|  |
| --- |
| Fire Service Review Background: Funding options and alternatives 27 May 2015 |
|  |

Contents

[Purpose 2](#_Toc420401467)

[Executive summary 3](#_Toc420401468)

[Background – the Commission, the Swain report and the revised funding review 7](#_Toc420401469)

[Fire services are predominantly a public good 7](#_Toc420401470)

[The main source of the Commission’s income is the Fire Service Levy 7](#_Toc420401471)

[The independent Fire Review Panel made recommendations for reform 8](#_Toc420401472)

[The Swain report supports the status quo, but notes that it has several weaknesses 8](#_Toc420401473)

[The review builds on the Recommendations of the Swain report 9](#_Toc420401474)

[Objectives and criteria for reform 10](#_Toc420401475)

[High level options for reform 10](#_Toc420401476)

[Criteria to assess the funding options 10](#_Toc420401477)

[Option 1 - Enhanced status quo: a FS Levy based on insurance contracts 12](#_Toc420401478)

[The current FS Levy can be confusing to calculate and difficult to forecast 13](#_Toc420401479)

[The FS Levy could be collected from the sum insured on property or the insurance premium 14](#_Toc420401480)

[The FS Levy should be charged using a fixed rate 15](#_Toc420401481)

[The FS Levy should be capped on residential property 17](#_Toc420401482)

[Introducing a cap on the FS Levy for commercial properties involves a trade-off between equity and reducing evasion 17](#_Toc420401483)

[FS Levy rates should differ for residential and commercial properties 18](#_Toc420401484)

[Rural and urban revenue and cost of services 19](#_Toc420401485)

[Compensating insurers for the cost of collecting and administering the FS Levy 20](#_Toc420401486)

[Charging for services and other revenues streams 20](#_Toc420401487)

[Transition period 21](#_Toc420401488)

[Option 2 - Mixed funding model: combined Crown and insurance based funding 22](#_Toc420401489)

[Collecting funding for attending fires at Crown properties 22](#_Toc420401490)

[The public good element of fire services could be funded by a Crown appropriation 24](#_Toc420401491)

[Funding the Commission’s motor vehicle response activities 25](#_Toc420401492)

[Discarded options 27](#_Toc420401493)

[A property-based levy 27](#_Toc420401494)

[Funding from general taxation 28](#_Toc420401495)

[Appendix: Discussion of the strengths and weaknesses of the NZIER’s reports on the Fire Service Levy 29](#_Toc420401496)

# Purpose

The discussion document sets out two primary options for reforming the Commission’s funding model, and a set of evaluative criteria for assessing these options. This paper supports the discussion document by providing a more detailed analysis of these funding options and their implications for the equitability, stability and sustainability of Commission funding.

The scope of this paper is limited to the Commission’s funding, and does not extend to evaluating the funding of Rural Fire Authorities. These issues are considered separately in the *Background paper: Rural Fire* and the public discussion document. This paper also does not discuss the wider funding implications of the governance and support options outlined in the discussion document.

# Executive summary

The New Zealand Fire Service Commission (the Commission) is primarily funded by the fire service levy. The fire service levy (FS Levy) is charged to property owners and collected by insurance companies or brokers when their customers take out fire insurance for contents, buildings, or motor vehicles.

There are two main problems with the current levy. Firstly, the levy does not reflect the scope or services carried out by the Commission. A rising proportion of the New Zealand Fire Service’s (NZFS) activities involve responding to non-fire emergencies (such as hazardous substance spills and medical emergencies). Another issue is that residential property owners are paying more than their fair share relative to other (mostly commercial) property owners.

There are ambiguities in the current legislation that make it difficult to calculate and forecast levy payments. Additionally, many state sector agencies choose not to take out full insurance cover (thereby reducing their contribution to the levy). As a result, the levy does not reflect the total risk of fire in New Zealand, forcing smaller property owners to pay more, while large commercial operators and state agencies pay less.

The *Fire Services Review: Discussion Document* (the discussion document) seeks feedback on two options for funding reform: an insurance-based model (enhanced status quo) and a mixed model comprising an insurance-based levy, Crown funding and a contribution from the motor vehicle sector.

There are multiple ways that an insurance-based model or a mixed model could be designed. This paper provides a discussion of the trade-offs between the different sub-options for those models. The paper does not evaluate the funding of Rural Fire Authorities (see *Background paper: Rural Fire*). This paper also does not discuss the wider funding implications of the governance and support options.

*An insurance-based model (enhanced status quo)*

The insurance-based option would look to build upon the recommendations of the independent Fire Review Panel in 2012, by extending the insurance base to cover all contracts of material damage. The levy could be charged on the value of sum insured, the premium on insurance, or some other measure. The trade-offs between these two options are:

|  |  |
| --- | --- |
| Sum-insured | Premiums |
| *Advantages** Cost-effective to implement.
* Revenues are more stable.

*Disadvantages** Does not incentivise minimising fire risk.
 | *Advantages** Those with more fire-prone properties are likely to pay more.

*Disadvantages** Premiums are highly variable and difficult to predict.
* Premiums may be influenced by factors besides risk.
 |

Another issue is how the levy should be charged, and whether:

* a levy should be a fixed charge, a fixed rate, or a variable rate; and
* whether the levy should differ for residential and commercial properties.

In both cases, the primary trade-off is between equity and operational simplicity. For example, a fixed charge would not reflect the ability of individual property owners to contribute to the levy, though it would be very straightforward to administer. On the other hand, while a variable rate would be the fairest option in terms of recognising different peoples’ circumstances (e.g. ability to pay, cost to service, risk of fire, etc.) it would be difficult to implement and administer. Likewise, while implementing the same levy rate for both residential and commercial sectors would be the most administratively simple option; this would not reflect the costs of the Commission’s services to the two sectors.

Another issue is whether levy payments should be capped at a fixed level. This involves a tradeoff between different concepts of fairness. On the one hand, caps reduce equity, as people with greater ability to pay (to the extent that property values measure ability to pay) contribute less to the Commission. However, lower-value properties are likely to be associated with a greater risk of fire (especially in the residential sector), and the costs of attending fires are not always correlated with property value. For these reasons, it is proposed that a cap on levy payments for residential properties continue.

 *A mixed-model combining the insurance-based levy with a Crown contribution*

A mixed funding option would use the same insurance-based levy outlined above, but could also include:

* funding from the Crown to recognise the under-insurance of Crown properties and the costs of non-fire emergencies (e.g. medical responses); and
* funding from motor vehicle owners for motor vehicle-related emergencies.

Despite benefitting from the Commission’s activities, state sector agencies do not always take out full insurance cover as it is sometimes cheaper for them to carry the risk. As a result, their contribution to the Commission does not reflect the value of state sector property compared to the residential and private commercial sectors.

