

REPORT

To the Local Government
Rates Inquiry on
Exemptions from Liability
for Rates

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EXECUTIVE SUMMARY

Background

1. Since 1876 exemptions from rating have existed. The exemptions initially covered Crown land, land used for religion, and land covered by native title.
2. Over time the exemptions have expanded and developed, but become more technical. The exemptions affecting Crown land in particular have changed to reflect:
 - the changing nature of the state including sale of assets and devolution of functions to entities that are legally separate from the Crown; and
 - that some Crown land is now used for commercial purposes.

Rationale for rates exemptions

3. The reasons generally given for the creation and continued inclusion of exemptions in statute broadly fall within one or more of the following:
 - properties are held for public good purpose (i.e. they are meeting some national good purpose);
 - properties have no or very limited economic use and thus may not be able to pay rates; and/or
 - properties do not consume services provided by local authorities or consume only limited amounts.

Impacts of rates exemptions

4. The councils we spoke to, and this was confirmed by Local Government New Zealand, are almost exclusively concerned with the impact of non-rateable Crown land. It has been estimated that if Crown land that is currently non-rateable was rateable the Crown would pay \$120 million per annum (based on 2005 values).
5. Councils identified the main impacts of non-rateable Crown land as:
 - ratepayers bear the costs of delivering services which primarily, and in some cases exclusively, benefit non-rateable land;
 - the Crown benefits from generic subsidised council services e.g. District Plans; and
 - having non-rateable land in a local authority dilutes the available rates base with the result that either a reduced level of services is provided or the rates bill is higher than it would otherwise be.
6. We recognise that the councils interviewed were chosen for high levels of non-rateable land and the examples they provide are not representative of the impacts on all councils.

Non-rateable land contributes to cost of services

7. Information on exactly how much money non-rateable landowners contribute to the costs of services provided to their land, and whether that contribution covers the costs of the services is very limited. Councils argue that targeted rates can be charged only for some services and do not cover the costs of the many different council services that non-rateable land owners use and benefit from.

Community benefits from non-rateable land

8. The councils interviewed acknowledged that their communities benefited from the activities carried out on rating exempt land, but found it difficult to quantify the benefit.

9. Local communities enjoy benefit from the activities undertaken on non-rateable land. However, the same types of benefits are often obtained from land that is rateable.

Rating – a policy perspective

10. A sound public policy approach to who should pay for goods and services would assess: the type of good that is obtained, how much is obtained, and whether the benefit produced is local or national.
11. The four types of good that are commonly used to assist with analysis of appropriate cost allocation are: private good, merit and club good, and public good. Conventionally, private goods would be funded privately and merit goods would also have some element of private funding.
12. In some situations, land providing public goods might justify an exemption from rates. Without public funding, public goods are generally under-provided because the incentives are poor for private organisations to fund goods that it is not possible to exclude people from using, or for goods that when consumed can still be consumed by others.
13. Benefits enjoyed predominantly by local communities ought to be funded by local authority rates. Local authorities have the funding tools available to reflect their communities' decisions about who benefits from services and how much they should pay. Benefits enjoyed at a national level ought to be funded by central government.
14. Transaction costs, particularly those relating to the cost of valuing land for rating purposes may also provide adequate reasons for making land non-rateable. Research is required to determine which types of land would have excessive transaction costs, but roading is a likely candidate in this regard.
15. Given our conclusion that no landowner receives no benefit from the services provided by local authorities, then in the absence of other significant policy factors, it seems difficult to conclude that some of those who benefit should not contribute to the cost of producing those benefits.

Options for the future

16. We identified the advantages and disadvantages of 5 options for the future of rating exemptions:
 - no change;
 - expand the services that targeted rates can be charged for;
 - introduce Crown contributions in lieu of rates;
 - remove some of the existing exemptions; and
 - remove all exemptions.

Conclusions

17. Many rating exemptions have been derived from a broad policy of exempting Crown lands. The policy concepts of transaction costs and public good that in some situations could justify ongoing exemptions are not directly reflected in the current exemptions.
18. Given the significant impacts exemptions can have on particular council budgets, or potentially on the growth of the local economy, care should be taken when exempting categories or large areas of land.
19. We think the efficient functioning of Government would not be impaired if Crown land were generally rateable. We consider that on balance a generic exemption in favour of Crown land is not justified. In some cases an exemption may be appropriate where there are specific policy factors relating to such matters as transaction costs or public good.

20. We are aware that officials have been working on the option of the Crown making payments in lieu of rates (our option 3). We consider this work should be completed and reported on to the Government, and consideration also be given to other matters. In particular, as a minimum, we think the services that targeted rates can be charged for could be expanded (our option 2).
21. While our focus has been predominantly on Crown owned lands, similar issues and arguments apply for non-Crown exemptions as well. The impacts and issues arising from those exemptions are minimal, however, and are unlikely to justify legislative change at this time.

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1. Introduction

1. The Local Government Rates Inquiry's (the Inquiry's) terms of reference require it to "examine the impact and ongoing need for existing exemptions from liability for rates, including Crown exemptions."
2. The Inquiry contracted Ross Philipson Consulting Limited (RPCL) to prepare policy advice on exemptions from liability for rates. RPCL was required to prepare a written report that meets the objectives for this project which are:
 - to examine and review the findings and recommendations of the Local Authority Funding Project with regard to the current appropriateness of exemptions to rates;
 - to examine the impact exemptions have on local authorities, the organisations that qualify for exemptions, and ratepayers in general;
 - to understand the rationale behind rates exemptions for Crown and non-Crown land, and the extent to which the rationale remains valid, and the on-going need for exemptions.
3. When commissioning this report, the Inquiry agreed that certain aspects of rating exemptions were to be outside the ambit of our brief. Therefore, this report does not consider the exemptions relating to certain classes of Maori land.

