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Auckland Council submission

New Zealand Productivity Commission Local government funding and financing: Issues Paper

26 February 2019

Auckland Council's submission on the Productivity Commission's issues paper on its local government funding and financing inquiry

1. Auckland Council welcomes the opportunity to make a submission on the Productivity Commission's (the Commission's) issues paper. The council looks forward to the opportunity to make further submissions in response to the Commission's draft report on the local government funding and financing inquiry due to be released in June 2019.

2. This submission has been approved by the council's Finance and Performance Committee. The address for service is Auckland Council, Private Bag 92300, Victoria Street West, Auckland 1142.

3. Please direct any enquiries to Matthew Walker, Group Chief Financial Officer, at matthew.walker@aucklandcouncil.govt.nz and/or on 021-229-4094.

Introduction

1. This submission sets out the council's views on the key financing and funding challenges as identified in our 10-year Budget 2018-2028, Auckland Plan 2050 and our 30-year Infrastructure Strategy. Commentary is also provided on some of other issues that are not covered by those documents.

Executive summary

2. Auckland is going through a period of economic and population growth that is placing demands on our ability to sustain services levels and to provide the new infrastructure to support this expansion. At the same time our communities' service level expectations are rising and our costs are increasing faster than the CPI. The council cannot access all the capital to meet these investment demands without facing substantially higher interest costs and its primary funding source is constrained by the community's strong preference for low rates increases.
3. In 2018 the council partnered with Fulton Hogan and Crown Infrastructure Partners (CIP) for CIP to finance the additional infrastructure needed to progress the Milldale development. The council is continuing to work on new ways to partner with others to fund and finance infrastructure within the current legislative environment building on the success of Milldale. Done successfully this will enable more development areas to be supported earlier. We will continue to work with central government on the Urban Growth Agenda and changes to legislation that would support these kinds of arrangements.
4. The government benefits from increased income tax and GST revenues arising from council investment in economic development, e.g. the Americas Cup and visitor attraction whereas the financial returns to the council are low. Despite the benefits to the region most ratepayers gain little and are unwilling to fund it. Accordingly, there is a strong case for the council to have access to some of the tax gains from this investment and/or the government funding a greater share of the required investment. In addition the council would like the ability to set some industry specific charges like bed taxes as in these circumstances they are superior to our targeted rates mechanisms for recovering some of these costs.
5. The council also considers there is scope for the government to make changes to enhance existing funding tools; rates, development contributions and New Zealand Transport Agency (NZTA) subsidies. Useful changes could include:
    - allowing the regional fuel tax and development contributions to be set based on broad future funding intentions rather than specific identified projects that limit the council's ability to respond to the development market and changing transport priorities
    - amending NZTA subsidy level rules to reflect the agreement on the share of local and central government funding in the Auckland Transport Alignment Project (ATAP)
    - provide the council with greater information gathering powers to establish how properties are being used so rates can be set fairly. At present ratepayers aren't required to advise the council on how they are using their land.

Financing and funding challenges

Infrastructure and investment demand

6. Auckland continues to experience strong population and economic growth. It is estimated that the Auckland region has a current shortfall of around 35,000 dwellings to meet demand for housing. A further 313,000 dwellings and work places to support over 250,000 jobs will be required by 2050 to meet expected growth.
7. To support this development the council's 10-year Budget, covering the period 2018-2028, has a capital programme of over $26 billion. This investment is not, however, sufficient to enable all the future urban areas to be developed or all of the intensification projects to proceed immediately. The council has had to necessarily prioritise and sequence its investment meaning that some infrastructure challenges are still to be addressed.
8. The cost of infrastructure is rising as the cost of land and construction costs increase beyond the CPI. In addition, the cost of providing for consequential operating expenditure is increasing as our investment in infrastructure expands. At the same time the community's level of service expectations are growing.
9. In particular the cost of transport investment is rising as construction is conducted with greater attention to management of environmental issues and worker and public safety. Councils experiencing higher growth also face proportionally higher road maintenance costs than more stable regions arising from the heavy vehicle movements associated with construction activity.
10. As New Zealand's premiere city the council is taking responsibility for hosting key events like the America's Cup and major sporting contests. These and other economic development initiatives require the council to make substantial investment and expenditure commitments. The benefits of this expenditure extend beyond the Auckland region, have little impact on our rates revenue and aren't felt directly by most ratepayers, particularly those on fixed incomes. However, the primary source of financing and funding remains general ratepayers.
11. Beyond the infrastructure demands required to support growth the council also has to deal with the pressure growth is placing on existing services and systems, in particular transport and the environment.
12. In transport, almost 25 per cent of Auckland's arterial roading network is now congested in the morning peak compared to 18 per cent less than four years ago. Congestion outside peak times and on weekends is also becoming more frequent with over 10 per cent of the network now experiencing inter-peak congestion. Auckland has also seen a near-doubling in road deaths and serious injuries over the past five years.
13. Auckland's growth is placing increasing pressure on the environment. Marine and freshwater sites have been polluted by sediments and contaminants arising from development, building and industrial activities. Continued investment is required to manage the development of 15,000 hectares of future urban land identified in the Unitary Plan and intensification in the existing urban area.
14. Climate change will also place pressure on our transport and three waters assets. We are already seeing increasing problems with coastal assets, such as sea walls, being severely damaged during storms and roads such as Tāmaki Drive are experiencing inundation on a more regular basis. The SOLGM submission identifies the direct costs to council's at between "… $1-$3 billion for roads and three waters." SOLGM notes that "… while these are significant on their own these may be dwarfed when the process of managed retreat begins."

