land use; in particular the corridors for water and transport infrastructure, land for community facilities (eg, schools, hospitals, recreational spaces, and conservation areas), protection of high-value ecological and cultural sites, and natural hazard management;
- enable all key stakeholders to participate and share information, including iwi, central agencies, developers and infrastructure providers and operators; and
- be the platform for a suite of plans in a region covering both land use regulation (district and unitary plans) and operational and budgeting plans (eg, council long-term, annual and infrastructure plans) (NZPC, 2017, p. 294).

A number of councils have used the LGA to establish spatial or growth management plans, which act as linchpins to guide RMA and LGA decisions as well as Land Transport Management Act decisions. Councils use the LGA plans to set the strategic goals for their cities, and then use the RMA to set regulatory controls aimed at achieving these goals.

In its review of 2018–2028 LTPs, the OAG examined the approach of two councils to develop their LTPs. The OAG reported that both councils found benefit in a spatial planning approach.

The [Palmerston North] City Council felt that a spatial planning approach was an easy way to engage with the community and would allow it to reach a broader range of people. (Office of the Auditor-General, 2019b, p. 46)

A key comment made by [Gisborne] District Council staff we spoke to was the need for an integrated planning approach across the Resource Management Act 1991, the Local Government Act 2002, and the Land Transport Management Act, which could result in a spatial plan. They described spatial planning as the “why” for the approaches included in the infrastructure and financial strategies, and noted that this is particularly the case for regional councils. (Office of the Auditor-General, 2019b, p. 48)

Waipa District Council’s submission echoed this finding.

We see a future planning system centered on integrated spatial planning with input from all layers of government. This would provide the mechanisms to generate better outcomes, including better use of public funds. (Waipa District Council, sub. 88, p. 1)

In *Better urban planning*, the Commission recommended that spatial plans or strategies become a standard and mandatory part of the planning hierarchy (NZPC, 2017). To the extent that councils engage in spatial planning as recommended by the Commission, they will have a stronger basis for making and prioritising investment decisions.

F5.11

Undertaking long-term planning within a spatial planning approach promotes a more coordinated and integrated approach to strategic planning as well as investment decision making.

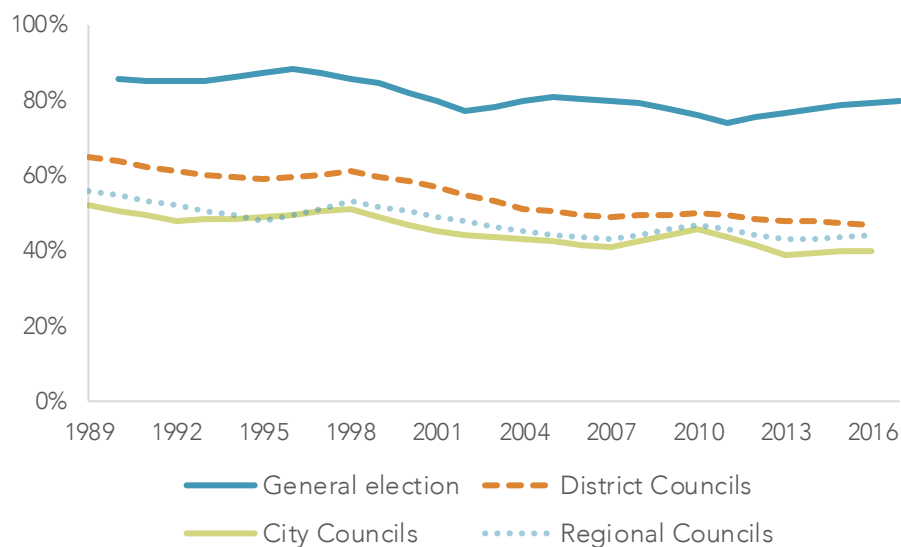
5.7 Participation in local democratic processes

Local authorities are independent statutory bodies governed by directly elected members. As such, they are primarily accountable to the electorate through the democratic process. (Office of the Auditor-General, 2013a, p. 219)

One main way that residential ratepayers can hold councils to account for the expenditure and funding decisions is through local body elections. However, voter turnout in local body elections is notoriously low, and has been steadily declining since the late 1980s.

Voter turnout for the general Parliamentary election has also been declining overall (though the last election saw an increase). However, as shown in the chart below, the rate is substantially higher than for local body elections (Figure 5.10). The total voter turnout for the most recent³⁹ general election was 79%, compared to 47% for district councils, 44% for regional councils and 40% for city councils.⁴⁰

Figure 5.10 Voter turnout in general and local authority elections



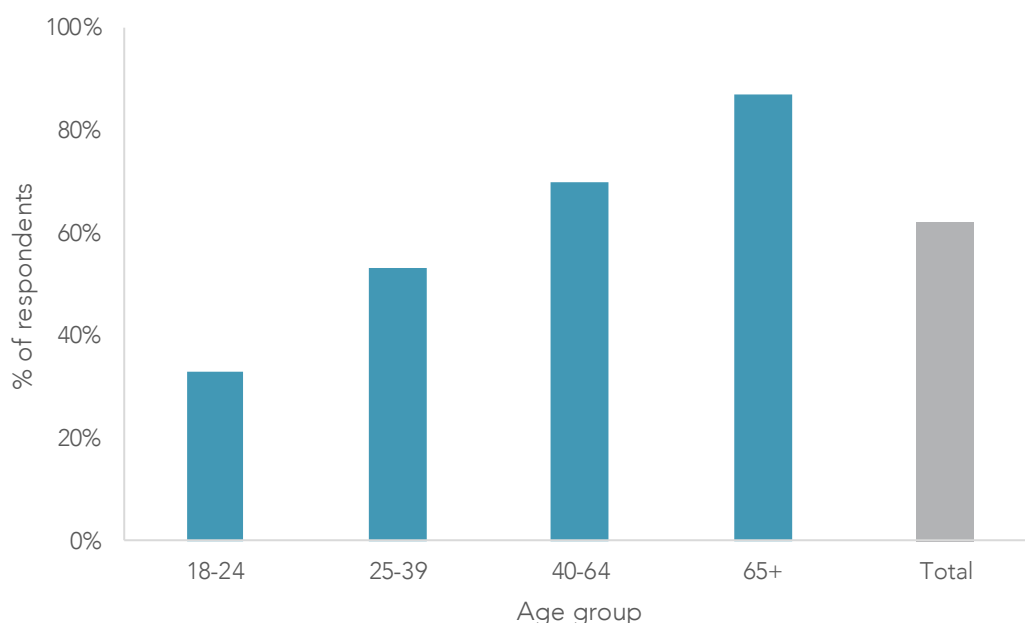
Source: Department of Internal Affairs, 2016a; Electoral Commission, 2018.

Voter turnout in New Zealand tends to be higher in local authorities with smaller populations (LGNZ, n.d.). For example, in the 2016 local elections, the voter turnout in Central Otago District (with a resident population of under 20 000) was 68.4% compared to 38.4% in Auckland (with a population of over 1.6 million) (Department of Internal Affairs, 2016a).

Voting behaviour is correlated with a number of factors, including age, level of education, property ownership, ethnicity and length of time lived at the same property (LGNZ, n.d.; Zhang, 2015). For example, older people are much more likely to both vote and be homeowners (and therefore ratepayers). The chart below has results from a survey of Auckland residents following the 2010 local elections. Those results show that people aged 65 and older were more than two and a half times more likely to have voted than people aged 18 to 24 (Figure 5.11).

³⁹ The percentages for the most recent voter turnout are 2017 for the general election and 2016 for local authority elections.

⁴⁰ The higher turnout in the 2010 elections was partly due to increased local voting for the first Auckland “super city” election and increased voting in Christchurch following the 2010 Canterbury earthquake (Department of Internal Affairs, 2016a).

Figure 5.11 Incidence of voting by age, 2010 Auckland local elections

Source: Stones-Havas, 2015.

A range of theories explain why people do not vote. Analysis for Auckland Council found that reasons for not voting included lack of political knowledge and civic literacy, political apathy and administrative barriers to voting (Zhang, 2015).

The low participation in local elections is mirrored in the low rates of community engagement in council engagement processes, such as submissions on annual plans and LTPs. For example, Rangitikei District Council submitted that community participation in their latest LTP was 0.82% (Rangitikei District Council, sub. 115, p. 4). And as with voter turnout, feedback on LTPs tends to come from a non-representative cross-section of the community. For example, an analysis of feedback on Auckland Council's 2015 LTP, Nunns (2015) showed that males and older people (particularly those aged 55 and above) were over-represented in submitters; younger people (particularly those aged under 25), Māori, Pasifika and Asian people were all significantly underrepresented (Nunns, 2015).

In its 2018 review of consultation documents, the OAG noted that Auckland Council had created partnerships with community groups to target diverse audiences, and that "this resulted in consultation responses coming from a more representative profile of Aucklanders" (Office of the Auditor-General, 2018b, p. 20). However, the overall low rates of engagement across the sector, combined with non-representative participation, mean that using community feedback on LTPs as a barometer of community sentiment and buy-in is generally problematic.

Civic understanding

LGNZ's New Zealand Local Government Survey has found that people's understanding of local government's roles varies widely across its services and functions. While most people are aware that councils provide infrastructure and core services such as solid waste management (average of 80% awareness), the awareness for functions such as natural resource and hazard management (average of 57%) and economic development (average of 54%) is lower (LGNZ, 2017c).

Understanding of council decision-making processes is also low. The Quality of Life Survey measures the perceptions of New Zealanders across a suite of domains, including council processes. The 2016 survey found that 32% of people agreed that they understood how their council makes decisions (Colmar Brunton, 2016).

Perceptions of local government

LGNZ's New Zealand Local Government survey asks a sample of people from the general public and business about their perceptions of local government. The survey produces a number of measures, including

a reputation index, which is a weighted summary of people's ratings across the dimensions of leadership, service performance and communication. The 2018 survey found that the overall reputation of local government was rated just 28 out of 100 (LGNZ, 2017c). This result was consistent with the 2014 score, and was the impetus for the development of the CouncilMARK™ programme (discussed earlier).

The 2018 survey found that among the general public, net satisfaction with local government was 17% (up from 12% in 2014). Business satisfaction was net -6% (a slight improvement on -7% in 2014).⁴¹

Respondents also rated local government performance across a suite of areas. Decision making was rated relatively high by members of the public. Good spending decisions and value for money were among the lowest ratings by both the public and business (see Table 5.3).

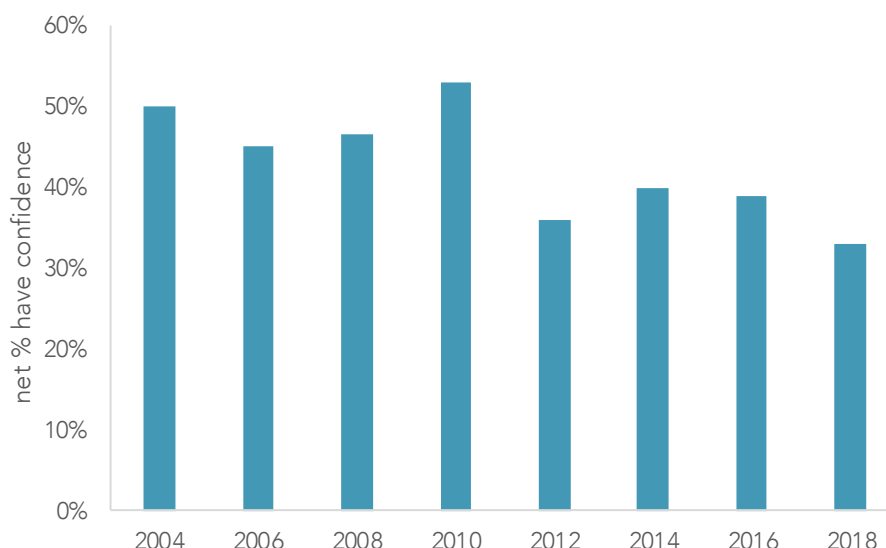
Table 5.3 Perceived areas of stronger and weaker local government performance

	Areas of stronger performance	Areas of weaker performance
Public	<ol style="list-style-type: none"> 1. Keeping people informed 2. Providing opportunities for people to have their say 3. Making the right decisions 4. Leading on matters of importance to communities 5. Skills/expertise to manage community affairs 	<ol style="list-style-type: none"> 1. Providing good value for rates dollars spent 2. Trust to make good spending decisions 3. Managing finances well 4. Councillors displaying sound and effective leadership 5. Listening to the needs of the people
Business	<ol style="list-style-type: none"> 1. Solid waste 2. Maintaining town centres 3. Attracting and planning festivals and events 4. Water and sanitation 5. Promoting the local area to visitors 	<ol style="list-style-type: none"> 1. Improving the building consent process 2. Improving the resource consent process 3. Making good spending decisions 4. Procurement policies with a weighting for local business 5. Providing good value for rates dollars spent

Source: LGNZ, 2017c, p. 14.

The Quality of Life survey asks people whether they are confident that their local council makes decisions in the best interests of their city or area. In 2018, 33% of respondents either agreed or strongly agreed that they did. As the cities included in the sample differ between surveys, it is not possible to directly compare results over time. Mindful of this limitation, scores for this question have generally reduced over time (Figure 5.12).

⁴¹ Net satisfaction is the proportion of those who are satisfied minus the proportion of those who are dissatisfied.

Figure 5.12 Confidence in council decision making

Source: Quality of Life Survey.

Notes:

1. Results not directly comparable across time. Survey in 2004, 2005 and 2006 included 12 cities; in 2010 and 2016 included 7 cities; and in 2012 and 2014 included 6 cities. The 2018 survey included 8 cities but results are shown for 6 cities to assist comparability.

Scope to improve civic understanding and participation

The effectiveness of procedures in the decision making of local government hinges on the public understanding and taking part in local democratic processes, including engaging in councils' LTP and other consultation processes. Previous reviews, including the Shand review, pointed to the need for greater civic education. SOLGM's submission to this inquiry reinforced this conclusion, advocating for work by DIA, SOLGM and LGNZ to "enhance the breadth and availability of the public resources on local government" (SOLGM, sub. 24, p. 11).

The Commission notes the campaigns by LGNZ and SOLGM in 2016 and now in 2019 to encourage greater participation in local body elections. In addition, changes to the LGA in 2019 included an amendment to the role of council Chief Executives to include facilitating and fostering representative and substantive elector participation in elections and polls held under the Local Electoral Act 2001 (s 42(2)(da)). However, the accompanying Regulatory Impact Statement included no analysis of the costs or benefits of this proposal, as the DIA considered its impact to be too minor (Department of Internal Affairs, 2016b). The Commission posits that the impact will depend on how councils choose to give effect to this requirement. Given the flexibility and discretion entailed, and the variety of local circumstances, this will vary across the sector.

The Commission sees scope for further, concerted efforts to lift public understanding of the role and procedures of local government and how to engage in its decision-making processes (not just the local body elections).

F5.12

The effectiveness of the decision-making procedures by local government depends on the public understanding, and taking part in, local democratic processes – both of which are notoriously deficient. This weakens the incentives that those processes provide for local governments to be accountable for the quality of their decisions.

5.8 Conclusions

Governance and financial capability across the local government sector is patchy, with a number of councils lacking the necessary systems and skill-mix for effective decision making. However, some councils, including those with challenging external circumstances, are managing their decision making better than others, and making good use of the flexibility provided in the LGA. Based on evidence from case studies, submissions,

the CouncilMARK™ assessments and other literature, the Commission identified the following success factors that support good decision making.

- **Effective working relationships**, based on high trust and good understanding of the respective roles of management and councillors, particularly between councillors, and between the Mayor/Chair and Chief Executive, which then filters down through the organisation.
- **Strong and capable leadership**, encompassing the requisite skill mix and experience across the Mayor/Chair, Chief Executive and senior management. This means that appointing a Chief Executive with the right skills and experience is one of the most crucial decisions a council will make. Experience in the role is important given the complexity of council business, though this can also entail risks around loss of key people (and therefore institutional memory) and risk of resistance to change.
- **Good information to support decision makers**, including high-quality, comprehensive and transparent financial and risk reporting to councillors, and the use of business cases to inform investment decisions.
- **Use of independent, external governance expertise** to strengthen internal capability and support robust governance and decision making (such as asking the right questions). The inclusion of external experts on Audit and Risk Committees appears to be particularly beneficial.
- **Effective community engagement** that generates productive conversation and buy-in around service levels, willingness to pay and trade-offs.

The effectiveness of decision making by local government largely depends on the public understanding, and taking part in, local democratic processes – both of which are notoriously low. This weakens the mechanisms by which councils understand and match community preferences.

The Commission has identified some legislative impediments to effective long-term strategic planning. While the decision-making principles in the LGA are clear, the requirements around LTPs are overly detailed and prescriptive. This is resulting in plans that are long, complex and repetitious, and not meeting their strategic objectives.

This chapter makes a number of recommendations for improving the disciplines and incentives on councils to make effective decisions. The combined benefits of these initiatives would be:

- lower compliance costs for councils, through reducing the level of prescription, and potentially also the frequency, of LTPs;
- lowering the risk and costs of poor decisions, by improving the decision-making capability of elected members and strengthening the monitoring and management of costs and emergent risks through new requirements for Audit and Risk Committees;
- encouraging better community participation and engagement in local democratic processes;
- more effective community engagement and consultation by councils, leading to better understanding of community preferences;
- improved transparency of council decision making, supporting better decision making and greater community buy-in to decisions and trade-offs; and
- relief of some of the political pressure on decision makers, through greater community understanding and acceptance of councils' investment and funding decisions.

Improvements in governance and financial capability will enable councils to make better use of their existing resources, within the current funding and financing framework. Also, better engagement will assist councils to ascertain and meet community preferences. Improvements to the knowledge and incentives of decision makers are also important enablers of ongoing innovation and adaptation and, as such, enablers of productivity growth and better outcomes from local government.

6 Future funding and financing arrangements

Key points

- Local government's role is to enhance community wellbeing through regulating land use, choosing and funding a set of local amenities and investing in essential infrastructure for transport, water, wastewater and stormwater.
- Central government takes the lead on macroeconomic stabilisation and redistribution across citizens including by providing a social safety net for the least well off. Local government may still consider ability to pay, but it should use the benefit principle as its main guide to allocate the costs of its services in a fair and efficient manner.
- The current main funding tools of local government measure up well against the principles of enhancing local government's autonomy and accountability, coherence within national policies and institutions, efficiency, enforceability, and the stability and predictability of revenue. Yet scope exists for many councils to make better use of their funding tools. This would help relieve funding pressures. The tools also enable councils to consider ability to pay.
- Given the modest scope of local government in New Zealand and the absence of a clearly superior alternative, rating land and property should continue as local government's main taxing power.
- Yet four areas of funding pressure suggest the need for some additional tools: These areas are (i) supplying enough infrastructure for urban growth; (ii) coping with the growth of tourism, (iii) central government's growing list of responsibilities and standards for local government; and (iv) adapting to climate change.
- The failure of high-growth councils to supply enough infrastructure to meet demand is a serious social and economic problem. Councils have funding and financing tools to make growth pay for itself over time, but debt limits and the perception that growth doesn't pay are significant barriers.
- Innovations such as the Milldale Special Purpose Vehicle debt model and its proposed extension will help deal with the debt-limit problem. A new funding stream for territorial local authorities based on new building within an authority's boundary could create an effective incentive to encourage councils and their existing residents to embrace growth.
- Maintaining services in smaller districts with falling populations requires openness to new scalable technologies, collaborating with others, and some fiscal assistance from central government.
- Tourists do not fully pay for the costs of local infrastructure and services that they consume in tourist hotspots. The Government should enable councils in larger tourist hotspots to charge tourists through an accommodation levy, and make payments to small hotspots without much accommodation from the new international visitor levy.
- Central government payments to help fund local government activities are justified when the activities give rise to national benefits. Payments much beyond this could undermine local-government autonomy and accountability. A reset of the relationship between central and local government to one of partnership would alleviate the problem of "unfunded mandates".
- The Commission's recommended additions to the local government funding toolkit should enable councils to deal with the pressures from rapid urban growth and tourism. The rising funding pressure from the need to adapt to climate change is dealt with in Chapter 8.

In this chapter, the Commission draws together various threads of its inquiry into the fitness for purpose of New Zealand's system of local government funding and financing. It begins with principles for the design and operation of local government funding and financing. It then provides an assessment of current arrangements against those principles and makes recommendations for future arrangements. Later chapters will deal with equity and affordability (Chapter 7), the funding challenges of adaptation to climate change (Chapter 8), and reform of three-waters services (Chapter 9).

The inquiry's Terms of Reference (TOR) ask the Commission to examine funding and financing arrangements and options in the context of rising expenditure pressures on local government (Chapter 4). In some areas, the Commission has found those pressures have increased or changed in nature to an extent that justifies new approaches to funding and financing, including some new tools to augment existing tools. However, in broad terms the current funding and financing arrangements seem to perform well and be fit for purpose.

6.1 Principles for funding and financing

Several past reviews of funding local government in New Zealand have set out principles for revenue-raising instruments. The reviews include *Alternative tax bases for local government* (Local Authority Funding Project Team, 2006), *Funding local government* (Shand Report, 2007) and *Alternative to rates: review of mechanisms to supplement local authority rates* (NZIER, 2007). Bailey (1999) is a UK example. Reviews of taxation at a national level have also listed principles for good taxation (*Future of tax: interim report* (Tax Working Group, 2018); *A tax system for New Zealand's future* (Victoria University of Wellington Tax Working Group, 2010)). These sets of principles have a surprisingly common core of features, including economic efficiency, fairness, revenue adequacy and low compliance and administrative costs. Additional principles relevant to revenue-raising by local authorities include local autonomy and accountability.

The Commission's view is that a set of principles with these sorts of features remains valid and suitable for this inquiry. The Commission has distilled the following set to evaluate the funding and financing tools currently available to local governments in New Zealand.

Funding and financing instruments for local government should be:

- **Appropriate for local government use** – given the role of local government and the need for local autonomy (flexibility to align with local preferences) and accountability (including transparency).
- **Coherent within national policies and institutions.**
- **Efficient** – instruments should minimise harmful incentive effects on resource allocation, investment and innovation, and should minimise compliance and administration costs (the latter two properties need instruments to be reasonably simple).
- **Equitable and fair** taking account of who benefits from local government services, and also horizontal equity, vertical equity, affordability and inter-generational equity.
- **Sustainable** through minimising avoidance and providing fiscal adequacy and stable and predictable revenue over time.

In the New Zealand context, the Treaty of Waitangi is an important frame when thinking about principles for local government funding and financing. As Ngāi Tahu submitted:

In relation to principles of a funding and financing framework (p48 [of the issues paper]) Te Rūnanga note that Treaty partnership integrity is a relevant principle. This certainly has links to the equity and fairness principle, and to fiscal adequacy, but is also a distinct and significant element that should be considered in design. (sub. 53, pp. 6-7)

Chapter 2 outlined how local government decisions have a strong impact on Māori interests which are explicitly recognised in legislation. Chapter 5 sets out how the Local Government Act 2002 (LGA) places requirements on councils to facilitate Māori participation in council processes and decision making. In doing so, councils are giving effect to the Crown's Treaty obligations, for which the Crown retains ultimate responsibility. The Resource Management Act 1991 (RMA) similarly sets out responsibilities to engage Māori

in resource management decisions. Treaty settlements have progressively given increased weight to councils partnering with iwi and hapū in the joint management and governance of natural resources important to Māori as tangata whenua (Chapter 4).

The following sections briefly explain each of the revenue-raising principles listed and how they relate to local government funding and financing.

Appropriate for local government use

Regulating land use, providing local public and “club” goods (eg, public parks, street lights, streetscapes, recreation and cultural facilities), and providing essential infrastructure such as roads, footpaths and drainage are natural tasks for local government because they are specific to a community. Further, community wellbeing is enhanced when the community can make the choices about these amenities that suit it best.

The amount of choice and control depends critically on the extent that funding for the amenities comes from the community, rather than from external sources not under the community’s control, such as central government. The more local government depends on funding from central government, the more its *autonomy* will suffer. In addition, local choice, control and funding have the benefit of making elected local councillors more *accountable* for how well they spend the funds raised from the community.

The main downside of local autonomy and choice is that the production of many goods and services could be much more efficient at a scale larger than the size of a local authority. This can create a tension between autonomy and efficiency. Collaborating or contracting with others can sometimes achieve scale without sacrificing autonomy, but in other cases the community may have to strike a balance between them.

Coherent within national policies and institutions

Local government sits within national policies and institutions. Its powers and mechanisms need to be coherent with the national system of laws and responsibilities. Standard public finance texts argue that, of the three basic fiscal functions of stabilisation, economic efficiency and redistribution – the first and the third functions should be the primary responsibility of central government, while central and local government should share the second function (Oates, 1999). The reason for this separation is that fiscal stabilisation and redistribution outcomes could be undermined and achieve no-one’s intended objective if two levels of government follow inconsistent policies. In addition, welfare transfers are better undertaken at a national level because:

- central government has better information on personal incomes and indicators of household status such as unemployment, single-parenthood and disability; and
- significant differences in regional or local welfare policies can encourage “benefit shopping” where people move to live in areas that offer generous welfare benefits. If such movements were significant, they would likely create instability and be harmful to desirable redistribution goals⁴².

Oates (1999, p. 1134) summarised this natural division of roles and responsibilities:

Central government plays the major role in macroeconomic stabilization policies, takes the lead in redistributive measures for support of the poor, and provides a set of national public goods. Decentralized levels of government focus their efforts of providing public goods whose consumption is limited primarily to their own constituencies. In this way they can adapt outputs of such services to the particular tastes, costs, and other circumstances that characterize their own jurisdictions.

Economic efficiency divides naturally across levels of government for the goods and services for which each is responsible. In addition, since costs and preferences for local public goods differ across local communities, efficiency is enhanced by leaving choice and control to those local communities.

⁴² In contrast, a national welfare system largely avoids this risk because it can draw on the much larger and more stable national population as the insurance pool to cover risks that will affect some people, for example the risks of falling sick, being injured, suffering unemployment or living with a disability.

Without careful coordination, different levels of government that share the same tax base can impair coherence. For example, each level could set its tax rate without considering the rate set by the other – which could result in a damagingly high combined rate.

Efficient funding and financing for local government

Efficient funding and financing is a huge topic. It relates not only to taxes but any form of revenue raising to cover the costs of goods and services (eg, user charges). It is easy to accept the desirability of minimising the costs for taxpayers of having to **comply** with a tax system (ie, the costs of time and effort as well as funding costs). These costs depend largely on the simplicity of the system and how much it is automated.

Administrative costs are those incurred by the tax authority in assessing what people owe, collecting the funds and enforcing the rules. Clearly also, the lower these costs the better.

Taxes can cause harmful effects by distorting people's decisions about consuming, working, saving and innovating relative to what would be most economically efficient. Careful choice of taxes and tax design can reduce these harms (called the "deadweight costs" of taxation) but do not usually eliminate them. In general, taxes cause less inefficiency when producers and consumers are less inclined (or less capable) to reduce their tax bills by switching from more highly taxed goods and services to more lightly taxed goods and services⁴³.

Dynamic efficiency is an important characteristic that exists when innovators have optimal incentives to create and introduce new goods, services and methods that raise productivity and wellbeing over time. Innovation is the major source of increases in living standards. Funding methods and sources can have a significant bearing on dynamic efficiency because innovators need access to funding and financing to enable them to develop their ideas and try them out. Innovators arguably should also receive a reward for the new ideas they generate that spill over and benefit others. This reward could be a tax credit for R&D.

Council-supplied local services range from pure public goods to pure private goods with several service types that have elements of each such as infrastructure services that are natural monopolies. Box 6.1 describes the distinction between public and private goods. The type determines which funding method and institutional arrangements are conducive to economic efficiency. As a result, there is a need to tailor funding methods to a service's characteristics as described below.

- **Council services that have private-good characteristics** (ie, the services are rival and excludable). Unit charges (ie, volumetric prices paid by users) are the usual means to fund these services. Kerbside rubbish collection with a unit charge per bag of rubbish is an example. Unit charges are efficient if councils set them at the marginal cost of providing the service and the council uses efficient means to produce the service.⁴⁴ In some cases, charging marginal cost will not generate enough revenue to cover a council's costs because the marginal cost will be lower than the average cost of production (average cost includes upfront fixed costs of providing a service while marginal costs only include costs that vary with the services actually supplied). Determining the efficient way to make up this revenue so that the council can cover its costs is complex. The next two points deal with infrastructure services where this problem is common.
- For **infrastructure services** with identifiable consumers whose access can be controlled, such as drinking and wastewater services, the price that consumers should be charged (to achieve economic efficiency) depends on whether overall demand for the service is comfortably within, close to, or above the capacity of the existing system:
 - *Demand within existing capacity* – once an additional customer is connected, the operational cost to supply them is very low. This is the short-run marginal cost (SRMC) and the efficient price is the SRMC.

⁴³ This lack of response (or inelasticity) to a tax is efficient for taxes that seek to raise revenue. But when the purpose of a tax is to make a person or business face the costs they are imposing on others, and they respond in a way that reduces this cost, this is the aim of the tax and is a good thing.

⁴⁴ Chapter 5 covers the factors that influence a council's productive efficiency.

- *Demand close to existing capacity* – SRMC will now be higher because additional use will likely cause the quality of the service to other users to deteriorate. So the efficient price is the SRMC, but it will be higher to reflect this additional “congestion” cost. This is the rationale for charging vehicles for access to congested roads – it obliges an additional driver to consider the extra cost they impose on other road users because they slightly worsen congestion for everyone.
- *Demand above existing capacity* – the efficient price will be higher again. It will be whatever price reduces demand to the available capacity.
- The different efficient prices described in the previous bullet could worry household consumers who do not wish to face short-term price uncertainty. Such price uncertainty could arise if demand fluctuates between peak and off-peak times. In these situations, a wholesale purchaser of the service will usually be willing to offer households price certainty for an appropriate margin.
- With **infrastructure services that require expensive upfront investments** such as roads, water and wastewater, charging SRMC will not fully cover costs (ie, a situation of high fixed costs and low marginal costs). The efficient solution will be either to raise prices above SRMC, adopt some form of multi-part pricing, treat the service as a “club good”, or cover the deficit with revenue raised from taxation. For further details see NZPC (2017, pp. 307–311).
- **Council goods and services with public-good characteristics** should be funded by local taxes, at least for the local benefit component. Councils cannot charge directly for them because it is not possible to exclude users who do not pay (or at least it would be very costly to do so). Elected councils make decisions on behalf of their communities to determine the types, quantities, locations and funding/financing of local public goods and services. Typical local public goods are uncongested local roads, public parks, enhanced streetscapes and waterfronts. A council decision to supply and fund a new local public good, or extend an existing one, will be efficient if the total community benefit it generates exceeds its total costs, but not otherwise. Of course, this is not always easy to determine and often comes down to judgement.

Box 6.1 Definitions of “public goods”, “private goods” and “club goods”, and how they differ

“Public goods” are goods or services with two specific characteristics:

1. the good or service is *non-rival*, which means that many people can “consume” it and benefit from it without diminishing the benefit to others (eg, well-lit city streets, or the public-health benefits of wastewater systems); and
2. the good or service is *non-excludable*, which means that it is impossible (or at least highly impractical) to exclude people from using and benefiting from it (eg, a city’s stormwater system).

If a good or service is non-excludable, it is not practical to charge users. As a result, private businesses will choose not to supply a non-excludable good or service (except in rare cases).⁴⁵ Therefore it is governments – either central or local – that supply most public goods.

The geographical reach of public goods varies – at one end of the spectrum, national defence simultaneously benefits all citizens of a country; at the other end, street lights in a suburban cul-de-sac benefit only the street’s residents. As such, *local public goods* are those with a relatively local effect across a region, city or town.

Local public goods include a broad spectrum of objects, facilities and endeavours that local governments provide and maintain for their residents to enjoy. Examples include parks, reserves,

⁴⁵ Ronald Coase (1974) drew attention to one example that is consequently well-known among economists. Before public lighthouses were put into service, some British private insurance companies built lighthouses. It was in their interests to do so because it reduced shipwrecks among the ships of their clients, even though ships not insured with the companies were able to free-ride and also gain the benefit of the lighthouse service.

gardens, squares, public monuments and works of art, waterfront development, and the design and layout of streetscapes and pedestrian areas.

“Private goods” are goods or services with two opposite characteristics:

1. the good or service is *rival*, which means that if one person or household consumes it then other people or households cannot do so (eg, a loaf of bread, an armchair); and
2. the good or service is *excludable*, which means that it is possible to exclude people from using and benefiting from it (eg, withholding the bread or armchair). This property enables private businesses to charge for the supply of private goods and services.

Yet governments may still wish to provide services that are excludable (such as many health services) for no or little charge for equity reasons or because of wider social benefits.

“Club goods” are excludable but non-rival up to the point they become congested. A swimming pool is an example. Excludability means that users can easily be charged, but this may not be efficient when the pool has few users. When the number of users is close to or at capacity, it will be efficient to charge to limit demand to capacity. Even in quiet times, a charge contributes to cover costs, but efficiency would suggest setting it at a lower off-peak rate to encourage people to visit.

Source: NZPC, 2017, p. 6.

Equitable and fair

Councils have a lot of flexibility in deciding from whom they collect local taxes and charges. Councils and ratepayers are typically very concerned to achieve “fairness” and “equity” in who ends up paying for what. Indeed, many complaints that people express about funding tools, such as rates or charges, come down to people’s dissatisfaction with having to pay for goods and services they either do not value or think someone else should pay for.⁴⁶

But what is fair? Tax scholars have developed several concepts and categories to aid thinking about fairness. Inevitably, fairness involves value judgements – there is no objectively correct answer to the question of what is fair. Fairness concepts relevant to local government funding decisions include:

- **Benefit principle** – services should be funded by those who benefit from them. This implies user charges (where such charges are feasible and efficient) or perhaps a targeted rate on a specific group of residents who benefit from a service. It also implies local services should be funded from local government revenues (drawn from residents). Services benefitting the nation (ie, that contribute to the national interest or national policy objectives) should be funded by central government. It is possible that some local assets and their associated services could benefit both local residents and national interests. In these instances, the benefit principle points to shared funding (Figure 6.1). Yet it can be difficult to determine how much a person benefits from a service that they consume, and to separate local from national benefits.
- **Exacerbator principle** – the exacerbator principle is a variant of the benefit principle. Whoever causes a need for, say, a clean-up or a preventative activity should pay for it.
- **Horizontal equity** – a tax principle that citizens with the same characteristics should pay the same tax. The relevant characteristic on which sameness is based depends on the type of tax. It could mean the same income (for an income tax), the same consumption spending (for a consumption tax) or the same property value (for a property tax).

⁴⁶ Even when the argument is that the central government should fund and provide a service, this is essentially saying that taxpayers across the country ought to be paying rather than local residents.

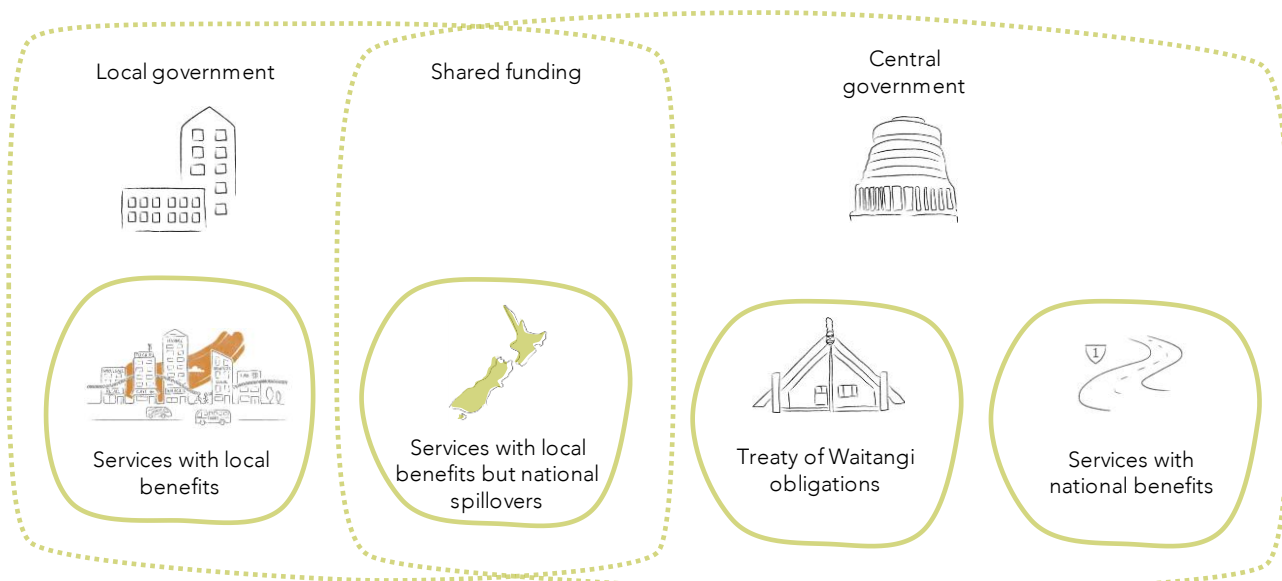
- **Vertical equity** – a tax principle that citizens with greater ability to pay should pay more tax than those with less ability to pay. The degree to which someone on a higher income should pay proportionately more tax is termed the “progressivity” of the tax system. Ability to pay can be assessed in different ways such as current income, current consumption, wealth, or property value.
- **Inter-generational equity** – a principle that seeks fairness across generations. Inter-generational transfers – where one generation pays for a benefit enjoyed by another generation or imposes a cost on it – often lack inter-generational equity. One example is that emissions of greenhouse gases by past and current generations will impose costs on future generations through damaging climate change. Applying the benefit principle to inter-generational transfers implies that such transfers should be minimised because each generation should pay for the costs of the benefits that it enjoys. Generations should not shift the costs onto future generations; neither should they have to incur the entire costs of building long-lived assets from which future generations will also derive benefits.
- **Tax incidence** – this refers to who ultimately pays taxes or rates. It is important to differentiate “nominal incidence” and “economic incidence”. The former is who is legally obliged to pay the tax; the latter is who is actually worse off from the tax payment. For example, retailers are legally obliged to pay GST on their sales of goods to consumers, but because they pass the GST on as part of the retail price, the consumer ends up paying the GST. A relevant example for local government is that while landlords are legally responsible for paying rates, and because all landlords in a location are similarly obliged, the cost of rates will get factored into market rents. Therefore, the tenants will end up paying a substantial portion of the rates on a property through their rent payments.

The different fairness concepts can conflict with one another. For example, the benefit principle may conflict with ability to pay. It follows that the designer of a funding system will have to choose which fairness concept to follow and, where necessary, strike a balance between them.

In the Commission’s view, the benefit principle should play the primary role in determining who should pay for most council-supplied goods and services. This follows from the assumption that redistribution is the primary responsibility of central government. A system in which two levels of government practised significant redistribution would lack coherence.

Even so, councils may be well placed to seek what they see as better outcomes for their communities by shifting some of the funding burden of some council-supplied services from those who benefit to those with greater ability to pay. Providing such shifts are modest, councils can express community preferences and improve wellbeing without undermining national redistributive goals (Chapter 7).

Figure 6.1 Should local or central government pay for publicly-funded local services?



Sustainable

A funding and financing system for local government will not be sustainable unless it has three key attributes:

- **Robust against avoidance** – taxpayers paying for collectively funded goods and services, and consumers of private goods and services, will quickly undermine sustainability if they can avoid making payments. Revenues will fall short of costs, and greater burdens will fall on those who act honestly by paying. Financing a major piece of infrastructure by borrowing will not be sustainable without an assured and secure future revenue stream to repay the debt over time.
- **Fiscal adequacy** – the tax system and other revenue sources must be capable of providing the amount of revenue that a government requires. A tax base could be too small or suffer other limitations so that even high rates of tax will not raise enough revenue or do so only at the cost of severe distortions or hardships. Another dimension of adequacy is having a flexible menu of taxes and revenue sources. This is important for local governments so they can select a mix that fits local circumstances and preferences. For example, under New Zealand's current local government rating system, councils have a choice of charges, general rates and targeted rates, and whether to use capital value or land value as the rating base.
- **Stable and predictable revenue** – councils must make long-term plans and investments. For each, stable and predictable revenue streams over time are highly desirable. A sudden fall in revenues, particularly when it happens unexpectedly, can precipitate a fiscal crisis. For example, national tax revenues in Ireland fell sharply when the Global Financial Crisis broke in 2008 because a large portion of its revenues was based on the value of property transactions.

The above principles can be used to evaluate funding and financing systems for local government. The next section will do this for New Zealand's current system and later sections will use the principles to assess proposals for improvements. Designing a system that satisfies all the principles is probably impossible. Tensions could emerge between the principles, such as:

- between efficiency and ability to pay (if ability to pay is chosen as the fairness concept); and
- between funding instruments that closely reflect benefits (which could be very complex), and the simplicity needed to keep administrative and compliance costs low.

6.2 How do current arrangements measure up against the principles?

Section 2.5 described the features of New Zealand's current system of funding and financing local government. Without repeating the description, the main sources of funding (with approximate percentages of total revenue) across all councils in 2018 are user charges for services (13%); regulatory income (about 5%); taxes on property (about 47%, in the form of general rates, targeted rates and uniform annual general charges (UAGCs)); grants from central government (about 19%, mostly for roading and transportation); investment income (about 5%); and development contributions (DCs) and vested assets (about 11%).

The current system gives councils a lot of flexibility. The LGA sets out the many sources of funding available. For example, within the rates category, councils can vary their mix of general rates, targeted rates and uniform annual charges; can apply rating differentials for different classes of taxpayers (residential, business and rural); and choose whether to base property-value rates on land value or capital value. Chapter 7 gives specific examples of this flexibility and how councils use it.

The two biggest concerns that submitters raised about the current system were:

- sustainability, to meet rising spending pressures on local government despite revenues increasing faster than the Local Government Cost Index; and
- fairness, assessed either on the benefit principle or ability to pay.

Box 6.2 has examples of submitters' concerns about sustainability. Box 7.1 has examples of concerns about fairness and affordability.

Box 6.2 Submissions on sustainability of current funding and financing arrangements

...there is a growing sense in the sector that current arrangements – which have a significant over-reliance on property taxes to deliver services – are not sustainable in the long-term, and that if local government is to play a broader role in community wellbeing as envisaged by central government, it needs the tools and access to resources to be able to deliver on that objective. (Wellington City Council, sub. 61, p. 2)

Ultimately, these challenges...lead Council to the conclusion that the funding and financing system for local government is fundamentally broken, and unsustainable heading into the future. It is appropriate therefore that central government, with the assistance of the Commission, assess the drivers of cost and price escalation and recommend appropriate funding and financing solutions. (Timaru District Council, sub. 25, p. 2)

The ability of local government to fine tune and apply the existing powers of land rating and borrowing are limited, and are unlikely to provide any enduring solution to the matters raised by the Minister in the referral to the Productivity Commission. (Ken Palmer, sub. 10, p. 12)

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

Successive governments have amended the Local Government Act 2002 (LGA) to try and get territorial authorities to better manage their funding and finances, although nothing appears to rectify the on-going issues. This shows there is something fundamentally wrong with the system. (Property Council NZ, sub. 117, p. 4)

Several submitters want councils to have a more flexible set of funding tools to tailor solutions to local circumstances:

Councils represent different communities and many of these communities face quite different challenges. The critical issue is that councils have access to a menu of funding tools (or the authority to develop appropriate tools) so that they can apply the relevant tool to whatever the local issue happens to be. (LGNZ, sub. 112, p. 25)

There is considerable variation in the need for tools – this depends on the type of council (e.g. district vs regional), its priorities, social / demographic make-up, community needs and economic pressures (which also change over time). We consider the important thing is that there is an expanded tool-box available to address this diverse range of issues. (Northland Regional Council, sub. 32, p. 15).

These concerns echo the inquiry's TOR, which ask the Commission to investigate, among other questions:

- the ability of the current funding and financing model to deliver on community expectations and local authority obligations, now and into the future; and
- rates affordability now and into the future.

The Commission's evaluation of New Zealand's current system will focus on these concerns. The following subsections evaluate the system against the funding and financing principles described above.

Appropriate for local government use?

Local governments in New Zealand raised over 75% of their total revenues from local residents and businesses in 2013 through their powers to tax and charge. This is a high proportion by international standards and among OECD countries in particular (OECD & UCLG, 2016). This feature gives the current system two important benefits:

- the community, through the council, has the autonomy to choose the quantities and types of services that suit local tastes, costs and other circumstances to maximise wellbeing, subject to what the community is prepared to fund; and
- the council is accountable to its community because it has autonomy and control in what it chooses and achieves – this will limit how much it can credibly blame other parties (eg, central government) for failures. (Bailey, 1999; OECD & Korea Institute of Public Finance, 2012)

In some circumstances, the supply of local services by a local provider can have disadvantages. First, economies of scale in some services may favour their production at a higher level of government and/or on a greater scale than is feasible at the local level. Second, some local services may benefit non-residents and even the whole country. Local roads, for example, form a part of a national roading network, which indicates that others should also contribute to funding them. Contribution by others happens in New Zealand through the co-funding of local roads by the New Zealand Transport Agency (NZTA).

Even so, local autonomy and accountability are important benefits of New Zealand's current system of funding local government.

Coherent within national policies and institutions?

There is wide agreement in New Zealand that central government is in charge of fiscal stabilisation and the redistribution of resources from those well-off to those in need. To achieve these outcomes, central government holds and controls the levers of fiscal policy, monetary policy, tax and benefit policy and taxpayer-funded health and education. Coherence requires that local government has no or little influence in these policy areas. This is true under current arrangements.

The tax tools of local government – mostly rates based on property values or property units – are separate from the main tax tools of central government – income tax and GST. This separation of tax bases is sufficient (but not necessary) for the two funding mechanisms to work coherently together.

In allocating resources to satisfy needs and preferences for public goods and infrastructure, central and local government efforts in New Zealand largely focus on separate goods and services. As a result, conflicts are infrequent. Central government funds and oversees national public goods such as defence and law and order; local government funds and oversees local public goods and local infrastructure such as street lighting, public parks and water supply. Some areas such as roading, conservation, civil defence and public health do overlap, but clear lines of demarcation, or a good system of cooperation, usually avoid conflict.

Exceptions occur. For example, the Commission heard about NZTA's recent re-prioritisation of a long-promised upgrade of an important section of state highway suffering from high traffic volumes and accidents. This re-prioritisation created a conflict because it dashed the plans of a district council – and the significant resources it had already committed – for a major housing development in an area with a serious housing shortage. The development depended on the highway upgrade for the new residents to commute to work in the nearby large urban area.

As noted, other difficulties can emerge when benefits or costs cross local-authority boundaries, and the funding system does not consider this. For example, residents of districts popular with tourists are feeling increasingly aggrieved at bearing the cost of services to tourists. Another example is the problem of "unfunded mandates" when central government requires local authorities to take on regulatory tasks (aimed at least partly at national benefits) yet supplies no funding to help meet the costs of the regulation (section 6.7).

F6.1

The roles and funding tools of local government do not impinge on the prime responsibilities of central government to stabilise the macro economy and redistribute income and the cost of services from those well-off to those in need. The responsibilities for making choices about public goods and infrastructure are mostly coherent across the two levels of government.

Some areas of difficulty and tension between central and local government have emerged. These tend to be where the benefits or costs of local government infrastructure and services cross local-authority boundaries, yet current funding arrangements do not consider this.

While New Zealand's system of funding local government has a high degree of coherence within national policies and institutions, this could change should local governments take on more or fewer responsibilities than they do today. This draft report assumes that the scope of local government in New Zealand (ie, what it does) remains like what it is today.

Efficient funding and financing?

The following evaluation of the efficiency of New Zealand's current funding and financing arrangements for local government looks separately at administration costs, compliance costs, and static and dynamic efficiency (including the use of development contributions and connection charges).

Administrative costs

Once set up, rating systems generally have low compliance and administrative costs. New Zealand's is no exception. The main reason is that the rating base of land and buildings has well-defined boundaries that do not move, and ownership of these assets is clear. It is relatively easy to serve rate notices and to enforce payment. An effective rating system requires an up-to-date property register. An up-to-date digitised and computerised register exists in New Zealand. The register has other purposes, the main one being to keep track of the ownership of property and to register changes of ownership from property sales and purchases. The register would have to exist even if local government raised its revenue in a different way. Hence, most of the costs of the register would remain even if rates were replaced with a different funding system.

The rating system also depends on a valuation system that maintains reasonably accurate property values associated with each title. This is a significant administrative expense of the rating system.

Another significant administrative cost can be the complex work involved in setting targeted rates to match rate payments to benefits received, or to the cost of preventing or mitigating harm caused by property owners. For example, councils can set a targeted rate on the impermeable surface area of a property as a proxy for the load the property puts on the stormwater system.

Collection and enforcement costs are relatively low. Property is visible and cannot disappear or move and it is straightforward to track legal ownership from the property register (Collier et al., 2018). Councils have strong powers to enforce payment.

Compliance costs

It is easy and costs little in time or money to comply with paying rates. All property owners each year receive a rates demand from their council which they then pay in instalments (eg, quarterly or more frequently). They do not have to fill in a return.