2. Structure of report

4. This report begins with a section explaining the methodology used in this report's preparation. The next three sections, sections 4, 5 and 6 explain the current New Zealand law, the international practice on Crown exemptions, and the development of the statutory provisions for rating exemptions.
5. The rating exemptions policy section, section 7, identifies the reasons provided for rating exemptions. Where the reasons have changed over time these are summarised.
6. The impact of the current policy, focussing mainly on the impacts of non-rateable Crown land, is explained in section 8.
7. An analysis of the policy issues associated with rating exemptions is contained in section 9.
8. A series of options that can be considered in relation to exemptions is identified in section 10. Our conclusions are contained in section 11.

3. Methodology

9. We used the following methodology to assess the rationale behind exemptions policy and the impact exemptions are having:
 - to examine and review the findings and recommendations of the Local Authority Funding Project with regard to the current appropriateness of exemptions to rates;
 - reviewed the Local Authority Funding Project's reports;
 - reviewed 3 draft local authority case studies produced by the Project on Opotiki, Dunedin and Tauranga.
 - to examine the impact exemptions have on local authorities, the organisations that qualify for exemptions, and ratepayers in general;

- interviewed central government officials involved in local government policy, and financial policy about the impacts of the current exemptions policy;
 - interviewed staff from 4 local authorities that have high levels of non-rateable land about their views of the impact of the current policy;
 - interviewed a representative from Local Government New Zealand about their members' views of the impact of the current exemptions policy;
 - interviewed central government officials from the Department of Conservation about the impacts of the current exemptions policy.
- to understand the rationale behind rates exemptions for Crown and non-Crown land, and the extent to which the rationale remains valid, and the on-going need for exemptions.
 - interviewed central government officials involved in local government policy;
 - reviewed policy papers and Cabinet decisions on rating policy;
 - reviewed papers on overseas rating practices and considered judicial comment on rating exemptions.
10. Our approach and the methodology we have used to prepare this report were agreed with the Inquiry. They reflect that ratings exemptions is an extensive policy issue and that there was a short timeframe in which to complete this report. The short timeframe affected particularly the approach taken to understand the impacts ratings exemptions were having, with the result that it was decided to interview a more limited set of local authorities and to limit the collection of quantitative data.
11. We note that government departments have not released all relevant reports or draft reports to us.

4. Current New Zealand law

12. The Local Government (Rating) Act 2002 (the Act) provides for certain categories of land to be non-rateable. Schedule 1 of the Act list 22 categories of land that are exempt from most rates, and 3 categories of land that are 50% non-rateable.

Clause reference	Type of non-rateable land
1	National parks, reserves and conservation areas
2	The foreshore, seabed, lakes and rivers
3	Publicly accessible land owned by private entities for conservation purposes, which is not for profit
4	Land used by local authorities for the provision of various amenities (such as parks, swimming pools and libraries) or for soil conservation and river control, for which no revenue is received
5	Land owned or used by certain named charitable trusts
6	Schools and early childhood centres that do not operate for profit
7	Religious institutions
8	Hospitals
9	Churches and other places of worship
10	Cemeteries and crematoria
11	Maori customary land
12	Marae, Maori reservations and meeting places
13	Maori meeting houses
14	Maori land that is non-rateable by virtue of an Order in Council
15	Electricity generation and transmission equipment
16	Any land declared non-rateable by other Act of Parliament
17	Roads
18	Operational areas of airports
19	Operational areas of railways, owned by New Zealand Railways Corporation
20	Wharfs
21	Land used for charitable purposes
22	Parliament and vice-regal residences.

Clause reference	Categories of land that is 50% non-rateable (These 3 categories of land must not be for profit, and not hold a liquor

	licence)
1	A&P showgrounds
2	Sports grounds (excluding horse and greyhound race tracks)
3	Land used for the arts

13. Non-rateable land is not totally exempt from local authority rates. The land is liable for targeted rates covering water supply, sewage disposal, and refuse collection where the property receives those services.¹
14. Land owned or used by the Crown for defence establishments is liable for rates; but local authorities can only collect rates based on the properties' land value². Local authorities consider defence land as having a partial exemption from rates.

5. Legislative history

Introduction

15. Since 1876, when New Zealand's provinces were disestablished and the ability to fund local government from rates was centralised, there have been statutory exemptions from rates.
16. All three of the exemptions that existed in 1876 exist today, albeit with different wording; "land in the property of Her Majesty", "land occupied by churches and chapels" and "land over which native title has not been extinguished".³
17. Rating legislation was enacted in 1876, 1894, 1908, 1925, 1967, 1988 and 2002.

Key provisions

18. To show in a general sense how exemptions have developed over time, we have identified the key provisions that relate to various exemptions. We have grouped the exemptions together as follows:
- Crown land (covering conservation, education, hospital land but excluding roading);
 - land used for religious and charitable purposes; and
 - transport land (roads, wharves, airports and railway land).

Crown land		
Conservation	<ul style="list-style-type: none"> • its non-rateability relies on it falling within the definitions in conservation statutes e.g. a national park under the National Parks Act 1980. 	<ul style="list-style-type: none"> • Crown conservation land became a distinct category from other Crown land in 1988.
Education	<ul style="list-style-type: none"> • Crown and non-Crown land that is used for education including early childcare centres, schools, and tertiary education institutions is exempt. 	<ul style="list-style-type: none"> • since the late 19th century exemption has covered land that is both Crown and privately owned but used for educative purposes.
Hospitals	<ul style="list-style-type: none"> • land "used by a district health board and used to provide health services" is exempt. 	<ul style="list-style-type: none"> • A hospital specific exemption was introduced in 1957 with references to Hospital Board owned land, subsequently changed to reflect changes in

¹ Section 9 Local Government (Rating) Act 2002.

² Section 22(2) Local Government (Rating) Act 2002.

³ Section 37 The Rating Act 1876.

		health sector, egg CHEs and DHBs.
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Land used for religious and charitable purposes		
Religion	<ul style="list-style-type: none"> land used “as a place of worship” 	<ul style="list-style-type: none"> over time references to churches and chapels changed to refer to buildings associated with particular religions such as mosque and synagogue, more generic language reintroduced in 2002.
Charity	<ul style="list-style-type: none"> land used for “free maintenance or relief of persons in need” 	<ul style="list-style-type: none"> charitable purposes land definition essentially unchanged over time.

