Growth Challenges - Current Financial Issues

Part 1: Financial Pressures on Local Government Growth Areas

August 2009

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Executive Summary

Tauranga City, Hamilton City, Queenstown Lakes District and Western Bay of Plenty District are known growth areas in New Zealand. They are all facing, either now or projected in the medium to longer term, financial sustainability issues given their growth rates, high infrastructure and service costs, timing lag between investment in growth infrastructure and recoupment through development contributions, and significant increases in operating costs arising from the growth in network infrastructure.

The purpose of this paper is to engage with Central Government in order to identify an approach that will deliver a pragmatic and fiscally sustainable solution for the Councils. This work is made up of two parts, the first being this paper which provides an overview of the current challenges facing the growth councils and the second being a paper containing a detailed analysis of the growth issues faced by each council.

It is acknowledged that whilst this paper outlines information on four high growth Councils, the issues raised in this paper are also likely to be a challenge for the other high growth Councils in New Zealand, over the medium to long term. What distinguishes these four Councils however is the combination of high population growth, high levels of debt per capita, limited sources of investment income and high levels of development contribution income required for growth-related infrastructure.

Some Councils currently have insufficient borrowing capacity to prudently fund the level of expenditure required over the medium to long term.[1] Significant attempts have been made to reduce expenditure but this still leaves a problematic position in terms of delivering services to the community.

The Councils referred to are facing challenges because of their growth rates. This is largely due to the fact that there are significant infrastructure projects that are needed to accommodate growth. There are a number of issues for growth areas to address that may not occur to the same extent in other places. Such issues include:

- High growth rates which involves increasing demands for infrastructure and services.
- A growing population with increasing needs and expectations (eg more community services required).
- High tourism numbers which places pressure on existing services and facilities along with the pressure to provide more.
- Higher land costs for purchases that need to be made (eg for reserve and open space purchases and designations).
- Managing traffic congestion and transport networks.

[1] See Part 2 of this report for further details. In particular Table 1 on page 1 which indicates that the Councils have debt increasing significantly from the 2009 level and increasing ratios of debt to revenue.

The current funding tools available will not bridge the gap for these growth areas. A “do nothing” approach at this point will inevitably lead to the deferral and cancellation of projects in growth areas.

The Councils concerned would like to partner with Central Government in order to achieve a sustainable funding approach for the medium and long term. The tools proposed involve some or all of the following:

- A Funding Guarantee
- A Funding Facility
- Zero Interest Loans
- Grants, Subsidies and Suspensory Loans

The benefits of these funding tools would be that it allows important infrastructure projects to go ahead, provides stimulus to the local and national economy, reduces the debt burden on growth Councils, reduces the cost of borrowing and reduces the impact on ratepayers.

1. Introduction

1.1 Purpose

This paper is a joint initiative of the Tauranga City Council, Hamilton City Council, Queenstown Lakes District Council and Western Bay of Plenty District Council ("the Councils").

All four Councils are known growth areas in New Zealand. They are all facing financial sustainability issues given their growth rates, high infrastructure and service costs, variable patterns of development which impacts on development contributions and the rating base, and declining income.

The purpose of this paper is to engage with Central Government in order to identify an approach that will deliver a pragmatic and fiscally sustainable solution for the Councils.

This paper provides an overview of growth and financial challenges, focusing on the issues facing growth Councils.

1.2 Challenges for Growth Areas

The financial position of the Councils referred to above may not be sustainable in the medium to long term. This has become apparent during the preparation of the 2009 - 2019 Long-Term Council Community Plans ("LTCCP"). This is due to a number of reasons including:

- Greater infrastructure and service needs in growth areas
- Increased borrowing to fund the infrastructure and the interest costs associated with this.
- The pressure to hold forward rate increases at or near the current rate of inflation even though this does not reflect the actual cost base of providing infrastructure.
- Rate increases at either the rate of inflation or close to it will not generate enough income for future capital works.

