

9 CURRENT USE OF RATING TOOLS TO FUND SERVICES

The terms of reference asked the Local Government Rates Inquiry to consider trends in the use of rating tools. The application by local authorities of particular rating tools varies widely, reflecting the considerable flexibilities given by the Local Government Act 2002 and Local Government (Rating) Act. The following analysis looks at the current tools and considers how the rating system might be changed to improve equity and transparency. Understanding these trends and their implications also focuses attention on the system of property valuation. The Panel reviewed the valuation bases used to set rates, the valuation rules issued by the Valuer-General, and the institutional arrangements for property revaluations.

SUMMARY OF KEY POINTS

9.1 There is considerable diversity in the way local authorities have designed their rating systems. Since 2002 when the Local Government (Rating) Act (LGRA) was introduced, rating systems have become generally more regressive. Rates based on the value of properties have been reducing, with a higher proportion of rates now coming from flat charges (uniform annual general charges and targeted uniform rates). Only 64% of rates revenue was based on property values in 2006/07.

9.2 The toolkit of rating tools contained in the LGRA is extensive and provides local authorities with great flexibility. There are some exceptions to this flexibility, such as the 30% cap on uniform charges (excluding water and waste-water charges).

9.3 For territorial authorities, on average, the larger the council the more progressive the rating system is in relation to incomes. Rating systems for smaller councils tend to be more regressive, with higher fixed charges.

9.4 There is a strong relationship between household incomes and property values. To the extent that rates are a tax based on property values, the Panel considers that rates-based funding of local government is not inherently inequitable. The use of capital value for rating gives a better relationship of rates to incomes than does land value.

9.5 There is a wide variation between local authorities in the quality of analysis and transparency of decisions about the design of the rating system. In some there is robust analysis that is clearly presented to the public, but in others there appears to be little analysis and transparency.

9.6 Business and rural differentials are used by approximately half of local authorities. These differentials are set in a non-transparent way and are essentially arbitrary political decisions. The Panel considers that differentials should be abolished.

9.7 Instead of differentials, councils should use targeted rates, for which a greater degree of transparency is required where there is a justification for levying different classes of ratepayers differently.

9.8 The average level of uniform charges in 2006/07 was 19% (excluding charges for water and waste water), although several councils are at the legislative limit of 30%. The 30% cap appears to have been an arbitrary figure inserted into the LGRA to limit the regressiveness of a council's rating system and should be removed. The Panel considers that, as with differentials, uniform annual general charges are set arbitrarily, with little relationship to the services they are to fund. The Panel considers that on transparency and equity grounds uniform annual general charges should be removed. This does not prevent them being replaced by targeted uniform rates. However, these rates are also regressive and their use needs to be explicitly addressed by councils through an explicit requirement in section 101(3) of the Local Government Act 2002 to consider rates affordability when designing the rating system.

9.9 Currently council-controlled organisations can charge for waste water by volume, but local authorities themselves cannot. The Panel considers that volumetric charges for waste water by way of rates should be allowed in the LGRA – and indeed believes it should be encouraged. (This is further discussed in Chapter 10.)

9.10 The system of valuation of property for rating purposes is not satisfactory. Valuations are not accurate or frequent enough. The Panel considers that valuation indexing is the preferred short-term solution while more frequent revaluations using computer-based mass-market appraisals would address many of the current concerns. Valuation of rural land often does not reflect the productive value or income potential of the land.

9.11 Valuation problems are greater under land value rating systems. Use of a single system is likely to lead to enhanced public understanding of the rating system. The Panel supports capital value as the preferred basis for rating valuations. Capital value also has the advantage of being a somewhat more progressive system, especially for rural properties.

9.12 Overall the Panel proposes greater simplicity and consistency in rating systems, more transparent user charges for the purposes of demand management and a stronger valuation basis.

What we were asked to do and the approach taken

9.13 The nature of rates was outlined in Chapter 5. Here we draw on work by the Local Authority Funding Project, as well as independent analysis undertaken for the Panel,⁹³ to identify trends in the use of rating tools.

Trends in rating tools usage

9.14 There is considerable diversity in rating systems. Table 9-1 shows the main types of rates used and the proportions of total rates that each accounts for. Each of these rating types reflects a range of decisions about valuation bases to be used, the use of differentials, the amount of any uniform annual general charge (UAGC) and the selection of targeted rates that apply to specific

⁹³ Covec, *Trends in the Use of Rating Tools Nationally to Fund Services*, Report to the Rates Inquiry, Covec Ltd, Wellington, 2007 (available at <http://www.ratesinquiry.govt.nz>; referenced subsequently in this chapter as the "Covec report to the Rates Inquiry on rating tools").

Table 9-1 Rates by type, 2006/07, showing percentage change on previous year

	Territorial authority 2006/07	% change 2006/07	Regional 2006/07	% change 2006/07	Total local government 2006/07	% change 2006/07
Value-based rates						
General rates	1,617,713,358	10%	178,811,756	3%	1,796,525,114	10%
Targeted rates	461,223,871	-2%	162,243,989	0%	623,467,860	-1%
Total value-based rates	2,078,937,229	7%	341,055,745	2%	2,419,992,974	7%
% of total rates	61%		94%		64%	
Fixed or uniform rates						
Uniform annual general charges	384,579,510	3%	25,851,354	31%	410,430,864	4%
Targeted uniform rate	309,148,965	6%	159,851	0%	309,308,816	6%
Water and sewerage						
Targeted fixed rate	301,037,519	16%	16,612,600	103%	317,650,119	18%
Other						
Pan tax	162,068,318	21%	–	0%	162,068,318	21%
Total fixed rates	1,156,834,312	9%	42,623,805	53%	1,199,458,117	10%
% of total rates	34%		11%		32%	
Other rates						
Rates based on other proxy prices	140,501,694	-15%	297,668	33%	140,799,362	-15%
Rates based mainly on area	5,434,947	-65%	20,319,070	17%	25,754,017	-21%
Total other rates	145,936,641	-19%	20,616,738	17%	166,553,379	-16%
% of total rates	4%		5%		4%	
Total all rates	3,381,708,182	6%	404,296,288	6%	3,786,004,470	6%

Source: Department of Internal Affairs and Rates Inquiry.

areas and services. Each council therefore goes through a complex set of decisions in developing its rating system.

9.15 The Panel concludes that since 2002, when the Local Government (Rating) Act 2002 (LGRA) was introduced, rating systems in New Zealand have become generally more regressive. This is a result of the shifting of rating systems away from rates based on the value of property to those with higher proportions of rates from UAGCs and targeted fixed rates. Since 2002 uniform charges have become a larger share of local authority rates, while general rates have become a smaller share (see Chart 9-1).⁹⁴