Transport land		
Roads	<ul style="list-style-type: none"> land vested in the Crown or a local authority that is used as a road is non-rateable 	<ul style="list-style-type: none"> distinction drawn between Crown roads and roads owned by non-Crown entities since at least 1967.
Airports	<ul style="list-style-type: none"> land used by the Crown or any airport authority is non-rateable 	<ul style="list-style-type: none"> references to airport authorities introduced in 1988, before that covered by Crown owned land exemption.
Wharves	<ul style="list-style-type: none"> “land used as a wharf” is non-rateable 	<ul style="list-style-type: none"> references to land owned by Harbour Boards (introduced in 1925) and port companies were removed in 2002.
Railway	<ul style="list-style-type: none"> “land occupied by New Zealand Railways Corporation or a railway operator” is non-rateable 	<ul style="list-style-type: none"> previously part of Crown land exemption, railways operator references introduced in 1988.

6. International practice

19. In considering international practice on exemptions we have focussed on the Crown exemptions in the common law jurisdictions of the United Kingdom, Canada, and Australia. These countries face similar issues to those faced by New Zealand in relation to exemptions from liability for rates.
20. The funding of local government and the breadth of services delivered by local government in the United Kingdom Canada and Australia differ significantly from New Zealand. Generally other jurisdictions receive a higher level of central government funding and deliver a broader range of services e.g. social services, housing, education and law enforcement than in New Zealand.
21. Our research indicates that, in the United Kingdom, the Crown is not exempt from local government rates, but that this was not always the case. Local government in the United Kingdom is funded from three sources; central government, non-domestic (or business) rates and council tax. Historically the Crown was exempt from paying rates. In 2000, that exemption was narrowed when the Local Government and Rating Act 1997 took effect and

the Crown became liable for non-domestic rates. Our research indicates that the Crown is not exempt from council tax.⁴

22. The Canadian Government has a constitutional exemption from taxes levied by local and provincial government.⁵ The Government makes payments in lieu of property taxes to local governments in recognition of “the valuable benefits received from both provincial and municipal levels of government in Canada”.⁶ The Government also says it “feels it has a moral obligation to contribute to the cost of local government where federal property is located.” Payments are made on a discretionary basis. The operational details of the payments in lieu scheme are summarised in the Local Authority Funding Team’s report on Crown Contributions in Lieu of Rates.
23. The Australian Commonwealth also has a constitutional exemption from taxes levied by local government.⁷ The Commonwealth Parliament’s consent is required before any Commonwealth property can be taxed. Our review of the rating legislation for the states of New South Wales, South Australia, Queensland and Victoria indicate that Crown land, or a broader category of “public purpose land” is non-rateable. In the case of the Northern Territory the council can declare any non-rateable Crown land rateable for certain purposes.⁸ Although the federal government does not pay local government rates, it does provide untied grants to local authorities which account for approximately 12% of council’s total revenue in 2003/04.⁹ The value of the grants has been estimated at approximately 1% of GDP.¹⁰
24. In our view the international practice of Crown exemptions from rating, as evidenced by the comparable jurisdictions of the United Kingdom, Canada and Australia, indicates that governments are increasingly willing to make a contribution on behalf of the Crown to the costs of local government even where constitutional exemption from liability continues to exist.

7. Rating exemptions policy

Rationale for exempting land from rates

25. Until 2006, official documents had not identified any generic reason that underpins all exemptions. For example, a Department of Internal Affairs report stated “no single, clear and coherent policy rationale has been identified as underlying all the current exemptions”¹¹.
26. In its 2001 review of rating exemptions, officials developed a policy framework to guide analysis of the exemptions existing at that time. The framework was:
 - “the extent to which the local community benefit from the land should have a bearing on who makes decisions about the rates liabilities of that land;
 - local authorities should have discretion to determine whether land that provides a substantially local public benefit should be liable for general rates; and
 - local discretion can be overridden where the Crown believes there is an overriding national interest.”¹²

⁴ The Council Tax (Exempt Dwellings) Order 1992.

⁵ Section 125 The Constitution Act 1867.

⁶ Public Works and Government Services Canada, “Payments in Lieu of Taxes Frequently Asked Questions” <http://www.pwgsc.gc.ca/pilt/text/faq-e.html>.

⁷ Section 114 Commonwealth Constitution.

⁸ Section 58(3) Northern Territory Local Government Act 1993.

⁹ Australian Local Government Association website <http://www.alga.asn.au/about/>.

¹⁰ Progress report of the Local Authority Funding Project, Crown Contributions in Lieu of Rates, Nov 2006, page 6.

¹¹ Department of Internal Affairs “Review of Local Government Funding Powers: Progress Report”:18 December 2000 para 31.

¹² Cabinet Policy Committee Paper: Minister of Local Government; “Review of Local Government Funding Powers Paper 4: Exemptions from property rates; rates rebate scheme and petroleum tax,” paragraph 26.

27. At the time, Treasury and the Ministry of Economic Development considered that a preferable approach would be one based on the “general rule [that] all properties should contribute financially to the services that benefit the district that the property is part of”.¹³
28. The most recent policy statement that addresses the rationale for the current exemptions was released in November 2006 by the Local Authority Funding Project Team. The Team stated the “policy rationale for each exemption varies but is generally one or more of the following:
- properties are held for public good purpose (i.e. they are meeting some national good purpose);
 - properties have no or very limited economic use and thus may not be able to pay rates; and/or
 - properties do not consume services provided by local authorities or consume only limited amounts.”¹⁴
29. The two approaches are not necessarily inconsistent and share a common element of being derived from the concept of public and private benefit. The balancing of these factors lies at the heart of exemption policy and is explored further in section 9.

Reasons for particular exemptions and issues arising from those exemptions

30. Below we identify the key reasons put forward for the groups of exemptions outlined in paragraph 18. We also identify and comment on issues arising from the scope and nature of the exemptions.

Crown exemptions: generally

31. Our research into why Crown land generally was made exempt from rates identified a notable lack of comment or questioning on this issue. When the Crown exemption was first enacted in 1876 no Member of Parliament questioned the rationale for exempting all Crown lands from rating.¹⁵
32. Since the introduction of Crown exemption, reasons put forward have included those matters outlined in paragraph 27, as well as an additional reason specific to the unique constitutional position of the Crown – that the Crown should not have to pay tax.

