

PART TWO: CONTEXT FOR THE INQUIRY: LOCAL GOVERNMENT PURPOSE, PLANNING, AND FUNDING

The purpose of this section is to provide a background and context for the Rates Inquiry by explaining the objectives, functions, and diversity of local government.

3 PURPOSE OF LOCAL GOVERNMENT

3.1 Local government is responsible for the provision of services that form the basis of community life in New Zealand. Discussion of funding issues cannot be separated from an understanding of the purpose, role, and structure of local government. These diverse roles create complex funding systems and challenges.

3.2 As a creature of statute, local government's functions, powers, and duties are those set out in legislation. The Local Government Act 1974 was seen as very prescriptive, and the Local Government Act 2002 sought to provide a broad empowerment. The purpose of local government, as set out in section 10 of the Local Government Act 2002, is to

- enable democratic local decision making and action by, and on behalf of, communities
- promote the social, economic, environmental, and cultural well-being of communities, in the present and for the future. (This is also known as the sustainable development principle.)

3.3 Section 12(2) notes that a local authority has full capacity to undertake any activity to achieve the purpose of local government set out in section 10. Although the Local Government Act 2002 aims to be broadly empowering, as opposed to prescriptive, under the Local Government Act 1974, councils also had wide powers to promote community well-being. Hence, the Panel considers that the Local Government Act 2002 has not specifically resulted in an expansion of activity into new areas, as further discussed in Chapter 8.

3.4 This general empowerment is accompanied by obligations for each local authority to

- conduct its business in an open, transparent, and democratically accountable manner¹
- make itself aware of, and have regard to, the views of all of its communities.²

1 Local Government Act 2002, section 14(1)(a)(ii).

2 Local Government Act 2002, section 14(1)(b).

3.5 Local government services are critical to local economies. These services include land transport, and water and waste infrastructure and operations, which are by far the greatest focus of local authorities. Of increasing importance is local government's role in building social infrastructure such as recreational and cultural facilities. These community activities help to build the "sense of place" and quality of life that is critical to attracting and retaining a modern workforce and businesses. Delivery of central government's economic transformation agenda³ objectives will therefore require local government to play a leading role.

3.6 Local government in New Zealand comprises two types of local authority: 73 territorial authorities (either a city or a district council) and 12 regional councils (Schedule 2 of the Local Government Act 2002). Four territorial authorities are unitary authorities with the powers of regional councils. The boundaries of the local authorities are shown in Appendix 2.

3.7 Other features of the structure of local authorities include the use of community boards to represent local community interests within some territorial authorities. Local authorities also use council-controlled organisations that exist at arm's length from councils to manage assets and/or deliver services. These council-controlled organisations include companies or trusts that may or may not operate for profit. Examples include a water supply company and a trust to manage museum operations. These entities have their own board of directors and work to councils' objectives set out in a statement of intent.

3.8 Local government's purpose is to promote the well-being of communities. The roles local authorities undertake to do this are diverse. The diversity of roles and structure of local government creates complex funding systems that are often difficult for the average ratepayer or even elected members to fully understand.

3 See www.med.govt.nz. The Economic Transformation Agenda seeks to progress New Zealand to a high income, knowledge-based market economy, which is both innovative and creative, and provides a unique quality of life to all New Zealanders.

4 DIVERSITY OF LOCAL GOVERNMENT CIRCUMSTANCES AND ACTIVITIES

4.1 Any consideration of funding of local government must take account of the variety of conditions faced by territorial and regional authorities (“local authorities” or “councils”) as they seek to promote the well-being of their communities.

Diversity of council circumstances

4.2 Councils exhibit a wide diversity in characteristics including their population size, level of historic and projected population growth, proportion of Māori, levels of wealth and social deprivation, the proportion of rural and urban residents, and their own level of wealth including investment assets. This diversity creates a range of drivers of expenditure and funding challenges. Local Government New Zealand divides the sector into four main types:

- rural territorial authorities with a population of less than 20,000
- provincial territorial authorities with a population from 20,000 to 90,000
- metropolitan territorial authorities with a population greater than 90,000
- regional councils.

Population size and growth rates – variation among councils

4.3 Territorial authorities vary greatly in population size, with a small number of large councils and many with relatively low population. Over half (52%) of New Zealanders live in the 10 largest territorial authorities and only 7% live in the 25 smallest rural territorial authorities. One-third of New Zealand’s population lives in the Auckland region. The focus of council activities and the funding challenges are related to population size. For example, larger councils typically have a relatively greater expenditure on community infrastructure such as libraries and swimming pools than do rural councils.⁴

4.4 Some of the greatest pressures on territorial authorities are rapid changes (both growth and decline) in the population of their communities. New Zealand has a very mobile population and this can be seen in the wide variation in population growth rates. Ten-year growth rates (percentage change 1996 to 2006 as measured by the 2006 census) range from minus 19% in Ruapehu District to plus 61% in Queenstown-Lakes District. Twenty-eight territorial authorities experienced declines in population from 1996 to 2006, almost all of these being smaller rural territorial authorities (except for Wanganui and Invercargill). These territorial authorities have had to deal with cost increases and a wider range of regulatory responsibilities with generally little or no increase in the rating base. Ten territorial authorities, on the other hand, experienced population increases of 20% or more from 1996 to 2006. These are generally large urban territorial authorities or growth areas on the edge of large urban areas and include Tauranga city and Western Bay of Plenty district, Selwyn and Waimakariri districts, Manukau and Waitakere cities, and Rodney district. The largest population increases from 1996 to 2006 were in Manukau, Auckland, Waitakere, North Shore, Christchurch, Tauranga, and Wellington

