Local Authority Funding Issues
Report of the Joint Central Government/Local Authority Funding Project Team

8 July 2005

Executive Summary

Purpose

The Local Government Funding Project was established to gather accurate statistics on local authority rating levels and the extent and nature of any affordability problems. In particular, the project team was asked to provide answers to the following questions:

1. What is the magnitude/nature of fiscal pressure facing the local government sector?

2. What are the drivers of fiscal pressure facing the local government sector?

3. Are fiscal pressures sustainable for some or all communities, and for groups within the community?

4. To what extent will the revenue raising powers provided in the Local Government Act 2002 ("the LGA") and the LG (Rating) Act 2002 ("the LGRA") assist local authorities to meet any fiscal pressures?

5. If a problem is identified, what options are available to resolve the issues, and how appropriate are these?

This report deals with the first four of these questions. The fifth of the above questions will be the subject of a second phase of policy work, which is due to report in December 2005.

Methodology

In order to make judgments about the sustainability of local government finances, judgments must be made as to whether local authorities can continue to provide the services expected by stakeholders, given current revenue sources. This includes consideration of matters such as current and projected future rating levels, revenue received from revenue producing assets (such as port company shares), revenue from fees and charges, and the ability of funding tools to better match the recovery of costs to the timeframe over which benefits accrue (such as debt and development contributions).

Detailed data sets necessary to support this analysis were not available, especially regarding future expenditure needs. The project team has therefore developed its own data sets derived from expenditure, revenue and other projected financial data contained in local authorities' first long-term council community plans[1] (LTCCP). The bulk of Section Two of this report describes the methodology for doing this.

Feedback from a focus group of local authority chief executives revealed that some local

[1] These plans can be considered to be 'transitional' in that they are the first to be produced under the LGA.

authorities have not yet included expenditure in these plans that is considered necessary to promote social, economic, environmental and cultural well-being. Auckland City Council, on behalf of local authorities, undertook a survey of 20 local authorities to determine what levels of expenditure had been excluded from transitional LTCCPs.

Conclusions

Analysis of the data shows a wide variability in the local government sector which is a result of their individual circumstances, history of investment in infrastructure, and management. It is therefore challenging to draw conclusions that apply across the whole sector.

There are a number of fiscal constraints or pressures on local government. It appears that most local authorities are managing these pressures successfully and providing appropriate services and facilities for their communities. Their transitional LTCCPs and financial projections indicate that this is sustainable over the foreseeable future.

There appears to be a small proportion of local authorities where increasing pressures will be difficult to accommodate using existing funding tools. For some this is evident from their published information (i.e. transitional LTCCPs), and for others this expenditure is yet to be included in LTCCPs. We consider that fewer than 10 percent of local authorities fit into the first category. The percentage in the second category will be affected by the amount of expenditure not included, potential for discussion of expenditure priorities with the community, and ability to manage it using existing tools. It is not possible to extrapolate this from a sample of twenty, but the survey results indicate that additional councils will have issues when this expenditure is included.

1. What is the magnitude/nature of fiscal pressure facing the local government sector?

In our view the term “fiscal pressure” is really a reference to the challenge of meeting increasing demands within a constrained budget and in an environment where stakeholders have increasing expectations of service quantity, quality and “value for money”, and where the cost of maintaining current service levels is increasing. We expand further on the sources for these increased pressures in our answer to the second of the questions put to us by parties to the Forum.

Making judgements on behalf of the community as to the types of services the local authority should provide has always been the most fundamental part of the governance role of an elected member.

The increasing demands, described in more detail below, become a “problem” where local authorities, individually or collectively exhibit a lack of financial tools to meet these pressures.

We conclude that there is a group of local authorities that may be approaching their capacity to generate additional revenue to meet these projected expenditures. These local authorities either currently have, or have signalled that they will have, high levels both of rates and debt. Based on evidence from the first set of LTCCPs, fewer than 10 percent of local authorities currently appear to fall into this category.

There is a second group of local authorities with potential issues, where the LTCCP has not included expenditure that may be necessary to support quality of life, and where the scale of expenditure readily cannot be met from existing sources. It is however not clear how much of this expenditure has been considered by elected members or the subject of community consultation. Without an agreed definition of "necessary to support the quality of life", and data from all councils, it is not possible to quantify exactly how much expenditure there is, or how many local authorities are in this position. The data from the sample survey indicates significant expenditure that, if included, could push some councils into a similar situation to the first group. Further work is needed since the quantum of expenditure not included needs to be clarified for all councils and existing planning processes employed to include it in LTCCPs as appropriate.

In our discussions it became apparent much of this expenditure is likely to appear in the next set of LTCCPs. This is, in our view, consistent with the intent of the LGA.

These two groups are not mutually exclusive – two local authorities from the first group also appear to have significant expenditure not included, indicating a more serious problem than signalled in their published LTCCP information. Confidentiality requirements on the survey responses means an exhaustive list of the local authorities that are likely to fall into these groups cannot be provided. We consider that problems meeting the needs of communities with existing funding tools are the result of the *cumulative effect* of a *significant* number of factors from the list below. A local authority that has affordability issues is more likely to:

- have lower population densities than higher (which makes the cost of infrastructure and services higher per person);
- have lower holdings of revenue-producing assets such as port and airport company shares;
- have more substantial amounts of land that is exempt from rates;
- have more substantial amounts of Māori freehold land;
- face substantial needs for new or replacement capital works on the existing stock of infrastructure;
- have significantly higher than average rates of population growth or by contrast;
- population decline (which reduces the rating base available to fund investment);

- have high levels of non-participation in the labour force, unemployment, and unskilled and semi-skilled workers with consequent low incomes;
- be more reliant on residential rates i.e. have low commercial and industrial rating bases.

We found very little evidence of affordability problems in the regional sector. Regional rates tend to be relatively low, many have substantial levels of income from other sources, and very little debt. We consider no more than one or two regional councils are facing significant issues in meeting the needs of communities with existing funding tools. The issues facing regional councils are more in the nature of political acceptability of rates increases – regional council rates are low thus any significant absolute increase will seem large in percentage terms[2].

2. What are the drivers of fiscal pressure facing the local government sector?

The local government sector has stated that the following are drivers of the increasing demands on local authorities:

- the unpopularity of rates (or any tax) and electoral pressure to minimise their absolute level and any increases;
- the cost of new or replacement infrastructure driven by cost escalation and higher environmental and health standards;
- higher community expectations of the quality of services and facilities, and lower tolerance of service failures;
- new regulatory roles such as the new gambling, building and dog control legislation. While these new functions are usually accompanied with charging powers, there is often no way of recouping the costs of policy development and consultation;
- increased costs from the consultative and procedural requirements of the LGA 2002; and
- increased responsibility under the LGA 2002 to:
  - (a) meet community needs and preferences; and
  - (b) promote social, cultural, environmental and economic well-being and adopt a sustainable development approach.

Although there was some degree of agreement with this list of drivers, there was insufficient evidence to confirm that all of these were drivers. For example, the

[2] Nowhere is this better illustrated in than by the "rates revolt" in the Auckland Region. The average rate increased by approximately $30 per year, but appeared much larger when reported in percentage terms. Having said that a significant percentage rise was also accompanied by a substantial shift in the incidence of rates created, in part by revaluation, and in part by the council moving to collect its own rates using its own differential system rather than collection by the constituent territorial authorities.

LGA was an empowering statute. Promotion of community well-being is a matter for the judgement of communities – it is to be expected that some degree of prioritisation between projects will always occur. Not all of the regulatory functions passed to local government carry specific obligations – though most do.

3. Are fiscal pressures sustainable for some or all communities, and for groups within the community?

This area of work looked in more detail at affordability issues at a household level. It used the total level of rates divided by the number of households in an area (local authority and census area unit) as an indicator of affordability. In most local authorities some of the rates are levied on businesses and for the purposes of this analysis it is assumed that these rates are ultimately borne by the community.

Based on transitional LTCCP data the average level of rates as a percentage of household income will increase from 4.7 percent to around 5.4 - 5.5 percent between now and 2012/13. All of the data we have gathered points to a "bulge" in expenditure needs in the period 2007-2010 thus we cannot draw firm conclusions about sustainability beyond 2012/13.

There is wide variation across the country, even at local authority level. Rates range from as little as three percent to as much as eleven percent of household income. Residents in two thirds of local authorities pay between four percent and six percent.

We found about 30 census area units where households are paying our more than 10 percent of their income in rates These census units generally had lower populations (even those in urban areas tended to be among the smallest units in the local authority), lower income levels, higher unemployment, and higher concentrations of unskilled and semi-skilled labour. Our analysis also showed that rates placed a significantly higher burden on incomes in households with a single income earner.

One of the central features of this analysis is the importance of incomes to affordability. A policy response that addresses the income issues may provide for better targeting than a response that addresses rating issues in that it can better cover low income ratepayers in all local authorities. Recent changes to the Rates Rebate Act will go some way towards addressing concerns about the affordability of rates for some groups.

Overall, our conclusion is that rates levels, and their projected increases, do not place an unsustainable burden on communities in relation to the services and facilities provided. Many of these are basic services like water and sanitation, are mandated by the community through the political process.

There are, however, specific instances where rates represent a higher proportion of household income and this is likely to be producing affordability pressures. This is of particular concern where there are projections or indications of additional, necessary expenditure.

4. To what extent will the revenue raising powers provided in the LGA 2002 and the LG (Rating) Act 2002 assist local authorities to meet any fiscal pressures?

The two main new sets of revenue raising tools offered in the 2002 legislation were the extension of the set of targeted rating tools and the conferring of the ability to assess development contributions. Other extensions of revenue raising powers (such the fee-setting power in section 150 of the LGA) are more limited in their scope.

We found that the sector as a whole is making any more use of targeted rating powers in the current year than in the year before enactment of the LGRA. There have been shifts between the different types of general rating tool, especially in regional councils, and shifts between the different types of targeted tool. Some of the new powers are not being used at all. However the LGRA is still comparatively new and that some of these tools require the gathering of information that is not typically gathered during the valuation process (and thus requires some lead time to implement).

We must also note that targeted rating tools provide options to allow a more equitable distribution of the impost of rates among properties, categories of property and the community as a whole. They are not tools for tapping previously untapped pockets of revenue raising potential.

We have also found that powers to assess development contributions under the Local Government Act are being used by almost half the eligible local authorities, and more are likely to access these in the near future. Not surprisingly the local authorities that are currently using this tool are those for whom the tool is likely to generate the highest level of revenue – those with the highest rates of growth. Our analysis does not indicate the extent to which income derived from development contributions is off-setting the actual cost of development.

We consider that most local authorities could make more use of debt than they do currently. Almost seventy percent of local authorities do not come with 20 percent of their self-imposed debt limits at any time between now and 2012/13. Although we acknowledge debt is a tool for spreading revenue raising needs it appears some local authorities are currently expecting today's ratepayers to meet more than their share of infrastructure costs, and expecting too little from future ratepayers.

1.0 Introduction

1.1 Our Task

In December 2003 the Central/Local Government Forum ("the Forum") established the Local Government Funding Project. The Forum resolved the following:

> *More work and research is needed to gather accurate data on current rating levels and the extent to which there is an affordability problem. The research will also need to encompass the degree to which any identified pressures are likely to be resolved by recent changes to councils' funding powers and examine appropriate solutions where gaps might be identified.*

The Local Government Funding Project was asked to provide an analysis of the extent to which required local authority funding, now and over the next 8-10 years, is sustainable for the communities which they serve. For the purposes of this project "sustainable" funding was taken to mean funding requirements that are affordable over time. The analysis will be based on data which is measurable, independently verifiable and objective.

In particular, the project team was asked to consider the following questions:

1. What is the magnitude/nature of fiscal pressure facing the local government sector?
2. What are the drivers of fiscal pressure facing the local government sector?
3. Are fiscal pressures sustainable for some or all communities, and for groups within the community?
4. To what extent will the revenue raising powers provided in the LGA 2002 and the LG (Rating) Act 2002 assist local authorities to meet any fiscal pressures?
5. If a problem is identified, what options are available to resolve the issues, and how appropriate are these?

A project team of central and local government officials was formed to advance the project. The full terms of reference and membership of the Project Team is included as Appendix A.

The first phase of the review seeks to address the first four of the above questions. In the event that the first phase of work identifies particular funding issues, the project team will move to a second phase of work identifying possible options to resolve those issues. A final report setting out these options would then be delivered to the Central/Local Government Forum in December 2005.

What is Affordability?

The project was established to assess the affordability of local government's future funding needs. The New Zealand Treasury has defined affordability as "having sufficient income to be able to pay for expenditure without crowding-out other expenditure"[3]. In this case, affordability is a measure of a particular community's ability to pay, i.e. to meet the burden of local government funding needs over time.

The issue of affordability must be addressed within the context of the new statutory role of local government. The LGA recognises that local authorities have a primary role in promoting a healthy, prosperous local community. The legislation acknowledges that local authorities are not simple service providers: they are shapers of communities and guardians of their well-being. Local authorities must take a long-term view when considering aspects of community well-being as it is no longer only a matter of providing for the satisfaction of current needs. Consequently councils are required to continually address and balance requirements to meet increasing community expectations about standards of existing and new services.