In his overview of tax compliance and administrative costs, C. Evans (2008) notes that studies of the main central government taxes (eg, income tax and GST) "suggest that compliance costs of such taxes are typically anywhere between two and ten percent of the revenue yield from those taxes In contrast, compliance costs of property taxes are low in absolute and relative terms ... The studies also suggest that administrative costs are absolutely and relatively less burdensome than compliance costs." (pp. 457-458)

Rates payments do not have a cashflow automatically available to pay them in the way that PAYE income tax and GST do. This can cause difficulties for ratepayers who have wealth (property ownership) but a low cash income. They may need to act, at some cost, to acquire liquidity.

Economic efficiency – static and dynamic

Rates on land value – the unimproved value of the land on which a property sits – are among the most efficient taxes because no owner can do anything to change the amount of land and therefore change the amount of tax owed. For this reason, taxes on unimproved **land value** cause no economic distortion.

As noted, taxes on **capital value** create a disincentive at the margin to owners to make improvements because the improvements will raise capital values and increase the amount of tax payable. As shown in Table 6.2, many local authorities have shifted from land value to capital value for their rating base in recent years and this is likely to have reduced economic efficiency. However, the Commission is not aware of any empirical estimates of the size of this reduction.

An important exception to rates on capital value negatively impacting efficiency is when capital value is a good indicator of benefits received. For example, the capital value of business premises could be a proxy for the number of people using them which, in turn, could be a proxy for services such as street cleaning, drinking water or wastewater. In this situation, the decision of an owner to improve the property is effectively a decision to use more services and, to the extent that supply of these services is a cost to the council, it is efficient that the property owner pays more in rates.

When councils levy **rates on the capital value of businesses**, they risk even greater inefficiency than rates on the capital value of residential property – unless these business rates are a good proxy for benefits received from council services (in which case, as just explained, the rates promote efficiency). If rates on the capital value of a business are simply a tax to raise revenue for the council, then this risks creating productive inefficiency⁴⁷ that is avoidable. This outcome is an important result in economic theory (Diamond & Mirrlees, 1971)⁴⁸.

A striking example of rates on the capital value of businesses causing productive inefficiency is when councils apply a high differential to rates on electricity generators. Several hydro and other generation plants are in rural districts. On average, councils in rural districts apply a business differential of 4.25 (Insight Economics, 2019a). That is, not only do generation assets have high capital values, but the rates their owners must pay *per dollar of rateable value* are 4.25 higher on average than rates on residential properties.

Apart from these high rates distorting generators' decisions, the generators will tend to pass them on in higher electricity prices. As a result, electricity is more expensive than its true resource cost to the many hundreds of thousands of businesses that use electricity. This is likely to cause them to make decisions about electricity use that are inefficient. Meridian Energy's submission described its experience and that of other generators' as follows:

Meridian and other electricity generators have high capital value assets on their land and therefore pay extraordinarily high rates, while consuming very little local government services. Rates bills are an input cost for electricity generation and ultimately capital value rates increase the cost of electricity for New Zealand consumers. (sub. 73, p. 7)

Use of **targeted rates** gives councils flexibility to match rates payments to benefits received and also to match them to service costs. The ability to base targeted rates on land value, capital value, uniformly across dwellings or on some other basis matters for efficiency. In general, the better a rate is targeted on benefit received and cost, the more it will support efficient choices.

⁴⁷ An economy is productivity efficient when it is on its "production-efficiency" frontier. This means that it is impossible to use available resources to increase the output of any one good or service without reducing the output of another. When production inefficiency exists, it will be possible to increase one or more goods or services without reducing any of the others.

⁴⁸ The explanation for this result is as follows. Business rates on capital value make an important business input (the use of physical premises) more expensive. This distorts business choices about which inputs to use. In addition, the business will tend to shift the cost of the rate onto other parties such as its customers or employees. As a result, another party ends up paying the rate indirectly. It would be more efficient to tax that other party directly and avoid the productive inefficiency within the business.

Use of user pays among New Zealand councils appears to have decreased with revenues from sales and user charges declining as a percentage of total revenue from about 20% in the 1990s to 13% in 2018. User-pay charges are efficient, providing that the charges correspond to guidelines described in section 6.1. Councils could improve efficiency with greater use of user charges; for example, to moderate congestion and pollution, and to ration use of capacity when near the capacity limit for services such as drinking water. Some legislative changes would be needed to allow councils to impose some user charges.

As noted, in New Zealand the main example of central government paying **grants** to local authorities (because local amenities create benefits that cross boundaries and contribute to national policy objectives) is for local roads. Local roads are co-funded by NZTA and councils, with the split roughly approximating the national versus local benefits.⁴⁹ Co-funding enhances efficiency because each party is paying for its own benefits. Also, each has got “skin in the game”, which gives both the NZTA and councils an incentive to see that the total money is well spent.

Councils often recoup a portion of their infrastructure capital costs from users (usually developers) at the point of new residential or non-residential development by levying **development contributions or connection charges**. If well implemented, these levies support efficiency. Where new property developments cause the need for new or extended local infrastructure (such as the three waters or roads), making the new residents and businesses bear the costs is efficient (as well as fair).

When those who benefit from new infrastructure pay the capital costs (either through DCs, connection charges or targeted rates), they automatically consider these costs when deciding what and where to build. Effectively, the infrastructure capital costs are the marginal costs of adding capacity to the local network (Kahn, 1988, p. 75). Since these costs are avoidable, benefits need to exceed these costs to justify investment. If developers and buyers of the newly developed properties do not face these costs, they will find locating away from the existing network artificially cheap. This can bias development towards greenfield areas and away from land already serviced by network infrastructure. It can also impose the cost burden on existing ratepayers.

The LGA established DCs as a cost-recovery tool for local governments in 2002. Following some criticisms⁵⁰ and a review of DCs in 2012, the Government amended the LGA in 2014 to include a clear purpose and set of principles (Box 6.3) that councils are obliged to follow. Developers also gained a right to appeal against DCs if they feel that they are unfair or incorrect.

Several aspects of implementing DCs are complex. First, any new council infrastructure project could be a mix of renewals, backlogs, or greater capacity to cater for growth. Of these, councils are entitled to charge DCs only for greater capacity to cater for growth. Second, this cost of growth must be allocated over multiple developments in line with how much each development has caused the need for the infrastructure and/or benefited from it. Councils estimate what costs a standard new house will cause. Then each other type of development (eg, a new supermarket or warehouse) is assigned a number of Housing Unit Equivalents (HUEs) which give the estimated impact of that development as a multiple of a standard house. HUEs vary not only by type of development but also by the area or catchment in which the development is located.

Some councils have online calculators to help deal with this complexity. These give developers an early, rough indication of the likely DCs that they will be required to pay for any project they have in mind. Even so, developers of non-residential properties continue to complain either that councils fail to explain the basis for their DC charges or that the charges are unreasonable or contain errors (eg, Foodstuffs, sub. 23, Property Council NZ, sub. 117). Section 6.4 examines the issues raised by developers.

⁴⁹ NZTA grants for local roads also take into account the funding capacities and needs of local authorities (with some authorities having many more kilometres of roading than others).

⁵⁰ The Commission’s inquiry into Housing Affordability (NZPC, 2012) reviewed DCs and made several recommendations to improve them. Some of these recommendations were included among the 2014 amendments to the LGA.

Box 6.3 Development contributions principles, inserted by amendment in 2014 in the LGA section 197AB

- (a) development contributions should only be required if the effects or cumulative effects of developments will create or have created a requirement for the territorial authority to provide or to have provided new or additional assets or assets of increased capacity;
- (b) development contributions should be determined in a manner that is generally consistent with the capacity life of the assets for which they are intended to be used and in a way that avoids over-recovery of costs allocated to development contribution funding;
- (c) cost allocations used to establish development contributions should be determined according to, and be proportional to, the persons who will benefit from the assets to be provided (including the community as a whole) as well as those who create the need for those assets;
- (d) development contributions must be used:
 - (i) for or towards the purpose of the activity or the group of activities for which the contributions were required; and
 - (ii) for the benefit of the district or the part of the district that is identified in the development contributions policy in which the development contributions were required;
- (e) territorial authorities should make sufficient information available to demonstrate what development contributions are being used for and why they are being used;
- (f) development contributions should be predictable and be consistent with the methodology and schedules of the territorial authority's development contributions policy under sections 106, 201, and 202;
- (g) when calculating and requiring development contributions, territorial authorities may group together certain developments by geographic area or categories of land use, provided that:
 - (i) the grouping is done in a manner that balances practical and administrative efficiencies with considerations of fairness and equity; and
 - (ii) grouping by geographic area avoids grouping across an entire district wherever practical.

Source: Local Government Act 2002.

Dynamic efficiency is about decision makers making the right investment decisions at the right time, managing assets well and having a system that encourages disciplined experimentation and innovation. Dynamic efficiency is a major driver of productivity growth and improved outcomes over time. The way local governments are funded and financed is seldom conducive to disciplined experimentation and innovation leading to higher-quality, value-for-money services. One problem is that potential innovators in councils rarely have the resources, decision rights and incentives to trial new ways of doing things. Chapter 9 investigates how the arrangements within local government could be changed to improve innovation, dynamic efficiency and service outcomes in the supply of drinking water and wastewater.

F6.2

The rating tools of New Zealand local governments have low compliance and administration costs. The complexity of development contributions (DCs) causes them to have higher administration and compliance costs.

Rates based on (unimproved) land values cause little or no economic distortion and therefore are a highly efficient way to raise revenue.

Rates on capital value are relatively less efficient because they can disincentivise land and building development. Rates on the capital value of businesses can, in addition, cause unnecessary productive inefficiency.

Even so, when rates, user charges, DCs and connection charges reflect benefits received and the marginal cost to the council of providing services, these are efficient ways to raise revenue.

Are current funding and financing arrangements equitable and fair?

Who pays rates, charges, DCs and connection charges to local governments in New Zealand? The fairness of who pays can be assessed against the benefit principle (including its exacerbator variant) or ability to pay. The equity and fairness in New Zealand's local government funding and financing arrangements are covered in Chapter 7.

As explained in section 6.1, the Commission's view is that the benefit principle should play a primary role in determining who should pay for most council-supplied goods and services. Two aspects of this are worth noting:

- Applying the benefit principle by charging citizens directly for local government services or levying rates that reflect benefits is not only fair (under the benefit principle) but also mostly promotes efficiency. The efficiency comes about because the charge or the rate indicates the cost of the service or facility, and citizens can then decide whether the value they will receive from it is greater than this cost. For example, a new bridge could improve an isolated settlement's access. If the bridge is to be funded by a targeted rate on the properties in the settlement, then the residents are likely to make a rational collective decision about whether the bridge should go ahead based on overall benefits and costs.
- Fairness demands that the cost of a large investment in a long-lived infrastructure asset should be spread over time so that all who benefit from the asset pay for it, not just the ratepayers at the time of the investment. Spreading the cost with a loan avoids having to impose a large rate rise on these ratepayers. Otherwise, these ratepayers are likely to block the investment even though it produces overall net benefits. This would be inefficient.

Are current funding and financing arrangements sustainable?

Local government rates and other main funding tools are robust against avoidance. Very few rates demands go unpaid and councils have strong powers of enforcement. The revenue streams that rates and charges deliver to councils are generally stable and predictable. The way that rates are set each year (by setting the total revenue required and then setting rates and charges to achieve that) enables councils to be precise about how much revenue they will receive.

Revenue from rates has remained remarkably stable as a proportion of GDP since the mid-1940s, varying between 2% and 2.5% of GDP (Jason Krupp & Wilkinson, 2015). Rates revenue as a percentage of GDP in 2018 was 2.1%. Figure 3.1 shows the track of rates revenue as a proportion of Gross National Income and other similar measures from 1993 to 2018. The series are remarkably flat.

Whether the current system of local government rates and charges deliver a fiscally adequate amount of revenue for the needs of councils is a central question of this inquiry. The inquiry's approach to answering it is to evaluate the pressures on local government (as described in Chapter 4) to see if they are putting

demands on local government that they cannot reasonably meet, or should not be expected to meet, from the current funding and financing tools. Two areas where new pressures exist and are on a rising trend are:

- **the fast growth of tourism.** Section 6.7 of this chapter identifies the nature of the funding problem created by tourism and proposes solutions; and
- **adapting to climate change.** This pressure will increase inexorably over time. The Commission's analysis of its implications for local government funding, with findings and recommendations, is in Chapter 8.

Both pressures are unevenly distributed across local authorities and, for those authorities affected, the sustainability of the current tools looks doubtful.

Two other areas stand out as ongoing problems for local government:

- **infrastructure funding for high-growth councils.** A key question is whether growth can pay for itself in the eyes of councils and their existing residents. Analyses of this and the potential barrier of council debt limits, together with findings and recommendations, are in section 6.5.
- **councils' accumulation of responsibilities** placed on them by central government – so-called “unfunded mandates”. Analysis of this funding challenge along with recommendations is in section 6.8.

The funding challenges in these four pressure areas lie in the future. Looking back, the historical picture of trends in rates revenues, council expenditures and various measures of national economic growth and income suggests that local government revenues have been both adequate and sustainable⁵¹.

Over long periods of time, and with some variation, increases in local government revenue and rates have roughly matched increases in national and household income (Chapter 3). Between 1993 and 2018, council operating income per person, rates per person, and Gross National Income per person grew respectively at average rates of 1.8%, 1.9% and 2.0% a year (after adjusting for inflation) (Stats NZ (2019b); Stats NZ (2018a); Stats NZ (2018b)). This shows that rates per person have gone up over time but no faster than people's incomes. It is not surprising that council expenditure increases as people's incomes increase. As their incomes rise, people are likely to demand more and better goods and services, including the goods and services they receive from local government.

Even so, past adequacy and sustainability is not necessarily a reliable guide to future sustainability and adequacy. The two new pressures and the continuing effects of the two ongoing problems may well require new funding tools.

F6.3

The fiscal adequacy of the local government funding system is under strain in the areas of tourism, adaptation to climate change, growth infrastructure and unfunded mandates from central government. Pressures in these areas are mostly uneven across councils, and in the first two areas are set to continue rising.

Since the early 1990s, rates revenue per person, council expenditure per person and income per person have grown at similar rates. While this suggests that the current funding system has proved adequate and sustainable in the past, the new and growing pressures may require new funding tools for the future.

⁵¹ It should be noted that this observation is not conclusive evidence of adequacy. For example, if councils exercise fiscal constraint to keep rates from growing faster but at the cost of running down service quality, neglecting maintenance and not investing in new or replacement infrastructure.

6.3 Rating land and property should continue as the main tax revenue source for local government

Despite the growing pressures on local government funding in the areas mentioned, the current suite of funding tools generally measures up well against the principles of a good system. Given that these tools have served local government and New Zealand well historically, they should not be lightly discarded. Providing satisfactory solutions exist to deal with the pressures, it will be preferable to retain a known and successful existing system to incurring the disruption and costs of transferring to another system that is not substantially superior.

The Commission's view is that acceptable solutions are likely to exist for each of the areas under strain. As noted, its analysis and recommendations on these are covered later in this chapter, and in Chapter 8. Another potential concern with the current system, voiced by many submitters, is that rates are becoming increasingly unaffordable for some ratepayers. Chapter 7 investigates this concern and finds no reason, on that concern alone, to make fundamental changes to the current system.

Are any radically different approaches available to raise local government revenue that would be more suitable for local government use, coherence, efficiency, equity and sustainability? The Commission has examined the main options and does not find any that meet requirements. Table 6.1 lists these options and their chief advantages and disadvantages.

Table 6.1 Potential alternatives to rates on land and property

Alternative to rating land and property	Advantages	Disadvantages	Location of further analysis
Local income or sales taxes	<ul style="list-style-type: none"> Revenue more responsive to economic activity Income tax could be more progressive 	<ul style="list-style-type: none"> High administration and compliance costs 	Section 6.5
Some share of national GST or income tax	<ul style="list-style-type: none"> Revenue more responsive to economic activity Low administrative and compliance costs 	<ul style="list-style-type: none"> Risks undermining local autonomy and accountability Determining shares would be controversial 	Section 6.5
Property tax based on a percentage of the property value	<ul style="list-style-type: none"> Revenue generated without having to set rates each year Revenue more responsive to economic activity 	<ul style="list-style-type: none"> Potential loss of fiscal discipline Risk of volatile revenue because of volatile property prices 	Section 6.5 and Oliver (2019)
Value capture	<ul style="list-style-type: none"> Raises revenue efficiently on windfall gains in property prices caused by city development Fair 	<ul style="list-style-type: none"> Not suitable for raising the bulk of revenue Somewhat complex 	Section 6.5; Chapter 11 in NZPC (2017), and Oliver (2016)
Tax on vacant land	<ul style="list-style-type: none"> Incentivises productive use of land (eg, discourages land banking) 	<ul style="list-style-type: none"> Hard to define vacant land (and therefore could be easy to avoid) Limited revenue 	The Commission will investigate and report back in its final report in late 2019
Poll tax (a per person uniform charge)	<ul style="list-style-type: none"> High economic efficiency 	<ul style="list-style-type: none"> Hard to enforce Regressive and unfair Highly unpopular 	No further analysis

As noted in Chapter 1, the Commission intends to respond to the Minister of Finance's request to consider whether a tax on vacant residential land would be a useful mechanism to improve the supply of housing for New Zealanders. The Commission would welcome receiving views and other relevant material on this question to help it respond to the request in its final report of the inquiry, due on 30 November 2019.

Q6.1

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?

Overall, the Commission finds that the current system of rates on property and user charging performs reasonably well against the principles of a good system of local government funding. Yet this conclusion is subject to a full assessment of fairness and equity (dealt with in Chapter 7), and to further investigation of the areas where funding is under strain.

Even so, significant opportunities exist for many councils to make better use of current funding tools, and to further relieve funding pressures through better organisational performance and decision making (Chapter 5). Opportunities also exist for councils to innovate more and more effectively, leading to higher productivity (Chapters 5 and 9). The better use of existing funding tools is examined in the next section.

F6.4

The current main funding tools of local government in New Zealand measure up well against the principles of appropriateness for local government use, coherence within national policies and institutions, efficiency, enforceability, and the stability and predictability of revenue. Yet scope exists for many councils to make better use of their funding tools and this would help relieve funding pressures.

6.4 Making better use of existing funding tools

Councils have wide choice in how they raise the revenue they need each year to fund their expenditure. They can use many different combinations of general rates, targeted rates, UAGCs, user charges and DCs. They have a choice to use land value or capital value for rates based on property value, they can levy targeted rates according to various characteristics and they can apply rating differentials between different classes of ratepayers (residential, rural and business).

This section notes some differences between councils in how they use existing funding tools, and comments on how councils should be using the funding tools to implement the benefit principle (or the exacerbator principle) and to promote economic efficiency. A further objective is clarity and transparency – it is important that ratepayers understand the choices councils make in setting rates and charges. If ratepayers can see that rates and charges are being set in line with benefits received (even if only approximate alignment is achievable), then they are more likely to accept rating and other bills they receive from their councils.

Since the last major review of local government funding more than a decade ago, certain trends in how councils use their funding tools have emerged. These are described in Chapter 7. In total in 2019, rates will raise 58% of council operating revenue. This overall percentage has been stable since 2007, but it differs markedly across councils ranging from about 30% to over 80% in 2019.

The overall use of targeted rates has also remained stable. Yet councils' relative use of targeted rates, general rates and UAGCs is highly variable. For example, in 2019 Northland Regional Council, Masterton District Council and Marlborough District Council raised 100% of their rates revenue from targeted rates while Auckland Council raised about 76% from general rates and only about 12% from targeted rates (Insight Economics, 2019a).

Since 2007, councils have markedly reduced their use of land value as a rating base and increased their use of capital value. In 2007, 51% of councils used capital value; in 2019 this has risen to 71%. Also, a far greater percentage of general rates raised are now based on capital value (Table 6.2).

Table 6.2 Change from land value to capital value over time

Rating bases	% of councils using base		% of general rates raised	
	2007	2019	2007	2019
Capital value	51%	71%	41%	88%
Land value	47%	29%	33%	12%
Annual value	2%	0%	26%	0%
Totals	100%	100%	100%	100%

Source: Insight Economics, 2019a.

Notes:

1. The annual value of a property is now discontinued as a rating base. The annual value is whichever is the greater of (i) 80% of the gross annual rental, or (ii) 5% of the property's capital value.

Some trends have been favourable...

- Councils experiencing rapid population growth have been making greater use of DCs to help fund infrastructure needed to service new developments. From when councils acquired the power to levy DCs in the early 2000s, DC revenues increased until the Global Financial Crisis in 2008–09 when they dipped with construction activity. From about 2015, DC revenues have grown strongly again (Insight Economics, 2019b). In Auckland, the creation of Watercare, with the ability to levy volumetric charges for water and wastewater and connection charges for new customers, gives the Council Controlled Organisation (CCO) an independent source of revenue. This gives Watercare greater incentives and decision rights to bring in new ways of doing things to better serve customers over the long term (dynamic efficiency and higher productivity).
- The creation of the Local Government Funding Agency (LGFA) in 2011 has given councils easier access to debt at favourable rates. This has enabled councils to invest in needed infrastructure (both new and replacement) and spread the cost of it over the successive generations of ratepayers who benefit from it.

... but other trends have been less favourable.

- The shift from levying general rates on land value to capital value is not conducive to efficiency because land value is a highly efficient tax base while capital value can create a disincentive to add capital value and put land to its highest value use (NZPC, 2017).
- The use of rating differentials remains high but, at their best, differentials are a crude and non-transparent way to implement the benefit principle (discussed further in Chapter 7).
- Debt limits have hampered the ability of some high-growth councils to invest in infrastructure fast enough to meet the demand for new development.

Ongoing concerns about how DCs are being implemented

Property Council New Zealand is concerned that councils place “a heavy reliance on development contributions which are often used to supplement rates, rather than undertaking the due analysis required to collect them.” It “has significant concerns with the analysis that councils use to justify the use and proportionality of development contributions.” (sub. 117, p. 13)

In its submission, Foodstuffs notes it is not against the principle of DCs but is critical about how some councils operate their DC policies:

While we consider the use of DCs as justified, Foodstuffs has had occasion to question the reasonableness of individual charges and believes some councils are using their statutory powers to charge developers a disproportionate share of infrastructural development costs. (sub. 23, p. 4)

Foodstuff's submission was accompanied by an assessment of DCs by TDB Advisory (sub. 23, Appendix). Foodstuffs is a major developer of properties for supermarket purposes and has had a variety of experiences

at various sites throughout New Zealand. TDB Advisory assessed these cases against the principles for DCs in the LGA (Box 6.3). The main issues that TDB Advisory identified were:

- significant recent increases in DC revenues could suggest policy misuse by councils;
- disproportionate charging in excess of the costs imposed by developments;
- variation in charging across DC policies (from one year to the next) and across catchments;
- lack of transparency in councils' charging methodologies for DCs and in how councils calculate HUEs for specific developments; and
- system unreliability evidenced by errors, and a lack of integrated and up-to-date data.

To help it understand councils' use of DCs and assess the above issues, the Commission asked Insight Economics to conduct a review of the DC policies of four high-growth councils – Auckland, Hamilton, Tauranga and Queenstown Lakes (Insight Economics, 2019b).

DC revenues do not appear to have grown unreasonably since 2007. This is because revenues have closely tracked consents for new dwellings – as one might expect. Figure 6.2 plots DC and financial contribution revenues⁵² for the four high-growth councils of Auckland, Hamilton, Queenstown Lakes and Tauranga against building consents (with a lag of one year). The fall in revenues since 2007 mirrors the fall in development activity following the Global Financial Crisis, just as the rise from 2012 mirrors the subsequent increase in development activity.

DC charges in some of the Foodstuffs' cases did seem disproportionate. Yet whether they were indeed excessive often came down to whether councils gave enough HUE credits for work undertaken by the developer itself (eg, for roading works, stormwater works or water supply tanks) and the extent to which the development placed residual load on councils' infrastructure. Initial DC assessments can certainly be coarse and neglect site-specific factors. Councils mostly appear willing to consider these factors once developers provide the site-specific information. However, council systems may also be at fault because data is not integrated across different council departments. As a result, the DC database does not contain all relevant council information for a property.

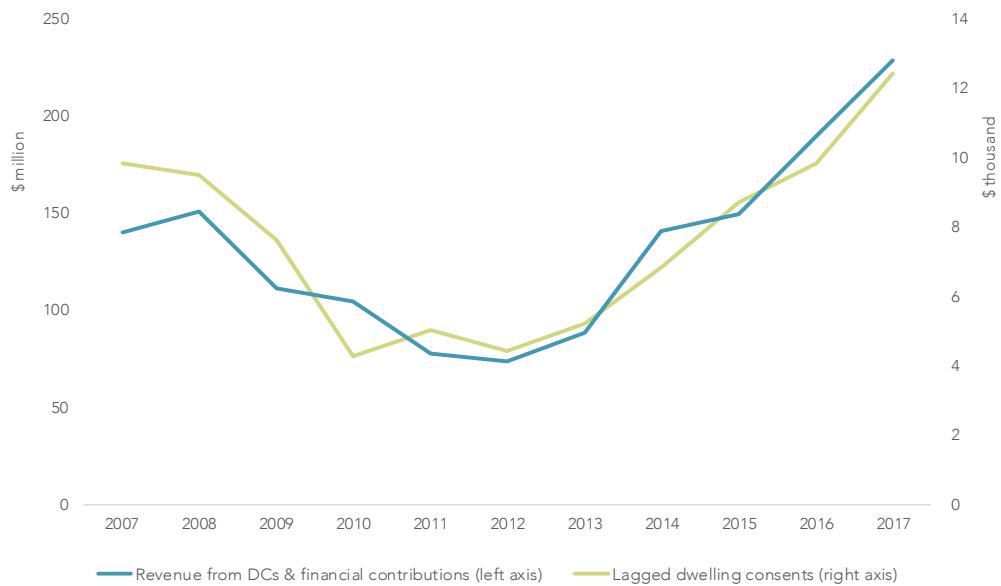
TDB Advisory chronicles significant inconsistencies in DC charging across different councils, developments and policy years. For example, a large single-retailer development in Queenstown got charged a stormwater DC of \$388 971 under the council's 2014-15 DC policy, yet a very similar adjacent development was charged a DC of only \$86 739 (under the council's 2013-14 policy). While charges for the same DC can vary for legitimate reasons across DC policy years, the changes should be modest and have a clear explanation. Neither was the case in this instance (sub. 23, Appendix p. 20).

Large inconsistencies are clearly undesirable. They undermine confidence in the DC system, undermine developers' ability to budget accurately for DCs when assessing feasibility and likely violate the principle of having a clear causal nexus between a development and council's expenditure on new additional or expanded infrastructure.

TDB Advisory and Foodstuff's last two criticisms of lack of transparency and system unreliability also raise concerns. It is important that councils explain their DC policies and methodologies well and make it clear in each instance how they arrive at the DCs they charge to developers. Methodologies should be available online, with supporting information such as the list of council infrastructure projects that feed into each DC charge.

⁵² Financial Contribution revenues are included because official data series report them jointly with DC revenues. Financial Contributions are like DCs but are levied under the RMA instead of the LGA.

Figure 6.2 Revenues from DCs and Financial Contributions vs lagged dwelling consents



Source: Insight Economics, 2019b.

Another desirable improvement, suggested by both TDB Advisory and Insight Economics, is to require councils to follow a standardised template for their DC policies and another one for the DC assessments that they make for individual developments. This will improve transparency and understanding and reduce compliance costs for developers dealing with different councils.

The Insight Economics (2019b) review of the DC policies of the four high-growth councils since the 2014 amendments found much that is sound and in line with the LGA purpose and principles for DCs. It reviewed each council’s DC policy under the headings of “cost allocation methodology”, “funding areas” (ie, the catchments within which developments are linked to council infrastructure required for growth), “cost recovery methodology”, “development types and conversion ratios”, “policy content, transparency and overall usability” and “policy strengths and weaknesses”. The review concluded that, overall,

... certain policy features have evolved over the last five years, such as greater use of localised funding areas, and the identification of more development types. Both help forge closer links between the infrastructure demands of specific developments (in certain locations) and the suite of capital works that they are required to help fund via DCs. Accordingly, both help give effect to the DC principles.

While the DC policies for Auckland, Hamilton, and Tauranga represent sophisticated and well-written documents that reflect constant refinement over an extended period, we consider Queenstown’s policy to lack the same quality and detail. Although Queenstown’s population is considerably smaller, and its Council therefore possibly not as well-resourced, the policy appears to be deficient in many ways and should be updated to align with best practice.

That observation aside, we believe that the DC policies reviewed in this report generally reflect the DC principles to the greatest extent practicable, and thus provide a transparent and reliable platform for setting DC charges. (p. 29)

F6.5

Development contribution (DC) policy and implementation are inherently complex. Good examples exist of council DC policies. Councils appear to have been refining and improving them over time. Yet the DC policies of some councils still fall considerably short of best practice. The good policies provide a transparent and reliable platform for setting DC charges in line with the purpose and principles of DCs in the Local Government Act 2002.

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.

Depreciation and managing “depreciation funding”

Depreciation is a significant expense for most councils and has been growing as a proportion of total council operating expenditure (opex) (Figure 3.7). This partly reflects that councils own increasing quantities of physical assets. Depreciation spreads the initial investment cost of purchasing or constructing assets over their useful lives. Local authorities’ general approach to depreciating their infrastructure assets is satisfactory (Public Sector Performance (NZ) Ltd, 2019).

Even so, several issues relating to depreciation impinge on local government funding and financing. First is managing “depreciation funding” – the large amounts of cash that can become available to councils when they take in revenue to cover depreciation cost. Second, is accurate estimation of asset lives and its impact on estimating depreciation. Third, is the lack of merit in one of the financial prudence benchmarks that councils are required to report on, the Essential Services Benchmark.

Managing depreciation funding

Depreciation is a large expenditure item, and councils normally must balance their budgets in accrual terms. While the depreciation component of opex is a non-cash item, revenues to pay for depreciation are largely realised in cash. Hence, depreciation funding can generate large amounts of cash. How should councils manage these large cash balances that can arise?

Were a council to put all the depreciation cash into a reserve account and invest it in safe low-yielding financial assets, the funds would be likely to build up to levels great enough to cover the cost of replacing the asset at the end of its useful life. But this may not be the best use of the funds. To determine the best use, a council should treat the decision as part of its wider financial and infrastructure strategies. The Commission consulted Professor Ian Ball, a public-sector accounting expert, who commented:

“Depreciation funding” should be seen as simply one element of a number of factors that need to be considered in developing financial and infrastructure strategies. These include factors related to the condition and future life of major assets, projected growth in the demand for services, levels of rates and charges relative to community income and wealth, external economic factors such as interest rates, risks such as climate change and natural events, and the community and council’s attitude to risk and resilience. Also relevant is how councils view intergenerational equity, and the desirability of spreading the cost of infrastructure assets over their economic life. (Public Sector Performance (NZ) Ltd, 2019, p. 26)

Monitoring the condition of assets and estimating asset lives

The Auditor-General has expressed concern in his report on matters arising from audits of council 2018-2028 Long-Term Plans (LTPs) that lack of knowledge of the condition of their assets could be leading councils to be overly conservative in their estimations of asset lives. This in turn could lead to over-estimation of depreciation expense. Several submitters, including councils, agreed with the need for improved knowledge about the condition of assets (eg, Ruapehu District Council, sub. 85; Tararua District Council, sub. 18; Water New Zealand, sub. 19; Whangarei District Council, sub. 46).

The consequence of setting depreciation expense higher than it should be is that, given the balanced-budget requirement, ratepayers could be paying more than they should be for services that their council charges them for, and rates could be higher than they should be. This could also be placing more of the cost burden of assets on the current generation.

Section 5.7 describes other benefits from councils’ improving their asset knowledge. The Auditor-General called on councils to continue to work on improving their knowledge about the condition and performance

of their assets and “should prioritise work on confirming whether the asset lives they have assigned to their assets are accurate” (Office of the Auditor-General, 2019b, p. 23).

The Essential Services Benchmark is not sensibly framed

The Essential Services Benchmark is one of several financial prudence benchmarks in the Local Government (Financial Reporting and Prudence) Regulations 2014 that councils must disclose in their LTPs, Annual Plans and Annual Reports. The benchmark is that “[a] local authority meets the essential services benchmark for a year if its capital expenditure on network services for the year equals or is greater than depreciation on network services for the year” (Local Government (Financial Reporting and Prudence) Regulations 2014, 20 (1)).

The aim of this benchmark is to monitor the extent to which councils are investing adequately in renewing their infrastructure. The Auditor-General has expressed concern that councils appear not to be doing so for their core assets. He examined forecast renewals expenditure as a proportion of forecast depreciation across councils over 2019 to 2028 (as reported in LTPs) and found average ratios less than 100% for all core asset classes except flood protection and control works. The average figures over the period for other classes were roading (83%), water supply (82%), wastewater (67%) and stormwater (52%).

These figures certainly raise a concern that the investment intentions across all councils and over a horizon of 10 years are too low. But the Essential Services Benchmark does not measure renewals over many councils and years – it suggests that each council should be investing in renewals each year at least as much as its depreciation expense. Yet, as Ian Ball, points out:

While depreciation is allocated in a relatively smooth pattern over the life of an asset, the cost of asset acquisition is inherently lumpy. Other things being equal, the larger the number of assets owned by a council, the smoother would be the pattern of capital expenditure. A council with fewer significant assets would tend to have a lumpier capital expenditure pattern associated with the replacement of those assets, than would a council with a larger portfolio of significant assets.

To a degree, this calls into question the appropriateness of the Essential Services Benchmark that capital expenditure in a year is equal to or greater than the depreciation expense. The relationship between depreciation expense and capital expenditure should be viewed over a longer time period than a year. (Public Sector Performance (NZ) Ltd, 2019, p. 26)

Several submitters also made the point about the lumpiness of asset-renewal expenditure (eg, Greater Wellington Regional Council, sub. 68 and Selwyn District Council, sub. 84).

R6.2

While local authorities’ general approach to depreciating their infrastructure assets is satisfactory, three issues are of concern and may require action:

- councils’ decisions about the best use of the large amounts of cash that depreciation funding can give rise to should be part of formulating their wider financial and infrastructure strategies;
- councils should prioritise improving their knowledge of the condition and performance of their assets to, among other benefits, avoid the risk of underestimating asset lives and overestimating depreciation expense; and
- the Essential Services Benchmark should be reviewed as part of the wider review of the local-government performance reporting framework referred to in Recommendation 5.4. Any reframing should avoid the implication that individual councils must invest in as much asset renewal each year as their depreciation expense.

What is the best way to use the current funding tools?

In *Better Urban Planning*, the Commission put forward a decision framework laying out a sequence of questions that would guide decision makers to choose the best instrument for funding infrastructure (NZPC, 2017; Oliver, 2016). With some modifications, the decision framework can be used as a guide to the broader question of what funding tools are best for services as well as infrastructure (bearing in mind that the two are closely related because the delivery of most local government services relies on underpinning infrastructure).

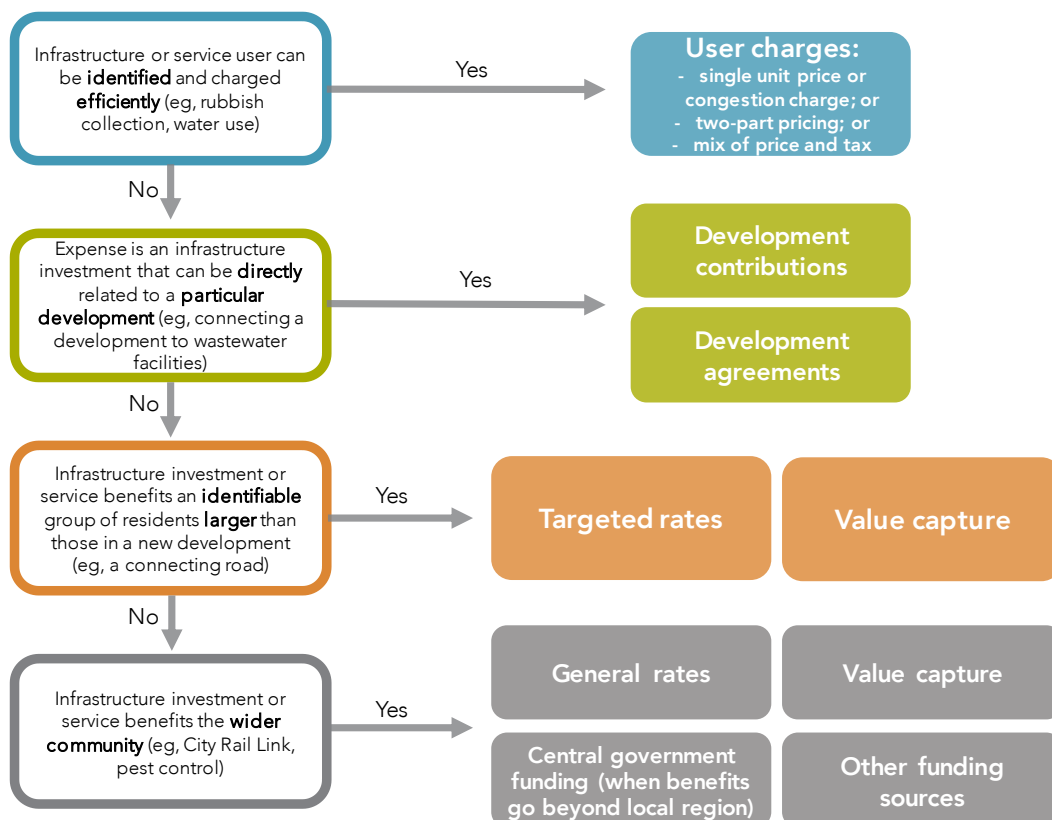
The decision framework is shown in Figure 6.3 and is based on important distinctions explained in section 6.1 (under the Efficiency subheading) between public and private goods and whether the set of beneficiaries can be identified and charged. The choice of funding tool is dictated by what scores best on a combination of efficiency and the benefit/exacerbator principle.

A further consideration is to balance the achievement of economic efficiency with keeping compliance and administration costs low. In some cases, keeping funding instruments simpler may sacrifice economic efficiency. Yet the simplicity avoids higher compliance and administration costs to an extent that the trade-off is a net benefit.

Local authorities can be monopoly suppliers of some services to citizens. The lack of competition creates risks that the services will be supplied inefficiently, or below an acceptable quality, and/or they could be overpriced. Two forms of protection against these risks are democratic accountability and transparency but these vary in effectiveness (Chapter 5). Another mechanism often used to mitigate risks with private monopolies is regulation. Chapter 9 examines the use of regulation to improve water and wastewater services.

It is important to note that this framework does not consider ability to pay. The next chapter analyses and discusses how this key concern can be factored in.

Figure 6.3 Decision-making framework for choosing funding tools for local government services and investments



The decision framework includes a value capture tool. This is not currently available but is further described in section 6.5. Central government funding is dealt with in section 6.8.

As with congestion charging, local authorities are not legally able to use taxes to discourage environmental “bads” such as discharging pollutants into the air or water bodies or onto land⁵³. Such taxes can be an efficient means to modify behaviour and improve environmental quality. They are not primarily for raising revenue. The recent Tax Working Group developed a “Framework for taxing negative environmental externalities” and stated that significant scope exists for New Zealand to make greater use of environmental taxes (Tax Working Group, 2019). Regional councils in particular could be well placed to make use of environmental taxes to help carry out their environmental stewardship responsibilities.

R6.3

In choosing among funding tools, rating bases and whether to charge rates as a percentage of property values or as uniform charges or some other targeted feature, councils should emphasise the benefit principle and efficiency in the first instance. They should also balance greater economic efficiency against lower compliance and administration costs.

Councils should factor in any significant concerns about ability to pay at a second stage in their decision making.

6.5 Funding and financing growth

The previous sections concluded that the funding powers and tools of New Zealand local governments mostly measure up well against the principles of appropriateness for local government, coherence with national policies and institutions, economic efficiency, and capability to achieve equity and fairness. They also produce revenue streams that are stable and predictable, and the tools are not prone to avoidance. However, the sections did not answer the important question of whether powers and tools are fiscally adequate – can they produce enough revenue for the needs of councils, particularly for local authorities with fast-growing populations?

This section investigates this question. Does fiscal inadequacy lie behind the failure of some high-growth councils to supply enough infrastructure to serve land to meet housing and business demand?

Conclusions from past inquiries into how councils fund growth

In three past inquiries, the Commission has investigated the topics of housing affordability, the supply of land for housing and better urban planning (NZPC, 2012, 2015, 2017b). These topics are closely related to each other and to this section.

A recurring question in all three inquiries has been, from a council’s perspective, “does growth pay for itself?”. More precisely, as the population of a district grows, are the revenues that accrue to the council from the new residents and their properties enough to cover the costs that the council incurs from the growth (eg, the costs of new water, wastewater, roading and community infrastructure)?

If growth does not pay for itself, some of the costs of growth will fall on existing residents. Across all three previous inquiries, and in this one (as noted in Chapter 4), the Commission heard from many councils and others that growth does not pay for itself and that, perhaps more importantly, many residents of growing cities or towns *perceive* this, and that growth puts a financial burden on them. Naturally, these residents put pressure on councils to resist growth because it will hit them in the pocket. This lack of enthusiasm for growth (either expanding the urban geographic footprint or by urban intensification) has been a significant contributor (although not the only one) to the undersupply of development capacity for housing in fast-growing urban areas. In turn, this supply-demand deficit has been a major driver of rapid and harmful house-price increases in New Zealand since about 2000.

⁵³ In the case of waste disposal, a Waste Disposal Levy is payable by landfill operators (many of whom are councils) who pass it on to customers. The revenue goes to central government and it is then partly returned to territorial authorities for waste minimisation activities.

In the last of the three reports – *Better urban planning* – the Commission’s research on urban growth led it to conclude that a council’s additional revenues from growth *can* cover the costs of the infrastructure needed for growth. Yet this conclusion was subject to several caveats.

- Council’s growth expenses will tend to arrive early in the growth cycle (eg, for large, lumpy pieces of infrastructure) while revenues (eg, additional rates and charges) will be spread over many following years. Councils will need to finance these timing gaps by borrowing if costs are not to be a burden on existing residents.
- Councils must bear the risk of making their large, lumpy investments in infrastructure based on forecasts of demand growth that are uncertain. If the forecasts turn out to be over optimistic, councils are locked into their expenditure and may face high borrowing costs and underused assets at the same time as facing a rating-revenue shortfall relative to expectations. In other words, councils face significant risks in trying to fully service growth in their districts.
- Lenders and credit-rating agencies place debt limits on councils which if exceeded would lead to a downgrading of the councils’ credit rating and higher interest costs. The limit that fast-growing councils are most likely to find binding is the ratio of total debt to revenue (which must stay under 270%). This limit is a binding constraint on some fast-growing councils such as Auckland and Tauranga and prevents them from investing as much as they need to keep up with growth (despite the prospect of strong council revenue increases that would more than pay for the additional borrowing over time).
- The political economy is often not favourably disposed to growth because, even if evidence indicates that growth can pay for itself, existing residents do not perceive it this way or they resist the council taking on more debt (which in turn means that the costs of growth would indeed need to be funded in part by current residents). The high visibility of rates compared to GST and PAYE tax contribute to the political-economy resistance (see next section).

Because of these concerns, and considerations of fairness, the Commission recommended a new funding tool for councils. The tool would raise revenue by “value capture”. Property owners who enjoyed windfall gains in the value of their property because of nearby infrastructure that the public has funded, would be required to pay a portion of this gain to the council. In turn, revenue raised would help the council fund future growth. The Commission made the following recommendation (NZPC, 2017, p. 334):

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

The Government has so far not responded to the Commission’s recommendation. If value capture were introduced in the way recommended, it would yield additional revenue associated with growth because the increase in the value of urban property is a natural part of urban development as public and private investment makes nearby land more valuable.

Another source of additional revenue could come from removing rating exemptions. In previous inquiries, the Commission has recommended that central government should pay rates on its properties. The TOR for the current inquiry direct the Commission to make no recommendations on this topic.

As explained in *Better Urban Planning*, the funding tools that a council could use under current law to fund investment in growth infrastructure without putting a burden on existing residents are:

- resource-consent fees;
- development contributions (developers also typically pay for and install infrastructure in a subdivision, and that infrastructure is then vested with the council);
- infrastructure growth charges (IGCs) (Auckland only, paid to Watercare by property owners or developers for connections to Watercare’s water and wastewater networks. The charge contributes to the capital cost of new or enlarged treatment plants and pipe networks to meet growth in demand);

- targeted rates on new properties that benefit from any new infrastructure not already paid for by DCs or IGCs (eg, for roads, stormwater, freshwater, sports facilities, parks and reserves);
- water charges (which could be targeted rates, fixed charges, volumetric charges or a combination of these);
- wastewater charges (only Watercare in Auckland can charge volumetrically, but other councils can use targeted rates);
- solid waste management charges; and
- regional fuel levy (currently Auckland only, revenue will increase as regional traffic increases with growth).

The Commission has recommended in past inquiries that the Government should give councils the power to levy volumetric wastewater charges and road-congestion charges. It concluded that adding these powers and the value-capture tool to existing funding tools would be likely enough to give councils the means to fund growth without placing a financial burden on existing residents (providing large, upfront costs can be financed with additional debt). These means would be fair because the costs fall on those who benefit – the new residents. They would also be efficient given the efficiency of user charges, DCs, congestion charges, and the reasonable efficiency of rates – particularly when based on land values.

F6.6

Councils have a portfolio of charging and rating tools to recover the costs of their growth-related infrastructure investments. Yet cost recovery may take many years, councils face investment risks (eg, over-investment or investing in the wrong location) and some councils face debt limits. Councils also face political pressure to not support growth. The result is that some councils in fast-growing cities are either not willing, or not able, to invest in growth-related infrastructure at levels that match demand.

F6.7

Giving councils powers to levy a value-capture rate, congestion charges and volumetric wastewater charges would give them additional means to recover the costs of growth without burdening existing residents. Yet some councils and their residents may still not be willing to accommodate growth to the extent needed for supply to match demand.

Despite available funding tools, the perception still exists that growth harms existing residents

Investing to meet the demand for housing and other amenities in fast-growing cities has very high social returns (NZPC, 2017). Yet, as noted, the returns to councils and existing residents from investing in growth sometimes appear to them to be negative, or, even when they see the investments as desirable, limits on debt stop the investments. The high social returns mean that it is of the utmost importance to lower the barriers to these investments.

Concerns about the negative attitudes of existing ratepayers towards growth have been echoed by the Minister of Housing and Urban Development, Hon Phil Twyford. In a speech to the New Zealand Initiative on 22 March 2019, he stated:

[T]o a large extent, local government politicians have been unable to convince their ratepayers to invest in growth, leaving a burgeoning infrastructure deficit for the next generation.

The unwillingness or inability to invest in the infrastructure to support development stops cities growing. When a city cannot grow in response to demand, a pressure cooker effect is created, which is what has given Auckland some of the most expensive urban land and housing in the world relative to local incomes.

One barrier that submitters and others often mention to the Commission is that the rating system does not automatically generate more revenue when economic activity in a council district grows. They draw a contrast between local and central government funding tools. The latter set of tools includes income tax and

GST that generate more revenue for the central government as the volume of economic activity grows. This does not happen under the rates system. Councils do not set the equivalent of the rate of GST or the rate schedule for income tax and then see what revenue those rates (combined with economic activity) will bring in. Rather, councils are obliged to decide on their expenditure needs and then set rates yearly to generate enough revenue (after considering receipts from user charges, development contributions and other sources).

In addition, it is argued that citizens find income tax and GST far less painful forms of taxation because money gets taken either before it gets into taxpayers' pockets (income tax) or in the act of spending (GST). In each case, the tax is deducted automatically while rates require property owners to make explicit payments from their existing funds to councils. The different perception is partly irrational, but it is also understandable: because of the way PAYE tax and GST deductions work, taxpayers have a cashflow out of which to pay these taxes. But ratepayers do not necessarily have cash on hand when rates are due.

The Government recognised in 2017 the importance of investing in urban infrastructure to keep up with the growth in residential and business demand by issuing a National Policy Statement (NPS) for Urban Development Capacity. This NPS acts as a regulatory instrument that tries to compel councils to make available enough land for development and service it with infrastructure. This is a "stick" approach to incentivising councils. The Commission's sees merit in considering a "carrot" incentive to complement it.

F6.8

Many councils and ratepayers still perceive that council revenue from local growth does not fully cover costs that councils incur from growth and that therefore growth is financially disadvantageous. This perception is exacerbated by the:

- highly visible way that property owners are billed for and pay rates;
- much less visible way that most people pay income tax and GST; and
- the automatic link between economic activity and revenue from income tax and GST which does not exist for rates.

Property taxes and other tools that link revenue to growth

Some organisations and individuals have called for an additional funding tool or a modification of the current rates system that, like income tax and GST, would have an automatic link between growth and revenue. Such a tool could create an incentive for councils to embrace growth and alleviate concerns of existing residents that growth is a burden on local government finances and will disadvantage them financially. Several candidates for such a funding tool have been suggested:

- a local property tax;
- local income or sales taxes; or
- a portion of national GST or income tax.