- A three yearly electoral cycle that is not conducive to a Council being able to raise its rating revenue baseline to the necessary level.
- Development levels being less than projected in the 2006-2016 LTCCPs. This has reduced the amount of development contributions coming in to pay for new infrastructure and it will also reduce the future growth in the level of the rating base. Councils often need to forward-fund growth-related infrastructure costs and rely on development contributions to pay for this over time. If the contributions are lower than expected this can leave a significant funding shortfall.

The Local Government Act 2002 ("LGA 2002") requires councils to manage their finances prudently while also promoting the social, economic, environmental and cultural well-being of present and future communities.

Some Councils currently have insufficient borrowing capacity to prudently fund the level of expenditure required.[2] Significant attempts have been made to reduce expenditure through reprioritising, scaling down projects, deferral and cancellation of some projects.[3] However, there is a limit to how much cost cutting can be achieved. Councils still need to be able to deliver responsible outcomes to the community. Councils also have a role to play in promoting local economic development. It is for these reasons that a solution needs to be found to ensure that the Councils concerned can continue to provide the infrastructure and services that their communities require over the medium to long term.

1.3 Defining Growth Areas

The Growth Councils referred to in this report have all had annual population growth rates over the four years from 2001 to 2006 which are well above the national average of 1.5%. There are other Councils which are also experiencing high growth rates. In total there are 14 territorial local authorities that have a growth rate above 1.5%.

While population growth is important, it is not the only driver of growth. This is discussed further in section 2 of this report. The Growth Councils that are part of this report exhibit a combination of high population growth rates, high development rates and are all now facing challenges in terms of how to sustainably fund expenditure into the future. Not all Councils that have high population growth rates are in this position as it depends on a number of factors including development levels, the amount of expenditure required and funding available.

All four Councils covered by this report do not have significant investments that generate income. As a result only a very small percentage of their income comes from investments.[4] This

[2] See Part 2 of this report for further details. In particular Table 1 on page 1 which indicates that the Councils have debt increasing significantly from the 2009 level and increasing ratios of debt to revenue.
[3] See Part 2 of this report for further details on how the Councils have attempted to reduce expenditure.
[4] The four Councils each have levels of investment as a percentage of income that is less than 1.1%. This is very low compared to other territorial authorities. The national average is 4.5%. Source: Statistics NZ.

means that they are more reliant on funding expenditure through sources such as rates and development contributions.

Of the 74 territorial local authorities, 12 have will have debt per capita by 2019 that is greater than $3,000. Nine of these 12 Councils have investment income that is less than 5% of total revenue, therefore they have limited investment income to contribute to projects and debt repayment. Of these nine, seven have growth rates greater than 1% per annum. The four councils covered by this report fall into this group.

1.4 The Role of Councils

Local Government is charged with promoting the four well-beings (social, economic, environment and culture) under the Local Government Act 2002. Councils have a mandate to deliver a range of services and facilities to their communities.

These services and facilities arise as a result of:

- The need to provide basic services to existing and new communities
- Statutory standards
- Requests from the community

The nature and timing of services are agreed to by councils and their communities through the long-term council community plan process. Councils are required to be transparent through long-term council community plans, annual reports, audits, open meetings, consultation and dialogue with local communities.

The provision of infrastructure and services is an expensive exercise and local authorities are often limited in terms of their funding sources. There is often criticism that Councils rely too heavily on rates and that rating increases are excessive. However, councils are required to deliver services and facilities and on the whole they manage to do this well and at a reasonable cost.[5] There are also those that state that Councils are operating outside of their mandates and shouldn't be funding certain projects. However the majority of a council's capital expenditure comes from network infrastructure (transport and the three waters).[6]

Each Council area is different and is subject to varying pressures for essential services depending on growth rates and the state of existing infrastructure.

The contribution of Councils to the general economy is often significantly under rated. Economies work best when there is an adequate supply of zoned and serviced land which is made available in a timely manner in order that the market can invest efficiently. Too often there are hidden delays and significant opportunity costs arising from shortages of zoned land.