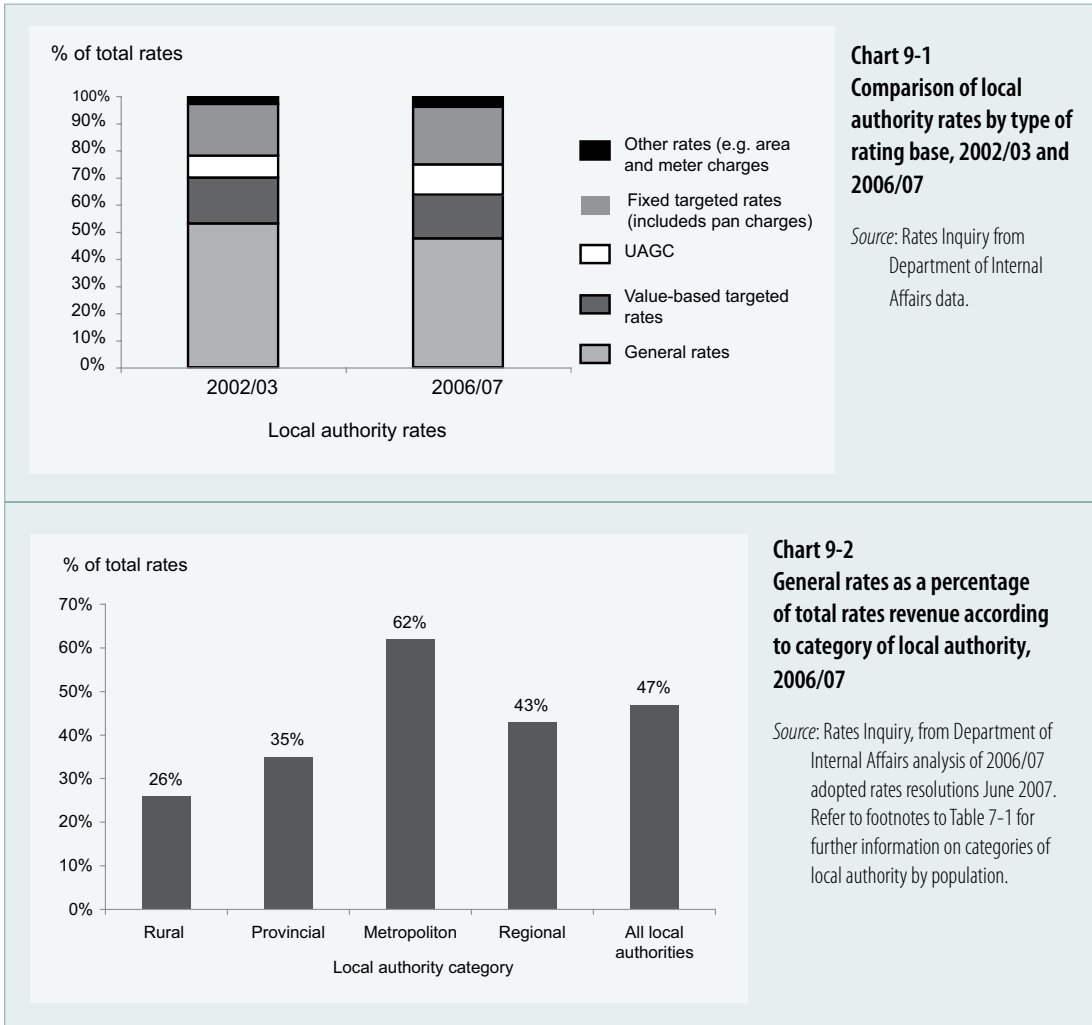
Choice of valuation base for general rates

9.16 Traditionally local government has utilised land value as the valuation basis for general rates. More recently capital value has become the valuation basis for the majority of local authorities. Three local authorities do not set a single general rate, instead using a series of “targeted” general rates (technically “targeted value-based rates”).

9.17 In 2006/07 44 local authorities are using capital value for their general rates, with 36 using land value, and two using annual value, while three have no general rate.⁹⁵

94 Throughout this chapter “uniform charges” means uniform annual general charges and targeted fixed rates.

95 The three local authorities that do not use general rates are Southland District, Masterton District, and Chatham Islands councils.



9.18 These rates figures do not include user charges for local authority services such as solid waste (rubbish) disposal, regulatory services (for example, building and resource consents), and in a few cases water supply and waste-water treatment. There has been a general shift to more user charges over time. However, the data to quantify these changes are not readily available. Separately invoiced user charges for services such as water and waste water are alternatives to rates funding. For example, two councils use council-controlled organisations to deliver water and waste-water services that invoice separately on a volume basis, and one has contracted out this service to a private provider.

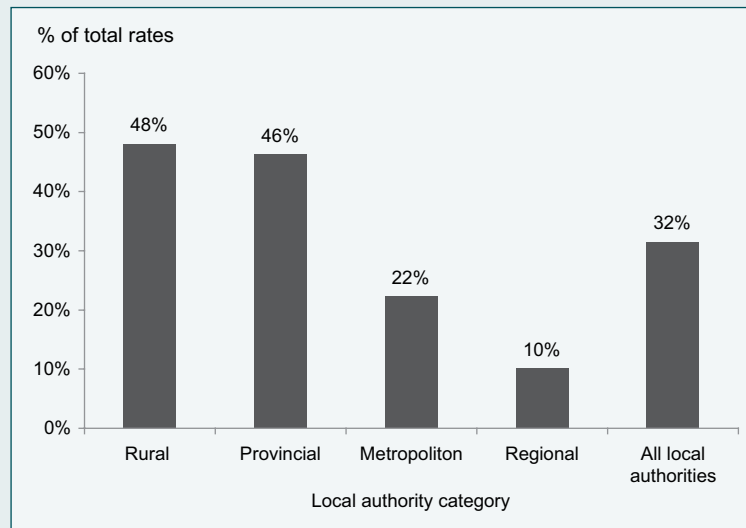
General rates

9.19 The extent of use of general rates by local authorities varies across the country. General rates account for anything from 0% to, in one case (Hamilton City), over 90% of total rates. One-third of local authorities received between 26% and 50% of their rates from general rates. Forty percent received less than this and 27% received more. Using the Local Government New Zealand classification of types of local authority, Chart 9-2 shows that metropolitan councils are far more reliant on general rates than their provincial and rural counterparts. Metropolitan councils on average receive more than twice the percentage of total rates from general rates than rural councils.

9.20 Councils may also levy a differential general rate; that is, they may levy different amounts of rates per dollar of property value for different classes of ratepayers such as businesses or farmers. This is discussed later in this chapter. They may also levy a “stepped” general rate with a different

Chart 9-3
Uniform charges as percentage
of total rates revenue, 2006/07

Source: Rates Inquiry, from Department of Internal Affairs analysis of 2006/07 adopted rates resolutions June 2007.



rate per dollar of value on properties of different values. Two councils levy a lower rate per dollar on higher-value residential properties.

Uniform charges

9.21 Almost all local authorities use uniform charges (UAGCs, uniform targeted rates, and/or pan charges) to some extent, with three regional councils being the exception. Only four territorial authorities do not set a targeted fixed rate for water or waste-water services, but three of these charge for water through a council-controlled organisation or through a contract with a private sector organisation. Twenty-four local authorities raise 50% or more of total rates revenue from uniform charges, while 13 local authorities (seven of which are regional councils) raise less than 25% from uniform charges. The 30% legislative cap on uniform charges excludes targeted fixed rates on water and waste-water networks.

9.22 There is again a significant difference between metropolitan councils and provincial and rural councils in the use of uniform charges (see Chart 9-3). Uniform charges as a percentage of total rates range from an average of 10% for regional councils and 22% for metropolitan councils to 48% in rural councils.

Targeted value-based rates

9.23 In 2006/07, 12 local authorities levied no targeted rates based on property value, while six local authorities received over 50% of their total rates from this source. The majority of local authorities levied between one and five targeted rates; however, a handful levied more than 10. One council (Southland District) levied 33 targeted rates in 2006/07, while three councils that set no general rates each levied 20 targeted rates.

9.24 Targeted value-based rates are clearly favoured by regional councils as a rating tool (Chart 9-4). This is likely to be because of their greater geographical area and variations of levels of service between different areas, for example, catchment management activities. For territorial authorities there is an inverse relationship between the size, measured by population, of a council and the proportion of total rates that is made up of targeted value-based rates; the larger the council, the lower the proportion of targeted rates.

Chart 9-4
Targeted value-based rates
as a percentage of total rates
revenue, 2006/07

Source: Rates Inquiry, from Department of Internal Affairs analysis of 2006/07 adopted rates resolutions June 2007.

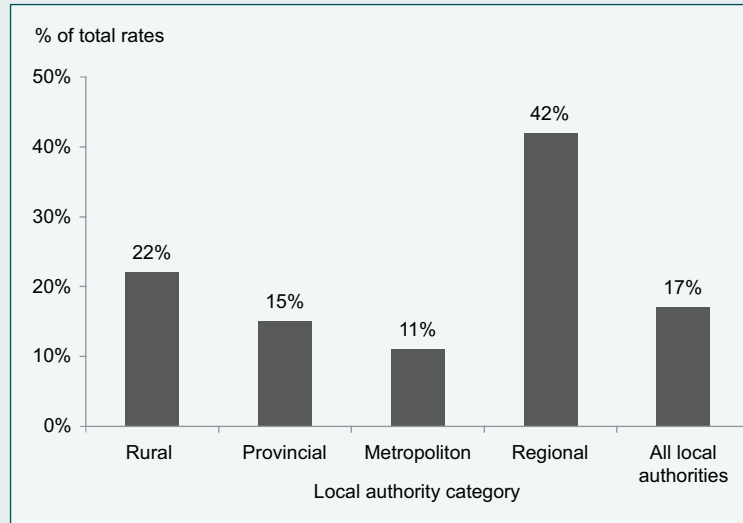


Table 9-2 Proportion of rates based on property value, 2006/07

Local authority category	% of rates based on property value
Metropolitan	73%
Provincial	50%
Rural	48%
Regional	85%
All local authorities	64%

Source: Rates Inquiry from Department of Internal Affairs data. Refer to footnotes to Table 7-1 for further information on categories of territorial authority by population.