A local property tax

Many local authorities in the United States and elsewhere draw significant funding from local property taxes. Each authority sets the property tax rate as a percentage of the value of property in its jurisdiction.⁵⁴ If the value of a property increases or decreases, the amount of tax paid adjusts accordingly. If property values generally increase across a jurisdiction, then the authority would automatically gather more revenue. New houses and businesses in an area, as its population grows, would also increase revenue automatically.

The two automatic and transparent links – between the growth in property values and council revenue, and between the number of properties and council revenue – would mean that the level of revenue determines the amount a council can spend rather than councils having to set expenditure at step one and then set rates to cover this expenditure at step two, as under the current system. It is argued that linking the growth in property values and council revenue would better align incentives for councils and existing residents to

⁵⁴ For example, across the 50 US states in 2007, residential property tax rates varied between 0.14% in Louisiana and 1.84% in Texas (Tax Foundation, 2009).

favour what is good for the whole community – that the growth in the quantity and quality of property matches demand.

Glaeser (1996) developed a model that shows how a local property tax could align incentives and achieve an efficient outcome. The model assumed that councils are not pure agents of local voters or benevolent maximisers of social good. Rather, their main objective is to maximise council revenue; and this gives rise to the need for a judicious mix of incentives and constraints on them (Box 6.4). Glaeser wanted to explain why local property taxes are widely used at the subnational level in the United States.

Box 6.4 **A model of the incentive effects of property taxes on local governments**

Elected representatives are assumed to want to maximise the revenue of their local government.

Property owners in a community want the right amount and mix of local amenities and the extent to which each local government delivers these is reflected in property values. Citizens move to communities with local amenities, and what the local government charges in local property taxes for those amenities, that best suit their preferences.

Each local government knows that, to maximise tax revenues, it must invest the revenues in the right set of amenities for its population – because these amenities are the ones that will maximise property values and therefore tax revenues. Further, current property values will reflect expectations of future amenities. As Glaeser notes, this has an important effect on politicians:

Since property values will reflect, immediately, expectations about improvements in future amenity levels, taxes based on property values will induce politicians to worry about the future. (p. 4)

While the Glaeser model gives interesting insights into why property taxes could provide a highly transparent link and incentive for local governments to invest efficiently in local amenities, Oliver points out several caveats that limit its application to the problem of councils not embracing growth in New Zealand.

- The model focuses on amenities that benefit existing dwellings and not on those required for the additional dwellings needed for a growing population.
- Local amenities provided by US local governments include schooling and policing that are likely to have a much more direct impact on property prices than the basic transport and water infrastructure that are the main responsibilities of New Zealand local governments.
- Revenues in practice will be neither stable nor predictable. Property taxes risk generating either too much or too little revenue because property prices can grow strongly over extended periods for reasons unrelated to the quality and quantity of local amenities, and sometimes they can drop quite sharply.⁵⁵
- The US has strong constitutional provisions against Congress bailing out states (and by implication other subnational levels of government). The threat of bankruptcy is real, and this provides robust incentives for local authorities to act fiscally prudently and responsibly. In New Zealand, local governments face “softer” budget constraints. Instead, fiscal discipline is provided through the rating framework that requires councils to be very transparent in setting out expenditure in long-term plans, setting annual expenditure and rates, and abiding by a set of financial prudence benchmarks.

Source: Glaeser, 1996; Oliver, 2019.

⁵⁵ Concerns about property-tax revenue increases in California led to the famous Proposition 13 ballot of voters who voted in 1978 to restrict annual revenue increases to 2% and to set a maximum rate of 1%.

Several submitters echoed the concerns described in Box 6.4 about the volatility of property tax revenues and the reduction in fiscal discipline such volatility could cause. For example, Waikato Regional Council submitted:

A disadvantage of this approach is that Council's revenue is dependent on the property values of its area. In a growing area, the tax revenue would likely grow with expenditure. However, in a declining area, if property values are falling this could create serious difficulties for councils as their revenues fall too. Similarly, if property values are over-valued for a sustained period, a bursting of the bubble may create a cash-flow crisis for a council. The thinking behind the rating system is that revenue can only be raised for the things that the community wants and has collectively agreed to pay for. This acts as a kind of discipline on local government. This would not be the case for a local property tax which is a disadvantage. (sub. 125, p. 17)

Glaeser et al. (2005) have presented strong evidence that the strictness of planning regulations largely explains shortages of land for housing (and therefore housing affordability) rather than the method of local taxation. The Commission agrees that this evidence is convincing.

For this reason, and the caveats listed in Box 6.4, a property tax (levied as a percentage of the value of properties) would cause significant concerns in the New Zealand context. The Commission agrees with Oliver that a property tax is not the answer to the problem of councils lacking enough incentive to embrace growth. Oliver (2019, p. 14) summarises his conclusion:

What sort of changes to the rating framework would be required to better align incentives? A move to a property tax along the lines considered in this paper would require a relaxation of the existing fiscal constraints on councils, closer government micro-management of council expenditure forecasts or imposition of market driven fiscal constraints as per USA. Such options do not seem viable or justified in the New Zealand context.

Overall the preferred approach seems to be to retain the existing rating framework and encourage councils to utilise the tools they have in order to align the costs of growth with the benefits from growth. This might include some relaxation in revenue raising rules (such as allowing for value capture along the lines of previous Productivity Commission Reports.) This seems to be the preferred option.

Yet despite this conclusion, a perception problem may remain because of how rates are set in the current rating framework. The way they are set provides fiscal discipline, yet it can fail to incentivise councils and voters to support growth.

F6.9

While local property taxes are in widespread use in other parts of the world such as the United States, they are not a panacea for aligning the incentives of existing voters and property owners with socially desirable growth rates in dwellings. Given that property prices in New Zealand have been neither stable nor predictable, property tax revenues would not be either, and this would be undesirable. The highly transparent system of rating in New Zealand provides a fiscal discipline on councils and should be retained.

Local income or sales taxes

The Commission examined the case for a local income or sales tax in its *Better urban planning* inquiry. While revenue from these taxes would increase with local economic activity and councils would benefit more directly from growth, it found that implementing such tools in New Zealand would be complex and difficult. These taxes would be likely to have high administrative and compliance costs. Revenue from them would be more volatile than from rates and they would make it difficult for councils with falling populations to maintain existing service levels.

In his report for the Commission for its inquiry into *Better urban planning*, Oliver (2016) gave an example of the difficulty and complexity in determining in which local authority a company's income is earned and tax is payable.

Local authority income tax could be implemented as a surcharge on the existing income tax with the surcharge set by each region. However this form of tax would require complex rules to allocate the revenue to each local authority – an internal web equivalent to our international tax treaties... These

rules would need to decide, for instance, where to allocate the tax on a company with a Christchurch Head Office, owned by shareholders in Dunedin, manufacturing in Wellington and selling in Auckland.

Given that allocating company income and tax would be highly complex, a practical local income tax could be restricted to tax on personal income with taxable income being identical to each person's income for national income taxation. IRD could simply apply a local income surcharge on each person's taxable income. Yet this system would require each person to have an authentic address that fairly reflected their use of local services. The system could also be open to individuals "sheltering" their income in companies that they control in order to avoid the local income tax surcharge.

Designing and implementing a local GST would also be complex and problematic. A sales tax on final goods and services within a local authority would be simpler but would face the difficult tasks of determining goods and services that are for final consumption rather than for sale to another business, and collecting and enforcing the local tax on those sales.

Even so, the Commission is aware that local income and sales taxes exist in other countries (Bailey, 1999; OECD & UCLG, 2016). It plans to investigate the design and characteristics of these and report on them in its final report.

The options of local income and local sales taxes received mixed support in submissions to the Commission's issues paper. Some submitters drew attention to the benefit of revenue being more buoyant and reflective of local economic activity and the incentive effects of this on councils to support growth (Ruapehu District Council, sub. 85, p. 14; NZ Initiative, sub. 96, p. 26; LGNZ, sub. 112, p. 24; Infrastructure NZ, sub. 128; p. 28). Yet some of these same submitters and others also drew attention to the downsides of complexity and volatility (Wellington Chamber of Commerce, sub. 72, p. 13; Rangitikei District Council, sub. 115, p. 11; Ruapehu District Council, sub. 85, p. 14; NZ Initiative, sub. 96, p. 26; Waikato Regional Council, sub. 125, p. 16).

A portion of national GST or income tax

Several submitters to the Commission's issues paper argued that local government should have access to a portion of national GST or income tax to solve the failure of rates to provide enough revenue for councils to fund growth (eg, Youth Hostels Association of NZ, sub. 64, p. 4; Selwyn District Council, sub. 84, p. 4; Whakatane District Council, sub. 121, p. 7; Hamilton City Council, sub. 130, p. 7). Like a local income or expenditure tax, the revenue from this access would increase automatically with economic activity. Submitters argued however that, unlike their local versions, the administrative and compliance costs of such access would be low. All the tool would require is a formula allocating across local authorities whatever portion of national GST or income tax that central government agreed to give up.

This proposal has two main problems.

- A fair allocation formula is likely to prove elusive if by "fair" is meant an allocation reflecting how much income or spending has occurred in each local authority. As noted for local income or sales taxes, it would be highly complex and costly to determine these shares. Even a formula based on population share would not be easy, given the infrequency of census counts and the frequency with which many households move.
- The approach would be likely to undermine local autonomy and accountability by putting more of a local authority's revenue outside its control. Local politicians would be able to blame central government for setting the portion too low or for unfairness in the allocation formula, rather than conducting a more honest discussion with the local community about how much local people are prepared to pay for additional services.

The Commission's conclusion at this draft stage is that none of the above options is satisfactory because they do not meet one or more important criteria for a good local tax.

F6.10

None of the options of a local property tax, a local income or sales tax, or a portion of national GST or income tax is a fully satisfactory solution to the problem of councils and existing property owners and voters failing to embrace growth, because no direct and transparent link exists between growth and council revenue.

Each option does not meet at least one important criterion for a good local tax. The revenue from local property tax would be neither stable nor predictable, local income and sales taxes would be complex and likely to have high administrative and compliance costs, and a portion of national GST or income tax would be likely to undermine local autonomy and accountability.

A system of payments from central government to territorial authorities based on new building work put in place

Another way to provide a direct link between local growth (that puts pressure on council infrastructure spending) and council revenue would be a system of central-government payments to territorial local authorities based on the amount of new building work put in place in each territorial authority's jurisdiction. Such a tool would tick several boxes in that it would:

- be largely consistent with local autonomy and accountability;
- link council revenue directly to local growth and development; and
- be transparent and relatively low cost to administer – the payment would be proportional to a simple estimation of construction and development in a territorial local authority's area (eg, based on the value of building consents or new construction measured by floor area).

The direct link between new building work in a jurisdiction and council revenue would incentivise councils to facilitate development and construction – two activities over which they have a considerable influence through land-use planning and infrastructure investment.

This option has similarities to schemes that operate in some European countries such as Germany where local politicians have strong incentives to support development. The system in Germany is complex but, critically, the revenue of municipalities comes partly from a share of income tax and from state-government grants where each of these is linked directly to local economic activity and the number of local inhabitants. This incentive to grow council revenue through attracting business and new residents has seen councils compete with other municipalities by providing land and infrastructure to the extent that house prices in Germany have been stable for decades. As Evans and Hartwich (2005, p. 27) note:

They [the councils] have very clear incentives to provide land for residential and commercial uses as they receive state grants based on the number of inhabitants and are required to finance their local infrastructure with tax revenue created at the local level.

In addition, a scheme of central government grants to territorial authorities directly linked to new building can be justified under the benefit principle because of the strong national interest in an adequate supply of infrastructure-serviced land and new houses to meet demand. As noted, the sluggish supply of these in council areas with high population growth has been the major driver of the very socially and economically damaging rise in house prices in New Zealand over the last two decades.

The level of the payments and what they would be based on would be choices for central government. It would be important that factors determining the size of the payments are clear and stable to maximise the incentive effect on councils. Relatively modest payments (as a percentage of total rates revenues) could have quite strong incentive effects. Total rates revenue of all councils in 2018 was about \$5.8 billion. Five per cent of this, for example, would amount to a yearly fiscal cost for central government of about \$290 million. The total value of building work put in place in 2018 was \$22.76 billion (Stats NZ, 2018f).

Possible rules for allocating the revenue would be (i) the floor area of completed new buildings, (ii) the value of building consents or (iii) the value of building work completed in each year in each territorial local

authority area. The relative size of the chosen measure across local authorities would determine the division of the total payment across councils.

The total payment could be fixed in dollars, adjusted each year with a price-level index, or be a percentage of total rates or other suitable variable. While the rules would remain stable over time in normal circumstances, it would be important for the Government to retain ultimate control over the rules to ensure national fiscal management.

Given the novelty of this proposal, the Commission would like to test it with interested stakeholders. It is interested to obtain a full picture of the proposal's advantages and disadvantages, to understand what the best design for such a mechanism would be, and to hear whether others think it would be effective in incentivising councils to respond to growth pressures.

F6.11

A system of payments from central government to councils based on new building work in territorial local authorities could offer local government a practical additional funding source. The system would substantially preserve local autonomy and provide a direct link between council revenue and a council's effectiveness in keeping land supply and infrastructure responsive to demand. This could be effective in incentivising councils and their existing ratepayers to support growth.

R6.4

The Government should consider implementing a system of payments to territorial authorities, based on new building work put in place in each territorial local authority, to incentivise councils to increase the supply of infrastructure-serviced land to match growth in demand.

Q6.2

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?

Reducing the barrier to local growth from council debt limits

In its *Better urban planning* inquiry, the Commission found that fast-growing councils who were close to reaching their borrowing limits on council debt faced a problem. The limits were contributing significantly to the councils' failing to supply enough infrastructure (to service new property development) to keep pace with demand for development. The Commission commented:

Such limits have high social costs – the large foregone net benefits from preventing highly-valued development (well in excess of its opportunity costs) going ahead. Further, capital is not in short supply. Particularly now, with the world awash with cheap capital looking for secure and reasonable returns, this is a large system failure. It is damaging the wellbeing of many thousands of New Zealanders because, for example, housing is unaffordable for them. (NZPC, 2017, p. 338)

It is not surprising that fast-growing councils need to borrow large amounts if they are to spread the costs of growth across the future residents who will be beneficiaries of the new growth infrastructure. This avoids imposing growth costs on current residents. Instead, the beneficiaries – the future residents – will provide the payments (eg, by means of a targeted rate) to service the loan and meet the cost of the growth infrastructure.

The debt limit used most often is keeping a council's debt-to-revenue ratio below 270%. Fast-growing councils who are close to this limit, or for whom it could become a problem, include Auckland, Tauranga, Hamilton, and Kāpiti Coast. This limit comes primarily from rating agencies such as Standard & Poor's and Moody's, but the LGFA (the main lender to councils), and the Local Government (Financial Reporting and

Prudence) 2014 regulations also impose limits. In its submission, Auckland Council explained the implications for borrowing costs of exceeding its debt limit.

Borrowing beyond our debt ceiling – which the council is very close to – would risk a downgrade to [our] credit rating, meaning higher interest costs across all our borrowing and a reduced ability to access capital markets. A downgrade in Auckland Council's credit rating would also impact on the credit rating of the Local Government Funding Agency (LGFA) thus also impacting the borrowing costs of all other councils that raise funds through the LGFA. (sub. 120, p. 6)

Property Council NZ pointed to the debt limit's impact on the failure to fund much needed infrastructure:

In developing the [Future Urban Land Supply Strategy], Auckland Council recognised its significant barriers to financing and funding all the necessary infrastructure within the timeframes needed to meet projected demand. ...the strategy attempts to help manage these financial issues by sequencing land release over time, [but] it has not resolved how and when the necessary infrastructure investment can be funded. (Sub. 117, p. 4)

Despite the importance of solving the council's debt-limit problem, the Commission found it difficult in its *Better urban planning* inquiry to come up with a fully satisfactory solution. It recommended a debt-constrained council such as Auckland should tackle the problem by some combination of:

- raising more revenue so it can borrow more within prescribed debt-to-revenue limits;
- financing more infrastructure on the balance sheets of others, such as private homeowners and body-corporate entities in large new subdivisions;
- negotiating central-government capital grants or some form of debt guarantee when a national interest exists; and
- working with central government and finance experts to make the case to credit-rating agencies to impose less stringent limits in return for assurances on creditworthiness and fiscal prudence.

Since the 2016 *Better urban planning* inquiry, progress has occurred on the first three of these options.

- Parliament passed regional fuel tax legislation in 2018 that allowed Auckland to introduce a tax of \$0.10 a litre (the maximum rate allowed in the legislation), to support transport projects that would otherwise be delayed or not funded. NZTA collects the tax directly from fuel distributors and passes it back to Auckland Council (less a service cost and less any rebates paid). This additional revenue increases Auckland Council's borrowing capacity. Under the legislation, the Minister of Finance and another Minister have "complete discretion" to approve or decline proposals from regional councils to introduce a regional fuel tax from 2021.⁵⁶ Even so, on 24 October 2018, the Prime Minister stated in Parliament, "I can give this guarantee to this House and to consumers: there will be no other regional fuel taxes while I'm Prime Minister" (Prime Minister (Rt Hon Jacinda Adern), 2018).
- The Treasury, Crown Infrastructure Partners (CIP), the developer Fulton Hogan and Auckland Council have worked together and established a Special Purpose Vehicle (SPV) that has raised nearly \$50 million in long-term finance that will not sit as a debt on the balance sheet of either Auckland Council or the Crown. The SPV will finance the cost of five bulk roading and wastewater infrastructure projects to connect a large new residential development – Milldale at Wainui 25 minutes north of Auckland – into Auckland's existing networks and provide for future growth. CIP ran a competitive process to secure the finance. As a result, the Accident Compensation Corporation (ACC) became the main investor. The loan is secured by a charge on the titles of the Milldale properties so that the property owners fund the projects through sharing loan repayments and interest over the 35-year term.
- The Government and Auckland Council have continued to work together on the Auckland Transport Alignment Project (ATAP) and the City Rail Link. These are very large city-shaping, transport projects that involve a significant national interest because they are critical to the successful development of New Zealand's major city. The parties are sharing capital costs.

⁵⁶ Land Transport Management (Regional Fuel Tax) Amendment Bill, Sub-part 3, Section 65J.

The Milldale SPV model is a contractual model to finance the connecting infrastructure for major new greenfield developments. The developer is responsible for building the bulk infrastructure, to the specifications of Auckland Transport and Watercare. The two CCOs will become the owners once the infrastructure is completed. The model entails property purchasers committing voluntarily to a charge over their properties. It could be used elsewhere in similar circumstances. Even so, it is not suitable to finance major infrastructure upgrades and new infrastructure relating to urban development and regeneration in existing (ie, brownfield) areas where the beneficiaries are existing property owners as well as the owners of new properties. To work in that type of situation, a scheme would need to make the loan-servicing charges compulsory for existing property owners. That would be a significant additional step.

The Government and officials are investigating whether it is possible to extend the SPV model in this way. While more challenging to design, and requiring legislation, these investigations promise to provide a valuable extension to the SPV model that will further reduce the barrier of debt limits for fast-growth councils.

It is notable that debt limits are a problem for only a few fast-growing urban authorities. Most councils have adequate capacity on their balance sheets to finance investment in infrastructure. Even fast-growing Queenstown Lakes District Council has this capacity and should make more use of it to tackle its infrastructure deficits,⁵⁷

Some councils face a lack of funding, not financing. The capacity to pay for the infrastructure, even over a long time, may not exist because of limited income and/or wealth. This could be the situation for some councils with small and static or falling populations. This problem is examined in the next section.

In other councils, the problem could be one of political economy: a voting bloc of current residents who are reluctant to see council debt increase will elect councillors who stand on that platform. Ways to address this problem include more effective public engagement and consultation, and better financial knowledge and capability of councillors, leading to better decision making. Chapter 5 examined these issues.

F6.12

While councils vary widely in their use of debt, they should use it to spread the cost of long-lived infrastructure assets fairly over the people and properties that benefit from these assets. Most councils have adequate capacity on their balance sheets to finance their infrastructure development. A few high-growth councils face debt-limit barriers that have the potential to cause serious social harm by preventing council infrastructure investment keeping pace with demand for new development.

F6.13

Special Purpose Vehicles (SPVs) can be an effective way to reduce the barrier caused by council debt limits where these limits constrain a council's ability to invest in infrastructure to serve new greenfield developments. The SPVs raise finance for infrastructure investment in a way that puts debt on the balance sheets of new property owners who benefit from the infrastructure, rather than on the balance sheet of their council or the Crown.

F6.14

The Government and officials are working on ways to expand the use of Special Purpose Vehicles (SPVs) to finance large brownfield infrastructure investments that will benefit both new and existing residents. While more challenging to design, and requiring legislation, these expanded SPVs promise to deliver a further valuable means to reduce the barrier of debt limits for fast-growth councils.

⁵⁷ As shown in Figure 3.15, Queenstown's debt per capita has fallen from about \$4 000 in 2009 to under \$2 500 in 2018. This is lower than Auckland, Kāpiti Coast, Tauranga, Wellington and Hamilton.

R6.5

The Government should direct officials to continue work on how to expand the use of Special Purpose Vehicles to finance investment in growth infrastructure in fast-growth local authorities that face debt limits. If needed, the Government should promote legislation in Parliament to enable the placement of debt-servicing obligations on existing residents who will benefit from the infrastructure.

6.6 Funding in areas with static or falling (and ageing) populations

As noted in Chapter 4, councils in areas with static, falling and/or ageing populations must continue to fund services and the supporting infrastructure from a smaller rating base or from ratepayers with less ability to pay. Many of these services such as drinking water, wastewater and roading are subject to strong economies of scale. This means that the costs of a pipe network or road network, or the fixed costs of a wastewater treatment plant must be spread over fewer ratepayers, or ratepayers with low fixed incomes.

The funding challenges for such councils are compounded by the need to replace ageing infrastructure and meet new higher minimum standards for drinking water and wastewater. Chapter 4 noted that, in communities of 500 or fewer people, the estimated yearly household cost to upgrade wastewater treatment discharges to meet the new National Policy Statement for Freshwater Management⁵⁸ standards is three times that for an average household. Gibb (cited in RNZ (2014)) described how these councils can struggle to fund their essential infrastructure services.

A lot of these smaller towns in rural New Zealand that have got reticulated supplies are facing static or declining populations, which causes challenges round supplying water services because, of course, they depend on funding... These services are capital intensive. So if you've got static and declining populations and your funding base, through your rating base, is put at risk then you're faced with a situation such as Ohura is in, where the council has said, 'Well look it's actually cheaper to take the reticulated services out and put catchment from roofs in place'. (p. 1)

Meeting the funding challenges

In its 2018–2038 population projections, Stats NZ estimated that 15 of the 26 rural districts would have falling populations. Most have small existing populations. No metropolitan or provincial authority is projected to have significantly negative population growth. Several councils pointed out to the Commission that their recent experiences were contrary to the projections and that their population growth rates had turned from negative to positive. Common drivers cited for this turnaround included rising tourism and the attraction of cheaper house prices. Time is needed to tell if the recent growth is a turning point or a blip.

Small councils with falling populations need to be innovative in finding new ways to deliver essential services. For example, new modular technologies for water treatment can deliver safe drinking water, and small-scale, modern, local and effective wastewater treatment options exist (as an alternative to centralised, reticulated systems). Yet, some small councils may lack the specialist knowledge and capabilities to know about and implement new technologies. A further problem may be unwillingness to collaborate. For example, Wellington Water proposed a coordinated rollout of standardised modular drinking-water treatment plants that would upgrade 105 existing plants and bring safe drinking water to 520 000 additional people across central New Zealand (Wellington Water, 2018b). Yet, the Commission understands few councils were interested in the proposal.

A common strategy to address falling population and associated funding pressures has been to develop plans and strategies to revitalise the local economy (Hollander et al., 2009). Most councils with falling populations prepare economic development strategies aimed at stimulating population and economic growth. Examples of initiatives include removing development contributions to encourage commercial and housing development (Whanganui District), redeveloping the CBD (Grey District) and collaborating between districts to promote local business (Kawerau District, Whakatane District and Ōpōtiki District) (NZPC, 2017).

⁵⁸ This NPS came out in 2014 and councils must progressively implement it to ensure it is fully implemented by 31 December 2025.

Yet, evidence on the success of these policies is mixed. Neumark and Simpson (2014) reviewed relevant literature and found that policies aimed at boosting the economic performance of underperforming areas are often ineffective. McMillan (2015) argues that attempting to combat decline is increasingly challenging in New Zealand as demographic and economic trends encourage out-migration. Similarly, Hollander et al. (2009) contend that:

aiming for economic growth in order to regain population growth – an uneasy compromise – is the most typical response of planners and politicians, a strategy that rarely leads to success anywhere. (p. 12)

Councils in this position should seek to adapt to trends that are driven by strong underlying economic and social forces. The Commission's *Better urban planning* inquiry also recommended that central government should consider providing funding and advice to councils in areas with falling populations to help meet infrastructure needs. The Commission recommended that any support should be conditional on councils taking sensible steps to adapt to, rather than try to reverse, any declining population in their area.

As mentioned, a main area of concern is drinking water and wastewater infrastructure. It is notable that the country's two largest specialised providers of water services – Watercare in Auckland and Wellington Water – are extending their services to districts on their periphery (Waikato District Council and South Wairarapa District Council). While neither of these districts has a falling population, these examples point to a potential solution for small councils struggling to maintain or upgrade their water infrastructure. That possible solution is to contract with an existing provider that can apply its scale and specialised knowledge to the council's area. Chapter 9 sets out a way forward on water reform that could deal with the challenges of many small communities struggling to fund safe, cost-effective drinking-water and wastewater services.

F6.15

The factors driving population decline in rural districts and small centres are often difficult to counter and may result in funding shortfalls that affect a council's ability to supply basic infrastructure services.

R6.6

In its review to improve the service delivery of the three waters, the Government should favour models capable of applying efficient scale and specialisation to help small communities meet the challenges of maintaining and upgrading their water, wastewater and stormwater infrastructures.

6.7 Funding to address pressures from tourism

As noted in Chapter 4, New Zealand has experienced a large and rapid increase in international visitor numbers in recent years. Domestic tourism has also increased. This has led to sharply increased pressure on several types of services and infrastructure in districts that are popular tourist destinations. These services and the facilities are known as **"mixed-use"** in that both residents and visitors use them.

Councils in the tourist districts are finding it difficult to fund the needed expansion in their roading, parking, recreational, public toilet, rubbish, water and wastewater facilities from their usual sources. Residents (sometimes outnumbered by visitors, especially in the peak visitor seasons) are not appreciating being asked to pay the entire bill.

This section examines the nature of the problem that councils in popular tourist destinations face and makes recommendations about how the Government and councils can tackle it.

Councils and tourism stakeholders have made several proposals

Councils and other tourism-industry stakeholders acknowledge that central government already helps cover some tourist-related costs from the Tourism Infrastructure Fund and other sources. But many argue that the sums are inadequate, cover capital costs but not operating costs, and are irregular and uncertain (Chapter 4). In the Commission's engagement meetings and in submissions, councils and stakeholders proposed new funding tools to cover the costs.

Tourism Industry Aotearoa, for example, proposed that central government set aside 20% of the GST collected from international tourist spending, and redistribute this to local authorities based on the proportion of visitor nights in each district (sub. 49). Many councils supported the notion of a “return” of a proportion of international visitor GST to local authorities to help them deal with pressure from tourism (eg, Ruapehu District Council, sub. 85; Kaikōura District Council, sub. 101; Auckland Council, sub. 120; and Whakatane District Council, sub. 121).

Some councils have called for changes to the LGA to allow them to introduce an accommodation or visitor levy, most likely taking the form of a per-night charge on commercial and online accommodation. Such a charge could be either a flat rate, or a percentage of the accommodation cost (eg, Auckland Council, sub. 120; and Queenstown Lakes District Council, sub. 67). Currently the Local Government (Rating) Act 2002 (LGRA) does not allow local authorities to set targeted rates on accommodation providers based on nightly occupancy.

However, accommodation providers have strongly opposed a levy, or “bed tax”. This is largely based on the providers being the collection point for such a levy and concerns about the equity of a mechanism that targets only a subset of the businesses that benefit from tourism.

Our accommodation members do not support targeted rates, bed-taxes or any other accommodation-only levy, rate or tax (either locally or nationally) as these do not accurately capture all those who benefit from tourism infrastructure and the tourism economy ... We believe that councils looking to remedy funding pressures through targeted rates, increasing general rates, levies and taxes (for example a bed-tax) applied to a small sector of businesses is neither sustainable, equitable or fair. (Hospitality New Zealand, sub. 78, p. 5)

We are not in favour of targeted rates that unfairly target accommodation providers – particularly individuals and family (short-term rental accommodation) homeowners – when visitation and tourism benefit many other local businesses (restaurants, bars, venues, transport, activity providers). (Bookabach, sub. 99, p. 1)

All businesses deriving income from visitor spending should fall within the purview of any newly recommended fiscal mechanisms for raising revenue for local infrastructure to support tourism. Equity, fairness and affordability are reasons for widespread strong opposition to the QLDC’s request for a visitor levy that would be applied only to the accommodation sector. Most accommodation providers in the district are deeply concerned about the proposed levy’s administrative burdens, compliance costs, market distortions and risks to profits that could drive some out of business. (Queenstown Lakes District Bed Tax Lobby Group, sub. 39, p. 2)

Several other suggestions have also been offered, including the previously mentioned regional fuel taxes to help fund roading infrastructure.

Less prominent are suggestions that councils make more use of existing tools to fund tourism costs such as user charges and targeted rates. These can offer a means to charge tourists directly or charge the businesses that benefit from tourist spending. Before reaching a conclusion about the best solution, the next section will analyse the nature of the problem caused by high levels of tourism.

All businesses have costs that their customers are expected to cover

To understand the problem of tourism funding pressures, a good place to start is to note that a successful private business produces goods and services that customers value more highly (indicated by their willingness to pay) than the resource costs of producing those goods and services. A basic tenet of economic efficiency is that if a business cannot achieve this surplus of providing value over cost, then it is making poor use of resources which would be better deployed elsewhere in the economy.

Tourism should be no exception to this basic tenet. Often no problem exists as tourists, either directly or through the tourist industry, pay for and cover the costs of the goods and services they receive. To identify where the problem lies, it is necessary to analyse the different types of goods and services that residents and tourists⁵⁹ consume and how the costs of providing them are recovered. This analysis is set out in Table 6.3 by

⁵⁹ Tourists could be international or domestic because the distinction relates to the use of facilities that may be funded by local rates.

class of good or service, how they are paid for and whether how a resident pays is different from how a tourist pays.

Table 6.3 Types of costs and means of payment by residents and tourists

Type of cost	Residents' means of payment	Tourists' means of payment
Private cost incurred by a business, eg, wages, rent, purchased inputs from other businesses.	Customers of business pay the cost indirectly through the purchase price.	Same as for residents.
Cost to a business of a mixed-use service within a user-pays system. One example is businesses paying for use of state highways via fuel excises and/or road-user charges. Other examples are use of water, wastewater and trade-waste services where these are user pays.	Customers of business pay the cost indirectly through the purchase price set by the business to cover these costs.	Same as for residents.
Cost of mixed-use services directly used by final consumers within a user-pays system (eg, travellers using a state highway).	Consumers pay the cost directly through the user charge.	Same as for residents.
Cost of mixed-use services directly used by the final consumer and paid for collectively and jointly via rates by business and residential ratepayers (eg, public facilities such as signs, local roads, streetscapes, parks, toilets, street cleaning and rubbish collection).	Residents pay partly through buying from businesses (who add the cost of their rates into their prices) and partly through their own residential rates.	Tourists pay indirectly, but only the part that businesses pass onto customers in their prices.

The table shows that tourism is like other industries in paying for the costs it creates in all but the last type of cost. In the former types, tourists do pay and arguably cover their costs. For example, most businesses, including tourism businesses, use the state-highway network. New Zealand has an effective user-pays system to cover the cost of the highway network – users (including tourists) pay either through fuel excises or road-user charges.

Local businesses use rubbish, water and wastewater services and pay for these through their business rates. The customers of these businesses pay these costs indirectly through what they buy from the businesses.⁶⁰

The type of cost where tourists do not fully pay for the costs they help to create (in the last line of the table) are the costs of the local infrastructure and services that tourists consume directly but which are paid for through rates. While tourists contribute indirectly when they buy from businesses that pay business rates, they do not pay any equivalent of the portion of residential rates that goes towards meeting these costs.

The problem can be exacerbated by the need for infrastructure that caters for peak loads. Tourism tends to be highly seasonal. This makes the cost greater than would otherwise be needed. Even when a user-pays system is in place it may not be feasible to charge at the very high rate per tourist needed to fully cover the additional capacity costs (compared to if costs could be spread over a steady, all-year-round stream of tourists).

F6.16

Tourists pay for many of the costs they create, either directly through a user-pays system, or indirectly by paying for services they buy from businesses. Yet, because tourists do not pay any equivalent of residential rates, tourists do not fully pay for the costs of local infrastructure and services that they consume directly. The payment shortfall is exacerbated by the strong seasonality of tourism that creates the need for infrastructure that can cater for peak loads.

⁶⁰ Some industries have regulatory costs; for example, the meat industry pays for hygiene and meat inspection services.

Assessment of proposals for meeting funding pressures from tourism

Accepting that the tourist industry ought to cover its costs like other industries, and that the problem lies in the difficulty that local governments have in charging tourists for some of the mixed-use facilities they provide directly to the tourists, what are the potential solutions? Table 6.4 lists possible solutions and assesses them in the light of the above problem definition and analysis.

Table 6.4 Possible solutions to ensure tourists pay their share of mixed-use facilities

Possible solution	Advantages	Disadvantages
1) Councils in tourist areas make greater use of user pays for the facilities that tourists use and make sure that tourist businesses pay the full cost of council services that they use.	<ul style="list-style-type: none"> Under user pays, tourists and tourist businesses cover the costs they create. 	<ul style="list-style-type: none"> Some facilities are difficult to charge for directly (eg, public parks, reserves, street cleaning, streetscapes, lake and sea fronts, use of local roads). Even when charging is possible, it can lead to unhelpful or unacceptable outcomes.⁶¹
2) Businesses charge tourists higher prices and the extra revenue is handed over as additional rates to the council.	<ul style="list-style-type: none"> Through these higher prices, tourists potentially cover the costs of mixed-use facilities that they consume directly and are not subject to user charging. This is fairer to residents who currently pay these costs through their rates. 	<ul style="list-style-type: none"> Businesses face high compliance and administrative costs from charging tourists more than residents. Businesses charging tourists could damage the reputation of the destination. Charging residents and tourists differently may be impractical.
3) Central government rebates a portion of the GST that it collects from tourists' consumption in the tourist area.	<ul style="list-style-type: none"> Councils receive more revenue to help ease their funding pressures. 	<ul style="list-style-type: none"> Tourists do not pay more, so are still not covering their full costs GST rebate to a single industry is essentially a subsidy. Identifying GST by tourist area is difficult.
4) Councils put up business rates to cover the cost of services that tourists consume directly yet are not subject to user pays.	<ul style="list-style-type: none"> Councils receive more revenue to help ease their funding pressures. 	<ul style="list-style-type: none"> Although tourists pay more through higher prices that businesses charge to cover their higher rates, so do residents. As a result, the desired outcome is not achieved.
5) Tourist accommodation levy.	<ul style="list-style-type: none"> To the extent tourists stay in the tourist district, they pay an extra charge and residents do not. The amount of the levy depends on the length of stay, which in turn correlates with the likely use of the mixed-use facilities. 	<ul style="list-style-type: none"> Tourists could avoid a levy by staying outside the town or city or in unregistered accommodation. If the levy is a percentage of the accommodation bill, the amount may not correlate well with the actual use of the mixed-use facilities that are otherwise not charged for.

⁶¹ One example is charging for public toilets, which may prompt some people to go to the toilet "in the bushes".

Possible solution	Advantages	Disadvantages
6) Central government gives councils in tourist areas a share of the new international tourist border levy.	<ul style="list-style-type: none"> International tourists pay more and councils receive more revenue to help ease their funding pressures. 	<ul style="list-style-type: none"> The payment would not cover domestic tourists. The revenue that councils receive is subject to central government control. The share received is unlikely to cover costs – the total expected revenue from the international visitor levy is \$80 million a year, with only half of that amount going to the tourism industry.

None of the possible solutions in Table 6.4 is perfect. Yet some can be more easily dismissed: the second option (businesses charging tourists higher prices) is impractical; the third option (higher business rates in tourist towns) penalises residents and the sixth option fails to charge domestic tourists (residents of tourist towns would subsidise residents of non-tourist towns who are domestic tourists).

As noted, several submitters supported the third option (councils in tourist areas receive a portion of GST from tourist spending). However, it is not possible to identify GST by location or by the identity of the final consumer (eg, GST on a rental car hire is not related to where the car is driven or for what purpose – tourism, personal non-tourism, or business). A more principled objection to this option is that no other industry is, or expects to be, subsidised by receiving a GST rebate. Implementing such a rebate would violate the principle that businesses should cover their costs.

A possible justification sometimes offered for this option is that international tourists do not have free use many expensive services that taxes pay for, such as schools and hospitals. Even so, international tourists do benefit from some services (such as ACC, police and rescue services, and national conservation services) while travelling in New Zealand. International tourists also do not pay income taxes in New Zealand. In addition, the justification fails entirely for domestic tourists who make up a large proportion of the total.

Of the six possible solutions, this leaves only the first and fifth options – greater use of user pays and a tourist accommodation levy. In the Commission's view, these two options offer the best solutions for councils to charge tourists for use of some of the mixed-use facilities they provide directly to tourists.

Greater use of user pays and accommodation levies are the best options

Greater user pays for tourist facilities could help in areas such as car parking, public toilets, freedom camping and road congestion charging. Even doing this would not cover facilities where applying user pays is too difficult or not cost-effective.

A tourist accommodation levy appears to be the most effective and principled other way to collect the shortfall of revenue from both international and domestic tourists. Accommodation is a necessity, so comes close to a tollgate point for entering and spending time in a tourist destination. The Stewart Island visitor levy embodies the tollgate idea. It is not levied via accommodation providers because a better option exists given Stewart Island's isolation. Only two practical ways exist for tourists to get to the island and so it makes sense to impose the toll at those points (ie, flights and ferry journeys).

An accommodation levy could be applied as (i) a fixed amount per night per tourist, (ii) as a percentage of the accommodation charge, or (iii) some combination of these (such as a percentage subject to a minimum charge). The first option would likely correspond more closely to use of council-provided facilities (not otherwise charged for) while the second option, a percentage, is more geared to ability to pay.

Accommodation levies are quite common in other countries. Auckland, through its Accommodation Provider Targeted Rate (APTR) has introduced a visitor levy within existing rules. Queenstown held a referendum in mid-May 2019 on whether the residents support an accommodation levy. Over 80% of those who voted

supported an accommodation levy. The LGRA does not allow councils to set targeted rates on tourist bed nights and this has complicated the form of Auckland's APTR. To implement an accommodation levy, Queenstown Lakes District Council will require legislation (just as Steward Island required legislation for its visitor levy).

Questions and concerns about the accommodation levy option include its economic incidence, its effect on tourist patronage and tourist businesses, avoidance problems and day trippers. Below are some comments about these questions and concerns.

- Economic incidence is about who ends up paying the levy because of movements in prices, wages, rents and investment returns. The most straightforward result would be that the tourist pays the levy as a straight addition to part of their accommodation bill. Alternatively, some of the effect of the levy could be transferred to owners of accommodation businesses in the short term, or to owners of land suitable for accommodation in the longer term, but these effects are likely to be minor particularly if tourist patronage is substantially inelastic (insensitive to change in price).
- A modest levy would be unlikely to cause more than a small decrease in tourist numbers. Further, some councils and residents would welcome a moderation in numbers, and any tourists lost are those who value the experience less than the costs they create – so losing them should enhance overall economic efficiency.
- Once set up, an accommodation levy's compliance and administration costs are likely to be only modestly greater than other targeted rates. Accommodation providers would pay regular amounts to councils calculated from the simple rule that defines the base of the levy (eg, revenues from guests or bed nights). Councils would need to maintain a database of accommodation providers. Airbnb has already indicated its willingness to collect such a levy on behalf of accommodation providers on its platform.⁶²
- A modest levy is unlikely to cause many tourists to stay outside the tourist centre so they can avoid the levy, especially if the centre is a large city or is relatively remote from neighbouring centres. Such a possible outcome might necessitate adjacent jurisdictions such as Wellington City and Hutt City, and Napier City and Hastings City to coordinate any accommodation levies they imposed. The levy must apply to all accommodation in a centre, including through platform providers (eg, Airbnb and Bookabach).
- Some small tourist spots such as Tekapo and Punakaiki do not offer much accommodation and many of their visitors stay for less than a day. An accommodation levy would not work in such places because it would be unlikely to raise enough revenue to cover the costs caused by tourists. Such places would need to use other options such as introducing more user pays (eg, paid car parking and public toilets, access charges to scenic spots) or receiving a portion of the new international visitor levy collected at the New Zealand border.

F6.17

Greater user pays and accommodation levies are the two best options for recovering from tourists their share of the cost of facilities provided by local government for which it cannot otherwise charge. These are the only options that target the right group, are practical, do not involve an industry subsidy, promote economic efficiency, are consistent with local autonomy, and have reasonably modest compliance and administration costs.

⁶² Airbnb notes that they already do this in 500 places overseas (Jamieson, 2018).

R6.7

The Government should legislate to enable councils in tourist centres to choose to implement accommodation levies to recover the tourism-induced costs of providing local mixed-use facilities not otherwise charged for.

Councils in tourist centres should make greater use where possible of user pays for mixed-use facilities.

R6.8

The Government should provide funding from the international visitor levy for councils responsible for small tourist hotspots which cannot reasonably recover all their operating costs of providing mixed-use facilities from tourists through user pays or accommodation levies.

Another issue related to the fast growth of tourism in New Zealand is important yet lies outside the inquiry's TOR. The issue, by no means specific to New Zealand, is working out how best to deal with the negative consequences for broader wellbeing from having large volumes of tourists. On the one hand, tourism undoubtedly brings benefits such as business growth, jobs, revitalising areas otherwise in decline and better international connections and understanding. On the other hand, mass tourism can spoil the wilderness experience, put pressure on the natural environment and cause congestion for citizens in various ways. The Parliamentary Commissioner for the Environment is currently investigating the environmental risks from mass tourism.

6.8 Central government funding for local government infrastructure and services

When should central government contribute to local government funding? The answer based on local-government funding principles is that, in the first instance, central government should not generally fund local benefits that are confined to a local authority's jurisdiction. Doing so would undermine the autonomy, responsibility and accountability of the local authority by weakening the system of separation of roles and responsibilities between central and local government – a separation that is a great strength of the New Zealand system.

If, on the other hand, a local government's activities create benefits that spill over its boundaries to a wider area and possibly to the whole country, then there is a case for central government to contribute to the cost of those activities. For example, a local authority, in meeting National Environmental Standards (NES), could create benefits beyond the region. Or a local authority may play a significant role in helping the Crown to meet its Treaty obligations – both through giving effect to Treaty settlements and in other ways.

NZTA funding and the Auckland Transport Alignment Project

The most obvious example of central government helping to fund local government services is for local roads. The NZTA works with councils to agree a regional roading programme and co-funds it. The rationale is that the state highway network interconnects with local roads to form a secondary part of the national roading system. While most use of local roads is by local people, out-of-district people and businesses also use them. As a result, local roads yield wider benefits. While NZTA funds 100% of state highways, it also funds a proportion of local roads – about 50% up to about 70%, depending on roading priorities and the funding capacities of councils.

The ATAP began in 2015. ATAP is a collaboration of central government and Auckland Council in recognition that Auckland is New Zealand's major city and its success is a matter of national economic interest (NZPC, 2017). That success depends on Auckland having a transport system that works – one that supports economic growth and productivity. Yet transport in Auckland has been heading in the opposite direction, with projections of increasing transport demand and worsening congestion.

ATAP has a governance structure within which officials from the Ministry of Transport, Auckland Council, Auckland Transport, the NZTA, the Treasury and the State Services Commission work together to improve

alignment between the parties about the way to develop Auckland's transport system. This includes an agreement on cost sharing.

ATAP has proved to be an effective institutional innovation to enable the council of a leading city and central government to work together and implement a central-government funding contribution for a major programme of urban infrastructure with national spillover benefits.

Contested territory – increasing responsibilities and unfunded mandates

Earlier in this report, section 4.3 drew attention to the rising funding pressures on local governments from the accumulation of tasks and responsibilities that central government has passed to councils over the years. Sometimes these additional tasks and responsibilities fit the description of “unfunded mandates” that central government imposes on local governments. Local governments see this as a case of central government shifting costs from its budget to theirs.

One cause of funding pressure can be new national regulations that apply to all businesses and other organisations across the country, such as health and safety regulations. Then all, including councils, must comply and bear the costs. That is the nature of regulation – the judgement is that making sure people behave in line with the regulations, benefits society overall. Of course, this does not mean that people cannot have different views about what and how to regulate.

Two other situations resemble unfunded mandates more closely. These situations give greater cause for local authorities to feel that central government is requiring them to do things that are in the national interest yet not providing an adequate funding contribution.

- Central government requires local governments to act as regulators (eg, administering problem gambling levies under the Gambling Act, licensing food premises, licensing liquor outlets, licensing the sex industry, and licensing dog control).
- Central government sets national standards and local governments are responsible for meeting those standards. For example, the various NPSs, NESs and higher standards for drinking water (as described in Chapter 4).

In both cases, arguments can go either way as to who should fund the tasks involved. For example, regulating food premises and liquor licensing are both intensely local issues and a matter of national benefit given the fallout for the health system or visitor reputation in the event of a serious incident arising from lax standards. Yet, it is possible to conclude two things:

- the default in the event of central government assigning a regulatory role to local authorities is that the regulator should be given a means to adequately fund its operations – either from the regulated parties, or through government payments; and
- if significant national benefits are involved, then there is a good case for a contribution from national funds.

Towards a true partnership between the levels of government

A major cause of the problem of unfunded mandates is the poor state of relations between central and local government. There needs to be a shift from treating local government as an agent of central government to a relationship of genuine partnership. If that were to happen, regulatory regimes would be co-designed and jointly implemented with the needs and circumstances of local government kept front of mind.

The need for genuine partnership between central government and local government is clear for conducting business and fulfilling obligations under the Treaty of Waitangi. As noted in Chapter 4, the primary obligations under the Treaty lie with the Crown; yet, often local governments fulfil responsibilities with respect to local iwi. It is vital that central government ensures that local government has the funding to carry out these responsibilities to an acceptable standard. For its part, local government would then need to deliver to this standard and provide assurance that it has done so.

A recurring theme of the Commission's *Local government regulation* inquiry was "the poor state of the relationship and interface between central and local government, across all aspects of the regulatory system" (NZPC, 2013, p. 6). In that inquiry, the Commission concluded that central government's involvement in regulatory regimes managed locally needed to improve, particularly in the following areas:

- the interface between central and local government needs to improve, with local authorities recognised as "co-producers" of regulatory outcomes;
- central government agencies need to enhance their knowledge of the local government sector and increase their capability to undertake robust implementation analysis; and
- meaningful engagement and effective dialogue with local government needs to occur early in the policy process.

The Commission has continued to hear from inquiry participants that, despite some examples of successful collaboration (such as the ATAP), the interaction between central and local government on regulatory and planning matters is poor. Also, a 2016 Colmar Brunton survey of councils indicated that communication between central and local government was poor.

Central-government agencies are currently not fulfilling at least some of their regulatory stewardship responsibilities. A more productive relationship and interface between central and local government on regulation are possible, and desirable, in helping to fulfil these obligations. They should feature:

- central and local government providing input (formally or informally) into each other's relevant policy-making processes, and that this process is governed by an agreed set of principles;
- meaningful engagement and effective dialogue with local government occurring early in the policy process;
- cooperative approaches to tackling potential problems with implementing relevant new legislation, regulations, NPSs or NESs;
- the creation of formal and informal feedback loops to identify problems, when they first appear, with delegated regulations; and
- the spread of information through the system and the sharing of expertise and knowledge.

To make progress, both central and local government need to foster a more open and productive relationship. The Commission sees significant value, and has previously recommended, that central and local government work together to develop a "Partners in Regulation" protocol (NZPC, 2013). The protocol would articulate an agreed set of behaviours and expectations when developing and implementing local regulation and, more generally, would promote a constructive interface between central and local government (Box 6.5).

Box 6.5 **Partners in regulation protocol**

The protocol would aim to promote a constructive interface between central and local government by:

- developing a common understanding of, and respect for, the roles, duties and accountabilities of both spheres of government; and
- articulating an agreed set of principles to govern the development of regulations, with implications for the local government sector.

The protocol would be a jointly created document signed by the Government and representatives from the local government sector. To signal strong commitment, the Prime Minister and the Minister of Local Government could sign it. This would increase the protocol's status as a "whole-of-government" document. It is equally important that local government illustrates ownership and commitment to the

protocol. For this to occur, the sector must see the signatories to the protocol as legitimate representatives with the authority to “speak for councils”.