[5] *Funding Local Government – Report of the Local Government Rates Inquiry,* August 2007 at page 1.
[6] Ibid at page 4.

Sometimes given infrastructure investment demands Councils cannot service zoned land in a timely manner.

For growth areas, an important way of managing land use and effective infrastructure provision is through the use of planning techniques such as sequencing of development and urban limits. The use of urban limits and other such tools can be a practical means of setting specific boundaries for urban growth based both on demand and location. Urban Limits helps to ensure enough land area is available for development according to population growth estimates.

Using planning tools like urban limits means that:

- Development can be planned and carried out logically.
- There is enough land in the right places to cater for population growth.
- There will be definite limits to growth.
- The protection of productive soils and outstanding natural features and landscapes.
- There is enough land set aside for employment.

Three of the four Councils covered by this report currently have, or are likely to have in the near future, urban limits in place. Urban limits are not a barrier to growth but a means of ensuring that development is carried out in an efficient and effective manner and that it is well integrated with infrastructure and funding.

2. National Overview of Growth

2.1 Growth and Decline

Over the last 50 years New Zealand as a whole has experienced rapid population growth. This growth has not been uniform with the highest rates occurring within larger urban areas (for example Hamilton and Tauranga Cities), districts that surround the larger urban areas (for example the Western Bay of Plenty District) and lifestyle locations (such as Queenstown Lakes District).

New Zealand has seen a surge in growth in lifestyle, holiday and recreation areas.

The following table provides a summary of the annual average population growth rates of each of the Councils.

Council	Annual Average Growth Rate[7]	Forecast Annual Average Growth Rate[8]
Tauranga City	2.7%	1.8%
Queenstown Lakes District	6.2%	2.5%
Hamilton City	2.1%	1.3%
Western Bay of Plenty District	2.0%	1.2%

All of these areas are currently experiencing growth rates well above the current national average of 1.5%.

The annual average growth rates included above are based on Statistics New Zealand population figures. This can lead to an under forecast as it is based on Census night population. Some of the growth areas have high vacancy rates on Census night due to large numbers of holiday and second homes, and tourists.[9]

Statistics New Zealand has forecast that New Zealand's population growth rate will slow, particularly from 2040 onwards. However, as is currently the case, there will be growth and decline throughout New Zealand. The current growth areas are likely to continue experiencing population increase due to age structure of the population and migration factors.

[7] 2001 – 2006. Source: Statistics NZ
[8] 2006 – 2031. Source: Statistics NZ
[9] For example Queenstown Lakes District had a vacancy rate of 42% during the 2006 Census. Source: Statistics NZ.

2.2 Drivers of Growth

Growth is about more than just population increase. There are a number of factors that can influence growth within an area.

Drivers of growth within cities and districts include:

- Population
- Labour force and employment
- Economic expansion
- Migration
- Improved transport and communications
- Changes in household composition
- Sea change and tree change – migration to the coast and rural lifestyle areas
- The visitor industry
- Lifestyle factors

The four Councils that are the focus of this paper exhibit some or all of these growth drivers.

2.3 Background Material

There are several pieces of work that provide a context for this paper and highlight some of the issues that local government is currently facing, particularly for areas of high growth.

The 2007 rating enquiry, *Funding Local Government – Report of the Local Government Rates Inquiry* (August 2007), found that the local government funding system is under pressure because of significant growth in expenditure and growing affordability problems with the main source of funding (rates). The enquiry noted that some of the greatest pressures on territorial authorities are rapid changes (both growth and decline) in the population of their communities.

The briefing to the incoming Minister of Local Government by the Department of Internal Affairs (November 2008) has noted that local authorities are feeling the impact of the current economic situation in several ways, including:

- *Councils that typically rely on investment returns as a significant funding source may be exposed to a substantial loss in income because of the decline in world share markets.*
- *Councils are reporting some difficulty in obtaining access to debt funding, especially long-term debt funding*
- *Some councils have indicated that their exclusion from the investment guarantee scheme is a deterrent to proceeding with planned retail stock issues*

- *Councils providing new debt-funded infrastructure with the intention of repaying the debt from development contributions may now find themselves severely constrained in their ability to service those loans or continue with planned capital expenditure programmes.*[10]

The briefing paper also states that the provision of infrastructure and its cost is a key issue for councils and a major cause of a rapid growth in capital expenditure.

