

Office of the Minister of Internal Affairs

Chair

Cabinet Government Administration and Expenditure Review Committee

Fire and Emergency New Zealand: a funding review

Proposal

1. I propose Cabinet agree to initiate a review of the funding regime for Fire and Emergency New Zealand (FENZ). Terms of reference (TOR) for the review are attached at **Appendix One**.

Executive summary

2. FENZ is almost entirely funded by a levy on property insurance. This regime is largely a continuation of historical arrangements, and has several inherent inequalities. Since FENZ's amalgamation in 2017, we now have a much better understanding of the costs of the functions of the new organisation. I consider the time is right to initiate a review of this regime.
3. The review will canvas a wide range of options for funding FENZ. We will be looking to achieve a funding model that is stable, universal, equitable, predictable and flexible. No one option will fully satisfy all of these criteria, but I think that we can do better than an insurance-based levy. Options for consideration include a property-based funding model, levies on car registration, and a modified status quo.
4. The review will not consider other aspects of FENZ beyond funding. The review, and the implementation of any new funding model, would take at least two years. In the interim, FENZ will continue to be funded under the transitional levy provisions of the Fire and Emergency New Zealand Act 2017, which in the main continue the levy provisions of the Fire Service Act 1975.

Background

5. The Fire and Emergency New Zealand Act 2017 (the FENZ Act) came into force in July 2017. It established FENZ from the amalgamation of the former New Zealand Fire Service Commission, the National Rural Fire Authority, twelve enlarged rural fire districts and 26 territorial rural fire authorities. The post-amalgamation transition programme is progressing well, and New Zealanders are beginning to see the benefits of a modern, unified fire and emergency service.
6. FENZ is almost entirely funded by a levy on property insurance.¹ This is largely a continuation of the historical arrangements that have funded the New Zealand Fire Service Commission, although an updated and modernised insurance-based levy regime is authorised under the FENZ Act but has not yet come into effect. While the funding regime was reviewed as part of the reforms that led to the FENZ Act, the only options considered at that time were variations on an insurance-based model.

¹ In the year end 30 June 2018 FENZ's total revenue was \$612m, of which \$568m was from levy. FENZ's costs and revenue have increased following amalgamation, as it has taken on more responsibilities and the levy rate has increased from 7.6c to 10.6c per \$100 of insurance. Revenue immediately prior to amalgamation (year end 30 June 2017) was \$418m, of which \$392m was from levy.

7. Currently a transitional levy applies, which continues most aspects of the levy regime from the previous legislation, with an increased levy rate to fund the transition to a unified organisation. Under the FENZ Act as it currently stands, the new regime would come into effect on 1 July 2019.
8. In November 2018 Cabinet decided to introduce the Fire and Emergency New Zealand (Levy) Amendment Bill (the Bill) [LEG-18-MIN-0152 refers]. This is a short bill which will implement a time-critical subset of decisions that Cabinet took in August 2018 [GOV-18-MIN-0056 refers]. Principally, the Bill will extend the transitional levy period until 1 July 2021, with the option for the date to be brought forward by Order in Council if necessary.
9. Further amendments agreed by Cabinet in August 2018 were targeted to be implemented through a second amendment bill. These were to relate to other aspects of the levy regime, infringement offences, and evacuation schemes.

Purpose of the review

10. The purpose of the review is to identify whether more suitable options exist for funding FENZ than the current levy on property insurance.

The current insurance-based funding model has significant limitations...

11. In considering the proposed changes to FENZ's funding arrangements in detail, I have come to the view that any insurance-based levy system will have significant inherent flaws:
 - property owners who do not insure still benefit from FENZ's services, 'freeriding' on those who do insure;
 - charging a levy on insurance contracts increases the cost of insurance,² which may disincentivise property owners from fully insuring;
 - levy systems are complex to administer for insurers, and are prone to uncertainty as commercial insurance arrangements become increasingly complex and insurance products change with shifts in the market and technology;
 - prevalence of "first-loss" insurance contracts (that cover high value property portfolios for less than their full value) which results in similar properties being subject to different levy liability based solely on their insurance structures; and
 - FENZ's post-amalgamation functions and services are now much broader than was historically the case. They may not be appropriately reflected in FENZ's revenue sources.
12. There is incomplete information about the extent of some of these problems. For example, we do not have complete information about the extent of the 'freerider' problem in the commercial property sector. There is also a lack of information due to the commercial sensitivity of insurance contracts.

