

Submission

By:



**FEDERATED
FARMERS**
OF NEW ZEALAND (INC)

To

the Inquiry Panel

On

Local Government Rates

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THE LOCAL GOVERNMENT RATES INQUIRY

SUBMISSION BY FEDERATED FARMERS OF NEW ZEALAND

1/. INTRODUCTION

Federated Farmers has for many years called for an independent inquiry on local government rates and welcomes this opportunity to submit.

Federated Farmers is New Zealand's premier rural lobby group, representing 17,000 farmers and farming families in a wide range of enterprises. Within the membership there are a number of farmers in elected positions on local authorities.

The reform of local government funding is among the main policy objectives of the Federation. The significant dependence of local authorities on property value rates is no longer appropriate, given the wide role of modern local government and the amalgamation of urban and rural rating areas.

Federated Farmers has strongly supported this inquiry as it is the first opportunity in many years for meaningful change that rectifies the serious anomalies, inequities and controversy arising from the outdated property value based system.

In terms of this Inquiry Federated Farmers has also engaged with a number of local authorities and other stakeholders in an effort to produce a submission offering viable alternatives to property value rates.

In the drafting of this submission Federated Farmers circulated information on this Inquiry to members and widely consulted on its content. A summary of the Inquiry Panel's background information paper was circulated to branches and provinces and attendance at the public meetings encouraged.

This submission focuses on the funding of local government that is based on land, capital, or annual value. It first outlines Federated Farmers' work on the rating issue and assesses the major concerns the farming community has with respect to the present system of local government rating. Our responses to the questions raised in the background information paper follow.

Federated Farmers would appreciate the opportunity to meet with the Panel to discuss its submission.

2/. FEDERATED FARMERS' WORK ON LOCAL GOVERNMENT FUNDING ISSUES

The Federation's work on rating issues extends across a number of fronts. The dedication of significant resource to the issue is a consequence of strident calls for change from the farming community for assistance with ballooning rates costs.

Every year rates on farms increase, usually by more than the rate of increase for other farm inputs. Many farmers are struggling with annual rate demands exceeding

\$10,000¹, a very high price for community services that must be found from the farm income.

In response Federated Farmers members and staff invest considerable effort into submissions and related advocacy on council financial plans and other policies connected with rates. Annually the Federation produces a guide to rates on farms, which explains how various rating systems operate and provides a step by step guide to submitting on them.

The success of this work has been to raise the profile of the issue - in some cases achieving changes to rating systems through encouraging councils to make more extensive use of the rating tools available to them.

Despite these local achievements the Federation has always recognised that, to solve the very real problem of rating for rural communities, reform is needed at a national level. Property value rates need to be replaced to enable local government to be value for money to the farming sector. To this end the farmer case has been strongly represented to MPs and successive governments, and Federated Farmers has fully participated in previous reviews of local government legislation.

Federated Farmers is known to many local authorities as a consistent, constructive submitter on rating issues. Each year the Federation submits on 60 (out of 85) council draft annual plans and draft long term council community plans.

3/. RECOMMENDATIONS

- 1. Federated Farmers submits that property value rates cannot result in value for money from local government for farmers. Federated Farmers recommends that the Inquiry Panel seek information on rates levels according to common property use categories (farmland, residential, commercial/industrial etc.), rather than broad averages, to get a true picture of value for money concerns.**
- 2. Federated Farmers submits that property value rates are themselves inherent drivers of increased local government expenditure. Federated Farmers recommends that the Inquiry Panel seek information on the cost of individual services to ratepayers in various property categories and consider the impact on allocative efficiency.**
- 3. Federated Farmers recommends that the respective responsibilities of central and local government in economic, social and cultural areas be clearly defined.**
- 4. Federated Farmers submits that, while property value rates are inherently flawed, extensive use of all the available rating mechanisms can enhance revenue practices and go some way toward a transparent**

¹ Federated Farmers maintains a database of farming operations incurring more than \$10,000 in general rates to district and regional councils per annum. The purpose of this is to identify rating systems that are placing ordinary farming operations in financial peril. The database is ad hoc, but presently shows 136 farms with a total annual general rate liability of \$2,534,901

and fair allocation of council costs between liable property owners. We recommend that the Inquiry Panel call for the development of best practice information and guidelines on use of the available rating mechanisms, and that consideration be given to the limitations on rating information that may be preventing the uptake of some tools.

5. Federated Farmers recommends that the Inquiry Panel investigate the development of clear linkages in legislation between the activities of councils and the appropriate use of funding mechanisms with appropriate disciplines.
6. Federated Farmers recommends that the existing cap of 30% of total rate revenue on the uniform annual general charge should be removed.
7. Federated Farmers recommends that the Inquiry Panel investigate supplanting property value rates that fund local roads with increased use of Land Transport New Zealand's Financial Assistance Rate (FAR). Roads users should pay for a bigger share of local roads, rather than landowners.
8. Federated Farmers recommends that the Inquiry Panel incorporate in the development of best practice information and guidelines on available rating mechanisms, information on balance sheet management and appropriate levels of borrowing.
9. Federated Farmers submits that the list of non-rateable land in Schedule 1 of the Local Government should be cut back to make local government revenue tools consistent with the long-established philosophy that taxation should be 'broad-based, low-rate'. Land which is an integral part of a taxpayer funded activity, for example DOC and education land, should be fully rated.
10. Federated Farmers recommends that the Inquiry Panel investigate supplanting property value rates in large part with revenue sharing from central government. An amount equivalent to 1% is suggested (funded preferably by reducing government's share to 11.5% or alternatively by increasing GST to 13.5%).
11. Federated Farmers recommends that the Inquiry Panel does not support a regional petrol tax, a regional payroll tax, green taxes, or full environmental cost pricing for water services.

4/. THE PRESENT SYSTEM OF RATING

The present system of rating is not working effectively. Clearly there are strong perceptions in the community that the present system of funding local government is unfair.

Much of this problem arises from the reliance on property value based rates for raising revenue. The immediate and most apparent difficulty is that only a subset of the community directly pays rates, and therefore directly bears the burden of cost for the whole community. While it may be argued that people renting their homes indirectly contribute this does not alleviate the difficulties councils face when trying to convince ratepayers to accept the cost of new developments. To be a payer of a rate demand is to have a wholly different attitude to council on matters of expenditure than someone who doesn't.

Frequently new expenditure proposals of councils are treated with derision by ratepayers, especially those on fixed or limited incomes, and ambivalence and disinterest by the rest of the community.

Compounding this credibility problem is the fact that ratepayers in the same area or street can pay vastly differing amounts in rates depending on the theoretical sale price of the property. Many people do not regard the value of their property to be relevant to much of what a modern local authority does, and there is a feeling that high value property owners subsidise everyone else.

An example of the difficulty this can cause local government is a rural North Island Council's proposal to subsidise a small town doctor's residence, with the aim of attracting a medical professional to practice in the area. This was to be funded on the general rate on land value. The farming community supported this proposal on its merits, until analysis of the funding showed that one large farm on the outskirts of the town would pay more in rates for the doctor's residence than the total paid by all the ratepayers in the township.

Crucial to this credibility problem is the fact that property value has no immediate relationship to the income of ratepayers, and therefore their ability to pay rates from year to year.

4.1 A tax on wealth?

Much has been said about the question of whether rates are a tax on wealth or a payment for services received. Federated Farmers does not regard this question as helpful to successful reform of local government funding.

What is needed is a tax that complies with good taxation principles - that is fair and transparent - to fund the public good activities of local government. User pays principles should be applied when they can be, so that demand for services reflects their marginal cost.

To conclude that property value rates are a tax on wealth suggests that the vast disparity in contributions to local government must be justified in some way by

wealth distribution. This is not the case, as evidenced by the Government’s expansion of the rate rebate scheme.

It is easy to assume someone with an expensive property is “rich” – in much the same way that such assumptions can be made on the basis of the car a person drives – but the value of the property is not a reliable guide to their true wealth relative to others in the community. Property value is simply a statement about the value of a particular asset that may or may not generate or reflect income.

The tables below from MAF’s Monitor Farm series illustrate the disconnection between property values and income for both sheep and beef and dairy farms. While the incomes of sheep and beef farms were up 8.9% between 2000/01 and 2006/07, the property value increased 185.6%, while net profit after tax as a proportion of property value fell from 8.65% to a barely viable 2.06%. A similar trend is evident even for dairy farms.