9.25 Targeted rates may also be based on area or volume of use (for example, using water meters). Stockwater supplies and land drainage schemes are often funded using a mixture of land area, value, and water volume. However, these rates made up only a small proportion (4%) of total rates struck in 2006/07.

Use of property value for rating base

9.26 As set out in Table 9-1 and Table 9-2, the pattern that emerges is one of considerable variation between regional, metropolitan, provincial, and rural councils. Regional councils and metropolitan councils place a much greater emphasis on property values than rural and provincial local authorities.

9.27 As outlined in Chapter 5, general rates are less regressive in relation to income than uniform targeted rates and generally less regressive than user charges. To the extent that larger territorial authorities have less reliance on uniform targeted rates, their rating systems are likely to be more progressive. However, where councils have greater reliance on value-based general rates it is likely the rating system will be more progressive.

9.28 The exclusion of water and waste-water charges from data on rates for Auckland City and Manukau City (which are collected through council-controlled organisations) and Papakura District (contracted out to a private supplier) in 2006/07 affects the data. However, even if these charges were funded entirely from uniform rates, the overall percentage of rates based on property values for metropolitan councils would remain in the mid-60s range.

Transparency of rating policies

9.29 The Panel considers that there is a need (and indeed demand by the public) for clearer disclosure of the particular rating system adopted by each council and the reasons for it. Section 103 of the Local Government Act 2002 (LGA 2002) requires this to be set out in a statement of revenue and financing policy. Overall, there is a need for much greater transparency on the basis for the various components of the rates. Examples where there is lack of clarity include:

- ✦ the basis of differentials for general rates
- ✦ the activities funded by the UAGC
- ✦ the impact on the distribution of the rating burden of expenditure changes in the annual plan (increases in one activity and decreases in others should be able to be traced through to the rates assessment).

9.30 Comparison of rate levels between councils needs to be significantly enhanced. This is discussed further in Chapter 15 where a standard template is proposed. Clarity could be achieved in a number of ways:

- ✦ through a clear explanation in the statement of revenue and financing policy, which every council must adopt
- ✦ through enhanced disclosure of the basis of the rating system within the long-term council community plan
- ✦ through greater clarity of funding sources in the annual funding impact statement
- ✦ through a clearer rates assessment notice and supporting information.

9.31 If these opportunities are appropriately utilised, public debate and consultation will be improved. The Panel notes that there are strong policy and legislative expectations that the choice of rating system will be the subject of community consultation. Yet, overall, presentations and submissions to the Panel indicate that local authorities fail to clearly articulate their rating policies to ratepayers.

9.32 With good analysis a local authority should be able to identify the activity being funded and the amount to be charged to each property. This is currently required for a targeted rate. The inherent lack of transparency of the basis of fixing differentials and the UAGC is a particular problem area, as discussed later, and is a major reason for the Panel recommending their abolition.

9.33 The combination of these issues, with the requirements of section 101(3) of the LGA 2002, mean that local authorities should

- ✦ explicitly identify each service and its costs
- ✦ know who the beneficiaries are, and the distribution of benefits
- ✦ come to a conclusion on who should be charged – either the direct beneficiaries or the community as a whole, and the distribution of the burden between them.

Equity of rating systems

9.34 Councils must have regard to a number of factors when designing rates policies. Specifically, section 101(3) of the LGA 2002 requires councils to consider

- ✦ the distribution of benefits (both temporally and spatially)
- ✦ the extent to which action or inaction by specific individuals or groups contribute to the need for council expenditure
- ✦ the impacts of rates on community outcomes and policy transparency

- the likely impacts on the four well-beings (social, economic, environmental, and cultural), both current and future.

9.35 These criteria clearly require a consideration of equity, although the weighting or balance between these criteria is not explicitly laid down. A number of submitters suggested that local authorities should not be concerned with issues of equity between ratepayers and that income redistribution is a task for central government. However, the issue of the equity of rating systems was the focus of a very large number of submissions to the Inquiry, particularly from older people and groups representing “asset rich, cash poor” ratepayers.

9.36 The Panel emphasises that in reality local authorities influence income redistribution, whether they wish to or not. Although rates are overall a relatively small proportion of household income, the incidence of rates nevertheless has an impact on income redistribution. As discussed in Chapter 12 on sustainability and affordability of rates, the Panel considers that a requirement to explicitly consider affordability issues for low-income ratepayers should be added to section 101(3) of the LGA 2002.

Rates and property values

9.37 To the extent that value-based (general and targeted) rates are intended to be wealth taxes, their suitability depends on the extent to which property values reflect wealth. However, there are a number of reasons why property values do not fully reflect wealth.

9.38 First, real estate property is only one of many asset classes in which wealth may be held. Others include stocks, bonds, term deposits, and so on.⁹⁶ Second, many properties have very low gearing; so that the “owner’s” actual wealth is only a fraction of the property’s value.⁹⁷ Third, as will be explored in more detail later in this chapter, the actual value of a property may differ markedly from its valuation for rating purposes. Finally, it can be argued that wealth held in property is realised only when it is sold.

9.39 A criticism of rating systems is that they are regressive in relation to incomes. Research commissioned by the Panel⁹⁸ sought to test this assertion using information from the Household Economic Survey 2003/04, a detailed survey of New Zealand households’ spending patterns.

9.40 One of the items included in this survey is “payments to local authorities”. Chart 9-5 shows these payments as a percentage of post-tax incomes for each income decile.

9.41 Chart 9-5 indicates an overall regressivity in rates with payments to local authorities becoming smaller proportions of household income as incomes increase. The apparent decrease in regressivity in the highest two income bands where there is a small upward turn in the proportion of payment to local authorities may be because of the number of rental investment and/or holiday properties owned by these high-income households.

9.42 As also noted in Chapter 5, the extent to which rating systems utilise fixed charges and UAGCs influences the degree to which the rating system is progressive or regressive. The inference is that if local authorities had fewer uniform charges, there would be a closer relationship between rates and household income. The regressive pattern shown above reflects these uniform charges.

96 This may have been less of a concern historically, when a greater proportion of wealth was held in property relative to today. See Ulbrich, H., *A Property Tax for the 21st Century*, 1998, for example.

97 One obvious, but ultimately unworkable, solution would be to levy rates on net property wealth.

98 Covec report to the Rates Inquiry on rating tools.

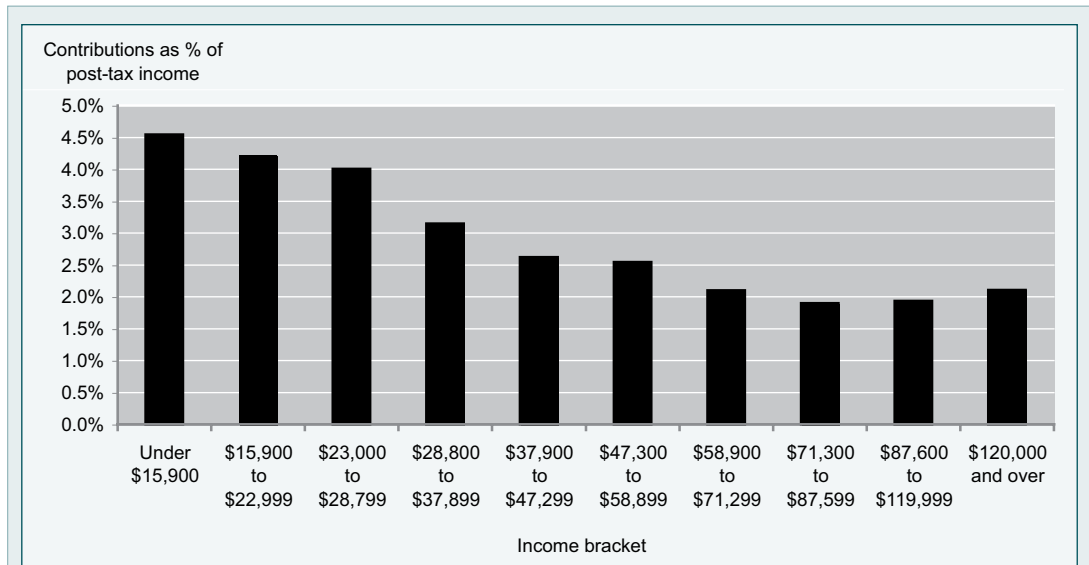


Chart 9-5 Payments to local authorities as percentage of household incomes

Source: Statistics New Zealand, Household Economic Survey 2003/04.