There are two main options considered for a Crown contribution to funding:

* requiring state sector agencies to make a contribution to the Commission (either by a direct charge, or by an annual proxy for the levy based on the value of the properties that are protected); or
* providing a lump sum appropriation, funded from general taxation.

|  |  |
| --- | --- |
| Agency contribution | Crown appropriation |
| *Advantages*Grows with expansion in the Crown’s risk and/or the value of the Commission’s services to agencies.If a direct charge is used, it will possibly incentivise agencies to reduce fire risk.*Disadvantages*Costly to administer.Difficult to implement with state sector agencies. | *Advantages*Cost effective to administer.Allows scrutiny and increased clarity of Commission’s expenditure.Makes the size of the Government’s contribution more transparent.*Disadvantages*Dependent on the availability of Crown funding. |

The NZFS is also undertaking an increasing number of non-fire related activities. Given the public good nature of the Commission’s activities, there is a strong argument that these activities should be publicly funded. Again, these activities could be funded from an agency contribution (e.g. direct charge or a levy on properties) or a Crown appropriation.

|  |  |
| --- | --- |
| Agency contribution | Crown appropriation |
| *Advantages*Grows in line with any expansion in the non-fire activities funded by the Commission.*Disadvantages*Costly to administer.Difficult to clearly ascribe costs to individual agencies. | *Advantages*Cost effective to administer.Allows scrutiny and increased clarity of Commission expenditure.Makes the size of the Government’s contribution more transparent.Fair, given the public good nature of non-fire activities.*Disadvantages*Dependent on the availability of Crown funding. |

Finally, the mixed-model proposes requiring a contribution from motor vehicle owners. There are two suggested options:

* funding from a flat annual charge on vehicle licensing (commonly known as “rego”); or
* a transfer from road tax revenue.

|  |  |
| --- | --- |
| Funding from rego | Funding from road tax revenue |
| *Advantages*Costs are more transparent to the public.*Disadvantages*Administration costs could be significant.Greater visibility of the charge could reduce adaptability of funding to the needs of the Commission. | *Advantages*Low administration costs because of the existing administration process.*Disadvantages*Would require either prioritisation from existing spending or an increase in road user taxes. |

*Discarded options*

One of the primary alternatives to an insurance-based levy involved local government collecting a levy on the improved value of property. This option has several advantages, including avoiding distortions to the insurance market. However, a property-based levy suffers from significant implementation and administrative issues. The Department does not support this option.

Another alternative considered in this document is funding from general taxation. This model provides for all funding of the Commission through the Government appropriation process. This option was dismissed as it would require a very large appropriation to fund the Commission’s activities.

# Background – the Commission, the Swain report and the revised funding review

## Fire services are predominantly a public good

The Commission delivers a mix of public[[1]](#footnote-1) and private[[2]](#footnote-2) benefits. The Commission funds the NZFS. The NZFS is legally required to respond to fires within urban fire districts but also responds to fires in rural fire districts, which are the prime responsibility of rural fire authorities. The Commission also provides rural fire leadership in its capacity as the National Rural Fire Authority, and funding for rural fire authorities through the Rural Fire Fighting Fund.

The NZFS delivers the “4Rs”: risk reduction, readiness, response and recovery. The first two functions are largely public goods. Reduction focuses on matters such as public education and awareness. Everyone benefits from reduction efforts, and one individual’s enjoyment of these benefits does not limit anyone else’s. The same is true for NZFS’s readiness to respond to fire emergencies at local businesses and communities around the country.

Response has both public and private benefits. Individuals benefit from the NZFS’s responses, however the marginal costs of helping an additional person are generally small. The public also benefits through the reduction in the numbers of long-term injuries and other costs to the public health system. Recovery largely involves investigation and research – both of which are primarily public goods.

Finally, the NZFS’s non-fire activities such as disaster relief and responding to motor vehicle accidents also have the qualities of a public good, because they are available to everyone and help to engender a feeling of security within the whole community.

## The main source of the Commission’s income is the Fire Service Levy

Currently, the FS Levy is the main source of income for the Commission – accounts for 96 per cent of income ($339.44 million) in 2013/14. The FS Levy is paid on insurance contracts that cover a risk of fire. The current FS Levy rate is 7.6 cents per $100 of insured value. Since 2008, revenue from the FS Levy has risen and covered the Commission’s costs.

The FS Levy is calculated in the following ways:

* for insurance contracts covering residential buildings, the FS Levy is capped at $100,000 of insured value (a maximum levy of $76 per year);
* for contracts covering residential contents, the FS Levy is capped at $20,000 of insured value (a maximum levy of $15.20 per year);
* for contracts covering vehicles under 3.5 tonne, a flat rate of $6.08 per year; and
* for other property (mostly insurance contracts covering commercial and industrial buildings), the FS Levy is calculated on the sum insured, or if there is no sum insured or if the sum insured is greater than the indemnity value, on the indemnity value of the property. There are no caps on these FS Levy payments.

In practice, because of the caps, the FS Levy on most residential buildings is calculated on the sum of $100,000, and on most residential contents on the sum of $20,000. The FS Levy on most other property is calculated based on indemnity value. The majority (more than 80 per cent) of FS Levy revenue growth since 2008 has come from growth in the value of other property.

In addition to the FS Levy, under the Fire Service Act 1975 (the Act) the Commission may charge for any service or function it provides, apart from attendances at fires inside urban fire districts. Without limiting this power to charge, the Act states that the Commission may charge for:

* attendances at hazardous substance emergencies;
* fire safety activities;
* firefighting involving commercial forestry in urban fire districts; and
* attendances at false alarms.

## The independent Fire Review Panel made recommendations for reform

In 2012, the Government set up an independent Fire Review Panel (the Panel) to provide advice for New Zealand’s fire services. The Panel was asked to provide advice on how sustainable, stable and equitable funding for fire services could be achieved. The issue on whether fire services should be funded by the Crown was outside of the scope of the Panel’s review. However, the Panel was asked to provide recommendations on:

* how improvements could be made to the current FS Levy;
* whether there are other viable funding sources; and
* the impacts of any reforms on other services.

## The Swain report supports the status quo, but notes that it has several weaknesses

The Panel’s final report (the Swain report) stated that the existing arrangements have “much to commend them”, and that the status quo provides a “robust, reliable and resilient funding base”. However, the Swain report also noted several problems with the status quo:

* equity and alignment of funding sources – the FS Levy as it is currently calculated, does not reflect the scope or use of services carried out by the Commission;
* interpretation and calculation problems – ambiguities in the legislation have created uncertainty around how much non-residential property owners are obligated to pay under the FS Levy; and
* administrative inefficiency – the FS Levy can be expensive to calculate for the insurance sector, and is difficult to monitor for the Commission.

As a result, FS Levy payments do not always accurately reflect the range of risks that the Commission responds to, and the activities it is required to undertake (the 4R’s for fire). The Swain report made a number of recommendations regarding the FS Levy to address these issues, including:

* shifting the FS Levy base for other property to a levy on premiums and extending the base to cover all contracts of material damage (not just those covering risk of fire);
* adjusting the caps for residential and personal property and reducing the FS Levy rate; and
* that the transport sector contribute to funding.

