

THE LOCAL GOVERNMENT RATES INQUIRY

**Submission prepared by a group comprised of local
authorities and stakeholder interests**

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SUBMISSION TO THE LOCAL GOVERNMENT RATING INQUIRY

INTRODUCTION

This submission is presented by a group comprising a number of local authorities and stakeholder organisations who have been working collaboratively with the objective of determining whether there is common ground on matters which could be put before the Inquiry. The names and contact details of the members of the group are set out in Appendix 1.

The submission is divided into the following sections:

Section 1: Issues with the existing system.

Section 2: Principles to be applied to a local government funding system.

Section 3: A possible suite of funding tools.

The group has followed a collaborative process, meeting together on a number of occasions to work through the matters which concern them, and to review successive drafts of the submission itself.

The result is a submission that, with the exception of one item (referenda and recall), is put forward with the collective support of all participants. The one qualification on this is that individual participants, who will be making their own submissions, may for particular reasons affecting the area or organisation, propose a different approach. Where this is done, that difference, and the reason for it, will be noted in the individual submission.

This submission is supported by a companion resource paper prepared by McKinlay Douglas Ltd (a copy of which accompanies this submission). The submitters drew extensively on the resource paper but it is the submission itself, not the resource paper, that should be seen as representing their views.

SECTION1: ISSUES

The section deals first with context and then with a series of issues with the current system including the nature of rates, aspects of administration, and several specific issues which are primarily matters of government practice and/or legislation.

Context

- 30 years of evolution of local authority rating powers have created a very flexible system but confusion over whether rates are primarily a tax or a user pays mechanism.

A problem for the Rating Inquiry, and those submitting to it, is that there is no agreed set of definitions of local authority activities, and the benefits which result from them, such as would allow clear, replicable and uncontroversial judgements about whether any particular activity should be funded by a user pays mechanism, a taxation mechanism, or some combination of the two.

The submitters recognise that communities, community preferences and the nature of services can all differ. Where they do, it is understandable that funding arrangements may also differ. Their concern is with the apparent inconsistency, across the local government sector, in funding arrangements where both services and community preferences are broadly similar.

- The increasing extent and intensity of local authority regulatory powers may have contributed to undermining public trust in councils.
- There is a widespread perception that the Local Government Act 2002 gave local authorities a new power of general competence which has led to an increase in expenditure. That is wrong. Equivalent powers existed under the previous Act. If anything is driving an increase in expenditure it is the new statutory responsibility to promote economic, social, environmental and cultural well-being.

The nature of rates

- Rates provide anywhere from as little as 37% up to 93% - but an average of 56% - of New Zealand local authority operating revenue. Dependence on a single tax whose impacts cannot be avoided or mitigated itself creates a major problem of public acceptability. In turn this creates a major problem of affordability, especially for people in the bottom decile or quartile of income distribution¹, as well as for people on fixed incomes and for land intensive uses such as farming.

Rates as a tax or a payment for services

- Increasingly rates are regarded as a wealth tax on a particular asset class, a perception driven by the impact of rapid increases in property values. As a wealth tax it is both inefficient (covering only part of assets, and not accounting for liabilities) and regressive.
- Public confidence in the rating system has been undermined by the apparent conflict between the increased emphasis on rates as a payment for services, and the experience of rates as a wealth tax.

Valuation

- The legitimacy of the 'wealth tax' component of the rating system depends on the accuracy, reliability and consistency of the valuations which underpin it.
- There is clear evidence of a level of variability unacceptable for a process whose end result is what amounts to a tax demand.
- Aggravating factors include the "property boom" of recent years and the consequences of introducing contestability to the triennial revaluation process.

Value for money

- A common criticism of local government is that it is both a monopoly and inefficient. All submitters believe that local government should be as efficient as it reasonably can and able to demonstrate that efficiency.

¹ The submitters regard basing judgements of affordability on median incomes as potentially misleading.

- There are problems with performance measurement and benchmarking because of the major differences between local authorities, including physical conditions and the services provided. Despite this, all submitters agree that the problem of measuring and reporting efficiency needs to be addressed.

