LOCAL GOVERNMENT
BUSINESS FORUM

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Local Government Funding & Financing Inquiry
New Zealand Productivity Commission
PO Box 8036
The Terrace
WELLINGTON 6143
By email: info@productivity.govt.nz

LOCAL GOVERNMENT FUNDING AND FINANCING DRAFT REPORT

1. INTRODUCTION

1.1 The Local Government Business Forum ('the Forum') welcomes the opportunity to make a further submission to the New Zealand Productivity Commission on the Draft Report for its Inquiry into Local Government Funding and Financing.

1.2 The Forum appreciates the work done by the Commission to produce a comprehensive and well-researched draft report and the efforts it has made to engage with stakeholders, including the Forum and its individual members. The draft report has made a number of solid findings and useful recommendations which if implemented would be an improvement. They are very necessary but they are mostly incremental and we consider that it could have been a lot bolder.

1.3 The Forum is particularly supportive of the draft report's emphasis on the benefit principle to allocating rates primarily according to who benefits from council services. This is crucial yet as the draft report acknowledges council decision-making processes are often seriously lacking. We support findings and recommendations emphasing the beneficiary pays principle and improving decision-making processes. These are likely to need legislative changes and with regard to beneficiary pays we re-state our support for a return to the step-by-step process set out in the Local Government Amendment Act 1996 (No 3) repealed and replaced by weaker provisions in 2002.

1.4 The Forum also believes the report should more strongly support and promote the use of user charges, especially for private goods. User charges are by far the best form of beneficiary pays.

1.5 Individual Forum members will submit on specific proposed changes to rating and funding tools but at a high level we support the draft report's proposals to abolish business rating differentials (but not rural differentials) and the 30% cap on uniform charges. We also acknowledge at a high level that additional funding and financing tools could be helpful if implemented appropriately, especially for 'growth councils', but this is a big 'if' and would need much improved council decision-making.

1.6 However, when reading the draft report there are strong echoes of the last review of local government funding, the 2006/07 Shand Inquiry. Both made the conclusion that rates should remain the cornerstone of local government funding and both suggested relatively incremental change.

1.7 The Forum questions whether incrementally tweaking the status quo is sufficient when many councils and their ratepayers are facing serious challenges from rapid population growth or from static and declining populations. The incrementalism in the draft report is not all the Commission's doing. Most notably it has been restricted by its terms of reference, set by the Government: We discuss this in section 2 of the submission.

1.8 Like the Shand report the draft report also concluded that the expansionary 'wellbeings' purpose which was in place from 2002-12 (and is now back in place) did not drive higher rates of growth in council spending. We are not yet convinced and we discuss this further in section 3 of the submission.

1.9 With regard to specific comment on the draft report's findings, recommendations and questions, the Forum defers to individual Forum members who will be submitting on these in detail.

1.10 The Forum would be happy to meet further with the Commission to discuss the points made in this submission.

2. PROBLEMS WITH THE TERMS OF REFERENCE

2.1 While the inquiry's draft report is useful, it is largely incremental and the Forum believes the Commission has been hindered by three major restrictions in its terms of reference.

2.2 Firstly, the inquiry is not allowed to consider rating exemptions for Crown land. The Crown owns a lot of land and councils miss out on much potential rates revenue which has to be recouped from residents, businesses and farmers.

2.3 We note the Commission's comment on page 161 of the draft report *"Another source of additional revenue could come from removing rating exemptions. In previous inquiries, the Commission has recommended that central government should pay rates on its properties. The TOR for the current inquiry direct the Commission to make no recommendations on this topic."* We acknowledge this is probably as far as the draft report could go given the restriction it faced but we encourage the Commission to at the very least retain this wording in the final report.

2.4 Secondly, the inquiry is not allowed to make recommendations that would affect the structure of local government. While bigger is certainly not always better, the Commission should have been able to consider the pros and cons of structural change, and how any changes to the status quo would impact on funding and financing. This should include which level of government (central, regional and local) infrastructure, services and regulation should deliver services and whether private goods could be better delivered by non-government actors in the private sector and voluntary sectors.

2.5 The Forum also notes that many potential benefits can be obtained without amalgamation by councils jointly contracting for service delivery (e.g., Wellington Water).

2.6 On page 100 of the draft report the Commission states "*The Terms of Reference for this inquiry preclude the Commission from recommending council amalgamations. Yet it is clear that the small size of many councils makes it difficult to recruit and retain the range and quality of skills, experience and expertise required to perform to a suitable standard. With such competition for analytical resources, combined with lack of scale, the Commission recommends greater use of capability and resource sharing (e.g., via shared services arrangements, centres of excellence, and collaborative knowledge sharing and problem-solving).* Again, we acknowledge this is probably as far as the draft report could go given the restriction it faced. We encourage the Commission to at the very least retain this wording in the final report

2.7 The Forum's submission on the issues paper was understanding of the decision to exclude these two issues from the terms of reference. However, in hindsight we think they are important issues which should have been able to be considered with findings and recommendations.

