

Local Government Funding – Future Directions ?

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Where we are now ? – 2016 data

- LG sector about 4% of GDP – has been relatively constant over recent years
- Total operating expenditure (opex) \$10.5 bn
- Total capital expenditure (capex) \$4.9 bn
- Total assets \$128 bn
- Total gross debt \$13 bn (over one half is Auckland Council)
- Total revenue \$11.1 bn
- 50 percent of operating revenue is rates - \$5 bn.
- Subject to 15% GST so Central Government receives 13 percent of total rates collected or about \$650m
- Non-operating expenditure and revenue include changes in asset values (reflecting accrual accounting and budgeting)
- Note “balanced budget” requirement of LGA. Operating revenues must cover operational expenditure including depreciation (but some flexibility in this)

Where are we now?

- Rates are about 7 percent of total NZ taxation revenue
- Are part of our overall taxation system but are mentioned only in passing in Taxation Group TOR so will not be examined (?)
- Other local sources of revenue are development contributions (average 2% of revenue) and user charges
- 22 percent of opex is depreciation – involves no cash outlays but rates fixing is based on funding them as expenditure
- 8 percent is financing charges
- 75 percent is other opex (termed “core expenditure” by some LGs)
- In Auckland personnel costs around one third of opex
- Rating exemptions – land used for conservation, recreation, health and educational purposes, religious and charitable, transport infrastructure and various Maori land
- \$13.5 bn of capital value of assets exempt from rates
- Rates rebate scheme to address affordability but take up is well below intention and potential

2015-2025 Council 10 Year Plans

- Auditor-General's Report on these plans reviews
 - changes in spending patterns
 - adequacy of asset maintenance and replacement
 - forecast year on year rate increases and any self imposed limits
 - prudence of debt management including effective limits on debt levels
 - possible improvements to infrastructure strategies and better linking with financial strategies
 - lack of information on asset condition
- 66 LGs received “ standard” audit reports
- 12 LGs received “non standard” reports indicating matters needing attention

- debt rises from \$14bn to \$20 bn
- Assets rise from \$126bn to \$174 bn
- Revenue rises from \$9.8 bn to \$14 bn
- Capex fluctuates over the 10 years - \$5.1bn in 2015 but less than \$4bn in any subsequent years

Issues in LG 10 year budgets (Long-term Plans)- 2018-28

- 10 years budgets are updated every three years. Voluminous !!
- Also reviewed for reasonableness of assumptions and data and quality of consultation by Auditor-General
- Consultations currently underway
- Expenditure increases may be demand driven (population growth may be a major factor) as opposed to service quality improvements
- And by needed asset replacement
- Local Government (Financial Reporting and Prudence Regulations) 2014
- Debt affordability benchmarks – net debt and net interest as % of total revenue (benchmark of 15%) and net interest as percentage of total rates (benchmark 21% with a risk limit of 25%)
- Auditor-General will report on cases where a LG is not operating with financial prudence
- Market ratings of LG bonds are also a check on financial prudence

A Short Note on Debt

- Government Funding Agency (LGFA) established in 2011
- Issues bonds on the financial market, partly refinancing previous LG borrowing from Banks
- 53 of the 78 LGs are members plus the Government (20%)
- Around \$8bn loans outstanding at end 2016
- Objective is greater capex funding certainty for LG, more flexible borrowing instruments and lower borrowing costs
- “Leveraging” the balance sheet assets
- LGFA has its own financial covenants which borrowers must meet
- Has credit rating of AA+ reflecting this – and also the predictability of rates as a major source of LG revenue
- Over 20 LGs have their own bond credit ratings. Strong - all at least A+ (S and P)
- 11 LGs mainly regional councils, have no debt
- Poor transparency of funding of capex (including debt) – a key financial policy, is not clear from published financial statements – need to look at separate “funding impact statement”

30 Year Infrastructure Plan 2015

- Managed by Infrastructure Unit of Treasury. Developed from 2010
- LGNZ, CID and Business NZ are “strategic partners”
- “To promote increased understanding of how existing infrastructure can be better utilised and updated to meet NZ’s needs for the next 30 years”
- A tall and worthy order but hard to understand operational impact
- May assist in allocating resources within sectors but less so between sectors (?)
- Will it help align CG and Auckland Council transport objectives - which have not yet been aligned ?
- Has regional perspectives and some focus on Auckland and Christchurch
- Considerable emphasis on the “three waters”
- How will it impact on 2018-19 CG Budget and Council Ten Year Plans 2018-28?
- How much do we really know about the quality of existing infrastructure (Middlemore?)

Provincial Growth Fund

- CG has committed to investing \$1 billion per annum over three years in regional economic development to lift productivity potential in the provinces.
- Its priorities are “to enhance economic development opportunities, create sustainable jobs, enable Māori to reach their full potential, boost social inclusion and participation, build resilient communities, and help meet New Zealand’s climate change targets”.
- All provinces are eligible for funding, however, Tairāwhiti/East Coast, Hawke’s Bay, Tai Tokerau/Northland, Bay of Plenty, West Coast and Manawatū-Whanganui have been identified for early investment.
- Additionality – projects need to add value by building on what is there already, not duplicating existing efforts and generating clear public benefit.
- Projects must align with regional priorities. They will need to have been discussed and agreed with relevant local stakeholders.
- But how systematically will funds be allocated ?
- How much to CG projects and how much to projects that would otherwise be funded by LG ?
- So impact on local government funding not yet clear (?)