Ability to pay

9.43 Two equity criteria are commonly used to assess rates: ability to pay and benefits received. The following discussion on the relationship between rates and these criteria is informed by the research carried out for the Panel.

9.44 The equity criteria can be considered both across ratepayer groups, and within them. Thus, we may be interested in the distribution of benefits between residents, businesses, and others, and we may also be interested in the distribution between ratepayers within the residential group.

9.45 Ability to pay is concerned with taxpayers' abilities to meet financial demands and is often considered as having two dimensions: horizontal equity and vertical equity. Horizontal equity requires that people in similar income situations be treated similarly, whereas vertical equity requires that people in different situations be treated differently.

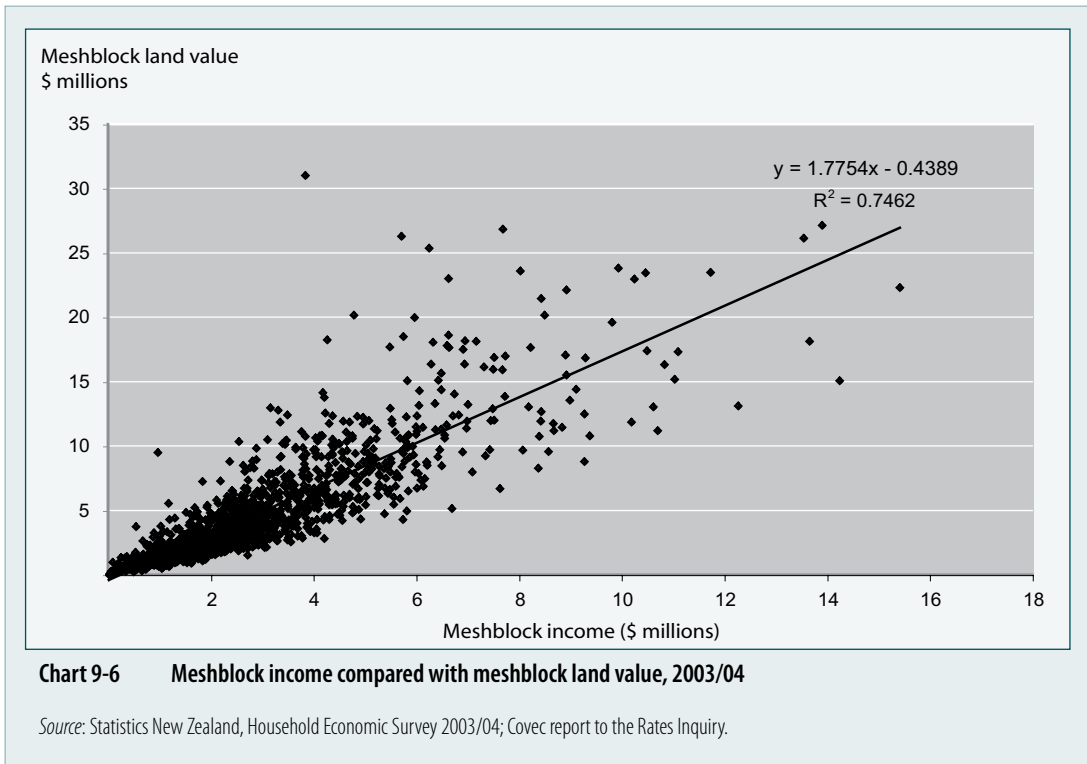
9.46 Factors influencing the degree of vertical equity include

- *regressive taxes*, where the proportion of income paid as tax decreases as income increases
- *flat taxes*, where the proportion of income paid in tax is constant regardless of income
- *progressive taxes*, where the proportion of income paid as tax increases as income increases.

9.47 Regressive taxes violate the concept of vertical equity, whereas progressive taxes adhere to it. Flat taxes treat people the same regardless of different income, and thus can have regressive effects. Progressive taxes are imposed where the goal is to improve vertical equity.

9.48 UAGCs (and other uniform charges) bear little relationship to ability to pay. As a flat charge, they are regressive.

9.49 In contrast, value-based rates have a reasonable fit with ability to pay. Although the closeness of this fit is influenced by the choice of valuation base and the use of differentials, the degree to which



property values are correlated with household incomes can be analysed. This provides some insight to the link between value-based rates and ability to pay.⁹⁹

9.50 In order to analyse relationships between property values and incomes across residential ratepayers, the rating information database of a large city council was examined. For each rateable property, this showed the ratepayer type, the property's rateable value, and its location. The analysis covers both land value and capital value.

9.51 Aggregating this data to meshblocks and linking it to census meshblock information the relationship between property values and incomes (at the meshblock level) was analysed.¹⁰⁰ The results are presented in Charts 9-6 and 9-7.

9.52 Chart 9-6 plots the relationship between *land* values and incomes.

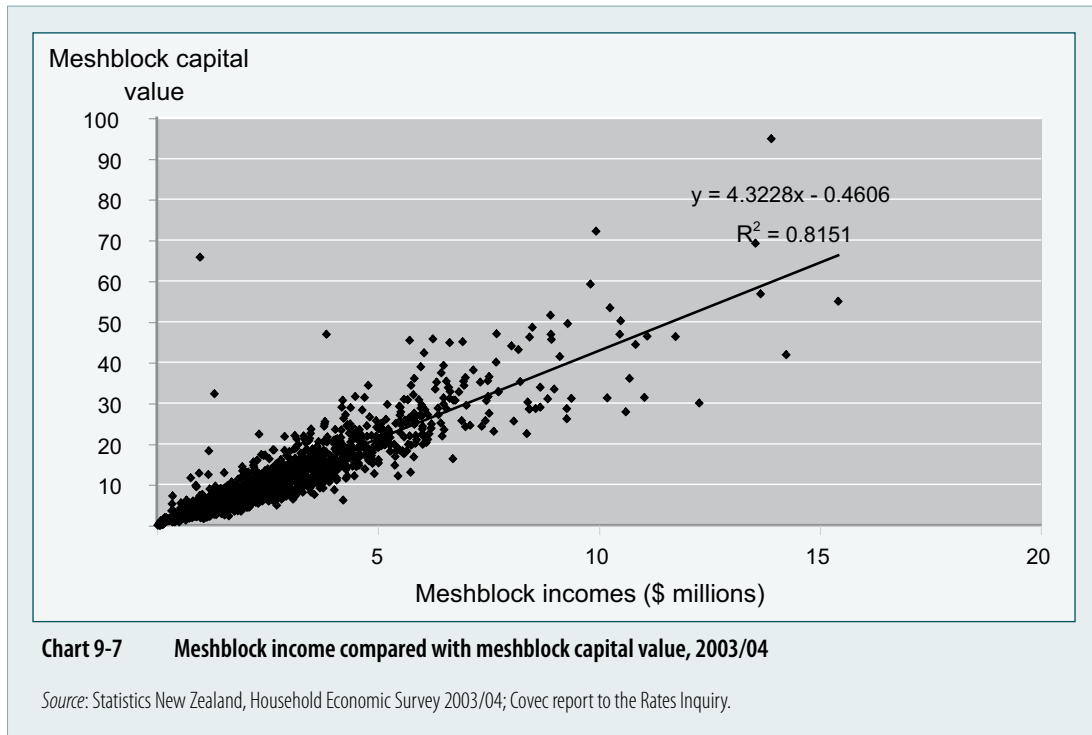
9.53 As Chart 9-6 shows, there is a relatively strong linear relationship between household incomes and land values at the meshblock level. Chart 9-7 shows the relationship between household incomes at *capital* values at the meshblock level.

9.54 Chart 9-7 shows that there are even stronger relationships between incomes and capital values at the meshblock level.

9.55 Combining these findings, one might reasonably conclude that there is a broad relationship between rates based on property values and ability to pay. There is, however, an important caveat:

99 A discussion of the effects of valuation bases and differentials is provided later in this chapter.

100 The meshblock is the smallest geographic unit for which statistical data is collected and processed by Statistics New Zealand. A meshblock is a defined geographic area, varying in size from part of a city block to large areas of rural land. Each meshblock abuts against another to form a network covering all of New Zealand including coasts and inlets, and extending out to the two hundred mile economic zone. Meshblocks are added together to 'build up' larger geographic areas such as area units and urban areas. They are also the principal unit used to draw-up and define electoral district and local authority boundaries. (Source: Statistics New Zealand Glossary)



these relationships are far from perfect. Consequently, the use of property values to set rates can result in

- *horizontal inequity*, because some households on similar incomes own properties of markedly different value and, therefore, pay quite different rates
- *vertical inequity*, because some households with markedly different incomes own properties of similar values, and hence pay similar rates.