The Royal Commission on Auckland Governance released its report in March 2009.[11] The Commission was appointed to consider and report on the local government arrangements that are required in the Auckland region over the foreseeable future. The terms of reference for the Commission note that the Auckland region will face enormous challenges over the next 100 years brought about by global economic, environmental and political forces. Trends which include high population growth are cited as adding to the challenges and opportunities for the region.

One of the matters that the Commission has been tasked with investigating is:

What ownership, governance, and institutional arrangements and funding responsibilities are required to ensure the effective, efficient, and sustainable provision of public infrastructure, services, and facilities to support and enhance—

(i) the current and future well-being of the Auckland region and its communities; and

(ii) the performance of the Auckland region as a growth engine in the New Zealand economy and in its role as a key transport hub for New Zealand and the Pacific region; and

(iii) the ability of the Auckland region to compete internationally as a desirable place to live, work, invest, and do business; and

(iv) the ability of the Auckland region to respond to economic, environmental, cultural, and social challenges (for example, climate change)[12]

The Royal Commission has stated in its report that Auckland needs robust, considered and consistent planning to support the region's ongoing growth and development. The report also clearly recognises that there is a need for major investment in infrastructure development in Auckland in order to support the growing population.

The Commission's report has said that the financial viability of Auckland local authorities may change given the current economic downturn and that those Councils facing rapid growth and already committed to significant infrastructure spending are likely to be particularly affected.[13]

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[10] Briefing to Incoming Minister – Local Government, The Department of Internal Affairs, November 2008 at page 11

[11] Royal Commission on Auckland Governance, March 2009: Volume 1 Report

[12] Terms of Reference for the Royal Commission on Auckland Governance, 30 October 2007

2.4 Legislative Framework

Local Government has to meet a number of statutory requirements. Territorial authorities have functions, duties and powers under various pieces of legislation. The legislation outlined below provides the context for how Councils operate and what obligations they have to their communities.

The Local Government Act 2002

The LGA 2002 provides the general framework and powers under which New Zealand's democratically elected and accountable local authorities operate. The purpose of the LGA 2002 is to provide for effective local government that recognises the diversity of New Zealand communities. The purpose of local government as set out in the LGA 2002 is:

(a) to enable democratic local decision-making and action by, and on behalf of, communities; and

(b) to promote the social, economic, environmental, and cultural well-being of communities, in the present and for the future.[14]

This purpose, in effect, means that local government has to provide for a very wide range of activities. In short, territorial authorities are responsible for:

- Providing local infrastructure, including water, wastewater, stormwater and transport
- Social and community development activities
- Environmental safety and health
- Recreation, leisure and cultural services
- Economic development and tourism promotion

The reporting and financial requirements in the LGA 2002 require a prescriptive and transparent approach.

The LGA 2002 allows territorial authorities to collect development contributions to cover growth-related capital expenditure from new developments. While development contributions might fund any infrastructure required as a direct cause of a development, Councils are still responsible for the maintenance and depreciation of any infrastructure under the LGA 2002.

The 10th Schedule of the LGA 2002 sets out Councils' obligations to consider demand for services, service levels and standards, asset capacity and the cost implications in their LTCCPs and other strategies and plans for the long-term future of its communities. LTCCPs must contain the following:

- Information on community outcomes;

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[13] Royal Commission on Auckland Governance, March 2009: Volume 1 Report at pages 441 - 442
[14] Section 10, LGA 2002

- Identify assets and assess activities;
- Funding and financial policies adopted under section 102 of the LGA 2002;
- A summary of its policy on determining the significance of groups of activities set out in their LTCCPs;
- Forecast financial statements;
- Funding impact statements; and
- Significant forecasting assumptions

The risk of not planning for growth and funding it appropriately at the LTCCP level has implications for:

- A local authority's ability to provide key infrastructure in a timely manner in order not to frustrate the ability of the private sector to develop land in suitable locations. Lack of trunk infrastructure also adds to a developers holding costs.
- A local authority's ability to adequately service development debt.
- A local authority's credit rating if the costs of borrowing increase to service growth that is not adequately planned for in LTCCPs or managed through the district or regional plan processes.
- The general ratepayer who will likely end up funding the increased costs of councils' borrowing.