4 Statistics New Zealand. 2006 Census, Usually Resident Series.

cities. The largest decreases from 1996 to 2006 were Ruapehu, South Taranaki, Wanganui, South Waikato, Southland, and Rangitikei Districts, and Invercargill City.⁵

4.5 Rapid changes are forecast to continue over the next 10 years. Statistics New Zealand forecasts⁶ show that territorial authorities' forecast population growth rates from 2006 to 2016 range from minus 13% (Kawerau District Council) to plus 22% (Queenstown-Lakes District Council). Territorial authorities that experienced rapid population growth from 1996 to 2006 are forecast to continue this trend while those that experienced population decline are also expected to experience continued declines. The local impacts of population changes can be dramatic. For example, Statistics New Zealand is forecasting that Queenstown-Lakes District will increase its population in the next 20 years by 35%. The forecast for Ruapehu District is a decline of over 18% over the same period. For Auckland City the increase from 2006 to 2016 is forecast to be 30% or around 130,000 people, the equivalent of the population of Dunedin City.

Percentage of Māori – variation among councils

4.6 There is a wide variation between territorial authorities in the percentage of population identifying themselves as Māori, ranging from 60% to 4% of territorial authority populations. The Chatham Islands, Kawerau, Wairoa, and Opotiki District Councils have more than 50% of the usually resident population who identify themselves as Māori, whereas 5% or less of persons in Waitaki, Waimate, and Mackenzie districts identify as Māori.⁷ These areas with high proportions of Māori have significant Māori land and associated issues as discussed in Chapter 13 of this report.

Visitor numbers – variation among councils

4.7 The demand for network services provided by territorial authorities is also impacted by the number of visitors. Some territorial authorities have a large number of properties that are usually unoccupied but are used by people during holidays. The people that use these properties, whether they own the property or not, are not included in the usually resident population figures. The proportion of all households that were usually unoccupied in 2006 within territorial authorities ranges from 5% in Manukau City to 49% in Thames-Coromandel District.⁸

4.8 In terms of visitors, both domestic and international who occupy beds in accommodation facilities (hotels, motels, etc), Auckland City has a 12% share of the national total, Christchurch City 10%, Queenstown Lakes District 9%, Wellington City 6%, Rotorua District 6%, and Far North District 4%. No other local authority exceeds 2%.⁹

Household income – variation among councils

4.9 Household incomes vary widely across New Zealand. In the 2006 census median annual household incomes by territorial authority ranged from \$31,900 in Buller District to \$74,200 in Wellington City. The national median household annual income was \$51,400 with 16 territorial authorities having median household incomes above this and 57 below.¹⁰ Higher median incomes are generally in metropolitan and surrounding areas. Lower median household incomes are usually in rural territorial authorities with declining populations. This often results in potentially greater rates affordability issues in rural areas compared to metropolitan areas.

5 Statistics New Zealand. 2006 Census, Usually Resident Series.

6 Statistics New Zealand, Sub-national population projections, February 2005 medium projections.

7 Statistics New Zealand. 2006 Census, Usually Resident Series.

8 Statistics New Zealand. 2006 Census, Unoccupied Dwellings.

9 Ministry of Tourism, *International Visitors Survey*. Year ending March 2007

10 Statistics New Zealand. 2006 Census, Household Incomes.

4.10 One of the influences on low median income is the number of older people in a territorial authority area. The proportion of usually resident population in 2006 65 years of age and over varies from 8% in Porirua, Manukau, and Wellington cities, to 23% in Kapiti Coast District, 21% in Thames-Coromandel District, and 20% in Waitaki District. The national average is 12%. Many retirees are on a largely fixed superannuation income and are also more likely to be in a one-person household.¹¹ As discussed in Chapter 12, one-person households on average tend to have the greatest rates affordability issues. The proportion of one-person households in each territorial authority also varies across the country, ranging from 14% of all households in Manukau City to 31% in the Buller District with a national average of 23%.¹² Territorial authorities with high proportions of one-person households tend to be rural districts and coastal areas that have attracted older people as a place to retire such as Kapiti Coast and Thames-Coromandel Districts. The majority of the territorial authorities with high proportions of one-person households have declining populations.

Property values – variation among councils

4.11 As well as differences in household income across territorial authorities there is significant variation in average property values. For example, the average value of a residential house in June 2007 varied from \$180,652 in Invercargill City to \$593,611 in Queenstown-Lakes District.¹³ With the incidence of rates reflecting the relative property values within a territorial authority, average property value cannot be used to compare rating levels between territorial authorities. Average rates per rateable property in Invercargill were estimated at \$1,457 in 2006/07¹⁴ compared with \$2,120 in Queenstown-Lakes.¹⁵ These variations in property wealth, incomes, and rating levels all impact on the affordability of rates.

Local authority wealth – variation among councils

4.12 The level of financial health within councils themselves varies depending on the levels of investment assets, past governance decisions, and even the historical wealth of an area. Some councils benefit from owning ports, electricity networks, and airports, whereas others have none of these assets. One measure of wealth is total public equity. This is the total amount of assets held by a territorial authority less debt and divided by the number of rateable properties. Total public equity per rateable property in 2006 ranged from \$15,698 in Kawerau District Council to \$88,377 in Waimate District Council, with an average of \$39,629.¹⁶ A number of rural territorial authorities such as Clutha, Central Hawke's Bay, Southland, Waimate, and Tararua District Councils have high levels of public equity per rateable property. This reflects extensive roading networks and low population. The issue for these territorial authorities is often the difficulty of maintaining these large networks with a small rating base.