9.56 The most prominent example of a breakdown in the property value-income relationship is ratepayers described as “asset rich but income poor”. These people, many of whom are retired, own high-value properties that now attract high rates but their income is not high.

9.57 The Panel is aware of the public concern, especially among these asset rich, cash poor categories of ratepayer. However, there are three key measures that can potentially provide assistance to these ratepayers. First, there is central government’s rates rebate scheme. Second, councils may have rates postponement and remission policies.¹⁰¹ Finally, property-based equity can be drawn down using equity release schemes. These measures are discussed in detail in Chapter 12.¹⁰²

9.58 The data indicates that there is a strong relationship between incomes and property values. Although rates are not based purely on property values, the link to income is evident. This leads the Panel to the conclusion that the rates system is not inherently inequitable. There is a better fit of incomes with capital value valuation than with land value.

Benefits received

9.59 A further aspect of equity, which is particularly related to local government rates, is the requirement to consider alignment between payments and benefits or services received. The LGA

101 For more information see Johnston, Karen, *Council Policies on Rates Remissions and Postponements and Māori Freehold Land*, Report to the Rates Inquiry, 2007 (available at <http://www.ratesinquiry.govt.nz>).

102 Some might argue that the use of reverse equity schemes erodes the value of inheritances and, in turn, could exacerbate future housing affordability issues.

2002 explicitly requires receipt of benefits to be considered when designing funding policies.¹⁰³ Many submissions to the Panel suggested greater alignment between services (benefits) provided and the distribution of the rating system.

9.60 Rating analysis generally identifies two types of benefits:

- *private benefits*, which accrue directly to the users of services
- *public benefits*, which capture a range of non-user benefits as well as the direct-use benefits of public goods for which the identification of users is impractical (for example, street lighting).

9.61 In general it is appropriate for private benefits to be funded by user charges and public benefits to be funded by rates.

9.62 To the extent that benefits of activities accrue uniformly to properties, uniform charges are an appropriate rating tool. However, refraining from high uniform charges is seen as desirable to avoid rates becoming too regressive. In addition the benefits may accrue on a uniform basis to individuals in each household rather than households. A restriction on the levels of fixed charges in a rating system has been in legislation since 1982.

9.63 There appears to be a wide variation across councils in the quality of analysis and transparency associated with the selection of rating tools. Whereas in some councils there is robust analysis of benefits or services used that is clearly presented to the public, in others there is effectively no analysis and no base for a public discussion of how the rating system is designed and the rationale for that design.

Intergenerational equity

9.64 Intergenerational equity refers to a fair balance in the relative contributions of current and future generations to funding local government expenditure. Judgments about fairness take into account the relative benefits received, as well as relative ability to pay, of different generations. For example, if future ratepayers are likely to have higher incomes than current ratepayers or if they are likely to receive a greater share of benefits than current ratepayers, a fair distribution would mean that future ratepayers would pay more. This concept is particularly important for the funding of infrastructure, which provides benefits over long time horizons.

9.65 There is no apparent difference between the rating tools with respect to intergenerational equity. The achievement of intergenerational equity depends entirely on the way that capital costs are recovered over time. This, in turn, depends on the degree to which council uses debt (and other long-term funding mechanisms) to match the period of funding with the perceived period of benefit. Once raised, these loans may be repaid using any combination of rating tools, without any effect on intergenerational equity.

Merits of targeted rates

9.66 The Panel advocates greater use of targeted rates, as they have greater potential than UAGCs and differentials to reflect the principles of transparency, efficiency, and equity. Typically the rate name (for example, sewerage rate) is sufficient to explain the purpose, but in addition in setting targeted rates councils need to define the activity to be funded, the amount to be raised, the factors to be used in calculating the rate, and the group of properties to be targeted. The opportunity to use targeted rates also provides councils with greater flexibility to respond to local needs. Targeted rates may be based on property value but are often a uniform or fixed charge.

¹⁰³ Local Government Act 2002, section 101(3)(a).

9.67 Currently, the content and distribution of general rates is masked by differentials and UAGCs, making it difficult for ratepayers or analysts to identify the rate structure or make-up.

9.68 General rates remain the default rate (in the absence of any targeted rate), and should focus on recovering the costs of

- general benefits from all services
- direct benefits that, in the opinion of the council, cannot be charged to the direct beneficiaries as user charges or targeted rates
- direct benefits of services where the ratepayers at large are the beneficiaries, in proportion to the value of the rate base.

9.69 Targeted rates should be used for all other rate charges where they reflect

- variations of service levels
- customer benefit assumptions leading to differentials
- distribution of expenditures by uniform charges
- where the rate catchment is less than all the (fully rateable) rating units in the whole district.

9.70 If the benefit distribution is

- equal to all stakeholders, general rates are preferred
- sector-dominated, then targeting by differentials is preferred
- to identified consumers, then targeting by geographical area is preferred
- uniform to each rating unit, then targeting by uniform charges is preferred.

9.71 UAGCs are a fixed charge on every separately rateable unit within a local authority. The argument for UAGCs assumes a fixed common charge is fairer because the service value is assumed to be equal to all rating units. It assumes occupancy and benefits are common across all rating units. In essence “high value” ratepayers want a greater proportion of uniform charges to reduce their rating burden, and “low value” ratepayers will pay less with a smaller proportion of uniform charges. The argument has less to do with rates as a tax or service charge than with the distribution of rates across different groups of ratepayers.

9.72 The Panel considers that UAGCs can be set arbitrarily to alter the incidence of the rating burden with limited transparency as to which expenditures are considered as conferring benefits equally to each rateable property.

9.73 It should be noted that UAGCs could be replaced with targeted uniform rates for particular services or classes of ratepayers. Thus the overall proportion of fixed charges may not change.

9.74 The Panel received many submissions advocating a removal of or an increase to the 30% limit on uniform charges. The current 30% cap on uniform charges (excluding water and wastewater charges) is somewhat arbitrary and appears to have been inserted into the LGRA to limit the regressiveness of a council’s rating system. This restriction is at odds with the general principles of the LGA 2002 and the LGRA around local autonomy to decide on appropriate rating policies. The Panel considers that this restriction should be removed.

9.75 Removal of the UAGC will not mean the end of uniform charges and with the removal of the 30% cap, could lead to a much wider use of targeted uniform rates and create affordability issues. To ensure that councils explicitly address the issue of affordability in formulating the revenue and financing policy, in Chapter 12 the Panel recommends additional requirements to be added to section 101(3) of the LGA 2002.

9.76 Many submissions supported a volumetric charging for waste water. At present, council-controlled organisations can charge in this manner, but councils themselves cannot. The Panel supports greater use of volumetric charging as a demand management mechanism. This is recommended in Chapter 10 in relation to user charging.

Recommendations

- 5 **That the power to set uniform annual general charges be removed from the Local Government (Rating) Act 2002.**
- 6 **That the 30% cap on uniform charges be removed from the Local Government (Rating) Act 2002.**
- 7 **That local authorities be encouraged to charge for waste-water disposal by volumetric charging.**

Rating differentials

9.77 The LGRA permits local authorities to set different levels of rates for different types of properties with the same property value. These are usually expressed as multipliers of the residential rate, and are described as “differentials”. For example, if the residential rate is \$1.00 per \$1,000 of property value and the business rate is \$2.50 per \$1,000 of property value, the business differential is said to be 2.5.

- 9.78 Differentials may be used for various reasons, but are most often used to
- increase the incidence of rates on business properties
 - decrease the incidence of rates on rural properties (recognising situations where property values are an inequitable basis for farmers’ contribution to rates)
 - ease the burden on high-value properties (for example, farming properties in coastal areas where rates increases are influenced by the recent sharp increases in coastal land values).

Business differentials

9.79 In 2006/07, while 40 local authorities did not have a business differential, 45 local authorities (including one regional council) set business differentials on general rates. Many set more than one differential. Differentials are used to increase the incidence of rates on businesses (there is only one business differential less than one on the general rate – that is, in favour of business, and it applies to only a small subsection of businesses). However, a number of councils have a policy of gradually reducing the existing business differential.