Consistency

- The strength of New Zealand's rating system is the flexibility it offers councils.
- The downside, from a ratepayer's perspective, is the apparent inconsistency in the way different councils choose to fund similar services.

Consultation

- Some submitters consider that one driver for increased local government expenditure is inadequate compliance with consultation requirements, and provided examples of instances where they believe councils have inappropriately ignored substantial public opposition to expenditure proposals.
- Other submitters, primarily from local government, believe that the consultation process can become a means for special interest groups to exercise undue influence, effectively pressuring councils to adopt additional spending proposals councils would not otherwise have taken on.
- Not all submitters agree with these various (but not necessarily incompatible) views, but all believe the widespread public perception that there are genuine problems with consultation processes needs to be addressed.

The unfunded mandate

- The practice of central government passing activities to local government without equivalent funding is a major concern for all submitters.
- A major part of local government's concern is relative lack of meaningful consultation or understanding by central government of the impact on local government in its relationships with ratepayers and residents of handing over new, especially regulatory, functions - even if fee setting powers accompany them.

Rating of Maori land

- Present rules are extremely complex and costly to administer. They are a frustration both for local government and for Maori.
- Local government sees them as the unfortunate product of an inappropriate means of achieving a desirable objective: that of protecting the ownership of Maori land.

Grants in lieu and Rating exemptions

- Large areas of New Zealand, concentrated in districts such as the Far North, Opotiki, Gisborne, Ruapehu, Taupo, Wanganui, Tasman, Buller, Grey and Westland, are Crown land administered by the Department of Conservation or are National parks. This land is not rateable.

- A very wide ranging collection of land uses are exempt from rating. Many of these are now fully commercial, or taxpayer funded.
- The failure to pay grants in lieu amounts to the Crown using its legislative powers to extract a subsidy for the taxpayer from, largely, relatively less well off local authorities.

SECTION 2: PRINCIPLES TO BE APPLIED TO A LOCAL GOVERNMENT FUNDING SYSTEM.

- The submitters have reviewed a number of reports on local government funding and considered their statements of principle.
- The preferred statement of principles is found in the Independent Inquiry into the Financial Sustainability of NSW Local Government (and set out at pages 19 and 20 of the resource paper). In the submitters' view these strike an appropriate balance between the 'benefit' and 'ability to pay' principles.
- The submitters recommend the adoption of these principles with two amendments: that they apply to the entire local government **funding** system rather than simply to the local government **rating** system; and they include an additional principle to the effect that local government funding instruments should serve the dual objectives of raising revenue and providing incentives which complement the objectives of local government.

SECTION 3: A POSSIBLE SUITE OF FUNDING TOOLS

The submitters propose a suite of the funding tools based on the following approach:

- The present dependence on rates is no longer appropriate. Local government requires a mix of tools which will reduce this dependence but still provide the flexibility needed to suit local circumstances.
- As far as possible funding tools should both raise revenue and promote other important objectives.
- There should be alignment between the activities undertaken by local government, their drivers and the funding tools available to meet the costs.
- Preserving local government autonomy² is important but conditional upon local government showing both that it is efficient and can demonstrate its efficiency.

The proposed suite is a mix of new revenue sources, enhancement of existing funding tools, good practice measures and addressing central government/Crown obligations.

It is recommended that the Inquiry support adoption of the full suite with one exception, the question of referenda or recall which is the one matter on which submitters did not achieve a consensus. The suite follows:

General revenue sharing

² Autonomy is not a power for local government to act independently of its community. Autonomy exists when local government is able to act on behalf of its community without interference from central government

- Part funding from central government's tax base is appropriate given the new community well-being responsibilities of local government and their impact.
- Arrangements should be entrenched in statute, and general revenue sharing allocated by an independent commission against general criteria established in the statute. Membership should be appointed 50/50 by central government and local government, with an independent chairman jointly appointed
- To the extent that general revenue sharing resulted in a reduction in the need for other revenue including rates, where practical those reductions should be reflected in subsequent rating proposals.