The issue of sustainability of local government funding depends significantly on the priority that ratepayers place on local government services and infrastructure and other competing demands on the household budget. The project team considered ways to measure acceptability of rating levels but has not found an objective, robust and comparable measurement. Complicating this is the fact that many local authorities are facing significant issues with current and predicted rapid growth, whilst others are struggling with a declining rating base.

For this project we have addressed questions of affordability in two dimensions which we shall refer to as the *aggregate* and the *distributional*. For the purposes of this report, the *aggregate* dimension refers to affordability issues as they relate to local authorities, groups of local authorities, and the sector as a whole.

The *distributional* dimension refers to affordability issues as they impact on individuals and groups within local authorities. For example, because household income levels can vary widely within local authority areas, quite small changes in a local authority's rating policy may appear to have minimal impact across local authorities as a whole, but may have major impacts for particular individuals or groups within a local authority (such as beneficiaries, superannuitants and others on fixed incomes).

Each of the dimensions is of importance in determining whether local authority funding is sustainable. The nature of the policy responses for each may be quite different. For example, distributional issues may require solutions that are targeted at individual ratepayers. The Rates Rebate Scheme is an example of a current initiative aimed at addressing affordability issues for particular groups of ratepayers. In addition, the issue of acceptability of rates increases, whilst difficult to measure, provides a practical limit to local government's ability to generate revenue.

[3] NZ Treasury. *Sustainability of Local Government Funding: Auckland. Nov 2004, p7.*

1.2 What's in This Report?

Section Two of this report sets out in detail the methodology that was used in the project – its uses and its limitations. This material will mostly be of interest to readers with an interest in the research techniques that were used, or have views on the methodology (in particular those who wish to know why a particular indicator was selected in preference to others).

Section Three of this report sets out our findings. The findings are grouped around four key headings; expenditure trends, rates, other income sources, and debt.

Finally, Section Four provides our overall conclusions and recommendations for further investigation. Section Four also includes a commentary on funding issues written by some of the local authority representatives on the Project Team.

1.3 What This Report Does Not Do

Development of Options

This report forms part the problem definition phase of the project. The parties to the Forum agreed that it was necessary to obtain a clear picture of the magnitude, scale, nature and drivers of fiscal pressures on local authorities, before evaluating potential options to address any problems. Consequently this phase of the overall project does not consider potential solutions at all. If participants to the Forum concur with the conclusions of this report, any alternative options that are explored in the next phase of the project will be linked to resolving the identified issues.

Affordability vs Acceptability

At several points during the process we discussed the development of indicators to measure the political or community "acceptability" of rating levels. Another way of expressing this is as a measure of elected members' perceptions of the community's willingness to pay[4]. We agreed that a community's willingness to pay can be a practical barrier to a local authority's ability to raise funds both in terms of the choice of mechanism and the level of the charge. We considered several techniques for measuring willingness to pay including:

- *conventional willingness to pay surveys* - willingness to pay surveys have been used in this country to gauge the likely level of public use of roading projects in the event that road pricing is introduced. We are not aware of any systematic studies that have attempted to gauge community willingness to pay across the

[4] A good example of the difference between affordability and acceptability lies in this comment from a local authority that "*(its) rates are unpopular rather than unaffordable*".

entire range of local government activity. We also considered that an individual's willingness to pay springs from their perceptions of the value that they receive in return, and that the bundles of changes in services will be so markedly different across the country that these estimates cannot be reliably compared (for example Auckland City's bundle might focus on transport and various community and recreational facilities necessary to support its vision of being a world city, while Central Hawkes Bay's bundle might be more in the nature of improving water and sewage facilities to meet their needs). Controlling for these differences would be methodologically difficult.

- *techniques based on revealed preference* – a second technique which the Project Team explored in some detail took each local authority's historical rates increases, adjusted these for inflation and population growth, and considered whether this revealed local authority's judgements about acceptable levels of rates increase. The Project Team concluded that these estimates were good measure of historical rates increases but that linkages between these and future "acceptable" rates increases were weak[5].

As a result of measurement difficulties for indicators of acceptability, this report focuses solely on measures of ability to pay and of future need. Despite difficulties in measuring the issue of acceptability, however, it remains a significant practical and political issue with major implications for local government funding.

Performance Measurement

The indicators developed by the project team were developed for a very specific purpose – to determine whether local government and the communities they represent are facing affordability issues and the characteristics they have in common (if any). These indicators were not developed for the purpose of performance measurement (or "benchmarking").

We consider that the important messages in this report lie not in which local authority had the highest rates per household, or the lowest debt, but in the factors that councils with high rates may have in common. For this reason, our datasets have not been included in this report, and we have identified individual local authorities only where the information is already publicly known.

[5] For example, events such as an emergency situation or windfall revenue gains (or losses) could determine what the acceptable rates increase was, not just the judgment of elected members. Merely looking at rates changes also does not take account of changes in the quantity and quality of services delivered, thus linkages to value cannot be demonstrated.

2.0 Methodology

2.1 Methodological Elements

Rates

In respect of local authority rates, we had the following key questions to answer:

1. how affordable are rates at the present time, and how is this likely to change in the future?
2. are local authorities making use of the wider range of rating tools available to them under the Local Government (Rating) Act 2002?

Data on historic rating levels were obtained from Statistics New Zealand.

Data on rates in the current rating year (2004/5) were obtained from local authorities 2004/5 rating resolutions. A rates resolution specifies each type of rate assessed by the local authority, the level of each rate and many also specify the total amount of the revenue sought from each rate. Where the revenue sought was not specified this was obtained either from the local authority's Funding Impact Statement (contained in the relevant Annual Plan)or alternatively by direct enquiry. Amounts of revenue were cross-checked against the results in the LTCCP and discrepancies referred back to the local authorities concerned. For comparative purposes data for 2002/3 was also gathered from rates resolutions[6].

Forecast rates data has been sourced from LTCCP documents. It is important to note that the forecast data for each council is based on a set of assumptions made by each of the 86 different local authorities, which are not necessarily common[7]. Some care therefore needs to be taken with interpretation of this data.

All rates estimates quoted in this report are GST **inclusive** as this gives the best measure of the actual amounts ratepayers must meet.

We have selected rates per household as our primary indicator of rating levels in each local authority. Statistics New Zealand defines a household as:

[6] The rationale for choosing the 2002/3 year as our comparator was that it was the last rating year before the LGRA 2002 took effect – we are thus able to compare local authorities selection of rating tools both before this Act took effect with a time two years after the legislation took effect. Over this period local authorities would be more familiar with the tools available under the Act and had had some time to gather the necessary information, amend policies, redesign forms etc.

[7]A good example of differing assumptions is the treatment of price changes. Although we are aware of no local authority that made full allowance for inflation over the entire life of the LTCCP – many included some partial allowance either through using nominal interest rates, or made three years allowance either fully or partially, some made no allowance at all.

"either one person who usually resides alone or two or more people who usually reside together and share facilities (such as eating facilities, cooking facilities, bathroom and toilet facilities, a living area)."

Rates per household estimates have three limitations. First these do not capture non-resident ratepayers in the calculations. Some districts have substantial numbers of properties where the owners are resident in another authority and use these properties as "holiday homes". Census night is the first Tuesday in March which finds most of these sorts of households in their usual residences. These property owners pay rates both in the local authority they usually reside in and those where the holiday home is situated yet are not counted as a household in the latter. Therefore, rates per household estimates in these local authorities may be higher than the actual level.

Secondly, the rates per household estimates are calculated as the total rate take divided by the total number of households in the local authority. This calculation does not distinguish between residential and business rates, and other differential rates (where councils use other categories). For the purposes of this report we have assumed that all rates are eventually born by a household. It *is important not to confuse the rates per household measures presented here with the average residential rate.*

Thirdly, we have made no attempt to control for the different selections of funding mechanisms so it is possible a local authority that is a heavy user of bag charges, refuse charges and the like will show up as a low-rating council. In a similar vein, those local authorities that deliver services through council controlled organisations (such as Metrowater), or have contracted services out, will show up as lower rating authorities.

We considered and rejected rates per rateable assessment as a measure because future series would require accurate and consistent estimates of the numbers of rateable assessments across each local authority for the next ten years. We were not confident that local authorities had followed the same, or even broadly similar methodologies in forecasting numbers of rating units, nor were we confident that projections for areas below local authority level were available. On the other hand, forecast household numbers[8] were available at local authority level and at the level of census area unit[9].

To better link rating levels to the ability of the local community to afford them we took ratios of the rate per household to median household income in each local authority (both regional councils and territorial authorities). At the second step of the analysis we combined territorial and regional rates and went to the level of census area unit. It was possible to do this even where a territorial authority was situated in more than one

[8] All projections of the adult population and numbers of households are based on medium fertility, medium mortality, medium internal migration scenarios prepared by Statistics New Zealand

[9] A census area unit is a non-administrative areas in between meshblocks and territorial authorities in size. Area units must either define or aggregate to define, regional councils, territorial authorities, urban areas and statistical areas. Each area unit must be a single geographic entity with a unique name referring to a geographical feature. Area units of main or secondary urban areas generally coincide with suburbs or parts thereof. Area units within urban areas normally contain a population of 3,000–5,000, though this can vary due to such things as industrial areas, port areas, and rural areas within the urban area boundaries.

regional council[10]. Combining regional and territorial rates at this step gives the most accurate reflection of the full impost of rates on individual households.

Although Statistics New Zealand does collect income statistics at a regional level through the Income Supplement to the Household Labour Force Survey, no data is available at the level of territorial authorities. We used median personal income from the 2001 Census as the measure of income. For comparability, we have inflated these numbers by 10.3 percent (equivalent to the national growth in earnings identified in the Quarterly Employment Survey) to 2005. No further adjustment has been made – this means that rates to income ratios are likely to be slightly overestimated in future years.

In each census area unit we used local authority-wide averages as the numerator. In local authorities that make significant use of geographic targeting (e.g. ward rating), this is likely to smooth out at least some of the extremes in affordability. This effect will tend to be greater in rural authorities where the degree of geographically based targeting is greater. It would be possible to make estimates – but this would require information from local authorities on the average property value in each census area unit and the rates that would be assessed on that property. This is likely to be a complex task, especially in local authorities that are not able to readily link their rating information databases to census information, or in local authorities with complex differential systems[11].

Census area units were ranked in terms of their rates to income ratios and a standard deviation was calculated to determine what might be "high" and "low" rates to income ratio relative to other units[12]. We then matched the 100 highest rated units with the profile of Census information available to determine what links to socio-economic status existed.

We have also been able to estimate rates to income ratios for different types of households using Statistics New Zealand's standard classification of household composition.

Debt

Our study of affordability issues also requires that we consider each local authority's use of borrowing, in particular:

[10] For example, the northern and eastern parts of Franklin District Council are in the Auckland Region, the southern parts are in the Waikato Region but we were able to isolate each piece and apply the correct regional rate.
[11] Good examples of this would be Southland District and its system of district and additional community rates, and the rating schemes some regional councils have introduced for soil conservation and river control.
[12] For readers unfamiliar with standard deviations – a standard deviation is a measure of the spread of a set of data. What this measure tells us is a range of values within which most local authorities (66 percent) – in this case 66 percent of census units fit within the rates to income ratio of 2.9 to 6.5 percent. A census area unit with a rates to income ratio of less than 2.9 percent was deemed to be low-rated, a unit with a rates to income ratio of 6.5 percent was deemed to be high rated.

- what is the current financial position of local government, and of individual local authorities, and how is this expected to change over time?
- to what extent have local authorities set limits on their borrowing, and how close are local authorities to their self-determined limits?
- is there the financial scope for local authorities to make more use of debt?

In considering debt, we have excluded accounts payable (e.g. suppliers) and various term liabilities that are not borrowing (mostly various types of taxation liability and some employee entitlements). Thus we consider the term and current portions of that money which the local authority has genuinely borrowed – as opposed to liabilities incurred through the regular day-to-day operation of the local authority[13].

Data from 2004/5 has been obtained from forecast financial statements included in Transitional LTCCPs. In both cases the data relates to the borrowing of the "core council" only – assets and borrowings of council controlled organisations are excluded.

Our analysis of debt levels makes use of a set of financial ratios – a commonly used tool in financial analysis. These are indicators only, the comments made in this part of the report and all subsequent commentary on borrowing levels should not be taken as stating or inferring a view about the financial condition, viability or prospects of any individual local authority. Detailed investigation on a case-by-case basis is required before robust conclusions can be reached regarding the financial condition of any given local authority.

The ratios we have selected are:

- *debt to assets* – a broad measure of the condition of a local authority's balance sheet (we have not attempted to separate assets into realisable and non-realisable);

- *debt/operating revenue* – this is a measure of the ability of local authorities to service their debts; and

- *interest payments to rates income*.

In all cases we have used gross debt as our measure of total indebtedness. Some local authorities have established mechanisms such as sinking funds to repay debt, which are not taken into account in the above calculations. While some local authorities may consider that the use of gross debt may overstate their overall level of indebtedness we consider that even revenue to establish sinking funds must first come from the local community so using gross debt is a better measure of the overall impost on the community.

When calculating interest/rates ratios for each local authority, we used the following procedure:

[13] Few local authorities had sufficient of these liabilities to make any significant difference to the analysis as a whole, or to the analysis of an individual local authority.

1. where a local authority has forecast interest expenses in its LTCCP and these were readily identifiable these estimates have been used; and
2. in other instances we have made the assumption that local authorities face a weighted average cost of debt (WACD) of 8.5 percent across the ten years. This is a little higher than the WACD that any council faces at present[14] or is likely to in the foreseeable future, and thus may overestimate the debt servicing costs some councils face.