Rural/urban mix – variation among councils

4.13 Additional diversity exists between urban and rural territorial authorities. There are 37 territorial authorities that include urban areas of 10,000 or more usually resident population. These account for 78% of the population of New Zealand. The remaining 36 territorial authorities account

11 Statistics New Zealand. 2006 Census, Usually Resident Series.

12 Statistics New Zealand. 2006 Census, Private Occupied Dwellings.

13 Source: Quotable Value website (<https://www.qv.co.nz/>), accessed 17 July 2007.

14 Note: In this document years expressed in the format 2006/07 refer to financial years ended or ending 30 June.

15 Rates Inquiry, Local Authority Funding Project, and Manukau City Council Finance Director.

16 Statistics New Zealand, Local Authority Funding Statistics, *Table 2*, year to June 2006 and Manukau City Council Finance Director.

Chart 4-1
Local government operating expenditure, year to June 2006

Source: Statistics New Zealand. Data Sets, Local Authority Funding Statistics, Table 3, year to June 2006, accessed July 2007.

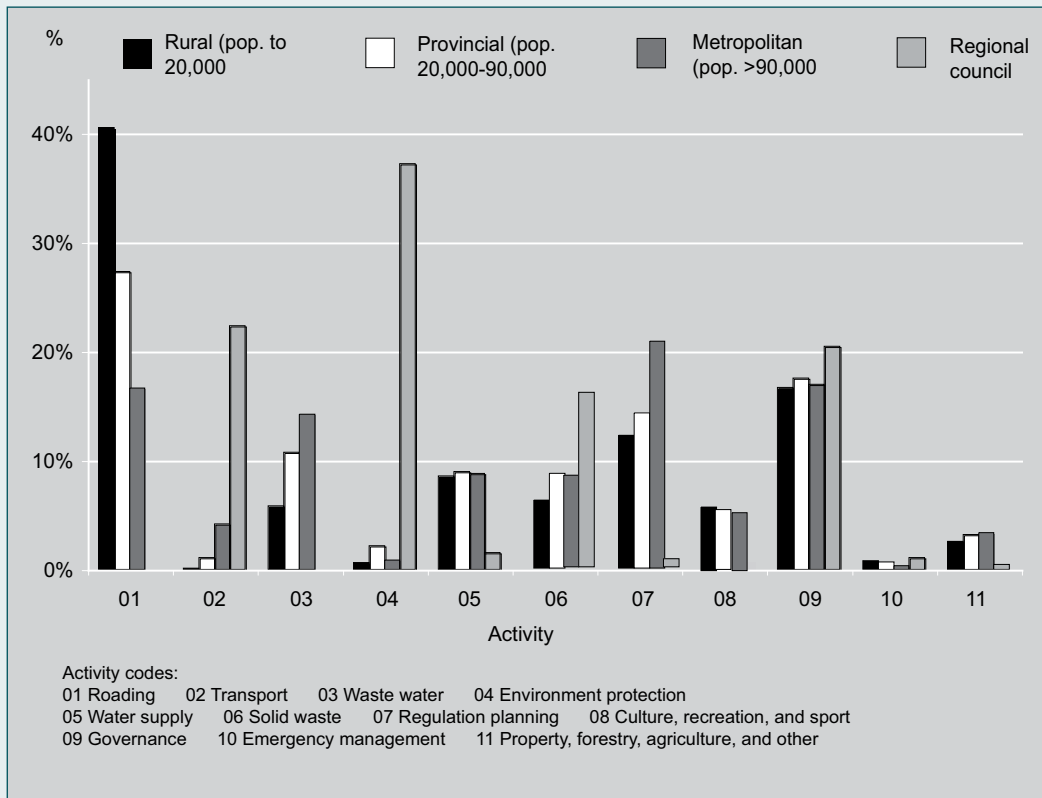
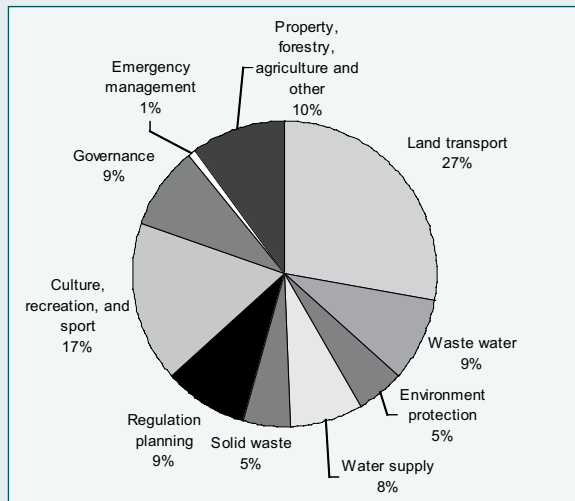


Chart 4-2 Average operating expenditure by activity as a percentage of total expenditure by type of council (rural, provincial, and metropolitan territorial local authority and regional council), year to June 2005

Source: Based on Statistics New Zealand data, Table 3.xls, at <http://www.stats.govt.nz/datasets/govt-finance/local-authority-financial-statistics-by-council.htm>, accessed 18 June 2007.

for 22% of the population and are largely rural in character, although all of these will be centred on a smaller urban township.¹⁷