A local GST

- If a consumption (as opposed to an income) tax is considered the preferred approach to general revenue sharing - an amount equivalent to 1% (funded either by reducing government's share to 11.5% or by increasing GST) - is suggested.
- Ideally local GST would eventually be set at a sub-national level if it were practical to administer it at that level. The submitters recognise that potentially significant transaction and compliance costs might make this difficult.

24/7 Road pricing

- With 24/7 road pricing, all road usage by powered vehicles, at least in congested or high use areas, would be charged for.
- The UK government has clearly decided in principle to adopt this system and is developing the required electronic technology.
- Road pricing could either replace existing road related taxes or supplement them.
- Any allocative methodology should recognise the needs of rural and provincial councils whose high use roads are normally state highways by ensuring that road pricing revenue was not solely captured by Crown roading agencies, but also helped meet local roading costs.
- The Inquiry should lend its support to a thorough investigation on its potential for New Zealand, including its use as a principal road funding mechanism.

Regional petrol tax

- Regional government has identified a clear need for a funding mechanism, separate from rates, for the further development of land transport options.
- A regional petrol tax is a possibility. It could raise the necessary revenue but would be a relatively poor tool both for accountability, and for demand management.
- Another negative factor is the impact on rural people who often need to travel long distances to access centralised services. This proposal could increase the cost of doing so quite significantly in relation to their disposable income.

A regional payroll tax

- A regional payroll tax is the principal means used in France for funding urban public transport.
- It is capable of raising the necessary revenue, scores well on accountability (employer organisations would take a very close interest in its use) and provides a strong linkage with one of the main drivers of demand, journeys to work.
- The conventional New Zealand objection to payroll taxes, of increasing the price of labour, may no longer be relevant. A principal economic concern is to improve productivity which implies reducing the cost of capital relative to labour - which a payroll tax would do.
- Implementation would raise questions of quantum, decision right (could regional councils do it as of right, or should they make a business case to the government) and the size of firm subject to the tax (in France it is firms with nine or more employees; in New Zealand it might be firms with five or more).
- Regions should only be able to introduce this tax in those districts within the region which are served by regionally subsidised public passenger transport.

Green taxes

- The Irish paper bag levy provides an example. This is set at 15 eurocents for each bag provided at retail level (about to increase to 25 eurocents).
- It is an example of levies that could be used to discourage pollution.
- For transaction cost reasons, the levy would probably need to be set and collected nationally, but should then be distributed to local government (at the regional level) to fund environmental activity.
- Green taxes should be supported not just as a revenue tool but as a means of helping manage the range of waste and environmental problems associated with modern packaging.

Full environmental cost pricing for water services

- Reticulated water services (including sewerage) would be charged for at full economic cost plus the cost of the impact on the environment.
- It would almost certainly increase significantly local government's revenue from water services. There will be a need to decide how this excess revenue should be allocated, and also to consider the impact on low income consumers.
- The submitters strongly recommend the introduction of full environmental cost pricing for reticulated water services.
- The submitters recognise that the cost of installing water meters will be a significant factor for many local authorities. However they expect that this relatively short-term impact should be offset by reduced capital expenditure on new infrastructure in the medium to long term as pricing moderates demand.

Lifting the existing cap on the uniform annual general charge

- The cap is inconsistent with the discretion which local authorities have, generally, to manage their funding arrangements as they and their communities see fit.
- The Uniform Annual General Charge (UAGC) is regressive in application. The consensus view of submitters is that the cap should be lifted only in conjunction with the introduction, through legislation, of additional funding tools so that its relative significance, and regressivity, is markedly reduced.

Development contributions

- Development contributions are becoming an increasingly important funding tool for territorial authorities. Regional councils have raised the issue of whether they should also be entitled to levy development contributions. The submitters agree they should.
- There is also evidence that development contributions place upward pressure on both housing prices and the price of commercial property. In each case it applies both to new and existing properties, as the cost of new supply is a strong influence on the market value of existing supply.
- The submitters have no recommendations to make on the use of development contributions except that: (1) there may be merit in the Inquiry considering whether the apparently conflicting objectives of developments carrying their own costs, and housing affordability, can be reconciled; and (2) Crown developments should be liable to meet development contributions in the same way as private sector and other developments. As an example of the need for this, Far North District Council ratepayers are having to meet the cost of the flow-on impacts from the development of Ngawha prison as a consequence of the Crown exemption.