2.8 Thirdly, and most significantly, the inquiry is not allowed to consider 'substantial privatisation'. Our submission on the issues paper expressed disappointment at this exclusion. Many councils which own substantial commercial assets also suffer from severe and worsening infrastructure pressures. If those councils were to sell some of these assets – in full or in part – they could have proceeds to plough into much needed infrastructure assets like roads, rail, water and wastewater.

2.9 An article in the Forum's recent Newsletter (copy attached FYI) discussed asset recycling:

New Zealand local government has around $113 billion worth of assets – ports and network infrastructure, roading and public transport services, water supply, wastewater, and stormwater, and rubbish collection. Councils provide parks and recreational facilities, museums, libraries and art galleries.

As New Zealand grows, local government is also getting bigger and since 2000 its operating spending has tripled, its employee numbers are up 42 percent, and its debt is up by a factor of more than five.

Ongoing spending increases have driven annual rate increases well above the rate of inflation, and these are causing serious concern about affordability and fairness.

The way local government is funded and financed is coming under pressure from the need to invest in essential infrastructure to meet additional demand, improve levels of service, and replace existing ageing assets.

More user pay is one option to reduce the pressure on rate increases. Another is smarter use of existing assets to fund new essential infrastructure.

Auckland Council, for example, has substantial financial, property and commercial assets yet it is struggling to fund core essential infrastructure and it is closing in on its debt limits.

How it might work
The first step might be for local councils to identify what assets they hold through a formal asset inventory. The asset inventory might identify unused and under-utilized property or buildings, or infrastructure assets such as ports or parking facilities.

At that point, councils have two options: they can either have a 'garage sale' and sell the asset, or they can lease the asset to a private company who is tasked with handling its operation and maintenance, including all costs. Ownership stays with council, who receives compensation for the negotiated term of the rental.

Sydney offers a good example. The New South Wales government leased its high voltage electricity transmission network, Transgrid, to the private sector for 99 years in exchange for $10 billion. Under the initiative NSW was able to invest about $8 billion into essential infrastructure projects, including the Sydney Metro.

The key is to use an "existing" asset to fund a new "essential" capital asset. A scale example in New Zealand, is the often talked about idea to sell-down a portion of, or lease Ports of Auckland to a private company and use the capital generated to fund long-sought "essential" transport infrastructure; say rail and road improvements for access to the city centre. The Port remains part of council's assets, but the revenue generated is far higher than currently, about equivalent to 4% of council's rates.

Plainly, using council's existing assets to fund essential new investments could be a very useful tool for both urban and rural councils to consider. In urban areas, leasing could attract new private partners who could take over the old asset while generating revenues for essential improvements to other assets, like nearby roads, improved public transport or upgraded water and waste water systems.

Rural councils could use assets to generate revenues needed to pay for infrastructure upgrades (from public toilets, to parking and camping facilities) for tourist inflows in communities that lack the economies of scale to raise funds themselves or increase rates to unfair levels.

Selling part of or leasing an existing asset as a tool to invest in creating a new essential capital asset is an idea work looking at. Its value is that its non-threatening and creative – the existing asset stays in council ownership but earns the money to allow council to do something new but essential to improve the quality of life or productivity of the community.

2.10 It's important to emphasise that the funds derived from any partial or total asset sale are recycled into other new council assets, the council's net asset position is hardly worsened. This point should be obvious but unfortunately there seems to be a lot of ignorance of it and it gets lost in ideological debate from asset sale opponents. The recent experience of Port of Napier's recent IPO shows what is possible[1].

2.11 The Forum continues to view the lack of discussion on asset recycling as a missed opportunity. There appears to be no clear understanding of what the exclusion of 'substantial privatisation' meant – a dollar amount, or a percentage of shareholding, or a particular type of asset? Nor was there any attempt to test the boundary between 'substantial' and 'not substantial'.

2.12 The Commission appears to have erred on the side of caution by simply not mentioning privatisation or asset recycling in its draft report. **We recommend the Commission discusses in its final report how asset recycling could be used as a financing option along with its pros and cons – at least in the way it discussed rating exemptions and council amalgamations.**

[1] See https://www.stuff.co.nz/business/115280775/napier-port-ipo-a-winwin-case-study-for-local-government, 20 August 2019

3. THE WELLBEINGS AND COUNCIL SPENDING

3.1 In our submission on the issues paper the Forum expressed concern about the impact of the four well-beings purpose statement on local government spending (and rates) over the period 2002-12.