17 Statistics New Zealand. 2006 Census, Usually Resident Series.

Diversity of council activities

4.14 Councils are also diverse in the activities they undertake. Chart 4-1 shows the breakdown of the total \$5.3 billion annual operating expenditure for the year to June 2006 for local government as a whole, comprising territorial authorities and regional councils. Land transport (roads and passenger transport) made up the largest single expenditure category, accounting for 28% of operating expenditure (\$1,481 million) in the year to June 2006. The next biggest categories are water and waste water combined at \$897 million or 17%; and culture, recreation, and sport, also at 17% or \$886 million.¹⁸

4.15 Chart 4-2 shows the variation in the nature of council operations for different types of councils, namely rural, provincial, and metropolitan territorial authorities and regional councils for the year ended June 2005. This shows that expenditure on roading increases significantly in relative importance as council population size decreases. For example, roading on average forms 40% of the annual expenditure for rural councils, and this proportion can reach as high as 60%. In metropolitan councils by comparison, roading forms only 15% of annual expenditure. Also shown is the increasing relative importance of expenditure on culture, recreation, and sporting activities as council size increases. The regional councils' focus on transport and environmental protection demonstrates the clear difference in their roles from those of territorial authorities.

18 Statistics New Zealand, Local Authority Funding Statistics, Table 3.

5 LOCAL GOVERNMENT REVENUE SOURCES

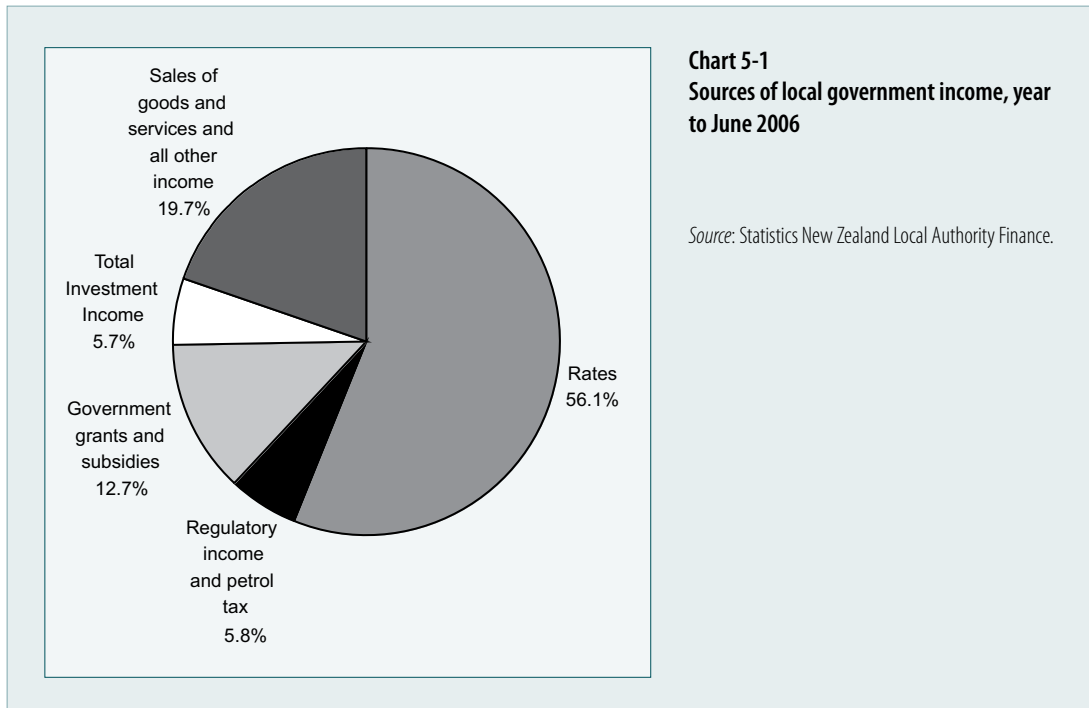
5.1 Local government funding covers a wide range of revenue mechanisms that can be used for each council in a number of combinations. The purpose of this chapter is to describe the funding processes, tools and relevant taxation theory to provide a foundation for the discussion of funding issues in later chapters.

Funding processes

5.2 Rates are one of a number of funding mechanisms available to councils. Section 103(1) of the Local Government Act 2002 requires that the local authority's policies on the use of these funding mechanisms are detailed in a revenue and financing policy. In developing revenue and financing policies, councils must consider, separately for each activity to be funded, a range of principles set out in section 101(3) as follows:

- (3) The funding needs of the local authority must be met from those sources that the local authority determines to be appropriate, following consideration of,—
 - (a) In relation to each activity to be funded,—
 - (i) The community outcomes to which the activity primarily contributes; and
 - (ii) The distribution of benefits between the community as a whole, any identifiable part of the community, and individuals; and
 - (iii) The period in or over which those benefits are expected to occur; and
 - (iv) The extent to which the actions or inaction of particular individuals or a group contribute to the need to undertake the activity; and
 - (v) The costs and benefits, including consequences for transparency and accountability, of funding the activity distinctly from other activities; and
 - (b) The overall impact of any allocation of liability for revenue needs on the current and future social, economic, environmental, and cultural well-being of the community.

5.3 Paragraph (a)(ii) of section 101(3) of the Local Government Act 2002 quoted above allows councils to consider the public good or private good characteristics of an activity. Public good benefits from an activity to the wider community may point towards the use of general rates. Benefits to an identifiable part of the community on the other hand may indicate the use of user charges or targeted rates if user charges are not practical. Paragraph (a)(iii) recognises that council expenditure, particularly on infrastructure, may provide benefits over a number of generations of ratepayers. In these cases the use of debt funding may be appropriate. Paragraph (a)(iv) is a user pays or polluter pays type of consideration that would support the use of fees and charges or metered use of a service. Paragraph (a)(v) allows councils to consider the



administrative costs of funding mechanisms. In some cases the fairest funding mechanism may have high costs of collection relative to the revenue gained.