A subsequent piece of analysis looks at the position of each local authority in relation to its own self-imposed debt limits[15]. For the purposes of this report we have assumed that a local authority would generally leave itself some "head room" in case of unforeseen events, and therefore that a local authority is approaching its limit if it gets within 20 percent of the maximum value for the indicator[16] for at least three of the eight years under consideration[17].

Operating Expenditure

While rates represent a core part of local authorities' annual funding requirement, many have other significant forms of income. For this reason, we have also looked at local authorities' operating expenditure as an indicator of their annual funding requirement. It is recognised that capital expenditure forms an important part a local authorities funding issues. Nevertheless, to the extent that it can be assumed that debt is used to finance capital expenditure, and if interest costs and depreciation have been fully accounted for, then operating expenditure represents a useful indicator of long term funding requirements.

Historical data from Statistics New Zealand and projected data from long-term council community plans was used to examine patterns of operating expenditure. Trends in operating expenditure were also examined in the context of inflation, population, and real GDP growth.

Representatives of local authorities, meeting in November 2004, considered that the use of LTCCP data, with its associated issues, meant that this analysis could not be taken as an accurate reflection of future expenditure patterns.

[14] A random sample of 30 local authorities revealed most had a WACD between 6.5 and 7 percent interest p.a. in the 2003/4 financial year. Other commentators are expecting interest rates to return to the "high sevens" in the next 12-24 months.
[15] Not all local authorities specified such limits in their liability management policies or specified limits where the indicator was not able to measured from published data.
[16] As an example assume that a district council has a liability management policy that says its borrowing will be such that the interest generated will not exceed 20 percent of rates revenue. Its LTCCP forecasts indicate that the interest/rates ratio is 15.8 percent in 2005/6, 18 percent in 2006/7 and 19 percent in each year thereafter. For the purposes of this report we would assess this council as approaching its limits in each year from 2006/7.
[17] This limitation eliminates those authorities that have a single year "peak" in debt from being considered as having potential funding problems.

Expenditure Excluded from LTCCP Documents

During the course of the project, a grouping of Chief Executives suggested that sole reliance on expenditure information contained in LTCCP documents would systematically underestimate the true level of expenditure needs in local government. Reasons given for this included that:

- expenditure identified in LTCCPs is part of a political decision-making process that sets limits for rating and debt levels;
- differences in approaches to preparing transitional LTCCPs meant that some councils included every project that they had "on the books" and asked the community to make tradeoffs, while others prioritised projects and then submitted them to the community;
- regulatory and policy initiatives imposed since the last LTCCPs would create the need for additional expenditure; and
- the expenditure implications of the Local Government Act requirement to carry out an assessment of water and sanitary services were not fully known, as such assessments are not due until 1 July this year. Similar arguments may apply in local authorities that have yet to adopt a waste management plan (also due by 1 July for those local authorities that had not already adopted them).

Auckland City Council, on behalf of the national Funding Project Team undertook to survey a sample of local authorities from across the sector to identify necessary capital expenditure that was not currently captured in LTCCPs. Data from the initial 16 councils in the survey was expanded with the addition of 4 more councils as the project progressed. The final data set contains information from 6 Metro councils, 5 Regional councils, and 4 each of Provincial and Rural councils[18]. A list of the local authorities who participated in the survey is set out in Appendix B.

The survey asked local authorities to identify projected capital expenditure not currently included in LTCCPs. By inference this meant that councils were being asked to identify expenditure at a very early stage of planning, including pre any formal planning processes. The local government sector had expressed the strong view that, using their present knowledge about expected new legislative and policy requirements on local government; 'catch-up' requirements for ageing infrastructure; new infrastructure to provide for growth and economic development; and newly devolved responsibilities on to local government; unfunded but necessary capital expenditure could be identified.

Projections of expenditure excluded from Transitional LTCCPs were obtained for the years 2004/5 – 2013/14, and were grouped, according to the type of project, into the following; land transport, stormwater, wastewater, drinking water, refuse, community and recreational facilities, information and communications technology, flood and river control and "other".

[18] Based on the Local Government New Zealand classification of local authorities.

Follow up questionnaires were sent to the participants to further explore:

- why this expenditure was excluded from LTCCP documents;
- whether this expenditure was required by legislation or a national/regional strategy, such as the new Environmental Standards for Air Quality Control;
- whether this expenditure was identified or anticipated by other strategic documents such as a Regional Land Transport Strategy or the Growth and Innovation Framework;
- what the likely consequences would be if the projects were not undertaken; and
- whether this expenditure was likely to be included in the next Annual Plan or LTCCP for public consultation.

Finally, the information was been matched with other indicators in the dataset to try and estimate what impact these might have on the particular local authority's finances. We have considered the impact on rates over the ten years, of fully funding this expenditure by rates, and the impact on debt limits that debt funding all of this unfunded capital expenditure would create.

The survey information is useful for helping to form a fuller picture of fiscal pressures on local authorities. It is interesting to note that local authorities right across the sector identified capital expenditure currently excluded from their LTCCPs. The survey information was self-reported and unfortunately the questions designed to act as "checks and balances" were not completed by many so they did not help the team to gain a picture of how many identified projects were actually required by legislation or had been through formal council decision making processes at the time of the survey. The sample of 20 contains more metropolitan (6) and regional councils (5) than provincial or rural (4 each) [19]. The project team therefore agreed that this information, although useful could not be extrapolated across the entire sector.

Rates Remissions and Postponements

Local authorities have at least one tool with which to address the distributional aspects of affordability – the ability to remit and postpone rates. We were aware that there was a large degree of commonality between the remission and postponement policies of local authorities – in many regions territorial and regional councils agree on joint policies. Rather than obtaining 86 remission policies we drew on a sample of 43 local authorities. The sample was stratified by type, population and location[20].

[19] Based on the Local Government New Zealand classification of local authorities.
[20] A list of the councils included in the sample is attached as Appendix C.

Other Indicators

Several other pieces of information were gathered for the project. The first, income from investments, was derived from each council's own LTCCP forecasts and is subject to many of the same limitations as the other data derived from this source.

The second was an estimate of the amount of non-rateable land in each district – these estimates are based on valuations that existed in 2000. We quote these as a percentage of the total value of the district rather than the absolute numbers, to minimise any impact of the values being out of date.

2.2 Limitations and Omissions

General Limitations

Much of the information presented in this report is reliant on data derived from local authority's forecasts contained in LTCCP documents. The information is therefore only as good as the assumptions and methodology each local authority used in preparing their own LTCCPs. We should also note that many of the LTCCPs from which this data was drawn were transitional in nature.

Expenditure by Function

One particular omission of note from this report is a lack of classification of local authority expenditure by function e.g. regulatory, water, wastewater, etc. Having such a breakdown of local authority expenditure, especially an indicative breakdown for the next ten years, would have provided much useful information to support our discussion of the drivers of local authority expenditure. Local authorities are, however, obligated to report details of planned expenditures at the level of "groups of activities"[21] and the categorisation of groups of activities can differ markedly from authority to authority. For example, some metropolitan local authorities have based their categorisation on the outcomes to which the activities contribute, others adopt a categorisation based on functions. It was not possible to construct such a data set from available information.

Central Government Policy Initiatives

During our deliberations several local authorities suggested that the biggest "unknown" they faced was in attempting to predict the cost of policy and regulatory initiatives that were either current or planned within central government. We held discussions with many of the government departments whose policy work programmes contain areas of interest for local government.

[21] See schedule 10 of the Local Government Act for further detail as to what constitutes a "group of activities"

We have found that the consideration of costs to local government in policy work and regulatory impact statements is often incomplete, or on occasion is not included at all. We have not been able to produce quality data to support this aspect of the project. We note that the Department of Internal Affairs is leading a Regulatory Framework Project that has reached a preliminary conclusion that there is justification for central government policy analysis to better incorporate these effects. We endorse this finding and look forward to seeing what progress this project makes.

User Charges

User charges have been excluded from this project. Many local authorities have combined these with revenue from other sources. The biggest single user charge – water charges – is, however, legally regarded as a rate and has been captured in the rating data. No attempt has been made to control for charges imposed by council controlled organisations such as Metrowater or through franchising arrangements such as between United Water and Papakura District.

Levels of Service

Although the report is not intended to be a tool for comparing rating and debt levels between local authorities, we do point to data such as maxima and minima, and make some comment about the common characteristics of local authorities with high and low values. This data does not attempt to assess and control for range and levels of service between local authorities. Thus it is possible that a particular council may have a high level of rates but may also be providing more services or higher levels of service than others, or alternatively that a lower rating local authority provides less service.

3.0 Findings

3.1 Expenditure

Operating Expenditure

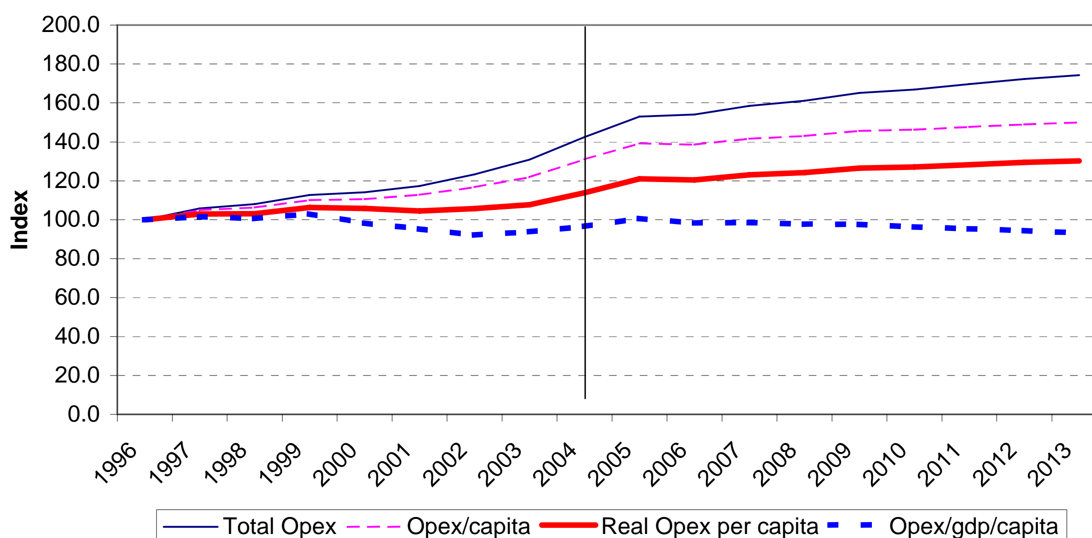
Trends in operating expenditure were examined over the historical period 1996-2004, and looking forward over the period 2005-2013 (see figure one). To compare trends in operating expenditure relative to various comparators (for example relative to changes in the price level, population and income), indexes were calculated based in 1996. Over the period as a whole (that is, 1996-2013), the funding requirement for local authority operating expenditure is estimated to increase by around 74 percent (or approximately 3.3 percent on an annualised basis). A significant proportion of this increase in expenditure can be attributed to inflation and population growth. Adjusting for these two factors[22], total operating expenditure is estimated to increase by 30 percent over 1996-2013 (or 1.6 percent per annum).

The issue of whether such increases in funding requirements are 'sustainable' is related to the concept of 'affordability', as sustainability is defined here as 'affordability over time'. To assess the affordability of the local authority-funding requirement, changes in operating expenditure are considered in the context of changes in income using gross domestic product (GDP) per capita as a proxy for 'ability to pay'. Historical GDP data was used up to 2004, with an assumed rate of real growth of 1.9 percent per annum thereafter. On this basis, local authority operating expenditure per capita declined as a proportion of GDP per capita from 3.3 percent in 1996 to 3.11 percent in 2013. This trend holds both for the historical and projected periods.

We acknowledged that capital expenditure is a significant element in local authority budgets. Intergenerational equity objectives are often best achieved by using debt to finance capital expenditure. As a result, provided the full cost of projected capital expenditure, however financed, is reflected in operating expenditure, the ongoing operational funding of a local authority should generally be a reasonably reliable indicator of general trends in expenditure. Subsequent commentary about the use of rates and debt both include those rates and debt raised for capital expenditure needs.

[22] Operating expenditure per capita for data up to 2004 is deflated by Statistics New Zealand's 'All Groups" Consumer Price Index to obtain real operating expenditure per capita; operating expenditure data obtained from LTCCPs is assumed to be real (to the extent that local authorities projections include assumptions about inflation, this analysis will overestimate the increase in real operating expenditure per capita; population data has been obtained from Statistics New Zealand estimates.

Figure One: Trends in Local Authority Operating Expenditure 1996-2014



Drivers

What factors have driven the increases in local government expenditure? In 2004, Local Government New Zealand conducted a survey of its members seeking their views on perceived pressures. Responses highlighted the following:

- the unpopularity of any tax and electoral pressure to minimise both the absolute level and any increases;
- provision of infrastructure, including both network infrastructure and community infrastructure;
- the high cost of new or replacement infrastructure driven by cost escalation and changing standards;
- higher community expectations of the quality of services and facilities, and lower tolerance of service failure;
- new regulatory roles such as the new gambling, building and dog control legislation. While these new functions are usually accompanied with charging powers, there is often no way of recouping the costs of policy development and consultation;
- the increased costs arising from the consultative and other procedural requirements of the LGA 2002;

- increased responsibility under the LGA 2002 to:
    - (a) meet community needs and preferences; and
    - (b) promote social, cultural, environmental and economic well-being and adopt a sustainable development approach.