Sheep and Beef – National Budget

	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07 (f)	% Inc 2000/01 - 2006/07
Gross Farm Revenue	\$311,361	\$340,143	\$326,594	\$319,729	\$350,326	320,766	338,980	+8.9%
Cash Farm Expenses	\$147,568	\$173,099	\$177,121	\$181,038	\$197,816	200,551	202,029	+36.9%
Net Profit After Tax	\$103,036	\$112,006	\$68,306	\$73,389	\$85,433	38,234	69,916	-32.1%
Property Value	\$1,190,882	\$1,450,179	\$1,903,198	\$2,160,134	\$2,760,039	3,289,190	3,401,091	+185.6%
Revenue/Property Value (%)	26.15%	23.46%	17.46%	14.80%	12.69%	9.75%	9.97%	-61.9%
NPAT/Property Value (%)	8.65%	7.72%	3.59%	3.40%	3.10%	1.16%	2.06%	-76.2%

Dairy – National Budget

	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07 (f)	% Inc 2000/01 - 2006/07
Gross Farm Revenue	\$406,953	\$467,379	\$378,527	\$446,019	\$486,191	\$536,685	\$540,786	+32.9%
Cash Farm Expenses	\$188,905	\$209,088	\$262,354	\$259,635	\$289,062	\$326,462	\$330,157	+74.8%
Net Profit After Tax	\$154,815	\$116,085	\$27,338	\$85,029	\$75,422	\$71,685	\$82,279	-46.9%
Property Value	\$1,316,029	\$1,396,923	\$1,728,338	\$2,190,995	\$2,487,326	\$2,932,689	\$3,309,879	+151.5%
Revenue/Property Value (%)	30.92%	33.46%	21.90%	20.36%	19.55%	18.30%	16.34%	-47.2%
NPAT/Property Value (%)	11.76%	8.31%	1.58%	3.88%	3.03%	2.44%	2.49%	-78.8%

Source: MAF Monitor Farm Reports

Property value rates are equally ineffective as a payment for services received as again the relationship with property value is unreliable at best. The value of a farm tells us nothing about the use by the farmer (or anyone else) of the library or public swimming pool.

To view rates as either a tax or payment is to evade the central need for a more credible way to fund local government. The debate should be abandoned in favour of finding a credible replacement for property value rates.

4.2 Affordability concerns

The farming community has significant affordability concerns with property value rates. Rates must be met from the farmer’s income, which obviously varies from year to year, and over which the farmer has little control. Farm incomes are dependent on a range of factors such as the weather, international commodity prices and the exchange rate. The farmer endeavours to run an efficient low cost operation with high quality outputs, and hopes that sufficient income is generated to meet the farm costs and

provide for the family. As price takers, a farmer is in no position to pass on increased costs by raising their prices - they must be absorbed within the farm budget.

Farmers question why their contribution to local authority community services should be based on a major portion of the value of their business. Trends in the value of the land making up the farm do not alter the farm income. The attractiveness of the views and the land for residential purposes, for example, does not improve the viability of the farm.

The difficulties faced by farmers with heavy rate burdens arising from development potential (e.g. subdivision), who wish to continue farming, are a pointer to this overall concern. Federated Farmers has been made aware of 310ha coastal farm north of Auckland that faced a \$25,000 rate bill for the 2006/07. That farmer applied for a rate rebate under the government administered scheme, expanded last year, and received the maximum rebate of \$500.

Viewed from the perspective of business productivity the rate burden on farms presents a troubling picture. The MAF monitor farm series, which analyses average farming operations to reflect economic trends in the industry, shows that rates are likely to rank in the top ten farm working expenses – ahead of the outlay for farm fuel and electricity in some cases. We contend that this situation is unique to rural land-intensive businesses, and our experience with submissions on rating policies of councils indicates that farms often pay more than major retail enterprises in general rates to district councils.

Clearly a farm expense of this high ranking requires the attention of any serious farmer. This again explains the focus on rates at Federated Farmers.

Federated Farmers asks that the panel consider the impact of property value rates on the viability of farm businesses.

4.3 Relativity

The resentment felt in the farming community towards the cost of rates is in part inspired by an impression that, by virtue of their property values, they are obliged to subsidise services to the whole community.

This is different to the concerns of the wider business community in that (without manipulation) property value rating systems will always result in farmers paying more in rates than owners of most other types of property, whereas for business a higher contribution is often derived by manipulation – for example through placing them on higher differentials.

Farmers know and feel that the rating system is tilted against them, and are more inclined to oppose local authority expenditure as an automatic reaction. A 5% increase in rates can mean a great deal in total for a farm and less cash available for farm inputs.

In this uncomfortable situation it can often appear that farmers are selfish and against any community inspired efforts to improve living standards. In reality it is the fact

that council expenditure can have impacts on their budget in the thousands of dollars if property value rates are used to fund it. Farmers have no problem sharing costs fairly with the rest of the community, and will support council efforts when they are funded fairly. An example is the significant backing given by Taranaki Federated Farmers to the Yarrow Stadium in New Plymouth, which was funded by a uniform annual charge.

Our discomfort is in part shared by retirees who have purchased a home over their lifetime and are then faced with finding the cash to pay rates from a limited income. When they read in the paper that Council is proposing a new project they are more likely to oppose it – not because of the lack of merit of the project itself, but because of the threat of higher rates.

Local government faces the challenge of providing credible governance when their system of revenue gathering seriously lacks credibility. Property value rates do not result in anything like a fair allocation of a council's costs across the community. On the one hand ratepayers are viewed as the community group that wears the cost, and within that ratepayer group the differences in contribution are significant, producing resentment across the board. Battles with ratepayers frequently accompany efforts to develop community services, a situation that cannot be regarded as good for healthy governance.

4.4 Valuation Issues

Compounding these concerns are those with the basis of the system, the rating valuations. Farmers, like other ratepayers, frequently make use of the objection system when they feel their RVs are inaccurate. The method of valuation, however, is also of major concern and cannot be addressed by the objection process.

A major affordability problem arising out of the present system is the calculation of rating values on the basis of property sales in the area, not the economic returns of the farm. This disconnect in the case of the farm north of Auckland had obviously become extreme, but many farmers in coastal situations are now paying extremely high rates because of the effect of subdivision and the boom in lifestyle blocks.

Any good businessperson makes a daily judgement to remain in a business based on its profitability. Where farmers' profitability is reduced in a structured way (i.e. the permanent overheads of the property increase beyond a certain point) they are likely to consider exiting the business. The basing of rating valuations on sales averages is, in our view, contributing to the loss of farmland to lifestyle blocks – estimated by the Parliamentary Commissioner for the Environment to be 38,000 ha in 2005 alone.

A further difficulty with present methodology is the valuation of each individual title as a standalone property, despite the fact that a single economic unit can be made up of a number of individual titles. In our experience smaller titles are more likely to be valued at their residential potential.

5/. BACKGROUND INFORMATION PAPER

Federated Farmers appreciated the broad range of topics raised in Part 3 of the information paper. Comment is offered here on the commentary along with responses to most of the questions. Recommendations to the Inquiry Panel are interpolated.

5.1 The current level of rates and rates increases over the next 10 years

For individual farmers the current level of rates varies massively. A coastal farm in the North Island may pay \$15,000 in general rates, while a similarly productive farm further inland pays \$5,000. Therefore this is not an issue that can be dealt with in a general way. Clearly the current levels of rates for some can be ludicrously high, and for those people in areas where values are increasing beyond the average the future is uncertain.

In 2006 Federated Farmers fully participated in the LTCCP processes of most councils (60 out of 85). Our concerns were for the broad nature of the community outcomes process driving the LTCCPs and the potential for that to translate into increased rates disproportionately allocated to farms. Farmers felt that, while the community outcomes were laudable, they would pay the highest price. Adding to this concern was the involvement of central government in encouraging aspects of the community outcomes process, e.g. environmental and social outcomes while the Crown is not a ratepayer.

While the forecast expenditures in the LTCCPs themselves may present a picture of some moderation ten years out, their method of funding that expenditure will cause affordability problems for a number of ratepayers. Some will pay far more than others for this expenditure, while those without property will directly pay nothing at all.

5.1.1 How adequate is the value for money of the services provided by local authority rates?

There is little farmer perception of value for money from local authorities. This is an unavoidable outcome of revenue systems based on land and/or capital value and is not a statement about the efficiency or skills of local authorities.

While our evidence for this is anecdotal we are sure that the Inquiry Panel will also have been provided with evidence of the view that local government is overpriced in the course of the public meetings.

In the course of submitting on Annual Plans Federated Farmers regularly puts cases to councils of farmers paying more than \$10,000 in general rates. At that end of the spectrum it is surely understandable that farmers feel they are not getting value for money, especially when the cost to an urban resident is likely to be closer to \$1,000.

While all farmers value their councils for the provision of local roads, emergency response and a raft of infrastructure such as flood protection schemes, rates on farmland are too relatively expensive to be seen as value for money.

A difficulty with this question relates to the complexity of rating systems. Property owners are unsure of what is funded by rates and to what extent, although a very small number of councils have itemised their general rates costs for individual ratepayers in recent years. If a simple definition of value is benefit minus the cost then ratepayers need to see what individual council services are costing them in order to make a value assessment.

Recommendation 1:

Federated Farmers submitss that property value rates cannot result in value for money from local government for farmers. Federated Farmers recommends that the Inquiry Panel seek information on rates levels according to common property use categories (farmland, residential, commercial/industrial etc.), rather than broad averages, to get a true picture of value for money concerns.