Financing

15. The council's lack of debt headroom is the primary constraint on our ability to provide the infrastructure to meet the demands identified above. The council has a credit rating of Aa2 and AA from Moody's and Standard & Poor's, respectively. Borrowing beyond our debt ceiling – which the council is very close to – would risk a downgrade to the credit rating, meaning a higher interest costs across all our borrowing and a reduced ability to access capital markets. A downgrade in Auckland Council's credit rating could also impact on the credit rating of the Local Government Funding Agency (LGFA) thus also impacting the borrowing costs of all other councils that raise funds through the LGFA.

Funding

16. Even if we could raise the debt to finance all the required investment the council is likely to face constraints in generating the on-going funding to support additional borrowing. Rates (including targeted rates) are a highly visible form of tax that account for 46 per cent of funding for Auckland Council. Control of its own source of taxation gives local government in New Zealand a larger degree of autonomy than is the case in many other systems of local government, but this comes with a greater degree of accountability to local communities.
17. The community has expressed a strong preference for lower rates increases. The 10-year Budget has set rates limits of 2.5 per cent for 2018/2019 and 2019/2020 and 3.5 per cent for the remainder of the period. It is not certain that the community, and future councils, will support 3.5 per cent increases when incomes are not rising at this level.
18. As part of the 10-year Budget the council consulted on targeted rates[1] set, on capital value, to fund additional investment in improving the quality of Auckland's waterways, harbours, beaches and environment. This provided for a more informed discussion with the community about increasing the rates take to meet these investment needs. The community supported these changes and they were adopted as part of the 10-year Budget.

Solutions

19. The Auckland region and the council need access to new financing arrangements and a broader range of funding tools to enable the investment required to maintain service levels for the existing population and provide the infrastructure needed to support future growth. Legislative change and a continuation of the government's involvement in infrastructure financing and funding are required to enable provision of the capital to unlock the region's potential.

New sources of financing

20. Limits on the council's ability to borrow mean that new sources of financing are required to support the investment required to accelerate Auckland's growth and speed up housing development. An example of this is the partnership the council, Fulton Hogan and Crown Infrastructure Partners (CIP) entered into for the Milldale development. The arrangement used capital from CIP along with debt obtained by CIP in the private market to fund the additional investment required for the project to proceed. Fulton Hogan and subsequently new house buyers will pay this back over time via an infrastructure payment to be collected by the council and recorded on their rates invoices.
21. The council is continuing to work on new ways to partner with others to build and finance infrastructure within the current legislative environment. Done successfully this will enable more development areas to be

[1] Water quality targeted rate and Natural environment targeted rate.

supported earlier. We will continue to work with central government on the Urban Growth Agenda and changes to legislation that would support these kinds of arrangements.

Regional fuel tax and NZTA transport funding

22. To manage the demands for greater investment noted above within these revenue constraints the council replaced the Interim Transport Levy, a targeted rate set per separately used or inhabited part of the rating unit[2], with a regional fuel tax developed in conjunction with central government. The regional fuel tax provides a stronger connection between those paying and road users. Raising the cost of driving also serves to provide incentives to reduce pollution and congestion. However, there are concerns that the higher cost of fuel most impacts on those on lower incomes for whom fuel makes up a greater proportion of expenditure and who are likely to live in areas further from main centres and in areas with less transport options.
23. In conjunction with the introduction of additional funding from the regional fuel tax the council and government agreed on a package of transport investments through the Auckland Transport Alignment Project (ATAP). The joint ATAP announcement identified the funding sources for the package of projects. This funding package was identified, however, at a high level and how individual projects would be funded was not specified. The current settings of both co-funding levels and qualifying activities in the Government Policy Statement on Land Transport are not sufficient to support the funding set through ATAP. Additionally the timeframe for business case approval means that the council cannot plan in advance for NZTA funding with any certainty.
24. Consideration should be given to amending NZTA transport funding decision making rules to reflect the funding commitments that the government and council have agreed in ATAP. Without these changes some agreed priority projects may not proceed and committed funding could go unspent.

Funding economic growth

25. The council would have better incentives to invest in economic development activities like the America's Cup, major events, stadiums, cruise ship infrastructure and innovation if it had access to some of the resultant tax take gains. These investments increase economic activity and raise the tax take. Central government should consider taking a greater role in funding this kind of development and considering whether the council should have access to a wider range of funding tools better linked to economic activity like a bed tax as discussed below.

National approach to managing impacts of climate change

26. Councils will likely require government support to make infrastructure networks resilient to climate change. It is more certain that some councils and communities absorbing the impact of managed retreat will be beyond their capability. The council supports the Society of Local Government Managers submission which suggests the government develop a national framework for addressing the impact of climate change and determining how the impacts on affected communities will be managed.

Amendments to development contributions legislation

27. Current growth funding tools like development contributions are limited in their scope. Development contributions can only require developers to pay a share of costs of infrastructure investments required to service growth. Many of these projects would not proceed without the demands of growth but the cost of funding the wider benefits from these investments fall to ratepayers. Legislation requires development

[2] A separately used or inhabited part of a rating unit includes both the main house and granny flat and treats each shop in a shopping mall separately.

contributions charges to be supported by detailed planning at a project level over a 10-year horizon. However, Auckland has a wide range of potential development areas and effective prioritisation of scarce capital has to be responsive to the market.