5.4 The Local Government (Rating) Act 2002 (LGRA) provides the detailed legislative empowerment for council rating.

Total funding by revenue source

5.5 Local authorities obtain their operating revenue from a number of sources in the following order of magnitude:

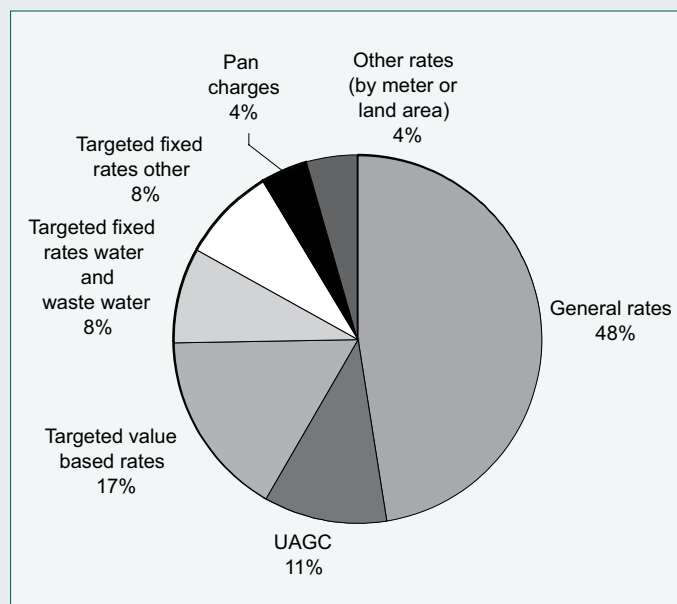
- rates (including general and targeted rates and uniform annual general and pan charges)
- user charges
- transfers from central government (for example, for roading, public transport and water infrastructure)
- dividends, rents, and interest from commercial investments (for example, local authorities may be owners in whole or part of a port or airport)
- regulatory fees and fines income.

5.6 In the year ended 30 June 2006 local government received approximately \$5.3 billion in operating income (GST exclusive). Chart 5-1 shows that around 56% of this came from rates, 13% from central government transfers, 6% from investments (dividends and interest), 6% from regulatory income (fees and fines), and 20% from sales of goods and services (user charges) and other sources.

5.7 The figures in Chart 5-1 do not include borrowings or asset sales. It is common for local authorities to borrow money to finance long-life assets. At 30 June 2006 local authority debt amounted to around \$3 billion, but when considered against the \$79 billion in assets owned by local authorities as at June 2006, this is not large. Interest payments in 2005/06 amounted to something

Chart 5-2
Territorial local authority – use of rating tools as a percentage of total rates revenue, forecast year 2006/07

Source: Department of Internal Affairs, analysis of 2006/2007 rating resolutions, June 2007.



over 6% of rates income.¹⁹ Sometimes local authorities may also sell assets they no longer require and use the proceeds to reduce the level of rates that would otherwise be required to fund capital items.

Rates

5.8 Chart 5-1 shows that rates provided the major source (56% of total revenue in 2005/06) for funding local government expenditure. Local authorities have access to a wide range of rating tools allowing extensive flexibility to tailor individual rating systems to the needs and wishes of communities. One implication of this choice and flexibility, however, is the highly complex funding systems that have developed over time. These rating tools, displayed in Chart 5-2, can be listed under four main headings below:

- general rates
- uniform annual general charges
- targeted rates and pan charges
- other rates or user charges by meter or land area.

5.9 Almost all property owners in New Zealand pay rates. People who rent property do not pay rates directly, but property owners will take account of the cost of rates when they set the rent. As a result, those who rent properties also have an interest in the level of rates, as well as in the services provided by councils using these rates.

5.10 Some countries use other means to fund local government, but most make significant use of property taxes or rates.

General rates

5.11 General rates are appropriately used where a local authority decides that all ratepayers should pay for all or part of a particular council service. The amount each ratepayer pays depends on

¹⁹ Statistics New Zealand Local Authority Financial Statistics, Table 1.

the assessed value of their property relative to the value of other properties. Generally, the higher the assessed value of the property, the higher the rates.

5.12 General rates apply to all rateable land within a local authority area and have traditionally formed the majority of local authority funding. In order to strike a general rate, local authorities distinguish rateable land from non-rateable land, select a valuation base, and may set differentials between different types of properties – for example, residential, business, and rural.

Targeted rates

5.13 Targeted rates are applied where a council decides that the cost of a service or function should be met by a particular group of ratepayers (possibly even all ratepayers) on a basis different from that of its general rate. There is considerable scope for local authorities to target functions in specific areas and to set different levels of rates for different properties. For instance, a targeted roading or water supply rate might be specific to a particular town or locality, or it might apply to the whole council area. Targeted rates are often used as a proxy for a user charge where the costs of individual charging (such as water meters) may be prohibitive.