5.1.2 What information is provided by councils about how rates are used and the value for money of the services provided from rates? Is the information adequate?

The provision of information varies from council to council. In our experience some councils work with averages and present the average daily ratepayer cost for each service as compared with say, the cost of a home telephone, electricity etc.

Given that farm rates are usually far above the average farmers do not find this sort of information useful.

What is needed to make a value assessment is some comparison between the respective rates of example properties, and for the services funded by those rates to be itemised for each property. This information is rarely provided by councils, but there are exceptions. Otorohanga District Council, for example, provides a useful breakdown of examples of contribution to Council services in their Annual Plan. This practice should be encouraged.

In our experience the Annual and Long Term planning processes incorporate a preponderance of information on the benefits of services, but far less information – usually limited to the Funding Impact Statement – on how those services are funded and by whom.

5.1.3 Do people have a good understanding of their opportunities to make an input to their council's long-term plans and rating policies?

Federated Farmers has invested considerable effort in apprising farmers of their opportunity to submit. While farmers are well aware of their opportunities many feel bamboozled by the property value system, its

complexities, and the challenge of standing up in front of the council and trying to make your point.

5.2 Drivers for increased local authority expenditure

In our experience with submitting on long term plans the justification for rates increases is often given as the demands of central government legislation.

Difficulties have clearly arisen for many councils as a result of the requirement to fund depreciation, although councils do have the flexibility to not do so.

Significant for smaller provincial and rural councils have been the heavy consultative demands of the Local Government Act 2002. The cost of preparing a LTCCP and having it audited is relatively more substantial for councils with declining populations and a limited rating base.

Federated Farmers does not believe that the rampant growth in rates in recent years is due to the “power of general competence” in the Local Government Act 2002, but see this as a natural consequence of a sector that operates without effective benchmarking and with inefficient revenue mechanisms that impose rates disproportionately on the community.

5.2.1 Are there drivers of increased rates, other than those mentioned above, the Inquiry should explore?

Property value rates are themselves an important driver of increased expenditure. The reason for this is that not all consumers of local authority services face the cost consequences of council’s expenditure decisions, while others bear cost consequences that are beyond what is reasonable.

Where the cost impact is not transparent, or is reduced by the high rates of a minority group of ratepayers, there is a tendency for the community to demand more from council – potentially beyond what is sustainable for ratepayers.

The itemised rate examples referred to earlier are revealing. The district council concerned shows that parks and reserves cost a large farm \$575 in rates, whereas a resident pays between \$44 and \$49. This is not a specific criticism of that council as such equations are endemic to property value rates – in fact the council concerned does the community a rare favour by revealing the true cost rather than lumping it all together in the general rate. We contend that residential ratepayers, on this basis, do not experience the true cost of the district’s reserves and are more likely to demand higher service levels as a result.

Recommendation 2:

Federated Farmers submits that property value rates are themselves inherent drivers of increased local government expenditure. Federated Farmers recommends that the Inquiry Panel seek information on the cost of individual services to ratepayers in various property categories and consider the impact on allocative efficiency.

5.2.2 What are the most significant drivers of local government expenditure?

This will obviously vary from council to council but we argue that the property value rating system itself ranks as the most significant, systemic driver of increased local authority expenditure.

Federated Farmers also agrees with local authorities that there are real pressures arising from the “unfunded mandate” of central government. These pressures may not be apparent when the situation is averaged across the sector, but are certainly apparent for the smaller provincial and rural councils.

The respective responsibilities of central and local government in economic, social and cultural areas are not clearly defined, and should be.

Beyond these two factors there are clearly major issues with infrastructure and the increasing cost of maintaining and replacing it, and the effect of general inflationary conditions.

Recommendation 3

Federated Farmers recommends that the respective responsibilities of central and local government in economic, social and cultural areas be clearly defined.

5.3 Trends in the use of rating tools to fund services

Federated Farmers fully concurs with the finding of the Funding Project, that relatively little use has been made of tools to better match rates to benefits, address affordability issues and promote understanding of ‘value for money’.

The use of targeted rates and differentials, and the councils’ attitude to them, is hugely inconsistent. In some cases councils persist with the argument that “rates are just a tax on land” and that they are under no obligation to link benefits from services to rates and make use of targeted rating mechanisms to improve transparency, accountability and fairness. These councils effectively ignore section 101 of the Local Government Act and do not consider the best funding tool in respect of each service delivered or activity undertaken. The rating systems of these councils largely consists of a general rate on land or capital value (without differentials), supported (often but not always) by a modest UAGC and the statutorily required targeted rates for water and sewerage.

On the other hand there are councils that have taken an innovative approach and sought to make the best use of the rating tools to balance the rating burden on different sectors of the community. Their systems typically consist of a general rate that is differentiated by property location and use, use of targeted rates for water and sewerage but also such activities as refuse collection, tourism promotion, CBD developments, and stormwater, and a UAGC.

The uptake of the rating tools newly made available in the Local Government (Rating) Act 2002 has been slow, inconsistent and disappointing, and strongly

indicative of the need for best practice guidelines and information for councils and their communities.

5.3.1 To what extent could greater use of the available rating tools assist local government to address equity issues for particular groups of ratepayers?

The range of rating tools available are designed to ensure local authorities have the flexibility to fairly and transparently fund each of their activities, and comply with the requirements of section 101 of the Local Government Act 2002.

Yet the argument that “rates are just a tax on land” persists in local government. As a result the toolbox remains largely unopened, and when rates increase substantially many councils simply blame the valuation system. In late 2004 the Minister of Local Government criticised a Mayor for doing precisely this, yet nothing has since been done to improve the standard of revenue and financing policies.

The available rating tools could indeed be used to a far greater extent, however the likelihood of that occurring voluntarily in local government is small.

5.3.2 What are the barriers to the optimal use of the range of tools?

Perhaps the most significant barrier to optimal use is the entrenched positions of some local authorities on rating practise, and the lack of knowledge among ratepayers of possible alternative approaches. Appendix 2 illustrates Federated Farmers’ concerns about the patchy uptake of available tools (in this case targeted rates).

Federated Farmers members that are also sitting councillors often contact Federation staff members to obtain advice on how other councils are using their rating tools, as they feel they are not being kept informed of what is happening in other councils. A number of queries, for example, have been made about Hurunui District Council’s move to a targeted rate to fund tourism promotion based on the value of the improvements of tourism-related businesses and we have received requests that Federated Farmers make that approach known to councillors through the annual or long term plan submission.

Beyond these issues of attitude and information there are also limitations arising from the quality and extent of valuation information on councils’ rating information database. Land use data can be outdated, for example, limiting the ability of councils to differentiate and target rates for particular groups of property.

Lastly, there are also considerable political issues surrounding the uptake of some funding tools. The uniform annual general charge, for example, is used to the fullest allowable extent by some councils and not at all by others. There is no significant barrier to its use, other than the fact that council costs are

allocated equally, and a move away from property value to uniform rating can cause discomfort to those ratepayers who have not experienced the true cost of council services.

Federated Farmers regards the UAGC as the simplest and fairest tool presently available, in that it simply allocates costs to properties on a uniform basis in keeping with the assumption that everyone benefits equally from public goods.

5.3.3 How can these barriers be addressed?

There is a need for best practice guidelines and information on the deployment of available rating tools for the activities and services of councils. Examples of best practice are not made widely known or explained. While the local government “Know How” project provided good technical information to councils on the Local Government (Rating) Act 2002, there were no guidelines on the use of particular funding tools for particular purposes.

The quality and consistency of rating valuations should also be considered. Valuation standards and methodologies vary significantly and improvements in this area would enhance the capacity of councils to use a wider range of funding tools.

Recommendation 4:

Federated Farmers contends that, while property value rates are inherently flawed, extensive use of all the available rating mechanisms can enhance revenue practices and go some way toward a transparent and fair allocation of council costs between liable property owners. We recommend that the Inquiry Panel call for the development of best practice information and guidelines on use of the available rating mechanisms, and that consideration be given to the limitations on rating information that may be preventing the uptake of some tools.

5.3.4 Does the rating system need to be changed to address any continuing anomalies or inequities?

The anomalies and inequities giving rise to this review indicate the urgent need for changes to the rating system overall.

While the availability of mechanisms to modify property value can produce a rating system more closely aligned with the distribution of benefits from council services, the examples of this in practice are few. There needs to be clear linkages in legislation between the activities of councils and the appropriate use of funding mechanisms with appropriate disciplines.

Property value rating must be replaced, or at the very least considerably supplemented, with alternative forms of funding that are not optional for individual councils.

Notwithstanding this we submit that the existing cap of 30% of total rate revenue on the uniform annual general charge should be removed.

For many years Federated Farmers and sections of local government have sought the removal of this cap, which is inconsistent with the wide discretionary powers enjoyed by councils elsewhere in rating law.

The UAGC can be of assistance to any ratepayer on a higher valued property but with limited income and councils should be free to use it to the fullest extent.