28. The council supports the proposed amendments to development contributions legislation in the Local Government (Community Well-being) Amendment Bill. This amendment would restore the Council's ability to collect development contributions to fund a broader range of community infrastructure (including, for example, public swimming pools and libraries). These facilities are demanded by new communities and include a growth component. They add value to land and developments. Restoring the ability to fund these activities with development contributions would reduce pressure on other funding sources.

29. The council also seeks the ability to levy development contributions for the provision of public infrastructure not owned by the council for which we have funding liability or provided on land we don't own. This would allow for developments in partnership with community groups and private providers for infrastructure beyond the traditional council owned and operated model. New ownership and operation models may bring better community outcomes, provide another vehicle for introducing outside capital and offer the potential for operating efficiencies.

Amending rating legislation to support use of targeted rates to fund growth infrastructure

30. Targeted rates may allow the council to broaden the funding base for infrastructure investment without having to call on general ratepayers. Targeted rates can provide an incentive to develop land, depending on the timing, and deliver greater revenue certainty for the council than alternatives such as development contributions. However, these advantages come from the element of compulsion inherent in rates. Broader implementation of targeted rates within the current rating legislation may provider a broader based revenue stream but is likely to be resisted by some land owners.

31. To support the development of third-party financing of infrastructure investment noted above and the council's wider use of targeted rates to fund growth infrastructure we are seeking amendments to rating legislation. However, the current rating legislation is designed for the application of general rates. The changes the council is seeking are intended to provide more flexibility in the design of rating schemes to fund infrastructure.

32. The changes sought for targeted rates to fund growth infrastructure (not to apply more widely) are:
    - ability for set a rate for more than one year - providing future funding certainty
    - ability to set a rate at any time during the year rather than only in June as part of an annual or long-term plan – as agreements with developers/financiers would not necessarily follow the Council's planning cycle
    - allowing rates liability to be based on valuations reflecting the council's future commitment to infrastructure investment as opposed to the use that land can be put to currently – current rating valuation rules require land to be valued on its best current use. Until such time as infrastructure is available some land in development areas may not be valued in accordance with the benefit it has received from commitments to invest in infrastructure. This change would ensure that if land value was used to apportion the cost of future infrastructure it was shared fairly between land owners
    - provision for rates liability to be incurred by subsequent purchasers at purchase rather than existing owner occupiers – providing the council with a means of managing the potential immediate impact on benefiting land owners who are not able or willing to realise the benefits of infrastructure investment
    - provision for the liability for future rates to be recorded on a land titles – to ensure purchasers are aware of the additional liability.

33. More detail on the council's position on infrastructure financing and funding is set out in the Additional Supporting Information, Section 7.2 Financing growth infrastructure, that was part of the consultation material for the draft 10-year Budget 2018-2028, see Attachment One.

Other funding commentary

Taxation relationship with government

34. The Local Government New Zealand (LGNZ) and SOLGM submissions raise the issue of the application of GST to rates and the Crown's exemption from rates and development contributions. The council has also previously noted these issues.

35. Central and local government both play key roles in the provision of public and social goods for the residents of Auckland and New Zealand. The primary funding sources for these services are income taxes, GST and rates. However, rates, while a key source of tax funding for the provision of public goods, are subject to GST like other private goods and services. Businesses are able to claim back GST, and expense rates, yet private residents, including those on fixed incomes must pay an additional 15 per cent.

36. Many Crown properties, activities and investments place costs on the council but are exempt from rates and GST. If council rates are subject to GST like private goods and services there is a case for government properties to pay rates and development contributions to cover a share of the costs they impose on the city. Like the capital, labour and other goods and services these activities consume properly pricing the benefits the council delivers these activities ensures their decision making takes account of all the costs they impose. Additional funding would allow council to increase its spending and investment on the challenges we've identified above. However, we recognise this would raise government's costs and present them with decisions on expenditure priorities, raising taxes or expanding the tax base.

Rates and funding fairness and affordability

37. The issues paper discusses the issue of fairness in levying rates and other charges. Fairness is a subjective issue to which there is no single answer. Assessing fairness requires consideration of:
    - setting rates or charges at similar levels for those for whom similar levels of service are provided or available
    - balancing the relative ability to pay of differing groups
    - the degree of change in rates that any alteration to funding would lead to.

38. Weighing the issues identified above is subjective and requires the exercise of political judgement. Section 101(3) of the Local Government Act 2002 provides a good framework to ensure that councils consider the factors above when making funding decisions. This is reinforced by the matters the council has set out in its Revenue and Financing Policy.

39. The Council considers affordability in determining the rates limit in the 10-year Budget and weight is given to considering this increase compared to the CPI. The Revenue and Financing Policy provides for council fees to increase annually at the council rate of inflation (i.e. the rate of increase in our costs) and to maintain cost recovery levels. Any more significant changes generally require consultation.

40. When reviewing its rating policy, the council considers the relationship between household income and property value and the level of home ownership. The council also considers the proportion of income rates represented for those on fixed incomes e.g. superannuation.

41. When considering the level of cost recovery when setting fees, the council assesses the financial implications for those who will be paying. Examples in this context are the provision of free pool entry for under 16s, no library fines for overdue children's books and subsidised public transport fares.

42. Issues of fairness and affordability were extensively canvassed when the council set the level of the UAGC and the business differential in the LTP 2012-2022 and when reviewing these for the LTP 2015-2025. For the business differential consideration was given to the relative demand that businesses placed on council services and their ability to pay. The council decided to gradually lower the business differential over time to a level roughly equivalent to the tax advantage businesses have over owner occupied residential properties.