The emphasis in this paper is on funding needs for infrastructure but demand for other services also puts pressure on councils. The distinction between services which are technically indispensable (e.g. sewerage systems), and those which are 'discretionary' (e.g. libraries) has been regularly tested by councils as part of planning procedures and clearly in the view of communities the definition of essential is much wider than "just infrastructure".

Infrastructural Needs

Some of the drivers of infrastructural costs include the following:

- rapid population growth in some areas fuelling needs for expansion of infrastructure networks and more community infrastructure;
- the effects of past under-investment in transport infrastructure (including passenger transport), in particular during the 1980s and early to mid 1990s;
- many of New Zealand's rural roads were built in the 1950s and 1960s and are nearing the end of their economic life with consequent accelerated demands both for maintenance and ultimate replacement;
- changing health and environmental standards;
- requirements in the LGA 2002 to conduct an assessment of water and sanitary services have identified areas for attention, especially as regards small communities;
- requirements to "fund" depreciation, introduced in 1996, are resulting in rates increases, while at the same time creating political difficulties as local authorities accumulate funds in depreciation reserves[23]. Local government representatives on the team contend that the amendments to the requirement in the LGA 2002 may have removed some of the unintended consequences but have not significantly ameliorated the financial impact;
- some investment in community infrastructure is required to maintain the quality of life New Zealanders expect, to support central government's economic development goals, and to compete internationally. This has generally, though not exclusively, been cited by metropolitan New Zealand; and
- local authorities have also pointed out that although central government has increased the level of financial assistance for some of these items this is generally on a dollar for dollar basis with a local contribution (which generally must come from rates).

[23] Depreciation costs have increased 120 percent between 1996 and 2004, by comparison the value of fixed assets have increased 54 percent.

New Standards

Central government and other agencies have powers to regulate and from time to time set binding standards that local authorities must meet. These generally reflect community aspirations or standards considered appropriate in a first-world society. In meeting these standards local authorities often need to undertake activities to ensure the standard is met (for example, upgrading the standard of treatment of sewage outfalls). The standards, while mandatory, do not of themselves create the cost, rather it is activities undertaken in compliance that create the cost.

Work being undertaken by the Local Government Regulatory Framework project that has reached a preliminary conclusion that there is justification for central government policy-making to better incorporate the effect of changes to regulatory responsibilities on local government into its analysis.

It should be noted that some of the standards that are of concern to local authorities are not set by central government. For example, the largest single item of expenditure identified in the survey is a stormwater upgrade required if the local regional council changes its regional policy statement. In these cases there may be scope for discussion between territorial authorities and regional councils, and it seems that local authorities could also better incorporate impacts on other authorities in their policy analysis.

New Regulatory Roles

Some regulatory roles have been set for local government in recent years. These include the development of policies on gaming, additional inspection requirements under the Building Act 2004, and the movement of the setting of speed limits from the (then) Land Transport Safety Authority.

Some of the regulatory legislation is empowering rather than mandatory and are matters for community choice, although we note that in some cases community pressure leaves local authorities with little choice. Bylaw making powers under the Prostitution Reform Act are a good example of this.

The more recently enacted and/or reviewed pieces of functional legislation tend to have more flexible charging powers at least with regard to the cost of processing applications, undertaking inspections and the like. Ability to recover the costs of policy development and the like are far less typical.

Older, less frequently reviewed pieces of legislation are more prescriptive in their charging powers. An oft-cited example is that of the regulatory inspector who travelled for four hours to inspect an amusement device, for which the council was able to recover only $12 for the inspection. Reviews of the charging powers in these sorts of legislation, and their consistency with the objectives of that legislation are an area for potential policy work.

Increased Consultative and Procedural Requirements in the LGA 2002

The LGA 2002 created a more complex accountability and consultation framework. It's aim of boosting public participation was generally achieved through clarifying the circumstances in which consultation was required, and requiring items such as summaries for greater clarity. The requirement to obtain an auditor's opinion on the forecasting assumptions and service levels before consultation has created a new cost that does not seem to vary greatly according to size or type of authority.

Other examples of additional consultative or procedural requirements include the following:

- the requirement to review all bylaws and to adopt bylaws via the special consultative procedure
- requirements to consult on transfer of small water schemes
- requirements to prepare an assessment of water and sanitary services
- requirements to consider community views at each stage of the decision-making process.

General Empowerment

The general empowerment of local government contained in the LGA 2002 may have created additional expectations on local authorities especially from the community and the voluntary sector. However there is little evidence at this point to suggest that these have translated into additional expenditure.

It is important to view the greater empowerment and sustainable development focus of the LGA 2002 in their full context. The LGA itself places few **direct** obligations on any local authority to provide any service or undertake any activity[24]. Local authorities and their communities are free to make their own judgements as to what constitutes social, economic, environmental and cultural well-being; what the local authority's role in promoting well-being is; and what services are necessary to fulfil that role.

Making decisions between competing local needs is, and always has been, the central part of the role of an elected member. The team accepts, however, that the new purpose of the LGA has meant that a potentially wider range of calls can be made on local government.

[24] The main mandatory functions imposed on local government are provided for in other legislation such as the Land Transport Act, Health Act, Building Act and the like.

Expenditure Excluded From LTCCP Documents

The survey identified some $1.67 billion in (mostly) capital expenditure that 13 of the 20 local authorities surveyed consider to be necessary, but which was not included in the transitional LTCCP documents prepared under the Local Government Act 2002.

These 13 councils include 4 metropolitan local authorities, 2 regional councils; 4 provincial local authorities, and 3 rural local authorities.

Of the sample of twenty local authorities, seven stated that all of their necessary expenditure was in their LTCCP (with one qualification[25]). These included 3 metropolitan local authorities, 2 regional councils, a provincial local authority, and a rural local authority.

Figures Two and Three show firstly the differences in excluded expenditure by sector and then by individual local authority on a per household basis. The interesting point from Figure Two is that, although the metropolitan sector accounts for almost three quarters of the excluded expenditure, when viewed from a per household basis, it is the provincial sector that has the highest level of excluded expenditure. Similarly in Figure Three, councils A and F have the largest amounts of expenditure in absolute terms, yet this is dwarfed by provincial councils I and K. When interpreting averages the small sample size needs to be kept in mind – especially in the rural sector.

Figure Two. Expenditure Excluded From LTCCPs Per Household by Sector

[25] One metropolitan authority noted that they had not included any unfunded capital projects in the survey that may arise from their recently adopted Regional Growth Strategy.

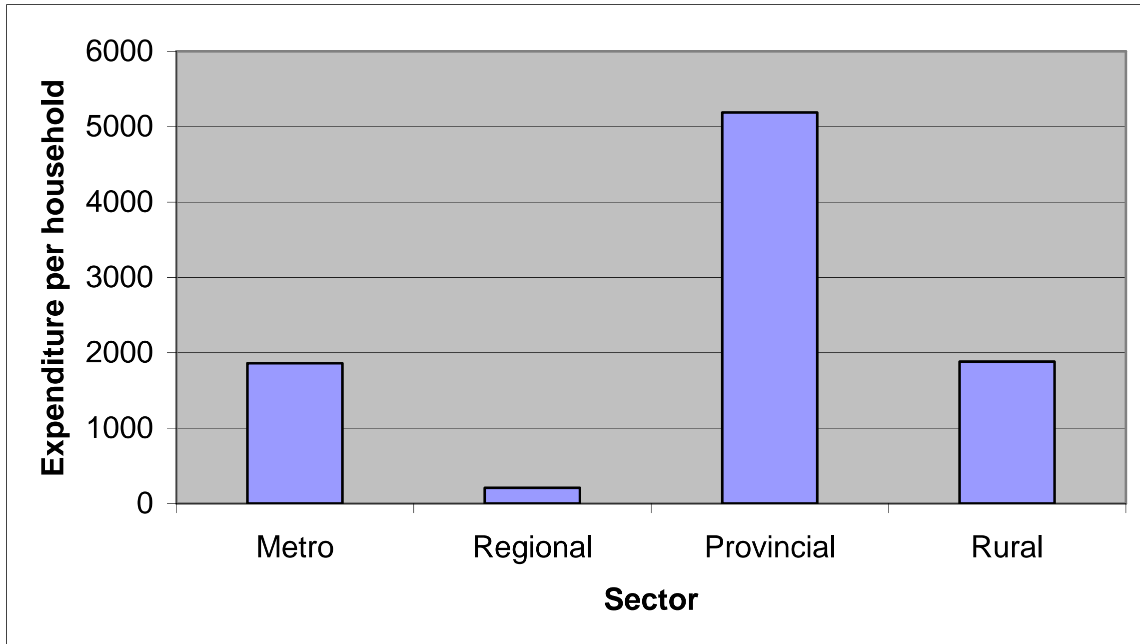
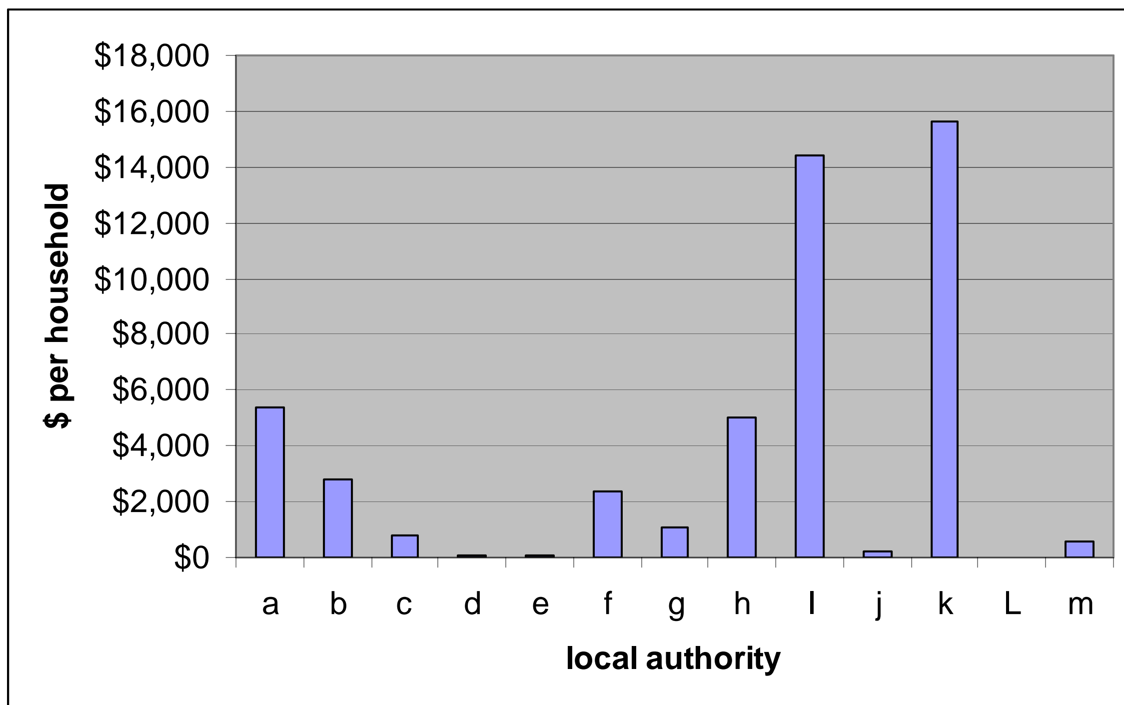


Figure Three: Excluded Expenditure Per Household by Authority 2004/5-2013/14



The two local authorities with the most excluded expenditure collectively account for 65 percent of the total. These two local authorities account for 19 percent of the total population of New Zealand.

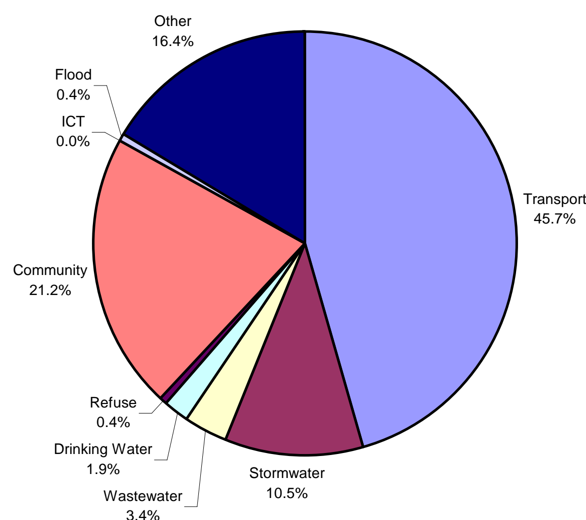
Of the remaining 13 local authorities, four identified total amounts (i.e. from 2004/5-2013/14) that were less than $200 per household for the entire period (i.e. $20 per household per year). On the other hand four local authorities identified amounts that were in excess of $5000 per household (i.e. $500 per household per year).

When compared with current levels of operating expenditure five councils have identified amounts of expenditure than would more than double their operating budgets. One local authority has identified projects to a value that is more than four times its 2004/5 operating budget.

Figure Four breaks the expenditure into categories. From this it can be seen that transport is the largest single category and accounts for almost half of the excluded expenditure. The next largest category (at 21 percent) is community infrastructure – which includes expenditure on libraries, museums, sports grounds and stadia, convention facilities and halls and the like. Expenditure on drinking water and sewage disposal is somewhat lower than we had anticipated.