Crown exemptions: conservation

33. In relation to the conservation land exemption, the following reasons are commonly asserted:
- Conservation land attracts tourists who enhance businesses and industry and provide economic benefits to local communities;
 - the Department of Conservation’s (DoC’s) management of the conservation estate provides ecosystem services e.g. DoC’s maintenance of the upper reaches of the water catchment contributes to better water control and quality;
 - the land surrounding the conservation estate benefits from DoC’s work e.g. pest management; and
 - the Department meets the costs of those using conservation land e.g. by providing facilities and services such as rubbish removal and toilets.
34. The conservation exemption has narrowed as commercial activities began to occur on Crown conservation land. The Act makes rateable any conservation land that is used for private or commercial purpose under a legal agreement. Conservation land used for tourism ventures would presumably be rateable.

¹³ Cabinet Policy Committee Paper: Minister of Local Government; “Review of Local Government Funding Powers Paper 4: Exemptions from property rates; rates rebate scheme and petroleum tax,” paragraph 93.

¹⁴ Local Authority Funding Project Team Progress Report: Crown Contributions in Lieu of Rates, Nov 2006, page 3 section 2.2.

¹⁵ The Rating Bill 2nd reading, 7 July 1876, Parliamentary Debates Volume XX.

Crown exemptions: education and hospital services

35. The reasons given for health and education exemptions are based almost exclusively on the national interest argument; that it is in the national interest to have healthy and educated people.¹⁶
36. The education exemption has, since at least 1925 covered land that is used to provide housing for teachers.¹⁷ This amendment illustrates how an exemption has been broadened to cover an activity (providing residential accommodation), which could be considered ancillary to the purpose of the original exemption (education).
37. The hospital and education exemptions also raise an issue of competitive neutrality between public and private providers. Private suppliers in the tertiary education sector and private suppliers of hospital services are liable to pay rates when their public equivalents are not.

Land used for religious and charitable purposes

38. The 1876 Act included an exemption for land occupied by churches and chapels. Whether or not the exemption should be included attracted debate by MPs considering the Bill. Those in favour of exempting church land argued the exemption was simply “follow[ing] the example set them in the old country”, and the exemption was needed as the churches could not afford rates.¹⁸ Those against the exemption argued that it indirectly assisted religious institutions, which they thought was not an appropriate role for the State.¹⁹
39. Broadly, the reason given in more recent years for exempting land used for religious and charitable purposes is that the use benefits the communities in which they are based. In considering whether to continue the exemption for church land in what was to be the Local Government (Rating) Bill, officials stated that central and local government value the “community-building activities” of such organisations and the exemption should be continued.²⁰
40. As charities and churches broaden the activities undertaken on their land to obtain revenue, the boundary of exempt and non-exempt land use becomes an issue. The issue of whether the activities that an entity undertakes today are consistent with the purpose for which their exemption was granted was recently considered by the Court of Appeal. The Court considered whether land leased by a charity (the Royal New Zealand Foundation of the Blind) to a third party on commercial terms fell outside the society’s rating exemption. The Court found it did fall outside the exemption as the land was being used for investment purposes and not for charitable works.²¹

Transport land (roads, wharves, airports and railway land)

41. The two main reasons cited in support of the transport related exemptions are:
 - the need to maintain intermodal neutrality between transport types – it is argued that exemptions for wharves, airports, railway and roads are necessary to avoid distortions in the transport market; and
 - difficulty and/or the cost involved in valuing the roads and railway corridor²².

¹⁶ Cabinet Policy Committee Paper: Minister of Local Government; “Review of Local Government Funding Powers Paper 4: Exemptions from property rates; rates rebate scheme and petroleum tax,” paragraphs 39-42.

¹⁷ Note 4 to Part 1 of Schedule 1 of the Local Government (Rating) Act 2002 requires land used as residential accommodation for a principal, teacher or caretaker which is let at a discounted rent to be treated as being used as education land.

¹⁸ The Rating Bill 2nd reading, 7 July 1876, Parliamentary Debates Volume XX.

¹⁹ The Rating Bill 2nd reading, 7 July 1876, Parliamentary Debates Volume XX.

²⁰ Cabinet Policy Committee Paper: Minister of Local Government; “Review of Local Government Funding Powers Paper 4: Exemptions from property rates; rates rebate scheme and petroleum tax,” paragraph 43.

²¹ Auckland City Council v Royal New Zealand Foundation of the Blind, CA 112/05, 29 August 2006.

²² Ibid paragraphs 30 and 31.

42. The transport exemption has been maintained over time, despite the entities that own the infrastructure changing. When various Crown assets were sold (airports and wharves) or their ownership changed to a legal entity distinct from the Crown the historical exemptions such as transport were amended to accommodate the development. Who owned a piece of land could no longer be used solely to determine whether the land was rating exempt. Instead the exemption was changed to reflect the purpose the land was being used for e.g. landing aeroplanes and used as a wharf.
43. As the definition of exempt transport land has changed, the boundaries of what is and is not rateable land have come into question and become increasingly complex. This is particularly an issue for airports and wharves. The legislation expressly provides that land used for a variety of purposes including administration, parking, cleaning, buying and selling of tickets, and freight consolidation are rateable.

Changing rationale over time

44. The reasons provided for some of the exemptions from rating, mostly Crown exemptions have changed over time. The changes to the exemptions affecting Crown land reflect:
- the changing nature of the state including sale of assets and devolution of functions to entities that are legally separate from the Crown;
 - that some Crown land is now used for commercial purposes.
45. When various Crown assets were sold (airports and wharves) or their ownership changed to a legal entity distinct from the Crown (such as tertiary institutions and district health boards) the historical exemptions were amended to accommodate the modern development.
46. As exempt land started to be used for commercial purposes the exemptions were amended to ensure that the land for commercial purposes was rateable. For instance conservation land that is used primarily for commercial purposes under a legal agreement is rateable.²³

8. Impacts of current policy

Introduction

47. The Local Authority Funding Project Team reported that approximately 4% of the total value of land in the average local authority is in exempt properties.²⁴
48. Although the impact of exemptions from rates is felt nationwide the impact is most marked for a limited number of local authorities that have particularly high levels of non-rateable Crown land.
49. The local authorities we interviewed wanted to draw the Inquiry's attention to the impact of non-rateable Crown land²⁵. The impact of exemptions from non-Crown land did not raise particular concerns with the authorities we interviewed.
50. This impact assessment will therefore focus on the impacts of non-rateable Crown land, with a specific focus on the impacts felt by local authorities we interviewed.