The LTP 2015-2025 review decided to extend the time to reach this target level from 10 to 20 years to reduce annual change in residential rates from 1 per cent above the general rates increase to 0.5 per cent.

43. The move to a single rating system based on capital value when Auckland Council was established in 2010 led to substantial changes to rating levels for many individual Aucklanders over multiple years, therefore, while not directly identified in s101(3), the extent of change in rating policy was a key element of the debate around the UAGC and business differential. Minimising change is one of the factors the Revenue and Financing Policy commits the council to considering. This has also featured directly and indirectly in subsequent rating policy considerations.

44. The commission also asks about the rating of commercial property. Is rates, as a proxy for a wealth tax, an appropriate basis for assessing how much businesses should contribute towards the provision of local public goods and services? With changes in technology the degree of economic activity undertaken by a business is not readily proxied by its holding of land assets and improvements. This raises the question of whether there are grounds for using different instruments than rates for the local taxation of businesses. Different taxation instruments for businesses may make a stronger link between the council's revenue and its investments in economic development activity discussed above.

Rates rebates

45. The council is pleased that the government's recent amendments to the Rates Rebate Act provide for residents of licence to occupy retirement villages to gain access to the scheme. However, the council notes that further changes are required to ensure the Act recognises other ownership structures that have developed since the act was passed in 1973, like papakainga housing. In addition, changes are needed to ensure that eligible residents in cities like Auckland whose water charges are levied by a Council Controlled Organisation (CCO) rather than being included in rates bills aren't disadvantaged and can have these charges included as part of their assessment.

Expansion of local government responsibilities

46. Delegation by central government of social and environmental regulatory responsibilities to local government is often the most effective means of delivering these services. The services can be delivered locally building on expertise and systems held by local government.

47. It is common for Treaty of Waitangi settlements to include some form of 'co-governance' over significant natural resources and reserve lands with local authorities. Council's ongoing costs often exceed any Crown contributions.

48. Given the pressures on ratepayers noted earlier additional obligations must be accompanied by the appropriate funding from central government. If any future costs are to be funded from fees and charges these should not be fettered by regulations restricting full cost recovery.

Local income and sales taxes

49. The council does not have a position on the local income or sales taxes. Local income and expenditure taxes would connect council revenue to the economic activity stimulated by our investments to support growth. However, the revenue would follow the economic cycle whereas the core expenses associated with infrastructure investment are steadier and more predictable. This would require the council to move away from a balanced budget approach and plan its expenditure on a cyclical basis accumulating reserves in periods of growth to manage lower revenue during downturns. These instruments are also likely to have high implementation and compliance costs. Rates provide a more certain income stream better matched to this expenditure.

50. The council promoted the introduction of the regional fuel tax allowing for additional investment in transport infrastructure and to replace the ITL. A regional fuel tax has a better correlation between who pays and who benefits but has a greater impact on low income groups. The next step for the council in terms of revenue

raising and demand management is congestion charging. The council supports acceleration of the introduction of new types of charging for roads and in particular congestion charging.

51. We would also support the ability for councils to apply local bed taxes to fund regional tourism organisations and tourism infrastructure. The council has recently introduced an Accommodation Provider Targeted Rate (APTR) to provide funding for half of its major events and visitor attraction expenditure. The APTR allocates these costs to those who most directly benefit. However, a bed tax would better share this burden between accommodation providers. A bed tax would distribute the costs between operators based on their revenue and hence benefit from increases in visitor numbers. The APTR distributes the costs based on capital value which is related to revenue but not as directly as a bed tax. In addition, the ownership structure of accommodation providers varies and the liability for rates does not fall evenly between the parties involved in the sector. For some properties the rates may fall on land owners and for others on the operator depending on the contract structure.

52. Changes in technology are changing the way in which business is conducted and properties are used. Current rating legislation was designed for a time when it was very clear how properties were being used. At present ratepayers have no obligation to advise the council of how they are using their properties and face no penalty if a use other than that which we have recorded is subsequently discovered. Changes to rating legislation to require ratepayers to advise the council how their property is used would help ensure rates are applied fairly. Legislation should also oblige third parties to share information they hold on a property's use with the council.

Tax increment financing

53. The council notes that tax increment financing (TIF) is often promoted as a means to fund investment in infrastructure to support redevelopment. Investment in infrastructure raises property values. Higher property values under the TIF model lead to higher rates. A TIF takes the increase in value and uses that to pay back the capital investment in infrastructure.

54. TIFs are not well suited to the New Zealand environment. Auckland Council includes forecast growth in the rating base into its long-term revenue projections. This revenue provides funding for the consequential operating costs (operations, maintenance and depreciation) of additional infrastructure investment to serve growth. Removing this revenue stream would create additional financial pressure.

55. However, TIFs may have value in circumstances where there is confidence the investments they fund are adding development potential beyond current forecasts. This may arise where new financing arrangements allow material acceleration of the planned infrastructure investment required to release development. Careful design of the instruments to implement TIF would be required to manage the measurement issues associated with separating the impact of infrastructure investment on land values and other market movements.

Local property tax

56. The Issues paper also considers a local property tax set at a fixed percentage of a property's value. Revenue from a tax in this form would rise or fall with the property market. This would expose the council to wide fluctuations in revenue over time unrelated to the costs of running the city. While the council may be able to forecast and budget over the property cycle this would be much more difficult for individual ratepayers who over the last ten years would have seen their rates more than double.