The Commission does not envisage that the protocol would be a legally binding document. However, the requirements of the protocol should be added to the Cabinet Manual, along with a directive that the principles are to be complied with when formulating local regulation in all but exceptional circumstances. At the same time, performance assessments of relevant central government agencies should include progress towards implementing the protocol. Likewise, the protocol should include a provision that local authorities include a “statement of intent to comply” in their annual reports.

Source: NZPC, 2013.

R6.9

The benefit principle and maintaining the integrity of local government autonomy, responsibility and accountability should guide central government funding of local government activities. This implies that central government should generally limit its funding to where there are national benefits. Central government should not expect local government to act simply as its regulatory agent. Rather, the two levels of government should seek a regulatory partnership based on mutual respect and an agreed protocol.

R6.10

Central and local government should strive to achieve a more constructive relationship and effective interface through:

- central and local government providing input (formally or informally) into each other’s relevant policymaking processes, under an agreed set of principles or a protocol;
- central government engaging in a meaningful dialogue with local government early in the process of developing relevant new regulations;
- cooperative approaches to tackling problems with implementing relevant new legislation, regulations or environmental standards;
- the creation of formal and informal feedback loops to identify problems with delegated regulations when they first appear; and
- the spread of information through the system and the sharing of expertise and knowledge.

6.9 A future funding and financing system

The conclusion of this chapter is 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.

That the foundations of the system should remain largely the same reflects the soundness of land and property rating as the main revenue-raising tool for local government. Rating is an efficient and effective tax that generally yields a stable, predictable and adequate stream of revenue for councils while supporting local autonomy and accountability.

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.

Yet questions remain about the ability of some property owners to afford to pay rates. These questions are dealt with in the next chapter.

In three areas where funding pressures have called into question whether current funding tools can generate enough revenue or generate sufficient incentives, the chapter has recommended solutions.

For **funding and financing growth**, the recommendations 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 (the Commission previously recommended this value capture tool in its *Better urban planning* report);
- consider a new system of central-government payments to territorial local authorities based on new building work in their districts to incentivise councils and existing residents to support growth and overcome their perception that “growth does not pay for itself”;
- enhance councils’ ability to charge for congestion and wastewater (by volume); and
- complete policy work on and implement an enhanced version of Special Purpose Vehicles to help high-growth councils up against debt limits to finance investment in infrastructure to meet demand for growth.

For councils under pressure from high levels of **tourism**, the recommendations are to:

- enable councils in large tourist hotspots to introduce accommodation levies to collect revenue from tourists who consume mixed-use facilities directly but, unlike residents, do not contribute to their cost via rates; and
- distribute a portion of the international visitor levy to tourist centres with minimal accommodation to contribute towards their additional costs from providing mixed-use facilities for tourists where it is not feasible to charge for these facilities directly.

To substantially ease the funding pressure that local government feels from increasing **central government regulatory requirements**, the recommendations are as follows.

- The benefit principle should be used to test whether a funding contribution from central government is justified. If benefits from local government activities yield significant national benefits, then central government should fund a share commensurate with those benefits.
- The two levels of government should seek a regulatory partnership based on mutual respect and an agreed protocol. The protocol would articulate an agreed set of behaviours and expectations when developing and implementing local regulation and, more generally, would promote a constructive interface between central and local government.

These recommended changes can happen broadly within the current system. Given this, while the changes are significant, the Commission does not see that implementing the recommended changes would be unduly disruptive.

In following chapters, the Commission explores some areas of local government funding that could involve more disruptive change. Chapter 7 examines affordability and fairness, and ways to extend targeted rates to improve transparency and accountability. Chapter 8 examines and makes recommendations about the funding pressures that some local authorities will increasingly feel because of the imperative to adapt to climate change. Chapter 9 explores the future funding and financing of the three waters, including the challenge to make these important services both higher quality and more innovative.

7 Equity and affordability

Key points

- Councils have great flexibility in allocating rates to different classes of properties. Councils may base rates on property values, or levy charges that are the same for every rating unit. They can target rates to particular types of properties, to particular locations, or to fund specific services. For both general and targeted rates, they may apply rates “differentials” to different types of properties (eg, “business” or “rural”). They can base targeted rates on a wide range of factors.
- Councils vary considerably in how they use rating tools and alternative means are available to achieve similar results in spreading the burden of rates. Yet the principles that councils use to apply rates are often unclear and controversial.
- Statute provides only weak support for the benefit principle (that those who benefit from or who cause the need for a service should bear the cost); and councils apply the principle inconsistently if at all. Often no clear distinction exists between applying the benefit principle and the ability-to-pay principle.
- Statute should provide unambiguous support for applying the benefit principle in the first stage of setting rates. In the second stage, adjustments to reflect ability to pay should be transparent and take into account central government’s primary role in income distribution.
- To improve transparency in setting rates, the ability to set differentials and a uniform annual general charge should be removed, along with the 30% cap on uniform charges. If they wish, councils will be able to use targeted rates to achieve the same distribution of the rating burden.
- There is little or no evidence that rates have become less affordable over time. Much of the affordability concern focuses on low-income (particularly elderly) households who own their own homes, usually without a mortgage. Yet such households generally have much lower housing costs than other low-income New Zealand households who rent or who have a mortgage.
- The Rates Rebate Scheme (RRS) is targeted to low-income homeownership households. The RRS is inequitable (because renting households in otherwise similar circumstances do not qualify), administratively cumbersome and modest (the maximum payment amounts to a little over \$12 a week, or \$630 a year).
- The Accommodation Supplement (AS) is the Government’s principal form of assistance for accommodation costs to low-income households living in private residences. Most recipients of the RRS would not qualify for the Accommodation Supplement because their housing costs are too low (as they usually own their own homes without a mortgage).
- A national rates postponement scheme would better fulfil the purposes that the RRS is designed to address. The Government should collaborate with local government and interested financial institutions to design, implement and promote such a scheme. Once a successful national rates postponement scheme is in place, the RRS should be phased out.

The inquiry terms of reference identify “equity” and “affordability” as some of the principles for evaluating local government funding and financing arrangements. Chapter 6 sets out a framework for thinking about equity and affordability.

In this context “equity” refers to the fairness of revenue-raising arrangements across different revenue sources (such as different types of properties). Fairness can refer to either:

- the “benefit principle” – rates and other charges should be levied in rough proportion to the benefit that a property owner receives from council-provided services; (or the extent to which they have caused the need for such services); or
- the “ability to pay” principle – collect tax in relation to some measure of income or wealth of the property owner (NZPC, 2017).

In Chapter 6, the Commission recommended that, in raising revenue, councils should place primary weight on the benefit principle. This could be, for example, through user charges, targeted rates, or (where the benefits are widespread and proportional to property values) through general rates.

Submitters and other participants sometimes use “affordability” to mean affordability of funding arrangements for local communities collectively – which, in practice, is often difficult to distinguish from “willingness to pay” (New Zealand Society of Local Government Managers (SOLGM), sub. 24). In this context, Chapter 5 discusses how well-designed institutional and legal arrangements can influence local government to make prudent revenue-raising and spending decisions that reflect the wishes of their community.

Even so, some communities have higher proportions of households on low incomes, many of them paying rents (Chapter 4). Councils in such communities find it challenging to raise sufficient rates to match the infrastructure and service provision standards that are common in better off communities. Central government recognises this by providing more generous subsidies for roading, through the New Zealand Transport Agency (Chapter 6). Policies to support local communities in adapting to climate change (Chapter 8) and in the provision of the three waters (Chapter 9) may need a similar approach.

This chapter (sections 7.3 & 7.4) focuses on the affordability of rates for specific groups within the community. Councils may understandably want to redistribute the burden of rates to relieve such affordability concerns. Even so, redistribution of income is primarily a role for central government, given the better information it holds (eg, about household income and composition) and its large-scale and efficient tax and benefit systems. Scope for local government to address affordability of rates (or user charges) for specific groups is limited by the need to be coherent with central government policies.

This chapter supplements Chapter 6 by assessing in more detail the use of rating tools to allocate rates across different groups of ratepayers. It draws on submissions and work for the Commission updating 2007 analysis undertaken for the Shand Inquiry. Sections 7.3 and 7.4 then look at the issue of affordability of rates within the broader framework of central government’s assistance for those facing hardship in meeting housing-related expenses. The chapter identifies weaknesses in the current policies to address affordability for specific groups of ratepayers and recommends changes.

7.1 Equity in local government rates

Councils raise revenues in ways that have different impacts on members of local communities. Factors that affect the distribution of costs across the community include:

- the proportion of revenues raised through different instruments including user charges, dividends from invested assets, subsidies from central government, and rates;
- the design of user charges and the choice of goods and services to which they are applied; and
- the types of rates used and the use of differentials, and how these features are applied in practice.

The approach that councils take to levying rates and other charges has a significant impact on the affordability of local government services for different households, businesses and other organisations. As the SOLGM explained, under current local government law

[a] local authority that wishes to treat its rates as more of a tax has the option of selecting a value-based general rate as the mainstay of its rating system. A local authority that wants to treat its rates as being more akin to a charge for services might load up the rating system with fixed charges, water metering or

some of the proxies from schedule 3 of the Act. Both, and all points between, are perfectly valid policy choices provided they are justified to the community. (SOLGM, sub. 24, p. 55)

The burden of rates is tempered by their relative importance in raising revenue. Councils vary in their access to investment income and in the extent of user charging. While 58% of local authority revenues are raised through rates nationally, this varies from as low as 32% (for a regional council) to over 80% (for ten territorial authorities) (Insight Economics, 2019a). The remainder of this section discusses the way the burden of rates is distributed.

Rating tools give councils great flexibility in allocating rates

The suite of rating tools gives councils great flexibility in allocating rates. The main types are:

- general rates, in practice now based either on capital or land values, with or without differentials for different types of land uses (as explained below);
- uniform annual general charges (UAGCs), which apply across all rating units uniformly (whatever the value of the rating unit); and
- targeted rates to fund particular activities, which may be based on the value of properties that benefit from the activity, be uniform, or have differentials; and may be restricted to specific locations.

Section 101 of the Local Government Act 2002 (LGA) governs how councils set rates. In funding activities, councils need to consider how the benefits of those activities are distributed, the contribution of the actions or inaction of persons to the need for the activity, and the overall impact on the community of any allocation of liability for revenue needs. The Local Government (Rating) Act 2002 (LGRA) specifies in more detail liability for rates and the permitted bases for differential and targeted rates.

To limit the potential impact of fixed charges on the overall rating burden for low-income households, the LGRA specifies that revenue from uniform charges (including UAGCs and uniform targeted rates applying across the district, but excluding uniform water and wastewater rates) must not exceed 30% of rates revenue.

Rating differentials

Differentials are used to reduce or increase the allocation of rates to different types of property. They are usually expressed as a proportion relative to residential rates (for a given property value). Most often differentials are used to:

- reduce rates revenue from rural properties (with an average current differential across councils of 0.7, reflecting their reduced access to urban services, facilities and amenities); and
- increase revenue from urban business properties (with a median differential across councils of 2.5) (Insight Economics, 2019a).

For example, Table 7.1 shows the differentials used by Hutt City Council and Hamilton City Council along with the proportion of total rates collected from each differential group.

Where a council elects to set a rate differentially, the different rating categories along with the reasons for the differentiation must be clearly explained in that council's funding impact statement (part of a council's annual plan) (SOLGM & LGNZ, 2013).

Table 7.1 Hutt City Council and Hamilton City Council rating differentials for 2018-19

Hutt City Council			Hamilton City Council		
Category	Differential	% of total rates	Category	Differential	% of total rates
Residential	1.0	70.3%	Residential	1	59.90%
Business ¹	2.58, 2.74 or 2.86	24.4%	Commercial	2.2938	30.96%
Community facilities ¹	0.5, 1.0 or 2.38	1.1%	BID Commercial ²	2.1791	7.75%
Rural	0.74	0.6%	Other	0.7420	1.39%
Utility networks	2.38	3.6%			

Source: Hutt City Council, 2018; Hamilton City Council, 2018a.

Notes:

1. Hutt City Council applies differentials for three groups of business and three types of community facilities.
2. BID Commercial refers to commercial properties located within Hamilton City Council's business improvement district.

Targeted rates

Councils can use targeted rates to fund designated activities or a group of activities. Councils can base targeted rates on land or capital value; or on any of the following:

- the value of land improvements;
- land area;
- area of land paved, sealed, built upon or protected;
- area of floor space of buildings on the land;
- number of connections to the local authority reticulation system;
- number of toilets and urinals;
- number of separately used or inhabited parts of the land; and
- extent of services provided to the land occupier (LGRA, Schedule 3).

Targeted rates provide councils with a transparent means to raise revenue from those who benefit from particular services or amenities or who impose costs on services. As SOLGM advises, "[t]argeted rates allow an almost unlimited range of options" (SOLGM, 2017a, p. 33).

Do rates based on property values reflect benefits or ability to pay?

Almost all councils derive some revenue from general rates, though the general rates share of rates revenue varies greatly. Across New Zealand, general rates account for 50% of total rates funding (76% for Auckland and 55% for other metropolitan areas) (Insight Economics, 2019a). As discussed above, differentials are commonly used to adjust the impact of rates on particular types of property.

Rates based on property values (including all general rates and some targeted rates) may, in theory, reflect a combination of:

- benefits received (where these vary by property or land values); and
- ability to pay (as there is a broad correlation between property values and incomes or wealth, and the value of property may, in any case, be realised or borrowed against to meet liabilities).

It is likely that councils mostly think of rates based on property values as being closely correlated with ability to pay. Even so, amenities provided by councils (such as central city landscaping and design and recreational

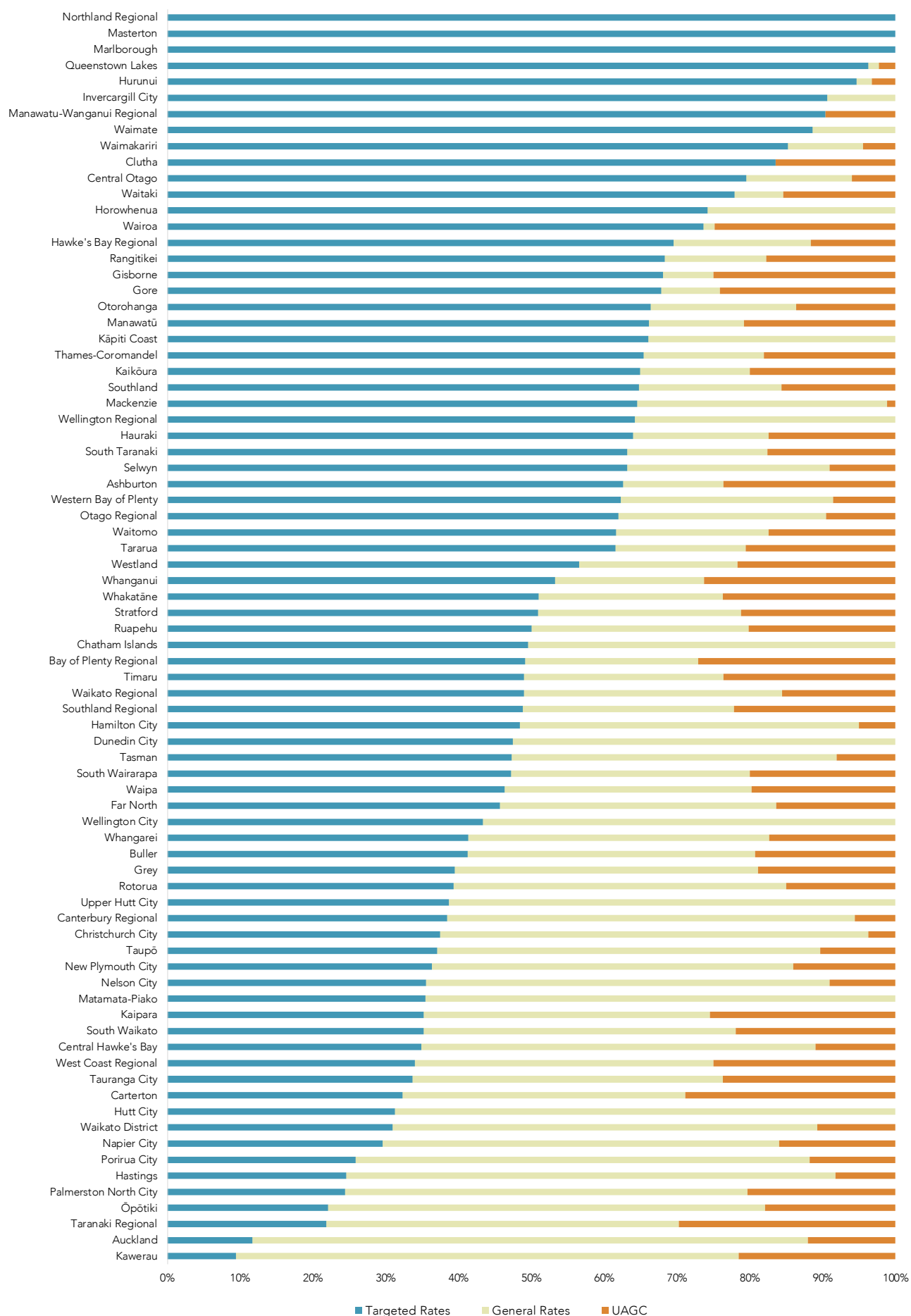
facilities; or public transport infrastructure) may be capitalised into the value of nearby properties. This situation would justify councils using rates based on property values to apply the benefit principle.

Rates based on property or land values may not accurately reflect differences in the incomes of property owners and therefore their ability to pay from current income (Federated Farmers of New Zealand, sub. 75; Western Bay of Plenty District Council, sub. 34). For instance, rural property values may have risen because of factors (such as proximity to urban boundaries) that do not reflect current income (but do reflect wealth to some extent). Federated Farmers of New Zealand also points out that the value of land (including any improvements) plays a much more important part of the capital structure of farms compared to other businesses (and yet other forms of capital are not taxed). Paying rates based on property values in a poor farming year can place a burden on farmers.

As discussed further in section 7.3, many councils and other participants worry about the ability of households on a low, fixed income – particularly retirees – to pay rates. This is likely to be especially a problem for those living in high-value properties and facing rates based on property values.

Different types of councils use rating tools differently...

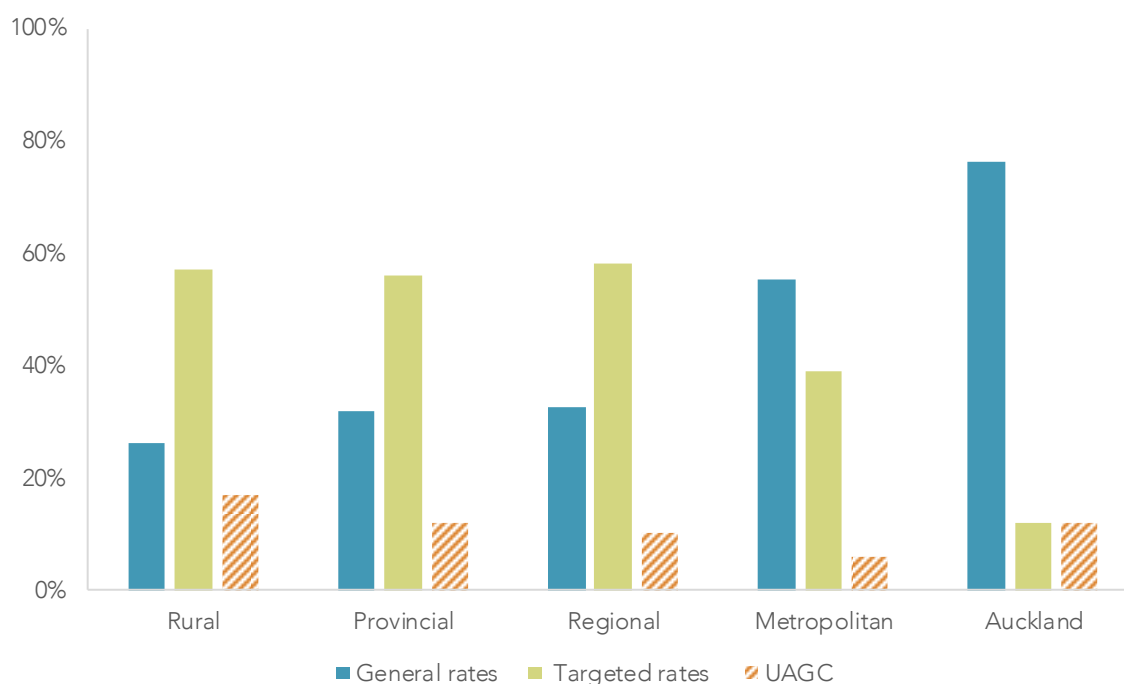
Insight Economics (2019a) has updated work for the Commission on councils' use of rating tools, originally carried out for the 2007 Rates Inquiry (Colegrave, 2007). Strikingly, the way that councils use rating tools varies greatly across councils (Figure 7.1).

Figure 7.1 Composition of council rates revenue in 2019

Source: Insight Economics, 2019a.

Some of this variation is explained by the different types of councils (rural, provincial, regional, metropolitan and Auckland). Regional councils are more likely than other councils to set targeted rates (and to set a greater number of targeted rates) – reflecting their responsibilities for activities like drainage and flood protection that relate to particular locations (Insight Economics, 2019a). Metropolitan councils, and particularly Auckland, get a much larger share (than others) of their rates revenue from general rates (Figure 7.2). Rural councils get a greater share of revenue than other councils from UAGCs (which may reflect an intention to reduce the relative rates burden on farms). Metropolitan councils are more likely than others to use rural differentials for this purpose (Table 7.2).

Figure 7.2 Rating-tool share of rates revenue by type of council



Source: Insight Economics, 2019a.

Table 7.2 Business and rural differentials in 2018

Sector group	Business differential		Rural differential	
	Proportion of councils	Average	Proportion of councils	Average
Metropolitan	100%	2.26	70%	0.82
Provincial	39%	2.99	42%	0.84
Regional	0%	n/a	9%	0.11
Rural	38%	4.25	42%	0.62
All Councils	41%	3.26	41%	0.70

Source: Insight Economics, 2019a.

...but variation often simply reflects local choices

Much of the variation in the use of rating tools seems to reflect idiosyncratic local choices. For instance, Selwyn and Waimakariri District Councils serve similarly located communities, but Selwyn makes substantially greater use of general rates and less use of targeted rates than Waimakariri. Some district councils have no general rates; others make little use of targeted rates; others again, have no UAGCs. This variation in the use of rating tools likely shows that councils can use different means to achieve much the same rating outcomes as desired by communities. As discussed in section 7.2, some approaches are more transparent than others.

Ratepayers are often unhappy about their share of the rates burden

Business and farming interests and those representing older ratepayers are often unhappy with the way that councils assign the burden of rates. They are dissatisfied either because the burden does not reflect the benefits received, or because it is unaffordable for some households (Box 7.1).

Box 7.1 Submitters' views on whether councils allocate rates fairly

Many submitters thought that rates were allocated unfairly, though they had differing reasons for thinking this.

Rates levels on farmland are simply too high to make a serious case for trust and value. There is no connection between rates and services rendered, in terms of general rates, and no credible relationship with incomes...

The concern for many farmers is that much of their rates contribution is for services located many kilometres from the farm, such as parks, stormwater, streetlights and other amenities. (Federated Farmers of New Zealand, sub. 75, pp. 1 & 25)

There are numerous examples of rating differentials and targeted rates imposed with little evidence of rigorous, objective analysis, particularly of access to service and benefits derived. These include increased business differentials and imposition of new targeted rates. A particularly egregious example is Greater Wellington Regional Council's targeted rate for funding public transport where Wellington CBD businesses were considered the primary beneficiaries (rather than the commuters) and a 7 to 1 differential was imposed on those businesses. (Local Government Business Forum, sub. 54, p. 8)

[T]he level of rates paid is often entirely disproportionate to the level of services received. The situation is exacerbated by the widespread use of business/commercial rating differentials despite strong evidence supporting their removal. Where councils have agreed to reduce the differentials, they have often been tardy in doing so, tending to incremental change due to 'expenditure pressures'. (BusinessNZ, sub. 54, p. 3)

We strongly oppose rating differentials and endorse the Shand report's recommendations that they should be abolished and replaced with targeted rates. There is no economic rationale that supports business rates differentials. For example, Tauranga City Council recently introduced a business differential in their recent Long-term Plan, although reducing it to a 1.2 differential from their proposed 1.6 differential. Its main rationale is: other councils had differentials; and that it needed to raise more money than they thought they could from residential rate payers. The rationale for greater benefits to the business community was shaky at best. (Property Council of New Zealand, sub. 117, p. 7)

For decades now, Horowhenua Grey Power has made detailed assessments of the unaffordability of the district's rating model for low to middle income householders and, has unsuccessfully resisted incremental transfer of inherent rating costs from rural and urban business to the disadvantage of householders... Councillors have simply set our representations aside, apparently preferring, by some unspoken policy, to relentlessly prioritise commercial interest over the wellbeing of low-income recipients. (Horowhenua Grey Power Association Inc., sub. 21, p. 9)

Rating differentials must relate to genuine differences in the level of services provided. Cross subsidisation between business and residential ratepayers, rural and urban ratepayers, should be eliminated or minimised. Differentials to deal with affordability concerns are inappropriate. (Foodstuffs, sub. 23, p. 6)

Meridian and other electricity generators have high capital value assets on their land and therefore pay extraordinarily high rates, while consuming very little local government services. Rates bills are an input cost for electricity generation and ultimately capital value rates increase the cost of electricity for New Zealand consumers... (Meridian Energy, sub. 73, p. 7)

The allocation of rates does not clearly reflect the way benefits fall

Local variation in rate setting is appropriate given differences in circumstances and preferences. Even so, the current variety of practices means that it is often unclear whether and to what extent councils are applying the benefit principle. Councils are ever mindful of the need to consider ability to pay when they apply the benefit principle and they often do not clearly distinguish between the two principles.

Lack of clarity also results from most adjustments to rates being made at the margins rather than from first principles. These adjustments are political choices mainly designed to raise enough revenue to meet spending plans while taking account of affordability and the willingness of ratepayers to pay.

For example, Federated Farmers of New Zealand argued that when councils are under pressure from growth, decline or an ageing population they turn to increasing rate revenue from farmland as a solution. They often do this by reducing the percentage of rates taken from a UAGC or replacing targeted rates for community facilities with district-wide rating (sub. 75, p. 15). The Horowhenua Grey Power Association supports the increased use of differentials precisely because they will relieve the rates burden on residential ratepayers (sub. 21).

When councils do apply the benefit principle they necessarily apply “rules of thumb” to do so.⁶³ Yet council staff and elected members do not usually have skills in economic analysis required to identify robust rules (Chapter 5). As a result, it is easy for specious considerations to influence judgements (Box 7.2)

Box 7.2 Does the tax status of businesses justify a rates differential?

A common argument for business differentials is that businesses, unlike households, can claim back GST paid on rates and claim rates as an expense to reduce their income tax liability. Colegrave (2007) noted that many councils use this argument “to justify their business differentials” (p. 40). For example, Wellington City Council had taken this approach in working out one version of the benefit shares that informed their business differentials. This was contested in *Woolworths vs Wellington City* ([1996] 2 NZLR 537). The High Court Judge and the presiding Judge in the Court of Appeal saw this as a “pragmatic assumption” that was within the competence of elected representatives (pp. 551-552).

BusinessNZ submitted against taking tax status into account when setting business differentials.

These claims have been discredited by reputable economists for the following reasons. First, a firm can only claim a tax deduction for rates because its income is subject to tax and nobody could seriously argue it is an advantage to be subject to income tax. Second, a GST registered person or firm can claim a credit for GST paid on inputs because supplies (outputs) are subject to GST. But as the net GST collected is paid to Inland Revenue, businesses get no advantage. (sub. 54, p. 27)

The Shand Inquiry also thought tax status was irrelevant in setting differentials.

The Panel does not support a higher differential on businesses to compensate for the tax deductibility of rates for business income tax. The tax status of residential ratepayers is not considered when setting rates, and many owners of residential investment properties also have an ability to claim rates as a tax expense. More importantly, other taxes and goods and services are not set on the basis that businesses should pay more because of their tax status. The Panel considers that the tax status of a business or individual is not a relevant factor in deciding the incidence of rates. (Shand Report, 2007, p. 131)

F7.1

Councils often make rating decisions in a non-transparent manner that follows a confused consideration of benefits, affordability and local politics.

⁶³ For example, Wellington City Council staff used such “rules of thumb” to help determine commercial differentials in the early 1990s (as described in *Wellington City Council v Woolworths New Zealand Ltd* [1996] 2 NZLR 537).

Statute provides only weak support for applying the benefit principle

Previous and current local government legislation provides only weak support for the benefit principle. *Wellington City Council v Woolworths New Zealand Ltd* ([1996] 2 NZLR 537) is the landmark case and continues to provide guidance on the setting of rates. In this case, the Court of Appeal canvassed the difficulty in precisely identifying benefits for the purpose of setting rates. Woolworths and others had successfully challenged Wellington City Council's commercial rating differential in the High Court. The Court of Appeal found, among other things, that the Council had acted in good faith and weighed the relevant considerations and that the ultimate decisions could not be invalidated as unreasonable. The Court of Appeal noted in particular that:

[r]ating required the exercise of political judgment by the elected representatives of the community. The economic, social and political assessments involved were complex. The legislature had chosen not to specify [in the Local Government Act 1974 and the Rating Powers Act 1988 then applying] the substantive criteria but rather to leave the overall judgment to be made in the round by the elected representatives. (p. 552)

The Court saw force in the Local Government New Zealand (LGNZ) submission that the scheme of the legislation provides for a rating system that "remains primarily a taxation system and not a system inherently based on a principle of user pays" (p. 544).

The Court pointed to evidence given by Professor Claudia Scott in the High Court hearing that "calculating benefits received from services is a complex task and developing the appropriate methodology to determine the level of benefits received by different groups is extremely difficult...many services provided by governments give rise to both private and externality benefits and there is no uniform technical answer as to how particular services should be funded: it is the role of councils to make appropriate expenditure and tax decisions which reflect the policy goals of the communities they serve". (p. 551)

In 1996, the Government, as part of broader reforms to local government finance, amended the Local Government Act 1974 to clarify the process and matters that councils need to consider in funding decisions (including on rates). The amendment contained explicit reference to the benefit principle and the economic efficiency of the allocation of the costs of expenditure (Local Government Amendment Act 1996 (No 3) inserting sections 122E to 122H of the principal Act).

The LGA 2002 replaced these provisions with a brief and more general statement of things that councils must consider in determining their funding needs.

The funding needs of the local authority must be met from those sources that the local authority determines to be appropriate, following consideration of, —

- (a) in relation to each activity to be funded, —
 - (i) the community outcomes to which the activity primarily contributes; and
 - (ii) the distribution of benefits between the community as a whole, any identifiable part of the community, and individuals; and
 - (iii) the period in or over which those benefits are expected to occur; and
 - (iv) the extent to which the actions or inaction of particular individuals or a group contribute to the need to undertake the activity; and
 - (v) the costs and benefits, including consequences for transparency and accountability, of funding the activity distinctly from other activities; and
- (b) the overall impact of any allocation of liability for revenue needs on the current and future social, economic, environmental, and cultural well-being of the community. (s 101(3))

The Local Government Business Forum submitted:

[T]oo often councils make ... important decisions [about the allocation of rates] based on political or populist factors rather than an objective analysis of ability to pay and beneficiary pays. The Local Government Amendment Act 1996 (No 3) had what we believe were rigorous steps for councils to go through and useful principles, considerations and matters to guide them in going through those steps. These should be revisited. (sub. 52, p. 24)

The Commission agrees that current legislation lacks clarity around councils using the benefit principle in their rating decisions. Section 7.2 discusses how legislation should be amended to give more weight to the benefit principle.

F7.2

Local government legislation currently provides only weak support for allocating rates primarily according to who benefits from council services.

7.2 Equity in a future funding system

Local decisions on the allocation of rates appropriately provide an opportunity to reflect local service choices and preferences. Even so, the Commission believes that scope exists to improve the process through greater transparency around the allocation of rates; and more guidance on applying the benefit principle.

Applying the benefit principle

The Commission recommended (in Chapter 6) that the benefit principle should be the primary basis for allocating rates. Current statute is not clear enough on this point, and in practice the basis for setting rates is far from transparent (section 7.1). It is therefore not surprising that weak guidance in statute has resulted in a lack of practical guidance to councils, and widely varying interpretations, about how to apply the benefit principle.

Differentials and uniform annual general charges

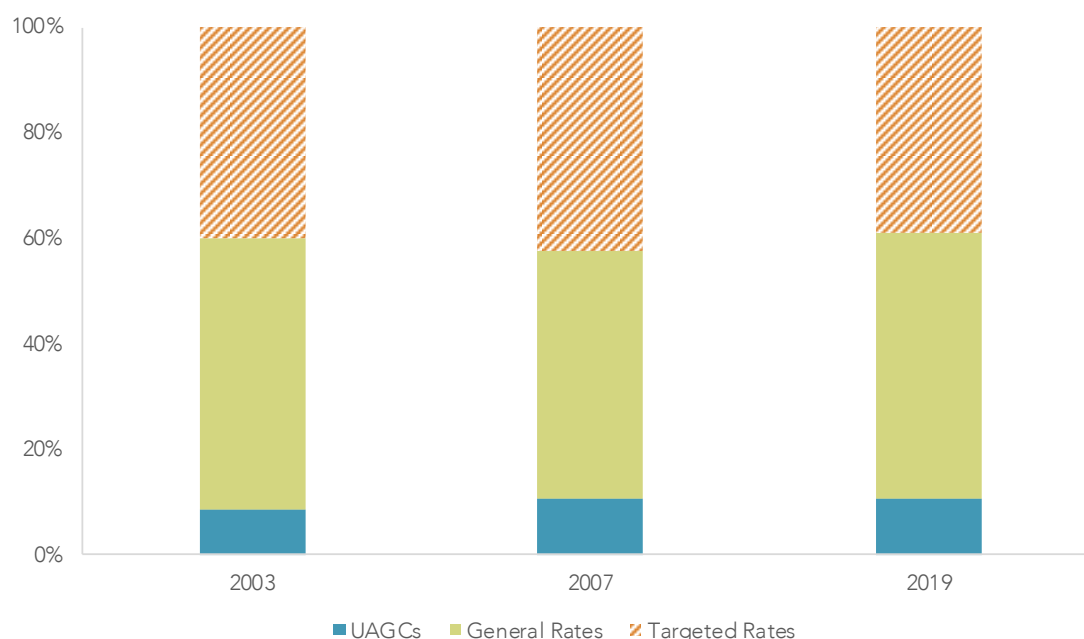
Lack of clarity around the rationale for rates differentials has been a longstanding problem. The 2007 Shand Inquiry found that:

differentials are set in a non-transparent way and are essentially arbitrary political decisions. The Panel considers that differentials should be abolished...Instead of differentials councils should use targeted rates, for which a greater degree of transparency is required where there is a justification for levying different classes of ratepayers differently...The Panel considers that, as with differentials, uniform annual general charges are set arbitrarily, with little relationship to the services they are to fund. The Panel considers that on transparency and equity grounds uniform annual general charges should be removed. This does not prevent them being replaced by targeted uniform rates. (Shand Report, 2007, pp. 117-118)

LGNZ also found that the “rationale behind rating differentials is not always transparent” (2015, p. 56). The Commission reviewed a recent selection of councils’ rating policies and also found a lack of clarity about the rationale for differentials. This reinforces the views of inquiry participants (Box 7.1).

Even so, Federated Farmers of New Zealand submitted that some ways of setting differentials are better than others. They refer to councils, such as New Plymouth District Council, that allocate a percentage share of rates to different property types according to a formula. The formula may include factors such as population density, proximity to services, and kilometres of road network, that reflect the benefits received. The council then bases the differentials on the allocated share of rates. However, councils could use targeted rates to achieve the same allocation of rates as this type of differential.

Since the Shand Inquiry, councils, collectively, have made only small adjustments to the proportions of rates revenue from targeted rates, UAGCs and general rates, and in the wrong direction (the proportion from targeted rates fell between 2007 and 2019) (Figure 7.3).

Figure 7.3 Shares of total rates revenues by rating tools, 2003-2019

Source: Insight Economics, 2019a.

The Commission agrees with the Shand Inquiry recommendations to abolish both differentials and UAGCs. Conceptually, both can be replaced with more transparent targeted rates.⁶⁴ Indeed, some councils already get a very large part of their rates revenue through targeted rates (Figure 7.1). Around one-third of councils do not currently use differentials at all, only 32 councils use business differentials and 32 use rural differentials on general rates (Insight Economics, 2019a). Targeted rates have great flexibility both in their scope and in their choice of base (section 7.1). They can reflect land or capital value or be uniform across rating units. They can also reflect other property characteristics that correspond to benefits (or the exacerbation of problems that council services seek to tackle). They can apply to all properties in the district or be targeted just to some locations or types.

F7.3

Differentials and the uniform annual general charge are not transparent in allocating the burden of rates to those who benefit from council services. Targeted rates provide a more direct connection between the funding and the beneficiaries of services; and therefore are a much more transparent way of giving effect to the benefit principle.

If differentials and UAGCs are abolished, some councils will need time to transition to a rating system that does not use them. The Shand Inquiry recommended that councils should have five years to make the adjustment. Any current distribution using differentials and UAGCs can likely be readily replaced using targeted rates.⁶⁵ Yet councils need time to apply the benefit principle transparently and canvass and gain support for any changes.

R7.1

The Local Government (Rating) Act 2002 should be amended to remove rates differentials and uniform annual general charges. Councils should have five years to implement their removal.

⁶⁴ Waikato District Council made the point that they could use either differentials or targeted rates to achieve the same distribution (Waikato District Council, 2018, p. 148).

⁶⁵ SOLGM and LGNZ (2008) asked a selection of councils, in one scenario, to model the Shand recommendations on the assumption that, apart from removing differentials and UAGCs, their rating system would remain unchanged. This meant that targeted rates could not be used instead. The study unsurprisingly found that, for some councils, the abolition of differentials and UAGCs led to an extreme redistribution of the rating burden.

Applying the benefit and ability-to-pay principles in separate steps

The Commission considers that allocating rates should be based primarily on the benefit principle. The legislative scheme in the LGA for setting rates (and raising revenue more generally) gives only weak support to the benefit principle (section 7.1). In practice, councils often conflate and confuse the benefit and ability-to-pay principles (Box 7.1).

The Commission considers that statute should provide for councils to apply the benefit and ability-to-pay principles in separate and distinct steps in their rating decisions. This will allow councils to address affordability for specific groups of ratepayers in a transparent manner, after they have considered who benefits from council services. Councils can then choose the adjustments to the allocation of rates that they consider will best address any ability-to-pay issues they identify.

SOLGM similarly recommends that statute should provide for councils to consider affordability explicitly, probably as a distinct step in setting rates (sub. 24).⁶⁶ SOLGM does not think that this requires either a mandatory definition of affordability or a statutorily set approach to assessing it. Given the variety of ways in which “affordability” is used, the Commission thinks it preferable to refer to the “ability-to-pay” principle but is open to how this should be worded in statute.

When statute places clear emphasis on applying the benefit principle first, interested parties will be in a better position to influence outcomes. This will give councils incentives to be explicit about the principles and data they are using to allocate the rates burden. In turn, sector interests will want to develop clear guidance for councils on how to do this.

Applying the ability-to-pay principle

An important consideration, in applying the ability-to-pay principle to redistribute the burden of rates, is consistency and coherence with the income-distribution policies of central government. When local government rating systems were first established in New Zealand (almost from the beginning of European settlement), the scope and depth of central government’s income distribution policies were relatively weak. As discussed in section 7.3, the balance between central and local government has since changed radically. Central government now has access to revenue and administrative systems and information that place it in a far stronger position than local government to redistribute income efficiently and equitably. Yet it is not clear that local government decisions on redistributing the burden of rates adequately take central government capabilities and policies into account.

Councils have various tools to adjust the allocation of rates to reduce the burden on particular types of households (after applying the benefit principle). For example, councils could:

- reduce the total rates allocated using the benefit principle, and increase the amount allocated through a general rate (based on property values);
- apply a targeted rate based on property values, either to all properties, or to some; or
- use their rates remissions policies to reduce the rates burden of households in specified circumstances.

Each council will need to decide on the approach that suits its community best, while being transparent about the reasons for its preferred approach and the outcomes. Many councils already make these types of adjustments.

Councils should be free to make their best judgments in setting rates

The Commission proposes that legislation be amended to provide for greater transparency in setting rates. Statute would require councils to go through a two-stage process, first applying the benefit principle and then considering ability to pay. Even so, this requirement should sit within the context of the general powers that a council has under section 12 of the LGA to perform its role. This could be achieved by appropriate drafting of the new provisions to recognise that it is within the competence of councils, on reasonable

⁶⁶ The Shand Inquiry also recommended that statute contain specific reference to affordability in rating decisions (Shand Report, 2007).

grounds, to make their best judgments on rating policies (see, for instance, Local Government Act 1974, s 122I(1)).

R7.2

Local government legislation should be amended to require councils to:

- match the burden of rates to the benefits of council services, as a first step in setting rates;
- consider ability to pay as a second step;
- set out the reasons for their rating decisions in each step in a clear and transparent manner; and
- (in applying the ability-to-pay principle) consider coherence and consistency with the income-redistribution policies of central government.

Councils should continue to have the power to determine, on reasonable grounds, the appropriate allocation of rates within their district or region.

Councils need more guidance on how to apply the benefit principle

Current statute provides only weak support for using the benefit principle in rating decisions. As a result almost no guidance exists for councils about how to apply the principle. More guidance is needed.

- Councils of necessity use “rules of thumb” to apply the principle. These rules will necessarily be approximations of the true incidence of benefits and taxes (Chapter 6). Even so, the rules of thumb must be able to stand up to scrutiny of affected parties, so that the reasons behind rating decisions are clear and supportable. Authoritative guidance that commands the support of the local government sector as a whole would give each council more confidence in applying the principle.
- There are trade-offs between accuracy and transparency in reflecting benefits; and administrative complexity and ease of communicating ratings policy. The trade-offs will be different for each council (eg, depending on its size, the dispersion of its population, the mix of services it provides, and the types of properties that form its rating base). More guidance on how to make these trade-offs in applying the benefit principle would help each council work out an approach that is both robust and suitable for its circumstances.

SOLGM and LGNZ have provided a guide to the rating system (SOLGM & LGNZ, 2013) and more recently SOLGM has developed comprehensive advice for councils on rating reviews (SOLGM, 2017a). Further advice on applying the benefit principle in rating policies would complement the Commission’s proposed legislative changes.

R7.3

Local Government New Zealand and the New Zealand Society of Local Government Managers should develop advice for councils on how to apply the benefit principle (the burden of rates should reflect the benefits received) in their rating decisions.

The statutory 30 per cent cap on uniform charges should be removed

The LGRA currently specifies that revenue from uniform charges (including UAGCs and uniform targeted rates applying across the district, but excluding uniform water and wastewater rates) must not exceed 30% of rates revenue (section 7.1). SOLGM submitted that this cap is inappropriate:

The existence of the cap devalues the regime of accountability and community choice promoted in the *Local Government Act* ... The cap is also inconsistent with the purposes of the [Local Government (Rating) Act] (one of which was to provide local authorities with flexible powers to set and assess rates). (sub. 24, p. 55)

Federated Farmers of New Zealand (sub. 75), the Local Government Business Forum (sub. 52) and BusinessNZ (sub. 54) also support removing the 30% cap. BusinessNZ argues that the cap prevents councils from effectively signalling costs to ratepayers.

The 30% cap was intended to prevent the rating system being too regressive by, in effect, requiring a substantial proportion of rates to be levied on the basis of property values. Even so, no rationale exists for where the cap is set (as noted by the Local Government Business Forum, sub. 52). Only four councils are close to the cap (Insight Economics, 2019a).

Under the Commission's proposals, councils will need first to apply the benefit principle when setting rates. The 30% cap on uniform charges may unduly constrain their ability to do this. Councils will then apply the ability-to-pay principle as a separate step, which would give them the opportunity to consider the overall distribution of the rates burden. As discussed above, councils have a range of rating tools available to apply the ability-to-pay principle, including targeted or general rates based on property values, and rates remission policies.

F7.4

The statutory 30% cap on uniform charges (covering Uniform Annual General Charges and uniform targeted rates applying across the district, but excluding uniform water and wastewater rates) has no clear rationale and unnecessarily restricts the discretion of councils to use rates to reflect the benefit of services and amenities. Currently, few councils are close to the cap.

R7.4

The Local Government (Rating) Act 2002 should be amended to remove the statutory cap on uniform charges.

7.3 Affordability of local government funding for households

While this inquiry is primarily about local government cost drivers and the funding and financing framework, a further consideration is affordability, particularly the affordability of rates. Concerns about the affordability of rates are not new. In 2007, "concerns about the impacts of rates increases for low-income groups and other sectors of society and the economy" were factors leading to the establishment of the Shand Inquiry (Shand Report, 2007, p. 22).

People use the term "affordability" in different ways (see above). The primary focus of this section is on the affordability of rates for specific groups in the community. Chapter 5 covers council decision making on the quality and quantity of services and amenities and how these reflect local preferences and willingness to pay. Chapter 6 discusses user charges and this section also briefly touches on how councils address affordability of such charges.

The Shand Inquiry provided a useful broad definition of affordability: "[Affordability] means the ability to pay without serious economic difficulty" (Shand Report, 2007, p. 185). Shand then considered the affordability of rates in a relatively narrow context:

Ability to pay rates requires consideration of

- the cost of rates relative to income and also relative to wealth, to the extent that wealth can be converted to income
- having sufficient income to pay for rates without crowding out other critical expenditure
- ratepayers earning greater income as a result of council investment in infrastructure and services. (p. 185)

This chapter takes a broader approach by looking at rates as a component of housing costs. Much better and more reliable data and analysis is available about housing costs (rather than rates alone) as a proportion of income, and the effects on material hardship (especially Perry, 2018a, 2018b). In addition, as discussed

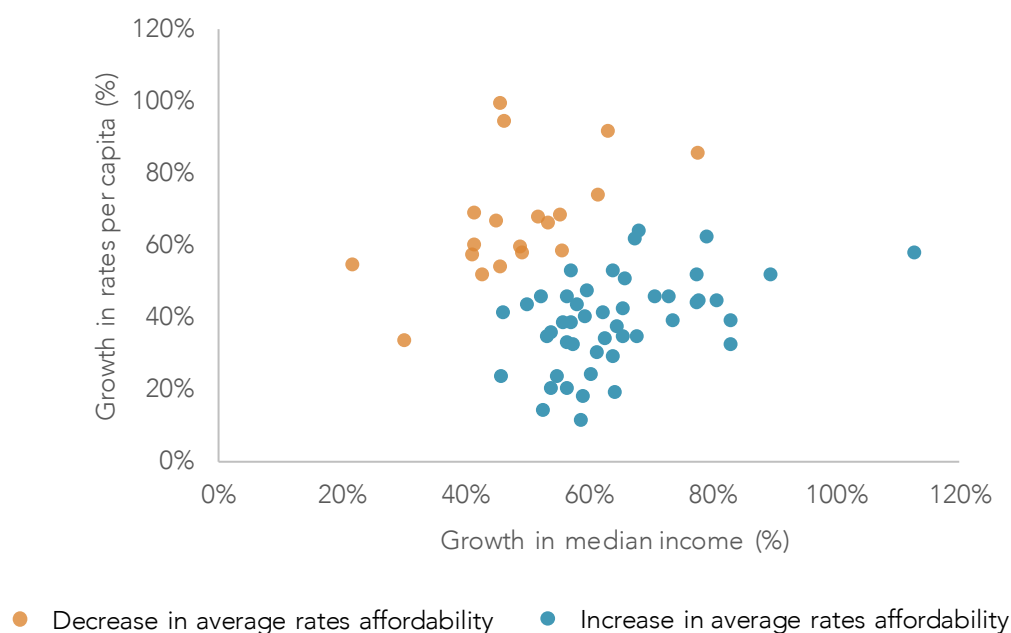
below, rates paid by landlords are likely largely passed on to tenants. As a result, the economic position of tenants is as relevant to the question of rates affordability as the economic position of residential ratepayers.

How has affordability of rates changed over time?

Comparing the growth in rates revenue with growth in gross domestic income (GNI) is a simple, if somewhat blunt, method for measuring aggregate changes in the affordability of rates over time. Between 1993 and the late 2000s, rates continued to increase in line with GNI. However, income growth stalled between 2008 and 2012, due to the global financial crisis, while rates continued to rise (Chapter 3). More recently GNI and rates have again been increasing at a similar rate, and by 2018 rates stood at 2.1% of GNI.