Some people have suggested that removing GST from rates would address anomalies and inequities. Federated Farmers disagrees. We consider that the advantages of the current broad and relatively simple application of GST should not be compromised. Rates should also remain subject to GST consistent with the view that rates are a charge for a service.

Recommendation 5:

Federated Farmers recommends that the Inquiry Panel investigate the development of clear linkages in legislation between the activities of councils and the appropriate use of funding mechanisms with appropriate disciplines.

Recommendation 6:

Federated Farmers recommends that the existing cap of 30% of total rate revenue on the uniform annual general charge should be removed.

5.4 Other sources of revenue currently available to local authorities

Federated Farmers strongly submits that existing alternative sources of revenue need to be augmented and the dependence of local authorities on rating reduced.

The use of fees and charges should be applied to the fullest extent (subject to the application of sound charging principles), ensuring that there is not excessive demand for services.

Transfers from central government, appear to be mainly infrastructure related and, aside from the Land Transport New Zealand Financial Assistance Rate for local roads, made on a case by case basis. There is little certainty among local authorities what form of central government assistance may or may not be available. Central government clearly has the more equitable revenue mechanisms for public goods and social services and should share revenue on a consistent, formulaic, ongoing basis with local government.

Federated Farmers agrees with the Funding Project finding that borrowing is under-utilised.

5.4.1 Should greater use be made of currently available funding mechanisms, other than rates?

Federated Farmers contends that greater use of fees and charges and borrowing should be encouraged in the local government sector. Transfers

from central government should be formalised and made available to fund the provision of public good services, usually funded by general property value rates, on a consistent, formulaic basis.

Greater use should also be made of Land Transport New Zealand's Financial Assistance Rate (FAR). Federated Farmers, along with a group of rural councils, has been promoting this for some time. Federated Farmers' policy is for a 90% FAR.

Funding a large portion of roading on the basis of property value is not equitable. On a land value rating system an average farm will pay more for roads than businesses such as supermarkets and timberyards where land does not form such a high component of the capital of the business.

There has been much written about the lack of fairness and inefficiencies associated with relying on rates to fund roads, including reports to the Ministry of Transport. For example, the 1997 report of the Roothing Advisory Group observed that:

“Rates contribute approximately 20% of total road income. In urban areas road funding accounts for 10-15% of local rates, while in rural areas more than half of rates go on roads. The extent of this funding is often little understood by ratepayers.

“Rates are based on the value of property, and have no relationship to road use. Property owners can therefore subsidise other road users. Rates can be an unfair means of charging for road use because there is no link between payment and consumption. For example, in forestry areas ratepayers have to meet the cost of damage to lightly built local roads caused by logging trucks.”²

More recently, the Surface Transport Costs and Charges Study stated that:

“Rates are fixed charges based on property values and bear no relationship to the use of the roading network by property owners. While it can be argued that most ratepayers use public transport and/or drive cars, using rates to contribute to the costs of roads creates equity issues, particularly as the demography of New Zealand's population is changing.”³

If Transit's Cost Allocation Model (used for state highways) were applied to local roads then it would show that property owners are indeed subsidising road users. We have seen an unpublished report which concludes that in 2004/05 the very most local authority rates should have been contributing to roads was \$129 million and that property owners were effectively overcharged by \$248 million.⁴

² *Road Reform – The Way Forward*, Roothing Advisory Group Final Report, November 1997.

³ *Surface Transport Costs and Charges: Summary of Main Findings and Issues*, Ministry of Transport, March 2005.

⁴ This report was prepared for the Road Transport Forum and we understand that it has been provided to the Ministry of Transport, Land Transport New Zealand, Transit New Zealand and Local Government New Zealand.

There is no question that the rating base is inadequate for many rural councils to successfully maintain the local roading network, especially in large districts with low population density and areas that are heavily impacted by tourism.

Federated Farmers' policy entails councils receiving up to 90% of their roading costs via the petrol excise, instead of the current 43-64%. In this way road users would pay for a bigger share of local roads, rather than landowners, and the management and maintenance of local roads would remain in council hands.

Further information on the Federation's 90% FAR policy is attached in Appendix 3.

Recommendation 7:

Federated Farmers recommends that the Inquiry Panel look at supplanting property value rates that fund local roads with an increased rate for Land Transport New Zealand's Financial Assistance Rate (FAR). Roads users should pay for a bigger share of local roads, rather than landowners.

5.4.2 Are alternative forms of revenue, such as development contributions and user fees, established through a transparent process? Are they equitable?

It is equitable for developers to pay a fair price for the infrastructure arising from their activities. As more local authorities have moved to exercise their power to demand contributions under the LGA 2002, rather than the Resource Management Act, development contribution policies have been included in the long term plans of some councils. While very complex this is a sufficiently transparent process.

User fees are also struck through the long term and annual processes. One concern we would have with this is the frequent failure to explain the reasons for fee increases, or whether it is simply a policy of council to increase them every year.

Whether these mechanisms are equitable is dependent on the quality of the council's methodology in arriving at the price.

5.4.3 Is there a case for an increased use of borrowing by local authorities to address inter-generational equity or other issues, such as accelerating infrastructure investment?

The ability of communities to meet the considerable upfront costs of infrastructure can be eased through borrowing. This allows loans to be repaid as the benefits accrue to future ratepayers over the lifetime of the assets, which is an efficient outcome that promotes intergenerational equity.

Recommendation 8:

We recommend that the Inquiry Panel incorporate in the development of best practice information and guidelines on available rating mechanisms

information on balance sheet management and appropriate levels of borrowing.

5.5 Sustainability of rates

Affordability issues exist mainly at the level of individuals and ratepayer groups, and we emphasise that within the farming community there are considerable affordability problems with rating.

Affordability problems certainly relate to low and limited incomes, and it should be emphasised that such incomes include the incomes of farmers. Affordability must also be viewed as relative to the level of rates, which we understand to be the methodology pertaining to entitlement to government's rates rebate scheme. For affordability problems to arise a ratepayer's income may not necessarily be "low" in the common measure if their rates climb into the thousands because of a valuation increase or change in rating policy.

Federated Farmers' views on the affordability analysis of the Funding Project have been communicated to the Inquiry Panel by separate memorandum (this is attached as Appendix 1).

5.5.1. How should the affordability of rates for communities and individual ratepayers be assessed? What factors are relevant?

Analysis of affordability issues should take into account business viability as well as household incomes. It is well known that rates are commonly an expensive part of farming, and economic analysis of the relevant industries is made available by central government which features the cost of rates.

It is also insufficient to assess affordability solely on the basis of average rates and median incomes. Serious anomalies are concealed by averaging rates across all types of property use and rates are not based on incomes. An accurate analysis requires more detail, such as looking at categories of property use and the level of rates and incomes pertaining to them.

5.5.2 Which groups of people do you consider are most affected by the affordability of rates? What data is available to determine this?

Federated Farmers contends that considerable affordability problems are arising for those on fixed and limited incomes that own property in rapidly developing areas or high value areas such as the coast.

Federated Farmers is aware of many cases of coastal farms that are not substantial but incur rates in excess of \$20,000. In the case of sheep farms rates of this magnitude can render the business unviable. While booming coastal values represent a theoretical capital gain for farmers, this can only be realised as income when the property is sold. If it is developed the relevant development contributions are applied, along with rates and charges on the separate titles, for the infrastructure cost.

We contend that the retirees have a similar problem with property value rates in that their earning capacity is limited relative to the value of the property they own.

Our evidence is anecdotal as no data is available from local or central government. We do, however, maintain a small database of rate demands on farms that exceed \$10,000. This year we also issued a nationwide report card on local authorities, and were surprised at the number of returns showing rates above \$20,000. We are in the process of verifying these cases.

5.5.3 Is the affordability of rates only an income issue, or does it also involve assets held or other factors?

The issue of affordability is related to the value of the property asset and the associated level of rates, relative to the income of the ratepayer.

Farmers are disadvantaged by the fact that a significant portion of their income generating capacity, in the form of land and improvements, are rated, whereas for other community groups and businesses this is not the case. Furthermore the rateable value of that land and improvements is driven by the potential sale price of the farm, not the economic return.

5.5.4 To what extent can affordability problems be addressed through greater use of rates rebates and rates remission and postponement policies, or by reverse mortgages and similar mechanisms from private sector sources?

The efficacy of measures such as rates rebates and postponements is limited by their cost and complexity. It would be far preferable for the dependence of local government on property value rates to be reduced to a point where rating no longer generates the anomalies and inequities that it presently does.

Some councils operate rates postponement policies for farmland – where that part of the rateable value of a farm that is related to the potential for development such as subdivision is identified and the rates applicable to it postponed for a certain period. These policies apply while the farmer continues to farm and endeavours to relate the economic value of the business to the rateable value, so the farm is not made uneconomic by the potential sale price of the property where there is no intention for it to be sold.

This practice is fully supported by Federated Farmers in that it provides an option to reduce a farm's rateable value to a level that reflects its economic returns, enhancing the farmer's ability to pay the rates from the farm income and remain in business.