Role of the Auditor-General in respect of the LTCCP

- Currently the Auditor-General reports on the quality and relevance of the information and assumptions underpinning the forecast information in the LTCCP, and the extent to which information provides an appropriate framework for assessment of actual levels of service provision.
- The submitters propose a further role; reporting on the fairness and objectivity of the presentation of the material in the LTCCP (but not on the fairness and objectivity of the policies and objectives themselves, as that would take the Auditor-General into the political realm).

Consistency

- The high degree of flexibility in New Zealand's rating system is a real strength. Councils have discretion to make decisions appropriate to their own local circumstances.
- There is one potentially serious disadvantage: the risk to the credibility of the rating system if councils fund apparently similar services, in similar circumstances, in quite different ways.
- There is a strong case for a good practice guide on the use of local government funding tools to provide a common starting point for decision-making on how to

fund any particular service or activity, and a set of agreed rationales, to assist councils achieve consistency where that is desirable, or explain departures when they decide to take a different approach.

- A related issue is how councils address (or do not address) the question of affordability of their rates and other funding mechanisms. The submitters recommend that the statutory requirement for local authorities to adopt the funding and financial policies set out in section 102 of the Local Government Act 2002 be extended to include the council's policy on affordability, with specific reference to the impact on the bottom decile and quartile household incomes.
- The submitters recommend that the Inquiry encourage the local government sector to develop the good practice guide referred to above, to include a common methodology for assessing affordability pursuant to the proposed policy on affordability.

Performance improvement/benchmarking

- New Zealand local government has little in the way of external monitoring and performance management designed to demonstrate efficiency. This has become a credibility problem for the sector, and a concern for stakeholders.
- A prescriptive approach is not recommended.
- Instead this should be done on a voluntary basis in consultation with stakeholders. The submitters recommend the Inquiry strongly supports the voluntary development of a comprehensive performance management/benchmarking system.

Balance sheet management

- Evidence suggests that New Zealand local government, in general, is "under borrowed". This is consistent with experience, for example, in Australian states, reflecting a general "debt averse" approach in New Zealand.
- The consequence is that typically today's ratepayers pay too much towards the cost of infrastructure, and tomorrow's ratepayers too little.
- The recent New South Wales Inquiry undertook an in-depth analysis of balance sheet management issues and recommended a set of financial key performance indicators in order to address this problem. The submitters strongly recommend that the Inquiry undertake a similar exercise in respect of New Zealand local government.

Funding of depreciation

- Many ratepayers see themselves as paying twice for infrastructure - through rates to create the infrastructure itself, and through depreciation so that future ratepayers will not need to invest similarly when replacement comes due.
- Councils are required to fully fund depreciation but also have the discretion not to fully fund operating expenditure if they deem it prudent. This provides scope to minimise the impact of depreciation.

- There is a need for consistency in the approach councils take to minimising the impact on ratepayers. The submitters recommend that the Inquiry develop a set of principles to be applied by all local authorities for this purpose.

Problem targeting

- There is evidence that local authorities are not yet making sufficient use of some of the new rating powers, such as the targeted rate, to better match funding arrangements with the benefit of activities.
- Some local authorities have been able to use this power very creatively, working with ratepayer groups, to provide additional or enhanced services that meet particular needs.
- The submitters recommend that the Inquiry highlight the potential of this tool and the desirability of making greater use of it.

Choice of rating base

- Local authorities are able to choose from three principal rating bases: land value; capital value; and annual value.
- There is evidence that capital value (which is increasingly the preferred rating base of most councils) and, to a lesser extent annual value, is regressive in its impact on low income households.
- The submitters also note that land value rating results in a less affordable outcome for land intensive uses such as farming.
- The submitters recommend that the Inquiry consider whether the actual choice of rating base itself is something councils should consider in the context of promoting community well-being.