The bulk of the items listed were expected to fall in the period 2008-2010.

Figure Four: Excluded Expenditure By Category, 2004/5 – 2013/14



We matched the information from the 13 local authorities who stated they had excluded expenditure with the indicators elsewhere in this project. We found that fully funding the excluded items through rates increases would result in:

- annual rates increases of 10 – 26 percent in seven of the 13 local authorities (in addition to projected rates increases in their Transitional LTCCPs); and
- annual rates increases of five percent or less in six of the thirteen local authorities (this includes those items already in the Transitional LTCCPs).

Alternatively, fully financing the unfunded capital expenditure through debt funding results in:

- seven councils reaching or exceeding their borrowing limits set in their liability management policies;
- three councils could fund significant amounts of their excluded expenditure if they borrowed to the limits they set for themselves in their debt management policies;
- two councils are already beyond their debt limits; and
- the remaining council appears to have low limits on its debt (by comparison to others) and could with some adjustments, also borrow to finance the excluded expenditure.

The team acknowledges that proposing significant changes to a local authority's borrowing policy would require community consultation through the special consultative procedure.

3.2 Rates

During the period 1993-2002 the total rate take in local authorities increased by 44 percent. After adjusting for inflation and population growth the average increase was approximately 2.1 percent per annum.

Current Use of Rating Tools

In the current (2004/5) rating year local government expects to collect some $3.152 billion (GST inclusive) in rates. This represents a 14 percent increase in rates over the 2002/3 year.

The LGRA provided local authorities with a wider set of rating tools[26]. In particular, local authorities were given a wider range of powers to assess targeted rates (rates assessed on particular categories of ratepayer or to fund a particular project). Local authorities sought more flexible powers largely because they considered that the range of powers available to them at that time did not promote high standards of compliance with

[26] This is particularly true of regional councils, as the historical restrictions on the use of uniform charging powers and differential rating on the general rate were removed. All local authorities now have access to the same powers.

the financial management provisions in Part VIIA of the Local Government Act 1974. It was expected that local authorities would be making greater use of targeted rates and less use of general rates, now that a greater range of tools is available and with public pressures to demonstrate the "value for money".

Table One demonstrates that the shifts which have occurred have been between the different types of general rating tool and the different types of targeted rating tool[27].

Table One: Local Authority Rates Revenue by Source 2002/3 and 2004/5

Type of Rate	2002/3	2004/5
Prices	2.1	3.5
Proxy prices	0.8	0.9
Pan charges	2.8	2.3
Uniform general charge	7.5	10.4
Fixed rates – water/sewage	11.4	10.0
Fixed rates – other	5.2	8.1
Value based general rates	53.3	48.9
Value based targeted rates	16.9	15.8

Another interesting feature from Table One is the increase in local authorities use of what historically have been referred to as "uniform charging" powers (where the rate is a flat dollar amount per property or separately used or inhabited part of a property). Uniform charging powers accounted for 24 percent of local authority revenue in 2002/3 and now account for 28.5 percent of local authority revenue. Some local authorities are legitimately[28] raising 60 percent or more of their revenue through these charges. These charges are regressive in nature. While some of the increase has come from the extension of powers to regional councils, territorial use of them has also increased. Continued increases of this magnitude may have affordability issues for ratepayers on low incomes or in low value properties.

Looking at the use different types of local authorities make of rating mechanisms we found that:

- urban local authorities tend to make more use of general rating mechanisms and lower use of targeted rating;
- rural local authorities tend to make more use of targeted rating and uniform charging; and
- regional councils have historically made far higher use of targeted rating than their territorial counterparts.

[27] These terms are explained in further detail in Appendix D, as are each of the categories of rating revenue.
[28] Although section 21 of the Rating Act limits local authorities to collecting no more than 30 percent of their rates revenue from these charges – charges for water supply and sewage disposal are exempted from that calculation.

The LGRA introduced several new powers to local authorities (for example the power to make rates on the basis of a charge by areas that are sealed, paved or built on, or the area of floor space within the property, and on the value of improvements) and new options for using existing powers (for example the ability to assess targeted rates using combinations of valuation bases). Our analysis of 2004/5 resolutions showed that no local authority is currently using any of these new powers. Many of these do involve some collection of information that is not usually held on valuation databases – and such changes would take some time to implement. We also anticipate that as local authorities experience with this legislation and the LGA increases local authorities will explore what use they can make of these tools.

Provision of a wider range of tools does not necessarily enable local authorities to access previously "untapped" pockets of revenue, rather these tools have enabled local authorities more flexibility in how they allocate the burden of rates. Beyond this, and the potential issue with uniform charging, it appears that the current use of rating tools has few implications for affordability.

Rating Levels

In 2004/5 the average household paid $1843 in territorial rates and $238 in regional rates for a total of $2081[29]. This amount is equivalent to 4.7 percent of median household incomes.

These figures mask wide variations in rating levels around the country. Territorial rates range from $1224 up to $3675. The variability in regional rates is even greater – with rates per household ranging from $89 to $358.

Of the twenty territorial authorities with the highest level of rates in 2004/5:

- seventeen are areas of moderate-low urban density, three are high density urban areas;
- eleven have populations of less than 20 thousand, four have populations of between 20 and 30 thousand, two have populations of more than 100 thousand;
- four local authorities have substantial non-resident ratepayer interests (this includes the local authorities with the three highest levels of rates); and
- one is a unitary authority and has the functions of both a territorial and a regional council.

On the other hand, of the twenty local authorities with the lowest levels of rates per household in 2004/5:

[29] These are not arithmetic means–but are weighted averages derived by dividing the total rate take by total number of households.

- three have populations of 20 thousand or less, three had populations of between 20 and 30 thousand, eight had populations of between 30 and 50 thousand, three had populations of between 50 and 70 thousand, and three were metropolitan councils
- seven have high population density, 10 moderate density, and three low population density.

Despite this, the statistical correlation between population density and rates per household is on the margins of statistical significance (-0.36), while there is no statistically significant relationship between population levels, population growth, or the degree of socio-economic deprivation in the local authority.

In the regions the determining factor seems to be the range of functions each performs. Four of the five regional councils with the highest levels of rates have substantial responsibilities in passenger transport, and more complex regional transport planning obligations.

To the extent conclusions can be drawn from this data, it appears that population density (or the lack thereof) appears to be more of a determining factor of current rating levels, than population or growth.

Based on information in each local authority's last LTCCP, the average territorial rate will increase to $2186 by 2013 (a real increase of 18.6 percent), and the average regional rate to $302 (a real increase of 27 percent)[30]. The average rates bill per household is expected to increase 20 percent to $2488 (in real terms). This is slightly lower than rates increases throughout the period 1993-2002. This is expected to be equivalent to 5.4 - 5.5 percent of household incomes.

There is huge variability in changes in rates per household in individual local authorities. These range from an increase of 61 percent to a decrease of 22 percent in one particular regional council. This is not the same thing as actual rates in the dollar changing – for example a local authority where the numbers of households are growing by 5 percent per annum and rates are increasing by 2 percent will experience a decline in rates per household. The magnitude of changes in rates per household is shown in Table Two below.

[30] These estimates include the impact of changes in the quantity and quality of services provided by local government, new functions and/or functions that local authorities cease delivering, population growth and/or intra-authority shifts in the pattern of growth. With the exception of interest costs and some element of labour cost no allowance is made for inflation.

Table Two: Projected Rates Increases 2004/5 – 2012/13

Scale of Increase	Number of Local Authorities
40 percent or more	6
30 – 40 percent	14
20 - 30 percent	16
10 – 20 percent	13
0- 10 percent	28
Decrease	8

The local authorities with the largest levels of projected rates increases tend to have one or more of the following factors in common:

- substantial forecast increases in transport, water or wastewater expenditure (several are forecasting their expenditure in these areas will double). The introduction of asset management planning disciplines during the 1990s has highlighted the extent of past deferred maintenance. Local authorities also cite increasing standards – including those set nationally and at a regional level;
- rapid rates of population growth (in some – others are experiencing population decline) creating increases in demand for services "across the board";
- historically low levels of rates (thus while percentage increases may be relatively high the absolute level of increase is not necessarily high).

There are no particular common factors with regards to the size, type or population density in these local authorities.

There are also some factors unique to particular local authorities. For example one local authority is expecting to borrow at levels that are very high relative to others, and by 2012/13 the interest costs will account for some 38 percent of the rate take.

The definition of affordability from section one made it clear that it is not the level of rates that is an indicator of affordability, it is the level of rates relative to the resources available to meet them. We have therefore calculated rates to income ratios for each local authority.

In 2004/5 the average rate per household accounted for 4.7 percent of median income. There was wide variation in these ratios on the level of the individual local authority. Rates to income ratios range from 2.5 percent to 10.3 percent[31]. Three local authorities have rates to income ratios of less than three percent. Seven have rates to income ratios of seven percent or more – although only one has a ratio higher than eight percent.

[31] Residents in this local authority pay the highest level of territorial rates, the second highest level of regional rates, and this local authority the third lowest level of median household income in the country. This local authority has a substantial non-residential ratepayer population.

In 2012/13 the average rates to income ratio is expected to be around 5.5 percent. The variability in rates to income ratios remains about the same.

Importantly, from a policy perspective, a high rates to income ratio is not necessarily the result of having high rating levels. Five of the twenty local authorities with the highest rates to income ratios in 2004/5 actually have rating levels that are below average, but have low-income levels relative to the rest of the nation. On the other hand only one of these local authorities has an income level above the national average.

We were aware that even the wealthiest local authorities can have pockets of low-income earners (and vice versa) so rates to income ratios were calculated for each census area unit. This revealed a wider degree of variability in rates to income ratios than is the case at local authority level, with rates to income ratios ranging from 1.8 percent to 19.7 percent. For 1.5 percent of the census area units in the country the average rate per household was more than 10 percent of median income for the census area unit.

We found that 56 territorial authorities had at least one census area unit that was "high" rated, only 17 territorial authorities had no units that met this test. On the other hand, only 19 local authorities had census area units that were "low" rated.

We then considered the characteristics of the 100 lowest and 100 highest rated census area units. Those with the highest rates to income ratios were characterised by:

- high unemployment rates (generally twice the national average or more);
- small populations (as a general rule even the metropolitan units tended to be smaller than others in their local area);
- workforces with high proportions of agricultural and fisheries workers or sales and service workers; and
- a high degree of socio-economic deprivation.

Units with low rates-to-income ratios tend to have larger populations, low unemployment (generally less than half the national average), high concentrations of legislators and managers or professional people, and low degrees of socio-economic deprivation.

Finally we considered the impact that rates have on different types of household. Table Three shows the median household income and rates to income levels in the different types of household. As would be expected the results suggest households with a single income earner tend to find rates are a bigger burden, than households with couples, or other types of household with more than one income earner.

Table Three. Rates to Income Ratios by Household Type 2004/5

Household Type	Income	Rates to Income Ratios
Couple only	50,570	4.1%
Couple only and other person(s)	81,946	2.5%
Couple with child (ren)	66,761	3.1%
Couple with child (ren) and other person(s)	78,431	2.7%
One parent with child (ren)	24,393	8.5%
One parent with child (ren) and other person(s)	42,871	4.9%
Total One-family Household	53,975	3.9%
Two 2-parent families	105,976	2.0%
One 2-parent family and a 1-parent family	78,893	2.6%
Two 1-parent families	45,163	4.6%
Other 2-family household	88,166	2.4%
Total Two-family Household	79,451	2.6%
Three- or more family household (with or without other people)	110,301	1.9%
Household of related people	39,980	5.2%
Household of related and unrelated people	68,326	3.0%
Household of unrelated people	52,415	4.0%
Other multiperson household, not further defined	56,377	3.7%
Total multiperson Household	50,791	4.1%
One-person household	19,267	10.8%
Household composition unidentifiable	34,440	6.0%
Total	**43,666**	**4.8%**

Rates Relief

Having concluded that low household incomes are a factor in any difficulties households may have in meeting their rates bills, we then turned to the question of the various mechanisms available for rates relief. These are:

- remission and/or postponement of rates under the Local Government Rating Act 2002[32];
- rates rebates under the Rates Rebate Act 1973; and
- other means of income support, for example the Accommodation Supplement.

The LGRA confers wide discretion on local authorities with respect to remission and postponement of rates. Effectively, a local authority may remit or postpone any amount of rates, on any property, for any reason. The only limits on these powers are those that the local authority and its community impose, since any local authority that wishes to

[32] Postponement of rates occurs where a local authority agrees to delay the due date for payment of rates until a specified time, or a specified event occurs (such as the sale or rental of the property on which rates were payable). Remission occurs when a local authority agrees to reduce the amount of rates owing on a property.

remit or postpone rates is required to adopt a policy through the special consultative procedure.

Analysis of a representative sample of 43 policies showed that:

- remissions policies are used for simplifying the day-to-day administration of the rating system (for example almost all of the local authorities in the sample had a policy allowing for the remission of penalties), ameliorating the results of the change in primary liability from occupiers to owners, and providing assistance to community and voluntary groups. Few local authorities have remission policies that target affordability issues directly.
- few local authorities make use of postponement powers – the overwhelming majority that use these powers do so as a means of to dealing with financial hardship[33].
- overall most local authorities tend to remit and postpone between 0.3 and 0.7 percent of their total rate take.