² The levy rate on property is 10.6c per \$100 sum insured. This is subject to upper limits and special calculations for a number of items such as: residential buildings (maximum levy payable of \$106); domestic contents (maximum levy payable of \$21.20); motor vehicles (flat rate of \$8.45 per motor vehicle not exceeding 3.5 tonne gross laden weight). Commercial property is not subject to these limits, so for example the annual levy payable on a commercial building insured for \$10 million is approximately \$10,600.

13. While the proposed new levy regime under the FENZ Act should be more equitable than the levy system that came before it, when it takes effect some property owners will face substantial increases. This could affect their viability and may result in businesses and other organisations reducing their insurance cover.

...overseas jurisdictions have moved away from an insurance-based method for funding their fire and emergency services...

14. Many international jurisdictions have moved away from using an insurance-based model to fund fire services delivered at the local or state level. For example, several Australian states (Queensland, South Australia, Western Australia, and Victoria) previously charged a levy on property insurance to fund fire services. These states have now moved to charging a fire levy on property values, collected by local authorities. New South Wales and Tasmania both have an insurance-based model; New South Wales has previously considered moving to a property-based model but deferred the transition due to implementation issues, and Tasmania is considering a move to a property-based model.

...and the time is now right to initiate a review

15. I consider the time is now right to take a fundamental look at FENZ's funding model. The recent reform efforts have achieved much in terms of modernising the structure and purpose of FENZ, but not how it is funded.
16. We now have a clearer, but still emerging, understanding of the costs involved in running the new national organisation – and its new structure and functions – than when FENZ was brought together in 2017. While no system is perfect, I think we can do better than an insurance-based levy.

Scope

Principles of design

17. I consider the purpose of the levy regime under the FENZ Act remains sound (section 80 of that Act). It provides for:
 - **a stable** source of funding to support FENZ in the performance of functions and duties and exercise of powers under the FENZ Act;
 - **universal**, so that FENZ's costs are generally shared among all who benefit from the potential to use FENZ's services;
 - **equitable**, so that those liable to pay should generally pay at a level commensurate with their use of, or benefit from the potential to use, FENZ's services and with the risks associated with the activities that those liable carry out (but without strict apportionment according to use, benefit, or risk having to be observed);
 - **predictable**, so that those liable to pay are able to predict the amounts that they will need to pay and FENZ is able to predict how much income it will receive; and
 - **flexible**, so that it can adapt to:
 - changes in the use, benefit, or risk associated with those who benefit from the potential to use FENZ's services; and
 - variations in FENZ's costs; and
 - changes to the expectations of the Crown and the strategic needs of FENZ.

18. These will form the basis of the criteria used to assess the different options for reform. I also expect that in making decisions related to FENZ's funding model, Cabinet will consider:
- the costs of administering any new system, in particular which agency or agencies is responsible for collecting the levy;
 - the affordability for some liable parties in moving to a new regime; and
 - ways to seek public feedback on FENZ's costs and services, similarly to the public consultation mechanism in section 143 of the FENZ Act.

The review will consider a range of funding models...