Attachment One

7.2 Financing growth infrastructure

Purpose

1. To outline the options and implications of proposed changes to the council's financial strategy in relation to financing infrastructure necessary to support new housing and business developments.

Summary

2. The Auckland Unitary Plan has provided sufficient zoning capacity to support substantial amounts of new housing development. However, the capacity of infrastructure needed to support these new houses is a constraint.
3. The infrastructure required to support growth includes arterial roads, public transport works, stormwater drains, sewer mains, pump stations, reservoirs, water mains, parks and community facilities.
4. Auckland Council's current financial strategy is to primarily finance this kind of housing-related infrastructure through borrowings which are repaid over time from development contributions or Watercare's infrastructure growth charges which are paid by developers as and when they develop their land.
5. While this general approach will continue, there are several reasons why we need to consider making some adjustments:
   a) the infrastructure costs per dwelling in some areas are considerably higher than our current charges and so some pricing increases will be necessary
   b) the council faces borrowing constraints
   c) many growth infrastructure projects also provide benefits to existing dwellings, and it is not appropriate to recover all of the infrastructure costs through development contributions which are charged on new developments. These infrastructure projects can only proceed if another funding source is available to cover the gap in funding.
   d) charging large one-off payments when developers choose to develop their land may incentivise land banking rather than early release of land supply to market.
6. To complement and enhance our existing approach, we are proposing to:
   a) review development contribution pricing in key growth areas
   b) be ready to introduce new growth infrastructure targeted rates in key growth areas
   c) work with central government on the establishment of new legal entities to take a lead role in financing this infrastructure in a way that doesn't rely on significant increases in council debt.

Background

The growth challenge

7. Auckland faces significant challenges in funding its critical infrastructure, including its transport and wastewater network. Auckland's population has grown by over 45,000 per year for the past two years, and is some four to five years ahead of official population growth projections.
8. Given these pressures, Auckland Council is firmly committed to increasing the supply of land for housing, as evidenced by the significant lift in zoning capacity enabled by the Auckland Unitary Plan. However, the council's lack of debt headroom is constraining our ability to provide the necessary infrastructure to service this land.

Current financial strategy and funding policy

9. The current financial strategy provides that the costs of growth will be met by those who are benefiting from that growth. When the council invests in infrastructure to support growth the beneficiaries are:
   a) land owners whose properties rise in value as they can now be developed
   b) developers who undertake construction
   c) future buyers of the homes constructed.
10. The council presently uses development contribution and Watercare's infrastructure growth charges as its primary tools to fund growth infrastructure, but can also use targeted rates.

Development contributions

11. Development contributions are only payable on development. If no development occurs then no payment is required. Developers can adjust the timing of development and their liability for development contributions to match the market and their cash position. However, this means that the council sometimes has to make major investments in infrastructure with no certainty of when costs will be recovered.
12. Development contributions are currently widely used and the current contribution policy aims to fund $2.2 billion of growth infrastructure assets over 10 years. While this will provide substantial infrastructure capacity to support new development across the Auckland region, it is not sufficient to keep pace with infrastructure demand in all areas, particularly in the greenfield areas where current infrastructure capacity is very low.
13. The average development contribution charge is currently $19,990 plus GST per household unit.

Infrastructure growth charges

14. Infrastructure growth charges are very similar to development contributions except that they are charged directly by Watercare Services Limited on connection to the water and wastewater networks.
15. Infrastructure growth charges are expected to be able to fund around $1 billion of growth infrastructure assets over ten years. Again, while this will provide substantial additional capacity across the Auckland region, it is not sufficient to enable accelerated development in every location where land owners want to commence development.
16. The infrastructure growth charge for the metropolitan area is currently $11,340 plus GST per household unit.

Growth infrastructure targeted rates

17. Targeted rates can be struck before development occurs and even before infrastructure is built. They are then collected whether development proceeds or not. Targeted rates provide the council with a certain revenue stream.
18. Targeted rates discourage land banking because they raise the costs of holding undeveloped land. However, implicit in higher holding costs is an element of compulsion. Targeted rates push land owners to develop to a timeframe that may not be their preference.
19. There are some practical implications that will need to be considered as part of any proposal to implement targeted rates. These include:
    - Ensuring appropriate timing and duration of any targeted rate e.g. balancing the timing of councils need to fund infrastructure with the developer's ability to commence development
    - Finding the fairest way to distribute the costs of development between landowners where there may be quite disparate values and benefits because of existing development, geography etc.
    - Managing the impact on existing residents who may be within a development area but not have the ability and/or desire to develop their own property
    - Ensuring that future purchasers are aware of the additional rating obligations.

A fuller discussion of these issues is attached as an Appendix.

20. While the council's Revenue and Financing policy has recently been amended to provide for the use of targeted rates to fund growth infrastructure, no such rates have yet been implemented. As proposals for individual areas are developed, appropriate tools for managing the issues outlined above will be recommended.

Infrastructure demand in key growth areas

21. Auckland Council's strategic growth planning envisages that 60 per cent of Auckland's future growth will occur in existing urban areas. A key focus is currently Housing New Zealand's intended large scale redevelopment activity in areas such as Mt Roskill, Mangere, Favona and Northcote where they have a high concentration of housing stock. Auckland Council is currently working with Housing New Zealand and its subsidiary Homes. Land. Community (HLC, formerly Hobsonville Land Company) to determine the additional growth infrastructure requirements to support these redevelopment plans.