5.14 Targeted rates made up 37% of total rates in 2006/07. Targeted rates included

- *targeted value-based rates*. These are based on the property value and make up 44% of targeted rates. They are typically used to fund roading, stormwater, tourism promotion, water supplies, and sewage treatment.
- *targeted uniform or fixed rates*. These make up 56% of targeted rates. This category of targeted rates comprises
 - *targeted uniform or fixed rates for water and sewerage*. These accounted for 33% of all targeted rates in 2006/07 and include pan charges. They are typically used by councils to rate for reticulated water and sewerage networks and rural water and sewerage schemes. Section 19 of the LGRA permits local authorities to set a targeted rate for the quantity of water provided. This may be calculated as a fixed charge per unit of water supplied or according to a scale of charges.
 - *“other” targeted uniform or fixed rates*. These make up 22% of all targeted rates. They are typically used to rate for stormwater, community facilities (halls, libraries, parks, and reserves), recycling, economic development, and waste collection.

5.15 Although water and sewerage networks are usually funded through a targeted uniform or fixed rate, there is wide variation between councils as to which activities are funded by way of general rates, targeted value-based rates, and targeted uniform or fixed rates.

5.16 Schedule 3 of the LGRA sets out the bases that may be used in calculating liability for targeted rates. These are similar to the valuation bases on which general rates must be set, but are much broader, also including, for example, the number of separately inhabited parts of the rating unit, number of service connections, floor area, and number of water closets.

Differentials on general and targeted rates

5.17 The LGRA permits rates (both general and targeted) to be set either uniformly (fixed charge), or at different rates per dollar of rateable value. Schedule 2 of the Act defines the land categories on which differentials may be set including use or area of the land, permitted activities under the Resource Management Act 1991, connection to a council service, or value of the property.

5.18 Differential rating across local authorities has arisen in response to specific local issues. Consequently, there is wide variation in its application. Since its inception in 1970, differential

rating has been used to adjust the incidence of rates between property groups, usually in favour of rural properties and against business properties. As a tool it provides flexibility to local authorities to better reflect costs and benefits. In practice, differentials are often used as a blunt but effective way of reducing the incidence of rates on residential properties or to change the incidence of rates in response to problems that arise, from a significant increase in valuation of one sector against other sectors. Some local authorities decide what proportion of rates should be paid by each type of property and then apply differentials to achieve this.

5.19 Thirty-two out of 85 councils set a general rate with no differential. Only two regional councils set a differential on the general rate. Just over half of all councils set a differential on the general rate for businesses, and these are as high as 6.75 times the residential rate in the dollar (North Shore City), with an average maximum differential of 3.2. Just under half of councils set a rural differential on the general rate and these are as low as 0.05 times the residential rate in the dollar (Tararua District), with an average minimum of 0.58. There are many other differentials on targeted rates as well as on general rates.

Uniform annual general charges

5.20 Under the LGRA, a local authority may set a uniform annual general charge that applies to all rateable units within its district. This may be a fixed amount per rating unit or a fixed amount per separately used or inhabited part of a rating unit. Uniform annual general charges are typically used to fund or partly fund activities that have similar benefits across all properties.

Cap on fixed charges

5.21 Section 21 of the LGRA limits uniform annual general charges and uniform targeted rates to 30% of the total revenue from all rates. This excludes targeted rates set solely for water supply or sewage disposal. The purpose of the cap is to limit the regressive impacts of fixed charges on lower-income households.

Discussion of the taxation principles behind rates

5.22 The Panel accepts that rates are a hybrid of a charge for services and a tax on real estate property. Rates are typically used as a service charge where it is either not practical or efficient to use a direct user charge. Rates as a tax are typically used to fund local public goods where everyone is expected to make a contribution regardless of the level of use.

5.23 Taxes in general can be levied on the following bases:

- wealth (of which land has long been a conspicuous example)
- consumption or use of particular services (for example, sales taxes)
- income
- other miscellaneous bases (for example, taxes per head such as poll tax).

5.24 Among these, taxes on real property (for example, land) have a very long history, because land has long been seen as a visible indicator of wealth and ability to pay. Also, land is immobile, which makes it easy both to assess liability and to collect taxes on it. Immobility makes land taxes less distorting than taxes on mobile bases (such as income or sales), because individuals can escape the tax only by selling the land.

5.25 Within the overall New Zealand tax system, the taxing of property is relatively light. Local government rates amount to less than 6% of the total government revenue in New Zealand. This is

less than many countries within the OECD.²⁰ Property taxes (rates) are limited to local government, and there is no capital gains tax on property. Stamp duty, once levied on agreements for sale and purchase of property, was removed in 1998.

5.26 Taxes are mainly used as revenue-raising tools, but some forms of taxes, such as “eco taxes”²¹ are also used as an incentive to change behaviour. If successful, eco taxes will result in reduced revenue.

Other rating decisions

5.27 Other rating issues include: what land is rateable, the valuation basis for rates, and the units of property to which rates apply.

5.28 Under the LGRA all land is rateable unless stated otherwise.²² Schedule 1 of the LGRA then defines a long list of land that is non-rateable, and a shorter list of land that is 50% non-rateable. All land not described in Schedule 1 is deemed fully rateable for the purposes of general rates.

5.29 The LGRA permits rates to be set on the basis of land value, capital value, or annual value using valuations prepared in accordance with the Rating Valuations Act 1998. Each is defined below:

- capital value – the price that a property probably would have sold for at the date of the rating valuation (excluding chattels, etc)
- land value – the price that a property’s land component probably would have sold for at the date of the rating valuation (including any work on drainage, excavation, filling, retaining walls, reclamation, and so on)
- annual value – the greater of (i) the estimated gross annual rental less 20% (or 10% for vacant land) or (ii) 5% of the property’s capital value.