Impact of rates exemptions on the Crown

51. The benefit of Crown exempt land is spread across those Crown agencies that own or administer the land. Crown land is held for many purposes; conservation, education, health, defence, transport, utilities are the major ones. The vast majority of the land is Department

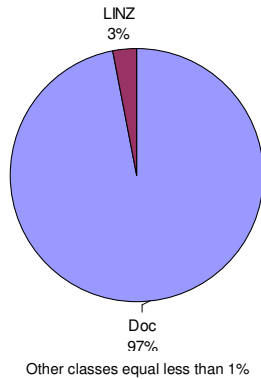
²³ Note 2, Part 1 Schedule 1 Local Government (Rating) Act 2002.

²⁴ Local Authority Funding Issues: Report of the Joint Central Government/Local Authority Funding Project Team 8 July 2005, pg 37.

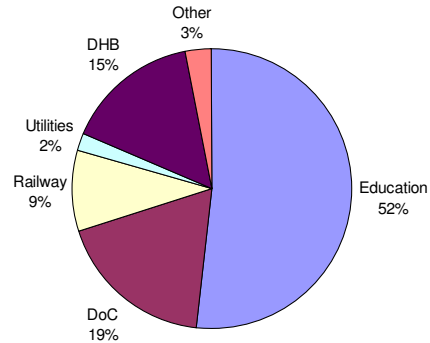
²⁵ We interviewed staff of the West Coast District Council, the Westland Regional Council, the Dunedin City Council and the Otago Regional Council.

of Conservation land; it accounts for almost all (97%) of Crown non-rateable land, by land area. By land value 50% of land is used by the education sector, 18% by conservation and 15% by District Health Boards.

Non-rateable Crown land by area 2004/05



Non-rateable Crown land by value 2004/05



52. The extent to which various agencies benefit from the Crown exemptions was considered by the Local Authority Funding Project. Based on 2005 values the Project estimated the rates that would be payable on various types of Crown land if existing exemptions were removed. It estimated the total rates payable would be approximately \$120 million per annum. Broadly the rates on Crown land would be:

Purpose land used for	Rates in millions
Conservation	\$21.7
Education	\$59.2
Health	\$17.8
Railways	\$10.2

Impact of rates exemptions on the councils

53. Councils were concerned to explain the financial impact that having high levels of rateable land had on their ratepayers. Their main concerns are:

- that ratepayers bear the costs of delivering services which primarily, and in some cases exclusively, benefit non-rateable land;
- that the Crown benefits from generic subsidised council services whose cost cannot be recovered through targeted rates i.e. District Plans; and
- having non-rateable land in a local authority dilutes the available rates base with the result that either a reduced level of services is provided or the rates bill is higher than it would otherwise be.

54. Councils see investment in infrastructure as necessary if the government's goal of "growing an inclusive innovative economy for the benefit of all" is to be achieved. The main impact that they identify of rating exempt land is they have less money than they need to invest in infrastructure.

55. Examples of each of the impacts on local authorities interviewed are attached in Annex A.

Contribution of non-rateable land to costs of services

56. Information on exactly how much money non-rateable landowners contribute to the costs of services provided to their land, and whether that contribution covers the costs of the services is very limited. The information we have obtained is outlined below.
57. Non-rateable land is liable for targeted rates for water supplied, sewage disposed, and refuse collected from that land.²⁶ An example of the magnitude of targeted rates paid was provided by Dunedin City Council. The University of Otago paid \$1.204 million in targeted rates and other charges in 2006/07.
58. Councils advised us that the owners of non-rateable Crown land benefited from many more services than what targeted rates could be charged for. The Westland District Council estimated the total cost to it of the Crown's share of roading, waste management, public toilets, district inspections, resource management and governance was \$656,252. The Council calculated if the rating exemption for all Crown land was removed, at current rating levels it would pay \$407,510, below what the Council sees as the actual cost of the main services the Crown benefits from.²⁷
59. The Dunedin City Council characterised the difference between the amount it received in targeted rates and the amount a fully rateable property would pay as a loss factor. The council's loss factor for non-rateable property is 3.08. It estimates if all non-rateable property in Dunedin were rateable the rates on those properties would rise from \$3.107 million to \$9.586 million.

Benefits from non-rateable land

60. The councils interviewed acknowledged that their communities benefited from the activities carried out on rating exempt land, but found it difficult to quantify the benefit.
61. Authorities we interviewed generally agreed that their cities/regions benefited from rating exempt activities but could see no direct link justifying the land being non-rateable.
62. In 2004 the Department of Conservation commissioned a report that sought to "demonstrate how significant the public conservation lands are to the West Coast regional economy".²⁸ The report concluded that "DOC spending and the activities dependent on public conservation lands form a significant part of the West Coast regional economy. They are equivalent to 15 per cent of employment, 13 per cent of earned household income and 12 per cent of regional value added."²⁹
63. The Department of Conservation identified a second benefit from conservation land which it calls ecosystem services benefits.³⁰ Ecosystem services are the services that DoC provides on conservation land when it manages that land. Ecosystem services benefits are the benefits that accrue to people from the services DoC provides. An example of ecosystem benefits is improved water control and quality resulting from habitat maintenance in upper water catchment areas.
64. We note that the two benefits that DoC identifies as arising from non-rateable conservation land are benefits also provided by some other rateable land. Both economic benefits and ecosystem services benefits can arise from rateable land. Communities receive economic benefits from many local activities particularly many commercial activities. For example the wine industry is often identified as enhancing tourism, and forestry production areas can also have a marked beneficial impact on water catchment.