## The review builds on the Recommendations of the Swain report

In 2014, the Department of Internal Affairs (the Department) sought Cabinet approval to undertake non-government stakeholder engagement on the Swain report’s recommendations. This engagement will help officials to develop the final options for reform.

When seeking Cabinet agreement to consult publicly, it was noted that while the scope of the Review would be broadened, it was not returning to a first principles approach. Instead the Department would use the Swain report as the base when engaging with non-government stakeholders.

The Cabinet paper also noted that, while the Swain report provides the base for stakeholder engagement, the Review could incorporate stakeholder’s views on matters that were not a key focus for the Panel (e.g. the issue of whether fire should be funded by the Crown).

# Objectives and criteria for reform

## High level options for reform

The discussion document sets two options to address issues with the FS Levy:

* option 1: an insurance-based FS Levy (an enhanced status quo option, similar to what was recommended in the Swain report); or
* option 2: a mixed funding model comprising an insurance-based FS Levy, Crown funding and a contribution from the motor vehicles sector.

Option 1 is based on the recommendations of the Swain report for an improved FS Levy, although it also incorporates findings from subsequent stakeholder engagement.

Within options 1 and 2, there are a variety of alternative configurations. This paper reviews these alternatives, and stakeholder feedback is sought through the public discussion document. The Commission will retain the ability to raise funding from [direct charges](#_Charging_for_services) for specific services under both options.

## Criteria to assess the funding options

A number of criteria for evaluating the funding options have been established for inclusion in the discussion document. The criteria are based on tax design principles,[[3]](#footnote-3) and include:

* *equity*: the funding sources should accurately reflect the 4R’s of fire and other emergency responses undertaken by the Commission, and:
	+ equity across the funding base with respect to the amount each participant pays relative to their contribution to costs (horizontal equity). Contribution to costs can vary due to the risk of fire, the cost of servicing a fire and the scale of the assets that need to be protected;
	+ equity in terms of amount paid relative to the standard of service received (vertical equity); and
	+ given the public-good nature of fire services, people should contribute on the basis of their ability to pay.
* *sufficiency*: the Commission has the necessary funding to carry out responses to other mandated emergencies across New Zealand.
* *predictability* *and clarity*: there are several elements to this criteria:
	+ revenues are not subject to sudden significant changes;
	+ revenues can be calculated readily and easily; and
	+ people should be aware of the charge, and how and when it applies.
* *adaptability*: the funding base should change in line with any expansion of the Commission’s response to risk.
* *non-distortionary*: the effect of the funding method on a levy payer’s decision making is kept to a minimum and in particular:
	+ minimises any perverse incentives that levy payers may have to not reduce the risk of fire (e.g. installing fire sprinklers and detectors, using flame retardant materials etc.);
	+ avoids discouraging people from insuring their assets due to the cost of the FS Levy; and
	+ avoids discouraging people from calling the fire services when they are needed.
* *cost effective*: costs of administering and collecting the funding are kept to a minimum, and the enforcement of payments is straight-forward.

# Option 1 - Enhanced status quo: a FS Levy based on insurance contracts

This option is based on the Swain report’s recommendation that the Commission continues to be funded by a levy on property insurance, but that the base for the FS Levy be extended to cover all contracts of material damage (i.e. not just fire insurance).

Collecting the FS Levy on fire insurance contracts does not reflect the fact that the Commission is responding to a growing number of non-fire related incidents (e.g. medical emergencies). Basing the FS Levy on all contracts of material damage would better align the cost of delivering non-fire responses with the sources of funding. Requiring insurers to assess the FS Levy on all material damage policies (instead of just fire policies) would increase compliance costs in the short term. However, over time, costs would revert to current levels.

Even with a broader base, a levy on insurance suffers from several drawbacks. A recent White Paper on tax from the Australian Government[[4]](#footnote-4) stated that insurance levies are highly inefficient as they have the potential to discourage households from taking out appropriate levels of insurance (especially amongst demographic groups that are vulnerable to a significant loss, like those with little disposable income). It has also been noted that insurance levies increase the cost of production in industries that use insurance.

However, it is still possible that the FS Levy can be changed so that the equity of the model is improved and inefficiencies are minimised. To achieve this, there are a number of questions still to be answered, including:

* If a levy is to be collected on insurance contracts, should the collection mechanism be based on “sum insured” or the value of an insurance premium?
* How should the FS Levy be charged?
	+ a fixed charge where everyone pays the same fixed amount per property;
	+ a fixed rate where everyone pays the same percentage of their insurance cover; or
	+ a variable rate, where people in different situations (e.g. different risk of fire, higher cost of service etc.) are charged differently.
* Should the charge differ for the residential and other (commercial) sectors?
* Should the residential cap remain?
* Should a cap be introduced for other sectors (e.g. commercial and industrial buildings)?
* Should insurance companies and brokers be compensated for the costs of administering and collecting the FS Levy?
* Should the FS Levy be assessed on all property – including those currently exempted under Schedule 3 of the Act?
* Should the Commission retain the ability to charge for certain services and responses?

## The current FS Levy can be confusing to calculate and difficult to forecast

Under the status quo, calculating the FS Levy on indemnity value or sum insured creates significant uncertainty, and in some cases has resulted in reduced FS Levy payments.

One example that arises from the use of sum insured is first loss arrangements. Under First Loss arrangements, multiple properties owned by the insured party are covered under one insurance policy, and the amount for which the properties are insured is set at the maximum potential single loss. For example, an insurance contract for 10 properties, each worth $1 million, will have a maximum pay out of $1 million in the event of a fire even though the Commission needs to prepare to protect and deliver services to all $10 million of assets.

It is acknowledged that some insured parties have multiple and valid reasons for how they structure their insurance. However, first loss arrangements still result in smaller property owners paying proportionally more, effectively cross-subsidising the costs of major commercial and state sector property owners. These arrangements also make planning and funding the Commission’s operations more difficult.

The term indemnity value also creates uncertainty that has led to confusion and litigation about how FS Levy payments should be calculated. ‘Indemnity value’ is not defined in the Fire Service Act, and does not align with modern insurance contracts. One result of this uncertainty is that some non-residential property owners have had a different interpretation to the Commission about how the FS Levy should be calculated. Some non-residential property owners are using split tier[[5]](#footnote-5) or collective[[6]](#footnote-6) policies to pay a lower fire service levy but receive the same insurance cover as someone insured for the total amount.

The Insurance Brokers Association of New Zealand (IBANZ) sought a declaration from the courts about how the FS Levy should be calculated on split tier and collective loss insurance policies. The Supreme Court gave its judgment on 13 May 2015 in favour of the Commission, noting that “to the extent that s 48 [of the Act] can be interpreted to enhance the universality of the levy, that interpretation should be adopted.”[[7]](#footnote-7)

The decision addresses the effectiveness of existing split tier policies and will make it much more difficult to put in place effective collective policies. However, it is possible that other arrangements intended to minimise the levy may develop, because the legislation is not as clear as it could be. Further litigation may be necessary to settle disagreements about how the levy should be calculated.