5.30 Each local authority, after consulting with its community, can decide which basis to use. Councils can also use a mix of these bases; for example, land value for the general rate and capital value for a targeted rate. Of the 73 territorial authorities and 12 regional councils, 45 use capital value-based rates, 37 use land value-based rating, one uses a mix of land and capital value, and two use annual value. Valuations are carried out by valuers contracted or employed by councils. The valuation process is overseen by the Valuer-General, as discussed in Chapter 9.

5.31 Rating units are defined in the Rating Valuations Act,²³ and depend primarily on the existence of a separate certificate of title. Land that does not have a certificate of title (and is not Crown land) may also be deemed a rating unit if certain conditions apply.²⁴

5.32 The sections above have discussed rates funding, including general and target rates and uniform annual general charges, which made up 56% of local authority revenues in 2005/06. The sections below explain the other sources of local authority revenue including user charges, government transfers, development contributions, and investment income.

20 Organisation for Economic Cooperation and Development, *OECD Revenue Statistics 2003*, Paris, “Figure 1: Tax revenue of main headings as a percentage of total tax revenue”.

21 “Eco taxes” is a term to describe taxes that are aimed at an environmental outcome through behavioural change and are usually applied in proportion to the costs specific activities impose on others. In practice, taxes aimed at changing behaviour will have some degree of revenue-raising purpose.

22 Local Government (Rating) Act 2002, section 7.

23 Rating Valuations Act 1998, section 5.

24 The land has (or could have) a finite beginning and end, or, there is no larger or prior estate or interest in the land, or, the land can be sold or transferred.

User charges and fees

5.33 Chart 5-1 shows that 20% of local authority income came from user charges and 6% came from regulatory income and petrol tax in 2005/06. Local authorities levy charges to contribute to the cost of some facilities (such as swimming pools) and also fees to fully or partly meet the cost of regulatory services, such as those under the Building and Resource Management Acts.

Central government funding transfers

5.34 Central government provides financial transfers for local government in a variety of ways, including roading and other aspects of land transport, bovine tuberculosis control, sewerage and drinking water schemes, and local authority tourism infrastructure. Land transport funding is by far the largest source (89% in 2005/06) of central government transfers to local authorities. Chart 5-1 shows that 13% of local authority income came from central government transfers in 2005/06. This issue is discussed in detail in Chapter 10.

5.35 The level of central government grants and subsidies to local government has been the fastest growing source of funding to local authorities over the past six years. From the year ending June 2000 to that ending June 2006 it has grown 72%, compared with a 45% increase in rates over the same period. In the year to June 2006 the level of central government transfers to local government totalled \$684 million.²⁵

Development contributions

5.36 Development or financial contributions from parties either subdividing or intensifying the existing use of land can be required to help local authorities meet the costs of their capital expenditure associated with these developments. Development contributions can be in land or money, and used for purposes of reserves, network infrastructure, or community infrastructure. Contributions can be levied as development contributions under the Local Government Act 2002 and/or financial contributions under the Resource Management Act 1991. Local authorities wishing to levy development contributions first need to adopt a policy on these contributions and incorporate this into their LTCCP.

Investment income

5.37 Some local authorities have access to revenue-generating assets, including ports and trading companies. In the year to June 2006 local authorities received \$308 million from investments or 6% of their total revenue. Total investment income has actually declined marginally since 1999/2000.²⁶ However, income from investments varies considerably among local authorities, and some regional councils receive a significant investment income from port or other assets. The proportion of total operating revenue received from investment income in the year to June 2006 ranges from zero (North Shore City, Hutt City, and Hastings, Gore, Kaipara, and Whangarei Districts) to 45% (Bay of Plenty Regional Council).²⁷ Regional councils have the highest proportion of operating revenue from investment income, generally reflecting their ownership of ports and property investments. Six out of the 10 councils that have the highest proportions of investment income to operating revenue are regional councils. The territorial authorities with the highest proportion of operating revenue from investment income are New Plymouth District (24%), Christchurch City (21%), and Selwyn District (20%). The average is 6% of total operating revenue, with 25 councils receiving the average

²⁵ Statistics New Zealand, Local Authority Statistics, March quarter 2007.

²⁶ Statistics New Zealand, Local Authority Quarterly Financial Statistics.

²⁷ Local Authority Financial Statistics dataset table 1, Statistics New Zealand, 11 July 2007.

Table 5-1 Investment income as a proportion of operating revenue, 2005/06

% of total operating revenue	Number of councils	% of all councils
zero to 5%	53	62%
5% to 10%	17	20%
10% to 20%	6	7%
20% to 50%	8	9%
Total	85	100%

Source: Local Authority Financial Statistics data set table 1, Statistics New Zealand, 11 July 2007.

or more and 60 councils less. More than half of councils receive 3% or less of operating revenue from investment income (see Table 5-1). This issue is discussed further in Chapter 10.

Conclusion

5.38 The funding mechanisms available to local government are wide ranging. Local authorities are required in their revenue and financing policies to consider where the benefits of activities lie in selecting a revenue source. Rates are the largest source of local government revenue and are both a tax and a user charge. They can be applied across the district, targeted, or as a fixed charge per property. The valuation basis and the use of differentials create further means to adjust the incidence of rates.

6 NEW ZEALAND AND INTERNATIONAL REPORTS ON LOCAL GOVERNMENT FUNDING

Earlier reports on funding of local government in New Zealand

6.1 Local government in New Zealand has been in existence for over 150 years in some form. During this time there have been frequent tensions between central and local government, as well as concerns about the efficiency and structure of local government. Attempts to find alternatives to rates funding have also occurred regularly. Issues today are not new and in fact have been the subject of many reviews instigated by central government over the years.