It would be preferable, however, for the problem of potential values to be resolved at source and for the dependence on property value rates to be reduced. Even with a postponement farmers are still paying rates on the basis of almost all of their income generating assets and thus remain in a disadvantageous position compared to the rest of the community.

Encouraging councils to take up such a postponement policy is a tortuous process, and Federated Farmers efforts have met with scant success in recent years. One coastal council actually proposed to *remove* its policy last year, which would have resulted in a rates bill of \$89,000 for one Federated Farmers member. Fortunately the policy was retained for those presently on it, but there will be no further rate postponements granted in that district.

5.6 Exemptions from liability from rates, including Crown exemptions

Schedule 1 of the Local Government (Rating) Act contains a long list of land uses that are either fully or partly exempt from rates. The list includes a wide range of land uses (everything from conservation land; land used by local authorities for public parks, libraries, museums, art galleries; land used for wharves, airstrips, rail-lines, roadways; land used for educational institutions, public hospitals, churches, agricultural and pastoral societies, etc). We submit that in this day and age there is no justification for many of these exemptions, particularly when these land uses can impose significant costs on local authorities and in many cases support activities that compete either directly or indirectly with rate-paying businesses.

With respect to Crown liability central government must accept that it should apply the principles of economic efficiency to its relationship with local government. While the Funding Project concluded that no general affordability issues arise this should not be principal consideration.

The fact is that difficulties do arise for a number of local authorities on account of the non-rateable status of land, particularly the DOC estate.

The track record suggests that grants in lieu will not rectify this problem. The experience of regional councils with DOC and the funding of pest management strategies is a case in point and a matter that was recently subject to a consultative process (see Appendix 1.).

The Crown has both an impact on local authority services and infrastructure and a demand for them. This extends beyond the “unfunded mandate” to strategies deployed by the Ministry of Social Development and DOC to influence the community outcomes processes of local authorities. DOC is also a major submitter on RMA policy.

5.6.1 Is the rationale for exemptions on Crown and Non-Crown land still valid?

The rationale for the Crown land exemption is no longer valid, and all remaining exemptions should be reviewed with a view to their removal.

The exemption of Crown land amounts to a subsidy from the local community to the national taxpayer, and distorts understanding of the full economic cost of the activity.

Recommendation 9:

We submit that the list of non-rateable land in Schedule 1 of the Local Government should be cut back to make local government revenue tools consistent with the long-established philosophy that taxation should be 'broad-based, low-rate'. Land which is an integral part of a taxpayer funded activity, for example DOC and education land, should be fully rated.

5.7 Other revenue-raising mechanisms

The land based rating system is totally inappropriate for funding the services of modern local government, which is focused on social and amenity services unrelated to land holdings.

The major capital item in any farming business is the land and improvements to it. Operating a profitable farm requires more land than any other business, meaning that individual farmers will usually pay more in rates than businesses with more significant demands on community amenities, such as supermarkets, banks etc. The rateable value of farms ensures any farmer, with rare exception, will pay more than any other resident in rates.

It is therefore vital to the future viability of farming that alternative revenue-raising mechanisms be identified and adopted as a result of this Inquiry. It is crucial to all parties that history is not in this instance repeated, where the same hackneyed, archaic and imbalanced system is handed back with alterations in the margin.

Notwithstanding our calls for rating valuations to reflect the economic returns of farms, for best practice guides to raising revenue, for the Crown to pay rates, the most urgently required outcome is an easing of the property value rate burden on local communities through the introduction of new revenue mechanisms.

5.7.1 What principles should guide the use of revenue sources to fund local government expenditure (including rates)?

Any system proposed to supplant property value rates should reflect the principles of “good” taxation, e.g. it should be equitable, neutral (especially that it doesn't give rise to perverse economic incentives), efficient, and convenient to pay. Property value rates fail on most of these principles.

5.7.2 What practical new revenue sources could, in full or part, be alternatives to rates?

Federated Farmers submits that Inquiry Panel should look into the possibility of central government providing local government with a share of GST revenue on a formulaic basis.

Such a system would be similar in nature to the present method for supporting the funding of local roads, but would apply to a basket of public goods agreed between central and local government, would be ongoing, and would be

subject to audit to ensure that property value rates were concomitantly reduced.

In our view GST revenue is most appropriate to the principles set out in 5.7.1. It would not necessarily take the form of an additional local sales tax as problems related to the practicalities and economies of scale of local collection would be insurmountable.

There are a number of other alternatives that have been floated such as regional petrol taxes, regional payroll taxes, 'green taxes', and full environmental cost pricing for water services. Federated Farmers has serious reservations against these alternatives and we consider that they fail against the principles set out in 5.7.1, for example:

Regional Petrol Tax to Fund Roading

While such a tax could raise the necessary revenue it would be a relatively poor tool both for accountability, and for demand management. Another negative factor is the impact on rural people who often need to travel long distances to access centralised services. This proposal could increase the cost of doing so quite significantly in relation to their disposable income.

Regional Payroll Tax to Fund Public Transport

Federated Farmers disagrees with the underlying assumption of proponents for such a tax that it is mainly employees that use public transport. The biggest users of public transport are people who are not employed⁵ and to have employers subsidising them is not appropriate.

Such a tax will be difficult and costly for councils to administer. Councils currently have no information about businesses and their employees.

Many rural employers with no access to public transport would have to pay the tax even under the proponents' proposal that the tax would only be levied in the districts served by public transport. For example, Christchurch and Dunedin cities and a number of mixed urban/rural districts have large rural hinterlands with no access to public transport.

Green Taxes

Federated Farmers supports policies to encourage waste reduction, but has reservations in practice about the use of 'green taxes' to influence behaviour. Experience has shown that such taxes have to be set at relatively high levels to achieve any change in peoples' behaviour. It is also likely that due to costs of

⁵ Recent regional surveys (e.g., Environment Waikato and Bay of Plenty Regional Council) on passenger transport patronage confirm that commuting is not necessarily the dominant use. The 'Big Cities' Quality of Life Survey also surveys people on public transport and with the exception of the Greater Wellington area it is evident that most use of public transport is not by regular commuters. See the following links:

<http://www.ew.govt.nz/policyandplans/ptp/ptp2003/ptp2003.14.htm>

<http://www.envbop.govt.nz/media/pdf/TC060811bus.pdf>

http://www.bigcities.govt.nz/pdf2004/Quality_of_Life_2004_Transport.pdf

administration and collection that such a tax would need to be administered centrally.

Full Environmental Cost Pricing of Water Services

Federated Farmers has strong reservations about the concept of ‘full environmental cost pricing for water services’. While the Federation is comfortable with charging for the operating costs of infrastructure services, such as reticulated water and waste water, we are concerned about the implications of imposing a theoretical, council-determined environmental ‘externality charge’. The Federation questions the scientific basis for such a charge and how it would be applied by Regional Councils and we are also concerned about such a charge being used as a convenient revenue raising device. While noting that the proposal is for reticulated water services, the Federation is concerned that it could be used as a precedent for the charging of other water.

Recommendation 10:

Federated Farmers recommends that the Inquiry Panel look at supplanting property value rates in large part with revenue sharing from central government. An amount equivalent to 1% (funded either by reducing government’s share to 11.5% or by increasing GST) is suggested.

Recommendation 11:

Federated Farmers recommends that the Inquiry Panel does not support a regional petrol tax, regional payroll tax, green taxes, or full environmental cost pricing for water services.

APPENDIX 1: Comment on Local Government – Central Government Funding Project (provided to Rates Inquiry Panel January 2007)

Memorandum

TO: Nick Clark, General Policy Manager
FROM: Nigel Billings, Senior Policy Advisor
DATE: 23 January, 2007
RE: Local Government Funding Project: Reference Group

I have taken some time to reflect on this process and record my observations below.

1. Despite the limitations placed on this project by the Terms of Reference I began my involvement with some hope that members of the reference group would have genuine input on the key issues of concern to us.

2. It was clear to me from the Phase One report that the Funding Project would ultimately fail to address the key concerns of ratepayers, especially those on limited incomes facing rapidly rising rates costs. Briefly and in summary my concerns regarding the Phase One report were as follows:

2.1 The analysis of fiscal pressures on local government was narrow and did not take into account distributional issues between ratepayers and the affect on expenditure demands (e.g. the propensity of non-ratepayers to lobby council for rate-funded services).

2.2 While emphasising that future expenditure must be “community mandated” the report did not assess the quality of that mandate or the cost of arriving at it (e.g. the huge relative cost to small rural councils of the LTCCP process itself).

2.3 The report correctly defined affordability as being directly related to income, but failed to comment on the central problem of rising rateable values relative to incomes for particular community groups (e.g. farmers and the elderly).