Local authorities are therefore not frequent users of powers to remit and postpone rates, and where these powers are used they tend not to be for affordability issues. However, we also noted that:

- many local authorities do not have access to the detailed income information to operate what is effectively an income redistribution mechanism on a large scale;
- postponement of rates may not be a viable option where property values are low and do not increase significantly;
- remissions and postponement shift the incidence of rates amongst ratepayers; and
- remission and postponement policies do not necessarily fit well with the income support policies operated by central government.

One direct mechanism for providing support to those having difficult meeting the burden of rates is the Rates Rebate Scheme. The scheme is particularly suited to those ratepayers that have low incomes, high rates, and own their properties outright. Currently the maximum rebate available under the scheme is $200, and this abates at the rate of $1 for every $8 of income that the ratepayer earns over a threshold of $7400.

While we were preparing this report the Government announced that it has approved a substantial increase in the income thresholds (from $7400 to $20000) and an increase in the maximum rebate of $500. An additional income allowance will also be increased from $156 to $500 for each dependent of the ratepayer. The impact of this is to extend full or partial coverage of the scheme to most beneficiaries and superannuitants who own their homes, especially where they receive no other income. These changes take effect from 1 July 2006.

[33] A common definition of hardship is that *"the council must be satisfied that the ratepayer is unlikely to have sufficient funds left over, after the payment of rates, for normal health care, proper provision for the maintenance of his/her home and chattels at an adequate standard as well as making provision for normal day to day living expenses"*

Rating Exemptions

Schedule One of the LGRA sets out a list of 22 different categories of property that are exempt from most rates, and a further 3 categories of property that are 50 percent exempt. Some of the largest categories of exempt land include the conservation estate, schools, public hospitals, land used for religious worship, the operational area of ports and airports, and the road and rail networks[34]. Both fully exempt and 50 percent exempt properties are fully liable for targeted rates for water supply, sewage disposal and refuse collection *where the property receives those services*. The 2004/05 Budget provided $967,000 for paying rates on Conservation land, and $1,245,000 for the payment of rates on other Crown land.

Approximately 4 percent of the total value of land in the average local authority is in exempt properties[35]. However, non-rateable land is not evenly spread throughout the country. In some local authorities as little as one percent of the land is non-rateable. On the other hand 6 local authorities[36] have more than 10 percent of the value of their district tied up in exempt land.

We found little evidence, on a national level, of any relationship between the level of exempt land and the level of rates. This is not to say that the level of exempt land is not a factor in the rating decisions of individual local authorities and this has not been explored with the sector. We noted that of the six local authorities with the highest amounts of exempt land, three had rating levels below the national average (including the two with the highest percentage of exempt land), and three had rating levels above the national average. The grouping of local authorities with between five and ten percent non-rateable land includes 3 of the 5 local authorities that have high levels of rates and debt.

We also noted that some categories of non-rateable land generate benefits of some value to the local area. For example, having a non-rateable university may attract students into a city from outside the immediate area, which creates a larger residential and commercial rating base. Some national parks have tourism industries associated with them which in turn creates local accommodation needs and associated services. This is a factor that should be further considered as part of the analysis of possible options around Crown contributions in lieu of rates requested by parties to the Forum.

Our preliminary conclusion is that the existence of rating exemptions, in and of itself, is not giving rise to affordability issues at the national level. Rating exemptions may, however, contribute to affordability issues in some individual local authorities.

[34] In 2002 the Government reviewed all rating exemptions and decided to retain the exemptions still in force. It also decided that some amendments were needed so that exemptions were phrased in terms of the use of land and not the ownership. For example, Crown owned land is exempt from rates if and only if it falls into one of the categories in Schedule One.
[35] Source: Quotable Value.
[36] Westland, Grey, Buller, West Coast Region, Dunedin and Southland. Five of these six have substantial amounts of conservation estate. The sixth, Dunedin, has substantial education interests. Westland has the largest proportion with 43 percent of the district value tied up in non-rateable land.

Some local authorities claimed that enforcement difficulties in collecting rates and differences in tenure on Maori freehold land can impose significant constraints on revenue raising. Maori freehold land cannot be the subject of the rating sale process, is seldom mortgaged (making recovery via a mortgagee difficult) and enforcement through the Maori Land Court is possible only to the extent the land generates income. There is a group of eight local authorities in Northland, the Bay of Plenty and the central North Island[37] for whom Maori freehold land accounts for more than 10 percent of the district, and for whom difficulties in enforcement do provide some constraint. While enforcement difficulties on Māori freehold is a significant issue in these local authorities, it is not a significant issue elsewhere.

3.3 Other Income Sources

Investment Income

Some local authorities have access to revenue generating assets such as port company shares, or have funds accumulated from the past sale of such assets.

Although a profit-making port or trading enterprise may well pay a dividend to its shareholders which can be used to fund other priorities, a loss-making investment may require contributions from the local authority to keep operating. We are aware of at least two local authorities that are forecasting a small net loss on their investments at various points over the next eight years.

In the current year the average territorial authority is expecting to receive an amount equivalent to 3.5 percent of their total revenue. One in five territorial authorities is receiving investment income in amounts equivalent to five percent or more of their total revenue, and one in ten are receiving more than ten percent[38]. On the other hand, one third of territorial authorities were expecting to receive less than one percent of their total revenue from investments.

On average, regional councils tend to have a far higher level of income from investments than their territorial counterparts (15 percent) – due in part to the allocation of port company assets in 1989. Eight of the twelve regional councils receive investment revenue that accounts for five percent or more of their total revenue. Three of these receive a third or more of their total revenue from this source.

On current forecasts few local authorities are predicting significant changes in the income they receive from investments in future years. The national averages remain unchanged.

[37] These are Far North, Kaipara, Western Bay of Plenty, Rotorua, Opotiki, Whakatane, Gisborne and Ruapehu Districts.

[38] In 2004/5 the territorial authority that was forecasting the most investment income is expecting that almost a quarter of its revenue will come from investments.

While on a national level there is no statistically significant relationship between the level of investment income and the level of rates, in some individual local authorities it can play a very significant role in keeping rates low. Lack of revenue-producing assets may be part of a wider affordability issue in particular local authorities, but of itself is not likely to create an affordability problem.

Development Contributions

The Local Government Act 2002 provided local authorities with an opportunity to assess development contributions under that legislation rather than assessing financial contributions under the Resource Management Act 1991. These can take the form of a financial amount or land and can be used for the purposes of providing reserves, network infrastructure or community infrastructure.

Financial contributions require that the local authority have an operative district plan and are subject to challenge in the Environment Court. A local authority wishing to assess development contributions must first adopt a policy on development contributions as part of its LTCCP. While these are subject to challenge, it is on the same basis as a rating decision e.g. misapplication of the law or on administrative law grounds[39]. There are some advantages to assessing development contributions as opposed to financial contributions.

We found that almost half (31) of the 74 territorial authorities[40] either have introduced these tools or will be doing so in their next LTCCP. The majority of these (22) are territorial authorities that are experiencing annual growth of 1 percent or more – although we also noted there were 3 authorities that had reducing populations[41]. Of the 41 local authorities still using the Resource Management Act, 30 have indicated they will be reviewing their choice of tool as part of their next LTCCP.

It appears that development contributions are currently being used by those local authorities with the highest level of development, and that the number of local authorities using this tool will increase in the next eighteen months. Our analysis has not identified how much of the increased cost of development are being met through developer contributions.

Central Government Funding of Local Needs

Central government provides support for local needs, via local government, in variety of ways. The main type of funding support is the direct provision of financial assistance through various grants and subsidies for infrastructure and services. The roles of central and local government are complementary in this area. For example, provision of tourism

[39] This is the so-called "*Wednesbury* test" – which holds a decision can be overturned if a decision-making body fails to take relevant considerations into account, takes irrelevant considerations into account, or the final decision is so unreasonable that no reasonable decision-making body would have contemplated it.
[40] Regional councils cannot assess development contributions under the Local Government Act 2002.
[41] We assume that these local authorities are experiencing growth in specific parts of the district, but that this growth is not sufficient to offset the decrease elsewhere.

infrastructure that caters for large amounts of visitors from outside a district may be partly borne by the local community (reflecting the local benefit), and partly by central government (reflecting the national benefit). This is effectively redistribution of tax at a national level.

Data on local authorities' income and expenditure published by Statistics New Zealand show that Government operating grants and subsidies[42], at approximately $570 million in 2003/04, comprise approximately 12% of local authority operating income[43]. This rose to $624 million in the 2004 calendar year.

Central government grants and subsidies increased by 45% over the period 1999-2004. This compares favourably with a 27 percent increase in overall operating revenue and a 32 percent increase in rates. Central government funding increases in recent years have included funding to provide more services that local government is currently delivering (as is the case in land transport) and towards the cost of meeting changing standards in services local government is already providing (as is the case with funding for drinking water standards). It should be noted that most of this funding is provided in such a way as to require some local contribution – generally on a dollar for dollar basis.

By far the largest funding of local needs by the Government is that provided by Land Transport New Zealand (formerly Transfund). This financial assistance is provided by the allocation of funds through Vote: Transport, and allocated through the National Land Transport Programme. Table Four provides an indication of the current assistance for local authorities through the National Land Transport Programme which, along with the Safety Administration Programme, makes up the bulk of expenditure from the National Land Transport Fund.

Table Four: National Land Transport Funding for Local Authorities

Activity class	**2003/04 ($million)**	**2004/05 ($million)**
Maintenance of local roads	282.20	329.09
Improvement and replacement of local roads	63.83	92.63
Passenger transport (community and social services)	95.98	101.59
Travel demand management, rail and barging	28.00	53.00
Regional development	23.16	25.00
Administration and project control	14.93	13.83
Walking and cycling		2.5
TOTAL	**508.1**	**617.64**

Source: National Land Transport Programme 2004/05

The Government has recently committed $3.225 billion over 10 years to the National Land Transport Programme. This funding is available to local authorities and Transit

[42] We are aware that there is an ongoing debate as to whether various funding streams are "grants" or "subsidies" – we use these terms in this section solely because that is the descriptor used by the chief source of information for this section, Statistics New Zealand.

[43] These data only reflect the operating income of local authorities. Assistance provided by the Government for capital projects is not included.

New Zealand, and it is not possible to say how much of it will be allocated to local authorities. The Investing for Growth package provided an additional $3 billion to land transport over 10 years. $2.07 billion is being allocated by region on a population basis over the whole of New Zealand (including Auckland), and an additional $900 million has been specifically earmarked for Auckland. In addition to the $3 billion package, the Wellington transport project provides a further $225 million over 10 years.

Local authorities also receive funding of $4.808 million each year through the Safety Administration Programme for the Community Road Safety Programme (CRSP).

A number of types of funding are available to local authorities for a variety of purposes. These include:

- *drinking water, fluoridation and sewage disposal funding* - the Government has established funds to assist local authorities and other water suppliers to improve drinking water and sewerage systems. Together these funds total approximately $270 million over 10 years;
- *local authority tourism infrastructure* – a scheme (via Vote: Tourism) provides $10 million ($5 million for each of the 2005/06 and 2006/07 years) to fund water and sewerage infrastructure costs for small local authorities; and
- *SPARC* provides funding to local authorities for a number of purposes. The Active Community Investment programme provides $10 million over 3 years to local authorities. Support is also provided to smaller local authorities to partner the development of physical activity plans ($400,000 per annum) and for assisting travel to sporting clubs in rural areas ($200,000 per annum).

In addition to funding that is specifically tagged for local authorities, there are a range of contestable funding schemes that they may be able to access. For example:

- *the Sustainable Management Fund:* this fund is aimed at providing support the community, industry, iwi and local government in practical environmental initiatives. A total of $4.3 million is available per annum;
- *the Regional Initiatives Fund:* local authorities, in partnerships with others, can access one-off, ad hoc funding for regionally focused projects. The Budget provides $2 million per annum for this fund;
- *Regional Partnerships Programme*: this programme provides funding for capability building of local partnerships, feasibility studies and major regional initiatives. A total of $56.25 million is available over the 3 years from 2004/05 to 06/07;
- *Digital Strategy*: two new initiatives under the Digital Strategy have established funds that local partnerships, including local government, can access to develop and implement proposals that improve capability and skills to use information and communication technology and develop community driven requirements for digital

content (a total of $17.936m over next 4 years, exclusive of GST); or extend high speed broadband to regional centres and businesses and make broadband available to smaller communities (a total of $20.267m over the next 4 years).

3.4 Debt

Why Local Authorities Borrow

Many in the general public hold the view that the local government sector is heavily indebted. The legislative history of restrictions on local government borrowing and experience with central government borrowing in the period 1935-1984 have conditioned the sector to avoid borrowing. Many of the assets owned and operated by local authorities have very long lives – often 50 years or more. Paying for a road, or a water scheme, or a stadium solely from current revenue sources (such as rates) effectively means that today's ratepayers and users of the service are paying for the benefits that accrue to future ratepayers (this does happen in some cases). This practice is contrary to intergenerational equity, which is one of a set of six matters that section 101(3) of the Local Government Act requires local authorities to consider when making funding decisions[44]. Borrowing and repaying the debt over time spreads the cost of the project over both today's and tomorrow's users and ratepayers.