## The FS Levy could be collected from the sum insured on property or the insurance premium

Under an enhanced status quo, the FS Levy could be collected on:

* the aggregate sum insured on all contracts for material damage which is the maximum amount payable under an insurance contract; or
* the premium on commercial and other insurance contracts which is the amount paid by the property owner for insurance cover.

Both are clear concepts that are widely used in modern insurance contracts. Both will also increase over time, and so will tend to keep pace with inflation.

The Insurance Council of New Zealand (ICNZ) has stated that a number of factors influence the size of insurance premiums. The risk insured is one of these determinants, although ICNZ states that this sits alongside how global financial markets (insurers’ investments) are performing, the cost of reinsurance, and other factors. ICNZ has noted that there has been a 10 per cent decline in gross written premiums in Australia in the last 18 months, and that a similar decline in New Zealand is possible due to the market being over-capitalised. ICNZ also note that premiums may vary on the basis of events that take place outside of New Zealand. This makes them inherently difficult to predict.

Table 1: Advantages and disadvantages of collecting insurance levies on sum insured or premiums

|  | Advantages and disadvantages  |
| --- | --- |
| **Premium** | + | * **Equity – risk of fire**: those who own properties that are more vulnerable to fire damage, and who therefore stand to benefit from more NZFS readiness and response capability, pay more. However, ICNZ has stated that premiums are influenced by a variety of other factors besides risk.
* **Horizontal equity:** more difficult to minimise FS Levy payments through insurance arrangements.
* **Non-distortionary**: people may be incentivised to reduce their fire risk.
 |
| - | * **Predictability**: insurance markets and especially premiums are difficult to predict. This volatility could affect the stability of the Commission’s funding base, and requires a more frequent adjustment to the FS Levy rate.
* **Horizontal equity:** where a company adopts a first loss arrangement, premium charges may be considerably lower per unit of building, and so the connection between the actual risk that the fire services must be prepared to respond to and the premium that is paid will be weakened.
 |
| **Sum Insured** | + | * **Cost effectiveness:** simple and relatively straight-forward to implement.
* **Predictability:** possibly more stable in the near-term than insurance premiums (although some volatility is still likely).
 |
| - | * **Horizontal equity:** more vulnerable to arrangements that minimise FS Levy.
* **Equity - risk of fire:** no link to risk of fire, so less aligned to risk compared to premiums. However, sum insured would still provide some indication of the level of potential loss. A high value of sum insured can indicate greater value of a response to a fire or other emergency in the non-residential sector.
* **Non-distortionary:** does not incentivise people to reduce their fire risk.
 |

Under both options, there is still the possibility that new FS Levy minimisation arrangements will be discovered and exploited. Whatever amendments are made to the regulatory framework, loopholes may be found that allow reduced payments under an insurance-based FS Levy.

General anti-avoidance rules (GAAR) could potentially allow the Commission to effectively address any future levy minimisation as they arise. In New Zealand GAAR, are currently available to the Inland Revenue Service under the Income Tax Act 2007. GAAR allow taxation authorities to deny the tax benefits of transactions or arrangements that do not have any commercial substance or consideration other than achieving the tax benefit. Under GAAR, tax authorities can assess arrangements that are not specified in law as being “unacceptable”. They therefore provide a means of addressing new and innovative arrangements.

However, there are several reasons why providing the Commission with GAAR powers may not be appropriate. Internationally, such powers are reserved solely to state taxation authorities, and no example has been found where a subsidiary government revenue-raising agency like the Commission has been assigned GAAR. Robust mechanisms (such as mandatory third party review or oversight) would be required to balance levy-payers’ rights and interests against any decisions and actions made by the Commission. Any GAAR would also need to be supplemented with detailed information about the characteristics and specific types of minimisation arrangements that exist.

It is therefore arguable that assigning GAAR powers to the Commission would be an unprecedented and likely out-of-scale response to potential levy minimisation issues.

## The FS Levy should be charged using a fixed rate

There are three options for charging the FS Levy:

* a fixed charge on both property and contents (e.g. $76 per insured property);
* a fixed rate on the sum insured or premium; and
* a variable rate that takes into account the characteristics of the insureds and the property (e.g. frequency of response to that insured, risk, the cost of service and ability to pay, type of property).

Table 2: Advantages and disadvantages of different methods of charging the FS Levy

|  | Fixed charge | Fixed rate | Variable rate |
| --- | --- | --- | --- |
| Advantages | * **Cost effectiveness:** simple to implement and understand.
* **Horizontal equity:** more difficult to minimise payments.
* **Equity – cost of service:** for residential properties, the cost of responding to fires is generally uniform, and does not vary greatly depending on the value of contents or property.
 | * **Cost effectiveness:** simple to implement and understand.
* **Non-distortionary:** under insurance could be avoided by capping payments at a fixed amount (i.e. the status quo for residential property).
* **Equity – ability to pay:** blunt measure of ability to pay.
* **Equity – costs of service:** for larger properties this can better address the costs of service.
 | * **Equity:** most equitable in terms of risk of fire, the cost of service and ability to pay.
 |
| Disadvantages | * **Equity:** least equitable in terms of commercial properties, value of the property, the cost of service, risk of fire and ability to pay.
 | * **Distortionary:** possible to reduce payments by reducing the amount that a property is insured for – though there are strong incentives for insureds not to do this.
* **Equity**: less equitable than the variable rate option.
 | * **Cost effectiveness:** very difficult for insurance companies to apply.
* **Predictability:** very difficult to forecast FS Levy revenue.
* **Horizontal equity:** the greater complexity may allow more opportunities for levy minimisation.
* **Non-distortionary:** the added expense of administering it would be passed on to insureds, potentially resulting in reduced insurance.
 |

In general, a fixed rate best balances the equity and cost effectiveness. The fairness of this option can be enhanced by considering the application of different rates for the commercial and non-commercial sectors, and capping overall payments for each individual insured.

## The FS Levy should be capped on residential property

Given that the majority of the Commission’s activities meet the definition of a public good, there is a strong case for people being charged a levy that is commensurate with their ability to pay. However, under the status quo, FS Levy payments are capped at a fixed level for residential properties. There are several reasons for this:

* property values are not always correlated with income, and a cap will help to protect those who are income poor and capital rich;
* those who live in high-value properties are frequently likely to have a lower fire risk than those who live in low-value properties; and
* a cap on residential FS Levy payments is arguably fairer, as the costs of attending emergencies at residential properties for fire services are generally similar.

The Swain report concluded that the current arrangement of a fixed rate up to a threshold “best matched the mix of private and public goods involved in the delivery of fire services”. However, housing prices have risen substantially since the current cap on residential payments was introduced in 1994. The Swain report considered that the $100,000 cap was inequitable. It effectively enforced a fixed charge funding scheme on the residential property sector.