2.4 The report failed to undertake a rates per rateable assessment analysis (readily available from local authorities), or attempt to compare the rating

burden between different types of property (e.g. rural residential, urban residential, farm household). The analysis simply averaged rates on a per household basis as a ratio of median household income. The effect of this was to immediately conceal the concerns of, for example, farmers with annual rates costs reaching above \$10,000, or the superannuitant with high cumulative percentage rates increases while their income is adjusted only for inflation.

2.5 As a consequence the report drew the hasty and risky conclusion that there is little in the way of affordability problems arising from local government expenditure. While some salient points were made, for example with respect to the exclusion of forecast expenditure from LTCCPs and the requirement to fund depreciation on an ongoing basis, I felt that the report added little to the public debate that had given rise to the Funding Project in the first instance.

3. The reference group process began with a briefing on the work plan of the Funding Project itself, and I was able to achieve some alterations, for example the inclusion of libraries in the items subject to functional case studies. This occurred in January 2006 with the first meeting of the reference group with DIA officials (only), and the subsequent exchange of ideas.

4. In terms of constructive input, however, the process ended there. We received no briefings on progress from the DIA officials until such time as a substantial part of the work plan had been completed, which was presented to the reference group in June 2006.

5. We were very disappointed in the methodology used to determine whether there are affordability issues with rates, and felt that the case studies in some instances read more like a local government promotional brochure than a hard analysis of affordability.

6. During the meeting of June 2006 it became clear to me, and I believe the other members of the group (although I am not speaking for them), that this process had been captured by the local authorities involved. While the information presented was interesting to someone in my line of work, I felt that the core funding problems were

being averaged away and we were to be given no opportunity to affect the conclusions of the Funding Project. With respect to affordability, the Funding Project's conclusions were couched within such phrases as "district-wide" and "council-wide" which did not appear to reflect the reality of what was appearing in the media at the time about spiralling rates.

7. The FOMA representative, perhaps being the boldest among us, responded particularly negatively to what was occurring. The members of the reference group present at the June meeting subsequently met in a café and discussed how we might yet have some sort of impact on the process. It was the collective view that we had become patsies in a tick the box exercise that was unlikely to deliver anything other than a suitably pretty picture of the state of affairs with local government funding.

8. Some among us were keen to withdraw from the process, however I encouraged them to remain on an "anything is better than nothing" basis. I subsequently drafted a further information request that went to the DIA officials and received no response (although this is perhaps understandable as it was around the time that central government announced the wider review).

9. I have received no further communications from the officials responsible for the Funding Project.

10. While I would suggest we continue to participate in the reference group I emphasise that, on the evidence to date, the exercise is more about keeping the Federation informed than having any real input.

Nigel Billings

APPENDIX 2: Comment on Targeted Rates (provided to Rates Inquiry Panel February 2007)

Memorandum

TO: Nick Clark, General Policy Manager

FROM: Nigel Billings, Senior Policy Advisor

DATE: 07 February, 2007

RE: Independent Inquiry into Local Government Rates: Targeted rates

In response to your request for information on targeted rates I provide below brief comment on the extent of their use since the enactment of the Local Government (Rating) Act 2002 (LG(R)A), and two examples of local authorities where their use, in my opinion, is exceptional to the norm.

Uptake of targeted rates

Setting aside the primary candidates for targeted rating – water, sewerage and flood protection services – the adoption of targeted rating tools by local authorities has been disappointing.

In the course of consultation on the draft Rating Bill, we were offered considerable hope that the targeted rate regime would serve to iron out many of the distortions in rate contributions between ratepayers.

You may recall the meeting of the Local Government Forum in 2002 where officials and the CEO of LGNZ suggested that the range of factors available in Schedule Three for the calculation of targeted rates should be of considerable interest to us.

Most notable among the factors referred to was the ability to target rates on the value of improvements (alone), it being felt that this tool could remove the distortions caused by high land prices and produce rate allocations more closely aligned with the availability of services to ratepayers.

I have found it disappointing, to say the least, that in the four years that Federated Farmers has repeatedly submitted to Councils encouraging them to investigate this option for services such as parks and reserves, roading, tourism etc. it has been utilised only twice. There may be more Councils targeting rates on the value of improvements, but the two I am aware of are Thames-Coromandel and Hurunui District Councils (to fund economic development and tourism promotion).

This is indicative of an apparent unwillingness across the board to make use of the new tools. Certainly rates that were separate rates before the LG(R)A have been transferred to the targeted method, but nothing particularly innovative has occurred since the introduction of targeted rates and the new factors underpinning them.

This is rather odd given that Local Government maintained, prior to the LG(R)A, that a shortage of modern and appropriate funding tools was the key cause of the ongoing nationwide controversy over rates.

While the targeted rate regime falls well short of a comprehensive solution clearly such provisions should in future be accompanied by some form of requirement to use them, or at least a benchmarking process to encourage their use, if they are to have a meaningful impact for ratepayers.

Examples of comprehensive use of targeted rating tools

I emphasise that the two Councils cited here have been selected on the basis of my own (not inconsiderable) experience with the development of local authority rating policies in recent years.

I have selected a Regional Council and a District Council that I believe to be far ahead of the general trend outlined above on the use of the new targeted rating tools.

- Regional Council

Environment Waikato (EW) were prompt in their response to the availability of the targeted rating provisions. In early meetings with senior financial staff EW were indicating that their philosophy going forward would be to adopt a targeted rate for each new function introduced or delegated to them.

Environment Waikato's revenue and financing policy reflects this commitment. Functions originally on separate rates, such as flood protection and drainage, were of course transferred to the targeted method. In addition, and more importantly, has been the introduction of targeted rates for passenger transport, biosecurity, weed and pest control, natural heritage, Lake Taupo protection, and permitted activity monitoring.

Federated Farmers has been fully supportive of this process and has assisted EW with the educative process surrounding the introduction of these rates.

I suggest Mr Warren Stevens, Finance Manager of EW, as a useful person to talk with about targeted rates and the introduction thereof.

- District Council

In terms of innovative and comprehensive use of available rating tools Thames-Coromandel District Council (TCDC) is, in my view, in a class of its own.

The Funding Impact Statement on pages 165 – 179 of their 2006-16 LTCCP best sets out how the rates are deployed.

Aside from the services commonly targeted, such as water, sewerage, land drainage etc. TCDC has adopted targeted rates using a range of factors (including the value of improvements alone as stated above), to fund a wide range of activities. The method principally used is to group local services together and target the combined costs to

particular geographic areas. This approach is a huge improvement on the general rate in terms of transparency, flexibility, accountability, and fairness

A range of stormwater services, economic development, aspects of roading, and building control are targeted district wide.

I suggest Mr Steve Ruru, CEO of TCDC, or Mr Carl Kelly, Finance Manager, as people knowledgeable about the development of the targeted rate regime, and the community's general satisfaction with it.

I trust this information is of assistance.

Best regards

Nigel Billings
Senior Policy Advisor

APPECDIX 3: FEDERATED FARMERS 90% FAR POLICY

Introduction

New Zealand's total roading network comprises over 92,000 kilometres from the busiest urban motorways carrying over 150,000 vehicles per day to the most isolated rural metalled roads carrying only a handful of vehicles per day.

While the challenges in managing such a diverse network will vary, all roads contribute to a single national network and they are all a critical facilitator for economic growth, personal mobility and community wellbeing.

Most recent Government attention has been on increasing the funding to maintain and upgrade the 10,700 kilometres of state highways. This part of the network bears around 44% of powered vehicle kilometres. It is very important that state highways are improved and we support the additional money that is being invested in the network.

However, lost amidst the fanfare of increased funding for new state highway projects is the plight of local roads. Local roads, managed by cities and districts, cover an additional 82,000 kilometres and, significantly, they bear 56% of powered vehicle kilometres.

Local roads are funded by rates collected by the responsible local authority and a central government contribution from the National Land Transport Fund (NLTF). The amount of money received from the NLTF by each council depends on its financial assistance rate (FAR).

The policy rationale behind the FAR formula is that there is a need for assistance to councils to retain the operational capability of the existing road network and that this level of assistance should depend upon the financial resources of councils. However, it is evident to us that the FAR does not provide adequate assistance, particularly for rural councils.

This paper discusses the problems of rates funding of local roads, problems with the financial assistance rate, and it discusses possible solutions. The Federation's preference is for the Government to move to at least a 90% financial assistance rate for all councils.

The Problem with Rates Funding of Local Roads

According to long-term council community plans, local authorities around the country are forecasting large rates increases over the coming years as they grapple with infrastructure pressures, particularly for roading, but also water and wastewater. These pressures on councils are due to:

- Cost increases driven by construction sector inflation that has been running at a higher rate than consumer inflation⁶; and
- A bow-wave of renewals and replacements over the next few years reflecting ageing infrastructure that is coming to the end of its useful life and/or, in the case of those councils experiencing rapid growth, infrastructure that is reaching its capacity due to increasing demand.

For some local authorities, particularly those rural councils with large networks and falling populations, the pressures are becoming acute and resulting in large per capita increases in both rates and debt. This is generating real concern over the ability of some local authorities to maintain their infrastructure, let alone improve it.