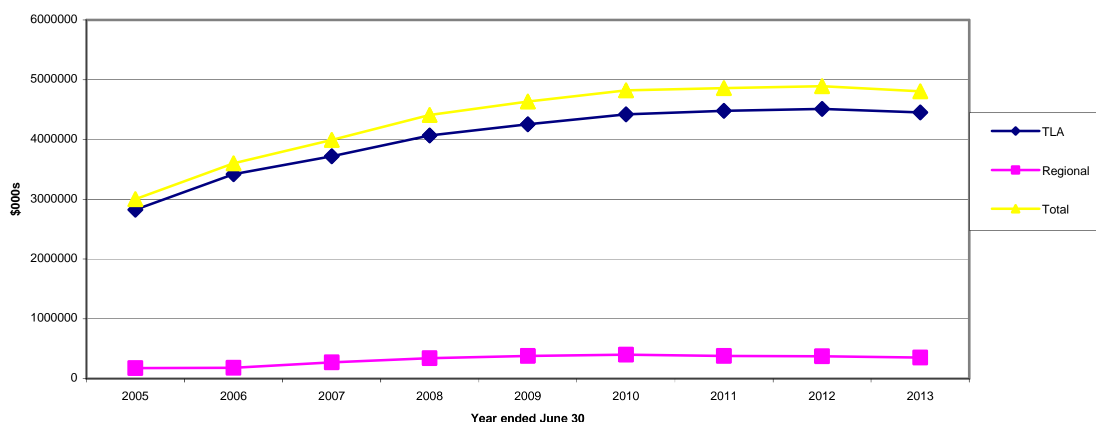
Debt Levels

In the 2004/5 financial year local authorities owed $3.003 billion in public debt. This needs to be viewed as part of the overall financial picture of local government. In the same year local authorities owned some $62 billion of assets, for a net worth of $59 billion. Put another way local authorities own $20 in assets for every dollar of term debt. This compares favourably with the financial position of central government which on 30 June 2004 had $110.6 billion in assets, $75 billion in liabilities (or $1.47 in assets for every dollar of debt).

Between now and 2012/13 local government debt is expected to increase by 60 percent and will stand at $4.8 billion. Regional council debt is expected to double and will stand at around $355 million[45]. As Figure Five shows debt is expected to peak in 2012 – although regional council debt is expected to peak earlier in 2010.

[44] To be precise, the Act requires local authorities to consider who benefits from particular activities *and the period over which the benefits are expected to accrue*.
[45] A single regional council will owe approximately two-thirds of all regional council debt.

Figure Five: Forecast Local Authority Debt Levels 2005-2013



Territorial authority debt is expected to increase by 58 percent. The largest increases in territorial debt are forecast in local authorities with populations of between 10 and 30 thousand (76 percent). The smallest increases in debt are expected in territorial authorities with populations of between 50 and 90 thousand (39 percent).

The sector wide increase in debt levels does not mean that the level of debt increases in every local authority. In 22 territorial authorities debt either stays constant or decreases. In 2004/5 six councils (2 territorial authorities and 4 regional councils) have no term debt whatsoever, by 2012/13 eight councils will have no term debt.

It is not, however, simply absolute levels of debt that are relevant in determining whether organisations could make more use of debt, but the organisation's ability to service the debt. Two commonly accepted measures of ability to service debt in local government are the ratio of debt to income and the ratio of interest costs to rates revenue. We consider that "comfortable" levels are 150 percent for the former and 20 percent for the latter[46]. In our analysis of the financial position of each council we found that there were eight local authorities that had debt levels in excess of 150 percent at some point over the next few years[47], and eight local authorities (including one regional council) that had interest costs in excess of 20 percent of rates revenue. Many of these local authorities, though not all, are experiencing above average rates of population growth. This is not to say that these local authorities are in financial difficulty, but that they either have or will reach levels of debt that they may have problems servicing comfortably. Going beyond these levels may, for example, mean that further debt would carry a higher risk premium.

[46] This is based on measures used by financial rating agencies for local authorities in this country.
[47] Including four where debt to revenue ratios exceed 200 percent i.e. debt is twice the level of revenue.

Debt Limits

Local authorities have few restrictions on their ability to borrow[48]. The majority of restrictions on a local authority's ability to borrow are in fact limits that they set themselves in their liability management policies. Required by law, this policy must be adopted through the special consultative procedure and includes matters such as the giving of security, interest rate exposure and debt levels.

We found that 23 local authorities will either approach or exceed (in a smaller number of cases) the limits in their borrowing management policy by 2012/13. Authorities that appear on this list appear to have one or more of the following factors in common:

- the local authority is growing rapidly;
- the local authority has a low population; and
- the local authority has set limits that are low by comparison with other local authorities (in our view 10 of this grouping fall into this category - many of these have no obvious financial rationale for the choice).

It is difficult to make comments about what a "desirable" set of borrowing limits for a local authority might be – a local authority that needs to invest heavily in infrastructure might have a very different outlook on the desirable level of debt than one which is fully developed with a stable population. It may also depend on other factors such as the mix of assets in each local authority's asset base.

It is our view that many local authorities can make more use of debt than they currently have, and more than they currently predict, without compromising their financial viability or even coming close to their self-imposed limits in their liability management policies.

We noted that loans for individual schemes and/or pieces of work were still very prevalent, especially in regional councils and the more rural territorial authorities. This is no surprise, as this has historically been the case, and we have seen that it is also true of the use of rating tools. The borrowing provisions both of the current legislation and its predecessor (the 1996 legislation) were very much modelled on a corporate model of treasury management (i.e. borrowing is done globally to fund the entire balance sheet). Local authorities may find competitive terms easier to secure and reduce management costs by moving to this model.

[48] With the exception of their own liability management policies the only restrictions on borrowing are a prohibition from borrowing in foreign currency, and the so-called balanced budget requirement which would prevent a local authority from borrowing for operating needs in the long-term.

4.0 Concluding Remarks

We have framed our conclusions in terms of the first four of the questions that the participants in the Central/Local Government Forum set us in the terms of reference. The last of the questions (regarding options) is a matter for the second phase of the project and is not discussed further here. This chapter also includes a commentary from Local Government New Zealand on funding issues.

Analysis of the data shows a wide variability in the local government sector which is a result of their individual circumstances, history of investment in infrastructure, and financial management. It is therefore challenging to draw conclusions that apply across the whole sector.

There are a number of fiscal constraints or pressures on local government. It appears that most local authorities are managing these pressures successfully and providing appropriate services and facilities for their communities. Their Transitional LTCCPs and financial projections indicate that this is sustainable over the foreseeable future.

There also, however, appear to be a proportion of local authorities where increasing pressures will be difficult to accommodate using existing funding tools. For some this is evident from their published information (i.e. transitional LTCCPs), and for others this expenditure is yet to be included in LTCCPs. We consider that fewer than 10 percent of local authorities fit into the first category. The percentage in the second category will be affected by the amount of expenditure not included, potential for discussion of expenditure priorities with the community, and ability to manage it using existing tools. It is not possible to extrapolate this from a sample of twenty, but the survey results indicate that additional councils will have issues when this expenditure is included.

1. What is the magnitude/nature of fiscal pressure facing the local government sector?

In our view the term "fiscal pressure" is really a reference to the challenge of meeting increasing demands within a constrained budget and in an environment where stakeholders have increasing expectations of service quantity, quality and "value for money", and where the cost of maintaining current service levels is increasing. We expand further on the drivers for these increased demands in our answer to the second of the questions put to us by parties to the Forum.

Making judgements on behalf of the community as to the types and levels of services the local authority should provide has always been the most fundamental part of the governance role of an elected member. What has changed is the degree of transparency and rigour in the decision-making and accountability processes.

The increasing demands, described in more detail below, become a "problem" where local authorities, individually or collectively exhibit a lack of financial

tools to meet these pressures.

We conclude that there is a group of local authorities that may be approaching their capacity to generate additional revenue to meet these projected expenditures. These local authorities either currently have, or have signalled that they will have, high levels both of rates and debt. Based on evidence from the first set of LTCCPs, fewer than 10 percent of local authorities currently appear to fall into this category.

There is a second group of local authorities with potential issues, where the LTCCP has not included expenditure that the local authority considers necessary to support quality of life, and where the scale of expenditure readily cannot be met from existing sources. It is however not clear how much of this expenditure has been considered by elected members, or has been the subject of community consultation. This is the sort of community discussion and prioritisation the LGA was designed to promote. Without an agreed definition of "necessary to support the quality of life", and data from all councils, it is not possible to quantify exactly how much expenditure there is, or how many local authorities are genuinely in this position. The data from the sample, however, indicates significant expenditure that if included could push some councils into a similar situation to the first group. Further work is needed since the quantum of expenditure not included needs to be clarified for all councils and existing planning processes employed to include it in LTCCPs as appropriate.

In our deliberations it became apparent much of this expenditure is likely to appear in the next set of LTCCPs. This is, in our view, consistent with the intent of the LGA.

These two groups are not mutually exclusive – two local authorities from the first group also appear to have significant expenditure not included, indicating a more serious problem than signalled in their published LTCCP information. Confidentiality requirements on the survey responses means an exhaustive list of the local authorities that are likely to fall into these groups cannot be provided. We consider that problems meeting the needs of communities with existing funding tools are the result of the *cumulative effect* of a *significant* number of factors from the list below. A local authority that has affordability issues is more likely to:

- have lower population densities than higher (which makes the cost of infrastructure and services higher per person);
- have lower holdings of revenue-producing assets such as port and airport company shares;
- have more substantial amounts of land that is exempt from rates;
- have more substantial amounts of Māori freehold land;
- face substantial needs for new or replacement capital works on the existing stock of infrastructure;
- have significantly higher than average rates of population growth;

- population decline (which reduces the rating base available to fund investment);
- have high levels of non-participation in the labour force, unemployment, and unskilled and semi-skilled workers with consequent low incomes; and
- be more reliant on residential rates i.e. have low commercial and industrial rating bases.

We found very little evidence of affordability problems in the regional sector per se – although they may be a contributing factor in affordability issues for some households. Regional rates tend to be relatively low, many have substantial levels of income from other sources, and very little debt. We consider no more than one or two regional councils are facing significant issues in meeting the needs of communities with existing funding tools. The issues facing regional councils are more in the nature of political acceptability of rates increases – regional council rates are low thus any significant absolute increase will seem large in percentage terms[49].

2. What are the drivers of fiscal pressure facing the local government sector?

The local government sector has stated that the following are drivers of the increasing demands on local authorities:

- the unpopularity of rates (or any tax) and electoral pressure to minimise their absolute level and any increases;
- the cost of new or replacement infrastructure driven by cost escalation and higher environmental and health standards;
- higher community expectations of the quality of services and facilities, and lower tolerance of service failures;
- new regulatory roles such as the new gambling legislation, and changes to building and dog control legislation. While these new functions are usually accompanied with charging powers, there is often no way of recouping the costs of policy development and consultation;
- increased costs from the consultative and procedural requirements of the LGA 2002; and
- increased responsibility under the LGA 2002 to:
  - (a) meet community needs and preferences; and
  - (b) promote social, cultural, environmental and economic well-being and adopt a sustainable development approach.

Although there was some degree of agreement with this list of drivers, there was insufficient evidence to confirm that all of these were drivers. For example, the

[49] Nowhere is this better illustrated in than by the "rates revolt" in the Auckland Region. The average rate increased by approximately $30 per year, but appeared much larger when reported in percentage terms. Having said that a significant percentage rise was also accompanied by a substantial shift in the incidence of rates created in part by revaluation and in part by the council moving to collect its own rates using its own differential system rather than collection by the constituent territorial authorities.

LGA was an empowering statute. Promotion of community well-being is a matter for the judgement of communities – it is to be expected that some degree of prioritisation between projects will always occur. Not all of the regulatory functions passed to local government carry specific obligations – though most do.

The LGA was an empowering statute, requested by the sector as a whole. Promotion of community well-being is a matter for the judgement of communities – it is to be expected that some degree of prioritisation between projects will always occur.

Not all of the regulatory functions passed to local government carry specific obligations – though most do.

3. Are fiscal pressures sustainable for some or all communities, and for groups within the community?

This area of work looked in more detail at affordability issues at a household level. It used the total level of rates divided by the households in an area (local authority and census area unit) as an indicator of affordability. In most local authorities some of the rates are levied on businesses and for the purposes of this analysis it is assumed that these rat2es are ultimately borne by the community.

Based on transitional LTCCP data the average level of rates as a percentage of household income will increase from 4.7 percent to around 5.4 - 5.5 percent between now and 2012/13. All of the data we have gathered points to a "bulge" in expenditure needs in the period 2007-2010 thus we cannot draw firm conclusions about sustainability beyond 2012/13.

There is wide variation across the country, even at local authority level. Rates range from as little as three percent to as much as eleven percent of household income. Residents in two thirds of local authorities pay between four percent and six percent.

We found about 30 census area units where the average rate per household was more than 10 percent of median income. These census units generally had lower populations (even those in urban areas tended to be among the smallest untis within the local authority), lower incomes, higher unemployment, and higher concentrations of unskilled and semi-skilled labour. Our analysis also showed that rates placed a significantly higher burden on incomes in households with a single income earner.

One of the central features of this analysis is the importance of incomes to affordability. Typically, a policy response that addresses the income issues will provide for better targeting than a response that addresses rating issues in that it can better cover low income ratepayers in all local authorities. Recent changes to the Rates Rebate Act will go some way towards addressing concerns about the

affordability of rates for some groups.