9.80 There are also differences across council types, with metropolitan councils more likely to use business differentials than provincial and rural councils. This is summarised in Table 9-3.

9.81 There are also a few extremely high business differentials for specialised industries. For example, Clutha District sets a differential on hydroelectricity plants of 23 times the main residential urban area rate in the dollar, and Central Otago District sets a hydro differential of 129. Business differentials have long been a point of contention with businesses claiming they are inequitable, and some submitters claiming that business pays 50% of rates in New Zealand.¹⁰⁴

104 For example, submissions from Business New Zealand [S572] and New Zealand Retailers Association [S481].

Table 9-3 Business differentials on general rates according to category of council, 2006/07

Category of council	Proportion of councils using business differentials on general rates	Average highest business differential on general rates
Metropolitan	90%	3.7
Provincial	62%	3.1
Rural	46%	3.2
Regional	8%	1.6
All local authorities	53%	3.2

Source: Rates Inquiry from 2006/07 local authority rating resolutions. Note: Many local authorities have multiple business differentials based on location and sometimes value. This analysis measures the highest differentials used on the general rate in each local authority.

9.82 The Panel's own research indicates that, although a small number of local authorities have a significant business differential, across the local government sector as a whole it appears that rates paid by the business sector are somewhat less than 50% of total rates collected. In the 2006/07 year, Wellington City, which has a very large commercial sector and a high business differential, raises exactly 50% of its total rates from the business sector. However, this is at the top end.

9.83 The Panel notes that, in general, differentials have been justified based on differences in

- *levels of service.* A group receiving a higher level of service than other groups or a disproportionate share of benefits should be charged more.
- *ability to pay.* If one group has greater means from which to pay rates, it should pay more. The deductibility of rates for business income tax is often put forward as part of this argument.
- *willingness to pay.* If one group is willing to pay more than another group, it should bear a higher proportion of costs.
- *cost.* If the cost of providing services to one group is higher than others, it should pay more.

9.84 The Panel does not support a higher differential on businesses to compensate for the tax deductibility of rates for business income tax. The tax status of residential ratepayers is not considered when setting rates, and many owners of residential investment properties also have an ability to claim rates as a tax expense. More importantly, other taxes and goods and services are not set on the basis that businesses should pay more because of their tax status. The Panel considers that the tax status of a business or individual is not a relevant factor in deciding the incidence of rates.

9.85 In most cases, businesses receive largely the same benefits as other ratepayers, and at a similar cost to the local authority. Services that are regarded as providing a greater benefit to the business sector than to other ratepayers include economic development, improvements to central business districts, and tourism promotion. In addition, local authorities sometimes consider that business causes more roading expenditure than other ratepayers because business enterprises generate more and heavier traffic. However, a contrasting point of view (often advanced by business) is that residents in the wider area benefit from having businesses in their locality and therefore should contribute to the costs that might otherwise be funded by a targeted business rate.

9.86 The Panel considers that business differentials have been set in an arbitrary fashion historically and are not related well to the benefits received. These are generally fixed by a subjective and essentially "political" decision. The Panel recommends that business differentials should be abolished. Instead, local authorities should make greater use of targeted rates to reflect any additional costs reasonably attributable to the effects of business (for example, roading and parking), and also

Table 9-4 Rural differentials on general rates according to category of council, 2006/07

Category of council	Proportion of councils using rural differentials on general rates	Average lowest rural differential on general rates
Metropolitan	70%	0.73
Provincial	54%	0.53
Rural	46%	0.56
Regional	0%	–
All local authorities	46%	0.58

Source: Rates Inquiry analysis of 2006/07 local authority rates resolutions. Note: Many local authorities have multiple rural differentials based on area: usually, the larger the size, the lower the differential. The data in Table 9-4 are based on the lowest differentials used in each local authority.

the relatively greater benefit enjoyed by business sector ratepayers from the provision of some local authority services. This will significantly increase the transparency of setting rates on the business sector. While targeted rates can also be used to achieve a particular balance of the rates burden between different classes of ratepayers, using this mechanism has the advantage of requiring a transparent process.

Rural differentials

9.87 In 2006/07, 39 territorial authorities set rural differentials on general rates. Rural differentials are generally used to ease the incidence of rates on rural ratepayers. Thus the overwhelming majority of differentials are less than one, with only a few being greater than one. The results are summarised in Table 9-4 according to the category of local authority.

9.88 There are differences across council types in the use of differentials, with metropolitan councils making much greater use of rural differentials. Without the application of such differentials, the values of rural properties in close proximity to a metropolitan centre would often cause such properties to be subject to an inequitable rates burden.

9.89 Rural sector submitters frequently raised concerns about rates affordability.¹⁰⁵ Chapter 12 discusses the issue of affordability for rural ratepayers; this chapter focuses on the choice of rating tools. Property value-based rating is regarded by farmers as inequitable because this means that rates are applied on the basis of a valuation, which does not reflect the actual income generated.¹⁰⁶ Rural land in recent times is being valued not on its productive value based on output and potential income but on factors such as lifestyle. The result is that some rural property values now bear little relationship to farm incomes, as indicated in the submission from Federated Farmers:

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.¹⁰⁷

9.90 This situation for rural ratepayers differs from that of other ratepayer groups such as commercial businesses where the property value reflects the economic return on their asset. Where there is a significant distance between rural properties and urban centres it may be argued that, compared with urban properties, rural properties receive lower levels of service in terms of the ability to access facilities such as parks, libraries, and swimming pools.

105 See, for example, submissions from Federated Farmers of New Zealand (Inc) [S577] and Ms Jean Hamilton [S688].

106 Submission from Federated Farmers of New Zealand (Inc) [S577].

107 Submission from Federated Farmers of New Zealand (Inc) [S577].

9.91 Many submitters from the rural sector argued that the rural contribution to rates is inequitable because they are paying for services that they do not receive (for example, street lighting or footpaths, where these costs are charged through general rates or UAGCs). Earlier in this chapter the relationship between concerns about affordability and willingness to pay was noted. Federated Farmers has been a strong advocate of itemised rates demands. As discussed elsewhere in Chapter 15, the Panel supports greater transparency and enhanced public understanding about the rates charged and the activities and services of local government. The Panel also supports greater use of the range of rating tools and, in particular, targeted rates. However, the Panel emphasises that valuation-based rates are a hybrid tax and cannot be seen as solely a charge for services.

9.92 A 2004 report produced by Harris Consulting's Agribusiness Group for the Ministry of Agriculture and Forestry concluded,

there are many instances where it would appear that there are inequities between urban and rural ratepayers in terms of the share of rates paid, just as there are instances of inequities going the other way and within urban and rural sectors. We cannot draw a conclusion of universal subsidy from rural to urban ratepayers. Some of these inequities are as a result of the constraints on the use of mechanisms and tools available to councils, some are a result of a failure to accurately match costs and benefits while some are conscious choices made by councils, in setting a tax on land designed to target wealth as measured by the rateable value of land.¹⁰⁸

Summary of uses of differentials

9.93 The Panel reviewed use of differentials based on a sample of 2006/07 differentials from Auckland City, Christchurch City, Clutha District, Kaikoura District, Kapiti Coast District, North Shore City, Papakura District, Tasman District, Wellington City, and Westland District. One of the most striking features from this sample was the variability between councils. For example, Kaikoura District uses a 1.2 differential on rural land, whereas most other councils use a rural differential less than one. Also, North Shore City has a maximum business differential of 6.55, whereas Auckland City has a business differential of up to 2.4.

9.94 There also appears to be a degree of variation *within* councils. For example, Clutha District in 2006/07 set a rate in the dollar on residential property value in the Kaitangata Township 25 times the rate in the dollar on residential properties in the nearby township of Balclutha. This difference is difficult to understand, although it appears to reflect a desire to equalise the amounts properties in different townships pay, which would otherwise differ because of widely varying property values. However, this is not explained in the Clutha District's funding impact statement.

9.95 This analysis reveals considerable inconsistency and divergent outcomes associated with the use of differentials. This probably reflects the process used for setting most differentials. It appears that the following process is often used: first, a local authority decides the total amount of rates that need to be struck; second, it decides what proportion of rates it wishes to raise from each group (residential, rural, business, and so on); and third, based on these target allocations, differentials are set.

9.96 Although most councils assert that differentials reflect the relative benefit each ratepayer group receives from council services, and/or the relative costs each causes, this assertion is questionable on two counts. First, it is extremely difficult to assess the distribution of benefits with any reasonable degree of accuracy. Second, the allocations often appear to have no reasonable relationship with relative benefits or costs.