19. The review will assess the following options for determining liability for funding FENZ, as well as any additional viable options that may arise through consultation:
- **Property based funding model:** a levy charged on the value of property.
 - **Levy paid on car registration:** a fire and emergency levy charged in a similar way to the ACC levy paid on motor vehicle registration.
 - **(Modified) status quo:** a levy on contracts for property insurance. This could include all or some of the following: insurance on real estate, personal property, stock and plant, motor vehicles, and includes the status quo.
 - **Any other options** that might emerge through consultation.
20. We have an opportunity to take a clean-slate approach to funding fire and emergency response services in New Zealand. No one option needs to be the sole basis for funding FENZ. For various reasons, for example equity or fairness, it may be best to fund FENZ based on a combination of options, weighted to reflect the benefit that different elements of New Zealand receive from FENZ's services.
21. Mixed funding models are often utilised in overseas jurisdictions. In New Zealand, the Government has previously made regular and stable contributions to funding its fire services.³
22. No potential funding model should be out of scope for the review. This will ensure a full public discussion and consideration of potential models. However, the review should consider the impacts of any change in funding model, to ensure that it does not generate excessive or sudden cost increases for businesses and individuals.

...and other mechanisms

23. As well as funding liability, the review will consider the mechanisms by which FENZ funding would best be collected. For example, a property based funding model could be collected centrally or by local authorities, or a mixture of the two.
24. I am also interested in exploring ways to best ensure the contribution made by property owners reflects their potential call on FENZ's services. For example, it may be that property with sophisticated sprinkler systems or properties used for certain activities may have less call on FENZ's services than other types of property. The review will consider the policy and practical elements of reflecting such mitigations in a property's funding liability.

³ Prior to 1999 Crown contributions (through Vote: Internal Affairs) made up approximately 8% of the Fire Service's annual funding.

Out of scope

25. The review will not recommend changes to affect:
- FENZ's expenditure that is not related to collection of revenues;
 - FENZ's operations (beyond its role in collections);
 - elements of the FENZ Act or broader legislative regime that are unrelated to funding FENZ; or
 - funding arrangements for non-FENZ emergency services.

Timeline and mechanics

The review, and implementation of the new model, would take at least two years

26. I expect the review, and implementation of any new funding model, will take at least two years. Thorough consultation will be needed because FENZ's services, and the ways in which FENZ is funded, are relevant to all New Zealanders. Certain groups (for example, representatives of the insurance sector, local government, and large property owners) will also have a keen interest in the funding options, and will be able to bring their expertise to the table to inform the consideration of options.
27. The review will be undertaken by the Department of Internal Affairs under my direction. Cabinet will be the decision-making body. I will consult with relevant Ministers on particular proposals as they develop.
28. The first step will be the production of a public discussion document to seek feedback on alternative options for funding FENZ. I intend to return to Cabinet in June 2019 to seek approval to release the discussion document. After a two-month public consultation process, and post-consultation policy work, I will then seek Cabinet approval to the new funding model in April 2020.
29. Implementation time will vary depending on the funding model ultimately agreed, but I expect the new regime to commence in mid-2021 at the earliest. To allow for the possibility that a new system may not need to be implemented in this timeframe, I seek Cabinet's approval now to shift the commencement date for the new levy regime (the default funding system) from 1 July 2021 to 1 July 2024 via Supplementary Order Paper to the Fire and Emergency New Zealand (Levy) Amendment Bill.
30. An indicative timeline is provided below. Detailed planning following Cabinet decisions may result in changes to this timeline.

Table 1: Indicative timeline for review of FENZ's funding model

Stage	Approximate date
One: Cabinet approval of discussion document	June 2019
Two: Public consultation	July – August 2019
Three: Post-consultation policy work	September 2019 – March 2020
Four: Cabinet approves new funding model	April 2020
Five: Legislation introduced	May 2020 – June 2021 (at earliest)
Six (sub-steps in parallel): 1. operational work for implementation of new model; 2. public consultation and setting of new levy rates (if required); and 3. budget bid process (if required)	September 2020 - June 2021 (at earliest)
Seven: New regime commences	July 2021 (at earliest)

Consultation

31. The following departments have been consulted in the development of this Cabinet paper: Accident Compensation Corporation, the Department of Corrections, the Ministry of Defence, the New Zealand Defence force, the Department of Conservation, the Department of Prime Minister and Cabinet, the Ministry of Education, Fire and Emergency New Zealand, the Ministry of Health, Inland Revenue Department, the Ministry of Business, Innovation, and Employment, the Ministry for Culture and Heritage, the Ministry for the Environment, the Ministry for Primary Industries, the New Zealand Transport Agency, the Office for Disability Issues, Parliamentary Counsel Office, the New Zealand Police, the State Services Commission, the Ministry of Transport, and the Treasury.