Resource Management Act 1991

Under the Resource Management Act 1991 ("RMA 1991") the functions of territorial authorities are:

- Integrated management of the effects of the use, development or protection of land and natural and physical resources
- Noise
- Control of effects of activities in relation to the surface of water in rivers and lakes

Natural and physical resources include land, water, air, soil, minerals, and energy, all forms of plants and animals, and all structures.

There is also an obligation on local government to carry out the sustainable management purpose of the Act which involves managing natural and physical resources in a way which enables people and communities to provide for their social, economic and cultural wellbeing and for their health and safety.

Land Transport Management Act 2003

Under the LTMA 2003 councils have the responsibility for providing information that feeds into regional land transport programmes. This involves:

- Identifying activities or combinations of activities relating to local road maintenance, local road renewals and local existing public transport services.
- Proposing activities or combinations of activities other than those referred to above (for example capital works and new public transport services).
- An assessment of each of these activities which needs to include the total cost broken down on an annual basis, timeframes and sources of funding.
- All activities, costs and funding over a 3, 6 and 10 year period.

There are also increasingly large transport projects which require funding from a variety of capital sources, for example Government funding, from the National Land Transport Fund or Crown Grants, local government funding (rates, development contributions, borrowing), tolling, regional fuel tax and private sector contributions.

Other Legislation

Other legislation affecting local authorities includes:

- Local Government (Rating) Act 2002
- Affordable Housing (Enabling Territorial Authorities) Act 2008

2.5 Current and Future Communities

The purpose of local government refers to promoting the well-being of communities in the present and in the future. This raises issues of intergenerational equity for local government which have to be borne in mind.

This is particularly important when significant costs are involved for councils in terms of the provision of infrastructure and services. There has to be a balance between how much is paid for now and how much is paid for in the future for services that cover a longer period. The current generation should not have to pay the full cost of services that have benefits for future generations, just as future generations should not be saddled with the debt of previous generations.

The best way to achieve a balance is to recognise the full costs and the benefits of all services and coordinate the provision of services with growth and funding. For instance, a new road may have a growth-related component as well as a public good component in terms of being of benefit to the existing community. The costs need to be balanced between existing and future users so that funding is equitable.

Issues of intergenerational equity are more acute in growth areas because the pressure for services is greater. Population and housing growth places demands on councils to provide adequate services for the existing and future population in a fair and equitable manner.

3. Comparative Characteristics: Growth Areas

The Councils of Tauranga City, Hamilton City, Queenstown Lakes District and Western Bay District are all experiencing growth and associated financial pressures.

These growth areas are facing significant challenges in order to provide the necessary infrastructure and services for existing and new areas. The Councils are required to ensure that there is:

- Infrastructure in place for people's health and well-being, to protect property from damage and to protect the environment.
- Adequate essential infrastructure and services (eg water supply).
- Local infrastructure for new growth areas.
- Community infrastructure and services.
- Environmental protection.
- A balanced programme of expenditure to both existing and future communities.