²⁶ Section 9 Local Government (Rating) Act 2002.

²⁷ Draft Position Paper : The exemption of Crown land from rates, and its effects in Westland District; by Robin Reeves, General Manager, Westland District Council, page 6 and 7.

²⁸ Department of Conservation "Regional Economic Impacts of West Coast Conservation Land: Final Report", 31 March 2004, Butcher Partners Ltd, page 3.

²⁹ Ibid page 3 paragraph 9. Value added is stated to include wages, taxes, interest, depreciation, self-employed income and profit.

³⁰ Department of Conservation: "The Value of Conservation: What does conservation contribute to the economy?" May 2006, pages 13-14.

Conclusion on impacts

65. We recognise that the councils interviewed were chosen for high levels of non-rateable land and the examples they provide are not representative of the impacts on all councils. Nonetheless the examples are strong evidence of the financial impact of rating exempt land.
66. Councils we spoke to, and this was confirmed by Local Government New Zealand, are almost exclusively concerned with the impact of non-rateable Crown land. The financial impact on the Crown if its land were rateable was estimated, based on 2005 values, as \$120 million per annum.
67. The councils are most concerned about the effect on their ability to fund the costs of infrastructure –roading, drainage (flood protection). It appears that councils are currently recovering these costs from general rates, or are restricting service levels.

9. Rating – a policy perspective

A first principles approach to rating

68. Rates are a tax that local authorities charge on property. Rates fund an extraordinarily wide variety of functions and services including infrastructure for roading, drainage and water supply, safety and flood protection, the costs of governing, services and venues such as libraries, parks and swimming pools, and regulatory functions under numerous statutes.
69. A sound public policy approach to who should pay for goods and services would assess: the type of good that is obtained, how much is obtained, and whether the benefit produced is local or national.
70. There are four main types of good that are commonly used to assist with analysis on appropriate cost allocation:
 - i Private goods people can be excluded from receiving the benefits of private goods at low cost, and use of a private good by one person conflicts with its use by another e.g. hiring a local hall for a private function
 - ii Merit goods the community as a whole desires a higher use of the good than would be likely if it were charged for at full cost e.g. library and swimming pools
 - iii Club goods people can be excluded from its benefits at low cost, but its use by one person does not detract from its use by another e.g. water and sewerage systems
 - iv Public goods excluding people from its benefits is either difficult or costly, and its use by one person does not detract from its use by another e.g. roading
71. Conventionally, private goods would be funded privately and merit goods would also have some element of private funding.
72. Public goods are often provided, at least in part, by Government and paid for through taxation. If the provision of public goods was left to the market they may not be produced. Two reasons commonly cited for this are:
 - public goods create positive externalities which aren't paid for, so there aren't incentives for private organisations to produce them;
 - it is not possible to exclude people from using public goods so some people can take advantage without paying (the free-rider problem).
73. In our view the question of who should pay for goods that are closer to public goods on the continuum relies on identifying where the benefits of a good are enjoyed; at local or national level. Benefits enjoyed predominantly by local communities ought to be funded by local

authority rates. Benefits enjoyed at a national level ought to be funded by central government.

74. Once a benefit has been identified as local, local authorities have a range of tools to raise revenue which allow them to reflect their communities' decisions about who benefits from services and how much they should pay. The rates can be imposed in a way that ensures a group of people who are thought to have more direct benefit from services than others pay for that benefit. Differential rates, targeted rates, and user pays are examples of some of the tools available under current legislation.
75. When assessing who benefits from local authority services it is apparent that all landowners obtain at least some level of benefit. At the very least, roading, planning and governance services provide a level of benefit. Most of us benefit from most of the services, and some get much more benefit than others. As everyone receives some benefit, in theory, we should all pay something.
76. Given our conclusion that no landowner receives no benefit from the services provided by local authorities, then in the absence of other significant policy factors, it seems difficult to conclude that some of those who benefit should not contribute to the cost of producing those benefits.
77. In some situations, land providing public goods might justify an exemption from rates. Without public funding, public goods are generally under-provided because the incentives are poor for private organisations to fund goods that it is not possible to exclude people from using, or for goods that when consumed can still be consumed by others.
78. However, we question whether rates exemptions are an appropriate mechanism to fund public goods as:
 - the public good may be enjoyed by the country as a whole and it is inappropriate that only local communities fund them; and
 - the value of the rating exemption for a specific property may have no direct correlation to the value of the public benefit provided.

Transaction costs

79. A policy factor sometimes advanced to justify exemptions is that the transaction costs created if all land were rateable are prohibitively high. The commonly cited example is that of the cost of valuing the land which at present is non-rateable.
80. The Local Government Act 2002 provides local government with a high degree of local autonomy to decide what services it wants to provide and how the cost of providing the services should be allocated.
81. The effect of having land declared non-rateable is to remove from local government the autonomy it has to decide whether and how to charge for those services. If all land was rateable councils would be able to implement their communities' views on whether to charge for services. They may decide that the costs of collecting the rates are prohibitive, but the community would be exercising its autonomy to decide that.
82. Transaction costs, particularly those relating to the cost of valuing land for rating purposes may provide adequate reasons for making land non-rateable. Research is required to determine which types of land would have excessive transaction costs, but roading is a likely candidate in this regard.

Crown exemptions: an alternative analysis

83. Local authorities are concerned most about the impact of non-rateable Crown land. It is therefore appropriate that an analysis of the rationale for exemptions focuses on this issue.
84. As we identified in paragraph 32, in the absence of any clear Government policy statement, we presume that the rationale for Crown exemptions from rates is derived from the old

common law concept that the Crown should not have to pay tax on the land it owns. If this presumption is correct, in our opinion it is outdated and fails to reflect that the Crown no longer is presumed to be exempt from complying with law.