If the same amount of FS Levy was to be collected from residential properties, raising the cap would reduce FS Levy payments for low-value residential properties (especially those whose properties are insured for less than $100,000) and increase payments for higher valued properties. There is a trade-off in equity in this proposal, because while it would be more reflective of people’s ability to pay, it would also mean that many of those who benefit the most from the NZFS’s response capability (low-income houses with a greater risk of fire) will pay less. Amending the cap would also likely involve some short term administration costs.

Given the public good nature of the NZFS’s response capability, it is considered that the advantages of a system that better recognises property value and the ability of property owners to pay outweigh the disadvantages. It is therefore proposed that, should the FS Levy be calculated on the sum-insured of residential properties,[[8]](#footnote-8) then the cap should be raised.

## Introducing a cap on the FS Levy for commercial properties involves a trade-off between equity and reducing evasion

A cap could also be introduced for FS Levy payments on commercial properties. Such a cap would involve the majority of commercial organisations being charged more, while the biggest commercial organisations will be charged proportionally less.

However, the commercial property sector is different from the residential sector in three ways:

* variance in residential property improvement values is relatively small (generally between $100,000 and $500,000) compared with commercial property values (a substantial proportion of total commercial assets is made up of properties valued at over $100 million[[9]](#footnote-9));
* residential property owners generally own one or two properties, while commercial property owners may have multiple properties across the country; and
* the cost of responding to emergencies at residential properties is generally fairly similar, while responding to emergencies at commercial properties can require specialised equipment and personnel, and can take a longer period of time.

These differences build a strong case for leaving FS Levy payments on commercial properties uncapped on equity grounds.

Table 3: Advantages and disadvantages of a cap on commercial FS Levy payments

|  | Advantages and disadvantages of different options |
| --- | --- |
| Cap on commercial FS Levy | + | * **Predictability:** may reduce incentives for larger commercial operators to attempt to find new ways to minimise their FS Levy payments, thereby increasing predictability and stability of funding and reducing future litigation (this is an issue that could potentially be mitigated separately through the introduction of anti-avoidance mechanisms).
 |
| - | * **Cost effectiveness:** a cap on payments complicates the administration of the FS Levy on commercial properties.
* **Equity - ability to pay:** a small number of larger commercial operations with more ability to pay will be subsidised by smaller commercial operators.
* **Horizontal equity:** the FS Levy burden is shifted from those properties whose values are increasing rapidly to those properties whose values are stagnant.
* **Cost to service:** larger operators will pay comparatively less despite the larger costs associated with servicing complex properties.
* **Risk of fire:** the FS Levy will less fairly reflect the global risk of fire for all properties across the country.
 |

## FS Levy rates should differ for residential and commercial properties

Under the status quo, where residential and commercial sectors are charged at the same fixed rate, the costs of the 4Rs associated with fires at residential properties amount to only 45 per cent of FS Levy revenue from residential properties.[[10]](#footnote-10)

Figure 1: Comparison of FS Levy revenues and NZFS costs associated with different property types

A 2014 study[[11]](#footnote-11) commissioned by ICNZ found that any uniform fixed rate on property values would lead to significant cross-subsidisation across sectors, and advocated separate rates on the basis of property type. A split fixed-rate system would allow a fairer allocation of costs across the sectors, resulting in a reduction in the FS Levy rate for non-commercial properties, and an increase for commercial properties.

The downside of charging different rates for the different sectors is that it would involve additional cost. The Commission would need to work with brokers and insurance companies to calculate the payments in situations where properties have a mix of commercial and residential purposes.

## Rural and urban revenue and cost of services

Some landowners, particularly those in isolated areas, consider that they pay more for the rural fire service than they receive because they pay a targeted rate for fire services to their territorial authority, on top of what they pay to the Commission through the FS Levy on their insurance. This varies across the country, because each territorial authority has a different approach.

The Swain report provides some information on the level of service provided to rural communities, and notes that the Commission provides good fire prevention advice. The Commission contributes to the rural fire sector, as it pays for the NRFA, pays grants to RFAs and contributes to the RFFF. NZFS brigades also attend the first hour at vegetation fires free of charge and attend structural fires in rural areas within practicable response times. As a result, those in rural areas paying the FS Levy receive services for their money.

## Compensating insurers for the cost of collecting and administering the FS Levy

If the FS Levy continues to be collected on insurance contracts, another issue is whether insurers and brokers should be compensated for the costs of collection and administration. ICNZ has reported that the aggregate costs for insurers of administering the FS Levy are $2.5 million per annum. It argues that an administration fee payable to insurers and brokers is justified given that the Earthquake Commission already pay insurers a 2.5% commission on the EQC levy collected by them.

While the Department acknowledges the costs associated with administering the FS Levy, we do not propose to allow insurers or brokers to collect a fee for the administration costs of the FS Levy. The treatment of the EQC levy is unusual in the New Zealand context. The IRD does not allow business to retain some GST to compensate them for administration costs, nor does the Accident Compensation Corporation allow collecting businesses to retain some levy to cover costs. Equally, the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 does not allow financial institutions to receive a fee from the Government for the costs of meeting their statutory obligations regarding the collection and verification of identity information.

The Department also notes that insurers and brokers are able to retain the money received for the FS Levy for 45 to 75 days from the start of the contract until it is paid to the Commission (this period will likely be retained under an enhanced status quo, even if new anti-minimisation tools are introduced). Brokers and insurers could therefore already be receiving interest on the FS Levy of $1.5-2.5 million each year.[[12]](#footnote-12)

## Charging for services and other revenues streams

The Commission has generally taken a light approach to charging for services other than false alarms, due to concerns that people might not call the NZFS when needed, and that the public relationship with the Commission might be diminished. Currently, the main sources of direct charges are false alarms, the monitoring of private alarms, and costs recovered from parties responsible for starting rural fires (which is contributed to by the Rural Fire Fighting Fund).

The Commission also receives revenue from other streams, the main element of which is good corporate citizen contributions[[13]](#footnote-13) ($2.3 million in the 2014 financial year). The Commission would still have the ability to charge and pursue these revenue streams under the enhanced status quo, where organisations wished to contribute in this manner.

If the current exemptions from the FS Levy listed in schedule 3 of the Act were to be removed, then the ability to charge for some services (e.g. attendance at hazardous substance spills) may no longer be required. However, a general power to charge would still be necessary for unforeseeable or unusual incidents (e.g. fires on marine craft).

## Transition period

The insurance industry would require a period of time between any policy decisions on these options and the implementation of an enhanced status quo. This transition period would be necessary, both for the development of systems to administer the FS Levy and for the education of the market (including the brokers, valuers and insureds). As a comparison, ICNZ have recently brought in a new insurance code for its membership. The compliance lead-in time before it takes effect is 6 months.

# Option 2 - Mixed funding model: combined Crown and insurance based funding

A mixed funding option would use the same FS Levy model outlined in option 1. However, it would also include:

* funding from the Crown to recognise the under-insurance of state sector properties;
* funding from the Crown to recognise the public good benefits of the remaining non-fire emergency services; and
* funding from motor vehicle registrations for motor vehicle emergency services (to replace the FS Levy on motor vehicles).