The Councils referred to are facing financial challenges because of their growth rates. This is largely due to the fact that there are significant infrastructure projects that are needed to accommodate growth.[15] There are a number of issues for growth areas to address that may not occur to the same extent in other places. Such issues include:

- High development rates which involves increasing demands for infrastructure and services.
- Large growth-related infrastructure projects.[16]
- A growing population with increasing needs and expectations (eg more community services required).
- Beyond boundary servicing. Some of the Councils are surrounded by significant low density settlements that have little or no local services and tend to draw on the infrastructure and facilities provided by the neighbouring urban area. This puts more pressure on these Councils in terms of demand for infrastructure and services.
- High tourism numbers which places pressure on existing services and facilities along with the pressure to provide more.[17]

[15] For the four councils, between 31% and 55% of all capital expenditure over the next ten years is growth-related.
[16] For example, Tauranga City Council has to put in place the Southern Pipeline (a large wastewater pipeline) at a cost of $105 million; Queenstown Lakes District Council has $151 million worth of wastewater upgrades and $171 million of water supply projects.

- Higher land costs for purchases that need to be made (eg for reserve and open space purchases and designations).
- Managing traffic congestion and transport networks.

Transport is a significant driver of costs. The *Rates Enquiry* found that network assets (land transport, water, stormwater and wastewater) make up 73% of total Council capital expenditure.[18] Transport makes up 44% of this.[19] A lot of network infrastructure, particularly transport, is still in a state of catch up around the country due to past under investment.[20] This is most apparent in the growth areas around New Zealand.[21]

There are also a number of initiatives that have resulted in increased responsibilities, expectations and some additional cost for local government.[22] This has had the most the most effect in growth areas. For example:

- Amendments to the Resource Management Act 1991 – increase in functions, national environmental standards
- The Building Act 2004 – increasing the level and standard of building approval and inspection
- The Land Transport Management Act 2003 - a shift to providing for all modes of transport, particularly in urban areas
- Affordable housing – expectations that Councils will address housing affordability, the Affordable Housing: Enabling Territorial Authorities Act 2008

The examples provided above have a greater impact on growth areas because they have more development occurring and higher levels of population growth. This can place more expectations on these Councils. Also, issues such as affordable housing tend to be more acute in growth areas.

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[17] Of the peak day population of Queenstown-Lakes District, approximately 30% is made up of the usually resident population while 70% is visitors. Tauranga City and Western Bay of Plenty District also have significant visitor populations at peak times.

[18] Network assets make up 82% of total capital expenditure for Western Bay of Plenty District Council, 80% for Queenstown-Lakes District Council and 71% for Tauranga City Council.

[19] *Funding Local Government – Report of the Local Government Rates Inquiry,* August 2007 at page 5

[20] See the *New Zealand Transport Strategy 2008,* page 22 where it states that New Zealand is behind in the basic provision of transport infrastructure and there is a need to 'catch up'. Also see A World Economic Forum report in 2007 which placed New Zealand at 20th out of 30 OECD countries on the state of its ground infrastructure (the quality of roads, rail and ports). The Infrastructure Stocktake: Infrastructure Audit (2005) found that there are significant local and sector-specific infrastructure issues. The audit noted in particular land transport, water and wastewater (see page 2 – summary).

[21] Transport makes up 54% of total capital expenditure for the Western Bay of Plenty District Council.

[22] *Funding Local Government – Report of the Local Government Rates Inquiry,* August 2007 at pages 83-84

4. Characteristics of Growth

4.1 Residential and Commercial Development

Land markets in New Zealand growth areas have been highly active. In the past 10 to 20 years there has been significant growth in residential and commercial building development.[23] At times this has even outstripped population growth.

Growth areas also tend to have high residential vacancy rates. This is characteristic of holiday and lifestyle areas where people may only live on a part-time basis or have holiday homes. This vacancy effect puts significant pressure on growth areas as the demand still remains for infrastructure and services to support the growth in housing. Seasonal fluctuations also place pressure on local areas.

There is a relationship between population growth and demand for business land. Employment increases with population growth as does commercial activity. This creates demand for business land and the services to support it. Business land requires significant infrastructure investment which is of high quality, efficient and reliable.

4.2 Infrastructure

Growth areas within a city or district need infrastructure in place to enable development to occur. The cost of putting in place infrastructure for new growth areas can be quite high.