85. Historically it was acceptable and common practice that the law did not bind the Crown. Since 1888 New Zealand law has contained a provision that no Act binds the Crown unless it expressly says it does.³¹ However, in recent times Cabinet recognised that fairness requires that the Crown should be subject to the general law of the land, including statute law. The general principle to be followed when assessing whether or not an Act should bind the Crown was changed. It is now:

“that the Crown should be bound by Acts unless the application of a particular Act to the Crown would impair the efficient functioning of the Government.”³²

86. Applying the Cabinet Office guidelines, as if new rating legislation were proposed today, we identified the following arguments in favour and against Crown land being rateable:

87. Factors favouring Crown land being rateable include:

- the Crown as a land owner uses the services provided by local authorities in much the same way as other ratepayers. It should be treated the same as other ratepayers for rating purposes.
- it is desirable for private and public service providers to enjoy competitively neutral circumstances when they are competing in the same market. Where tertiary education providers compete with private training establishments it would seem inequitable for one to be liable for rates and not the other.
- local authorities with high levels of non-rateable land would continue to be adversely affected in the ways described in paragraph 53.
- agencies managing Crown land would have more incentives for efficient investment.

88. Factors favouring Crown land being non-rateable include:

- some Crown land, such as that used for roading, provides public good that benefits the community as a whole. That public good may justify the land being non-rateable.
- the financial cost to the Crown of rating Crown land may weigh against it being rateable at least in the short term.

89. We think the efficient functioning of Government would not be impaired if Crown land were generally rateable. We consider that on balance a generic exemption in favour of Crown land is not justified. In some cases an exemption may be appropriate where there are specific policy factors relating to such matters as transaction costs or public good.

10. Options

Overview of options

90. We have identified 5 options for the Inquiry to consider when considering exemptions from liability for rates:

- no change;
- expand the services that targeted rates can be charged for;
- introduce Crown contributions in lieu of rates;
- remove some of the existing exemptions;
- remove all exemptions.

³¹ Law Commission Report, December 2000: To Bind Their Kings in Chains - An Advisory Report to the Ministry of Justice para 4. Current provision is section 27 of the Interpretation Act 1999.

³² Cabinet Office Circular CO (02) 4, Acts Binding the Crown: Procedures for Cabinet Decision, 13 March 2002.

91. Below we explain what is meant by each option and identify what we see as the advantages and disadvantages of each.

Advantages and Disadvantages

Option 1: No change.

This option would see the retention of existing exemptions legislation, no legislative amendments, and no introduction of any payments in lieu of rates system.

Advantages	Disadvantages
<ul style="list-style-type: none"> for the country as a whole the size of the problem is not a large one – in financial terms the rates on Crown land - which local authorities are most concerned about - is approx \$120m 	<ul style="list-style-type: none"> maintains historical anomalies
	<ul style="list-style-type: none"> the public continues to bear the costs of private gain that those exempt from rates enjoy
	<ul style="list-style-type: none"> technical complexities in the legislation will increase over time as further distinctions need to be drawn between what is rateable and non-rateable land
	<ul style="list-style-type: none"> some communities continue to face high costs

Option 2: Expand the services that targeted rates can be charged for.

The Local Government (Rating) Act 2002 permits local authorities to set targeted rates. Non-rateable land is liable to pay targeted rates for water supply, sewage disposal, and refuse collection. This option would see the types of services that targeted rates can be charged for expanded. The service would need to be identified, but may include drainage, and flood protection works. Consideration could be given to the ongoing appropriateness of the services being provided in relation to the land requirement.

Advantages	Disadvantages
<ul style="list-style-type: none"> addresses the areas of direct cost imposed on communities that are often captured by landowner 	<ul style="list-style-type: none"> doesn't address all services providing public benefit
<ul style="list-style-type: none"> a transitional measure if further reform was proposed in the future 	<ul style="list-style-type: none"> more technical boundaries and possibly anomalies
<ul style="list-style-type: none"> is consistent with the user-pays principle and also sets appropriate incentives for those who currently use or consume services and gain private benefit from services 	<ul style="list-style-type: none"> requires legislative reform
<ul style="list-style-type: none"> provides local authorities with funding for investment in infrastructure and services necessary for a growing economy 	

Option 3: Introduce Crown contributions in lieu of rates

Under this option the existing exemptions from rates would remain. However, the Crown would agree to pay local authorities a contribution in lieu of the rates foregone due to the exemptions on Crown land.

Advantages	Disadvantages
<ul style="list-style-type: none"> removes some and perhaps all of 	<ul style="list-style-type: none"> technical, and requires legislative

the private costs from communities	amendment to ratings law
<ul style="list-style-type: none"> maintains an element of the “old” approach to exemptions by retaining the Crown’s exemptions but addressing the costs issue 	<ul style="list-style-type: none"> local authorities may lack confidence in the robustness of the Crown determined contribution formula
<ul style="list-style-type: none"> a transitional measure if further reform was proposed in the future 	<ul style="list-style-type: none"> the community is removed from assessing the benefit of the non-rateable land
<ul style="list-style-type: none"> fiscal impact on the Crown can be managed directly by the Crown setting the payment 	
<ul style="list-style-type: none"> provides local authorities with funding for investment in infrastructure and services necessary for a growing economy 	

Option 4: Remove some of the existing exemptions or narrow the scope of existing exemptions

Under this option non-rateable land receiving services that provide the most private benefit in local communities would be rateable. Officials would need to undertake analysis on which exemptions would be removed either in part or in total. It might, for example, include education land used for residential accommodation.

Advantages	Disadvantages
<ul style="list-style-type: none"> provides local authorities with funding for investment in infrastructure and services necessary for a growing economy 	<ul style="list-style-type: none"> lacks the robustness of a complete review of exemptions
<ul style="list-style-type: none"> removes some of the private costs from communities 	<ul style="list-style-type: none"> some historical anomalies will continue
<ul style="list-style-type: none"> sets incentives for those currently gaining private benefit from services 	<ul style="list-style-type: none"> legislative amendment required
<ul style="list-style-type: none"> a transitional measure 	<ul style="list-style-type: none"> public goods provided at a national level may be under funded
<ul style="list-style-type: none"> local authority community could continue to subsidise costs from exemptions involving public, club or merit good that benefit that community 	

Option 5: Remove all exemptions

This option involves removing all legislative exemptions and providing local authorities the power to create exemptions for their local situations.