From a ratepayer's perspective, the forecast rates increases are coming on top of a decade where the rates price index has increased at almost three times the rate of the overall consumer price index. This trend seems likely to continue.

Federated Farmers believes that not only is rates funding of local roads becoming increasingly unsustainable but it is also unfair and inefficient.

There has been much written about the lack of fairness and inefficiencies associated with relying on rates to fund roads, including reports to the Ministry of Transport. For example, the 1997 report of the Roothing Advisory Group observed that:

“Rates contribute approximately 20% of total road income. In urban areas road funding accounts for 10-15% of local rates, while in rural areas more than half of rates go on roads. The extent of this funding is often little understood by ratepayers.

“Rates are based on the value of property, and have no relationship to road use. Property owners can therefore subsidise other road users. Rates can be an unfair means of charging for road use because there is no link between payment and consumption. For example, in forestry areas ratepayers have to meet the cost of damage to lightly built local roads caused by logging trucks.”⁷

More recently, the Surface Transport Costs and Charges Study stated that:

“Rates are fixed charges based on property values and bear no relationship to the use of the roading network by property owners. While it can be argued that most ratepayers use public transport and/or drive cars, using rates to contribute to the costs of roads creates equity issues, particularly as the demography of New Zealand's population is changing.”⁸

⁶ Statistics New Zealand's Producer Price Index shows that output prices for the construction sector were up 6.4% for the year to March 2005 and 8.9% for the year to March 2006.

⁷ *Road Reform – The Way Forward*, Roothing Advisory Group Final Report, November 1997.

⁸ *Surface Transport Costs and Charges: Summary of Main Findings and Issues*, Ministry of Transport, March 2005.

If Transit's Cost Allocation Model (used for state highways) were applied to local roads then it would show that property owners are indeed subsidising road users. We have seen an unpublished report which concludes that in 2004/05 the very most local authority rates should have been contributing to roads was \$129 million and that property owners were effectively overcharged by \$248 million.⁹

Turning specifically to farming, Federated Farmers is calling for an independent, first-principles review of local government funding, with the funding of local roads a key element of such a review.

An example of just how unfair property rates can be to farmers is illustrated by the example below from a medium sized North Island district. The example compares the rates paid in 2002 by one of our members to those paid by The Warehouse, the largest business in the district. The district used a land value system with differentials.

Type of Rate	The Warehouse	A Federated Farmers Member
General Rate	\$1,265	\$16,780
Roading Rate	\$1,400	\$31,500
Works & Facilities Rate	\$14,800	\$8,200
Parks & Reserves	\$180	\$2,073
TOTAL	\$17,645	\$58,553

In 2002 the farmer paid 22.5 times more than The Warehouse for the roading rate despite the fact that The Warehouse would have generated far more local and inter-district traffic than the farm could ever have. Since 2002 the situation has improved but only after intense lobbying by local Federated Farmers: we understand that the roading rate gap has narrowed from \$30,100 in 2002 to around \$19,000 today – but this is still totally inappropriate.

Some believe that rates are a fair and reasonable way to fund roads and other council services as property values reflect income and therefore ability to pay. Federated Farmers strongly contests this assertion, particularly for farms. The following tables are derived from MAF's monitor farms and would appear to debunk this myth.

Sheep and Beef – National Budget

	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07 (f)	% Inc 2000/01 - 2006/07
Gross Farm Revenue	\$311,361	\$340,143	\$326,594	\$319,729	\$350,326	320,766	338,980	+8.9%
Cash Farm Expenses	\$147,568	\$173,099	\$177,121	\$181,038	\$197,816	200,551	202,029	+36.9%
Net Profit After Tax	\$103,036	\$112,006	\$68,306	\$73,389	\$85,433	38,234	69,916	-32.1%
Property Value	\$1,190,882	\$1,450,179	\$1,903,198	\$2,160,134	\$2,760,039	3,289,190	3,401,091	+185.6%
Revenue/Property Value (%)	26.15%	23.46%	17.46%	14.80%	12.69%	9.75%	9.97%	-61.9%
NPAT/Property Value (%)	8.65%	7.72%	3.59%	3.40%	3.10%	1.16%	2.06%	-76.2%

Source: MAF Monitor Farm Reports

⁹ This report was prepared for the Road Transport Forum and we understand that it has been provided to the Ministry of Transport, Land Transport New Zealand, Transit New Zealand and Local Government New Zealand.

Dairy – National Budget

	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07 (f)	% Inc 2000/01- 2006/07
Gross Farm Revenue	\$406,953	\$467,379	\$378,527	\$446,019	\$486,191	\$536,685	\$540,786	+32.9%
Cash Farm Expenses	\$188,905	\$209,088	\$262,354	\$259,635	\$289,062	\$326,462	\$330,157	+74.8%
Net Profit After Tax	\$154,815	\$116,085	\$27,338	\$85,029	\$75,422	\$71,685	\$82,279	-46.9%
Property Value	\$1,316,029	\$1,396,923	\$1,728,338	\$2,190,995	\$2,487,326	\$2,932,689	\$3,309,879	+151.5%
Revenue/Property Value (%)	30.92%	33.46%	21.90%	20.36%	19.55%	18.30%	16.34%	-47.2%
NPAT/Property Value (%)	11.76%	8.31%	1.58%	3.88%	3.03%	2.44%	2.49%	-78.8%

Source: MAF Monitor Farm Reports

While acknowledging that these time-series are limited it is evident that over the past several years farm revenue has fallen sharply as a percentage of property value. This is mainly a reflection of property values rising much faster than farm revenue. Property values have risen for a number of reasons, some of which have no relationship to the fortunes of farming – e.g., nearby subdivision activity pushing up land values.

The large increase in farm expenses over the period is also notable. At a time of rising costs, farmers have become particularly sensitive to increasing rates demands, particularly when they bear no relationship to their true “ability to pay”. It means that funds that would be more usefully and productively deployed in farm businesses are being diverted elsewhere.

Some local authorities have recognised the inherent unfairness of rates funding of roads and have adjusted their road rates to make them more reflective of road use. These councils have undertaken roading impact studies using independent external consultants to apply similar methodology to Transit’s Cost Allocation Model¹⁰.

While the councils that have taken this approach should be congratulated, the exercise proves that there is a fundamental flaw with a property-based rating system that takes no account of road use. There is also no guarantee that the recommendations of roading impact studies will be properly implemented as councils’ decision making processes are inherently political.

Federated Farmers therefore considers that from a public policy perspective there are serious problems with funding local roads through rates. If we were to start from scratch we would not fund local roads in the way that we have been.

The funding of local roads must be considered within the wider context of road funding, with the costs allocated to types of road user in a transparent and objective manner. Concentrating on improving parts of the state highway network while ignoring local roads is not a sustainable solution.

¹⁰ For example, in 2004 Southland District Council commissioned PricewaterhouseCoopers and Montgomery Watson Harza to develop a model to evaluate the extent of differences between the contributions of rates from various land-use categories compared with the costs that these categories impose through their use of the district’s road network. The model found that farm ratepayers were being significantly overcharged for their use of the roads – to the tune over \$2 million per annum. GHD Ltd have since (2005-06) peer reviewed this work and came to similar conclusions. The Council is yet to fully implement these recommendations.

The Financial Assistance Rate

On average the National Land Transport Fund (NLTF) contributes around 50% of local road maintenance spending and 60% of local road construction spending. In administering these contributions, Land Transport New Zealand sets a Financial Assistance Rate (FAR) to determine the amounts individual councils receive from the NLTF. The FAR for each council is set by logarithmic formula:

$$IBR = k_1 + k_2 \log (P/LV)$$

Where:

IBR = Indicated financial assistance based rate for the following year

P = Current year's initial block allocation.

LV = Five-yearly averaged net equalised rateable value.

k_1 & k_2 = Constants which are established to give a national indicated FAR of 50%

The result for maintenance is as follows:

- 12 councils have a FAR of 43%;
- 22 councils have a FAR between 44 and 49%;
- 19 councils have a FAR between 50 and 54%;
- 10 councils have a FAR between 55 and 59%;
- 8 councils have a FAR between 60 and 64%;
- 1 council has a FAR between 65 and 69% (Kawerau); and
- 1 council has a FAR over 70% (Chatham Islands).

The FAR formula results in a number of mainly urban councils having the minimum FAR of 43%, while making it very hard for councils to get a FAR of 65% or more.

The result is that the local contribution for road maintenance per person is very high for councils which have large roading networks and low population densities. For example, 2002 research by Dr Robert Lowe for Far North District Council suggested that there was a huge variation in the spread of road maintenance costs per person. This is unlikely to have changed significantly over the intervening years.