3.2 The draft report disagreed there was an impact, stating for example on page 6*: "Local governments had the four community wellbeings (social, economic, environmental and cultural) as part of their legislative purpose from 2002 to 2012. The Commission did not find evidence that these gave rise to significantly increased cost pressures, despite concerns from some quarters. The Commission does not expect the recent re-introduction of the four wellbeings to the legislative purpose of local government to result in a material increase in the scope of local government activities, or its expenditure."*

3.3 The Forum is not convinced. As outlined in our submission on the issues paper, *"…the largest increases in real per capita operating expenditure took place in the 2004 to 2011 period, with seven years of that eight-year period having real per capita increases of more than 4 percent."* It is true that there were large increases in spending in 'traditional' areas of local government responsibility but the biggest percentage increase was for the catch-all 'other activities', expenditure not included under other categories and is highly variable from year-to-year. Transportation also increased significantly, mainly relating to public transport, but there were also large percentage increases for non-traditional activities of community development and economic development, which we consider are closely related to the wellbeings.

3.4 The 2012 Regulatory Impact Statement for the previous Government's *Better Local Government* Reforms (which resulted in the repeal of the four wellbeings purpose statement) noted that "…some councils are engaging in diverse activities, such as entering into commercial competitive businesses, running Lotto shops, focusing on NCEA pass rates, and developing strategies for improving the wellbeing of families."[2]

3.5 In addition during the wellbeings period there were a number of high-profile failed events such as the Hamilton V8 super cars (2006-12), a David Beckham/LA Galaxy football exhibition match in Auckland (2008), and Christchurch City Council's Ellerslie Flower Show (2009-14). These risky ventures should have been left to the private sector and the wellbeings purpose statement will not have helped rein in council enthusiasm to run them.

3.6 The Forum also believes the inquiry should reconsider whether looking solely at spending by broad activity areas provides a complete picture of the influence of the wellbeings. It is also not just *where* (broadly) the money is spent but *how* the money is spent *within* those activity areas.

3.7 The wellbeings purpose statement could have driven poor quality spending even in traditional core areas of council spending. For example, gold-plated spending on council buildings or even on roading and other infrastructure justified on the basis one or more of the four wellbeings. Meanwhile some low quality spending on council support services and governance (both of which have had large increases) could also be driven by the wellbeings, for example costly overseas 'junkets' by senior staff and elected representatives to become informed about or to promote one or more of the four wellbeings. While instances of poor quality spending occur depressingly routinely, (even during the period without the four wellbeings) the requirement to promote the

[2] *Regulatory Impact Statement, Better Local Government*, Department of Internal Affairs, 2012, page 11

four wellbeings provide added impetus or at the very least act against restraint and efficiency.

3.8 Councils have faced a lot of ratepayer opposition to rates increases and debt financing that could fund necessary infrastructure provision. One obvious reason for that ratepayer resistance is that ratepayers have seen too many examples of council profligacy. Renewing the wellbeings risks further entrenching ratepayer reluctance to grant councils the funds necessary to drive necessary infrastructure renewal. This will matter for local government financing and the ability for local government to fund necessary services.

3.9 The Forum agrees that poor decision-making within councils is likely to be most to blame for problems with how money is spent. We strongly agree with the draft report that decision-making must be improved and we support its recommendations in this respect. However, we continue to believe that providing local government with a requirement to promote the four wellbeings was irresponsible in 2002 and remains irresponsible today when there are such significant and widely-recognised problems with the quality of local government decision-making.

3.10 A further concern is that the Commission's assessment looks backwards to 2002-12 and not forwards. It assumes that because there wasn't in its view a big push to do new things during that period that local government, central government, and some in local communities will not in future have an appetite for councils to pursue a wider range of activities as part of a broader wellbeing agenda. The pursuit of wellbeing policies is a high priority for the current Government and the Minister of Local Government's media statement of 18 August 2019 provides a strong signal that councils will be expected to give effect to this high priority[3]. Where will the money come from to meet the Minister's stated wellbeing ambitions?

3.11 Nor does the Commission's assessment consider whether the local government sector's promotion of a localism agenda[4] would have an impact on the range of council activities to be undertaken. While localism could result in more effective and efficient councils it could also result in councils doing more.

3.12 It is not just the additional cost pressures from a wider range of activities which is of concern to the Forum. There is also the question, very relevant to this inquiry: is the current reliance on property value-based rates appropriate for funding 'modern local government' where councils are expected to deliver more 'people-based' activities thanks to the four wellbeings and localism? This question has not been answered in the draft report.

3.13 We recommend the Commission takes a deeper look at the impact of the four wellbeings and localism on future council activities and expenditure and on whether existing funding tools will be suitable into the future.

[3] *Powering up community wellbeing*, media statement Hon Nanaia Mahuta, Minister of Local Government, 18 August 2019

[4] See https://localism.nz/

4. ABOUT THE FORUM

4.1 The Forum comprises organisations that have a vital interest in the activities of local government. Its members include BusinessNZ, the Electricity Networks Association, Federated Farmers of NZ, Hospitality NZ, NZ Initiative, NZ Chambers of Commerce, and Property Council NZ.

4.2 The Forum was established in 1994 to promote greater efficiency in local government and to contribute to the debate on policy issues affecting it.

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