Financial implications

32. FENZ will continue to be funded by the transitional regime through the review period. In the year end 30 June 2018 FENZ's total revenue was \$612m, of which \$568m was from levy.

9(2)(f)(iv)

33. Any decision on changes to the funding model could have significant financial implications for households, businesses, and the public sector. Changes are likely to be greatest for the commercial/non-residential sector. Where the Crown owns property, decisions may affect the Crown.

Human rights, gender implications and disability perspective

34. There are no human rights, gender implications, or disability perspectives arising from the proposals in this paper.

Legislative implications

35. The new levy regime is due to come into effect on 1 July 2019. The Fire and Emergency New Zealand (Levy) Amendment Bill, which is currently before the Governance and Administration Committee, is already on track to shift the backstop for the commencement of the new funding regime to 1 July 2021. I intend to promote an amendment at the Committee of the Whole House stage to extend the transitional levy regime to 1 July 2024 to allow time for the review to be completed. I seek Cabinet's approval to draft the Supplementary Order Paper now.
36. Any change to the funding regime as a result of the review will require an amendment to the FENZ Act.
37. **9(2)(f)(iv)**

Regulatory impact analysis

38. Cabinet is being asked to initiate a review of the FENZ funding regime. The regulatory analysis requirements do not apply to this decision. The discussion document (Cabinet approval planned for June 2019) will be subject to the regulatory impact analysis requirements.
39. As a consequence of the decision to initiate a review, Cabinet is also being asked to further postpone the commencement of sections 80 to 140 of the FENZ Act, which relate to the new FENZ levy regime. The regulatory impact analysis requirements apply to this consequential decision. A Regulatory Impact Statement (RIS) was prepared by the Department of Internal Affairs and is attached to this Cabinet paper. The Department's Regulatory Impact Analysis Panel has reviewed the RIS and considers that the information meets the quality assurance criteria.

Publicity

40. It will be essential to give the public, the insurance sector, and FENZ certainty about FENZ's funding arrangements. This is a significant change in direction. Following Cabinet decisions I intend to make a press release to communicate the Government's intentions.

Proactive release

41. As per Cabinet Office Circular *CO (18) 4 – Proactive Release of Cabinet Material: Updated Requirements* I intend to proactively release this paper, subject to any redactions that may be warranted under the Official Information Act 1982, within 30 business days of decisions being taken.

Recommendations

42. The Minister of Internal Affairs recommends that the Government Administration and Expenditure Review Committee:

1. **agree** to initiate a review of the Fire and Emergency New Zealand (FENZ) funding system;

Scope of review

2. **agree** that the principles of design for the review should be to provide for a funding system that is:
 - 2.1 stable;
 - 2.2 universal;
 - 2.3 equitable;
 - 2.4 predictable; and
 - 2.5 flexible;
3. **agree** that in making decisions relating to FENZ's funding model, Cabinet will also consider:
 - 3.1 administration costs;
 - 3.2 affordability issues for parties moving to the new regime; and
 - 3.3 ways to provide for regular public consideration of FENZ's costs and services;
4. **agree** that the models considered by the review will include but not be limited to:
 - 4.1 a property-based funding model;
 - 4.2 levy paid on car registration;
 - 4.3 (modified) status quo; and
 - 4.4 any other options that might emerge through consultation.
5. **agree** that the review will also consider:
 - 5.1 mechanisms by which FENZ funding would best be collected; and
 - 5.2 ways to best ensure the contribution made by property owners reflects their potential call on FENZ's services;
6. **agree** that the review will not consider:
 - 6.1 FENZ's expenditure that is not related to collection of revenues;
 - 6.2 FENZ's operations (beyond its role in collections);
 - 6.3 elements of the Fire and Emergency New Zealand Act 2017 (the FENZ Act) or broader legislative regime that are unrelated to funding FENZ; or
 - 6.4 funding arrangements for non-FENZ emergency services;