This option would help to reduce cross-subsidisation (primarily from the residential sector) to non-fire, state sector and local government uses of fire services. If the Crown were to make a contribution, the total amount of the FS Levy would decrease for other FS Levy payers by the size of that contribution. This would reduce risks of distortionary incentives in the insurance market.

At the same time, it would also likely have the highest administration costs of the two funding options, as the Commission would need to both:

* engage in the government budget process or with other state sector agencies; and
* administer the FS Levy.

## Collecting funding for attending fires at Crown properties

Despite benefitting from the Commissions’ activities, state sector agencies do not always take out full insurance cover as it is cheaper for them to carry the risk. As a result, their contribution to the Commission is not as large as it could be.

A Crown contribution to the Commission would reduce the FS Levy rate, and ensure that people who do not own property but benefit from public assets (e.g. schools, hospitals, public housing etc.) would contribute more to the Commission through taxation. However, this could also make a portion of the Commission’s funding subject to Crown budget decision-making, which could reduce the predictability of overall Commission income.[[14]](#footnote-14)

There are two main options for funding the coverage of state sector assets. Both options would involve state sector properties being made exempt from the FS Levy, and a government contribution to cover the Commission’s activities in relation to state sector properties.

Firstly, the agencies that benefit from fire services could make a contribution to the Commission. This contribution could be made in one of two ways:

* a direct charge to the main beneficiary of the services provided (the agency that receives the service, rather than the individual users of the service like schools and hospitals) – with the charge reflecting the average cost of the fire services’ activities (including a proportional charge for risk reduction, readiness and recovery) based on historical trends in cost data and the value of the assets that are covered; or
* charging all state sector agencies annually with a proxy for the FS Levy based on the value of the properties.

Alternatively, the Crown component could be funded from a lump sum appropriation from general taxation. The viability of all alternatives will depend on the availability of resources (existing or new) and the importance of competing claims on Crown funding.

Table 4: Advantages and disadvantages of options for a government contribution for state sector properties

|  | Advantages and disadvantages  |
| --- | --- |
| Agency contribution | + | * **Clarity:** better targeted at the direct beneficiary of the Commission’s activities.
* **Adaptability:** the funding base will grow in line with any expansion of the Crown’s risk that needs to be responded to by fire services (subject to the availability of agency funding).
* **Non-distortionary:** incentive for agencies to minimise fire risk.
 |
| - | * **Cost effectiveness:** more costly and difficult to administer. Likely to be opposed by affected agencies unless they receive additional funding to cover the costs.
* **Equity - cost of service:** depending on whether a charge effectively incorporates the costs of all 4R’s. It may not effectively reflect the fact that what is being funded is a capability and not a response.
 |
| Crown appropriation | + | * **Clarity:** provides a means of scrutinising Commission expenditure.
* **Cost effectiveness:** cheaper to implement and administer.
 |
| - | * **Non-distortionary:** incentives may not be as strong for individual agencies to coordinate their activities with the Commission to reduce fire risk.
* **Sufficiency:** subject to competing demands and priorities for Crown funding.
 |

## The public good element of fire services could be funded by a Crown appropriation

A significant portion ($84 million including responses to incidents involving motor vehicles[[15]](#footnote-15)) of the Commission’s costs can be allocated to non-fire related activities (including emergency management capabilities, responses to natural disasters, medical emergencies, hazardous substances and special services with the Police). Given the public good nature of NZFS’s readiness and response capacity for non-fire activities, there is a strong argument that they should be publicly funded. The costs of these functions could be recouped from a direct agency transfer or from a Crown appropriation as discussed above.

Table 5: Advantages and disadvantages of options for a government contribution for non-fire activities

|  | Advantages and disadvantages  |
| --- | --- |
| Agency contribution | + | * **Clarity:** better targeted at the state sector beneficiary of the Commission’s activities.
 |
| - | * **Cost effectiveness:** very difficult to implement and administer.
* **Clarity:** it is technically difficult to ascribe the contribution of individual agencies to non-fire activities.[[16]](#footnote-16)
 |
| Crown appropriation | + | * **Equity – public good:** better recognises the public good nature of the Commission’s capacity to respond to non-fire activities.
* **Clarity:** makes the size of the Government’s contributions to fire services more transparent.
* **Clarity:** provides a means of scrutinising Commission expenditure.
* **Cost effectiveness:** much cheaper to implement and administer than an individual agency payment.
 |
| - | * **Sufficiency:** subject to competing demands and priorities for Crown funding.
 |

A direct agency contribution (either through a charge or a levy proxy) is more appropriate for the Commission’s activities for Crown properties than it is for non-fire activities. However, in both cases there are substantial administrative difficulties involved with calculating and agreeing on how many individual agencies should contribute. Regulations and guidelines would need to be established for to set out how the charge could be applied.

Under both options, there is a risk of “cross-subsidisation”, where funding from the Crown – ostensibly for state sector assets and non-fire activities – is utilised for the activities of the Commission that should be funded by the FS Levy. This risk could be mitigated through a reformed funding review process that supports more robust and transparent business planning. This would require the Commission to adopt improved information management and event recording methodologies, to allow effective analysis of trends in its activities.

Further, should the state sector contribution be funded through a Crown appropriation any funding would need to be sought through the Treasury, the Minister of Finance and Cabinet. This would provide an opportunity to scrutinise what services are being provided by the Commission, and how much funding is required.

## Funding the Commission’s motor vehicle response activities

The status quo for motor vehicle response activities involves the FS Levy being collected on comprehensive motor vehicle insurance contracts. A survey of 4,000 New Zealanders found that only 80 per cent had comprehensive insurance, indicating that there is a moderate free-rider problem.

Extending the FS Levy to third party motor vehicle insurance contracts has been suggested (which would increase coverage to roughly 93% of the market). However, people who purchase third party motor vehicle insurance generally do so because they are unable to afford comprehensive insurance. Charging the FS Levy on third party contracts could therefore increase under or non-insurance for a segment of the market that is reported to have a higher risk of being involved in accidents. It is considered that the distortionary effects of increasing the costs of insurance would outweigh any equity benefits from doing so.

Therefore, two main options are being considered for funding the motor vehicle related costs:

* funding from a flat annual charge on annual vehicle licensing (commonly known as “rego”); or
* a transfer from road tax revenue under section 9 of the Land Transport Management Act.

A charge on vehicle licensing would require the Commission to become an approved organisation with the NZ Transport Agency. Funding from road tax revenue would require an amendment to section 9 of the Land Transport Management Act to allow revenue to be spent on the Commission’s motor vehicle-related activities.

Both options would ensure that funding would be collected from a wider funding base –helping to address the free-rider problem.