22. The remainder of Auckland's growth is expected to occur in rural and coastal areas (15 per cent) and on around 15,000 hectares of land identified in the Auckland Unitary Plan (AUP) as areas for future urban growth (25 per cent). These future urban areas are located primarily in:
    - Kumeu, Whenuapai and Redhills in the Northwest
    - Silverdale, Dairy Flat, Wainui and Warkworth in the North
    - Pukekohe, Drury, Paerata and Takanini in the South.

23. Auckland Council is currently working with central government on a business case for $300 million of growth infrastructure over the next 10 years to support an estimated 10,500 additional houses in Whenuapai and Redhills. The government has agreed in principle to provide some support with financing this infrastructure through its Housing Infrastructure Fund. While this financing support will enable this infrastructure to be provided earlier, it does not remove the need for Aucklanders to ultimately bear the cost.

24. Auckland Council has also been working closely with central government on finding a way to enable investment in $600 million of growth infrastructure to support 5,500 additional houses in Wainui in Auckland's North and 17,800 houses in the South.

Investment partnership model

25. Work on the infrastructure investment for the North and the South has focused on a new investment partnership model, with this work now being led by Crown Infrastructure Partners.

26. Significantly, work on this model has focused on ways in which the accelerated investment can proceed without significant impacts on Auckland Council's balance sheet.

27. It has also focused on ways in which significant third- party private sector capital can eventually be used to finance this infrastructure rather than Crown capital. All parties involved see significant opportunity to apply this model to finance a wide range of housing enabling infrastructure in other greenfield and brownfield intensification areas.

28. As with the Housing Infrastructure Fund approach, this new financing approach would not remove the need for Aucklanders to ultimately bear the cost of the infrastructure.

29. A specific example of a large scale infrastructure project that this model could be applied to is Watercare's $1.1 billion Central Interceptor wastewater project. This project will facilitate the substantial intensification of large parts of the Auckland isthmus. It will also reduce the significant wastewater overflows into our harbours.

30. Financing the Central Interceptor project through an investment partnership model would free up council debt headroom, and this headroom could then be utilised to progress transport and housing outcomes for Auckland.

Options

31. The main options are:

    Option One: Do nothing – growth infrastructure investment is not built at the pace needed to keep up with demand. This is likely to exacerbate existing housing issues.

    Option Two: Adopt a strategy of using higher development contributions and infrastructure growth charges in the key growth areas to help pay for the additional infrastructure.

    Option Three: Adopt a strategy of being ready to implement new infrastructure targeted rates alongside existing development contributions and infrastructure growth charges in the key growth areas to help pay for the additional infrastructure.

    Option four: In conjunction with options (ii) and/or (iii) implement an investment partnership model to finance growth infrastructure.

32. Attachment A sets out the key implications of these options.
33. The council is proposing to proceed with a combination of options (ii), (iii) and (iv) to maximise our ability to provide the critical infrastructure needed to address Auckland's urgent housing issues.
34. A combined approach allows the mix of targeted rates and development contributions to be customised for each growth area based on its own unique set of circumstances.
35. While we acknowledge that implementing higher growth charges may create affordability issues for some, we consider that it is fair that those landowners who benefit from large increases in land values make an appropriate contribution to the cost of infrastructure that has enabled those large increases. We also consider that there are sufficient tools available to the council to deal with any specific cases of genuine financial hardship.

Attachments

No.	Title
A	Options table
B	Issues for consideration – targeted rates for growth infrastructure

Attachment A: Options Table

<table>
<tr><th>Options</th><th>Description</th><th>Rationale</th><th>Impact on developers/land owners</th><th>Wider policy implications</th></tr>
<tr><td>Option One:</td><td>Do nothing – growth infrastructure investment is not built at the pace needed to keep up with demand.</td><td>• Does not impose any additional council charges on anyone
• Leaves it to private landowners to work together to build and finance critical infrastructure to support their developments</td><td>• No additional charges, would only pay current development contributions and infrastructure growth charges if they are able to develop
• Many land owners will be unable to develop due to lack of infrastructure capacity</td><td>• Auckland’s housing issues highly likely to be further exacerbated</td></tr>
<tr><td>Option Two:</td><td>Adopt a strategy of using higher development contributions (DC) and infrastructure growth charges (IGC) in the key growth areas to help pay for the additional infrastructure</td><td>• Developers should make a fair contribution to the cost of the infrastructure that enables their development
• Consistent with well-established approach to paying for growth infrastructure</td><td>• Developers would pay higher combined (DC plus IGC) charges as follows:
<table>
<tr><th>Area</th><th>Current</th><th>Proposed[3]</th></tr>
<tr><td>North West</td><td>$30k</td><td>$40-50k</td></tr>
<tr><td>North</td><td>$25k</td><td>$40-65k</td></tr>
<tr><td>South</td><td>$28k</td><td>$40-55k</td></tr>
<tr><td>HNZ areas</td><td>$30k</td><td>$35-45k</td></tr>
</table>
• Land owners would be able to develop, but would not have to contribute anything towards the cost of the infrastructure until they choose to develop</td><td>• May enable faster housing development
• The use of this strategy may be limited by the availability of council debt headroom
• Potentially creates a greater incentive to land bank rather than release land early for development
• This policy tool does not provide a mechanism to recover any proportion of infrastructure costs that primarily benefit existing housing units</td></tr>
</table>

[3] The cost per house for the infrastructure to support the development of all the land provided for in the Future Urban Land Supply Strategy (FULLS) is in the range of $80k to $110k. The costs per house noted in the table have been assessed on a marginal approach based on the infrastructure to support the developments in these areas even though they may benefit from some of the wider investments in the FULLS.