Rates Postponement

- Internationally, there is increasing interest in local authorities offering ratepayers over the age of 65 years the option of indefinite postponement³.
- New Zealand local authorities have the power to offer rates postponement on a very flexible and cost-effective basis. Thirteen territorial authorities already do so.
- Perceptions of rates postponement differ. Local authorities see it as a service giving older people an additional means of managing their financial affairs. Older Persons advocacy groups point out that the availability of such services through local government in no way lessens or relieves the requirement on local authorities to test the affordability of their proposals against their ratepayers' ability to pay.
- All are agreed that there is a need to ensure older people are aware of the potential of rates postponement and understand how to access it. All also support measures to encourage more local authorities to offer rates postponement on this basis.

³ in New Zealand, local authorities which offer ratepayers this option, commonly also offer it to ratepayers under the age of 65, but subject to a maximum term of 15 years postponement.

- The submitters recommend that the Inquiry encourage greater understanding of the potential of rates postponement and that the local government sector as a whole ensures it is available for those older ratepayers who wish to take advantage of it.

Referenda and recall

Submitters are agreed there is a problem with public perception of the credibility of local government consultation, but are not agreed on a solution. Two alternatives are proposed:

Referenda (supported by Grey Power, Federated Farmers, and the Federation of Maori Authorities)

- There be a requirement for any non-core expenditure exceeding defined amounts to be put to a referendum of **ratepayers**, with information provided on the cost and proposed means of funding of the intended expenditure. Councils should be required to take note of the resultant expression of 'willingness to pay' in making their final decision.

Recall (supported by remaining submitters)

- Communities dissatisfied with their councils' major spending proposals should have the right to seek recall - a poll of **voters** which, if carried by a simple majority, would result in a fresh election for the entire Council (including the mayor).
- Recall would be triggered by a petition of not less than 10% of voters on the Council's electoral roll.

The unfunded mandate

- The imposition of new functions on local government by central government, without equivalent funding (either unfunded, or leaving local government to impose additional costs on its community) is a matter of real concern.
- Internationally there is a growing practice of developing protocols for the central government/local government relationship designed to ensure that, when new functions are imposed, adequate consultation takes place and funding is properly considered. Examples include the British Columbia Community Charter Act and the Australian Inter-Governmental Agreement.
- The Inquiry should recommend both that the government in consultation with local government adopt a set of principles to apply when it seeks to impose a new function on local government, and that it accompany any new function with adequate funding.

Grants in lieu and rating exemptions

- Government should not use its superior legislative position to privilege its own activities.
- The Inquiry should recommend that the Crown accept an obligation to make adequate grants in lieu in respect of Crown property currently exempt from rating

such as Department of Conservation and National Park land (the fact that the Crown does not do so amounts to a subsidy from ratepayers, often in relatively low income communities, to the general taxpayer).

- The current set of rating exemptions covers a very wide range of activities, some fully commercial, others taxpayer funded and yet others supporting special interests such as religion.
- Economic principles suggest that activities should bear their own full costs.
- An appropriate principle for the Inquiry to support would be that exemptions from rating should only be provided for land which supports activities that are local public goods, and that this should be subject to the discretion of the local community expressed through the LTCCP/annual plan process.

Roading financial assistance rate

- The cost of roading is a particularly heavy burden for rural local authorities. Typically 50% of their revenue is spent on roading as compared with 15% for a typical urban authority. A factor in this is the present level of the Financial Assistance Rate (FAR) which averages 50% for maintenance and 60% for new construction.
- There is widespread agreement throughout the rural community, and with the support of the urban community within local government, for increasing the average FAR from 50% to 75%.
- The submitters recommend that the Inquiry strongly support such an increase and that it also:
 - Affirm the principle that all tax derived by government from road related activity should be applied to roading.
 - Recommend that any increase in the FAR come from additional funding (if it does not, the practical effect would be a need to reduce the funding currently committed to major urban road construction - primarily but not exclusively state highways).
 - Consider the implications for future rating policy of the effect of increased FAR.

GST zero rating for certain local government expenditures

- In the submitters' view it is wrong that GST should be levied on rates to the extent that they are tax.
- The submitters recommend that local government expenditure on activities which are primarily of a public good character should be zero rated for GST purposes.