Logistics for the review

7. **invite** the Minister of Internal Affairs to return to Cabinet in mid-2019 to seek agreement to the release of a public discussion document seeking feedback on potential funding models;
8. **note** that thorough consultation will be required;

IN CONFIDENCE

9. **note** that the review, including implementation of any new funding model, will take at least two years and is expected to be completed by July 2021 at the earliest;
10. **note** that the Department of Internal Affairs will conduct the review;
11. **note** that a terms of reference to give effect to the above recommendations is attached to this paper as **Appendix One**;

Consequential legislative changes

12. **note** that the Fire and Emergency New Zealand (Levy) Amendment Bill, which is currently before the Governance and Administration Committee, will shift the backstop date for the end of the current transitional levy period in the FENZ Act from 1 July 2019 to 1 July 2021;
13. **agree** to prepare a Supplementary Order Paper to shift the backstop date for the end of the current transitional levy period in the FENZ Act to 1 July 2024 to allow time for the review to be completed; and
14. **invite** the Minister to issue drafting instructions to the Parliamentary Counsel Office for the required Supplementary Order Paper.

Authorised for lodgement

Hon Tracey Martin

Minister of Internal Affairs

Proactively released under the Official Information Act 1982

Appendix One: Terms of Reference

Context of review

The Fire and Emergency New Zealand Act 2017 (the FENZ Act) came into force in July 2017. It established FENZ from the amalgamation of the former New Zealand Fire Service Commission, the National Rural Fire Authority, twelve enlarged rural fire districts and 26 territorial rural fire authorities.

FENZ is almost entirely funded by a levy on property insurance. This is largely a continuation of the historical arrangements that have funded the New Zealand Fire Service Commission, although an updated and modernised insurance-based levy regime is authorised under the FENZ Act but has not yet come into effect. While the funding regime was reviewed as part of the reforms that led to the FENZ Act, the only options considered at that time were variations on an insurance-based model.

Currently a transitional levy applies, which continues the levy regime from the previous legislation, with an increased levy rate to fund the transition to a unified organisation. Under the FENZ Act as it currently stands, the new regime will come into effect on 1 July 2019. The Government has previously decided to extend this deadline.

Insurance-based levy systems have several inherent flaws:

- property owners who do not insure still benefit from FENZ's services, 'freeriding' on those who do insure;
- charging a levy on insurance contracts increases the cost of insurance, which may disincentivise households and businesses from fully insuring;
- levy systems are complex to administer for insurers, and are prone to uncertainty as commercial insurance arrangements become increasingly complex and insurance products change with shifts in the market and technology;
- prevalence of "first-loss" insurance contracts (that cover high value property portfolios for less than their full value) which results in similar properties being subject to different levy liability based solely on their insurance structures; and
- FENZ's post-amalgamation functions and services are now much broader than was historically the case. They may not be appropriately reflected in FENZ's revenue sources.

Purpose of review

The purpose of the review is to identify whether more suitable options exist for funding FENZ than the current levy on property insurance.

Scope of review

Principles of design

We need a funding model that, to the greatest extent possible, provides for:⁴

- **a stable** source of funding to support FENZ in the performance of functions and duties and exercise of powers under the FENZ Act;
- **universal**, so that FENZ's costs are generally shared among all who benefit from the potential to use FENZ's services;
- **equitable**, so that those liable to pay should generally pay at a level commensurate with their use of, or benefit from the potential to use, FENZ's services and with the risks associated with the activities that those liable carry out (but without strict apportionment according to use, benefit, or risk having to be observed);
- **predictable**, so that those liable to pay are able to predict the amounts that they will need to pay and FENZ is able to predict how much income it will receive; and
- **flexible**, so that it can adapt to:
 - changes in the use, benefit, or risk associated with those who benefit from the potential to use FENZ's services; and
 - variations in FENZ's costs; and
 - changes to the expectations of the Crown and the strategic needs of FENZ.