Overall, our conclusion is that rates levels, and their projected increases, do not place an unsustainable burden on communities in relation to the services and facilities provided. Many of these are basic services like water and sanitation, and are mandated by the community through the political process.

There are however specific instances where rates represent a higher proportion of household income and this is likely to be producing affordability pressures. This is of particular concern where there are projections or indications of additional, necessary expenditure.

4. To what extent will the revenue raising powers provided in the LGA 2002 and the LG (Rating) Act 2002 assist local authorities to meet any fiscal pressures?

The two main new sets of revenue raising tools offered in the 2002 legislation were the extension of the set of targeted rating tools and the conferring of the ability to assess development contributions. Other extensions of revenue raising powers (such the fee-setting power in section 150 of the LGA) are more limited in their scope.

We found that the sector as a whole is not making any more use of targeted rating powers in the current year than in the year before enactment of the LGRA. There have been shifts between the different types of general rating tool, especially in regional councils, and shifts between the different types of targeted tool. Some of the new powers are not being used at all. The LGRA is still comparatively new and that some of these tools require the gathering of information that is not typically gathered during the valuation process (and thus requires some lead time to implement).

We must also note that targeted rating tools provide options to allow a more equitable distribution of the impost of rates among properties, categories of property and the community as a whole. They are not tools for tapping previously untapped pockets of revenue raising potential.

We have also found that powers to assess development contributions under the Local Government Act are being used by almost half the eligible local authorities, and more are likely to access these in the near future. Not surprisingly the local authorities that are currently using this tool are those for whom the tool is likely to generate the highest level of revenue – those with the highest rates of growth. Our analysis does not indicate, however, to what the extent to which income derived from development contributions is off-setting the actual cost of development.

Although local authorities have had wide powers to borrow since 1996 we consider that it is appropriate to mention here that most local authorities could make more use of debt than they do currently. Almost seventy percent of local authorities do not come with 20 percent of their self-imposed debt limits at any time between now and 2012/13. Although we acknowledge debt is a tool for spreading revenue raising needs it appears some local authorities are currently expecting today's ratepayers to meet more than their share of infrastructure costs, and expecting too little from future ratepayers.

Commentary from Local Government New Zealand

Local Government New Zealand fully supports the Local Government Funding Project in its objective of analysing the fiscal pressures facing local government and developing possible options for addressing them. We congratulate the Government for the support it has given this project and the commitment of officials, particularly from the Department of Internal Affairs. We also wish to acknowledge the support of councils that have generously contributed staff and resources

The joint project team's report brings together a range of information and data on local government funding and expenditure that has never been collated before. It allows us for the first time to make informed judgements about local government funding and expenditure that should enable the sector to proceed into the future on a sustainable basis.

The picture of local government portrayed in the report reveals, not surprisingly, a complex picture of councils with different funding needs and facing different funding pressures. It identifies a number of problems that reflect the variability in circumstances of different councils and which may require a mix of different solutions.

The report highlights a number of new issues as well as reinforcing concerns that councils have raised with us many times in the past. Many are quite critical to the future well being of our communities. For example:

- the report identifies a number of cost drivers putting pressure on local government funding. These are largely beyond the capacity of councils to control and involve issues such as higher regulatory and environmental standards; increased infrastructure costs; rapid population change; increased accountability and process requirements and higher community expectations;

- a survey of 20 councils revealed in some councils a significant level of current and future capital expenditure that, for a variety of reasons, has not been included in each council's transitional LTCCP. The survey suggests that a group of councils are likely to be faced with substantial cost increases in the future to meet infrastructural costs;

- the analysis reveals a number of councils that have high levels of debt and also high levels of household rates which indicates their options for managing these pressures are limited. Questions are raised about the ability of this group of councils to provide a sustainable level of services to their communities in the future;

- the information suggests that a number of councils are under-investing in their infrastructure because these councils have taken the view that the necessary rates increases are unacceptable to their communities. Under investment has national consequences as quality infrastructure contributes to community well being and improved economic growth;

- it also suggests that due to their socio-economic circumstances the rating base of some councils lacks the capacity to fund the necessary infrastructure and services required to attract investment and meet future community needs.

- the report shows that some councils with average household rate levels have pockets of low-income citizens who are struggling to meet their rate bills. This can also act as a disincentive for councils when faced with the choice of raising rates to the level necessary to maintain appropriate investment in community and physical infrastructure or reducing services. (We note that the Rates Rebate Scheme will address some of these issues.)

Underpinning many of these issues is the nature of rates themselves as the primary funding source of local government. As a recent report to Tararua District Council noted;

- “rates rise every year, in a blaze of publicity and so are very visible
- benefits of rates are less visible than those of power and telecom (utilities) and/or taken for granted
- rates are non-voluntary and we cannot make savings as we can do by turning off a light
- council is not successful at communicating the value of rates to the ratepayers
- it is easier to influence council than it is to influence power supply companies.” (The Emperor’s New Clothes in Rural Local Government”, Tararua District council.)

The fact that rates must be set every year provides for transparent and accountable local government. However the reality of having to adjust rates annually in order to keep abreast of rising costs and demands can also discourage local government decision-makers from fully investing in significant community assets and services. This under investment not only diminishes the quality of life in those communities it also poses a national risk as those assets that contribute to New Zealand’s capacity to provide an attractive quality of life.

We look forward to continuing our collaboration with central government and the identification of funding options as we work though the second stage later this year.

Appendix A: Project Team Terms of Reference and Membership

Introduction

At the December 2003 Central/Local Government Forum the following was resolved:

> *More work and research is needed to gather accurate data on current rating levels and the extent to which there is an affordability problem. The research will also need to encompass the degree to which any identified pressures are likely to be resolved by recent changes to councils' funding powers and examine appropriate solutions where gaps might be identified.*

Preparatory Work Undertaken

In early 2004 *LGNZ*, in consultation with its members, scoped funding and affordability issues for local government in New Zealand. This work has highlighted a number of areas that the local government sector believes should be investigated more fully.

Outcome

The Review will provide an analysis of the extent to which required local authority funding, now and over the next 8-10 years, is sustainable for some or all of the communities which they serve. The analysis will be based on data which is measurable, independently verifiable and objective

For the purposes of this project "sustainable" funding shall be taken to mean funding requirements that are affordable over time. Affordability is a measure of a community's ability to pay and has two dimensions – the aggregate (that relating to local authorities and groups of local authorities) and the distributional or sub-local authority (that relating to households and groups within the community).

If analysis reveals that funding requirements are not sustainable then the project will move to a second phase, generation and consideration of options that will resolve any identified issues. Further policy work may be necessary around implementation of any options.

The above analysis will be undertaken in the context of:

- the impacts of changes to legislation and central government administrative decisions;
- changing demographics;
- changing community expectations; and
- pressure on infrastructure.

Key Questions

The Review will look at the following questions:

- What is the magnitude/nature of fiscal pressure facing the local government sector?
- What are the drivers of fiscal pressure facing the local government sector?
- Are fiscal pressures sustainable for some or all communities, and for groups within the community?
- To what extent will the revenue raising powers provided in the LGA 2002 and the LG (Rating) Act 2002 assist local authorities to meet any fiscal pressures?
- If a problem is identified, what options are available to resolve the issues, and how appropriate are these?

Scope of the Review

The Review will:

a. identify the history of available rating tools and other financial instruments;

b. identify local authority funding tools in other jurisdictions;

c. identify collections of rating data (e.g. data from DIA, *LGNZ*, possibly private contractors);

d. gather data and information on:

  - increases/decreases in total rates and other revenue;
  - the current use of funding tools such as development contributions and targeted rates (this will include an assessment of how these tools could be better applied);
  - the impacts of rating on sub-groups of local authorities (territorial authorities, regional councils, unitary authorities, metros, provincial centres, rural councils);
  - changes in household income and expenditure in comparison to changes in rates and therefore the net impact on the ability to meet increased rates;

- changes in rates and other local authority costs on consumers, against changes in CPI and GDP; and

- anticipated growth in local authority expenditure.

e. compare the impact of local authority rates and other charges with deprivation levels;

f. assess the cost of legislative and central government policy changes on local government;

g. assess the degree to which likely future funding pressures may or may not be able to be met through the current range of funding tools.

h. assess the range of existing and potential mechanisms that might be utilised to address any identified issues against criteria which might include (but are not limited to): implications for local accountability; implications for central government accountability, cost,

i. make recommendations to government on the implementation of any options identified under (h) above.

It is expected items a. through f. on the above list will be addressed in the first phase of the review. Items g. h. and i. will be dealt with in the second phase of the project.

The Review will not undertake a fundamental re-examination of the Local Government Act 2002 and Local Government (Rating) Act 2002. Reconsideration of these Acts will be in the context of any identified issues, and will consider change or amendment to these Acts only to the extent that it is necessary to resolve those issues.

Conduct of the Review

A joint *LGNZ* and central government officials working group, convened by the Department of Internal Affairs, will conduct the Review.

The Review will run in parallel with:

- the Treasury and Department of Internal Affairs Review of Local Authority Funding in Auckland; and

- the Review of the Regulatory Framework for Local Government.

Time Frame and Reporting

The key milestones for the project will be:

- key background information gathered by 30 April 2005;
- report to Ministers and the *LGNZ* National Council on progress and issues by 31 July;
- if necessary, final report on options for consideration to Ministers by 10 December 2005.

Membership (as at 20 May 2005)

John Allard, Corporate Policy Manager, Greater Wellington
Jeanette Black, Chief Executive, South Waikato District Council
Murray Darroch, Senior Policy Analyst, Ministry of Health
Paul Desborough, Senior Strategic Advisor, Wellington City Council
Bob Dickinson, Chief Executive, Tasman District Council
Jessica Hammond, Adviser, Ministry of Transport
Iain Haggarty, Manager Local Government Sector, Ministry for the Environment
Jim Harland, Chief Executive, Dunedin City Council
Garry Herrington, Senior Policy Analyst, Ministry of Agriculture and Forestry
Fiona Illingsworth, Manager Local Government Policy, Department of Internal Affairs
Deborah James, Strategic Policy Analyst, Auckland City Council
Phillip Jones, Chief Financial Officer, Western Bay of Plenty District Council
Andrew Pollock, Director Finance, Waitakere City Council
Mike Reid, Manager Governance, Local Government New Zealand
Mary Richardson, Director Local Government and Community Policy, Department of Internal Affairs
Sonia Wansbrough, Senior Analyst, The Treasury

Appendix B. Local Authorities Participating in the Survey of Expenditure Excluded From LTCCP Documents

The following were included in the original survey:

Auckland City
Christchurch City
Environment Bay of Plenty
Environment Southland
Franklin District
Greater Wellington
Hauraki District
Manukau City
Marlborough District
Opotiki District
Queenstown-Lakes District
Southland District
South Waikato District
Stratford District
Tasman District
Tauranga City
Wellington City
Dunedin City

The following were added to the survey sample at a later stage:

Environment Waikato
Thames-Coromandel District

Appendix C: Local Authorities Included in the Sample of Remission and Postponement Policies

Auckland City
Auckland Region
Banks Peninsula
Carterton
Central Hawkes Bay
Central Otago
Christchurch
Dunedin
Far North
Greater Wellington
Hamilton
Hauraki
Hawkes Bay Region
Hurunui
Hutt
Invercargill
Kapiti Coast
Mackenzie
Masterton
Nelson
New Plymouth
Northland Region
Opotiki
Otago Region
Otorohanga
Palmerston North
Papakura
Porirua
Queenstown-Lakes
Rodney
South Waikato
South Taranaki
Southland
Environment Southland
Tararua
Tasman
Thames-Coromandel
Waimakariri
Waipa
Waitakere
Waitaki
Western Bay of Plenty
Westland

Appendix D: Categories of Rates Reported in Table One

Rating Tools	Description
Prices	The only pricing powers included within the scope of this paper *are those legally regarded* as a rate for the purposes of the Rating Act. Virtually all of this is water by meter. See section 19 of the Rating Act.
Proxies	The majority of these are charges based on the area of land in the rating unit.
Pan Charges	Charges for sewage disposal set on the basis of the number of pans and urinals on the property (or connections to the sewage system).
Uniform Annual General Charges	Rates set as a fixed amount per rating unit or per separately used or inhabited portion of a rating unit for the general revenues of the local authority (i.e. can be used for any lawful purpose). These are set under the authority of section 15 of the Rating Act.
Fixed Targeted Rates – Water and Sewage	In 2002/3 this is the separate uniform annual charges (UAC) made for sewage disposal and water supply. In 2004/5 these are targeted rates set on a fixed basis per rating unit or per separately used or inhabited portion (under the authority of section 18(2) and schedule 3) for funding water or sewage disposal.
Fixed Targeted Rates – Other	In 2002/3 this consists of any separate UACS made to fund other specified activities. In 2004/5 these are targeted rates set as a fixed amount per rating unit or per separately used or inhabited portion (under the authority of section 18(2) and schedule 3) to fund identified services other than water or sewage.
Value Based General Rates	Rates set on the value of property for the general revenues of the local authority.

Value Based Targeted Rates	Rates set on the value of property to fund specified works or services, or across a specified category of property (most often these categories are specified by location).
Other Rates	Rates not elsewhere classified. In both years these were very small amounts ($2000 in 2002/3 and $1500 in 2004/5).