Table 6: Advantages and disadvantages of options for a contribution for motor vehicles

|  | Advantages and disadvantages  |
| --- | --- |
| Rego charge | + | * **Non-distortionary:** a small (estimated at roughly $10 [[17]](#footnote-17)) increase in licensing fees would be required.
* **Clarity:** makes the cost of the Commission’s activities more transparent to the public.
* **Horizontal equity:** ensures that the beneficiaries of the Commission’s activities contribute to costs.
 |
| - | * **Cost effectiveness:** the transition and ongoing costs of adjusting the NZ Transport Agency’s revenue collection model could be significant.
* **Adaptability:** an increase in licensing fees would be under greater public scrutiny, potentially reducing adaptability.
 |
| Road tax | + | * **Cost effectiveness:** would likely involve lower administration costs because of the existing funding administration and distribution process.
* **Horizontal equity:** road taxes have a better risk profile of what is a heavy vehicle and what is not.
* **Adaptability:** is more adaptable if the Ministry of Transport is supportive of the fund being used for Commission activities.
 |
| - | * **Sufficiency:** would require either prioritisation from existing spending or an increase in road user charges and fuel excise duty.
 |

# Discarded options

## A property-based levy

The Swain report assessed a funding model where local government would collect a levy on the value of improved property. Over the past 20 years, many Australian states have moved from collecting a levy on insurance to collecting a levy on property, and some stakeholders have suggested that New Zealand should follow suit.

### Advantages of a property-based levy over an enhanced insurance-based option

A property-based levy would have some advantages. A levy on property values would provide a stable funding base that would increase with the rising value of property. This option would also avoid distortions to the insurance market, potentially increasing incentives for people to insure their properties and ensuring that those that choose not to insure, still pay the levy. Furthermore, a property-based levy could avoid certain administrative problems with an insurance-based levy.

### Disadvantages of a property-based levy compared to an enhanced insurance-based option

However, after detailed consideration, the Panel determined that the property-related funding model had significant shortcomings in the current New Zealand context.

The trend of Australian states moving to a property-based levy is cited as an example of why New Zealand should do the same. However, the main reason why Australian states have made this decision is because of significant under-insurance and non-insurance in Australian property markets (when West Australia moved to a property-based levy in 2002, it was noted that as many as one third of Australian properties were not insured).

However, in New Zealand insurance premiums are generally lower than in Australia, and rates of non-insurance are lower (between 1 to 10 per cent). Therefore the primary benefit of moving to a property-based levy (reduced ‘free-riding’) is likely to be smaller in New Zealand.

While the funding base for property is stable, it is also narrower than for the FS Levy. A property-based levy would not cover motor vehicles, and large classes of property currently subject to the FS Levy on contracts of fire insurance are also exempt from rates (e.g. Crown property, churches and marae).

The narrower funding base would also exacerbate current equity issues regarding the use of the Commission’s activities. NZFS responses relating to motor vehicles and exempted properties would still need to be cross-subsidised by property owners.

Local authorities are also likely to be opposed to a property-based levy, on the basis that it will be perceived as an increase in rates. Local authorities will also likely object to the fact that they are required to collect funding when they have no say in how it is to be spent. Any mechanisms that do provide local authorities with some say in how funding is spent, will undermine the advantages of a centrally managed fire service.

Another problem with the property-based levy is that it would reduce the adaptability of funding relative to the insurance-based FS Levy. Local authorities are under pressure to keep their rates in check (both from their rate payers and central government) and, as a result, changing the levy to match the needs of the Commission would be difficult.

Finally, there would be significant transitional costs with a move to a property-based levy. A new system for collection and administration would need to be set up with local authorities (each of which construct and maintain their rating databases separately). Implementing a consistent rating basis and revenue collection by local authorities would involve significant costs relative to the status quo.

For these reasons, the Department supports the Panel’s finding that a property-based levy suffers from significant problems and does not consider it as a funding option in the discussion document.

## Funding from general taxation

Under this option, all of the Commission’s funding would be sourced from Crown revenues (these largely comprise tax revenues).  The level of funding for each year would be agreed in advance by Ministers and appropriated by Parliament through the annual Budget process. This is how most Government departments and many Crown entities are funded.

The Panel did not consider funding from general taxation as it was outside of scope of the Panel’s terms of reference. However, funding from general taxation generally scores well on our criteria for funding reform. This option scores strongly on horizontal equity by ensuring that all taxpayers are required to contribute and removing the current opportunities for levy minimisation.

Funding from general tax would also be highly cost effective, as the government would be able to leverage its existing tax revenue collection capabilities. Funding decisions would be subject to Treasury scrutiny, potentially increasing Commission accountability and efficiency. Finally, funding from general taxation would be relatively stable and predictable when compared to options like an insurance-levy on premiums.

This option would require a large annual appropriation (the current FS Levy raised $339.44 million in 2013/14) funded out of Crown revenues. Ministers have decided that the Government will not pursue further investigation into this option as part of this review process.

Appendix: Discussion of the strengths and weaknesses of the NZIER’s reports on the Fire Service Levy

In 2013, the report of the Independent Fire Review Panel (the Swain report) was released. The Swain Report stated that the current funding model has “much to commend it” and suggested small changes to the status quo (including moving the insurance levy to charge insurance premiums on all contracts of material damage).

The Insurance Council of New Zealand (ICNZ) independently commissioned NZIER to identify alternatives to the Fire Services Levy. The NZIER released two reports (the first was released in April 2013 and the second in May 2014). The first NZIER report, Better ways of funding fire services in New Zealand, noted that:

* Australian states are moving from insurance-based funding models to a levy on property values to address equity issues raised by under-insurance;
* the broadened scope of the NZFS, and the declining number of fires, means that the link between the current funding and fire services is increasingly tenuous; and
* uncertainties and loopholes in the current levy allow major asset owners to arrange their affairs in order to minimise their levy payments.

The second NZIER report, *Funding the Fire Service Levy on commercial real property*, used data from the insurance industry and property values information from CoreLogic to test the implications on the commercial sector of moving to a property rates based levy. This report concluded that:

* given the precedent set by Australian states, New Zealand should move to a property rates based levy;
* it is possible to construct levy regimes that do not increase costs for any commercial property owners, and which reduce costs for owners of higher value properties compared to current FS Levy payments; and
* for commercial property, the levy should be collected using a dual-rate system (with an initial rate similar to the current insurance-based levy, and a lower rate for property values above a set threshold – e.g. $10 million).

Both NZIER reports advocated moving to either a fully Crown-funded Fire Service or to a levy on property values using existing collection agencies (local authorities). The NZIER considered that a property-based levy would be considerably fairer, more transparent and cost-effective than the status quo.

The NZIER reports have a number of strengths. Their analysis of options for funding the fire service in the first report is based on strong and widely recognised tax design and administration principles. The first report also includes discussion of analogous levy regimes (such as the Australian fire levies, and the ACC mixed funding model), and assesses a range of potential options. The report also provides strong analysis on a number of the weaknesses with the current levy regime, such as the problems with the current cap on residential properties (i.e. the fact that the cap has not been adjusted since 1994).