These will form the basis of the criteria used to assess the different options for reform. In making decisions related to FENZ's funding model, Cabinet will consider:

- the costs of administering any new system;
- the affordability for some liable parties in moving to a new regime; and
- ways to provide for regular public consideration of FENZ's costs and services, similar to the public consultation on proposed levy rates that is required under section 143 of the FENZ Act.

Funding models

The review will assess the following options for determining liability for funding FENZ, as well as any additional viable options that may arise through consultation:

- **Property based funding model:** a levy charged on the value of property.
- **Levy paid on car registration:** a fire and emergency levy charged in a similar way to the ACC levy paid on motor vehicle registration.
- **(Modified) status quo:** a levy on contracts for property insurance. This could include all or some of the following: insurance on real estate, personal property, stock and plant, motor vehicles, and includes the status quo.
- **Any other options** that might emerge through consultation.

It may be best to fund FENZ based on a combination of options weighted to reflect the benefit that different elements of New Zealand receive from FENZ's services.

⁴ These criteria are adapted from those in section 80 of the FENZ Act.

IN CONFIDENCE

No options for funding models should be out of scope for the review. This will ensure a full public discussion and consideration of potential models. However, the review should consider the impacts of any change in funding model, to ensure that it does not generate excessive or sudden cost increases for businesses and individuals.

Other mechanisms

The review will consider the mechanisms by which FENZ funding would best be collected. For example, a property value based funding model could be collected centrally or by local authorities, or a mixture of the two.

The review will also explore ways to best ensure the contribution made by property owners reflects their potential call on FENZ's services. For example, it may be that property with sophisticated sprinkler systems or properties used for certain activities may have less call on FENZ's services than other types of property. The review will consider the policy and practical elements of reflecting such mitigations in a property's funding liability.

Matters outside of scope

The review will not recommend changes to affect:

- FENZ's expenditure that is not related to collection of revenues;
- FENZ's operations (beyond its role in collections);
- elements of the FENZ Act or broader legislative regime that are unrelated to funding FENZ; or
- funding arrangements for non-FENZ emergency services.

Governance and working-level arrangements

The review will be undertaken by the Department of Internal Affairs under the direction of the Minister of Internal Affairs. Cabinet will be the decision-making body. The Minister will consult with relevant Ministers on particular proposals as they develop.

Consultation

Thorough consultation will be needed because FENZ's services, and the ways in which FENZ is funded, are relevant to all New Zealanders. Certain groups (for example, representatives of the insurance sector, local government, and large property owners) will also have a keen interest in the funding options, and will be able to bring their expertise to the table to inform the consideration of options.

Timeframe for the review

The review, and implementation of FENZ's new funding model will take at least two years.

The first step will be the production of a public discussion document to seek feedback on alternative options for funding FENZ. The Minister of Internal Affairs intends to return to Cabinet in June 2019 to seek approval to release the discussion document. After a two-month public consultation process, and post-consultation policy work, the Minister will then seek Cabinet approval to the new funding model in April next year.

Implementation time will vary depending on the model ultimately agreed. The new regime would commence in mid-2021 at the earliest. An indicative timeline is provided below. Detailed planning following Cabinet decisions may result in changes to this timeline.

Table 1: Indicative timeline for review of FENZ's funding model

Stage	Approximate date
One: Cabinet approval of discussion document	June 2019
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Five: Legislation introduced	May 2020 – June 2021 (at earliest)
Six (sub-steps in parallel): 4. operational work for implementation of new model; 5. public consultation and setting of new levy rates (if required); and 6. budget bid process (if required)	September 2020 - June 2021 (at earliest)
Seven: New regime commences	July 2021 (at earliest)