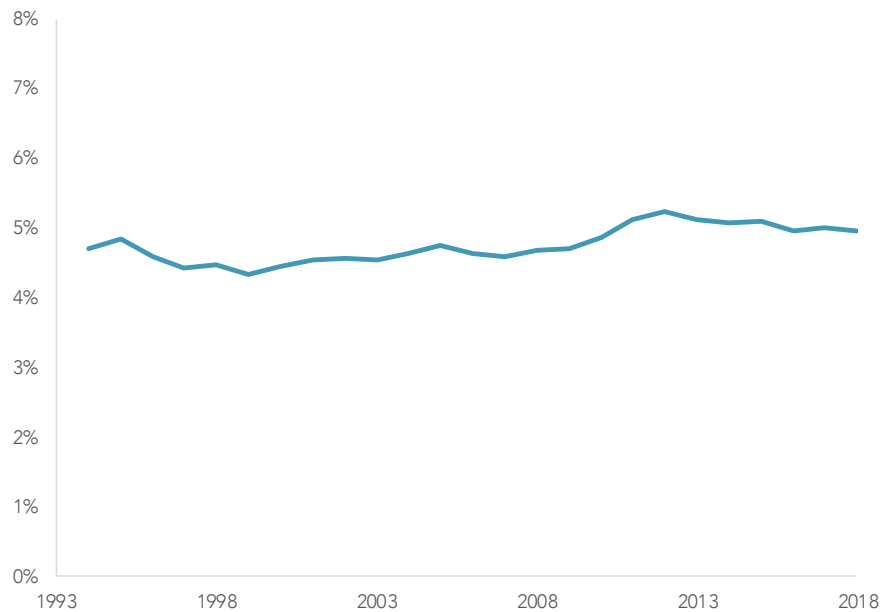
Yet rates trends vary among local authorities (Chapter 2) and income has grown faster in some areas than others. Comparing the change in rates per capita with median incomes, Figure 7.4 suggests that, between 2001 and 2013, over half of territorial authorities' rates became more affordable for a median household.

Figure 7.4 Growth in rates per capita and median household incomes across councils, 2001-2013



Source: Stats NZ 2014, 2019c.

Even so, comparing rates increases with income increases just focuses on changes for the typical household. Rates affordability may still be a concern for many lower-income households and households on fixed incomes (eg, for people who rely on superannuation). Rates as a proportion of the 20th percentile of household disposable income has also remained within a fairly narrow band over the last 25 years and has stayed almost constant around 5% for the last decade (Figure 7.5).

Figure 7.5 Rates per person as a proportion of low-income household disposable income

Source: Perry, 2018a; Stats NZ, 2018b, 2019c.

Notes:

1. Household disposable income is equivalised disposable income (before housing costs are paid) reported in Perry (2018) and derived from the Stats NZ Household Economic Survey. Disposable income refers to after tax and transfers income; equivalised income is income adjusted for household composition. The income data used in the figure is for the 20th percentile of people by equivalised household disposable income.

The incidence of rates on renting households

Most of the discussion of the affordability of rates for particular households focuses on ratepayers (owners of residential property). Yet the economically most vulnerable households are largely renting households (Perry, 2018a). Renting households, in effect, pay rates on the properties they occupy, through rent. It is not possible to accurately quantify the extent to which rates are passed on to renters because housing supply, housing tenure, employment and location decisions interact in complex ways (England, 2016). Even so, while landlords have choices about whether to continue to own and rent their properties, renters on average are less able to make choices that find them paying no rent. This suggests that rates are mostly passed on to renters.

Households facing material hardship are mostly young, renting and on low incomes

Housing costs can have a significant influence on whether households experience poverty or material hardship. Perry (2018a) looked at the percentages of individuals, by age and housing tenure, who live in low-income households after accounting for housing costs.⁶⁷ Renters are much more likely to live in low-income households than those who own their own house (and so pay rates directly). Younger people are three times more likely to live in low-income households than older people.

⁶⁷ "Housing costs include all mortgage outgoings (principal and interest) together with rent and rates for all household members. Repairs and maintenance and dwelling insurance are not included [though insurance will be in future reports]" (Perry, 2018a, p. 18).

Table 7.3 Proportion of individuals in low-income households by tenure and age, 2015

	Aged under 65	Aged over 65
Owned, no mortgage	5%	1%
Owned with mortgage	8%	9%
Rented – private (no AS)	7%	
Rented – private (AS)	32%	
Rented – public housing	32%	
Rented		12%
Total proportion in low income households	13%	4%

Source: Perry, 2018a, p. 141, Tables G 8A & G 8B.

Notes:

1. The data in the table show the percentage of individuals of each age and tenure type who are in low-income households.
2. Low income is defined as being below 50% of 2007 median equivalised household disposable income after housing costs.
3. Data are derived from the Stats NZ's Household Economic Survey.
4. "AS" refers to the Accommodation Supplement administered by the Ministry of Social Development.
5. "Owned" includes owned through a family trust.

Perry (2018b) looked at various measures of material hardship and found that the relationship between experiencing material hardship and living in low-income households is inexact.⁶⁸ Owning a home without a mortgage makes a significant difference. While 35% of those aged over 65 have before-housing-cost incomes in the lowest income quintile, this falls to 13% after accounting for housing costs, and only 7% on an index of material wellbeing (p. 11). One reason is that (in 2015) 72% of those over 65 lived in their own house without a mortgage.

Across a range of measures, older people consistently have much lower rates of hardship than younger people (and especially younger people in sole parent families and households dependent on benefits as their main source of income). Māori families were also significantly more likely to experience hardship than European families (Perry, 2018b).

Central government assistance

Any local government redistributive rating policy should complement relevant central government policies (section 7.2). The main forms of central government assistance for housing costs are the Accommodation Supplement (AS) and, to a much lesser extent, the Rates Rebate Scheme (RRS). The government also helps families in social housing through a large income-related rents subsidy programme (Ministry of Social Development, 2019). Some households receiving the AS require additional assistance to meet their essential housing costs. Temporary Additional Support (TAS) provides such assistance for a maximum of 13 weeks, after which recipients must reapply. More than 20% of recipients of the AS, also receive TAS at any one time (Welfare Expert Advisory Group, 2018).

The Accommodation Supplement is the primary programme to help low-income households meet housing costs

The AS is central government's most important programme to assist low-income families meet housing costs. The AS is a very substantial programme with a total annual appropriation in the 2019 budget of almost \$1.7 billion. Almost 303 000 persons (in most cases each representing one household) were receiving the AS in December 2018.

The AS is a non-taxable weekly payment that helps people with their rent, board or the cost of owning a home. Importantly, as the AS is available both to renters and to people who own their own home, it

⁶⁸ Non-income measures of material wellbeing are derived from responses to surveys about "actual day-to-day living conditions of households in terms of the basics of food, clothing, accommodation, heating, and transport, and more widely in terms of their ability to maintain or replace broken household appliances, purchase desirable non-essentials, cope with unexpected demands on the household budget and so on" (Perry, 2018b, p. 3).

addresses the effects of rates on costs whether direct or passed on through rents. Section 65 (2) of the Social Security Act 2018 (SSA) defines eligible “accommodation costs”. For homeowners, these costs include rates and mortgage payments, house insurance premiums and “essential repairs and maintenance”.

Eligibility for the AS depends on factors such as accommodation costs, location, income and cash assets, and family circumstances. The amount of AS is determined by the following factors.

- The Social Security Regulations 2018 (cl. 17) sets relevant main benefit rates (including the maximum Family Tax Credit rate for the eldest child, if applicable) as a “base rate”. The rates vary by household composition and relationship status.
- The AS is paid at 70% of actual housing costs that exceed 25% of the base rate (30% for homeowners). The payment is subject to a maximum depending on which of four areas the recipient lives in. The current maximum payment is \$305 a week for households with three or more people living in the most expensive housing area. The maximum for two-person households is \$220 a week (SSA, Schedule 4, Part 7). The maxima are not indexed for inflation.
- If the recipient is a non-beneficiary, the AS is reduced by 25 cents for every \$1 of income of the recipient and their partner.⁶⁹ If the recipient is a beneficiary (including New Zealand Superannuation), the AS is not abated against income. Instead:
 - the main benefit is abated for working age beneficiaries;
 - a person receiving New Zealand Superannuation is not eligible for the AS if the combined income before tax of that person and their partner exceeds \$835.04 a week (SSA, s 67(e) & Part 2 of Schedule 5).
- Recipients may hold cash assets of up to \$16 200 if they are in a relationship or with a dependent child), or \$8 100 otherwise (Social Security Regulations 2018, cl 15).

The current combined before-tax rate of New Zealand Superannuation for a couple is \$724.85 a week. That couple could earn around \$110 a week on top of their superannuation payments before losing eligibility for the AS. Yet a couple living in their own home without a mortgage is unlikely to qualify because their housing costs (rates and insurance) would not meet the 30% of their before-tax superannuation income threshold (just over \$13 000 per year).⁷⁰ More generally, it is most likely that only homeowners (including those living alone) who are making mortgage payments or who have significant essential repairs would meet the cost thresholds for AS.

The distribution of AS beneficiaries by tenure and benefit status reflects the groups for whom housing costs are the greatest challenge (Table 7.4). Homeowners are only 11% of the total, while homeowners who receive New Zealand Superannuation are only 2% of the total.

The Welfare Expert Advisory Group considered the AS as part of its review of the welfare system (Welfare Expert Advisory Group, 2018, 2019). It noted some well-known problems, including the different accommodation costs threshold for renters and homeowners, the fact that the asset test has not been adjusted for inflation since 1989, and that the maximum payments are not indexed for inflation. The Group also pointed to the suspected low uptake among non-beneficiaries (people who are neither on a main benefit or receiving New Zealand Superannuation). It made recommendations to the Government to address these issues.

⁶⁹ Every \$100 of cash assets held over specified values are treated as \$1 of income for the purpose of this income test (SSA, s 423(3)). Non-beneficiaries may be receiving the Working For Families tax credit.

⁷⁰ The costs of “essential repairs” might temporarily exceed the threshold.

Table 7.4 Accommodation supplement proportion of total by tenure and beneficiary status, December 2018

Tenure	Beneficiary	NZ Super	Non beneficiary	Total
Renting	42%	10%	14%	67%
Boarding	20%	1%	1%	22%
Own home	5%	2%	4%	11%
Total	67%	14%	19%	100%

Source: Ministry of Social Development.

Notes:

1. NZ Super includes recipients of the Veteran's Pension.
2. Columns do not always add to the total because of rounding.

More broadly, expenditure on the AS has been increasing rapidly in recent years as house prices and rentals have been rising. This points to deeper problems in the housing market which require a suite of solutions that have been canvassed in earlier Commission inquiries (NZPC, 2012, 2015, 2017a). The AS has struggled, by itself, to provide enough assistance to some low-income households, especially those who rent their homes, to meet these rising costs. As a result, many recipients also need TAS payments to meet their essential housing costs (Welfare Expert Advisory Group, 2018).

F7.5

There is little or no evidence that rates generally have become less affordable over time. Much concern focuses on affordability for low-income (particularly elderly) households who own their own homes. Yet such households generally have much lower housing costs than other low-income New Zealand households.

The Rates Rebate Scheme

The RRS was introduced in 1973, long before the AS and its predecessors were available to homeowners not receiving a working-age main benefit. The RRS was designed to assist low-income and older ratepayers facing affordability pressures and who wished to stay in their homes.

The maximum RRS is \$630 a year (or just over \$12 a week). Assistance reduces above an income threshold, which varies by the rates bill and number of dependants. For example, a single person whose sole income was from New Zealand Super would be eligible for the full rebate if their total yearly rates were \$1 050 or higher. A couple receiving New Zealand Super would be eligible for a full rebate if their rates bill was \$3 450 or higher (and no rebate at all, if their rates bill was under \$2 455). For a household without dependants, eligibility ceases with incomes above \$43 000 and rates below \$3 500. Unlike the AS, the RRS is not subject to any asset test (including any cash asset test).

In 2018, the Government amended the Rates Rebate Act 1973 to provide eligibility for residents of licence-to-occupy retirement villages (s 7A).

In 2017, just under 98 000 households received a rebate, with a total value of \$55 million (Department of Internal Affairs, 2019b). While the number of recipients is around one-third of those receiving the AS, the amount of the rebate is very modest compared to the AS. The maximum RRS payment is only 5.5% of the maximum AS payment for a two-person household.

Recipients of NZ Super are the main beneficiaries of the Rates Rebate Scheme

Of the people who received the Rates Rebate in 2017 and recorded their income, 78% were New Zealand superannuitants (Department of Internal Affairs (DIA), pers. comm., 4 February 2019). In a striking contrast, only 2% of AS recipients were homeowners NZ Super recipients. Despite, among homeowners, beneficiaries and non-beneficiaries greatly outnumbering New Zealand superannuitants in the AS, they do not feature strongly in the RRS. The main explanation is that homeowners New Zealand superannuitants are unlikely to

qualify for the AS unless they have a mortgage. Yet, as noted above, most homeownership superannuitants have no mortgage. Also some who receive the RRS would not be eligible for the AS because of the cash asset test applying to the AS.

F7.6

Recipients of New Zealand Super are the main beneficiaries of the Rates Rebate Scheme. Most recipients are not eligible for the Government's Accommodation Supplement because their accommodation costs are below the threshold to qualify, unless they have a mortgage or substantial essential repairs.

Income thresholds affect numbers eligible for the Rates Rebate Scheme

The maximum payment and income abatement threshold for the RRS was not adjusted between 1979 and 2006. As a result, the number of rebates fell from 102 000 in 1977 to under 4 000 in 2004. The Government then introduced a revamped RRS in 2006 that increased the maximum to \$500 and the income abatement threshold to \$20 000. The number of recipients leapt to 109 022 (Shand Report, 2007, pp. 197-198).

The number of rebates reached a peak of over 115 000 in 2011, but has since steadily declined. The main reason is that the income abatement threshold has not kept pace with increases in the value of New Zealand Super payments (especially couple households receiving New Zealand Super) (McCarthy & Thurston, 2018).

A cumbersome application process likely reduces the uptake of the Rates Rebate Scheme

The current application process is cumbersome. Ratepayers must apply to their council to receive the rebate and submit a statutory declaration about their income and family composition. They generally have to visit their local council offices personally, and often queue to submit their details. Although ratepayers apply to their local council, central government provides the rebate through the DIA. DIA transfers funds to the council to enter it in the applicant's rates account.

The RRS has suffered from low uptake since its inception. According to LGNZ, this is likely to have been because of "a combination of insufficient promotion, complex administrative processes and a sense that it is a state hand-out" (2015, p. 61). Because the rebate reduces to a very small dollar amount for people on higher incomes, many eligible people would not bother to apply. The DIA does not hold information on the eligible population to determine uptake rates (McCarthy & Thurston, 2018; DIA, pers. comm., 27 March 2019). SOLGM submitted that uptake is low (sub. 24, p. 90).

The DIA has been leading an initiative in collaboration with councils and supported by the Service Innovation Lab to provide a digital web-based alternative to the current application process. The Lab has collaborated with Tauranga City Council to trial the digital process. To date, the trial has reduced processing times both for applicants and councils, and made the process more user friendly for applicants (McCarthy & Thurston, 2018).

The Shand Inquiry recommended passing the administration of the RRS to the Inland Revenue Department, although many submitters to that inquiry favoured the Ministry of Social Development's Work and Income Service on the grounds that the service already held personal and household income data on most applicants. The Shand Inquiry preferred the Department because this would "better present the scheme as a rebate designed to adjust the incidence of tax rather than a form of social welfare payment" (Shand Report, 2007, p. 201).

Submitters see the Rates Rebate Scheme as useful but needing improvement

Many submitters supported increasing the generosity of the RRS and streamlining its administration. The Ōpōtiki District Council, for instance, recommended that the rates rebate abatement threshold is reviewed each year (sub. 126). Ken Palmer (sub. 10) thought the maximum rebate should be increased to \$1 500 and then indexed for inflation.

SOLGM proposed a "first principles review", pointing to the outdated and cumbersome administration, and the RRS shifting towards being a system of "social assistance" (sub. 24, pp. 90-92). BusinessNZ recommended that the scheme is administered centrally through Work and Income because councils have

no information on residents' incomes and "should not be in the business of income redistribution" (sub. 54, p. 26). Wellington Chamber of Commerce and Business Central thought that better education and promotion of the RRS would improve uptake (sub. 72). Auckland Council submitted that the scheme should be extended further to cover new accommodation ownership structures such as papakāinga housing, and to cover water charges levied by a Council Controlled Organisation (sub. 120).

Some submitters valued the RRS because it reduces pressure on councils to avoid rate increases, either generally or for particular groups of ratepayers. Federated Farmers of New Zealand, for instance, submitted:

Council reference affordability when they are reducing the UAGC; we find this perplexing given the existence of central government's rates rebate scheme for low income ratepayers that is provided to address affordability concerns. The Rates Rebate Scheme is related to income, the accepted measure of affordability. (sub. 75)

The Horowhenua Grey Power Association submitted, on the other hand, that

[t]he scheme provides easily accessed and greatly appreciated financial assistance to low-income households in Horowhenua.

But, it does not deserve to be regarded as we strongly suspect our elected council representatives are inclined; as a salve to their conscience for failure to honour their 'first principle' responsibility to design and maintain a rating model which delivers affordability to low-income households. (sub. 21, p. 5)

Assessment of the Rates Rebate scheme

The RRS has, over its long existence, served as a device to enable mostly households of older people on low incomes meet their rates bills without unduly reducing their incomes after housing costs are met. This reflects the fact that property taxes (unlike income taxes and GST) are not necessarily associated with cashflows that make payment easy (Chapter 6). Many older homeowners are on limited incomes, yet may receive fairly large rates bills due to the value of their properties.

Yet the RRS levels of assistance are modest – the maximum rate is just over \$12 a week (although every extra dollar is welcome to income-constrained households). Also, as shown above, the main recipients are among the least likely of New Zealanders to be experiencing material hardship.

As some submissions show, the existence of the RRS has also played a role in the political economy of setting rates. The very existence of the RRS (despite its relatively meagre provisions) gives some groups a means to urge councils to apply the benefit principle more rigorously, and to downplay the ability-to-pay principle. It also gives councils more courage to raise rates to meet spending preferences.

The Commission considers, as discussed below, that greatly improved rates-postponement arrangements would better tackle the problem that the RRS was designed to tackle.

Administrative efficiency

The current administration of the RRS is clearly cumbersome and inefficient for applicants and officials. If the RRS is to continue, a central government department, such as Work and Income, is likely to provide greater administrative efficiency. Work and Income has efficient access to information on incomes and has well-developed digital systems for accepting and processing applications and updating information on applicants. Work and Income already holds current records on most applicants for the RRS.

Does the Rates Rebate Scheme meet the equity test?

The RRS clearly fails to meet the principle of horizontal equity (discussed in Chapter 6). While the RRS provides extra assistance to homeowners, renters with the same number of dependents and with the same incomes and housing costs are not eligible for the RRS.

The RRS also does not meet the principle of vertical equity. On any measure of material wellbeing, homeowners are better off than renters, if income and household composition are the same. This is partly because homeowners, unlike renters, have access to equity to finance expenditure. It is also because sustained good incomes are usually required to accumulate a substantial property asset; these sustained

good incomes also allow people to acquire other assets (such as household durables and financial assets) that make life easier over time.

F7.7

The Rates Rebate Scheme (RRS) is administratively inefficient and satisfies neither the horizontal equity principle nor the vertical equity principle. The level of assistance currently offered by the RRS is just over \$12 a week at most. Low-income homeowners can, as an alternative, access equity in their properties to help meet living costs including rates.

Local government assistance to meet the cost of rates and user charges

Councils determine their own local policies to help low-income ratepayers and residents meet the cost of rates and user charges. These can include rates remission, concessionary user charges and rates postponement. At least one council – Kāpiti Coast District – supplements the RRS with additional assistance of up to \$350 a year, targeted to the neediest ratepayers, and with overall assistance in the district capped at \$125 000 (Kāpiti Coast Grey Power, sub. 12).

Rates remission

Under section 102(3) of the LGA, local authorities have the option to develop a rates remission policy. Yet the Shand Inquiry found that remission policies tended not to focus on solving financial affordability problems – the most common remission policy provisions dealt with the waiver of penalties for late or non-payment of rates (Shand Report, 2007). Similarly, SOLGM reviewed a selection of 28 such policies in 2016 and found that they were used more “to simplify the administration of the rating system, ameliorate the impact of sudden change in incidence or support cultural, recreational, heritage or charitable endeavours” (sub. 24, p. 82). Even so, rates remission is one tool that councils could use to address affordability (section 7.2).

Rates postponement

Under section 102(3) of the LGA, local authorities have the option to develop a rates postponement policy. Rates postponement occurs when a local authority agrees to delay the due date of rates payment until a specified time or a specific event occurs, such as the sale of the property.

The Shand Report (2007) found that rates postponement can help ratepayers who are asset rich and cash poor, but found that the level of rates remitted or postponed was usually very small – at between 0.3% and 0.7% of total rates revenue.

Rates postponement policies vary across councils. Some councils offer postponement for low-income households where paying rates would mean they could not pay for “day-to-day needs, healthcare or urgent maintenance” (New Zealand Government, 2019). Those same councils may also, or instead, offer postponement for people over a certain age (60 or 65) if those people choose to let their rates be paid by their estate when they die, or when their property is sold.

Councils typically limit the total debt from postponed rates allowed on a property (eg, to 80% of the current valuation), and register the debt as a statutory land charge on the rating unit’s title. They may require the owner to make a statutory declaration each year that sets out their relevant circumstances, and charge a yearly fee to cover administrative and financial costs (see eg, Auckland Council, 2019). SOLGM reviewed a sample of 28 rates postponement policies in 2016 and found that most policies allowed for postponement in cases of extreme financial hardship (sub. 24, p. 82).

Rates postponement is not used much to tackle affordability issues (SOLGM, sub. 24; Local Government Business Forum, sub. 52; and Waikato Regional Council, sub. 125). Likely reasons are:

- a homeowner’s caution about the risk of running down home equity, either because they fear eventually losing their home, or because they are concerned about not being able to pass the home to their heirs;

- confusion about how current rates postponement schemes work, given the wide variety of such policies across the country;
- cumbersome administration of current schemes which, for instance, might require the homeowner to make yearly statutory declarations about their financial circumstances;
- councils' lack of enthusiasm about rates postponement because, to the extent homeowners take up such postponement, councils will have more debt on their books (though also more assets); and
- lack of effective education about, and promotion of, rates postponement to homeowners as an option for easing financial difficulties.

Concessionary user charges

Under the LGA (eg, s 101(3)), councils can design user charges to reflect ability to pay, and to encourage greater use of community-financed services. Many councils vary charges for services such as public transport, by discounting rates for children or tertiary students. Councils sometimes also offer concessions to seniors, for example for access to swimming pools. In addition, councils offer some services free of charge or at reduced cost, even though they could apply full charges.

7.4 Addressing affordability of rates in a future rating system

Rates have been keeping pace with GNI and so, in general terms, with incomes (section 7.3 and Chapter 6; SOLGM, sub. 24). This means that, on average, rates are not becoming less affordable over time. Even so, rates (whether paid directly or through rents) are likely to pose some difficulties for low-income families.

Rates are only one aspect of housing costs. Renters pay yearly rents that are generally seven to ten times greater than the rates bills for an equivalent house. Landlords and homeowners need to cover insurance, the cost of housing capital, and repairs as well as rates. So, broad information on the incidence of housing costs is more relevant than information on rates alone when assessing effects on wellbeing.

Fortunately, data from surveys and from the administration of the AS provide reasonably comprehensive information on the incidence of housing costs on different types of households by tenure and composition (section 7.3). Analysis of this data shows unequivocally that the current recipients of rates rebates are mostly not those facing particular hardship after meeting housing costs. If they were, they would qualify for the AS.

The AS is a major central government programme to address housing costs for low-income households. The AS has developed and been tested over time to fit the wide variety of housing circumstances facing low-income New Zealand households in different regions. Work and Income has access to information and systems that allow it to administer the AS in an efficient and equitable manner, so that households in like circumstances receive similar levels of assistance. The Commission does not see a need for additional programmes to provide direct financial assistance to low-income households that own their own home so they can meet housing costs.

Yet the Commission notes that the Welfare Expert Advisory Group has made recommendations to improve aspects of the AS design (Welfare Expert Advisory Group, 2019). The costs of the AS have been rising strongly with increasing house prices and rents, over recent years. A significant proportion of recipients require additional TAS payments to meet their essential housing costs (see section 7.3).

F7.8

The Accommodation Supplement is a well-tested major government programme that, compared to the Rates Rebate Scheme, efficiently and equitably provides support to eligible low-income households to meet housing costs, in a range of circumstances across New Zealand.

The Commission acknowledges that most older homeowners may not qualify for the AS. Yet those homeowners could still find it difficult to pay rates bills if they do not give up some other desired spending options. Revamped and improved arrangements for postponing rates offer an obvious way to tackle such difficulties.

An improved national rates postponement scheme

Each council is currently responsible for its own rates postponement arrangements if it chooses to have one. Arrangements vary greatly across councils, are administratively cumbersome and not well-promoted (section 7.3). While reluctance to draw on housing equity may partly explain low uptake, improved arrangements that reduce the known problems will likely lead to greater acceptance. Submitters had different views on desirable changes (Box 7.3).

Box 7.3 Submissions on improving rates postponement schemes

Hauraki District Council submitted:

We suggest a Government-funded rates postponement scheme until the sale of property – similar to the reverse mortgage concept would be valuable. This would be a complex area for councils to get into, however we think we could help keep people in their homes if this service was offered. (sub. 43, p. 17)

BusinessNZ saw a primary role for the private sector, combined with public promotion:

While conceptually BusinessNZ is not opposed to the use of rates postponement options, we question the need for activity of this sort to be undertaken by local authorities rather than by the private sector through reverse mortgages and the like. Increasingly, the private sector is providing this type of arrangement for those who are effectively asset rich but income poor, as a means of ensuring people can continue to live in their family home while being aware the payments are a debt against their property or assets.

However, given a noticeable reluctance to adopt reverse mortgages (for a number of reasons), it might be desirable to market these to the general public as mechanisms for shifting expenditure and revenue streams over time. But apart from providing general advice to ratepayers, BusinessNZ does not see this as a core role for councils; councils should not become involved in the process of setting up reverse mortgages and the like. Private sector institutions, mainly banks, are in a much better position to market and manage such instruments. (sub. 54, pp. 26-27)

Auckland Council asked for a more universally available scheme:

For those who are asset rich but income poor rates remission and, more importantly, rates postponement must be implemented more closely to universality for those who qualify. This is so that councils can charge the fair property value rates, which should continue to be the main source of Council revenue. (sub. 120, p. 4)

The Commission considers that, even with public promotion, a purely private market arrangement will not make ratepayers confident enough for the uptake of rates postponement options to substantially increase. Financial firms have offered reverse mortgages for many years; indeed payment of rates may have been among the uses, though no information is available to confirm that. Yet the reluctance to take up reverse mortgages is at least partly due to perceived high fees and doubts about the security of the arrangements. Potential customers are likely to be more attracted to a nationally recognised product designed specifically to facilitate rates postponement and offered by a well-trusted public or private financial entity. A single provider (or a few large providers) are more likely to have sufficient scale to support moderate fees.

Development and implementation of a national rates postponement scheme should be a collaboration between central and local government and a preferred provider of finance.

The main features of such a scheme would be:

- a single set of clear and generous eligibility rules that apply across the country;
- administrative systems that allow easy access for applicants;
- moderate and transparent fees;
- clear communication about the effects over time of the arrangement on the equity held by the customer;

- national promotion of the scheme; and
- finance providers with the stability and reputation to give ratepayers and councils the confidence to participate.

The Commission has discussed a scheme along these lines with several financing organisations. The discussions indicated that such a scheme would be feasible but need careful design.

R7.5

The Government should work with local government and suitable financial providers to develop and implement a national rates postponement scheme. The scheme should:

- have a single set of clear and generous eligibility rules;
- be accessible and have provisions that are easy to understand and work with;
- have moderate and transparent fees; and
- be nationally promoted.

The Rates Rebate Scheme should be phased out

The RRS offers only modest assistance to low-income homeowners, is inequitable (because renters facing similar housing costs do not get equivalent assistance) and is administratively inefficient (section 7.3). Once an effective and well-accepted rates postponement scheme is available, there will be no need for a continuing RRS.

It will take time to set up a new rates postponement scheme. In the meantime, the RRS should continue for a defined period (perhaps five years). During this phase-out period, the current income abatement threshold and maximum payment should remain unchanged. This will mean that over time the number of eligible people will fall, as a new rates postponement scheme comes on stream.

R7.6

The Government should phase out the Rates Rebate Scheme (RRS) over a defined period, such as five years, from when an effective national Rates Postponement Scheme is in place. In the meantime, the current income abatement thresholds and maximum payments should be maintained.

7.5 Conclusion

Current rating tools give councils great flexibility in distributing the burden of rates across different classes of property. Councils vary greatly in how they do this in practice, but clarity about the principles they follow is often lacking. Many ratepayers find the basis for their assessed rates is far from transparent.

If councils followed the benefit principle in the first step of setting rates, ratepayers would have a better understanding of councils' thinking. Stronger direction in statute and the removal of rates differentials and the UAGC from the toolkit would help. Councils would then have to rely more on targeted rates which by their nature make a clear connection between the funding of services and amenities and the beneficiaries.

As a separate second step in setting rates, councils should consider ability to pay. They should clearly explain any adjustments they make to rates as a result and align those adjustments with the income-redistribution policies of central government.

The Rates Rebate Scheme (RRS) (a central government policy) is inconsistent with central government's principal policy to assist low-income families living in private accommodation to meet their housing costs (ie, the Accommodation Supplement (AS)). Most people who receive the RRS are not eligible for the AS, because their accommodation costs (mostly rates and insurance) are too low. Other low-income households who rent, but have the same or higher housing costs, are not eligible for assistance from the RRS.

An effective rates postponement scheme is the obvious solution for low-income homeowners who wish to increase their current income after paying out housing costs. Central and local government should collaborate with suitable financial providers to develop, implement and promote such a scheme. Once such a scheme is in place, the RRS can be phased out.

8 Adapting to climate change

Key points

- A new, challenging and growing pressure on local government funding comes from climate change – the threats from sea-level rise and more frequent and extreme weather events. The most direct threat is climate-induced damage to local government infrastructure such as roads and bridges, and stormwater, wastewater and flood-protection assets.
- Councils are responsible for planning and regulating development on at-risk land, and therefore have an important role in minimising future climate risk exposure and long-run adaptation costs. Councils are also the body closest to at-risk communities and will be expected to engage with them on an adaptation strategy. They must manage both pressures from property owners to invest in defences against sea-level-rise and flooding, and retreats from vulnerable locations.
- To help local governments prepare for climate change, central government should take the lead on providing high-quality and consistent science and data, standard setting and legal and decision-making guidance. It would be costly and risk inconsistency and inequity for councils to expend resources on these individually.
- New Zealand's laws and institutions acknowledge the risks from climate change and require local governments to plan for the approaching and rising hazards it will cause. Yet much thinking and practice is still dominated by assumptions that risks are unchanging, like earthquake risk. This is not the case for climate-change risk, which is deeply uncertain yet increasing and cumulative in nature. A systematic shift in understanding is needed to deal with the nature of climate risk.
- Institutional and legislative schemes need to move from their current focus on post-event recovery towards pre-event risk reduction. They need to lean against the tendency to continue along current pathways that rely on hard structures to protect new and existing land use, encourage the use of anticipatory and flexible decision tools, and incentivise actions that reduce long-term costs.
- Two broad principles to guide the funding of climate adaptation are minimising long-run costs, and fairness and justice. The first implies avoiding behaviour that leads to increased risk exposure for private gain at others' expense ("moral hazard" behaviour). The second brings into play New Zealand's tradition of societal support and risk sharing, and inter-generational equity.
- The Commission recommends extending the New Zealand Transport Agency's co-funding model to help councils with land-transport infrastructure at serious risk from climate change.
- The Government should also create a climate-resilience agency and associated fund to help at-risk councils redesign, and possibly relocate and rebuild, three-waters infrastructure threatened by sea-level rise and more intense flooding due to climate change. The agency should also assist regional councils and communities to lessen river flood risks.
- Benefits and drawbacks exist for supporting private property owners at risk from climate change. Central government will need to decide which course to take. Yet the existence, or not, of such support will have consequences for local governments grappling with climate-change adaptation, as they have the tricky job of working with exposed communities to try and agree on a wise course forward. Any public funding should be provided in a way that supports councils in this process.

The most challenging new and growing pressure on local government funding arises from climate change, including the threat of sea-level rise and extreme weather events. The effects of climate change are already evident in events such as major floods and sea damage to property. Although the main pressures still lie in

the future, they will grow inexorably, affecting some locations more than others and with significant uncertainties about just when, where and how the effects will materialise. A considerable literature already exists on adaptation to climate change, including research in and about New Zealand. Adaptation is on the radar of most local governments, and some are already grappling with it.

Climate change threatens to put significant cost pressures on councils on three main fronts.

- Councils are the owners of a large amount of the infrastructure that is directly at risk from the impacts of sea-level rise and other adverse weather events (eg, more frequent and intense floods and storms).
- Councils are the authorities responsible for planning and development on at-risk land, and therefore have an important role in minimising future risk exposure and long-run costs. Yet in taking actions or inactions in this role, councils face the threat of challenge and future liabilities (Hodder, 2019).
- Councils are the branch of government closest to communities and have a clear role in supporting community wellbeing. This could entail considerable expense in community engagement on an adaptation strategy, responding to pressures from property owners to invest in sea-level-rise and flood defences, and from overseeing managed retreats from vulnerable locations. Councils could also be drawn in to assist and compensate citizens for private losses from climate-related events.

Examining the funding aspects of climate change for local government requires exploring possible new frameworks and institutions, because funding arrangements only make sense within a wider context. The analysis in this chapter will be exploratory because climate change and the challenge of how societies adapt to it is unprecedented, and because so much is still uncertain. These features mean that policies and institutions suited to meet the challenges may require novel features, such as features that can cope with changing uncertainty (because some uncertainties will reduce, and new ones will emerge). The arrangements will need to be fit to operate in a complex, dynamic and uncertain environment.

8.1 Impacts of climate change

The severity of climate impacts will depend in large part on global greenhouse gas (GHG) emissions in the future. The Intergovernmental Panel on Climate Change (IPCC) states clearly in its examination of climate impacts that “increasing magnitudes of warming increase the likelihood of severe, pervasive, and irreversible impacts”, and that “the overall risks of climate change impacts can be reduced by limiting the rate and magnitude of climate change” (IPCC, 2014b, p. 14).

However, while the risks increase if global GHG emissions remain high, a certain amount of damage is already “locked in”. Globally, climate change will lead to greater weather extremes – extreme rainfall, storms and heatwaves. The IPCC noted that, “[i]n recent decades, changes in climate have caused impacts on natural and human systems on all continents”, and that “impacts from recent climate-related extremes, such as heat waves, droughts, floods, cyclones, and wildfires, reveal significant vulnerability and exposure of some ecosystems and many human systems to current climate variability” (Field, 2014, p. 40).

The impacts of climate change on New Zealand will be significant, with more frequent and extreme storms, cyclones and rainfall events resulting in more (and more frequent) flooding around the country. Flooding is already New Zealand’s most common natural hazard (Ministry for the Environment, 2008). Many towns and cities are built on floodplains, often protected by stopbanks and other flood defences, and about 75% of New Zealand’s population live within 10 kilometres of the coast (Stats NZ, 2006).

At the coast, increased flooding and storms will interact with rising sea levels, which will be one of the biggest impacts of climate change for New Zealand. The IPCC estimates that sea levels globally have risen by about 20 centimetres since the early 20th century. In their fifth assessment report (AR5), the IPCC estimates that by 2065 the global mean sea level will rise by up to an additional 38 centimetres, potentially reaching 98 centimetres by 2100. Sea levels will continue to rise well beyond 2100, and could reach several

metres by 2300 (Wong, 2014, p. 369). The IPCC (2014a) also notes that the rate of sea-level rise has accelerated over time, and will continue to do so.⁷¹

That the sea level is rising, and will continue to do so, is certain. Yet the scale and timing of the rise is highly uncertain – and more so the further into the future. This is due largely to uncertainty around future global emission levels and temperature rise. These will influence the rate at which water in the oceans expands, mountain glaciers retreat, and polar ice sheets melt – three main contributors to sea-level rise (Parliamentary Commissioner for the Environment, 2015). The rate at which the three polar ice sheets melt will have a huge impact. The Greenland, West Antarctica and the East Antarctica ice sheets collectively hold such massive amounts of ice that if all three were to melt, global sea levels would rise by about 64 metres.⁷² Yet the extent to which they will melt, and when or how fast, is very unpredictable.

The impacts sea-level rise will have in different locations is also very uncertain, as sea levels will not rise in line with the global mean in all places. The impacts of sea-level rise on a specific coastal location also depends on whether the land is rising or falling, which can depend on local geology, as well as natural features and local human-induced changes to the landscape.

Sea levels vary naturally all the time with tides (including spring and king tides), storm surge due to high winds and low air pressure, waves caused by high winds, and changes in sea level due to El Niño and La Niña phases (Parliamentary Commissioner for the Environment, 2015). These various causes can occur together in a way that increases their impact on coastal communities (eg, storm surge during a king tide). With sea-level rise, these natural variations will become even greater, and the impact when they combine even more severe. It is therefore not simply the slow creeping rise of the sea level itself that will impact New Zealand's coastal communities. More damaging are the other impacts that come along with it – three in particular:

- coastal flooding becoming more frequent, severe and extensive;
- erosion becoming more widespread as waves and currents damage shorelines; and
- groundwater rising, and saltwater intrusion into groundwater.

These impacts are already occurring in some coastal communities (eg, South Dunedin, Hawke's Bay, and the Kāpiti coast). Given New Zealand's long coastline, the number of communities and amount of infrastructure on that coast, sea-level rise presents a large challenge for the country. Box 8.1 defines the components that influence the damage that climate change will cause in specific locations.

Box 8.1 Components of overall damage due to climate change

Hazard: a climate hazard is a physical process caused by a climate event or climate variability (eg, sea-level rise, flooding, drought), which has the potential to cause damage to natural and/or human systems.

Exposure: exposure to climate risk is a measure of the potential damage from a climate hazard (or hazards). Exposure includes the presence of people, buildings, livelihoods, ecosystems, infrastructure and other assets in places and settings that could be adversely affected by climate hazards.

Vulnerability: the propensity or predisposition to be adversely affected by climate hazards. The vulnerability of a community depends on its sensitivity to the impacts, and its limited ability to adapt to changes (both reflect a lack of community resilience).

Source: IPCC, 2014b; Parliamentary Commissioner for the Environment, 2015.

⁷¹ The IPCC estimates that sea levels rose at a rate of about 1.7mm each year between 1900 and 2010, and at a rate of 3.2mm between 1993 and 2010 (global mean sea level).

⁷² The two Antarctic Ice sheets together could contribute 58 metres of sea-level rise (Fretwell, 2013), and the Greenland ice sheet could contribute seven metres of sea-level rise (Bamber et al., 2013).

As the risks of climate change unfold, areas of low-lying land across New Zealand that are already prone to flooding will experience more frequent and severe inundation. Some communities will experience more damage to assets and property, incur increased costs to manage and maintain urban facilities and infrastructure, experience more frequent disruption to business operations, and see a reduction in land values (CCATWG, 2017). Some existing communities will ultimately become unviable.

Risk to local government infrastructure

A recent Local Government New Zealand (LGNZ) (2019) report examined the scale of local government infrastructure exposed to sea-level rise at different increments. The report found that a sea-level rise of 1 metre would expose local infrastructure worth approximately \$5.1 billion (replacement value). According to IPCC projections, 1 metre of sea-level rise could be reached by around 2100.⁷³

Three-waters infrastructure is the most exposed, making up about half of this cost. Wastewater infrastructure is the biggest by far, followed by stormwater. Roding infrastructure is also vulnerable, with more than 1 300 kilometres exposed nationally to 1 metre of sea-level rise. About 1 300 council-owned assets are also at risk, including council buildings and community amenities, parks/sports fields, and airports (LGNZ, 2019).

These risks are not evenly distributed. The regions with the greatest amount of exposed local government infrastructure are Canterbury, Hawke's Bay, and Auckland. However, many other regions also have a lot of infrastructure at risk (including Bay of Plenty, Waikato, Greater Wellington, Otago, and Nelson/Tasman). More infrastructure is exposed in the North Island due to the larger population, although regions in the South Island face higher per-capita replacement costs. With higher levels of sea-level rise, the exposure (and associated replacement costs) increase – a sea-level rise of 1.5 metres would expose local infrastructure worth approximately \$8 billion.

The effects of climate change on different types of infrastructure, and the impacts of those effects, vary. For roading infrastructure, increased inundation will lead to more rapid degradation, requiring more frequent maintenance and replacement. Major flooding or erosion events will destroy some roads completely.

Both national and council roading infrastructure provide access to many private homes and businesses. As some roads become degraded or are destroyed, government, councils and communities will need to decide whether or not to replace those roads, and how. If that infrastructure is damaged or destroyed, communities may be cut off, and their access to essential services jeopardised. The recent West Coast flooding in March 2019, which destroyed the Waiho Bridge on State Highway 6, provides a stark reminder of the risk extreme weather events pose to roading infrastructure and to the communities it services. The Insurance Council noted this point in their submission: "[L]ocal government infrastructure underpins the activities and assets of communities and businesses" (sub. 69, p. 3).

The recent West Coast flooding also highlights the vulnerability of landfills in flood-prone areas. The historic Fox River landfill in Westland district (which operated between the 1960s and the early 2000s) was washed out during the flooding. The flood washed large quantities of rubbish into the river and along hundreds of kilometres of beach and Department of Conservation (DOC) land. At the time of writing, Westland District Council had received \$300 000 from central government to assist with the clean-up. Finding this insufficient for a full clean-up, it has requested additional funds. Many other current and historic landfills around New Zealand are potentially at risk of damage from flooding and extreme weather events as climate impacts worsen.

For water infrastructure, stormwater and wastewater systems are particularly vulnerable to climate change, and to the effects of both sea-level rise and increased weather extremes. Many storm and wastewater systems have their discharge points at the lowest elevation of populated areas. In many coastal areas, sea-level rise will lead to saltwater infiltration that will reduce the overall capacity of wastewater systems, and result in the corroding of pipes and machinery. For gravity-fed systems, sea-level rise will likely cause backflow of saltwater onto parks and roads during king tides. Extreme rainfall can also overwhelm storm and

⁷³ This estimate is premised on a high-emissions scenario.

wastewater systems, leading stormwater to enter wastewater systems and overload its capacity, potentially leading to the discharge of untreated wastewater (White, 2017).

Some councils indicated in their submissions that they already struggle to insure their infrastructure against floods and other natural disasters. Upper Hutt City Council, for example, noted that their insurance costs have increased by 40% in the last year, and that it was difficult for them to obtain insurance coverage (sub. 40, p. 5). Those that can still source insurance at a reasonable cost may not be able to do so for long.

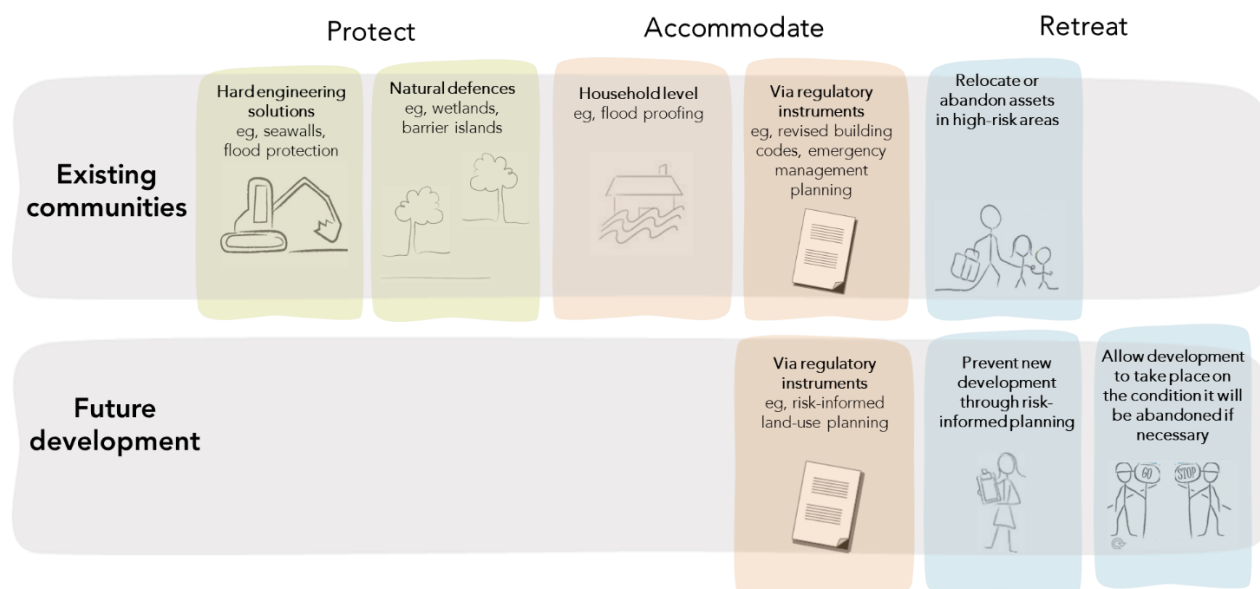
8.2 Preparing for change

Beyond risks to their own infrastructure, local government face other challenges from climate change – the effects on private homes and businesses, as well as wider economic, social and health impacts. Councils face difficult decisions about how to protect existing vulnerable coastal and river-plain communities, as well as with respect to land-use planning for future development.

Local government will need to decide how to adapt as the impacts of climate change unfold, including decisions about where, when and how to protect, accommodate or retreat. Protection strategies are wide-ranging. They can include hard engineering solutions such as the construction of stopbanks and seawalls, or nature-based defences such as coastal wetlands. Accommodation strategies can be implemented via regulatory instruments (eg, revised building codes) or at a household level (eg, flood proofing) (OECD, 2019). When communities become unviable, a managed retreat of people and infrastructure will be necessary (Figure 8.1).

Decisions about where and how future development in flood-prone areas or on the coast takes place will have a big impact on councils' future risk exposure, because inappropriate development can be a major cause of increased risk. Risk-informed land-use planning will be important, as local authorities make decisions about land-use zoning through their district plans, and impose conditions on subdivision and land-use consents.

Figure 8.1 Adaptation in coastal and flood-prone areas: minimising future risk exposure



Source: Content adapted from OECD, 2019.

Investment in risk-reduction through adaptation measures will save money in the long term though avoided future disaster costs. The Organisation for Economic Co-operation and Development (OECD) notes that well-prepared coastal communities will be better able to adjust as impacts are felt, and at lower cost, as well as 'bounce back' from disasters more rapidly when they occur (OECD, 2019, p. 83).

Three elements will be critical to ensuring councils are able to consistently minimise future exposure to climate risk. They are high-quality and robust science, data and guidance; a robust, adaptive process

appropriate for making decisions under deep uncertainty; and legal frameworks that councils can use to make risk-informed land-use policy decisions “stick”. The three elements are discussed in turn below.

High-quality and robust science, data and guidance

Decisions around local adaptation, and future land-use planning, need to be based on robust science. A thorough understanding of the risks, and uncertainties, is critical to ensuring appropriate action and avoiding ad hoc responses to climate related events. Some councils appear to be well prepared in this respect, and the recent Climate Change Adaptation Technical Working Group (CCATWG) stocktake report concluded that:

Local government appears to have a good understanding of the climate related changes they can expect for their region. This understanding comes from regional climate change projections including for groundwater, sea-level rise, ocean acidification and warming; and local government funded research to develop more local information. (CCATWG, 2017, p. 54)

Yet the report also noted that many councils want better data and information on local impacts, and the costs of obtaining this information is a barrier to action on adaptation (CCATWG, 2017, p. 55). Some councils raised the need for more information in their submissions. Whangarei District Council, for example, requested “greater support in terms of expertise, data and resources for local government to understand the risks to infrastructure and communities. The costs of exercises such as risk assessments is significant, particularly for smaller Councils” (sub. 46, p. 4). Environment Canterbury also state:

It is not efficient for each council to run their own resilience risk mapping process, and some smaller councils do not have the budget or resources to undertake risk mapping at all. Undertaking risk mapping at a regional level would provide consistency and economies of scale. This work will ensure that significant resilience gaps are identified and provide a consistent, robust, evidence-base for managing these gaps. (sub. 111, p. 6)

LGNZ and the Parliamentary Commissioner for the Environment (PCE) have also called for central government to do more to keep local authorities informed about how climate change will impact specific locations. LGNZ advocates for a centralised risk agency which would cover all natural hazards. The former PCE, Dr Jan Wright, made several recommendations for national direction and guidance. Box 8.2 outlines several of their key reasons.

The Commission agrees with the thrust of these arguments for high-quality information and guidance for councils from a central source that is expert and authoritative. It makes little sense for councils to be working individually on such a novel, important and complex challenge. For the most part, councils will welcome guidance and find it helpful not only as advice but as backing for taking the difficult and unpopular decisions that will sometimes be necessary.