Spread of Local Contribution per Person for Road Maintenance Costs¹¹

Highest Local Share per Person		Lowest Local Share per Person	
Council	Local Share Per Person (\$)	Council	Local Share Per Person (\$)
Southland	210	Kawerau	14
Kaipara	204	Porirua	22
Central Hawkes Bay	191	Tauranga	25
Clutha	191	Upper Hutt	27
Otorohanga	179	Manukau	27
Waitomo	177	Palmerston North	30
Wairoa	166	Waitakere	32
Banks Peninsula	163	Invercargill	34
Mackenzie	159	Christchurch	35
Rangitikei	157	North Shore	37

¹¹ Taken from Slide 1 of a presentation to Transfund NZ by Dr Robert Lowe on behalf of Far North District Council, 15 May 2002. The national mean local share per person was \$61.

The table above illustrates how much more rural council ratepayers must contribute to the maintenance of their council's local roads compared to their urban counterparts. This is despite the acceptance by Government that assistance to councils is needed to retain the operational capability of the existing road network and that this level of assistance should depend upon the financial resources of councils.

The main problems are that:

- Equalised rateable land value is not a good indicator of the financial resources available to councils. As mentioned in the previous section land value (and the same applies to capital value) is simply not a reliable proxy for a ratepayer's ability to pay. The actual rates in the dollar of capital or land value vary markedly even among neighbouring councils with similar rates revenues per capita.
- The k_1 and k_2 log functions of the formula result in an artificial floor and ceiling for FAR rates that do not appear to have any logic other than result in a convenient 50% average rate.
- The quantum of funds made available by central government (which results in the need to have a 50% average FAR) is insufficient.

There are four main options to improve the funding assistance for local roads:

- Adjust the k_1 and k_2 functions to allow a greater range of FAR percentages. While this would transfer more funds from urban to rural councils, it would only divide up a fixed pie (i.e., NLTF funding) in a different way and could be argued as 'robbing Peter (the urban councils) to pay Paul' (the rural councils).
- Change the equalised rateable land value indicator to one that is more reflective of the financial resources of councils. However, the challenge would be to find a better indicator.
- Increase the size of the pie and therefore the average FAR (to say 60%) so providing a higher upper limit for rural councils.
- Substantially remove rates funding of local roads and have them either wholly or primarily funded by road users through petrol taxes and road user charges (just as state highways are funded).

The problems with the FAR formula are such that in Federated Farmers' view mere tinkering will not provide viable long-term solution. Our preference would be for the final option, which is essentially the Federation's 90% plus FAR policy. This policy will be discussed in the following section.

90% FINANCIAL ASSISTANCE RATE

Federated Farmers' policy on the financial assistance rate should be considered in the context of its position on the funding of local government, which is to reduce the reliance on property value based rates.

Substantially reducing the contribution of property value based rates for the funding of local roads would be a positive step in this direction, particularly for ratepayers of rural councils, many of which spend over 50% of their operating expenditure on maintaining their roads.

Roads should be funded by road users rather than properties. Accepting this there is then the question of how funding of local roads by road users should be achieved – should local authorities raise their own revenue or should there be a greater contribution from central government collections from road users?

While local authorities could be given the power to levy their own use-based taxes or charges, there are problems with such an approach, for example:

- New charges: Technology and more importantly its affordability is not yet at the stage where location or time-specific electronic charging would be feasible so any new charges are likely to be difficult to implement and result in significant administrative and enforcement costs.
- Existing charges: Allowing local authorities to set existing petrol taxes or road user charges at differing rates would be likely to result in perverse outcomes such as encouraging motorists to cross local authority boundaries if petrol or RUC prices are significantly different.

The alternative to local authorities raising their own road user revenue would be to increase the contribution central government makes to them from the NLTF. In practice this would be through a higher financial assistance rate.

Federated Farmers' policy is that the 50% average financial assistance rate should be increased to a flat 90% for all councils. The remaining 10% would be raised by local authorities through a uniform annual charge (akin to a property access charge). This would dramatically reduce the rates funding of local roads and mean that roads would be substantially funded by road users.

There would be a financial cost for increasing the FAR as it would mean an increased call on the NLTF. According to the 2005/06 National Land Transport Programme, \$866 million was forecast to be spent on local roads, with \$386 million to be funded by ratepayers and \$480 million from the NLTF. We have estimated that a 90% FAR would have required an additional \$300 million funding from the NLTF, well under the almost \$600 million of petrol tax revenue that ends up in the Crown Account.

A 90% FAR would be readily attainable with a commitment to spend all petrol tax revenue on roads with plenty to spare for increased state highway expenditure. However, if there is a concern about the fiscal implications, we consider that part of the additional funding requirement could be met by reviewing and reprioritising other existing NLTF spending, including:

- The \$201 million ‘Regionally Distributed Funds’ that have so far have been spent on state highway projects only.
- The \$15 million ‘Regional Development’ output class which would no longer be necessary under a 90% FAR.
- The \$15 million allocated to the ‘Walking and Cycling’ and ‘Travel Demand Management, Rail and Sea Freight’ output classes which may not be delivering sufficient value for money.
- The \$180 million allocated to the ‘Passenger Transport’ output class which may not be delivering sufficient value for money.

The advantages of a 90% FAR policy are as follows:

- A flat 90% FAR would benefit all ratepayers and all local authorities:
 - Property owners would see immediate and in many cases dramatic falls in their rates.
 - Local authorities would receive a more sustainable revenue flow.
- Local roads would be funded according to the use of roads rather than the value of properties – a far more efficient and fair approach than the status quo.
- A flat 90% FAR would be simple and transparent – no longer would there be a complex and illogical formula that results in serious inequities between councils.

There are also potential disadvantages, but we believe that these can be readily addressed:

- Affordability – central government would need to find an additional \$300 million per annum for the NLTF. It will argue that the decisions in Budget 2006 will result in more money being spent on roads than is collected from road users and that increasing funding further to increase the FAR for local roads is unaffordable.

Response:

The Government should consider the funding of local roads within the context of wider road funding issues. This would include applying a rigorous cost allocation process to ensure that the different categories of road user (e.g., cars, trucks, etc) are paying their fair share for both state highways and local roads. Ultimately, if the total amount of road funding is to be increased then the Government should either reduce its large operating surplus and/or reprioritise other spending.

Meanwhile, although we welcome the increased funding in Budget 2006, the boost is temporary as it comes from one-off contributions from the Crown Account, including proceeds from a special dividend from Meridian Energy. We consider that the temporary boost will only partially catch up on many years of cumulative net takings from road users that amount to billions of dollars.

The Government should now take the final step and formalise the increased funding by dedicating all petrol tax revenue to the NLTF, including the 17.8 cents per litre that is currently diverted to the Crown Account.

- Accountability – By no longer raising their own revenue for local roads councils may become less accountable to ratepayers for their spending. Their shopping list of roading projects may then blow out.

Response

This argument assumes that ratepayers are able to effectively constrain council spending. We are not convinced – generally speaking, local democracy is weak with low participation in council planning processes and relatively low and reducing voter turnouts with non-ratepayers exerting too much influence.

We also understand that LTNZ already makes its existing financial assistance contingent on meeting a strict quality assurance programme and taking account of other information. We presume that this oversight would continue under a higher FAR and, if anything, would be strengthened.

- Logic of the 10% Local Share – Some will question the logic behind a 10% local share and why it could not have been set at 0% or 20% or some other number.

Response

While Federated Farmers advocates the removal of property value based rates from local road funding we accept that there should continue to be a modest local contribution. The simplest and fairest way to fund the local contribution would be through a modest uniform annual charge.

We accept that our proposed 10% local share could be a bit higher or a bit lower and we would welcome work being undertaken to find a more precise figure. However, we are confident that such a figure would be defensible as a fixed access charge and we note that a 10% local share would not be inconsistent with recent unpublished research which suggested that in 2004/05 the very most local authority rates should have been contributing to roads was \$129 million out of a total local road spend of \$833 million. This equates to an appropriate local share of around 15%.¹².

- Councils will spend more – there is a risk that councils will take any increased financial assistance from central government to increase their total spending rather than reduce rates.

Response

From Federated Farmers' perspective this change must be fiscally neutral – that is, we expect councils to pass on the savings to ratepayers. Federated

¹² This report was prepared for the Road Transport Forum and we understand that it has been provided to the Ministry of Transport, Land Transport New Zealand, Transit New Zealand and Local Government New Zealand.

Farmers would be most concerned if councils attempted to widen the scope of their local involvement in 'soft' spending and thereby exacerbating the problem of funds being diverted from productive investment in the farm business. If necessary we would ask the Government step in and require councils to pass savings to ratepayers.

- Impact on Remote, Low-Volume Roads – in theory, moving to pure user pays funding of local roads could have negative impacts on roads in remote areas that experience low traffic volumes.

Response

Various roading impact studies have been undertaken using objective cost allocation methodology. If anything, these studies have concluded that current rates funding systems result in farms paying far too much for road maintenance. In practice, rural ratepayers are subsidising urban roads rather than the other way around..

Federated Farmers also considers all roads to be part of a national network and should be funded accordingly. We point out that remote rural roads with low traffic volumes are often very important for the national economy thanks to the export volumes generated by the primary produce transported along them.