6.2 The history of local government is one of cycles based on the growth of the economy in general. There have previously been periods where local government has rapidly expanded, both to cater for increased infrastructure requirements and as a result of central government mandates to deliver services. Government reviews of local government funding and structure appear to be linked to these cycles. Reviews of local government structures have succeeded when political will has coincided with low economic activity (1940s and late 1980s). Reviews of local government financing have often occurred during periods of strong economic growth where local government has increased expenditure significantly to provide new infrastructure (1920s, 1950s, 1960s, and today). Some of the boldest attempts to reform local government stalled when the Government of the day lost a general election and the incoming Government did not support the reforms.

6.3 The Local Government Commission, established in 1945, has been a particular victim of changing Governments. Set up to overview the structure of local government in an independent manner with the power to prepare reorganisation schemes, its powers were significantly reduced in 1953. The Government in 1960 proposed to restore the commission's powers but a new Government scaled this back. The Local Government Commission's powers were increased in 1974 and then again in 1985, empowering it to implement amalgamation schemes in 1989.

6.4 Major central government reviews of local government finance since the World War 2 were carried out in

- 1945 Local Government Committee (parliamentary select committee)
- 1958 Royal Commission on Local Authority Finance
- 1959-1960 Local Bills Committee – Inquiry into the Structure of Local Government
- 1963 Committee on Local Authority Finance
- 1970–1973 Committee to Explore Local Authority Finance
- 1977 Committee on Local Authority Finance
- 1987–1989 Government Review of Local Government Structure and Funding.

All of these reviews were established in response to concerns over the impact of rates. Sometimes they were part of a wider review of structure and functions. So-called rates revolts are not new; during the 1970s there was much talk of this. All of the reviews have searched for an alternative

to rates as a major source of funding. All have concluded that rates were the best system available for the bulk of a local authority funding stream.

6.5 A number of reviews recommended additional taxes or general revenue sharing through central government. None of these recommendations were acted on to any significant extent. Recommendations to remove rates exemptions for central government owned land have been ignored since 1958. In 1973 central government dealt with the issue of rates affordability by directly supporting low-income property owners through the rates rebate scheme. Historically the reviews have resulted in ad hoc solutions to bolster the range of local government funding sources. The establishment of the National Roads Board in 1953, differential rating systems in 1970, and a local authority petroleum tax in 1971 were the solutions to perceived funding crises at the time.

6.6 The amalgamations of 1989 were designed, amongst other things, to deliver considerable administrative efficiencies. Central government transfers were significantly reduced at this time, and the range of services provided by local government increased over the 1990s. Central government withdrew from a number of funding areas such as catchment management and water and wastewater funding.

6.7 In the two years prior to the Rates Inquiry central government participated in a Joint Central/Local Government Funding Project, which issued reports in 2005 and 2006 on rating levels and affordability issues, as discussed in paragraph 1.3.

Recent Australian reports on local government funding

6.8 There have been at least six significant reports into local government funding published in Australia since 2001.²⁸ Three reports focused on the financial sustainability of councils have been undertaken at the state level for South Australia, New South Wales, and Queensland.²⁹ A further two recent reports have taken a nationwide overview:

- House Of Representatives Standing Committee on Economics, Finance and Public Administration, *Rates and Taxes: A Fair Share for Responsible Local Government* [Hawker Report], Commonwealth of Australia, Canberra, 2003
- PriceWaterhouseCoopers, *National Financial Sustainability Study of Local Government*, PriceWaterhouseCoopers, Sydney, 2006.

6.9 The reports since 2001 paint a picture of a financial crisis in Australian local government. In general, Australian local government is significantly more dependent than New Zealand local government on the vertical transfer of revenues from higher levels of government. During the 1980s and 1990s, Australian state and federal interest in local government focused on operational efficiency and effectiveness. Policy responses at this time tended to focus on structural change in the form of forced amalgamations of councils. The five reports reflect a shift in focus to the sustainability of councils, particularly from a financial perspective. Identified causes of non-sustainability include: the devolution of services without provision of adequate funding tools, increasing complexity and standard of services required by the state, and raised public expectations.

28 For further discussion of recent Australian reviews of local government funding see Brian Dollery et al., *The Mirage of Municipal Self Sufficiency: A Taxonomic Approach to Local Government Sustainability in Australia*.

29 Financial Sustainability Review Board (FSRB), *Rising to the Challenge*, South Australian Local Government Association, Adelaide, 2005.

Independent Inquiry into Local Government Inquiry, *Are Councils Sustainable? Final Report: Findings and Recommendations* [Allan Report], NSW Local Government and Shires Association, Sydney, 2006.

Local Government Association of Queensland Inc., *Size, Shape and Sustainability: Guidelines Kit*, Local Government Association of Queensland, Brisbane, 2006.

Lyons Report, United Kingdom

6.10 In the period between July 2004 and December 2006, Sir Michael Lyons issued two reports³⁰ looking at changes to the local government system in the United Kingdom, in particular tax reform, user charging powers, other revenue options, and local government's role and function. In contrast to New Zealand, in the United Kingdom local government delivers a wider range of services, many of which are delivered by central agencies in New Zealand. As a result in the United Kingdom there is a far greater transfer of central government grant funding, and in many respects local authorities are a service delivery arm of central government.

6.11 Notwithstanding these differences, the Panel noted with interest the Lyons Report's emphasis on the place-shaping role of local government in the 21st century.

³⁰ Lyons Inquiry into Local Government, *Consultation Paper and Interim Report*, December 2005, and *National prosperity, local choice and civic engagement*, May 2006.