Rating of Maori land

- Rating of Maori land is fraught with difficulty. The 10 or so local authorities in whose districts most Maori land is concentrated carry both a significant administrative burden, and a very considerable cost through an inability to recover rates (and most of these are councils with relatively low income communities).

- The basic objective underlying the present arrangements is to protect Maori land against alienation. That is a Crown objective consistent with its obligations under the Treaty of Waitangi. As such, it should be taxpayer funded (especially as the current alternative is a selective imposition on some of the country's least well off local authorities).
- Different approaches would be required for Maori land which is not used for productive or residential purposes, and land which is (where the main issue will be the Maori principle that land is inalienable and should not therefore be rated on a full market value that reflects what is sometimes referred to as a speculative premium).

Rating capability

- Some New Zealand authorities may be approaching, non-viability (or may already be non-viable) - meaning that they do not have a strong enough rating base or other funding instruments required to meet their needs.
- If any local authorities are in that position, the immediate question which arises is who should underwrite it. One possibility is [linking?] adjoining local authorities through amalgamation, but the likely outcome is simply creating one or more larger councils which themselves are non-viable.
- The submitters view is that, especially given New Zealand's commitment to being an inclusive society, the Crown should be the ultimate risk bearer. It is recommended that the Inquiry endorse this principle, and propose conditions that will apply (to avoid the perverse incentive that some councils could be encouraged to appear non-viable in order to attract Crown funding).

The rates rebate scheme

The submitters have concerns both with the principles of the rates rebate scheme, and with its administration.

Principles

- As an income support measure, both the maximum rebate and the abatement threshold for the scheme should be indexed to the consumer price index.
- The eligibility rules should be reviewed so that low income people who are de facto ratepayers, such as residents in retirement villages, and in homes owned by family trusts, also qualify.

Administration

- The scheme is intended to provide relief for low income ratepayers. At the time of introduction, it was expected that up to 300,000 ratepayers would be eligible.
- Actual take-up is approximately 30%-35% of those entitled.
- The submitters believe that an important reason for low take-up is that councils administer the application process. They have no information which would tell them which of their ratepayers are likely to be eligible, and so cannot target them.

There is no accepted practice of ratepayers disclosing their income to their council, and considerable resistance among some to doing so.

- In contrast, Work and Income New Zealand has a complete data base of all older people in receipt of national superannuation (by far the largest single group entitled to rates rebate). As well, people are used to disclosing their income to WINZ for a variety of income tested benefits.
- The submitters strongly believe that in order to increase the take-up rate significantly, administration of the rates rebate scheme should be transferred from the Department of Internal Affairs (the currently responsible department) and local government to Work and Income New Zealand.

CONCLUSION

This submission has been the result of the collaborative endeavours of a number of local authorities and key stakeholders. It represents a unique attempt by local government, and a number of organisations normally seen as critics of local government, to find common ground not just on rates as such, but on local government funding generally, and on the sector's obligations to demonstrate effectiveness and efficiency in its use of its funding tools, and the revenues they raise. It also represents an endeavour to look beyond the rating powers local authorities currently have, to the design of a balanced system of funding tools with the purpose of addressing collective concerns about the impact of those current rating powers.

A number of the organisations which have taken part in this process will themselves be making individual submissions which may differ somewhat, on individual matters, from what is stated in the collaborative submission. This is a natural consequence of a process which has sought to take a package approach, rather than require consensus on each individual item.

APPENDIX 1: MEMBERS OF THE GROUP INVOLVED IN THE PREPARATION OF THIS SUBMISSION.

Greypower
Federation of Maori Authorities
Local Government New Zealand
Carterton District Council
Environment Waikato
Far North District Council
Hastings District Council
Invercargill City Council
Kapiti Coast District Council
Masterton District Council
North Shore City Council
Porirua City Council
Queenstown Lakes District Council
Rodney District Council
Rotorua District Council
South Wairarapa District Council
Taupo District Council
Thames-Coromandel District Council
Wellington City Council
Whangarei District Council

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