¹⁰⁸ Harris Consulting Agribusiness Group, 2004, Urban/Rural Equity in Local Government Rating, MAF Operational Research project ICP441, p. 6.

9.97 Viewed this way, differentials appear to be a means to an end. Virtually any pattern of differentials can be justified simply by altering the target allocations for each class of ratepayers. In the Panel's opinion, this is unacceptable. Any differentials should be derived as far as possible from a systematic and objective process of evaluation of relative costs and benefits, rather than be the result of an arguably arbitrary and politically driven cost or benefit allocation.

9.98 The Panel's recommendation is to remove differentials, although differentials for rural property rates are supported by many farmers. The Panel considers that the same or similar outcomes in terms of the level of rates paid by rural properties could be achieved through the use of more equitable targeted rates across all sectors. This would be supported through councils making more use of their flexible rating powers so that rates better reflect value in use, as discussed later in this chapter.

9.99 Business differentials appear to account for some 15%–20% of all rates, but generally more in metropolitan councils. The Panel recognises that removing business differentials without changing the mix of rating would result in an increase in the level of rates paid by residential ratepayers. This should be alleviated by the use of targeted rates where these reasonably reflect higher benefits received by the business sector.

9.100 The Panel understands that these changes could have a significant impact on the incidence of rates in those councils that use differentials extensively. In order to alleviate this impact and allow time for councils to properly consider, consult, and resolve their rating policies, the removal of the ability to set differentials should take effect in five years' time. This time frame could be reduced; many councils do not set differentials now. Councils currently with differentials do not need any legislative change to remove these if they chose to do so. However, this time frame allows for differentials to be removed at the latest as part of the 2012–22 LTCCP process.

Recommendation

8 That rating differentials be removed from the Local Government (Rating) Act from an operative date of 1 July 2012.

Valuation issues

9.101 Any review of value-based rates also involves a consideration of the assessed values upon which rates are struck, in particular, the accuracy and methodology of valuation, as well as the institutional arrangements for undertaking valuation. This issue becomes even more important, given that the recommended removal of UAGCs may result in a greater proportion of rates being based on assessed property values, if not fully replaced by targeted uniform rates.

Accuracy of assessed values

9.102 One of the major criticisms in submissions on value-based rates was that assessed values are unreliable and may be poor indicators of the actual value of a property. The Panel became aware of a number of issues regarding the quality of information in property valuation rolls during the course of its inquiry. These issues were highlighted by a range of submitters, including local authority elected members and staff, Māori, and people across the spectrum who attended the Panel's public meetings, including residential, rural, and business ratepayers.

9.103 Analysis undertaken for the Panel¹⁰⁹ emphasises that the extent of the problem depends entirely on the variability of assessment errors. More specifically, if each property's market value is

¹⁰⁹ Covec report to the Rates Inquiry on rating tools.

a constant fraction of its assessed value, the distribution of rates is unchanged. If, however, market values are varying proportions of assessed values, the distribution of rates is changed.

9.104 Detailed analysis of one metropolitan authority's property sales database was conducted to identify the relationship between market values and assessed values. The database included 17,824 sales over a 22-month period. In summary, the data showed the following:

- On average, properties sold for 10% above assessed value.
- 29% of properties sold below assessed value.
- 44% sold for more than 20% above assessed value.

9.105 Moreover, 56 properties sold for less than half their assessed value, while 80 properties sold for more than double their assessed value.

9.106 The analysis also revealed the following (if everything else is held constant):

- The ratio of selling price to assessed value increased as the selling price decreased. Thus, assessed values are more accurate for expensive properties than they are for cheaper ones.
- The greater the gap between the date of assessment and the date of sale, the higher the ratio of selling price to assessed value (ratios increased at a rate of 0.09 per 12 months).
- There was significant variation across property types. On average:
 - Undeveloped land sold for 45% above assessed value.
 - Vacant land sold for 17% above.
 - Home and income properties sold for 4% below.
 - Rental flats sold for 6% above.
 - Dwellings and flats sold for around 2% above assessed values.

9.107 This analysis shows that there is significant variation in the ratio of market value to assessed values, which has significant implications for the distribution of rates. This indicates that the valuation accuracy has an effect on the incidence of rates.

9.108 If each type of property in the sample analysed paid rates on the actual market sale value rather than assessed value, then the following situation would result:

- Rates on undeveloped land would increase by 32% (on average).
- Rates on home and income properties would decrease by 13% (on average).
- The 56 properties mentioned above (paragraph 9.105) would face a decrease of 55% or more.
- The 80 properties mentioned in paragraph 9.105 would face an increase of 80% or more.

9.109 A conclusion of this analysis is that the inaccuracy of assessed values has significant implications for the distribution of rates.¹¹⁰

9.110 Because assessed values are based primarily on market transactions, it follows that everything else being equal, the valuation base with the most detailed or richest transaction data will generate the most accurate assessments.

¹¹⁰ The Panel notes that property owners may lodge a formal objection to the valuation of their property. However, altering the assessed value of one property in isolation does not correct assessment errors in every other property. Also, the objection process does nothing to resolve the infrequency of revaluations.

9.111 In the case of land value (LV) rating, in most areas (particularly urban ones), there are very few land sales upon which rateable values can be generated.¹¹¹ This raises questions about the reliability of assessed values under LV rating. Capital value (CV) rating, on the other hand, benefits from the availability of much richer sales information. For instance, in two Auckland cities over the past few years, there were around 50 sales of dwellings for every one sale of land. Thus, assessed values are likely to be far more reliable under CV rating than under LV rating.

9.112 The advantage of annual value (AV) rating is that, as a consequence of the bond lodgement scheme operated by the Tenancy Services section of the Department of Building and Housing, market rental information is readily available from within the residential sector at more frequent intervals and at even greater amounts than property sales information.

9.113 This information provides a comprehensive data set upon which the rental values of other residential properties (and hence their AV) can be derived. On this basis, one might conclude that AV rating generates more accurate assessed values than CV or LV. However, the robustness of AV rating depends not only on the quality of the comparative rental data but also on the extent to which properties are assessed on this basis rather than as 5% of CV.¹¹² The Panel was provided with examples where identical houses had significantly different rating assessments as a result of one house being assessed on an AV basis and the other on 5% of CV. Submitters referred to AV rating as “CV rating in drag”.

9.114 Territorial authority submitters argued that the 5% scalar on CV is too inflexible and causes the AV rating of most properties to revert to 5% of CV. In the case of business property, as market rental yields continue to fall, more business property will be assessed on 5% of CV. The Panel does not support the removal of the 5% scalar. To do so would further weight the rating incidence towards higher-valued residential and non-residential properties. The scalar would likely be seen as a “differential in disguise” by many ratepayers.

9.115 The Panel is of the opinion that a single rating system should be promoted across the country and is firm in its support of the capital value rating system.

Recommendation

9 That a common rating system based on capital value be promoted across the country for general rates.

9.116 As noted earlier in the chapter many rural submissions expressed concern that rural property rating valuations do not reflect the productive value of the property and thus may have little relationship to incomes. (This issue is also discussed above under rural differentials.) One solution to this problem already exists through local authority rates postponement policies. The Far North District Council, for example, allows rural ratepayers, on land over 50 hectares that produces the majority of the owner’s income, to pay rates on the reassessed productive value of the farm. The difference between the rating valuation-assessed rates and the productive value rates is postponed until the land is sold or changes use.

9.117 An alternative approach would be to allow a local authority to value all rural land generically on this value-in-use basis, rather than on a property-by-property basis. This would avoid the administrative costs associated with dealing with rates postponements on an individual basis.

111 Even in areas with a higher number of land sales, land transactions tend to be concentrated in peripheral (greenfields) areas. The value of land in these areas is often not representative of the value of land in other areas of the city or district. Hence, the accuracy of assessed values depends not only on the depth of market transactions, but also on how representative those transactions are.

112 Annual value is the greater of (i) 80% of rental value or (ii) 5% of capital value (Rating Valuations Act 1998, section 2).

Recommendations

- 10 That councils indicate in their rates remission and postponement policies a policy for postponement of rating of rural property based on reassessed productive values.
- 11 That councils be encouraged to make more use of their powers for flexibility in rating so that the rating burden better reflects value in use.