Councils work hard to ensure that development is staged so that new settlements only start when existing settlements have reached their capacity. Rates of growth are also carefully monitored within each settlement to ensure that they have not exceeded their ability to absorb development. This is a continual balance between ensuring there is sufficient land supply so as not to lead to inflated land prices, and protecting against over supply and consequently over investment in infrastructure.

Investing and building infrastructure in a timely manner is a core part of being able to influence and manage the location and pattern of future development that will occur as a consequence of growth.

Councils also have legal requirements to provide infrastructure and are responsible for the provision of water, wastewater, stormwater and transport. Growth places pressure on existing infrastructure and also creates demand for new infrastructure and ongoing maintenance.

[23] Building Consents Issued, Statistics NZ

4.3 Integration: Land Use, Infrastructure and Funding

This type of integration involves considering the impact of development on infrastructure and identifying funding for this so that infrastructure is provided in a timely manner, and that development does not have a negative impact on existing infrastructure.

Growth areas have to take a long term planning approach to land use which ensures that the rate and location of development is integrated with the provision of strategic infrastructure and associated funding mechanisms. The aim of this integrated approach is to reduce the potential costs of growth on the general ratepayer now and in future.

Such an approach is reliant on development levels being at projected levels, the timely provision of infrastructure and the availability of funding.

It is noted that the Royal Commission report on Auckland Governance included a key section on integrated growth management and noted the importance of a more integrated approach to planning.

5. Financial Challenges

Local Government needs to meet statutory requirements, progress adopted strategies and plans and comply with legislation requirements for prudent financial management in a manner that promotes the current and future interests of the community. This needs to be done in a way that ensures that rates, user fees and charges are affordable.

Growth areas are facing a number of challenges which have financial implications. Most of the challenges are particular to or more acute for growth areas because they revolve around catering for an increasing population and higher levels of development activity. These challenges include:

- When the capacity of existing infrastructure is about to be 'used up' the next generation of infrastructure needs to be introduced.
- The new infrastructure generally provides for the next 50 – 100 years (note: reducing the capacity period does not proportionately reduce cost).
- The infrastructure required is of a significant scale.
- Cost escalation (construction costs are increasing)
- Development contributions are a key funding tool to contribute to growth costs but they don't come in a timely enough manner to reduce the debt on the balance sheet of today's ratepayers. The contributions are received over a long period of time. In the interim Councils hold the debt for the growth infrastructure and this reduces the capacity of the Council to invest in other infrastructure for the current community.
- When periods of declining development occurs (as is being experienced now through the economic recession), the situation deteriorates further with the ratepayers wearing the risk of the debt and paying for a greater share of the provision of surplus capacity.
- There is currently no legislative means of funding tourism growth-related infrastructure and services.

Preliminary analysis from the long-term council community plans indicates that public debt per capita for each of the four Councils is high relative to other Councils. For 2009/10 debt per capita is well over $2,000 for the four Councils. There are only a small number of Councils with this level of debt. The four growth Councils are consistently in the top eight with the highest debt levels per capita. Attached as **Appendix 1** is a table which compares the per capita debt levels of 18 local authorities.[24]

[24] Note that this information is based on draft Long-Term Council Community Plans, not the final versions.

A significant amount of this debt is growth-related. Hamilton City Council's growth-funded debt increases by $242 million by 2019 (taking Development Contribution-funded debt from 37% of all debt to 52% of all debt); Queenstown-Lakes District Council's by $232 million by 2019 (which equates to 59% of total debt); Tauranga City Council's by $133 million by 2019 (38% of debt); and Western Bay of Plenty District Council's increases by $42 million by 2019 (65% of debt).

The fact that a large amount of debt for these four Councils is growth related has a significant financial impact. It means that debt has to be funded over a longer period of time. Once this is on the balance sheets it reduces the ability to borrow for other non-growth related infrastructure and services. It also means that existing ratepayers are carrying the costs and the risk for new growth areas.

High levels of debt impact on prudent treasury management, the credit rating of councils (rating goes down and therefore the cost of debt goes up) and the ability of councils to deliver on all four well-beings for present and future communities.