Box 8.2 A centre of knowledge and guidance about adaptation

In 2015 LGNZ proposed a central risk agency that pools and coordinates local government resources to lower the risks and costs of disasters. LGNZ has engaged with central government about the idea. LGNZ argues the need for a risk agency because New Zealand has a high natural-hazard environment, with exposure to earthquakes, tsunamis, landslides and volcanic activity. Also, climate change will cause more severe and more frequent river and urban flooding, storms and high winds, storm surges and coastal erosion in coming years.

The agency would establish guidelines, models and common data standards for local government to manage risks and share information. It would harmonise practices, improve skills in risk management and financing, provide quality assurance, and supply expert staff.

Dr Jan Wright, the former **Parliamentary Commissioner for the Environment**, concluded in her report titled *Preparing New Zealand for rising seas: certainty and uncertainty* that local government needs better direction and guidance in three broad areas:

- scientific assessment of the impact of a rising sea on coastal hazards;
- the process of engaging with the community; and
- the planning and management decisions that follow.

She pointed to the difficult and complex questions that councils will increasingly face, such as:

- Where should protective seawalls be built and who should pay for them?
- Where should beaches be left to retreat inland?
- When is abandoning maintenance of a coastal road justified?
- When does the retreat of a whole community become inevitable?

Councils and affected communities will have to plan and act in the face of uncertainty — never easy, but particularly difficult when choices will affect people's homes. In most situations, Dr Wright argues, haste is not necessary or desirable. Councils should take time to develop strategies and make fair decisions based on robust and fair assessments.

Dr Wright made seven recommendations to the Government aimed at improving direction and guidance from central government to councils. These included recommendations about:

- the best locations for the direction and guidance;
- nationally consistent land-elevation measures;
- consistent use across the country of the IPCC's projections as to sea-level rise;
- specified planning horizons for different types of development; and
- more explicit use of uncertainty ranges rather than vague use of the "precautionary principle".

Source: Parliamentary Commissioner for the Environment, 2015; LGNZ, 2016a.

Various official guidance publications aimed at local government already exist. Examples include:

- *Coastal hazards and climate-change: guidance for local government* (Ministry for the Environment, 2017);
- *Preparing for future flooding: a guide for local government in New Zealand* (Ministry for the Environment, 2010);
- *Climate change projections for New Zealand: Atmosphere projections based on simulations from the IPCC Fifth Assessment* (Ministry for the Environment, 2018).

The Ministry for the Environment (MfE) announced (in early April 2019) the appointment of an expert panel to create a framework for New Zealand's first National Climate Change Risk Assessment (NCCRA). The panel is to produce a framework by the end of June 2019, with the first risk assessment completed by mid-2020. The NCCRA is intended to inform and help prioritise effective adaptation action.

In May 2019 the Government introduced the draft Climate Change Response (Zero Carbon) Amendment Bill to Parliament. The draft legislation mandates the Climate Change Commission (which will be established under the Bill) to carry out regular risk assessments at least every six years to assess the range of risks from climate change. The government will then include, in a National Adaptation Plan, its approach to addressing the most significant risks identified through those risk assessments (Ministry for the Environment, 2019).

These developments signal progress towards providing more information on climate impacts, but a centre of knowledge and guidance would be beneficial to ensure consistency of approach. What institutional form

should a centre of knowledge and guidance on climate adaptation take? The Commission's view is that, in line with Dr Wright's recommended separation of scientific knowledge from policy and strategy, a centre of knowledge and guidance should be a centre (perhaps a "virtual" centre) that combines expertise from NIWA, GNS Science and Manaaki Whenua-Landcare Research with participation from local government and university experts.

A centre that specialises in delivering advice for local government on community engagement, risk management and planning should combine the MfE's resources with those of LGNZ and the Society of Local Government Managers. MfE's 2017 guidance has useful material on community engagement and on dynamic adaptive pathways planning (which are discussed in more detail below). This will need to be further developed together with training modules and updates that incorporate lessons from experience. The centre could also take on the broader role envisaged by LGNZ as a local government risk agency by covering both climate-change hazards and other natural hazards.

F8.1

Considerable guidance for councils on climate-change adaptation already exists. But more is needed, and providing it through central, specialised sources of knowledge will be more cost-effective than each council inventing its own solution. Most councils will welcome guidance and find it helpful not only as advice but as backing for taking the difficult and unpopular decisions that will sometimes be necessary.

R8.1

The Government and local government should work together to establish centres of knowledge and guidance about climate-change adaptation for councils. One centre should be an authoritative and up-to-date source of advice on science and data while another should be a source of specialist advice on policy, planning, risk management, legal issues and community engagement.

A robust, adaptive process for making decisions under deep uncertainty

Developing and adopting a robust approach to making decisions about adaptation and land-use planning will be critical to ensure that risk exposure is minimised. As noted above, even with the best available science, deep uncertainties exist about the course of climate change and the damage it will cause. In their respective domains, scientists and local communities will learn more over time. This means that the risk profiles facing local governments and their communities will be constantly shifting. Embarking on a specific adaptation plan that appears to be optimal given current knowledge may turn out to be unwise in the light of new information that becomes available a few years down the track – adaptation too early or late can be costly (Lawrence et al., 2019).

Decision tools to handle this sort of deep uncertainty in which knowledge evolves over time should be used in preference to decision making that assesses all relevant information available at a point in time and then sets an "optimal" path that is locked in for the future. The watchwords of the more useful tools are anticipation, flexibility and keeping options open. In looking at ways to address coastal risk, the OECD (2019) recommends an adaptation approach that builds in flexibility and identifies solutions that can perform well against a range of different scenarios to avoid "policy lock in".

Two decision frameworks that embed these features are Real Options Analysis (ROA) and Dynamic Adaptive Pathways Planning (DAPP). These are consistent with cost-benefit analysis (CBA). They are forms of CBA that explicitly recognise and value keeping options open until more information is available.

Real Options Analysis – the essence of ROA is recognition of the value of keeping options open for the future (when more information will be available to inform choice). It will often pay to avoid expensive investments now that lock in one solution that may turn out to be wrong (the "white elephant" outcome). Rather, it will pay to invest in better information, or in actions that create options or keep existing options open. For example, investing now in expensive hard defences against rising seas, when it is unknown how

quickly the sea level will rise, destroys the option value of choosing later with better information whether to defend or retreat.

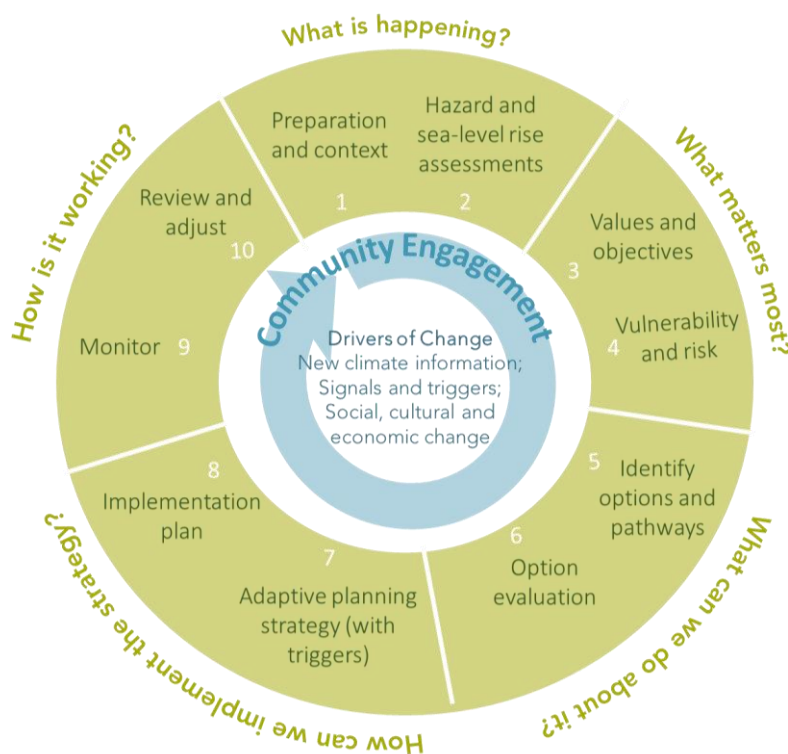
Sometimes, ROA will indicate that early action is desirable. For example, where erosion is incremental, cumulative and threatens a valuable asset, failing to take early action could remove the option of saving the asset later.

Dynamic Adaptive Pathways Planning – DAPP is a technique very much in the spirit of ROA, but it gives greater practical guidance to decision makers about how to proceed. Decision makers begin by defining their objectives and consider several or many scenarios about how the future could evolve (in the area that is subject to deep uncertainty). They also identify future timing points or trigger events where more information will become available and it may be possible to adjust the pathway taken to that point, or transition to a different pathway. The question, then, is what pathway to embark on initially to achieve short-term objectives, while enabling adaptation to changing circumstances to best achieve long-term objectives.

Funding arrangements for local governments that promote cost-effective adaptation to climate change need to encourage and support good decision making. Given the nature of the shifting risk profiles of climate change hazards, this means supporting processes like ROA and DAPP. Fortunately, DAPP is explained and recommended in the MfE's guidance to local government on coastal hazards and climate change (Ministry for the Environment, 2017).

Undertaking such an approach may be challenging and complex for councils, and will require considerable knowledge, capacity, specialist skills, and time. For example, the DAPP approach recommended by MfE calls for consultation at all stages of the proposed 10-stage decision cycle, as well as frequent re-assessment of plans, and revisiting of decisions (Figure 8.2). Even so, if done well, the DAPP approach will likely be least cost in the long run.

Figure 8.2 10-stage dynamic decision cycle for adaptation to climate change



Source: Adapted from Ministry for the Environment, 2017.

Legal frameworks to make risk-informed land-use policy decisions “stick”

High-quality data and information, and a robust and adaptive planning approach, need to be supported by appropriate legal frameworks. A major source of climate-change pressure on local government funding arises from councils’ responsibilities to regulate land use.

New Zealand has an intersecting collection of laws and institutions that set frameworks, rules and responsibilities relevant to the challenge of adapting land use and local-government infrastructure to climate change. As described in chapters 2 and 4, the Resource Management Act 1991 (RMA) and the Local Government Act 2002 (LGA) are pivotal in defining the responsibilities of local government in these areas.

The RMA requires local government to consider the effects of climate change and incorporate climate change into decision making. It charges regional councils with the main responsibility to control the use of land so as to avoid or mitigate natural hazards (including flood hazard management).

Under the RMA, the New Zealand Coastal Policy Statement 2010 (NZCPS) has statutory force. It requires all regional councils and local territorial authorities, in exercising their authority and in their regional policy statements, regional plans and district plans, to recognise the exacerbating effects of climate change on coastal erosion and other natural hazards, and where these effects threaten existing infrastructure and private property. Objective 5 of the NZCPS is:

To ensure that coastal hazard risks taking account of climate change, are managed by:

- locating new development away from areas prone to such risks;
- considering responses, including managed retreat, for existing development in this situation; and
- protecting or restoring natural defences to coastal hazards.

(Department of Conservation, 2010, p. 10).

Policies in the NZCPS require councils to:

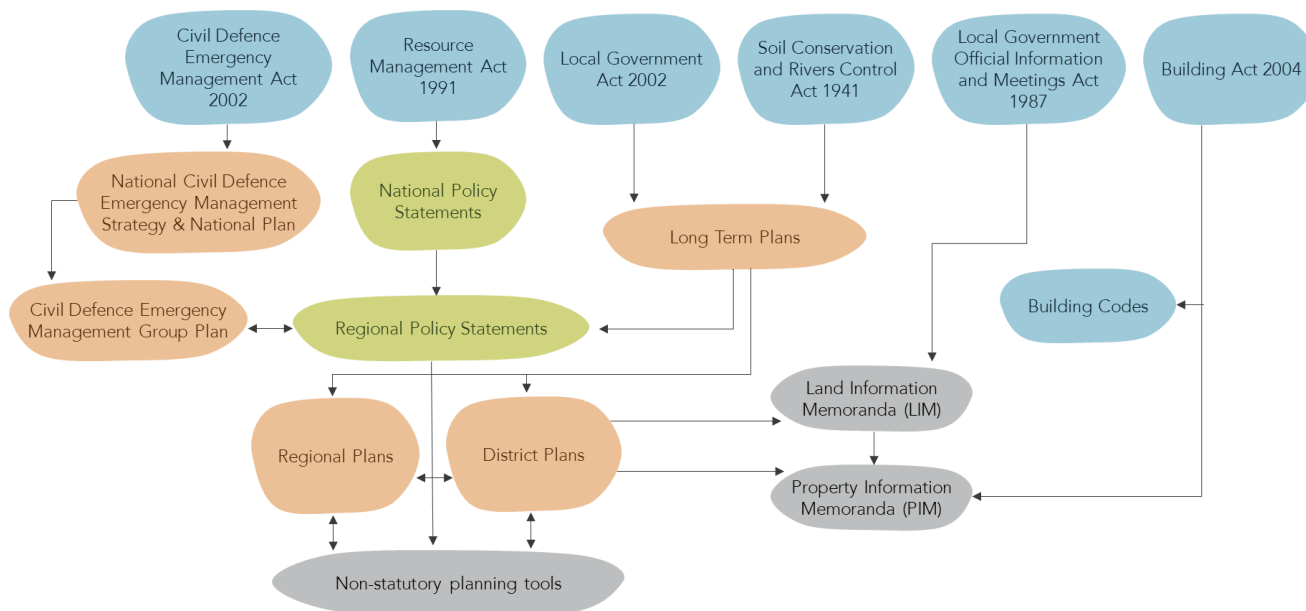
- identify coastal hazards over at least a 100-year horizon, including the “cumulative effects of sea-level rise, storm surge and wave height under storm conditions”;
- “avoid redevelopment, or change in land use, that would increase the risk of adverse effects from coastal hazards”;
- promote and identify long-term sustainable risk-reduction approaches, including the relocation or removal of existing development or structures at risk; and
- prefer natural defences (eg, wetlands, coastal vegetation, dunes) and their protection, restoration or enhancement to hard protection structures.

Yet while the NZCPS provides for councils to make precautionary decisions around land use, a DOC review in 2017 found that implementation has been challenging and very controversial for some communities. They found that in some areas pressure for development is

conflicting with best practice to set development back from the coast. This points to a need for stronger alignment between the NZCPS and the RMA versus the Building Act and any future NPS for Natural Hazards, particularly the need for consistency between timeframes, extreme events and the assessment of climate change effects. (Department of Conservation, 2017, p. 44)

As well as its guidance on climate-change coastal hazards, MfE also provides guidance for local authorities on flood-protection schemes under the Soil Conservation and Rivers Control Act 1941 (Ministry for the Environment, 2010, 2017).

Figure 8.3 gives a picture of the legislative and planning framework for natural hazards, including readiness for them and responses to adverse (disaster) events caused by natural hazards. The figure does not show the Land Transport Act 1998 and regional land transport plans, which are relevant to the planning, funding and resilience of land transport.

Figure 8.3 Legislative and planning framework for natural hazards

Source: Adapted from Rangitāiki River Scheme Review Panel, 2017.

Existing frameworks need to be better aligned to cope with climate-change risk

The legislative and planning framework, as a whole, appears to cover the rising risks from climate change, and requires the various actors (in particular for this inquiry the regional, unitary and local councils) to plan for the upcoming and rising hazards from climate change in their decision making. Yet, there are reasons to question the fitness of current institutional frameworks and practices to effect sensible climate-change adaptation in New Zealand.

First, the various acts and bodies do not mesh perfectly. For example, while the planning horizon of the NZCPS is 100 years, it is 50 years for assessments under the Building Act 2004, and 30 years for council infrastructure plans. No link is made in the RMA under matters of national importance between natural hazards and “the effects of climate change”.

As a further example, civil defence emergency management is defined in the Act as “the application of knowledge, measures, and practices that... are designed to guard against, prevent, reduce, recover from, or overcome any hazard or harm or loss that may be associated with any emergency”.⁷⁴ Yet other parts of the legislative framework put most emphasis on recovery, which could undermine councils’ incentive to focus on reducing risk.

Reinforcing this, the national civil defence and emergency management plan currently provides for central government to cover 60% of the costs of response to, and repair of, essential infrastructure *after* a natural disaster (Ministry of Civil Defence and Emergency Management, 2015). This example illustrates the tendency within the current system to focus too much on the response and recovery stages of an emergency event and focus too little on reducing risk. This tendency stems mainly from the historical attention on recovery from disasters such as major earthquakes.

Such examples show the need for greater integration across emergency management, natural-hazard management and planning practice when preparing for and adapting to risk related to climate change. As the CCATWG noted, “misalignment across legislation and policy creates confusion for local government regarding what is expected of them in terms of adaptation” (2017, p. 55). The Commission believes that a review of existing legislation and policy to integrate and align considerations about climate-change adaptation, as later recommended by the CCATWG (2018), is needed.

Second, as highlighted by Glavovic and Smith (2014), Lawrence (2016), Boston and Lawrence (2018) and the CCATWG (2018), there is an assumption, embedded within many institutions and current practices, of

⁷⁴ Civil Defence Emergency Management Act (2002), Section 4.

unchanging risk profiles for natural hazards. Yet climate risk will change in unpredictable ways and generally increase over time.

As Lawrence (2016) argues, the normal assumption that risks are unchanging has led to a default use of static protective structures and plans (eg, stopbanks and hazard zones) to mitigate risk, which, in turn, has led to path dependence and a public expectation of ongoing protection. This thinking reflects the limited capacity of institutions to contemplate or cope with variations in climate that are outside the range of current experience.

Third, most regional councils have been reluctant to use their statutory powers for constraining land use, and district plans that have attempted to change hazard zones to prepare for climate change have been successfully challenged in the courts. This is often because councils face individuals, families and organisations with strong interests who push for land-use consents and investment in hard protective structures, and who resist any shift from the current course.

The courts have sometimes allowed for the “voluntary assumption of risk” and used notions of “acceptable risk” and “risk mitigation”. However, as highlighted by Lawrence (2016), this has generally been done without enough consideration of several important factors, including that:

- the level of risk that cannot be eliminated (ie, residual risk) will rise over time with climate change;
- those assuming risk today will not be those bearing it in the future; and
- conditions of a consent could become unenforceable in the future, creating a moral hazard for future generations.

Councils are calling for stronger leadership from central government and for frameworks to give them more backing and knowledge to do the right things in land-use planning and infrastructure investment. Legal challenges to resource-consent decisions impose heavy costs on councils. So, on the one hand, the risk of immediate challenges may inhibit councils from saying no to development. On the other hand, the risk of future liability claims against councils can dissuade them from giving a consent for development when the proposed development is in a potentially vulnerable location (Hodder, 2019). The PCE describes these two sides of the situation:

Some may argue that individuals should be allowed to make their own choices and bear the consequences. It may be possible to do this in some situations, but this should be done at no cost to the public.

There are also risks with council planning. Restrictions on development that are premature or overly precautionary will incur significant opportunity costs. (Parliamentary Commissioner for the Environment, 2015, p. 80)

These opposing risks can put councils in a quandary. Are any legal means available that could help councils in this situation? Perhaps some form of covenant could make the consent subject to an assumption of risk by the owner and be attached to the title of the property. Then the council could be confident it would not suffer future obligations no matter what future climate hazards affected the property. The Commission is interested to know whether such legal means exist that would be enforceable in all future circumstances.

While the current system needs some changes, the Commission notes that awareness of climate-change hazards and their likely effects are rising. This consciousness will influence institutional actors including regional and local governments and the courts. For example, a current focus for many councils is building “resilience” into plans and built structures. LGNZ has also prioritised climate change as a major focus of its work programme over the last few years, including assessing the exposure of council infrastructure (2019) and preparing and promoting the Local Government Leaders’ Climate Change Declaration (2017b).

Yet, rising consciousness and a new emphasis on resilience are unlikely to be enough. Poor decisions now will cost councils dearly in the future. For example, investing now in hard structures for protection could lead to development on the “protected” land and create greater exposure to future climate-change risk. As noted above, councils risk not only their own infrastructure investments but also future claims from other individuals and entities based on today’s regulatory decisions about land-use.

F8.2

New Zealand's laws and institutions acknowledge the risks from climate change and require local governments to plan for the approaching and rising hazards it will cause. Yet much thinking and practice is still dominated by assumptions that risk profiles are static, like earthquake risk.

A systematic shift to a dynamic risk paradigm is needed to deal with the increasing and cumulative nature of climate-change risk. Such a shift will support decisions that:

- lean against the tendency to continue along current courses (with hard forms of protection for new and existing land use);
- encourage the use of anticipatory and flexible decision tools; and
- reduce risks and costs over the long term.

R8.2

The Government should implement a review of existing legislation and policy to ensure that considerations about climate-change adaptation are integrated and aligned within that legislation and policy where relevant.

R8.3

National and local authorities should adopt anticipatory and flexible approaches to climate-change adaptation, in line with recognising the constantly changing nature of the risks. Any additional funding for climate-change adaptation should be conditional on the use of such approaches.

R8.4

The Government should provide legal frameworks that give councils more backing and knowledge to make land-use planning and infrastructure investment decisions that are appropriate in the face of constantly changing climate risks.

Q8.1

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?

8.3 Funding adaptation to climate change: principles and insurance

Making decisions about where to protect, accommodate or retreat to minimise costs and risks over the long term will be challenging. Most adaptation actions will be costly. A crucial component of decisions will be how to fund adaptation actions.

The Insurance Council noted in their submission that it is important that “the Government carefully considers and formalises a principle-based approach to the role for central government in supporting funding of climate change adaptation measures” (sub. 69, p. 3).

Policy principles for adaptation to climate change

What principles would cut through the challenge and complexity of making decisions about adaptation and funding the chosen option or options? Such principles would ideally guide what actions to take and when, who should be supported and who should pay. Boston and Lawrence (2018) offer two high-level principles for adapting to climate change. While having wider application, they are a good starting point for thinking about funding the costs of adaptation.

- **Minimise long-run costs.** This principle guides decisions about whether, when and how to defend/protect, adapt, or retreat. It does not mean these decisions are easy because uncertainties will sometimes make it difficult to tell which sequence of actions will minimise costs and risks over the long term. In addition, the calculation will involve choosing how to weight future costs against more immediate ones (ie, the choice of a discount rate), which may be controversial.
- **Fairness and justice.** Principles of fairness and justice differ, ranging from letting costs lie where they fall on affected property owners, the law of tort where those who cause the damage pay, to sharing the losses of those affected across the whole population. New Zealand's tradition of social insurance (explored below) is in this last category.

Moral hazard

An important implication of the principles is to avoid moral hazard. Moral hazard, in the current context, will occur when arrangements motivate individuals to take on more risk than they would otherwise, because they predict they will be compensated for any losses that materialise from their increased risk.

An example of moral hazard is someone building a new house, or improving an existing house, on a seaside property only because they know or anticipate that they will receive seawall protection or compensation should rising sea levels and storm surges threaten or destroy their property in the future. Yet, many people built their homes in locations vulnerable to climate change long before the risks of climate change were appreciated and the locations considered vulnerable.

Moral hazard can also occur between levels of government, where local government is responsible for funding protection and risk reduction, but central government is responsible for funding response and recovery (OECD, 2019).

Moral-hazard behaviour raises overall costs and so violates the principle of minimising long-run costs. In most people's eyes, it would also violate the second principle. They would see the behaviour as unfair and unjust. As a result, the designers of institutions, policies and funding arrangements for adapting to climate-change should place a high priority on ensuring that they do not trigger moral-hazard behaviour.

The costs of climate change will fall unevenly across local authorities and will be uncertain in their timing and severity. Yet some actions that councils can take in the short term will reduce future costs and some will increase them. Institutions and policies should encourage the former and strongly discourage the latter (taking account of all costs and benefits).

Affected communities must be intimately involved in finding solutions

An essential part of tackling climate risks is giving affected communities the opportunity to be intimately involved (Ministry for the Environment, 2017; Schneider et al., 2017). The OECD emphasises that "policy makers should engage stakeholders in the early stages of decision making and throughout the entire decision-making process to enhance overall resilience in coastal areas, while supporting community ownership and buy-in" (OECD, 2019, pp. 84-86). This should be active engagement and empowerment, not simple consultation (Chapter 5). Such engagement should involve the community in:

- understanding near and long-term climate risks to the location;
- understanding what the risks could mean in practical terms for the community;
- agreeing on current actions that reduce future risk (eg, no new building in exposed locations, future-proofing new infrastructure investments);
- staying abreast of new knowledge about climate change;
- monitoring the local environment for changes, and
- planning what to do in the future should certain trigger points be reached (including, possibly, managed retreat).

These steps are consistent with ROA and DAPP. Participants in the process should include local government councillors and staff, local iwi, local businesses, central government agencies, technical experts and other members of the community. Two examples of engaging the community in planning for future climate-related risks are the Rangitāiki River Forum (in relation to the Edgecumbe flood in 2017, described in Rangitāiki River Scheme Review Panel (2017)), and a process led by a Joint Committee of three Hawke's Bay councils (Hawke's Bay Regional Council, Napier City Council and Hastings City Council) to develop a 100-year Coastal Hazards Strategy out to 2120.

In the second example, while each council is mandated to have a 100-year strategy for coastal environments (including assets, infrastructure and human settlements) under the NZCPS (to which they must give effect in all planning consent decisions under the RMA), "the councils chose to jointly respond and work in collaboration with the community, on the basis that a combined response would have greater traction with the community and be more likely to be successful than differing attempts by individual councils" (Lawrence et al., 2019). The collaboration included explicit use of the ROA and DAPP frameworks.

Almost certainly, affected property owners will think short term and favour defensive and protective measures. For example, coastal erosion and storms in Mercury Bay at Whitianga have already impacted many beachfront properties; yet Schneider et al. (2017) report that "climate change denial is commonplace and hard engineering solutions such as sea walls persist as the preferred solution". In the case of the Hawke's Bay exercise to develop a 100-year coastal hazards strategy, the affected communities initially shunned managed retreat even as an option (Lawrence et al., 2019).

This reluctance to face reality is a critical reason for early engagement with property owners. The first stage is to build understanding and acceptance of what is known and of likely trends based on the latest science. Building trust and empowerment are also important. Only then does it make sense to try to agree on a way forward.

Funding arrangements will be critical to decision making, including how to share the costs of adaptation between property owners, insurers, banks, and local and central governments. Whatever the level of assistance from outside a community, it should be fair across communities even when they pursue quite different approaches.

F8.3

Formulating a set of principles about funding the costs of adaptation to climate change is a helpful place to start. Persuasive, high-level principles include:

- decisions about whether, when and how to defend/protect, adapt, or retreat in the face of hazards related to climate change should aim to minimise long-run costs;
- the way costs of adaptation are shared should be fair and just across communities and generations; and
- active engagement with, and empowerment of, affected communities in developing adaptation pathways is vital.

The first two principles imply placing a high priority on avoiding behaviour that leads to increased risk exposure for private gain at others' expense ("moral-hazard" behaviour).

Insurance will be of limited help

Local governments (like private home and business owners) currently use insurance to protect against major loss due to natural hazards. Councils do not generally insure the total value of their infrastructure assets, because central government supports them through the 60% (central government) to 40% (council) funding split for damage caused by natural disasters.

However, the combination of unevenness, uncertainty and predictability mean that traditional insurance will not work as a means for transferring risk when related to the effects of climate change. This is because

insurance depends on sharing risks that have a stable probability distribution across a population who do not know who will suffer from an adverse event (eg, illness, fire, theft, and earthquake).

Insurable risks are not, and do not have to be, the same across people. Insurance companies price the protection they offer according to risk factors. Those in riskier situations will pay more. Yet at some point where the risk probability for a person exceeds a threshold, insurance companies will either refuse cover or offer it at such a high premium that it will be unattractive and/or unaffordable. Some property owners in locations at high risk from sea-level rise and flooding are already at that point.

Insurance can play a valuable role in communicating the level of risk properties face from natural disasters, including from the effects of a climate change. However, insurance policies usually last for a year – unlike mortgages, which usually last for several decades. And while insurance premiums provide a signal about current level of risk, they do not indicate how risks will evolve over time (Anderson et al., 2018; OECD, 2019, p. 54).

LGNZ in 2016 commissioned an insurance expert to write a guide for local governments on using insurance to transfer risk (LGNZ, 2016b). It is notable that the guide does not mention climate risk or risks from sea-level rise. Implicitly, the author explains why – by setting out the features that must be present for insurance to cover risks (p. 13):

Homogeneity. There must be enough subjects for insurance of a similar class to produce a reliable average of “loss experience”.

Calculability. It must be possible to calculate the chance of loss, either mathematically or through experience. The greater the uncertainty surrounding the probability of a loss occurring, the higher the premium loading.

Fortuity. Although it is known that losses will occur and that the frequency can be measured, a specific loss must be unforeseen. A loss that is intentionally brought about, or which is expected to happen, is not suitable for insurance.

Insurable interest. A financial interest in the subject matter of insurance is what differentiates insurance from gambling.

Climate-change risk fails two of these requirements. Its nature is deeply uncertain, so it fails the test of calculability. Yet it can be foreseen that losses will happen in certain locations, so it also fails the test of fortuity.

Even risks that traditional insurance usually covers (such as material damage, liability and business interruption) are not covered for the infrastructure assets of local government such as roads and underground pipe networks. Yet these assets are particularly exposed to climate risk in some locations.

Some local authorities already struggle to insure their infrastructure against floods and other natural disasters. They will find it more difficult to source insurance at a reasonable cost in the future. Exposed private home and business owners will also find it harder or more expensive to insure their properties, which may also have implications for councils. If insurance withdraws or becomes too expensive, public agencies will face pressure to fill the gap. If the gap is not filled, it could lead to significant inequities (CCATWG, 2018). As insurance becomes harder to obtain, conversations about compensation for climate-related loss and damage will likely become unavoidable (Dudley Tombs & France-Hudson, 2018).

F8.4

Properties at growing risk from sea-level rise, river-plain flooding or other types of climate-change hazard will become increasingly uninsurable. This is because the nature of climate-change risk lacks two essential characteristics for insurability:

- it is not possible to calculate the chance of loss either mathematically or through experience due to the novel, uncertain and dynamic character of climate-change risk; and
- losses are not unforeseen – climate damage is foreseeable (even though its precise form, magnitude and location are uncertain).

Social insurance

Given the above, New Zealand must make a fundamental choice about who should bear the costs of the damage to property from climate change that will certainly eventuate.

New Zealand has a tradition of social insurance in which society at large helps those in need who suffer hardship or loss through no fault of their own and where these losses may be uninsurable. This happens under New Zealand's national healthcare system and the Accident Compensation Corporation (ACC) system of social insurance for accident victims. Several other examples exist.

- Central government has funded much of the recovery from recent natural disasters such as the Christchurch and Kaikōura earthquakes and the Edgumbe floods. The government paid compensation to householders beyond payments available through the Earthquake Commission (EQC) and private insurance;
- The Ministry for Primary Industries (MPI) oversees payments to rural communities and individuals for adverse events. These cover things like droughts, floods, fire, earthquakes, and biosecurity incursions. In making payments, MPI assesses the magnitude of the event, the ability to prepare for it and the capacity of the community to cope. Two recent examples are the drought throughout the top of the South Island and the Tasman district fires.
- The NZTA funds repairs to storm- or earthquake-damaged roads and bridges (damage from the Kaikōura earthquake and the Westland floods are recent examples). It is notable that contributions to the National Land Transport Fund (NLTF) are unrelated to the geographical location of risk.
- General taxpayers have funded preventative actions to protect communities from known hazards. An example is Crown co-funding of stopbanks and other flood-mitigation works through the National Water and Soil Conservation Authority (NWASCA). Between about 1961 and 1988 the NWASCA subsidy rates to local government for flood-control works ranged between 40% and 70%, depending on the nature of the scheme and the perceived benefits (Ericksen, 1986, p. 124). After the NWASCA was abolished in 1988, regional councils became responsible for the works.

Certain conditions should apply to payments made under any social-insurance scheme. These conditions – which are lacking in some of the above schemes – include:

- losses should not be compensated, or costs met, if they are avoidable by taking sensible actions in the light of what is known about risks;
- schemes should prompt actions to reduce risks before disaster events if this can reduce long-run costs (eg, unconditional compensation of farmers who suffer a bad drought blunts their incentives to change farming practices to make the farms more drought resilient); and
- schemes should include some co-funding, that is a distribution of costs across the social-insurance funder and the recipient (eg, in the case of leaky homes, the eventual package on offer was 1/3 central government, 1/3 local government, and 1/3 homeowners). Co-funding is a device to reduce the risk of moral-hazard behaviour.

The Commission supports the idea of well-designed social-insurance to help councils significantly affected by climate change to fund the adaptation costs of their at-risk infrastructure. Most, but not all people, will see such a social-insurance approach as fair.

F8.5

New Zealand has a strong tradition of social insurance in which society at large helps those in need who suffer hardship or loss through no fault of their own and where these losses may be uninsurable. This tradition provides a possible basis for some form and amount of central-government assistance to councils seriously threatened by losses due to climate change. Any such assistance will need careful design to incentivise risk reduction and avoid moral hazard.

8.4 Assisting local governments facing climate change

As discussed above, the emerging funding pressures on local government from the impacts of climate change are large. The yearly costs of repairing land transport networks damaged by weather-related events has more than quadrupled over the past decade (Boston & Lawrence, 2018).

But does this imply the need for new funding tools? One could say no, and that councils and their citizens must deal with the costs they face within their jurisdictions. The Council's costs for infrastructure and local public goods (eg, flood protection, seawalls) should fall on ratepayers; private property owners' costs should fall on them or their insurers, and some citizens could qualify for support under existing central-government schemes (eg, social housing, accommodation supplement, and income support).

This approach has benefits and drawbacks. A big negative is that it would sharply increase the rating or tax burden on citizens in the worst affected districts. In many cases, these districts will not be sufficiently wealthy or have the capability to fund and manage adaptation.

An alternative approach would be to follow New Zealand's tradition of societal risk pooling and cost sharing in which central government mobilises resources from the general taxpayer to help those hit hardest. The NZTA model has elements of this tradition: the NZTA distributes funding for roading infrastructure on a regional basis giving those in greater need and/or less ability to pay greater help.⁷⁵ Councils still pay a significant portion of the costs of local roads (while the NZTA pays 100% of the costs of state highways). This is fair, and means that councils have a stake and an interest in achieving value for money. On the other side, the NZTA can use its financial leverage to insist on satisfactory quality standards and business cases, and to act as an honest broker in getting interested parties to agree.

Assistance for land transport infrastructure that is at risk

The current NZTA arrangements, supplemented with additional national funding and a clear government mandate expressed through the Government Policy Statement on land transport, are well suited to helping councils deal with the climate-change impacts on an important part of their infrastructure portfolio – their roads, bridges, footpaths and cycle lanes.

Expanding the NLTF and following the way that the NZTA currently co-funds local roads is likely to be the most straightforward and cost-effective method for the general taxpayer to assist councils relocate or re-align local roads that become non-viable because of climate-induced erosion and flooding. This approach will have several advantages that are evident in the current NZTA model when it works well. It will:

- meet a portion of the cost for councils and their ratepayers with assistance geared to council needs (eg, measured by the length of affected roads, the costs of relocation or re-alignment and the rating capacity of the district);
- act as an incentive for councils to be proactive in facing up to climate risks to local roads, and help persuade local people to come on board with the plan;
- prioritise spending in line with net social, economic and environmental benefits while taking account of equity across regions;
- make assistance conditional on avoiding optimism bias, meeting suitable business-case thresholds, community engagement and achieving engineering and environmental quality standards; and
- make specialist knowledge and skills available to councils and help spread best practice around the country.

Business cases would require the use of a CBA that takes account of deep uncertainty and changing risk over long timeframes, most likely by using ROA, DAPP or both. To lean against optimism bias and the risk of poor value for money, the agency would normally not invest in defensive structures. It might do so in exceptional cases if a very high business-case threshold were reached.

⁷⁵ The proportion paid by the NZTA that varies across councils is known as the Financial Assistance Rate.

Roads are long-lived assets that require major capital investment to build from scratch. Therefore, existing NZTA resources from the NLTF may be inadequate. While there will be scope to stage expenditure, the Government should consider supplementing the NLTF with general revenues or additional borrowing to enable it to assist councils in the way described. The Commission is aware that the likely widespread uptake of electric vehicles will, over time, undermine fuel-excite revenues which currently feed the NLTF. Given this, a major redesign of land transport funding will be needed within a decade or so.

A local-government climate resilience fund for water and river infrastructure

Alongside roads, the other class of local government-owned infrastructure vulnerable to climate damage consists of the three waters – particularly wastewater and stormwater systems because these tend to rely on gravity flows towards low ground – and river-control assets such as stopbanks (Rangitāiki River Scheme Review Panel, 2017; White, 2017). As noted above, council assets at threat run to billions of dollars. Many of the assets are ageing and require extensive investment, including so they can meet new higher environmental standards. Yet this need for renewal is also an opportunity for relocation and redesign.

At the current time, the Government is reviewing the regulation, governance and delivery of three-waters services. The Commission is contributing to this review in this inquiry, by examining drinking and wastewater services, and exploring how they could be improved with more effective funding, governance and regulation (Chapter 9).

Whatever approach emerges from the three-waters review, the Commission believes that central government help – like roading help – should go to councils with water assets seriously threatened by climate damage. The institutional vehicle to provide this assistance could be a Crown agency somewhat like the NZTA and with access to a Local Government Resilience Fund (LGRF).

This approach should also apply to river-management and flood-control works.⁷⁶ Many existing assets are old and need renewing, and some are no longer fit for purpose in the face of increased flooding risk from climate change – or will require far greater maintenance to provide the same level of protection. The amount of flood-control infrastructure varies widely between regions, but around the country about 364 different schemes protect about 100 towns and cities, thousands of hectares of farmland, as well as significant Crown assets and national infrastructure (Hutchings, Williams, Lawson & Chamberlain, 2018).⁷⁷ Decisions will need to be made about where to improve and strengthen existing river and flood defences, and where to decommission or relocate them. Such decisions are difficult and complex, and a national approach will be important to avoid ad hoc decisions, increase resilience, and minimise risk.

The LGRF would co-fund qualifying council infrastructure costs, with the LGRF's share based on council need and capacity. It would bring the same disciplines, and play a similar enabling, facilitative role, as set out in the bullet points above for the extended NZTA model for roading.

Such a co-funding approach would echo arrangements in New Zealand's relatively recent past when the NWASCA co-funded with regional catchment bodies many of the country's flood control schemes that exist today. The history of these arrangements, what they achieved and why a new approach is now needed in some locations are instructive. Box 8.3 describes the older approach of river containment and why it has given way to a new philosophy of "making room for rivers".

⁷⁶ This includes stopbanks, floodgates, pump stations, river structures, dams and drains.

⁷⁷ Capital expenditure and operating expenditure for these assets are currently paid for through regional-council rates – generally targeted rates on the direct and indirect beneficiaries of flood protection (Hutchings, Williams, Lawson & Chamberlain, 2018).

Box 8.3 Making room for rivers

The older philosophy of river containment (largely using stopbanks) is described in “River Control and Drainage in New Zealand” (Acheson, 1968). It focused on the confinement of river systems both to “flush” sediment through to the coast and to maximise the area of additional productive land, largely for agriculture, with corresponding returns on investment for the national economy. River schemes built in line with this philosophy exist across New Zealand. Subsidies for such schemes were often as high as the central government paying double the local government contribution.

Over the past decade, more frequent river flood events have occurred, and this is likely related to climate change. The stopbank failure on the Rangitāiki River leading to widespread flooding and property damage in the Bay of Plenty town of Edgecumbe in April 2017 is a dramatic example. Events like these, growth in environmental, recreational and cultural values, and the 1986 publication *Creating Flood Disasters? New Zealand's need for a new approach to urban flood hazard* by the NWASCA (Ericksen, 1986) have given impetus to a new philosophy of river management. The Bay of Plenty Regional Council-commissioned report on the Edgecumbe disaster (Rangitāiki River Scheme Review Panel, 2017) described this philosophical shift (pp. 118 – 119):

[A] paradigm shift began in the overall philosophy of floodplain management in New Zealand, especially with regard to the construction of stopbanks. The concept of stopbanks encouraging the intensification of floodplain development and, therefore, an increase in the value of assets at risk on the floodplain, which then led to even higher stopbanks and further development, has played out across New Zealand as well as in almost every other country across the world.

The realisation around the potential increased risks associated with higher and higher stopbanks led to the re-evaluation of methods, especially the position and height of stopbanks and was the start of the “Making Room for Rivers” concept which is now generally agreed to be best practice.

...The idea of “Making Room for Rivers” is based around reducing flood levels and velocities by having a wider river corridor that can utilise floodplain attenuation and controlled compartment spilling and storage to more safely manage flood risk. The idea is fundamentally based around restoring the natural functioning of river floodplains whilst working around the constraints that exist due to floodplain development.

A key aspect of making these programmes successful is achieving multi-functionality so that when these areas are not being used to store or convey flood waters they can be used for cultural wellbeing, agriculture, wetlands, recreation, ecological reserves and any other uses that the community values. The key barriers to the implementation of this philosophy in the New Zealand context are the legacy of “protection” provided by narrowed river systems, private property rights and, predominantly, the very high cost. It would generally only be considered feasible if the value provided by the other functions, which are often difficult to value in dollar terms, is included in the overall assessment and funding from the wider community is used to support these developments.

As indicated in the above passage, “stopbank retreat” and reconfiguring river systems to “make room for rivers” will involve property purchases and rebuilding infrastructure. This will likely not only stir up local political opposition but also be beyond local resources (largely drawn from targeted rates on local property owners). Yet such sweeping changes will be needed in many (but not all) places across New Zealand as climate-related flooding increases in frequency and intensity.

Source: Rangitāiki River Scheme Review Panel, 2017.

F8.6

The New Zealand Transport Agency model of co-funding local roads could be extended to provide central-government assistance to relocate local roads and bridges that will be non-viable because of climate-change-induced sea-level rise, flooding and/or storms. This approach has potential benefits to:

- incentivise councils to anticipate climate risks to local roads, and encourage community engagement and buy in;
- prioritise spending in line with net social, economic and environmental benefits while taking account of equity across regions;
- counter optimism bias by requiring that the discipline of a strong business case and engineering and environmental quality standards are met; and
- make specialist knowledge and skills available to councils and help spread best practice and successful innovations around the country.

F8.7

The past approach of containing many New Zealand rivers within relatively narrow stopbanks for flood protection and to maximise the area of productive land for agriculture and other uses will become less viable as climate change increases the risk of more frequent and more intense rainstorms.

Best practice is now to allow wider river corridors that give rivers room and make space to more safely manage flood risk. But making this change faces barriers of existing property rights, expectations of continued protection, and high costs.

R8.5

The Government should extend the New Zealand Transport Agency's role in co-funding local land-transport infrastructure to include assistance to councils facing significant threats to the viability of local roads from sea-level rise and more intense storms and flooding due to climate change. The amount of assistance should reflect the size of the threat facing each council and its rating capacity.

Assistance should be conditional on a strong business case and meeting engineering and environmental quality standards. It should only be available to defend existing infrastructure when business cases indicate that this option is superior to other options by a significant margin.

R8.6

The Government should create a new agency and a Local Government Resilience Fund. The new agency should work with at-risk councils and co-fund the redesign and possible relocation and rebuilding of wastewater and stormwater infrastructure when it becomes no longer viable because of sea-level rise and more intense flooding due to climate change.

The new agency should also assist regional councils and communities to work out the best way to lessen future flood risks from rivers. This could include moving to a new, more sustainable and best-practice paradigm of giving rivers room and developing multiple innovative uses of the wider river corridors.

8.5 Support for private citizens and businesses

Risk-informed adaptation and land-use planning can reduce the level of risk communities face from climate change.⁷⁸ But the question of how to fund the necessary adaptation measures remains. In their paper “Funding climate change adaptation – the case for a new policy framework”, Boston and Lawrence (2018) find that neither New Zealand’s governance, planning and regulatory frameworks nor its current funding arrangements are well suited to cope with the challenge of funding adaptation to climate change.

Tens of thousands of people – and perhaps more – will eventually need resettling on higher ground. Large investments will also be required to redesign, reposition and future proof public infrastructure, especially transport networks and water services. Additionally, the damage caused by climate-related natural disasters will impose growing financial burdens – on citizens, businesses and public authorities.
(p. 2)

Therefore, in addition to support to improve the resilience of local government infrastructure, consideration must also be given to the effects of climate change on private citizens and businesses. Several points can be made at the outset.

- Climate-change costs will be large and unevenly spread across geography, population and time.
- The size and inevitability of the costs, and that they will land largely on future generations even though past and recent generations have contributed to them, points to a strong financial and ethical case for an immediate start to pre-funding.
- Some costs will materialise in the near term in the form of falls in property values.
- Early and wise actions can save a lot of cost over time.
- Many deprived communities are already among those most vulnerable to the effects of climate change. This may be compounded if high-risk properties lose value and more wealthy residents relocate and the poorest community members move into the most vulnerable (cheapest) homes.
- Private and public action will often need to be coordinated, but political opposition to expensive, pre-event collective actions to reduce risk will be strong because the full benefits will be realised only well into the future (in contrast to the political support that tends to be forthcoming for recovery spending after a disaster).
- Local government is not responsible for compensating private losses in ordinary circumstances, but any use of compulsion is likely to trigger a lawful need for compensation from public sources (Dudley Tombs & France-Hudson, 2018).

In relation to the sixth bullet point above, Boston and Lawrence (2018, p. 24) note that

[t]his phenomenon is common across advanced democracies. It reflects humanity’s cognitive biases, including myopia: citizens tend to value post-event cures over preventative interventions. Finding ways to counter such propensities will be crucial over the coming decades. Otherwise, there will be many sub-optimal policy decisions – ones that increase and entrench risk exposure, thereby placing additional burdens on future generations. This works in the opposite direction to what effective adaptation requires, namely to reduce risk now and for the future.

The case for and against public support for private adaptation costs

Arguments have been made both for and against leaving citizens and businesses to bear their own adaptation costs. The different perspectives on this issue generally reflect differing views on the extent to which wider society should share the costs and risks associated with climate change.

Arguments that have been put forward *against* extending public support and risk-sharing arrangements for climate adaptation include:

⁷⁸ Although, as the OECD notes (2019), it is not technically feasible or economically sensible to reduce the level of risk to zero

- Under existing law, citizens and businesses are responsible for their own property. Private insurance is available, and, for residential property and land, it is supplemented by the EQC cover. While insurance can sometimes be costly, premiums reflect real risks. Citizens and businesses have choices about the risks they take on and risk premiums play a useful role in incentivising risk reduction.
- Existing arrangements already provide public cover for citizens' health needs and provide a variety of social safety nets to help those with housing or income needs;
- Property at risk from adverse climate-change events is a component of overall wealth. Other forms of wealth, such as financial wealth, are held at the private owners' risk. It would be unfair to privilege one form of private property by making only it eligible for public compensation.
- The worst risks from climate change are still two or more decades away. The vulnerable locations for property are reasonably clear and will become even clearer soon (eg, with the national risk assessment currently under way). This window gives adequate time to adapt by reducing existing risk and not creating new risk.
- A comprehensive scheme to compensate citizens and businesses for the costs to adapt to climate change would be a huge expense on the public purse, administratively complex to design and operate, and inevitably not fair to all. It could incentivise quite egregious moral-hazard behaviour.

On the other hand, arguments put forward *in favour* of public support to fund adaptation measures for private citizens and businesses include:

- Many existing properties and communities were built before any awareness of climate-change threats. The citizens who built them or have been occupying these properties for a long time did not have the opportunity to make informed choices about climate change.
- New Zealand has a tradition of societal risk pooling and cost sharing for natural disasters. As well as the Earthquake Commission (EQC) and the Adverse Events Fund (administered by MPI), many instances exist of ad hoc public compensation for property damage from natural disasters (eg, the Christchurch earthquakes, the Edgecumbe flood, and the Matata disaster).
- In the absence of a scheme with clear rules that supports risk reduction, people will expect governments to put things right after damage has happened and to fund hard protections. This will exacerbate risk exposure (eg, through continued development in vulnerable locations) and cost more money over time.
- Accommodating the effects of climate change in a location, or managing retreat from it, requires coordination between public and private actions. Private owners are strongly inclined to stay put and hope for the best against the evidence. So decisive action to achieve the lowest long-run cost (eg, managed retreat) requires the carrot of public support to persuade communities to agree.
- Moral hazard can be managed and indeed reduced by placing conditions on publicly-funded support. For example, property owners in the United Kingdom are compensated for flood vulnerability only if their buildings were built in 2012 or earlier.
- Property owners who suffer losses due to climate change will not simply be victims of bad luck. They will be victims of identifiable human activities in the form of GHG emissions. As such, they have a strong moral case and a possible legal case to receive some compensation for damages. Some funding for compensation could come from auctioning emission permits under New Zealand's Emissions Trading Scheme (ETS).⁷⁹
- At-risk communities will vary widely in their abilities to fund measures to adapt to climate change: poorer communities will find it much harder to prepare and protect themselves than wealthier communities.

⁷⁹ Through auctioning, the government sells emission permits to the market to the highest bidders (with a reserve price to avoid very low prices). The government announced in May 2019 that it will introduce auctioning into the ETS in late 2020 (Shaw, 2019).