Valuation methodology

9.118 As mentioned earlier, many submissions to the Panel expressed widespread disquiet with the accuracy, or appropriateness, of the rating valuations. Points made by these submitters included the following:

- The valuer did not inspect the property.
- The valuations are not representative of market value.
- The valuations reflect a single “high” or iconic sale (particularly in the area of lifestyle and coastal blocks).
- The valuations are not reflective of “productive value” (a common complaint from the rural sector).
- Valuations move up and down from one suburb or area to another at each revaluation.
- Valuations are volatile, changing sometimes erratically from one period to another (a particular concern of territorial authorities).
- There are anomalies in the annual value basis (for example, three identical houses but widely divergent assessments).

9.119 Significant concerns were also expressed about the valuation of Māori land. These are addressed in Chapter 13.

9.120 The Panel met with the Valuer-General to discuss the methodology used for valuation. The Valuer-General emphasised the following:

- A priority is to achieve consistency across the rolls and between various classes of property.
- An open market sale does provide the benchmark for valuations.
- The valuation impact upon rates assessed for a particular property or class of property is a matter for the territorial authorities to address in their rating policies.

Institutional arrangements for property valuation

9.121 In seeking to understand concerns about property valuation the Panel considered the background to the current practice. We understand that for much of its history New Zealand was recognised as having an excellent land tenure and land record system, which included a world-leading Valuation Department. Land valuation case law arguably evolved as a result of the involvement and leadership of the Valuation Department as valuation experts in this litigation.

9.122 The Valuation Department had responsibility for the preparation of the valuation rolls from North Cape to Bluff. The rolls were valued on a five-yearly (later reduced to three-yearly) cycle. Both the land values and the capital values were perceived and recognised as truly representative of

market values. The Valuation Department's database was extensive and was regularly updated with inspections of all properties at the time of any revaluation. All sales notices were received by the Valuation Department and provided the basis for both the revaluations and the extensive statistical reports published on a half-yearly basis by the Valuation Department.

9.123 In 1998 this data management was devolved to individual territorial authorities and has not been maintained with the same degree of consistency as previously. The valuation basis changed from being under the jurisdiction of the Crown through a process involving the establishment of Valuation New Zealand in 1988, and then the corporatisation of that government department 10 years later with the establishment of Valuation New Zealand Limited in 1998. Quotable Value was formed and duly became a state-owned enterprise in 2005. The regime for territorial authorities was also changed, with territorial authorities being given the right to contract out rating valuation work progressively from 1998. The Valuer-General's office was separated from Valuation New Zealand to become an audit function set up within Land Information New Zealand to provide a director/audit/quality overview of valuations completed under the auspices of the Rating Valuations Act 1998.

9.124 Valuation New Zealand lost the near monopoly to provide territorial authorities with their rating valuations.¹¹³ Other providers entered the market and prices were reduced, but with hindsight, the quality of both the background data and the roll values appear to have suffered.

9.125 With this background the Panel felt it necessary to address the following questions:

- To what extent are concerns about valuations a valuation problem per se?
- Can or should territorial authorities' own valuation policies for rating purposes address the concerns?
- Are there institutional issues that central government should or could address?

9.126 Much of the deterioration and criticism of rating valuations has, in the opinion of the Panel, resulted from the break-up of the former Valuation Department. The Panel is concerned that under the current State-owned enterprise model there exists a possibility that a territorial authority might not be able to secure a valuation contract of its roll on commercial terms. It would appear to the Panel that a review of the State-owned enterprise model as it relates to valuations and the local government sector is warranted. The need for annual revaluations exists but cannot be met from the present valuation suppliers. Indexation or value mapping are alternatives, but the Panel is unclear whether Quotable Value has the data and resources to undertake property indexation on a robust basis over different property classes and locations New Zealand wide. A return to order and clarity in the field of property taxation and valuations, the Panel argues, requires a reversal of the current model.

9.127 The Panel notes that a return to the previous model of a central government valuation authority with a high level of professional resources would benefit the whole community, not just territorial authorities. Moreover, much of the information gathered might be commercially marketable, thus reducing the cost of such an entity.

9.128 If the re-establishment of a central government agency is considered too radical or costly, the alternative suggested by the Panel is to increase the resources of the Valuer-General's office to facilitate better quality control. The Valuer-General could then require territorial authorities to raise the standard, for example, by preparing best practice standards such as regularity of physical inspections and use of computer-assisted valuation processes. The Valuer-General would thus put

113 It was a "near monopoly" because territorial authorities that used an annual value basis had their own valuation team.

greater pressure on territorial authorities to spend adequate funds on maintaining the valuation roll.

Consistency in valuations

9.129 The drive for consistency has been a hallmark of rating valuations over many years and it is accepted as an overarching principle. However, the Panel has concerns about whether this consistency is being achieved in practice.

9.130 Although the average or median rating value to the average or median sale price may be within an acceptable margin, it is the variance of a property's individual sale price from its rating valuation that should be of greater concern because this would indicate whether consistency is being achieved.

9.131 The absence of physical inspections of many properties must result in subjective rather than objective valuations, and the perpetuation of errors over time. Alterations and/or improvements to properties can remain hidden from the valuer resulting in the undervaluation of these properties and a regressive distribution of rates.

9.132 The reliance upon a single or limited number of sales to set valuations for nearby properties appears to ignore the fact that there are a limited number of special or wealthy buyers in the market and that their purchase of a property may have been driven by that property's singular attributes (locational or other). Scant regard is paid to the productive capacity of the land (in the case of many rural properties), and rural submitters have been strong in their call for a "productive value" or "value-in-use" approach to their land as distinct from a capital value driven from one-off alternative use sales.

9.133 An issue that should be of concern is the tendency for objectors to seek an increase in the rating value, when one might expect that they would object to have values reduced. There could be at least two reasons why this would occur. The objector may be aware that improvements have been disregarded and want them included to better reflect an actual value, possibly for refinancing. Alternatively, there would be a desire to have a value increased to achieve a higher sale price post-revaluation. Under either scenario the revised value would be inconsistent with other properties where the owner does not object because rates would be affected. It is unlikely that a rating valuer or a rating authority would strongly oppose an objector's desire for a value increase.

9.134 The Panel concurs with many submitters who expressed concern as to the relevance of the rating valuations. Put simply, these are not valuations that would meet the professional practice standards of the registered valuer in public practice. They are not valuations but rather rateable property assessments, and the LGRA should be amended accordingly to clarify this. Rather than the capital value definition contained in the LGRA, property assessments would better be seen against the following criteria: "The assessment of a hypothetical price for a transaction between a prudent willing buyer and willing seller, based on a statistical analysis of sales and without regard to a detailed consideration of market value on an individual property basis."

Territorial authorities' valuation policies for rating purposes

9.135 The Valuer-General's response that many submitters' concerns about valuation could be adequately addressed by a territorial authority's rating policies has some relevance in practice. The Panel has seen evidence of territorial authorities that, for example, have a policy to reassess for rating purposes productive farmland over a certain land area at a "value-in-use" rather than market value. This usually occurs where the roll value has been clearly based upon some form of "iconic" market value such as in coastal land. What is disappointing to the Panel is the lack of consistency between

territorial authorities in their rating policies approach to valuation issues raised by the community. The removal of section 25 (which provided for special rateable values) from the LGRA was intended to give territorial authorities greater control (and, some might say, empathy with their communities) in delivering special rateable values to remove or assist in addressing inequities in the level of rates payable by individual or even classes of ratepayers.

9.136 There was a clear preference from submitters for a single rating system with most calling for a capital value basis of assessment. If a property assessment model as described above were to be adopted across the sector, then separate assessments for land and improvements would be unnecessary. Conversely, greater emphasis would be required to ensure that all improvements to property were captured, and a more rigorous approach to valuation inspections would be required. For example, Tauranga City has a general policy that all improvements to properties arising from a building consent will be physically inspected and that 15% of all properties will have been physically viewed between each valuation cycle. Other councils should consider adopting explicit standards for valuations based on this.

Recommendations

- 12 **That the previous model of a central government valuation authority be re-established to increase the level of professional resources applied to rating valuations.**
- 13 **As an alternative to recommendation 12, that the resources of the Valuer-General's office be increased to facilitate better quality control of valuations and encouragement for councils to better maintain the valuation roll and databases.**
- 14 **That the rates assessment notice make it clear that the rating valuation currently represents a means of distributing the rating burden rather than a likely realisable sale price.**
- 15 **That councils develop explicit standards for valuation covering such issues as the proportion of properties to be physically viewed between each calculation cycle and the inspection of all improvements to properties arising from a building consent.**