Councils' Issues and Pressures Differ

- Problem of growth – Auckland and others
- Problem of past infrastructure neglect – Auckland and others
- Problem of declining population and rateable base and low incomes – many rural LGs
- Pressure of tourism growth
- Improving lakes and rivers, climate change – most RCs, Dunedin
- Natural disaster clean up and mitigation – Christchurch, Dunedin, Wellington, Marlborough
- Public expectations in all these areas are strong and growing
- Growing social deprivation – a role for LG (?). Some of regional NZ shows poor social outcomes
- Housing shortage – a role for LG (?)
- Metropolitan LGs provide a wider range of services
- Certainly well beyond the emphasis on “core services” required by the Local Government Amendment Act 2010 (pushed in the Key Government by ACT)
- New Government proposes to reinstate the “Four Well-Beings” in LGA

LGNZ Local Government Funding Review 2015

- Partnership between central and local government (the usual stuff)
- NZTA says its funding assistance is not a subsidy but part of an investment system which recognises there are both national and local benefits for investing in the land transport system
- To increase revenues Councils must show communities they are making sensible financial decisions
- Targeted rates may help give this impression
- Make greater use of existing available tools – user charges and debt for assets with inter-generational benefits
- CG help to lift the quality of the financial debate
- Media should also help (c.f. NZ Herald) by not confusing financial pressures with financial mismanagement
- Different LGs are facing different pressures
- And even now their revenue and expenditure patterns vary considerably (c.f. Statistics NZ Local Authority Statistics)
- There was no discernible response to this review by the Key Government

The Future is Already Here (?)

- A regional petrol tax for Auckland (10 cents per litre) \$130-150M per annum but offset by removal of interim transport levy (\$60m)
- Government Draft Land Transport Policy - increase in fuel taxes over next 3 years of 9 to 12 cents per litre to cover all land transport. Details of project allocation not yet clear (?) but no more than 10 percent for Rail
- The Provincial Growth Fund
- Likely impact of these (commendable?) measures on LG finances therefore difficult to determine at this stage
- Greater use of targeted rates so that rates are better related to public perceptions of benefits ? C.f. Proposed water quality targeted rate for Auckland?
- Lets see what comes out of the 10 Year Plans
- There is scope for greater CG assistance for lower socio-economic communities (not the whole of a LG unit) for the “three waters”
- Some discussion (initiated by Minister of Finance) about recoupment of increase in property values arising from major infrastructure expenditure – a form of targeted rate, but only for commercial ratepayers?
- Congestion charging will come to Auckland (and Wellington)? But this may be more a tool for demand management and deferral of capex rather than a significant revenue source

Other Diversions

- Regional sharing of petroleum and mineral royalties (LGNZ now pushing this)
- Local retail sales taxes
- Poll tax
- Transaction taxes - stamp duty, financial transactions
- Share of income tax distributed generally in terms of horizontal equity
- 2007 Review looked at these with advice from NZIER
- Land tax (will be examined by Taxation Working Group)
- Others unlikely to be considered - not on the agenda of CG (and Treasury)

Some History - The 2007 Rates Review

- No big recommendations, no *major* change proposed in LG funding
- Set up to respond to or defuse the “rates revolt” ?
- Showed depressing level of public ignorance about LG and rates
- Recommendations largely ignored by the Labour government (Treasury unconvinced there was a problem?)
- But the Report was also addressed to LG as well as to the Government
- Now 10 years old. Coalition Agreement between Labour and NZ First says it will be revisited
- Conclusion that rates will become unaffordable for *some sections of the community* (note careful wording) over the next 10 years
- But rates overall satisfactory as major source of LG revenues
- Efficiency, difficulty of evasion, flexibility through choice of rating base, size of uniform annual charge, targeted rates etc makes it possible for LGs to design their own progressive rating system – modelling using demographic and economic data
- Insufficient use of debt for funding capex

Some History - The 2007 Rates Review

- Many LGs had significant financial reserves, including profitable business undertakings which pay dividends
- Confusion about funding depreciation charge – inappropriate use of private sector accounting standards may result in overfunding
- Estimated possible rate reductions of 10 percent through more borrowing and reviewing funding of depreciation
- Playing games with “rate increases” figures – total rates collected, rates per property or per capita, include GST or not etc etc ??
- Full cost charging for water (demand management)
- New source of revenue from GST through a contestable infrastructure fund for the “three waters” of \$100m pa building on the 2005 water and waste water schemes for low socio economic communities (both \$150 million)
- Increase LA Petroleum Tax by 2 cents per litre for distribution to LGs by a general formula
- Remove most Crown rating exemptions
- Fix the rating of Maori land
- Update and promote rates rebate scheme