Elisabeth Ellis highlights this issue, stating “central government should...resource adaptation nationwide, so that community resilience does not vary according to ratepayer capacity” (Ellis, 2018).

The decision whether to offer public support for private climate-change adaptation is one that central government will need to make following a lot of scrutiny, public debate and analysis. It is a question that is largely outside the scope of this inquiry. Yet the existence or not of such support will have consequences for local governments grappling with climate-change adaptation.

Local governments will lead initiatives to reduce climate risks for their exposed communities. Even at best, these will be difficult conversations and processes. If councils fail to get community agreement to managed retreat (where that is the best option), it could leave them exposed to obligations to supply services to properties where people still live. Councils could be forced by court decisions to continue to supply services at very high costs which they could not recover.⁸⁰ Any public funding would need to be provided in a way that supports local government to achieve risk reduction and minimise long-run costs.

F8.8

Credible arguments exist both for leaving private owners to use current arrangements to find ways to adapt to climate change, and for public funding to support private owners to undertake cost-effective risk reduction up to and including managed retreat.

The decision whether to provide additional dedicated funding is for central government to make. Yet the existence or not of a scheme will impact local authorities' responsibilities for leading and implementing managed retreat or other forms of adaptation.

Considerations for funding private adaptation costs

In May 2019 the government introduced the proposed Climate Change Response (Zero Carbon) Amendment Bill, which proposes a framework for adaptation that consists of:

- a national climate change risk assessment, to improve understanding of climate risks;
- a National Adaptation Plan, outlining the government's approach to improving New Zealand's resilience to the effects of climate change; and
- monitoring and reporting against the National Adaptation Plan.

In developing the National Adaptation Plan, the government will inevitably need to consider how the actions identified in that plan will be paid for. This analysis will need to consider how costs of adaptation should be shared between central government, local government and private citizens, and how (through what mechanisms) any public support should be delivered.

Several options have been put forward. Boston and Lawrence (2018), for example, conclude that a case exists for proportionate pre-funding of future climate-adaptation costs (both public and private costs). They consider three options for nationally-funded support:

- expand and modify existing instruments and continue with ad hoc initiatives in response to specific situations, to be funded from annual or multi-year budget appropriations;
- amend the legislative mandate of the EQC so that it becomes responsible for pre-disaster funding (ie, for protective and preventative measures) as well as post-disaster funding; and
- establish a new national Climate Change Adaptation Fund with a statutory mandate to fully fund, partly fund or co-fund various specified costs related to adapting to climate change.

Boston and Lawrence favour the third option and argue for an early start to build up the Fund. The concept of pre-funding is already used in several existing funds. Pre-funding is a principle of the EQC and is mirrored

⁸⁰ A possible counter is that councils could charge targeted rates on remaining residents that would cover the full costs of the services

even more clearly in the NZ Super Fund. This fund's purpose is to anticipate a future, known cost (ie, the cost of paying NZ superannuation to the future large cohort of retirees at a time when the ratio of workers to retirees will have significantly fallen). Pre-funding has two key advantages:

- it allows time to build up the large sums that will be needed to fund adaptation; and
- it is fair that those who cause the problem should contribute towards the costs of remedying it – known as the exacerbator principle (noting that in this instance it has a strong intergenerational dimension).

Any public funding mechanism to help private owners of residential property undertake cost-effective climate risk reduction, up to and including managed retreat, would need to clearly specify criteria for who qualifies for assistance, how much they should receive, and with what conditions. A robust set of rules would be needed. The design of any mechanism would also desirably encourage community ownership and initiative.

8.6 Conclusion

The impacts of climate change present a significant pressure on local government funding and financing. A mismatch exists between resources and capability at the local level, and the scale of the adaptation challenges that exposed communities face. Although the risks are not evenly distributed, billions of dollars of council infrastructure are at risk from the effects of climate change, as are communities throughout New Zealand. Making decisions about where to protect, accommodate or retreat to minimise future risk and costs will call for challenging and intensive community processes. An exacting part of the challenge will be how to fund adaptation actions.

This chapter has noted the importance of national leadership in developing and providing high-quality and consistent data, information, guidance and legal frameworks. The Commission has suggested two new funding mechanisms to support local governments facing major climate damage to their infrastructure. The first extends the NZTA model to co-funding the costs of adapting land-transport infrastructure. The second is a Local Government Resilience Fund and associated agency to support affected councils to adapt their water infrastructure and their river and floodplain management to new climate risks and realities.

There are advantages and disadvantages of central government funding to support adaptation by private citizens and businesses. What the Government decides will have consequences for local government. Any support should be provided in ways that help councils work with their exposed communities to achieve risk reduction and minimise long-run costs.

A lack of national leadership and support creates a risk of disorganised, ad hoc adaptation to climate change, and of short-term, stopgap measures in place of more far-sighted, adaptive responses. Short-term and myopic approaches are likely to lead to greater risk exposure, higher long-term costs, and inequitable outcomes where some vulnerable and high-risk communities are left exposed while other locations are prioritised for protection.

9 Case study: Three waters

Key points

- Under current arrangements the provision of safe drinking water and cleanly disposing of wastewater and stormwater (commonly called “the three waters”) are core responsibilities of local councils. Some councils have taken the tough decisions to improve their performance, and they should be applauded for doing so. However, the three waters performance of many other councils has been poor for many years, with some harming the health of water consumers and the natural environment.
- In the Commission’s view, the issue is not whether to fundamentally reform the three waters sector, but rather how to do so. The Government is considering extensive reforms to the regulatory standards and regulatory regime for the three waters sector, and considering altering the way the sector is funded and delivered in New Zealand.
- Local governments spend a high portion of their funds on three waters. Achieving better safety and environmental outcomes may create additional funding and financing pressures on local councils, with some small populations potentially incurring very large cost increases. Addressing these pressures requires reforms that sustainably lift council safety and environmental performance, while improving productivity and cost effectiveness. Better investment choices are essential.
- Some councils have prioritised retaining direct control over how their water services are delivered – at the expense of building the *capabilities* of their supplier – even when it is clear significant performance improvement is needed. They have resisted funding, financing, organisational and governance changes that would bring better performance *disciplines* and *incentives* on those making or overseeing operational and investment decisions.
- The current regulatory regime imposes weak disciplines and incentives on council-led water suppliers to meet safety and environmental minimums, and there is little oversight of supplier charges and/or costs. No prosecutions have been pursued for breaches of health standards, and too many suppliers of wastewater are allowed to continue operating with expired consents.
- The performance of the three waters sector would be substantially improved through an approach that (1) rigorously enforces minimum health and environmental performance standards; and (2) is permissive about how councils meet these standards. This approach would have the following features:
 - The new regulatory regime would be administered by an existing, credible and independent regulator such as the Commerce Commission, which already regulates similar activities and has a credible “industry watchdog” reputation.
 - The performance regime would be permissive and flexible, but a backstop arrangement would be applied to councils that fail, by a specified time period, to lift their performance sufficiently to meet minimum health and environmental standards. The backstop would take the form of compulsorily merging water businesses, placing them in Council Controlled Organisation structures and requiring them to move to being fully funded directly from water consumers rather than through council rates.
- While significant cost efficiencies should be possible for most council-led water services, some communities will need financial assistance from government to help them make the transition to achieving minimum performance standards.

9.1 Introduction

Provision of safe drinking water and cleanly disposing of wastewater and stormwater are core responsibilities of local government, and expenditure on these activities accounts for a significant portion of local government expenditure. For example, drinking water and wastewater accounted for nearly 14% of total local government operating expenditure (opex) and 22% of capital expenditure (capex) in 2018.⁸¹ The water-related capex of five councils in 2017 exceeded 45% of their total capex.⁸² Despite the overall significant expenditure on three waters, poor quality provision appears to be occurring in many places in New Zealand.

Funding and financing pressures on councils from the provision of drinking water and wastewater appear likely to increase over the next decade. According to their long-term plans, local government capex on these activities is projected to be 25% of total capex over 2019–2028. Although that's a modest increase from the 22% average for 2018, the long-term plans are unlikely to have fully accounted for upgrades to treatment plants to achieve better health and performance levels.

Poor-quality water services are common in New Zealand

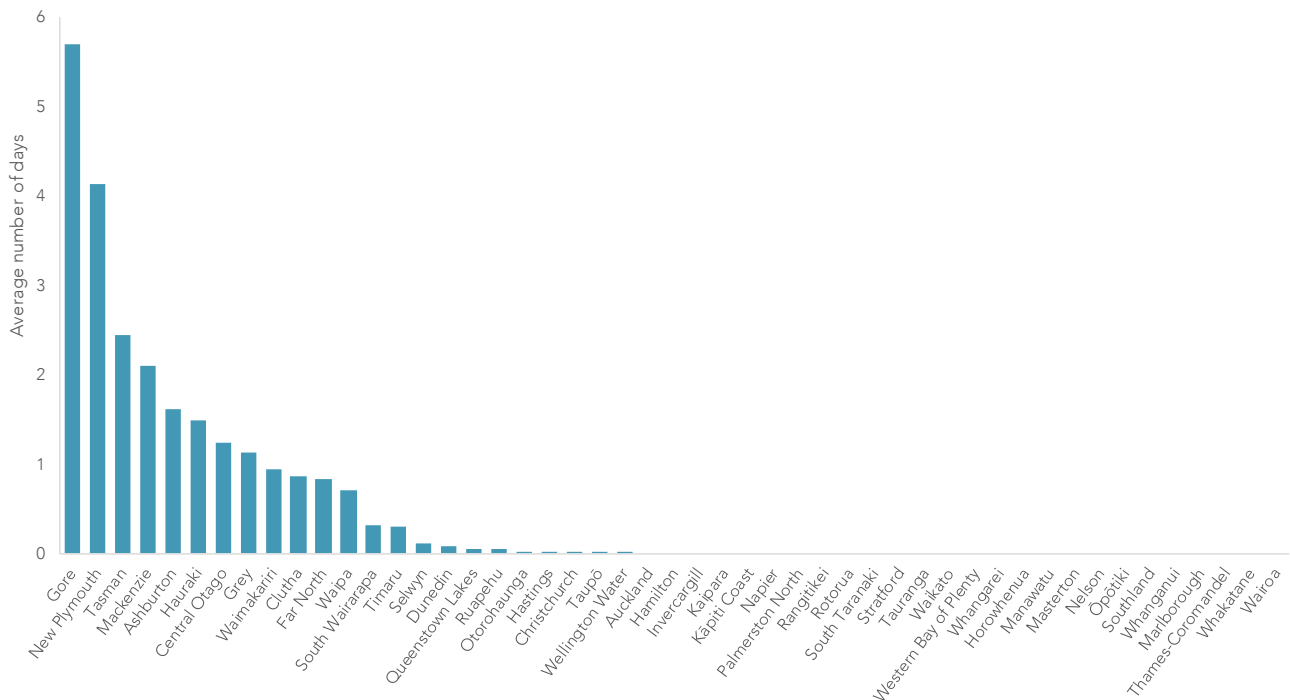
The provision of the three waters came to national attention with the Havelock North contamination of drinking water in August 2016, which is thought to have resulted in four deaths, long-term chronic health problems and widespread outbreak of illness in the area.

The Ministry of Health estimates that between 18 000 and 35 000 people become ill every year by consuming unsafe drinking water; the Government Inquiry into Havelock North Drinking Water accepted an estimate of up to 100 000 people a year (Havelock North Inquiry, 2017). According to the Inquiry, at least 13 other waterborne outbreaks occurred nationally in the 10 years before the Havelock North outbreak.

Boil water notices are issued when the authorities are concerned about the healthiness of the supply of their drinking water. Figure 9.1 shows the average impact of the notices issued in the 2017–18 financial year, for each council participating in Water New Zealand's National Performance Review exercise. It shows boil water notices were issued by 23 councils, and that eight of those councils recommended water boiling for periods equivalent to more than one day of the entire population served by them.

⁸¹ In both cases, the costs of stormwater appear to be part of roading or urban design costs and are not separately identified.

⁸² These figures are indicative only, as councils adopt different categories of expenditures. The five councils were Invercargill, South Wairarapa, Whanganui, Horowhenua and Whakatane. As a group, these councils also had high water-related capex over the five years ending 2017, averaging 28% against an average of 18% for all councils over that period.

Figure 9.1 The average impact of notices to boil water in 2017-18

Source: Water New Zealand, 2019.

Notes:

1. The chart shows results for councils providing data to Water New Zealand for its 2017-18 National Performance Review. The vertical axis shows the average number of population-days covered by boil water notices. For example, a score of 4 on the vertical axis means that on average the entire population served by a council was given notices to boil their water for four days. This may have been notices on four separate occasions to boil their water for one day or it may have been two notices to boil their water for the next two days, etc. If half the population were recommended to boil their water for one day, for example, then the score would be 0.5.

For populations of 10 000 or greater, only 88.4% of supplies are fully compliant with current drinking water standards. The compliance rate declines as population declines, with only 31.5% of supplies compliant for populations of 101 to 500 people (Minister of Local Government and Minister of Health, 2018).

These results are consistent with a 2014 survey by Local Government New Zealand (LGNZ), which distinguished between minor breaches of current drinking water standards and non-minor breaches. That survey showed that 60% of local councils serving metro areas had minor breaches and none had non-minor breaches, but noted that 15% of councils serving metro areas did not respond to the survey. This contrasts markedly with the results for councils serving provincial and rural areas, where 25% had minor breaches and about 5% had non-minor breaches. However, the non-response rate for these types of councils was about 50% (LGNZ, 2014, p. 17).

The low response rate to the LGNZ survey may mean the number of non-minor breaches is greatly underestimated. For example, if half the councils that did not respond had non-minor breaches, then about 30% of provincial and rural councils may have had non-minor breaches, rather than the 5% shown in the survey. This rate is more consistent with the evidence presented in the Havelock North Inquiry.

The Havelock North Inquiry reported:

[A]lmost 10 years after the 2007 amendments [introducing mandatory drinking water standards in the Health Act], there are still 759,000 people (20 per cent of the serviced population) who are supplied water that is not demonstrably safe to drink. Of these, 92,000 are at risk of bacterial infection, 681,000 of protozoal infection, and 59,000 at risk from the long-term effects of exposure to chemicals. (p. 25)

[T]here has been no marked improvement in the number of suppliers supplying safe drinking water throughout the 2009-2016 period. (p. 26)

Some council wastewater systems are also performing poorly. Some wastewater plants are degrading freshwater and coastal water quality, and sewage overflows are occurring at a frequency no longer

acceptable for communities. In many regions, regional councils do not (and are not required to) publish sufficient information to provide assurance about the impact of wastewater services on the environment. If comprehensive information was available, many hidden problems would likely be exposed. An audit of the Waikato and Manawatu-Whanganui wastewater systems showed that 50% of plants did not comply with consent conditions in 2017–2018. Ten per cent of wastewater treatment plants in Waikato and Manawatu-Whanganui are legally operating on expired consents for long periods of time (in some cases, decades).

The challenges facing council stormwater services are different to those facing drinking water and wastewater. This is in large part because stormwater is an open system closely associated with roading and urban land use. There is a lack of good quality information about the condition of stormwater infrastructure, its susceptibility to climate change, and its propensity to harm the environment. Climate change adaptation issues are discussed in Chapter 8.

As to economic efficiency, Water New Zealand reports that water losses amount to more than 20% of the water supplied to systems with known water loss levels. Only three participants in their survey achieved water loss levels low enough to make further reductions uneconomic. As Water New Zealand reported, “[T]his signals there is room to save both money and water through the implementation of water loss initiatives” (Water New Zealand, 2019, p. 8).

Where applied, volumetric metering and pricing appears to have reduced peak water consumption and waste by up to 30%. The Kāpiti Coast District Council (KCDC), for example, reports reductions in peak daily water use of about 25% (sub. 131, p. 22). A recent report by the Office of the Auditor-General reports the KCDC’s view that its initiatives have resulted in lower charges for most ratepayers and it has deferred the need for a new dam for many years (see Box 9.1 below).

Box 9.1 Kāpiti Coast District Council’s experience with volumetric metering and pricing

Kāpiti Coast District Council found that alternative water supplies (such as grey water and rain water) reduced the drinking water used by residential consumers by about 30%. Alternative supplies also have a role in increasing community resilience when an emergency affects usual drinking water supply.

Of all ratepayers in the district, 75% pay less for water than they would if the Council had stayed with its previous approach of charging for water supply. KCDC estimates that its approach has deferred the need for a new dam by about 40 years.

Peak daily water use is what drives the need for capacity upgrades in the system supplying the drinking water. Peak daily water use decreased by about 25% in the two years after universal metering was put in place.

- About 20% was saved by fixing leaks on private property and lateral pipes, which surprised the Council because it had assumed that leaks were on other parts of the network. The Council now has a proactive laterals renewal programme.
- About 5% was saved by consumers using less water.
- Based on a range of factors, including reductions in water use and wastewater discharges, water use reduced by an average of 21%. Estimates of reduced water consumption included reduction in dry-weather wastewater volumes of between 5% and 8%.

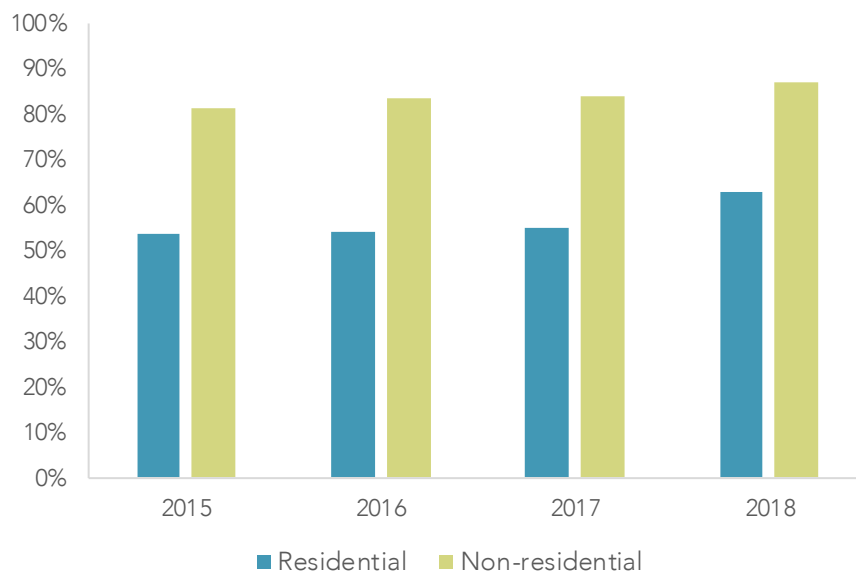
Each year, KCDC produces a water conservation report that discusses how it has met its water use target, the work done to manage water use and leakage on the public and private parts of the network, and planned water conservation work for the next financial year. The report fulfils a resource consent condition, but has greater value than merely meeting compliance requirements.

Source: Office of the Auditor-General, 2018c, p. 9.

Tauranga City Council has achieved a similar result. An independent report identified a 30% reduction in Tauranga's peak water demand, which enabled the Council to delay a proposed water scheme by at least 10 years. Taking into account the costs of installing and operating meters and associated billing systems, the authors estimate the average Tauranga City household would be paying at least 40% more each year for their water if the Council had not introduced water meters (Sternberg, 2011).

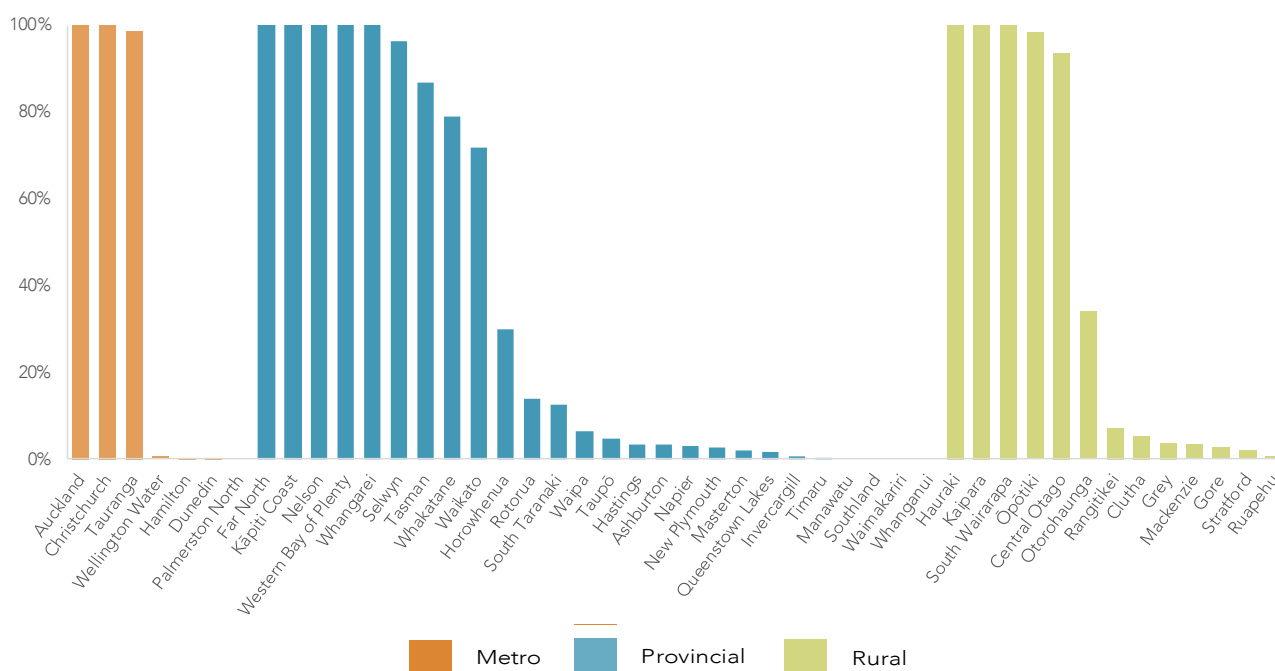
Despite the prospect of significant cost reductions for communities, the pace towards adopting water metering and volumetric pricing across New Zealand is slow. Water New Zealand's 2017–2018 report shows that water meters are installed at 63% of residential properties receiving water services and at 87% of non-residential properties. Although Figure 9.2 shows water metering has slowly increased in the past four years, the increase largely reflects the fast population growth in Auckland, where Watercare achieves full residential water metering.

Figure 9.2 Proportion of properties with water meters



Source: Water New Zealand, 2019.

Figure 9.3 shows the percentage of residential properties with water meters for each water provider supplying data to Water New Zealand. The chart shows that at least 27 councils had less than 20% of residential properties with water meters, and four metropolitan councils (Dunedin, Hamilton, Wellington and Palmerston North) had almost no water metering. Only 15 participants shown in the chart have more than 80% of their residential properties with water meters.

Figure 9.3 Percentage of properties with meters served by each water provider, 2017-18

Source: Water New Zealand, 2019.

F9.1

Considerable evidence shows poor performance of the three waters sector in many parts of New Zealand, in terms of their impact on human health, the natural environment, productivity and costs to consumers and ratepayers. However, some councils and providers are taking the tough decisions needed to improve performance, including Auckland's Watercare, Tauranga City Council, Kāpiti Coast District Council and the five councils involved in Wellington Water.

Case study of the three waters sector

The rest of this chapter presents a case study of the three waters sector. With such poor performance the issue is not whether to fundamentally reform the three waters sector, but rather how to do so. The Government is considering extensive reforms to the regulatory standards and regulatory regime for the three waters sector, and considering altering the way three waters is funded and delivered in New Zealand (Minister of Local Government and Minister of Health, 2018).

Better enforcement of safety and environmental standards, and raising those standards, is expected to create additional funding and financing pressures on local government, and some small populations could face very large increases in costs. Yet the focus should not just be about more money going into three waters to assist affordability. The focus also needs to be about sustainably lifting safety and environmental performance and productivity, particularly regarding future investment choices, to minimise cost impacts on communities. Therefore, the three waters sector is inevitably an important focus for this Inquiry.

An in-depth case study on the three waters sector has been prepared by Capital Strategic Advisors (CSA) for the Productivity Commission. The CSA report proposes fundamental changes to the funding and financing of three waters to significantly and sustainably improve safety and environmental outcomes and minimise the funding and cost impact (CSA, 2019).

The next section outlines the inherent features of three waters and explains why these features are not the reason for the poor performance. Section 9.3 applies the decision-making principles in Chapter 5 to the three waters sector, and identifies the key drivers of poor performance. Section 9.4 proposes comprehensive reform, and outlines key requirements for central government and local councils to have robust implementation plans. Section 9.5 discusses the benefits of the proposal.

9.2 Inherent features of three waters

Chapter 1 discussed inherent features of many local government activities, and the three waters sector shows many of these features. For example, the provision of reticulated drinking water, wastewater and stormwater services shows *large economies of scale*, which means it is efficient for a single local supplier of reticulated water to serve each population.⁸³ This can result in a local natural monopoly situation (if there are no suppliers of non-reticulated water, such as from bottled water suppliers).⁸⁴

Another important feature is that poor quality water can impose *negative externalities* on others. For example, unhealthy drinking water imposes costs on the health sector and the discharge of contaminated wastewater and stormwater can pollute the natural environment. Stormwater overflows can also damage properties; in some instances, very heavy rainfall events can result in stormwater mingling with the wastewater system, causing overflows of raw sewage.

Poor performance is not due to inherent features

Section 9.1 outlined the poor performance of the three waters sector. This poor performance is not due to the inherent features of the sector, as three waters services are delivered well by many councils and organisations (eg, Watercare, Sydney Water, Scottish Water, suppliers in England and Wales and major suppliers in Finland, to name a few).⁸⁵ Further, electricity and gas distribution services show similar inherent features as three waters, yet deliver acceptable performance.

Rather, the poor performance of the three waters sector is due to poor decision making by some local governments, particularly when dealing with the inherent features of three waters. Customer choice is largely absent when a local natural monopoly provides three waters, which can leave suppliers with weak performance incentives. In these situations, it is important for suppliers to have effective funding, financing, legal and governance arrangements in place.

Likewise, the human health and environmental externalities arising from poor water quality make it very important that suppliers provide a quality of reticulated water that is good for consumers and the environment. As a result, suppliers need to have the expertise and financial capacity to make sound investment and operational decisions, and councils need to have effective mechanisms to hold suppliers accountable.

F9.2

The inherent economic features of three waters makes it a natural monopoly in many cases, and poor-quality water treatment can impose large negative externalities on communities. These natural monopoly and externality features are not the reason for the poor performance of councils. Even so, they do make it very important that councils have effective decision-making, governance, accountability, funding and delivery arrangements in place.

9.3 Application of key decision-making principles to three waters

Chapter 5 outlined key principles for high-quality decision making by local government. It discussed the importance of decisions being made by parties with the capabilities, information, knowledge, disciplines and incentives to make consistently high-quality decisions.

⁸³ In practice, the sourcing, extracting and treating of drinking water is undertaken by the same entity as the provider of reticulation or conveyancing services, and likewise for the treating and disposing of wastewater.

⁸⁴ A related feature of reticulated drinking water occurs when all consumers in a reticulation system receive the same quality (taste, colour, smell and contamination levels) of supply. In this situation, on the one hand, collective decision making by consumers of reticulated water – perhaps via elected representatives – can play a role when the supplier is a local natural monopoly. On the other hand, if reticulated supply faces competition from bottled water suppliers, then consumers dissatisfied with the quality of reticulated water may be able to choose a more preferred quality of water from bottled water.

⁸⁵ For example, as to drinking water quality, public supplies in England and Wales, large Finnish supplies, and Scottish Water all had greater than 99.8% compliance with E.coli standards between 2011 and 2015. Further, England and Wales had almost no issues with protozoa during the same period (Havelock North Inquiry, 2017, p. 25).

Inadequate supplier expertise and capabilities

Most councils have prioritised retaining direct control over how their water services are delivered, at the expense of building the *capabilities* of their supplier. Currently, the scale of water suppliers matches the size of each local council's jurisdiction – which is often very small. This leaves some local councils with inadequate in-house specialisation and expertise. Auckland's Watercare has reasonable scale, with effective levels of specialisation and expertise. Wellington Water – a joint venture management company owned by five local councils in the Wellington region – appears to be making significant gains in performance due to greater specialisation and better use of scarce expertise, although further time is required confirm whether these gains are arising (Wellington Water, 2018a).

A report by Castalia (2017) for the Department of Internal Affairs looked at how well existing water assets are managed, and reported:

We found two examples of large, urban service providers with disparate AM systems, practices and processes have been brought together and standardised. This has created economies of scale and improvements in analysis, data collection, and procurement. (p. iii)

Small service providers typically have one or two individuals responsible for multiple asset classes, whereas larger organisations have teams of up to 400 individuals. This allows people to focus on niche areas and tasks, allowing for deeper analysis and a more thorough understanding of the asset base. It also allows larger service providers to 'look above the day-to-day firefighting' by hiring individuals to consider long-term strategy, the potential roles of new technologies, and advancing innovative practices. (Castalia, 2017, p. iii)

Waikato District Council has recently initiated discussions for services from Watercare, after having tried for many years (unsuccessfully) to form a joint venture water company with Hamilton City Council and Waipa District Council. In its submission, Hamilton City Council reflected on its experience investigating options for collaboration and aggregation of water services. Noting they had invested a significant amount of consulting resource into the project, they submitted that:

HCC is therefore of the view that Government intervention is necessary to achieve aggregation of water service delivery.. (Hamilton City Council, sub. 130, p. 4)

Hamilton City Council's submission to the Government's three waters review elaborated on this point, stating:

In addition, some councils appear to be reticent about losing control of their water functions as it is regarded as a significant part of their ongoing operation and, to a certain extent, is seen as justifying their "existence". (Hamilton City Council, 2018b)

Similarly, Infrastructure New Zealand submitted that:

[c]ouncils have opposed demonstrably superior water service provision, generally because it is feared that the loss of water would undermine other council services and local decision making more broadly. (Infrastructure New Zealand, sub. 128, p. 11)

Apart from Wellington Water, management and governance of water assets across local council boundaries is rare. This is unusual for services requiring significant operational, asset management and investment decision making skills and expertise. For example, gas and electricity distribution services require similar types and levels of skills and expertise, and they generally operate across multiple local council boundaries. Currently, 29 electricity distribution businesses are in New Zealand compared with 67 local councils.

Engineering New Zealand remarked on the fragmentation in the provision of water services, submitting that:

[t]here are significant economies of scale and scope in the provision of infrastructure services. But local government does not always have the mechanisms to plan and deliver infrastructure regionally, which can result in disjointed investment decisions. An example of fragmentation is wastewater and drinking water services outside of the Auckland and Wellington region. (Engineering New Zealand, sub. 98, p. 3)

The comments above reinforce the findings of the Commission in its *Using land for housing* report:

The current governance arrangements for water infrastructure have three major shortcomings that are likely to inhibit affordable and efficient provision:

- fragmentation in water provision;
- problems associated with monopoly provision; and
- evidence of inefficient pricing. (NZPC, 2015, p. 10)

Only six suppliers of reticulated drinking water and wastewater services serve England and Wales, and only one serves Scotland. Scotland, for example, went from having 13 suppliers in 1976 to three suppliers in 1996, and then a single entity in 2002, called Scottish Water. Since 2002, Scottish Water has reduced operating costs by 40%, reduced the number of lost-time accidents from around 30 per 1 000 employees to around 2.5 per 1 000 employees in 2015/16, and increased its customer satisfaction rating from 63% to 90%. Since 2010, compliance with water quality standards has improved steadily from 99.83% to 99.93% and the number of environmental pollution incidents has reduced from around 750 a year to around 250 a year (Hutchison, 2017).

Councils ought to be focused on service performance, which for many will require the requisite expertise and much of that may only come from increased scale. This could come from merging with other providers and/or pursuing expansion opportunities.⁸⁶

Poor governance capabilities and incentives

The performance of council-owned water suppliers appears to be inhibited by poor governance capabilities and incentives. Except for Watercare and Wellington Water, the governance of drinking water and wastewater suppliers is carried out directly by elected councillors and their officials. In many instances, this will be compromising supplier performance and muddying their accountability to councils.

Virtually all councils organise their water resources as a department within the council, with governance decisions made by a committee of elected members and/or council senior management. These arrangements typically provide weak performance disciplines and incentives because they shield committee members from the legal requirement to act in line with the business' constitution. These arrangements also shield committee members from the full suite of accountability requirements that company directors face. These weaknesses flow through to weak performance disciplines and incentives on council management and staff.

For example, in an audit of four councils about management of their water assets and services, the OAG asked the councils about the reasons for consistently failing to spend their budgeted capital for drinking water infrastructure. The OAG reported:

Reasons given to us included poor or overly optimistic planning, inefficient procurement practices, staff vacancies, lack of capability and capacity, limited interest from private firms in competing for work, and weak management and governance accountability. (Office of the Auditor-General, 2018c, p. 11)

As discussed in Chapter 5, MartinJenkins (2017) examined the water asset governance practices of ten councils where elected members govern the water assets, and found that councillors typically lacked understanding of what is involved in good governance of water assets.

In addition to poor governance capabilities, the MartinJenkins report expressed concerns that elected council members may not have the right focus given the varied interests and priorities among members (MartinJenkins, 2017, p. 17). At the central government level, members of parliament and ministers are not directly involved in the governance of any government-owned business for the obvious reason that doing so would compromise their ability, and the ability of their colleagues, to hold the business accountable for its performance. The same logic applies to council members and local government services.

Best practice involves:

- restricting member involvement to appointing independent directors (ie, no councillor or council staff or any people related to them); and

⁸⁶ As discussed in the Commission's report *Using land for housing*, councils should undertake a careful assessment of costs and benefits before deciding whether or not to merge their water assets with other councils (NZPC, 2015, p. 241).

- requiring the information and meetings needed to robustly monitor the performance of the business.

Box 5.2 in Chapter 5 outlines the advantages and disadvantages of Council Controlled Organisations (CCOs) and outlines the importance of councils having the capacity and capability to monitor performance and manage a relationship with a CCO.

Poor financing arrangements

Most councils finance their water-related investments from their own rates and borrowing⁸⁷, rather than place those assets in CCOs and leaving it to the CCO to obtain their own finance (as occurs for council-owned electricity businesses). This leaves council members to effectively decide investment activity for three waters, inhibiting the supplier's overall performance and making them less accountable.

Watercare is the only major supplier of reticulated drinking water and wastewater in New Zealand that is incorporated as a company and the water assets are owned by the company rather than directly by Auckland Council. Yet, even though Watercare can borrow against its assets in principle, in practice it cannot borrow significantly because its balance sheet is consolidated with Auckland Council's balance sheet, effectively constraining Watercare's investment activity, which, in turn, affects Watercare's performance and makes their accountability less clear.

Poor funding and pricing arrangements

Another factor inhibiting supplier performance arises from council involvement in water pricing decisions.⁸⁸ Almost all councils set supplier price levels and price structures and collect the charges through their rates system.⁸⁹ Watercare sets its own charges, but it does so in line with section 57 of the Local Government (Auckland Council) Act 2009, which in effect requires Watercare to set its charges no higher than needed to cover costs.

Section 9.1 outlined the significant cost reductions communities can achieve by introducing water metering and volumetric pricing, and highlighted that KCDC reported water savings of 25% of peak daily water use. In response to serious supply issues in the late 1990s and early 2000s, KCDC embarked on a multi-year programme to investigate and implement several measures to address the problems it was experiencing with its drinking water, which in total took about 15 years to complete.

In their audit of four councils discussed earlier, the OAG asked KCDC what other factor or incentive would have made it act earlier. The OAG reported:

Councillors and council officers told us that crisis and regulation are the only sure ways to achieve more comprehensive planning for, and management of, drinking water supply under the current arrangements. Incentives to stay with a traditional supply management approach and to make short-term decisions are strong, and there are political pressures to keep rates and rates increases low. (Office of the Auditor-General, 2018c, p. 12)

Although single supplier situations raise market power concerns, it is important to deal with those concerns in ways that preserve supplier performance incentives as much as possible. Lack of customer choice in single supplier situations leaves suppliers with weak incentives to innovate to improve their performance. So it is important to avoid pricing regimes that further weaken performance incentives.

However, many councils reduce performance incentives by funding suppliers with general rates and targeted fixed rates, which are not based on the service, and service levels, delivered. Further, these revenues are often insufficient to cover supplier operational costs, asset depreciation, and interest costs.

Water New Zealand, for example, reports that at least 20 of the 46 councils that gave them data did not

⁸⁷ Thirty local councils, along with the NZ Government, own the Local Government Funding Agency, which issues bonds to finance its council members.

⁸⁸ Although water is free in New Zealand, it can be costly to acquire, treat and convey water to consumers. Discussion of water prices and charges in this draft report is about paying for the service rather than for the water resource.

⁸⁹ The Local Government (Rating) Act 2002 empowers council-led water suppliers to use rates to charge for their services. Garnett and Sirikhanchai (2018) report that in 2014 five council-led water suppliers charged consumers directly rather than through the rates system. These were Auckland, Tauranga, Whangarei, Hauraki and Kaipara.

achieve full cost recovery (Water New Zealand, 2019).⁹⁰ As well as undermining performance incentives, these pricing and funding approaches inhibit performance measurement and the ability of councils to hold their supplier units accountable for their performance. If councils wish to subsidise their water services, a range of options are available that do not produce these effects.

In contrast, electricity and gas distributors receive their funding from charging consumers directly, and set their own pricing structures. Market power concerns are dealt with by the Commerce Commission setting maximum prices and minimum service requirements for suppliers subject to price control, and requiring information disclosure about these matters for those not under price control. The Commerce Commission operates an incremental rolling incentive scheme to give price-controlled suppliers incentives to improve their performance over time.⁹¹

Weak safety, environmental and economic regulation

Weak regulation is at the heart of the poor performance continually observed with three waters. The current regulatory regime imposes weak disciplines and incentives on council-led water suppliers to meet safety and environmental minimums. Supplier costs are not currently externally regulated. No prosecutions have been pursued for breaches of drinking water standards.

This may reflect regulatory capture by local government-owned suppliers. It may reflect that the health sector is a major service provider, with a “we’re here to help and care for you” culture, rather than being a respected and feared regulator that rigorously enforces performance standards.

Another reason for weak enforcement may be that the regulators are ill-equipped to deal with non-compliance with drinking water standards for reasons of affordability. The Health Act 1956 allowed affordability as a defence for not meeting drinking water standards. The Act does not contain any requirement for financially weak suppliers to achieve affordability over a specified period of time.⁹² It is likely that health regulators lacked the power to require affordability issues to be tackled and lacked the regulatory economics, financial and investment expertise to do so.

Effective regulation of three waters is essential because consumer choice is largely absent, considerably weakening performance incentives for council-led suppliers. Lack of contestability for greenfield developments further weakens performance incentives. Effective regulation would impose significant financial penalties for performance breaches, providing financial and reputational incentives for councils to confront the inadequacies of the arrangements they have in place for three waters. Effective regulation would also provide positive financial incentives for performance improvements, rewarding councils that improve their performance. Credible financial penalties and incentives help managers to build the business case for incurring the costs needed to lift performance.

⁹⁰ These figures are biased up due to the revenue measure excluding developer contributions and biased down to the extent that depreciation charges are not fully funding asset costs. Also, the 46 authorities participating in the benchmarking exercise represent about 94% of the population served with reticulated water.

⁹¹ Price-control regulation can create incentives for ‘gold plating’ of investment if the regulated price is based on an incorrect weighted-average cost of capital (WACC). This can occur when the regulated WACC exceeds the correct WACC. In these cases, the price-controlled entity has incentives to inflate its regulatory asset base (RAB), for example by installing excessive capacity, so that it earns high profits (ie, high WACC x high RAB). This effect is often called the Averch-Johnson Effect.

⁹² Sections 69H, 69V and 69ZZS of the Health Act 1956 allow affordability as a factor affecting whether a supplier has fulfilled requirements to take all practicable steps to comply with drinking water standards.

F9.3

The poor performance of the three waters sector in New Zealand can be attributed to the following factors in some cases.

- Inadequate supplier expertise and capabilities, resulting from some local councils prioritising local control of their three waters activities rather than increasing their operational scale through shared services, joint ventures or mergers.
- Poor governance capabilities and incentives, due to lack of independent directors and insufficient use of company-type structures when they are likely to be beneficial.
- Poor financing, funding and pricing arrangements, due to under-recovery of costs and funding from council rates rather than water service charges and development fees.
- Weak safety, environmental and economic regulation, due to poorly designed regulations, weak enforcement and lack of regulatory expertise.

9.4 Improving the performance of three waters

As discussed in section 9.1, the three waters sector is performing very poorly in many parts of the country and this has been occurring for a long time. It is important that the owners of the three waters assets, predominantly local councils, accept responsibility for their poor performance and take the tough decisions needed to lift performance to acceptable levels. The Government should focus on establishing an effective regulatory regime that strongly incentivises councils to make those tough decisions, and on offering financial assistance to communities in ways that encourage performance, and which are targeted to situations where a high level of assurance is needed and would be used wisely.

Establish an effective regulatory regime

The performance of the three waters sector will substantially improve by using an approach that (1) rigorously enforces minimum performance levels; and (2) is permissive about how councils meet these performance levels. The Government should set clear health and environmental performance standards for all three waters services. Councils achieving those standards within a specified time period should also be free to conduct their three waters business how they wish, although they would remain subject to regulatory oversight and possibly subject to price control. The regulator would be required to pursue significant financial penalties for serious breaches of health and environmental standards, and it would have the power to apply a backstop regime to councils that fail to sufficiently lift their performance within a specified time period.

The Commission's preliminary view is that the new regulatory regime should be administered by an existing, credible and independent regulatory agency, such as the Environmental Protection Authority, the Electricity Authority or the Commerce Commission. The Commerce Commission, for example, already regulates many other natural monopolies in New Zealand and is a natural candidate to do so for the monopoly parts of the water sector. It has the right culture, and is clearly a professional, independent and authoritative organisation, with a credible "industry watchdog" reputation. It has significant experience with applying supplier specific regimes, and with managing light-handed regulation for some suppliers and explicit price control for other suppliers.

Councils must lift their performance

For many councils a strong case can probably be made for councils to aggregate suppliers across council boundaries to achieve operational scales that facilitate far greater specialisation of resources. Councils could incorporate water suppliers in asset-owning CCOs and appoint independent and experienced directors to

them. The CCOs could fund themselves by charging their consumers directly, and they could secure their own finances independently of councils.⁹³

If councils are concerned about an asset-owning CCO structure facilitating privatisation in the future, they could retain ownership of the water assets and restrict the CCO to provision of water management services, as is the case for Wellington Water. Another approach would be for groups of councils to tender the provision of management services, as occurs in France. Each approach carries risks if implemented; yet, in most situations, is likely to improve performance over what exists now.

Adopting a company structure is essential for effectively managing and governing activities that need significant operational, investment and asset management expertise. A company structure provides a suite of accountability arrangements that provide disciplines and incentives designed to promote high-quality management and governance decision making. It assigns appropriate decision rights to management and boards that have the information, knowledge and skills to make complex investment and production decisions. Appointing independent directors frees elected councillors to focus on holding the board to account for the company's performance, and it enhances transparency of performance and the trade-offs involved. Central government⁹⁴ has used this approach of independent directors in many instances, and Auckland Council has made widespread use of asset-owning CCOs (including for provision of its water services).

On the other hand, adopting a one-size-fits-all remedy needs careful consideration. The “tough on needing to meet minimum performance levels /permissive on how to lift performance” approach provides the flexibility local councils may need to transition to new performance levels in ways that are most consistent with their local circumstances.

Some councils may deliberately avoid changes that reduce their direct control of three waters services even when their service quality remains very poor. The Commission's preliminary view is that the Government should empower the new regulator to formulate a backstop arrangement that would apply, after a specified date, to councils which fail to lift their performance sufficiently. The backstop would take the form of compulsorily merging water businesses, placing them in CCO structures with independent financing and requiring them to move to being fully funded directly from water consumers rather than from council rates.

Financial assistance needs to reinforce the regulatory incentives

Although significant cost efficiencies should be possible for most council-led water services, in some situations these efficiencies are unlikely to offset higher costs to meet higher minimum standards for drinking water and wastewater services. Financial assistance to communities needs to be, and can be, designed in ways that reinforce the above regulatory incentives and restrict assistance to situations where a high level of assurance is needed and would be used wisely.

Hamilton City Council's submission to the three waters review supported the idea of an independent regulator for water, and pointed to the need for the government to provide incentives for aggregation.

HCC supports a new independent regulator for drinking water.... An independent regulator will provide consistency, dedicated/focused technical competency and expertise to drive the required level of compliance to ensure water is safe to drink.... Any new regulator will need to be funded and resourced appropriately,...

To provide an incentive for aggregation, Government assistance for addressing any funding gaps in resilience, asset management and service delivery deficiencies (which nationally are estimated to be significant for water and wastewater), including meeting environmental and waters standards, should only be available to councils who are part of an aggregated service delivery model ie, a CCO.... It would be unacceptable for taxpayers to subsidise small, inefficient three water schemes. (Hamilton City Council, 2018b)

⁹³ Under these arrangements most councils would have a minority stake in their water CCO, and so they would not be required to consolidate CCO assets and liabilities on council balance sheets.

⁹⁴ Crown-owned companies include Crown Research Institutes, the broadcasting companies Television New Zealand Limited and Radio New Zealand Limited, and New Zealand Venture Investment Fund Limited. The Government also operates 14 State-owned enterprises, including for the critical functions of air traffic control and navigation (Airways New Zealand) and electricity transmission (Transpower New Zealand).

F9.4

The performance of the three waters sector would substantially improve by using an approach that (1) rigorously enforces minimum performance standards; and (2) is permissive about how councils meet these minimum performance levels. This approach would have the following features.

- The new regulatory regime should be administered by an existing, credible and independent regulator such as the Commerce Commission, which already regulates similar activities, has a credible “industry watchdog” reputation and has significant experience applying light-handed regulation to some suppliers and stronger forms of control to other suppliers.
- The performance regime would be permissive and flexible, leaving it to councils to decide how to achieve the regulatory standards. However, a backstop arrangement would need to be put in place for those councils that fail to lift performance sufficiently to meet minimum health, environmental and economic performance standards.
- While significant cost efficiencies should be possible for most council-led water services, some communities will require financial assistance from government to help them make the transition to achieving minimum performance standards for drinking, wastewater and stormwater services.

Effective implementation

Many councils may need to pursue an integrated package of reforms to adequately lift the performance of their three waters services. For example:

- decisions aimed at increasing scale and specialisation will need to dovetail with decisions about organisational form, financing, ownership and governance arrangements; and
- decisions about financing arrangements will depend on decisions about organisational form, asset ownership, funding and pricing.

Implementing an integrated reform package that involves multiple parties and multiple components will require robust and coordinated implementation by councils that are seeking closer collaboration. Councils will need to identify and remove factors that could undermine reform incentives, such as liabilities that may greatly hinder their ability to attract high-quality professional directors. Councils may also identify legislative barriers for the Government to address.

The “tough/permissive” approach outlined above would allow the Government to proceed with regulatory reforms separately from local council initiatives. However, the Government will need to move quickly to finalise minimum performance requirements, the timeframes for achieving them, the consequences of not achieving them and the tools the regulator will have available to carry out its job effectively.

It will also be important for the Government to move quickly to legislate for a credible and authoritative regulator to further develop and implement the regulatory regime. It will need to decide whether setting up an industry-specific regulator or broadening the regulatory mandate of an existing generic regulator such as the Commerce Commission is the best option. Alternatively, the Government could adopt a mixed approach in which a Water Commissioner is established as an adjunct to the Commerce Commission, similar to the Telecommunications Commissioner.

9.5 Benefits of adopting the above approach

The approach outlined in this chapter provides a workable solution to lifting three waters performance. It would provide strong and credible incentives for staff and councillors at local-council level to work constructively to better manage serious risks facing their communities and funding pressures on council

budgets. Councils that take the decisions and achieve expected performance levels retain local decision-rights over all aspects of three waters.

This approach would provide the Government with a set of workable reforms that will achieve what matters – tackling the unacceptable performance levels for three waters – while constraining fiscal costs. It avoids the Government becoming unnecessarily involved in the specifics of how to lift performance and navigating every local circumstance. Instead, the approach concentrates on advocating for consumers and intervening only where local councils have clearly failed in their duties. Fiscal costs are minimised by tying Government assistance to situations where councils have taken measures to sustainably lift performance and productivity and by structuring the assistance appropriately.

Finally, lifting the performance of the three waters sector is consistent with the Government's wellbeing framework. Safer drinking water will benefit the health of water consumers. Also, better and more consistent treatment of wastewater and stormwater will contribute to improving the natural environment. More efficient and cost-effective provision of three waters services will contribute to improving the country's productivity. It will also contribute to New Zealand's international reputation for being "clean and green" by reducing the incidence of tourists becoming ill from drinking water and by reducing pollution of coastal and freshwater catchments.

10 Bringing it all together

The Commission has found that the current suite of funding and financing tools generally measures up well against principles of a good system, and that rating land and property should continue as local government's main taxing power. Yet there is considerable scope for councils to make better use of existing tools.