<table>
<tr><th>Options</th><th>Description</th><th>Rationale</th><th>Impact on developers/land owners</th><th>Wider policy implications</th></tr>
<tr><td>Option Three:</td><td>Adopt a strategy of being ready to implement new infrastructure targeted rates alongside existing development contributions and infrastructure growth charges in the key growth areas to help pay for the additional infrastructure</td><td>Land owners should make a fair contribution to the cost of the infrastructure that enables their land to be developed</td><td>Land owners would pay new targeted rates in addition to current DCs and IGCs as follows:
<table>
<tr><th>Area</th><th>Proposed new rate[4]</th></tr>
<tr><td>North West</td><td>$900-$1,800</td></tr>
<tr><td>North</td><td>$1,300-$3,500</td></tr>
<tr><td>South</td><td>$1,100-$2,400</td></tr>
<tr><td>HNZ areas</td><td>$500-$1,100</td></tr>
</table>
Rates would apply for a 20 year period from when land is development ready.
Land owners would be able to develop and would be required to pay regardless of whether they choose to develop now or wait.
Where land is held in large blocks, the annual targeted rate will also be charged (e.g. a block large enough for 100 houses with a $2,000 targeted rate would pay $200,000 per annum)</td><td>Likely to enable and incentivise faster housing development
The use of this strategy may be limited by the availability of council debt headroom
Targeted rate may unintentionally impact on some smaller landowners in the area that will never develop their land
However, there are a range of rates policy tools available to the council to address those issues
Able to also charge a fair share of costs to existing housing units that also benefit from the infrastructure</td></tr>
<tr><td>Option Four:</td><td>In conjunction with options (ii) and/or (iii) implement an investment partnership model to finance growth infrastructure.</td><td>Enables faster housing development in a way that is not limited by the availability of council debt headroom
Provides an opportunity for a commercially focused entity with relevant skills and</td><td>Landowners will be able to negotiate with a commercially focused entity to access infrastructure financing
Developers / land owners will ultimately need to pay higher charges in some form to cover the cost of the growth infrastructure. This could take the form of higher DCs and/or IGCs, new targeted rates, higher user charges or voluntary payments under a negotiated contract.</td><td>Likely to enable faster and larger-scale housing development that is not limited by council debt headroom
A third party (not the council) would take substantial risk such as the risk that development is</td></tr>
</table>

[4] As note 1 above.

Options	Description	Rationale	Impact on developers/land owners	Wider policy implications
		expertise to take a lead role in negotiating infrastructure financing arrangements with developers	• Where private contracts are involved, land owners may need to accept a charge on the land title recognising the obligation • Charges may be slightly higher under an investment partnership model as investors (whether public or private sector) will require a rate of return on their investment that fairly reflects the risks they are taking around the timing of when they will be repaid	taken up over longer timeframes than anticipated • The Auckland Council group will still lead the construction of the infrastructure and will be the long-term asset owner and operator. • Implementation of the investment partnership model could involve the establishment of a new council controlled organisation.

Attachment B: Issues for consideration – targeted rates for growth infrastructure

Targeted rates provide flexibility to design funding arrangements that can accommodate a wide range of circumstances. A targeted rate can be applied in conjunction with other funding sources to:

- provide revenue security for financing infrastructure
- deliver incentives for land owners to develop
- while recognising the need to accommodate the:
  - cash flows constraints developers work within
  - interests of different land owners
  - interests of future house buyers.

This section addresses some of the key issues the council will need to consider when deciding how to apply targeted rates. Consideration of these matters also highlights areas where changes to legislation would provide the council more flexibility to set targeted rates that address both the council's goals and the particular needs of all interested land owners.

1. Timing

The commencement date and duration of a targeted rate will influence its impact on current land owners and future house buyers.

Commencement

A targeted rate can be levied at any time from when a decision is made to invest in infrastructure. Once a targeted rate is in place land owners will face an immediate increase in their holding costs and will have to find the cash to meet this additional demand. However, land owners may not be able to develop their land until the plans for infrastructure are finalised and consented or until construction is completed. Depending on circumstances the council has the following options for when it starts to levy a targeted rate. A rate can be applied from when:

- decisions are made to invest in infrastructure in a particular area – allowing funds to accumulate before expenditure is incurred
- infrastructure plans are finalised and consented – allowing developers to secure planning permission and to begin their own investments in readying land for construction
- developers are able to begin making their own investments – which may be triggered by a range of factors
- infrastructure is completed – providing complete certainty that development can proceed.

To start collecting a targeted rate the council will want to consider whether developers face any practical or regulatory barriers that would prevent them from commencing development. The timing of when land becomes "development ready" may differ depending upon the particular circumstances in different parts of the region.

Lifespan

The assets that a targeted rate will fund have long lives, for example roads. Accordingly a rate should run over a long time period. There isn't a definitive basis on which to set a repayment period. The council will need to consider this on a case by case basis. The recovery period will generally be over 10 years and more likely 20 years or more given the life of the assets. The choice of lifespan is a balance between faster repayment of debt and higher annual costs for ratepayers.