Advantages	Disadvantages
<ul style="list-style-type: none"> “fair” and equitable treatment 	<ul style="list-style-type: none"> potentially challenging issues in administering particularly in transport
<ul style="list-style-type: none"> enables local authorities to manage the transaction costs associated with services 	<ul style="list-style-type: none"> over time may be instability for ratepayers about rating levels – but administrative law and judicial review will provide a check on unreasonable decisions
<ul style="list-style-type: none"> local authority community could continue to subsidise costs from exemptions involving public, club or merit good that benefit that community 	<ul style="list-style-type: none"> legislative amendment required
<ul style="list-style-type: none"> local authorities have autonomy 	<ul style="list-style-type: none"> public goods provided at a national

11. Conclusion

92. We consider that several of the reasons put forward to explain the current exemptions lack robustness. In particular:

- i. *the Crown should not have to pay tax.*

This is an outdated concept. It is no longer presumed that new law will not apply to the Crown; rather the principle that is applied is the Crown will be bound unless to do so would impair the efficient functioning of Government.

- ii. *properties have no or very limited economic use and thus may not be able to pay rates.*

The ability to pay rates, and the landowner's decision to use land in a way that may have no economic use are not relevant factors in determining whether or not a landowner is liable for rates.

- iii. *properties do not consume services provided by local authorities or consume only limited amounts.*

No landowner receives no benefit from the services provided by local authorities. The benefit may be direct or indirect.

93. In some situations, land providing public goods might justify an exemption from rates. Without public funding, public goods are generally under-provided because the incentives are poor for private organisations to fund goods that it is not possible to exclude people from using, or for goods that when consumed can still be consumed by others.

94. However, we question whether rates exemptions are an appropriate mechanism to fund public goods as:

- the public good may be enjoyed by the country as a whole and it is inappropriate that only local communities fund them; and
- the value of the rating exemption for a specific property may have no direct correlation to the value of the public benefit provided.

95. Transaction costs, particularly those relating to the cost of valuing land for rating purposes may also provide adequate reasons for making land non-rateable. Research is required to determine which types of land would have excessive transaction costs, but roading is a likely candidate in this regard.

96. Many rating exemptions have been derived from a broad policy of exempting Crown lands. The policy concepts of transaction costs or public good that in some situations could justify ongoing exemptions are not directly reflected in the exemptions.

97. Given the significant impacts exemptions can have on particular council budgets, or potentially on the growth of the local economy, care should be taken when exempting categories or large areas of land.

98. We are aware that officials have been working on the option of the Crown making payments in lieu of rates (our option 3). We consider this work should be completed and reported on to the Government, and consideration be given to other matters in particular, as a minimum we think the services that targeted rates can be charged for could be expanded (our option 2).

99. While our focus has been predominantly on Crown owned lands, similar issues and arguments apply for non-Crown exemptions as well. The impacts and issues arising from

those exemptions are minimal, however, and are unlikely to justify legislative change at this time.

Annex A: Examples of the impact exemptions have on local authorities

Ratepayers bear the costs of delivering services which benefit non-rateable land

1. A strong example of this concern is the Otago Regional Council's Leith Lindsay Flood Protection Scheme. The Council has commissioned flood protection works along a waterway that runs through University of Otago land. The council identified the land that would directly benefit from the works and found that 39 percent of that land, by capital value, is non-rateable.³³
2. Another example of services that primarily benefit non-rateable land was provided by the Westland District Council. The Council explained that roading is the single biggest cost to the District and 19.4% of roads traverse non-rateable Crown land. The Jackson River Road is 21kms long and 20.5kms of it is through non-rateable land. It costs ratepayers \$13,295 to maintain per annum.³⁴ The roads are maintained principally so that the non-rateable land can be accessed.

The Crown benefits from subsidised council services

3. The two examples given for the Crown benefiting from subsidised council services was the Crown being an active participant in:
 - a. the development of regional and district plans, and
 - b. resource consent processes under the Resource Management Act 1991without contributing to the general rates which fund the council's cost of running the processes.
4. The Department of Conservation's role as an advocate for conservation was raised in this context. Some viewed the Department as a government funded lobbyist whose participation in planning processes and initiating litigation imposed significant costs, which was generally considered of benefit nationally, rather than locally.³⁵
5. The costs of processing consents are met by landowners (including the Crown) partially recoverable, and so the Crown does meet some costs. This does not capture the advocacy function of the Department however, as that function often involves consent applications of other landowners. For some councils, such as the West Coast Regional Council, 50% of the costs are met through the general rates which the Crown does not pay.³⁶

Non-rateable land dilutes the available rates base; increases rates or decreases services

6. Dunedin City Council estimates it would receive an extra \$9,586,079 in the 2006/07 year if all non-rateable property were rated. It has 48,420 residential properties that currently pay rates. The "subsidy" that each residential property pays, which would otherwise be paid by the non-rateable land, is \$198³⁷

³³ Rating Inquiry Data provided by Wayne Scott, Director Corporate Services, Otago Regional Council.

³⁴ Draft Position Paper : The exemption of Crown land from rates, and its effects in Westland District; by Robin Reeves, General Manager, Westland District Council, page 4.

³⁵ Draft Position Paper : The exemption of Crown land from rates, and its effects in Westland District; by Robin Reeves, General Manager, Westland District Council, page 5 and Counting the Cost of Non-Rateable Land on the West Coast: Submission from Chris Ingle, Chief Executive, West Coast Regional Council , page 2.

³⁶ Counting the Cost of Non-Rateable Land on the West Coast: Submission from Chris Ingle, Chief Executive, West Coast Regional Council , page 2.

³⁷ Information provided by Les Weir Financial Controller, Dunedin City Council, by email dated 13 April 2007.

7. The Westland District Council argued the dilution of the rates base arising from the very high level of conservation land in its district resulted in its having to provide “modest levels of service“ and adopting a minimalist approach to some aspects of its business³⁸

³⁸ Draft Position Paper : The exemption of Crown land from rates, and its effects in Westland District; by Robin Reeves, General Manager, Westland District Council, page 2.

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