However, a framework that has been broadly fit for purpose to date is now facing several significant emerging pressures. Local government is unlikely to be able to meet these new challenges with existing tools alone. Considering these pressures, the Commission has recommended some new tools and refinements to make the funding and financing system for local government fit for the future. Improvements to council capability and decision-making will also be important for councils to make the most effective use of the current framework, and the proposed new tools.

The recommendations in this draft report will improve the funding and financing framework within which local authorities operate. If implemented, they will support councils across New Zealand, in their diverse circumstances, to be high-performing in the service of the communities they represent. The recommended changes vary in scale and priority. Some can be phased in over time, while others are more urgent. This concluding chapter indicates which changes to the funding and financing system the Commission sees as the highest priorities for action, and the context for such action.

10.1 Which changes are highest priority?

The Commission has identified some key areas where councils face significant and rising cost pressures, and where existing funding and finance arrangements are likely to be insufficient or unsuitable. Addressing these gaps is the highest priority for action. Without new funding tools to deal with these significant pressures, they are likely to worsen over time.

The four most important changes to the funding and financing system for local government are therefore:

- help for at-risk councils to adapt to the impacts of climate change;
- new funding tools for growth-supporting infrastructure;
- new funding tools for tourism hotspots; and
- reform to strengthen the interface between central and local government, to ensure that regulatory regimes are co-designed and jointly implemented.

The Commission also considers the three-waters sector an important area for investigation. It presents a case study that makes proposals to improve sector outcomes and ease funding pressure.

Adapting to the impacts of climate change

The impacts of climate change present a large new (and growing) challenge to the wellbeing of communities. Adapting to these impacts will stress local government funding. As sea levels rise and weather events become more frequent and extreme, council infrastructure will be damaged or destroyed, communities around the country will face harm and disruption, and some communities will eventually become unviable.

The main pressures from climate change still lie in the future, although there are significant uncertainties about just when, where and how the effects will materialise. The impacts of climate change will unfold over decades, which means that New Zealand has the opportunity to prepare and spread the costs over time. Yet this timeframe also presents a challenge, because it provides temptations and incentives to delay action, or to undertake activities that will lead to greater future climate risk and long-run adaptation costs.

Local authorities make decisions every day that increase or reduce exposure to the impacts of climate change, and many councils have expressed frustration at the lack of national leadership on adaptation. The

first priority for central-government action should be to develop advice, guidance and legal frameworks to support decisions about land use. Some councils are concerned that they are currently in a kind of legal limbo, facing a no-win situation where either allowing or limiting development on at-risk land might result in litigation. These uncertainties need urgent attention.

The central government is currently developing a National Climate Change Risk Assessment framework, with the first national risk assessment expected to be completed by 2020 – a process that will feed in to a National Adaptation Plan. This is urgent and important work. Some councils, such as in Hawke's Bay and Dunedin, are making progress in engaging with their at-risk communities, and the lessons emerging from these initiatives need to be shared widely and incorporated into the central government process.

A national approach should also include the provision of funding support to local governments, to increase the resilience of council infrastructure – including roading and three waters infrastructure. The Commission proposes extending the New Zealand Transport Agency (NZTA) co-funding model to support resilience of roading infrastructure to climate impacts, and creating a similar agency (and fund) for three-waters infrastructure. The success of such a model will depend on the NZTA recovering its former status in the eyes of local authorities, and reversing the decline in performance that councils have observed over recent years.

Without central government leadership and support for climate adaptation, there is a real risk that adaptation will happen in an ad hoc and inequitable way, or focus only on the short term.

Funding tools for growth-supporting infrastructure

Some councils are still struggling to supply enough infrastructure to meet the demands of a growing population. This has led to serious social and economic problems such as lack of housing affordability, homelessness and urban transport woes. While councils can make better use of the funding tools already available to them and charge the costs of growth infrastructure on those who benefit from it, a perception still exists among many councils and their ratepayers, that growth doesn't pay for itself.

This perception risks an undersupply of infrastructure and development capacity and a continuation of rising land and house prices. While Auckland house prices appear to have stabilised, this is at very high levels and is likely to be a temporary respite only. Treasury and Westpac both predict house price inflation to resume.

The Commission therefore puts a high priority on enabling and incentivising councils to fund infrastructure to get ahead of growth pressures. It is pleasing to see the Government's Urban Growth Agenda aiming to fix blockages on several fronts including making planning rules more flexible and less restrictive, pursuing congestion pricing and enhancing infrastructure funding and financing.

The Commission supports the expansion of the Milldale Special Purpose Vehicle debt model as a means of financing growth infrastructure in fast-growth local authorities. The Commission also considers that a case may exist for a new funding stream for councils that is targeted at overcoming the perception problem that growth doesn't pay. A relatively modest payment from central government, based on new building work within territorial authority boundaries, could incentivise councils and their existing residents to embrace growth.

This new incentive, together with other measures in the Urban Growth Agenda, could substantially overcome the shortfalls of housing supply relative to demand that have plagued New Zealand's urban centres in recent years. If they can do so, the prize would be a healthy housing market and a boost in social and economic wellbeing, particularly for younger generations. Over the three years to June 2018, housing-market imbalances drove very different changes in the net worth of the old versus the young. Stats NZ's latest data show that the net worth of 55-64-year olds rose 31% to \$381 billion and that of 65-and-overs rose 45% to \$484 billion. In contrast, the net worth of 15-24-year olds fell 24% to \$5 billion.

Funding tools for tourism hotspots

The large and rapid growth in international visitors over recent years has increased pressure on the local mixed-use infrastructure and services that both visitors and residents rely on – such as roading, water and wastewater, parking, recreational, public toilet and rubbish facilities. Many councils in tourism hotspots are

finding it hard to fund, from rates, the maintenance and expansion of mixed-use infrastructure and services to cater for seasonal tourist peaks.

As with any other industry, tourism ought to cover its costs. Yet tourists do not currently fully pay for the costs of local infrastructure and services they consume. It is unsurprising that many councils and their ratepayers are increasingly vocal about not wanting to foot the whole bill. Auckland Council has attempted to work with current tools by introducing an Accommodation Provider Targeted Rate (APTR). Yet the APTR has faced legal challenge, and has proved difficult to enforce for online accommodation providers. Furthermore, the funds raised through the APTR go towards tourism promotion, rather than addressing the pressure tourism puts on the city's mixed-use infrastructure.

The Commission has recommended that, in addition to more direct user-charging, the best way to address the payment shortfall for mixed-use infrastructure is for central government to legislate to allow councils to implement local accommodation levies. The government is already considering a legislative change to allow Queenstown Lakes District Council to introduce such a levy following a local referendum. There is no reason why the option should be limited only to one district – the ability to introduce an accommodation levy would reduce cost pressure in tourism hot spots around the country.

The ability to introduce an accommodation levy will not solve the funding gap in all tourist destinations. In some hotspots like Matamata and Tekapo, for example, visitors generally stay for less than a day, and yet local mixed-use infrastructure is also under considerable pressure. Tourism funds from the new International Visitor Conservation and Tourism Levy coming into force later in 2019 should be targeted towards such communities, which are under pressure from tourism, but where an accommodation levy would not work.

Strong central and local government partnership

The passing of new functions and responsibilities from central to local government is not new. Yet some of the steady stream of new standards, regulations and requirements have been passed down to councils over the years without thinking through the resourcing requirements, or ensuring councils are able to recover costs. And some functions and responsibilities have a national benefit, yet come with no contribution of national funds.

This is largely the result of poor regulatory design, and has created pressure on many councils who are finding it increasingly difficult to manage. Where new regulation clearly has national benefits, there is a good case for a contribution from national funds. The Commission recommends that, when designing new regulation, central government should more fully consider the range of council circumstances, conduct thorough analysis of the impacts on local government, and engage local government in a meaningful way in the design, development and implementation process.

The Commission has, in the past, recommended the need for a better partnership relationship between central and local government – one that encourages meaningful engagement and dialogue, cooperative approaches to solving problems and developing regulation, and the sharing of knowledge and expertise.

Right now, central and local government too often treat each other with suspicion and mistrust. Central government has also tended to treat local government as an agent, rather than as a genuine partner. An improvement to the poor state of relations will be crucial to the success of other improvements to the local government funding and financing framework. The Commission recommends the adoption of a "Partners in Regulation" protocol to support this shift.

Reform of the three waters sector

The provision of safe drinking water and the safe treatment and disposal of wastewater and stormwater ("three waters") are core responsibilities of local government, and councils spend a high proportion of their funds on the three waters.

Following the contamination of drinking water in Havelock North in 2014, and as public concern about the state of freshwater quality has increased over recent years, reform of the three waters has been hotly debated. The government is currently considering extensive reforms to the regulatory regime, including

considering changes to the way the three waters are funded and delivered. Cabinet is expected to make decisions on potential reforms later this year.

Many councils are struggling with poor performance in the three waters sector. The need to reform the regulation, supply and funding arrangements of the three waters is urgent, and the current review offers an important opportunity to make significant changes to improve the sector's performance. The Commission has conducted a case study to identify proposals to improve outcomes, and ease funding pressure.

The Commission considers an approach should be adopted that effectively enforces minimum health and environmental standards, while also giving councils flexibility as to how they meet those standards. It will also be important for a credible regulator to administer the new regulatory regime, and that councils that fail to lift their performance sufficiently within a specified time period be required to adopt certain "backstop" arrangements, including merging water businesses and placing them in Council Controlled Organisations.

10.2 Changes to the way councils operate

As well as the priority recommendations described above, significant opportunities exist for many councils to make better use of current funding tools, improve their organisational performance and enhance their productivity.

The Commission has proposed several improvements to the way councils manage cost pressures, make decisions, and fund their services. Those recommendations include legislative changes to improve the quality and transparency of planning, decision making and rates. They also include recommended actions for the sector to strengthen decision-making and governance capability, and increase transparency around performance.

These recommendations will help improve councils' ability to make the best use of the available funding and financing tools, and manage cost pressures. Strengthening capability will also be vital to ensure councils can make effective use of new funding tools. However, it will take time to see the benefits of these changes, as building capability and changing the culture of planning and decision making will be an incremental process.

There is little or no evidence that rates have generally become less affordable over time. However, legislative changes are needed to make the current funding system more equitable and transparent, including changing rating powers to give more prominence to the benefit principle, phasing out the current rates rebate scheme (which is not equitable or effective), and introducing a national rates postponement scheme. These changes will take time to be implemented. In particular, the transition from the rates rebate scheme to a national rates postponement scheme will occur over several years.

10.3 Conclusion

This inquiry is focused on the funding and financing framework within which local government operates. The Terms of Reference for this inquiry asked the Commission to provide "an assessment and recommendations of current and alternative funding and financing options for local authorities to maintain and deliver services to their communities in the future".

This draft report has put forward the Commission's initial assessment of, and recommended improvements to, the local government funding and financing framework. Testing the ideas, conclusions and recommendations contained in this report with many and varied stakeholders is an important next step, and the Commission looks forward to receiving submissions.

Summary of questions

Chapter 3 – Trends in local government revenue, expenditure, prices and debt

Q3.1

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:

- carrying out more frequent reweighting;
- including output indices; and
- disaggregating by council type?

Chapter 4 – Pressures on funding and financing

Q4.1

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?

Chapter 5 – Improving decision making

Q5.1

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?

Q5.2

Is it appropriate for local authorities to include an adjustment for anticipated price inflation when they set rates each 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?

Q5.3

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?

Chapter 6 – Future funding and financing arrangements

Q6.1

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?

Q6.2

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?

Chapter 8 – Adapting to climate change

Q8.1

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?

Findings and recommendations

The full set of findings and recommendations from the report are below.

Chapter 3 – Trends in local government, expenditure, prices and debt

Findings

F3.1

Over long periods of time, and with some variation, increases in local government revenue and rates have roughly matched increases in national and household income.

F3.2

Local governments face higher price inflation than general consumers largely because of the specialised inputs councils use to construct and operate infrastructure. Councils have little direct influence on the prices of many of these inputs, but can adjust their demand and mix of inputs, in response to changes in prices.

F3.3

Modelling of price inflation in local government goods and services using an index that reflects yearly changes in the composition of expenditure produces a slightly lower measure of inflation than the Local Government Cost Index currently used by councils. This suggests that councils do adjust their mix of inputs in response to prices, to some extent.

F3.4

After adjusting for price inflation using the Commission's preferred price index, local government operating expenditure (opex) per capita (excluding depreciation and interest) grew at an average of 1.2% a year between 2007 and 2017. The opex per capita of regional and rural councils grew faster than that of metropolitan and provincial councils.

Chapter 4 – Pressures on funding and financing

Findings

F4.1

New Zealand's population has grown by about 30% in the last twenty years, but this growth has not been evenly distributed. Councils in high-growth areas are facing pressure from the costs of funding growth infrastructure, while some councils in small districts or districts with declining populations face pressure from high fixed costs distributed between a relatively small number of ratepayers. These challenges are likely to increase as New Zealand's population becomes increasingly concentrated in the future.

F4.2

All districts across New Zealand are ageing, and this is happening much more rapidly in some districts. An ageing population creates additional costs for councils as elderly residents require a different mix of accessible infrastructure and services.

F4.3

If some councils are not able to comply with all the responsibilities and functions being passed to them, then the objectives of central government legislation will ultimately not be achieved.

F4.4

When central government passes new responsibilities to local government, without providing adequate funding, this creates cost pressure for councils. Unfunded mandates fall broadly into four categories:

- new or stronger standards that councils must meet – without commensurate funding;
- new responsibilities, functions or processes that councils must undertake – without commensurate funding;
- reduction, cessation or removal of central government funding, or of government-funded programmes and services within the community; and
- restrictions on the ability of councils to set cost-recovery fees for services or functions.

F4.5

Central government's passing of new responsibilities and functions on to local government is not new. However, this process has continued, and some councils are finding the cumulative impact increasingly difficult to manage.

F4.6

Central government is sometimes passing new responsibilities to local government without adequate analysis, including consideration of the range of council circumstances. This can result in regulation that is "one size fits all", making it unfit for purpose, or particularly costly to implement, in some localities.

F4.7

To date there has been no comprehensive and independent in-depth analysis of costs associated with implementing Treaty settlement arrangements – either to councils or iwi. Such analysis would be valuable to clearly identify the additional resources councils must deploy to carry out this role.

F4.8

Co-governance and co-management arrangements established through Treaty settlement agreements between the Crown and Māori can impose considerable costs on local authorities. So far, central government support has been ad hoc, and fallen short of covering the initial and ongoing costs to councils.

F4.9

Some councils are struggling to meet the costs of implementing Treaty settlement arrangements. The durability and effectiveness of some Treaty settlement arrangements may be at risk if funding issues remain unresolved.

F4.10

Evidence reveals no major shifts over the last several decades in the range of services that local government generally provides. The Local Government Act 2002 defines the purpose of local government as "to enable democratic local decision-making and action by, and on behalf of, communities". The nature, quality and extent of services provided by councils is reliant on the quality of their democratic decision-making.

F4.11

Community expectations for levels of service from local (and central) government are rising over time in response to factors such as:

- changing perceptions of risk from climate change;
- drinking water quality and impacts of discharges into waterways;
- changes in the age mix of local populations; and
- rising incomes (which make it easier for people to meet the cost of better quality and additional services).

F4.12

Tourists use the same local infrastructure as residents. The seasonal nature of tourism in New Zealand creates the need for this local mixed-use infrastructure to be able to accommodate peak visitor numbers, even if that peak only lasts for a few weeks or months. Some communities have a high visitor-to-resident ratio during peak tourist season, which can create significant pressure.

F4.13

Local authorities have access to a range of tools to address pressure from tourism. Councils appear to under-use some of these tools, including user charges and targeted rates. Yet, even with more effective use of existing tools, a funding gap remains because tourists do not fully pay for the costs of the local mixed-use infrastructure and services they use.

F4.14

Rates of afforestation will increase as New Zealand transitions to a low-emissions economy. This increase in forested land will result in considerable new pressure on many local roads, particularly at harvest time. This will, in turn, lead to a need for more frequent maintenance and replacement of roads, resulting in increased costs. The cost pressure this creates for some councils may indicate a need to re-examine how funds from Road User Charges are distributed.

Chapter 5 – Improving decision making

Findings

F5.1

The elected member governance model does not consistently deliver a mix of councillors that collectively possesses the full range of skills required for effective governance, and evidence shows that many councils lack the necessary expertise for effective decision making. A lack of skilled councillors can be ameliorated by having a well-qualified and suitably experienced Chief Executive.

F5.2

A wide range of training, resources and supports are available for elected members. However, the uptake of these is patchy. Reported barriers include reluctance to travel, public scrutiny of travel and training expenses, dissatisfaction with training provided, and lack of personal awareness of the need for capability development.

F5.3

The accountability of local government to local communities is highly reliant on the transparency of its processes, decision making, and performance.

F5.4

The current performance reporting requirements on local authorities, including the financial and non-financial information disclosures, are excessively detailed, inappropriately focused and not fit-for-purpose.

F5.5

Successive legislative reforms aimed at increasing the transparency of council performance through prescriptive reporting requirements have been counterproductive. The local government performance reporting framework requires fundamental review, with a mind to significantly simplifying the required disclosures, and improving their overall coherence and fitness-for-purpose.

F5.6

While the purpose and content of Long-Term Plan consultation documents are prescribed in legislation, the form and manner of engagement are not. Councils are free to undertake early engagement to ask open-ended questions, and use a wide range of techniques tailored to their local communities. Some are doing this effectively.

F5.7

There is scope for greater transparency across councils, in how they have considered and balanced the range of community views in their decision making.

F5.8

Long-Term Plans (LTPs) are long, complex and contain duplication. This is partly a function of the legislative requirements, which are disjointed and require an unnecessary level of detail. This works against the strategic intent of LTPs.

F5.9

The benefits associated with auditing Long-Term Plans and their consultation documents currently exceed the costs. These benefits include assurance and transparency for the general public, as well as recommendations and advice for councils about good practice.

F5.10

A clear strategic framework is an important mechanism for guiding councils' prioritisation and resource-allocation decisions. While the current legislative requirements impose parameters around the content of Long-Term Plans (LTPs), they do not preclude the preparation of a strategic framework, and alignment of the LTPs and other accountability and planning documents within this. A number of councils have done this successfully; others lack a coherent framework to guide their strategic planning.

F5.11

Undertaking long-term planning within a spatial planning approach promotes a more coordinated and integrated approach to strategic planning as well as investment decision making.

F5.12

The effectiveness of the decision-making procedures by local government depends on the public understanding, and taking part in, local democratic processes – both of which are notoriously deficient. This weakens the incentives that those processes provide for local governments to be accountable for the quality of their decisions.

Recommendations

R5.1

The Department of Internal Affairs, Local Government New Zealand (LGNZ) and the New Zealand Society of Local Government Managers should work together to improve basic governance, including financial governance, skills and knowledge across elected members. In undertaking this work, they should consider:

- a range of mechanisms, such as formal training; peer support, mentoring (eg, via “sister council” links), and networking; and sharing of resources and best practice; and
- a variety of delivery platforms, including online media and collaboration tools.

LGNZ should ensure that resources and initiatives are well evaluated.

R5.2

Local Government New Zealand should work to achieve greater participation in ongoing professional development by elected members, including new and existing members, to ensure skills and knowledge are built and periodically refreshed.

R5.3

The Local Government Act 2002 should be amended to require all local authorities to have an Audit and Risk Committee (or equivalent assurance committee).

- Audit and Risk Committees should have an independent Chair, and ideally include at least one other external expert, to ensure they span the full range of necessary skills and experience.
- Independent members should be appropriately skilled and qualified.
- Councils should draw on the good practice guidance and resources that are available to develop and run their committees.

R5.4

The local government reporting framework (including the financial disclosures, Funding Impact Statement and performance measures for service delivery) should be subject to a fundamental, first principles review. This review would:

- identify financial disclosures of low value to users of financial statements;
- examine the mix of financial and non-financial disclosures, and recommend a revised framework that provides the most efficient, coherent and accessible way of reporting the range of information sought by both types of users;
- consider the potential for new forms of external reporting, including integrated reporting, to shape changes in the reporting framework; and
- be undertaken by a working group comprising the Department of Internal Affairs, the External Reporting Board and representatives of the local government sector and information users. The Office of the Auditor-General would be consulted.

R5.5

The Department of Internal Affairs, Local Government New Zealand and the New Zealand Society of Local Government Managers should continue to work together to promote and encourage councils’ participation in existing performance review and improvement initiatives, such as CouncilMARK™ and the Australasian Local Government Performance Excellence Program. The emphasis should be on learning for continuous improvement, rather than a one-off exercise. This work should include efforts to boost public awareness of initiatives such as CouncilMARK™ to increase demand for their use.

R5.6

The legislated information requirements for the consultation processes of local authorities should be amended to:

- make the terminology around the required analysis of alternative options consistent across relevant sections of the Local Government Act 2002;
- clarify that Long-Term Plan (LTP) consultation documents must describe the reasonably practicable alternative options for addressing each identified issue; and
- explicitly require that LTP consultation documents include high-level information on the implications for rates and future service levels associated with each of the identified options.

R5.7

The Local Government Act 2002 should be revised to clarify and streamline the required content of Long-Term Plans so as to reduce duplication, ease the compliance costs on councils, and help make them more accessible documents.

R5.8

The scrutiny on long-term planning provided by the audit requirements should not be considered a substitute for internal quality assurance processes. Councils should have robust quality assurance procedures across their Long-Term Plan process, including the use of expert review where appropriate (such as for significant decisions).

Chapter 6 – Future funding and financing arrangements

Findings

F6.1

The roles and funding tools of local government do not impinge on the prime responsibilities of central government to stabilise the macro economy and redistribute income and the cost of services from those well-off to those in need. The responsibilities for making choices about public goods and infrastructure are mostly coherent across the two levels of government.

Some areas of difficulty and tension between central and local government have emerged. These tend to be where the benefits or costs of local government infrastructure and services cross local-authority boundaries, yet current funding arrangements do not consider this.

F6.2

The rating tools of New Zealand local governments have low compliance and administration costs. The complexity of development contributions (DCs) causes them to have higher administration and compliance costs.

Rates based on (unimproved) land values cause little or no economic distortion and therefore are a highly efficient way to raise revenue.

Rates on capital value are relatively less efficient because they can disincentivise land and building development. Rates on the capital value of businesses can, in addition, cause unnecessary productive inefficiency.

Even so, when rates, user charges, DCs and connection charges reflect benefits received and the marginal cost to the council of providing services, these are efficient ways to raise revenue.

F6.3

The fiscal adequacy of the local government funding system is under strain in the areas of tourism, adaptation to climate change, growth infrastructure and unfunded mandates from central government. Pressures in these areas are mostly uneven across councils, and in the first two areas are set to continue rising.

Since the early 1990s, rates revenue per person, council expenditure per person and income per person have grown at similar rates. While this suggests that the current funding system has proved adequate and sustainable in the past, the new and growing pressures may require new funding tools for the future.

F6.4

The current main funding tools of local government in New Zealand measure up well against the principles of appropriateness for local government use, coherence within national policies and institutions, efficiency, enforceability, and the stability and predictability of revenue. Yet scope exists for many councils to make better use of their funding tools and this would help relieve funding pressures.

F6.5

Development contribution (DC) policy and implementation are inherently complex. Good examples exist of council DC policies. Councils appear to have been refining and improving them over time. Yet the DC policies of some councils still fall considerably short of best practice. The good policies provide a transparent and reliable platform for setting DC charges in line with the purpose and principles of DCs in the Local Government Act 2002.

F6.6

Councils have a portfolio of charging and rating tools to recover the costs of their growth-related infrastructure investments. Yet cost recovery may take many years, councils face investment risks (eg, over-investment or investing in the wrong location) and some councils face debt limits. Councils also face political pressure to not support growth. The result is that some councils in fast-growing cities are either not willing, or not able to, invest in growth-related infrastructure at levels that match demand.

F6.7

Giving councils powers to levy a value-capture rate, congestion charges and volumetric wastewater charges would give them additional means to recover the costs of growth without burdening existing residents. Yet some councils and their residents may still not be willing to accommodate growth to the extent needed for supply to match demand.

F6.8

Many councils and ratepayers still perceive that council revenue from local growth does not fully cover costs that councils incur from growth and that therefore growth is financially disadvantageous. This perception is exacerbated by the:

- highly visible way that property owners are billed for and pay rates;
- much less visible way that most people pay income tax and GST; and
- the automatic link between economic activity and revenue from income tax and GST which does not exist for rates.

F6.9

While local property taxes are in widespread use in other parts of the world such as the United States, they are not a panacea for aligning the incentives of existing voters and property owners with socially desirable growth rates in dwellings. Given that property prices in New Zealand have been neither stable nor predictable, property tax revenues would not be either, and this would be undesirable. The highly transparent system of rating in New Zealand provides a fiscal discipline on councils and should be retained.

F6.10

None of the options of a local property tax, a local income or sales tax, or a portion of national GST or income tax is a fully satisfactory solution to the problem of councils and existing property owners and voters failing to embrace growth, because no direct and transparent link exists between growth and council revenue.

Each option does not meet at least one important criterion for a good local tax. The revenue from local property tax would be neither stable nor predictable, local income and sales taxes would be complex and likely to have high administrative and compliance costs, and a portion of national GST or income tax would be likely to undermine local autonomy and accountability.

F6.11

A system of payments from central government to councils based on new building work in territorial local authorities could offer local government a practical additional funding source. The system would substantially preserve local autonomy and provide a direct link between council revenue and a council's effectiveness in keeping land supply and infrastructure responsive to demand. This could be effective in incentivising councils and their existing ratepayers to support growth.

F6.12

While councils vary widely in their use of debt, they should use it to spread the cost of long-lived infrastructure assets fairly over the people and properties that benefit from these assets. Most councils have adequate capacity on their balance sheets to finance their infrastructure development. A few high-growth councils face debt-limit barriers that have the potential to cause serious social harm by preventing council infrastructure investment keeping pace with demand for new development.

F6.13

Special Purpose Vehicles (SPVs) can be an effective way to reduce the barrier caused by council debt limits where these limits constrain a council's ability to invest in infrastructure to serve new greenfield developments. The SPVs raise finance for infrastructure investment in a way that puts debt on the balance sheets of new property owners who benefit from the infrastructure, rather than on the balance sheet of their council or the Crown.

F6.14

The Government and officials are working on ways to expand the use of Special Purpose Vehicles (SPVs) to finance large brownfield infrastructure investments that will benefit both new and existing residents. While more challenging to design, and requiring legislation, these expanded SPVs promise to deliver a further valuable means to reduce the barrier of debt limits for fast-growth councils.

F6.15

The factors driving population decline in rural districts and small centres are often difficult to counter and may result in funding shortfalls that affect a council's ability to supply basic infrastructure services.

F6.16

Tourists pay for many of the costs they create, either directly through a user-pays system, or indirectly by paying for services they buy from businesses. Yet, because tourists do not pay any equivalent of residential rates, tourists do not fully pay for the costs of local infrastructure and services that they consume directly. The payment shortfall is exacerbated by the strong seasonality of tourism that creates the need for infrastructure that can cater for peak loads.

F6.17

Greater user pays and accommodation levies are the two best options for recovering from tourists their share of the cost of facilities provided by local government for which it cannot otherwise charge. These are the only options that target the right group, are practical, do not involve an industry subsidy, promote economic efficiency, are consistent with local autonomy, and have reasonably modest compliance and administration costs.

Recommendations

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.

R6.2

While local authorities' general approach to depreciating their infrastructure assets is satisfactory, three issues are of concern and may require action:

- councils' decisions about the best use of the large amounts of cash that depreciation funding can give rise to should be part of formulating their wider financial and infrastructure strategies;
- councils should prioritise improving their knowledge of the condition and performance of their assets to, among other benefits, avoid the risk of underestimating asset lives and overestimating depreciation expense; and
- the Essential Services Benchmark should be reviewed as part of the wider review of the local-government performance reporting framework referred to in Recommendation 5.4. Any reframing should avoid the implication that individual councils must invest in as much asset renewal each year as their depreciation expense.

R6.3

In choosing among funding tools, rating bases and whether to charge rates as a percentage of property values or as uniform charges or some other targeted feature, councils should emphasise the benefit principle and efficiency in the first instance. They should also balance greater economic efficiency against lower compliance and administration costs.

Councils should factor in any significant concerns about ability to pay at a second stage in their decision making.

R6.4

The Government should consider implementing a system of payments to territorial authorities, based on new building work put in place in each territorial local authority, to incentivise councils to increase the supply of infrastructure-serviced land to match growth in demand.

R6.5

The Government should direct officials to continue work on how to expand the use of Special Purpose Vehicles to finance investment in growth infrastructure in fast-growth local authorities that face debt limits. If needed, the Government should promote legislation in Parliament to enable the placement of debt-servicing obligations on existing residents who will benefit from the infrastructure.

R6.6

In its review to improve the service delivery of the three waters, the Government should favour models capable of applying efficient scale and specialisation to help small communities meet the challenges of maintaining and upgrading their water, wastewater and stormwater infrastructures.

R6.7

The Government should legislate to enable councils in tourist centres to choose to implement accommodation levies to recover the tourism-induced costs of providing local mixed-use facilities not otherwise charged for.

Councils in tourist centres should make greater use where possible of user pays for mixed-use facilities.

R6.8

The Government should provide funding from the international visitor levy for councils responsible for small tourist hotspots which cannot reasonably recover all their operating costs of providing mixed-use facilities from tourists through user pays or accommodation levies.

R6.9

The benefit principle and maintaining the integrity of local government autonomy, responsibility and accountability should guide central government funding of local government activities. This implies that central government should generally limit its funding to where there are national benefits. Central government should not expect local government to act simply as its regulatory agent. Rather, the two levels of government should seek a regulatory partnership based on mutual respect and an agreed protocol.

R6.10

Central and local government should strive to achieve a more constructive relationship and effective interface through:

- central and local government providing input (formally or informally) into each other's relevant policymaking processes, under an agreed set of principles or a protocol;
- central government engaging in a meaningful dialogue with local government early in the process of developing relevant new regulations;
- cooperative approaches to tackling problems with implementing relevant new legislation, regulations or environmental standards;
- the creation of formal and informal feedback loops to identify problems with delegated regulations when they first appear; and
- the spread of information through the system and the sharing of expertise and knowledge.

Chapter 7 – Equity and affordability

Findings

F7.1

Councils often make rating decisions in a non-transparent manner that follows a confused consideration of benefits, affordability and local politics.

F7.2

Local government legislation currently provides only weak support for allocating rates primarily according to who benefits from council services.

F7.3

Differentials and the uniform annual general charge are not transparent in allocating the burden of rates to those who benefit from council services. Targeted rates provide a more direct connection between the funding and the beneficiaries of services; and therefore are a much more transparent way of giving effect to the benefit principle.

F7.4

The statutory 30% cap on uniform charges (covering Uniform Annual General Charges and uniform targeted rates applying across the district, but excluding uniform water and wastewater rates) has no clear rationale and unnecessarily restricts the discretion of councils to use rates to reflect the benefit of services and amenities. Currently, few councils are close to the cap.

F7.5

There is little or no evidence that rates generally have become less affordable over time. Much concern focuses on affordability for low-income (particularly elderly) households who own their own homes. Yet such households generally have much lower housing costs than other low-income New Zealand households.

F7.6

Recipients of New Zealand Super are the main beneficiaries of the Rates Rebate Scheme. Most recipients are not eligible for the Government's Accommodation Supplement because their accommodation costs are below the threshold to qualify, unless they have a mortgage or substantial essential repairs.

F7.7

The Rates Rebate Scheme (RRS) is administratively inefficient and satisfies neither the horizontal equity principle nor the vertical equity principle. The level of assistance currently offered by the RRS is just over \$12 a week at most. Low-income homeowners can, as an alternative, access equity in their properties to help meet living costs including rates.

F7.8

The Accommodation Supplement is a well-tested major government programme that, compared to the Rates Rebate Scheme, efficiently and equitably provides support to eligible low-income households to meet housing costs, in a range of circumstances across New Zealand.

Recommendations

R7.1

The Local Government (Rating) Act 2002 should be amended to remove rates differentials and uniform annual general charges. Councils should have five years to implement their removal.

R7.2

Local government legislation should be amended to require councils to:

- match the burden of rates to the benefits of council services, as a first step in setting rates;
- consider ability to pay as a second step;
- set out the reasons for their rating decisions in each step in a clear and transparent manner; and
- (in applying the ability-to-pay principle) consider coherence and consistency with the income-redistribution policies of central government.

Councils should continue to have the power to determine, on reasonable grounds, the appropriate allocation of rates within their district or region.

R7.3

Local Government New Zealand and the New Zealand Society of Local Government Managers should develop advice for councils on how to apply the benefit principle (the burden of rates should reflect the benefits received) in their rating decisions.

R7.4

The Local Government (Rating) Act 2002 should be amended to remove the statutory cap on uniform charges.

R7.5

The Government should work with local government and suitable financial providers to develop and implement a national rates postponement scheme. The scheme should:

- have a single set of clear and generous eligibility rules;
- be accessible and have provisions that are easy to understand and work with;
- have moderate and transparent fees; and
- be nationally promoted.

R7.6

The Government should phase out the Rates Rebate Scheme (RRS) over a defined period, such as five years, from when an effective national Rates Postponement Scheme is in place. In the meantime, the current income abatement thresholds and maximum payments should be maintained.

Chapter 8 – Adapting to climate change

Findings

F8.1

Considerable guidance for councils on climate-change adaptation already exists. But more is needed, and providing it through central, specialised sources of knowledge will be more cost-effective than each council inventing its own solution. Most councils will welcome guidance and find it helpful not only as advice but as backing for taking the difficult and unpopular decisions that will sometimes be necessary.

F8.2

New Zealand's laws and institutions acknowledge the risks from climate change and require local governments to plan for the approaching and rising hazards it will cause. Yet much thinking and practice is still dominated by assumptions that risk profiles are static, like earthquake risk.

A systematic shift to a dynamic risk paradigm is needed to deal with the increasing and cumulative nature of climate-change risk. Such a shift will support decisions that:

- lean against the tendency to continue along current courses (with hard forms of protection for new and existing land use);
- encourage the use of anticipatory and flexible decision tools; and
- reduce risks and costs over the long term.

F8.3

Formulating a set of principles about funding the costs of adaptation to climate change is a helpful place to start. Persuasive, high-level principles include:

- decisions about whether, when and how to defend/protect, adapt, or retreat in the face of hazards related to climate change should aim to minimise long-run costs;
- the way costs of adaptation are shared should be fair and just across communities and generations; and
- active engagement with, and empowerment of, affected communities in developing adaptation pathways is vital.

The first two principles imply placing a high priority on avoiding behaviour that leads to increased risk exposure for private gain at others' expense ("moral-hazard" behaviour).

F8.4

Properties at growing risk from sea-level rise, river-plain flooding or other types of climate-change hazard will become increasingly uninsurable. This is because the nature of climate-change risk lacks two essential characteristics for insurability:

- it is not possible to calculate the chance of loss either mathematically or through experience due to the novel, uncertain and dynamic character of climate-change risk; and
- losses are not unforeseen – climate damage is foreseeable (even though its precise form, magnitude and location are uncertain).

F8.5

New Zealand has a strong tradition of social insurance in which society at large helps those in need who suffer hardship or loss through no fault of their own and where these losses may be uninsurable. This tradition provides a possible basis for some form and amount of central-government assistance to councils seriously threatened by losses due to climate change. Any such assistance will need careful design to incentivise risk reduction and avoid moral hazard.

F8.6

The New Zealand Transport Agency model of co-funding local roads could be extended to provide central-government assistance to relocate local roads and bridges that will be non-viable because of climate-change-induced sea-level rise, flooding and/or storms. This approach has potential benefits to:

- incentivise councils to anticipate climate risks to local roads, and encourage community engagement and buy in;
- prioritise spending in line with net social, economic and environmental benefits while taking account of equity across regions;
- counter optimism bias by requiring that the discipline of a strong business case and engineering and environmental quality standards are met; and
- make specialist knowledge and skills available to councils and help spread best practice and successful innovations around the country.

F8.7

The past approach of containing many New Zealand rivers within relatively narrow stopbanks for flood protection and to maximise the area of productive land for agriculture and other uses will become less viable as climate change increases the risk of more frequent and more intense rainstorms.

Best practice is now to allow wider river corridors that give rivers room and make space to more safely manage flood risk. But making this change faces barriers of existing property rights, expectations of continued protection, and high costs.

F8.8

Credible arguments exist both for leaving private owners to use current arrangements to find ways to adapt to climate change, and for public funding to support private owners to undertake cost-effective risk reduction up to and including managed retreat.

The decision whether to provide additional dedicated funding is for central government to make. Yet the existence or not of a scheme will impact local authorities' responsibilities for leading and implementing managed retreat or other forms of adaptation.

Recommendations

R8.1

The Government and local government should work together to establish centres of knowledge and guidance about climate-change adaptation for councils. One centre should be an authoritative and up-to-date source of advice on science and data while another should be a source of specialist advice on policy, planning, risk management, legal issues and community engagement.

R8.2

The Government should implement a review of existing legislation and policy to ensure that considerations about climate-change adaptation are integrated and aligned within that legislation and policy where relevant.

R8.3

National and local authorities should adopt anticipatory and flexible approaches to climate-change adaptation, in line with recognising the constantly changing nature of the risks. Any additional funding for climate-change adaptation should be conditional on the use of such approaches.

R8.4

The Government should provide legal frameworks that give councils more backing and knowledge to make land-use planning and infrastructure investment decisions that are appropriate in the face of constantly changing climate risks.

R8.5

The Government should extend the New Zealand Transport Agency's role in co-funding local roads to include assistance to councils facing significant threats to the viability of local land-transport infrastructure from sea-level rise and more intense storms and flooding due to climate change. The amount of assistance should reflect the size of the threat facing each council and its rating capacity.

Assistance should be conditional on a strong business case and meeting engineering and environmental quality standards. It should only be available to defend existing infrastructure when business cases indicate that this option is superior to other options by a significant margin.

R8.6

The Government should create a new agency and a Local Government Resilience Fund. The new agency should work with at-risk councils and co-fund the redesign and possible relocation and rebuilding of wastewater and stormwater infrastructure when it becomes no longer viable because of sea-level rise and more intense flooding due to climate change.

The new agency should also assist regional councils and communities to work out the best way to lessen future flood risks from rivers. This could include moving to a new, more sustainable and best-practice paradigm of giving rivers room and developing multiple innovative uses of the wider river corridors.

Chapter 9 – Case study: Three waters

Findings

F9.1

Considerable evidence is available that shows poor performance of the three waters sector in many parts of New Zealand, in terms of their impact on human health, the natural environment, productivity and costs to consumers and ratepayers. However, some councils and providers are taking the tough decisions needed to improve their performance, including Auckland's Watercare, Tauranga City Council, Kāpiti Coast District Council and the five councils involved in Wellington Water.

F9.2

The inherent economic features of three waters makes it a natural monopoly in many cases, and poor-quality water treatment can impose large negative externalities on communities. These natural monopoly and externality features are not the reason for the poor performance of councils. Even so, they do make it very important that councils have effective decision-making, governance, accountability, funding and delivery arrangements in place.

F9.3

The poor performance of the three waters sector in New Zealand can be attributed to the following factors in some cases.

- Inadequate supplier expertise and capabilities, resulting from some local councils prioritising local control of their three waters activities rather than increasing their operational scale through shared services, joint ventures or mergers.
- Poor governance capabilities and incentives, due to lack of independent directors and insufficient use of company-type structures when they are likely to be beneficial.
- Poor financing, funding and pricing arrangements, due to under-recovery of costs and funding from council rates rather than water service charges and development fees.
- Weak safety, environmental and economic regulation, due to poorly designed regulations, weak enforcement and lack of regulatory expertise.

F9.4

The performance of the three waters sector would substantially improve by using an approach that (1) rigorously enforces minimum performance standards; and (2) is permissive about how councils meet these minimum performance levels. This approach would have the following features.

- The new regulatory regime is administered by an existing, credible and independent regulator such as the Commerce Commission, which already regulates similar activities, has a credible “industry watchdog” reputation and has significant experience applying light-handed regulation to some suppliers and stronger forms of control to other suppliers.
- The performance regime would be permissive and flexible, leaving it to councils to decide how to achieve the regulatory standards. However, a backstop arrangement would need to be put in place for those councils that fail to lift performance sufficiently to meet minimum health, environmental and economic-performance standards.
- While significant cost efficiencies should be possible for most council-led water services, some communities will require financial assistance from government to help them make the transition to achieving minimum performance standards for drinking, wastewater and stormwater services.

Appendix A Public consultation

Submissions

Individual or organisation	Submission number
Anthony Wilson	114
AREINZ	132
Ashburton District Council	092
Auckland Airport	065
Auckland Council	120
Bay of Plenty Regional Council	095
Bookabach	099
BusinessNZ	054
Carterton District Council	016
Catherine Stewart	129
CCRU – Christchurch Coastal Residents United	083
ChargeNet NZ	060
Chris Hook	002
D Hewison	022
Donald Ellis	089
Dr Anthony Brien	134
Dr Kenneth Palmer	010
Dunedin City Council	017
Economic Development New Zealand	118
Engineering Leadership Forum	045
Engineering New Zealand	098
Environment Canterbury	111
Environment Southland Regional Council	116
EROAD	036
Federated Farmers of New Zealand	075
Foodstuffs	023
Foxton Beach Progressive Association Incorporated	041
Graeme McInnes	001
Greater Regional Wellington Council	068
Grey Power New Zealand Federation Incorporated	113
Guardians of New Zealand Superannuation	122
Hamilton City Council	130
Hauraki District Council	043
Horizons Regional Council	082
Horowhenua Grey Power Association Incorporated	021
Hospitality New Zealand	078
Hospitality New Zealand Auckland Branch	029
Hospitality New Zealand Bay of Plenty, Gisborne and Thames Branches	081
Hospitality New Zealand Buller and Westland Branches	063
Hospitality New Zealand Canterbury Branch	033
Hospitality New Zealand Central Otago Branch	136
Hospitality New Zealand Hawke's Bay Branch	076
Hospitality New Zealand Manawatu Branch	059

Hospitality New Zealand Nelson and Marlborough Branches	062
Hospitality New Zealand Northland Branch	044
Hospitality New Zealand Otago Branch	071
Hospitality New Zealand South Canterbury Branch	103
Hospitality New Zealand Southland Branch	051
Hospitality New Zealand Taranaki Branch	056
Hospitality New Zealand Waikato Branch	030
Hospitality New Zealand Wellington Branch	055
Hurunui District Council	110
Hutt City Council	074
Infrastructure New Zealand	128
Insurance Council of New Zealand	069
J M Bragger	013
Jim Moore	080
John Robertson	020
Jon Turner	014 & 015
Justin Johnstone	011
Kaikōura District Council	101
Kāpiti Coast District Council	131
Kāpiti Coast Grey Power Assn Incorporated	012
Kathleen McCaughtrie	005
Kawerau District Council	097
Kelvin Coe	135
Lindsay McGowan	008
Local Government Business Forum	052
Local Government New Zealand	112
Local Government Think Tank	105
Lynda Murchison	133
Mackenzie District Council	027
Manawatu District Council	057
Mercury NZ Limited	050
Meridian Energy	073
Millennium & Copthorne Hotels New Zealand Limited	026
Ministry of Business, Innovation and Employment, Tourism Branch	028
Museums Aotearoa	102
Nelson City Council	107
Nelson Marlborough District Health Board	031
Neville Miller	003
New Zealand Airports Association	077
New Zealand Society of Local Government Managers (SOLGM)	024
Northland Regional Council	032
Office of the Auditor-General	070
Ōpōtiki District Council	126
Palmerston North City Council	124
Paul E Perry	090
Paul Elwell-Sutton	048
Pearler Bay Farm	009
Porirua City Council	079
Porirua Economic Development Group	035

Powerco Limited	091
Property Council New Zealand	117
PSA – The New Zealand Public Service Association	086
Queenstown Lakes District Bed Tax Lobby Group	039
Queenstown Lakes District Council	067
Rangitikei District Council	115
RATA – Waikato Regional Asset Technical Accord	037
Regional Tourism New Zealand	058
Rhonda Mitchell	038
Ruapehu District Council	085
Scripture Union NZ	004
Selwyn District Council	084
Social Credit	109
Society of Local Government Managers (SOLGM)	024
South Taranaki District Council	087
South Waikato District Council	100
South Wairarapa District Council	104
Southland District Council	106
Stewart and Raewyn Webster	007
T M Bevan	006
Tararua District Council	018
Tauranga City Council	119
Te Rūnanga o Ngāi Tahu	053
The Employers and Manufacturers Association (EMA)	194
The New Zealand Automobile Association Incorporated	23
The New Zealand Initiative	196
Tim and Jan Sintes	108
Timaru District Council	025
Tourism Industry Aotearoa	049
Upper Hutt City Council	040
Upper North Island Strategic Alliance (UNISA)	127
Waikato District Council	066
Waikato Regional Council	125
Waimate District Council	047
Waipa District Council	088
Wairarapa Voice Incorporated	042
Water New Zealand	019
Wellington Chamber of Commerce and Business Central	072
Wellington City Council	061
Western Bay of Plenty District Council	034
Whakatāne District Council	121
Whanganui District Council	093
Whangarei District Council	046
Youth Hostels Association of New Zealand	064

Engagement meetings

Accident Compensation Corporation
 Anthony Wilson
 BECA
 Better for Business
 Bruce Robertson
 Buller District Council
 BusinessNZ
 CouncilMARK™ Independent Assessment Board
 David Shand
 Department of Internal Affairs
 Engineering Leadership Forum
 Federated Farmers Golden Bay
 Federated Farmers Marlborough
 Federated Farmers North Canterbury
 Federated Farmers of New Zealand
 Federated Farmers Waikato
 Fulton Hogan
 Hawke's Bay Regional Council
 Hospitality New Zealand
 Ilan Noy
 Infrastructure New Zealand
 Jonathan Boston
 Judy Lawrence
 Local Government Business Forum
 Local Government Funding Agency
 Local Government New Zealand
 Local Government New Zealand Metro Meeting
 Local Government New Zealand Policy Advisory and Governance and Strategy Advisory Groups
 Local Government New Zealand Regional Sector Meeting
 Local Government New Zealand Rural and Provincial Meeting
 Ministry of Business, Innovation and Employment, Tourism Branch
 Ministry of Transport
 Morrison Low
 New Zealand Automobile Association
 New Zealand Society of Local Government Managers (SOLGM)
 New Zealand Superannuation Fund
 NZ Airports Association
 Office of the Auditor-General
 Parliamentary Commissioner for the Environment
 Peter McKinlay
 Porirua Economic Development Group
 Property Council New Zealand
 PSA – The New Zealand Public Service Association
 Queenstown Lakes District Council
 Tainui Group Holdings and Raupatu River Trust
 Te Maruata
 The New Zealand Automobile Association Incorporated

The New Zealand Initiative
 The Treasury
 Tourism Industry Aotearoa
 Waimate District Council
 Wairarapa Voice
 Watercare Services Limited
 Water New Zealand
 Wellington City Council
 Wellington Water
 Whakatane District Council
 Whangarei District Council

Council cluster meetings

Auckland City Council including:

- Auckland Transport
- Independent Māori Statutory Board
- Manurewa Local Board
- Waitematā Local Board

Christchurch City Council including:

- Ashburton District Council
- Environment Canterbury
- Hurinui District Council
- Kaikōura District Council
- Selwyn District Council
- Timaru District Council
- Waimakariri District Council

Dunedin City Council including:

- Central Otago District Council
- Environment Southland
- Gore District Council
- Southland District Council

Hamilton City Council including:

- Hauraki District Council
- Rotorua District Council
- South Waikato District Council
- Taupō District Council
- Thames-Coromandel District Council
- Waikato District Council
- Waikato Regional Council
- Waipa District Council
- Western Bay of Plenty District Council

Palmerston North City Council including:

- Central Hawke's Bay District Council
- Horizons Regional Council
- Horowhenua District Council
- Manawatu District Council
- Napier City Council

- New Plymouth District Council
- Ruapehu District Council
- South Taranaki District Council
- Taranua District Council

Tasman District Council including:

- Nelson City Council

Porirua City Council including:

- Carterton District Council
- Greater Wellington Regional Council
- Kāpiti Coast District Council
- Lower Hutt City Council
- Masterton District Council
- South Wairarapa District Council
- Upper Hutt City Council

New Zealand Chamber of Commerce meetings

Canterbury Employers' Chamber of Commerce

Manawatu Chamber of Commerce

Otago Chamber of Commerce

Waikato Chamber of Commerce

Case studies

The Commission undertook four case studies, covering:

- A rural district council
- A provincial district council
- A metropolitan city council
- A regional council

Interviewees included people in the following roles:

- Mayor/Chair
- Deputy Mayor
- Elected members
- Chief Executive
- Chief Financial Officer
- Senior Divisional/Group Managers
- Team Managers/Team Leaders
- Senior staff
- Independent members of the Audit and Risk Committee (where applicable)

Conferences and forums attended

BusinessNZ – Corporate Affairs Forum

Inclusive Growth Summit

The Localism Symposium

Tonkin + Taylor food for thought breakfast: managing risk and fostering resilience

Smart Cities and Resilient Communities

SOLGM – Council Collaboration and Partnering Forum

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