Many home owners like to pay off their mortgages early and may also wish to discharge the targeted rate liability early. In setting any targeted rates, provision will be made for early payment.

2. Sharing the infrastructure costs between land owners

A targeted rate to share the costs of infrastructure between the land owners who will benefit should aim to spread the costs as fairly as is possible. Infrastructure investments to support development provide benefits to current and future land owners:

- by allowing them to realise the uplift in land value from rezoning
- directly in terms of improved services to support a growing community.

The general rates requirement is shared between property owners based on the capital value of their properties. Capital value is the value of the land and buildings. The council can also use land value and land area. Each of these methods is discussed below.

Capital value

Capital value is the value of land and improvements (e.g. a house). Capital value does not share the costs of infrastructure required for development based on the benefits in terms of potential land value uplift. A growth infrastructure targeted rate set on capital value will be higher for a more developed property. While more developed properties are better able to take advantage of service improvements they don't gain as much from increased development potential. Less developed properties benefit more from infrastructure investment that allows them to develop.

All of the areas where additional infrastructure investment is being considered are underdeveloped. As a result land within these areas has widely varying degrees of development. The majority of investment being considered is to support growth and allow for development. Applying a targeted rate based on capital value would impose an unfair burden on land that was more developed at any point in time.

Land value

Some development areas, both greenfields and brownfields, may not require immediate infrastructure investment to proceed. However, they may still require substantial investment over time. For these areas the land value will reflect the development potential for all properties. Where this is the case, land value will be the best means to allocate the share of infrastructure costs.

Land value is a good, but not perfect, measure of a property's ability to benefit from infrastructure investment. Land value changes over time as property is subdivided ready for development shifting more of the burden to early developers. In addition, current rating valuation rules require land to be valued on current use potential. Some land cannot be developed until infrastructure is constructed whereas other land in the area may already be zoned and valued as residential. This is primarily an issue for greenfields development. Using land value rating would place a disproportionate share of the infrastructure cost burden on the properties presently valued as residential in the early years of any rate. This impact could be mitigated by applying the rates differentially, i.e. at a lower rate, to different land uses.

Land area

Land area better captures development potential. A larger property with space to build more houses will pay higher rates than a smaller property with less development potential.

However, land area does not differentiate between more and less desirable geography. A hectare of land in a gully will pay the same rates as land on a hill slope with a view. Land closer to a transport hub will pay the same as land more distant. Where these locational differences are material and impact on several properties they can be managed by the use of existing tools such as:

- differentials, where some land uses or locations pay more or less rates
- remissions.

Conclusion

Both land area and land value may be appropriate depending on the circumstances of individual development areas. The current mechanisms could be improved by allowing the use of land value based on development potential for the purpose of applying a growth infrastructure targeted rate. This would require a change to legislation. The current rules are appropriate for general rates purposes but not designed to fairly share infrastructure costs associated with development.

3. Managing the impact on different land owners

Rezoning land for more intensive development and investing in infrastructure to support growth, whether in greenfields or brownfields areas, requires major capital investments. Both large and small land owners will benefit from increases in land value and improved services.

While all land owners will benefit from rezoning and investment in infrastructure some are better able to realise these gains. Developers holding land in these areas will be able to realise the potential uplift in land value. Holders of smaller developable blocks of land may not be ready to realise the gains or have a different time frame for development. Many owners of existing houses may not:

- be able to realise any gain until they sell their property
- benefit from infrastructure that allows more intense development if there is limited development potential on their site
- want the additional service benefits that development will bring.

For existing home owners there may not be appeal in paying for infrastructure to support development. On the other hand the benefits may be substantial and it is more appropriate that the future beneficiaries pay rather than the cost falling on existing ratepayers. The council has a range of options to balance these concerns in how its sets any targeted rates.

The options are:

1. don't charge existing houses for the costs of infrastructure required to allow more intense development for example trunk water and wastewater works by:
   i) funding these with infrastructure growth charges and/or development contributions as these are only charged for new properties
   ii) remitting these costs for existing houses where targeted rates are used.
2. provide for postponement for the share of the cost of other infrastructure that benefits existing houses. The existing property owner would have no requirement to pay until they sold the property or were no longer resident.

The council would prefer that the recovery of costs in these circumstances is from the buyer of the property. The new buyer would be making a conscious choice to incur these costs in exchange for the benefits. The buyer would take this additional charge into account in their purchasing decision. The existing owner would not be required to contribute to these costs but the price at eventual sale would be impacted. This would require legislative change to provide for an entirely new type of charge to be available to the council. Rates are incident on current land owns and designed accordingly. Substantial changes would be required to provide for a new type of charge incident on buyers, akin to stamp duty but location specific, or for rates to be incident on buyers in particular circumstances.

4. Informed buyers

Houses developed where infrastructure is partly funded by targeted rates will have rates obligations higher than other properties where infrastructure has been funded from other sources. We have a number of ways to ensure new home buyers are aware of their future obligations:

- include information about targeted rates on the Land Information Memorandum.
- include provision in development agreements requiring sales materials to make the future targeted rates obligations clear to prospective purchasers
- support professional bodies for advisers involved in property purchases (lawyers, real estate agents and financiers) to inform their members
- present information on the council's website
- allow vendors and buyers to discharge future targeted rates obligation as part of a property purchase.

Further assurance could be provided that buyers, and their advisers, are familiar with the obligations by allowing the obligation to be recorded on a property's title. To provide for this legislative change will be required to allow the council to record this charge on land title.