The reports are also strong in their quantitative analysis of property values and their implications for alternative levy regimes. The first report uses data on residential properties to test the implications of different charging regimes (e.g. a fixed charge versus a fixed rate with a cap). The report clearly and concisely identifies the potential winners and losers associated with each option.

Likewise, the second report utilises strong data for its analysis. The report provides valuable analysis of how trends in property values differ across the residential and commercial sectors. This analysis provides the basis for its conclusion that charging a single levy rate for both sectors will necessarily overcharge/undercharge one of them.

However, the Department disagrees with the NZIER’s analysis in several areas.

Firstly, the NZIER report cites Australian states as an example of a foreign jurisdiction that is abandoning an insurance-levy. However, the main reason why Australian states have made this policy decision is because of significant under-insurance and non-insurance in Australia (as noted by the 2011 report by Deloitte cited in the NZIER report). In New Zealand, insurance premiums are generally lower than in Australia and rates of insurance are higher (between 90 to 99 per cent – similar to compliance with rates payments). Therefore the primary benefit of moving to a property-based levy cited in the Deloitte report (reduced ‘free-riding’) is less likely to eventuate in the New Zealand case.

The NZIER report also asserts that a property-based levy will be “simpler to administer”, and considers it a more cost-effective option than the status quo. However, the report gives little consideration to the administrative issues associated with working with local authorities, all of which have their own property database. The Department has assessed likely costs of between $3.3 and $6.6 million – at best little improvement over the costs for administering the status quo (estimated at 1 to 3 per cent of the levy revenues by the NZIER based on ICNZ data).

The NZIER reports also do not sufficiently consider the implementation issues associated with a property based option. The Swain report notes several practical issues with a property-based levy that led to it being rejected as a policy option, including:

* the funding base for property is narrower than under the status quo (there are numerous classes of property subject to the current levy that are exempt from rates – e.g. Crown property, churches, marae etc.) – while the second NZIER report does consider extending a rates-based levy to these properties, it does not discuss the likely transaction costs (including ratepayer confusion) of doing so;
* local authorities will likely be opposed to what will be perceived as an increase in rates, when they have no say in how this funding is spent;
* local government has already been encouraged by central government to restrict its focus to its core activities;
* because local authorities are under pressure to keep rates in check (both from their rate payers and central government), changing the levy to match the needs of the Commission will be more difficult; and
* there will be significant transitional costs. A new system for collection and administration would need to be set up with local authorities (each of which construct and maintain their rating databases separately).

The first NZIER report asserts that a property-based model would offer improvements in terms of transparency. However, Local Government New Zealand has repeatedly expressed concerns that there are significant transparency issues with this option. In particular, local government has stated it would not wish to take responsibility for collecting funding for a service it neither owns nor is accountable for, and would be uncomfortable with the fire service levy appearing to be part of local authorities rating charges.

It is true that such accountability issues also exist for insurance companies. However, the Department does not consider that the accountability issues of the status quo should be used as the basis for shifting to a property-based levy, when the alternative suffers from similar problems. Instead, this is an issue that can be better addressed through a stronger funding-cycle review process, in conjunction with the reforms to governance and support that are proposed as a part of the wider review.

Finally, the NZIER report is focused on analysing alternatives to the current insurance-based levy, and does not consider whether potential options may exist to improve the performance and fairness of an insurance-based levy.

The first NZIER report briefly notes the Swain recommendations to collect the levy from insurance premiums on contracts for material damage. However, it does not test the Swain Report’s recommendations against NZIER’s own assessment criteria or its own main alternatives. Instead it notes that the Swain recommendations would make it more difficult to move away from an insurance-based levy, which is not in itself a reason to reject the Swain Report’s findings.

The first NZIER report also states that the Swain recommendations would not necessarily ensure a funding base that reflects the risk of fire. However, a charge on property values – the NZIER’s preferred option – would also fail to reflect the non-property related activities of the Commission.

For these reasons, the Department does not agree with the NZIER’s conclusion that a levy collected on the value of property by local authorities represents the next best Commission funding option after Crown revenue.

1. A public good is a good that is experienced by everyone (non-excludable) and one person’s experience or use of the good does not detract from another’s (non-rival). Generally, public goods should be funded by the community as a whole (e.g. through general taxation). [↑](#footnote-ref-1)
2. A private good is a good that benefits an individual or group that others can be excluded from, and which can be fully consumed by the individual (rival). There is a strong case for recovering the costs of a private good from the individual who consumes it. [↑](#footnote-ref-2)
3. Principles have been incorporated from the Treasury’s *Guidelines for Setting Charges in the Public Sector*, and the American Institute of Certified Public Accountants *Guiding Principles of Good Tax Policy: A Framework for Evaluating Tax Proposals.* [↑](#footnote-ref-3)
4. *Re:Think – Tax discussion paper,* the Australian Government, March 2015. [↑](#footnote-ref-4)
5. Where one contract covers fire risk and is subject to the levy, and another contract covers all other risks and is not subject to the levy. [↑](#footnote-ref-5)
6. Where a first loss contract is held by a collective of property owners. [↑](#footnote-ref-6)
7. *New Zealand Fire Service Commission v Insurance Brokers Association of New Zealand Incorporated* [2015] NZSC 59 at [24]. [↑](#footnote-ref-7)
8. If the levy for residential properties were to be based on premiums then the implications for equity would be different, as the levy would factor in risk (to some extent) in the pricing of the premium. [↑](#footnote-ref-8)
9. *Funding the Fire Service Levy on commercial real property*, NZIER, 9 May 2014 [↑](#footnote-ref-9)
10. *New Zealand Fire Service – Report on Expenditure and Service Delivery*, MartinJenkins – commissioned by the Department of Internal Affairs, 17 March 2014. [↑](#footnote-ref-10)
11. *Funding the Fire Service Levy on commercial real property*, NZIER, 9 May 2014 [↑](#footnote-ref-11)
12. Based on a $350 million levy base and a 3.5% interest rate. [↑](#footnote-ref-12)
13. These contributions come from organisations which have no strict liability for levy under the Act, but who still choose to make a voluntary contribution to the NZFS. [↑](#footnote-ref-13)
14. This would depend on the manner in which funding is based. If there was a legislative amendment to require funds for some NZFS activities be derived from appropriations (as is the case for the Non-Earner’s Account for the ACC) then there would be far greater predictability and stability of funding from the Crown. [↑](#footnote-ref-14)
15. *New Zealand Fire Service – Report on Expenditure and Service Delivery*, MartinJenkins – commissioned by the Department of Internal Affairs, 17 March 2014. [↑](#footnote-ref-15)
16. *Understanding the New Zealand Fire Service’s Contribution to Non-fire Outcomes*, Martin Jenkins, March 2010. [↑](#footnote-ref-16)
17. Based on the cost to the Commission of motor-vehicle related incidents (approximately $34.1 million) and the number of licensed motor vehicles in New Zealand. [↑](#footnote-ref-17)