
March 2018 Monitoring Report

Introduction

For the March monitoring report our focus is on funding, not just funding of council expenditure but rather funding of the different services which communities expect to receive from the public sector whether central government or local government.

This shift in focus is proposed so that discussion can concentrate on affordability for services as a whole rather than be distracted by the often unhelpful suggestion that somehow a different part of the public sector has the resources needed to deal with current funding problems.

In local government this has been exemplified by the quite common suggestion local government's funding problems would be resolved if only central government would do as happens in a number of other jurisdictions and share one or more of its major taxes (income tax, GST) with local government. Leaving aside the reality that revenue sharing arrangements in other jurisdictions have their origins in different allocations of responsibility and different histories from those in New Zealand, too often the suggestion is made here without any serious consideration of the impact not just on central government revenue but on central government spending.

Context

Both tiers of government, central and local, are facing very significant fiscal constraints. Local government faces significant demand for further investment in infrastructure, some renewal, some new investment. Growth councils, especially the so-called golden triangle, are both running up against their borrowing limits, and facing the need to raise billions of dollars for infrastructure investment. Some at least are proposing rates increases very significantly above the rate of inflation and likely to face strong resistance from ratepayers. Other councils, with static or even declining rate bases face a different but related problem, the challenge of maintaining existing infrastructure to acceptable standards often after years of relative underinvestment.

Central government, under the current coalition government, appears to be discovering that it has inherited major areas of underinvestment for example in health and education. It seems likely it will run into very difficult choices between ensuring services can be delivered to the standard it regards as necessary and remaining within its stated fiscal parameters including reduction of debt over time to 20% of GDP.

Policy response

Within local government the principal policy response over a number of years now has been to argue that dealing with the sector's infrastructure investment will require a new source of funding to supplement rates. Most commonly suggested is a share of one or other of central government's major taxes.

What is not being considered alongside that suggestion is how central government would then manage its own expenditure and investment requirements.

The practical reality for at least the short to medium-term looks likely to be that both parts of the public sector will be struggling to identify additional sources of revenue adequate to meet the demands they currently face, at least using conventional approaches.

This suggests first that it is now timely for the two parts of the public sector to take much more of a joined-up approach to considering what are spending priorities for the communities they both serve. Doing so will require major changes of approach both in attitude, and in how each sector has traditionally managed its own expenditure and investment planning.

Secondly it suggests that local government will need to find unconventional answers to the question of how raise the capital and ongoing operating cost required to meet infrastructure needs.

A possible option

The major pressures on local government are a consequence of significant growth in population and economic activity primarily within the golden triangle of Auckland, Hamilton Tauranga but also in some other councils.

One approach under consideration is what is known as value capture. This is an approach which targets those properties within the district of the Council the value of which increases more than proportionately as a consequence of infrastructure investment. The argument that property owners benefiting from infrastructure investment should be required to contribute appropriately to the cost is an approach which has been used, for example, in London to assist with the cost of significant transport investment.

A review of the publicly available material on the Transport for London approach to value capture suggests that it is both complex and potentially quite controversial.

This monitoring report argues that at least in New Zealand there is a simpler approach already available and one which would be capable of raising significantly more revenue over time than the value capture approach in use in London and elsewhere.

The argument starts with the proposition that the same forces which have driven the need for major infrastructure investment are also responsible for very significant increases in the value of property in growth councils over the past 5-

10 years - approaching 100% in Auckland over the past decade and in the order of 60%, 70% for other growth councils. As a matter of principle, it seems logical that the cost of investing in the infrastructure required as a result of growth should be recovered at least in part from the increase in value which property owners have received as a consequence of that same growth.

Given public attitudes to the impact of rates on the cash flow of most ratepayers, it would be difficult to impose a significant value capture levy across all property owners if it was to be paid out of their current cash flow. Rating legislation allows an alternative albeit one which has not been previously used in New Zealand. What follows is a brief description of the approach which a Council could use.

A Council could impose a targeted rate on all rateable properties within the district to raise (say) 1%-2% of the rateable value. On average this would represent somewhere in the order of 3%-5% of value growth over the past 10 years. Rather than requiring immediate payment, the Council could instead allow ratepayers to defer payment without penalty until the earlier of (say) sale of the property or 20 years from the date of striking the rate.

This could be accompanied by a sliding scale remission policy so that people who sold within (say) the first five years would pay a lesser amount.

The immediate result would be the creation of a significant asset, the unpaid targeted rate, the net present value of which would be included in the calculation of a Council's net debt position (this has been canvassed orally with the local government funding authority), as well as an additional revenue stream, payment of the targeted rate as properties were sold.

This is an approach which would require careful development and also need quite strong leadership on the part of councils in gaining the support and understanding of their communities.

It's put forward for consideration two reasons. First because given the fiscal situation of both parts of the public sector, it's extremely difficult to see any practical solution within the use of existing instruments. Secondly there is for growth councils a clear relationship between the need for significant infrastructure investment and the very major value growth which most property owners have enjoyed.

In an ideal world this would be put forward as part of an overall package in which amongst other things central government worked with local government to resolve not just the problems facing growth area councils but those of others as well which may not have the same scope to use this type of approach.

Conclusion

This proposal is put forward recognising that it is somewhat radical but also recognising that given the fiscal position of both parts of the public sector, solving the infrastructure funding problems for growth area councils will require a radically different approach from the use of conventional instruments in a conventional way.