Councils can reprioritise, scale down, defer and not proceed with some projects. However, at some point councils will "hit the wall" where the short term options of deferral and cancellation will no longer be possible and the debt levels unsustainable.

A significant amount of effort has also gone into attempting to reduce the costs to Councils.[25] For example:

- Assessment of staging options for projects.
- Phasing of construction for infrastructure.
- Phasing of infrastructure in accordance with the growth / uptake rates.
- Deferral of non-essential projects.
- Adopting a 'just in time' approach to the provision of infrastructure.
- A greater emphasis on growth via intensification of existing communities.
- Requiring developers to advance fund infrastructure if they want it before a council's budget staging.

Part 2 of this report contains further details on how the Councils have attempted to reduce expenditure.

[25] Tauranga City Council reduced capital expenditure by $308 million and reduced some levels of service; Queenstown-Lakes District Council has deferred all non-essential capital expenditure past the first three years; Hamilton City Council reduced proposed capital expenditure funded by development contributions by 40% (approximately $200 million); and Western Bay of Plenty District Council deferred $60 million of projects to beyond 2020.

It should also be noted that a number of community projects are the subject of a targeted rate that those particularly communities have endorsed in order to get local services.[26]

The economic climate over the last two years has seen development slow down and therefore development contribution revenue has fallen significantly below 2006-16 Long-Term Council Community Plan projections. This has the consequence of keeping debt at higher levels for longer with interest costs continuing to accumulate.

This slow down also means that the projected increase in the number of rateable properties over which the rate requirement is spread has been reduced. User fees and charges are also down.

Councils have to continue providing the vital services that people need which means that they have to absorb the extra costs.

The economic recession has come at a time when there are various pressures on local government, particularly growth areas. This includes rising infrastructure costs, traffic congestion and an ageing population.

Development levels may well return to forecast levels in 3 to 5 years time, however it is going to take time for the funding streams to emerge again and banks are likely to be more conservative.

[26] For example the Queenstown Aquatic Centre.

6. Funding Tools

Various funding tools are available to local government. These are as follows:

- Rates
- Development contributions
- Investment income
- Tolls for new roading projects
- Cost sharing arrangements with the private sector
- User fees and charges
- Capital works borrowing

There is significant pressure on local government at present to keep rates, user charges and fees at modest levels. This is a particular issue in terms of rates which was highlighted by the Local Government Rates Enquiry.

The current economic climate is exacerbating the funding issues facing growth Councils. The development community is under considerable pressure and the reduced level of activity means that the amount of development contributions coming in has drastically decreased. The economic climate has also reduced any income from investments.

It should be noted that even if there were not an economic recession the growth funding issues would still exist. The recession is not the cause of the financial challenges but is exacerbating it. The recession is highlighting how quickly and dramatically revenue streams can reduce and therefore how much risk the current ratepayer is bearing on behalf of future growth.

Tolling is a possibility for large-scale local roading projects. However, these would have to be projects that could provide an alternative route and where there was a high degree of public support for such a measure. The tolling process takes time and is more likely to occur for State highway projects than local roading.

Cost sharing arrangements with the private sector is much less likely given the current economic environment.

There are significant limitations on borrowing since the debt servicing requirements are either a direct impost on rates or in some cases development contributions. Where a Council already has significant debt, this option is not available or only has a limited viable timeframe.

7. Consequences of a "Do Nothing" Option

A "do nothing" option will inevitably lead to the deferral and cancellation of projects in growth areas.

It is very important that growth areas are well prepared and continue to implement key infrastructure projects. The major infrastructure projects need to proceed as they are crucial to keeping pace with the growth needs of the local authorities as well as assisting economic development. For every year a major project is delayed there will be another year required to speed it up. If a major project is slowed down for two years it will take another two to regain momentum, meaning that four years are lost in terms of delivery. This adds four years of cost escalation and undermines confidence in the areas concerned.

At this point a "do nothing" approach is likely to result in:

- Deferral or cancellation of key projects.
- Associated loss of economic activity as a result.
- A loss of developer confidence in the growth areas.
- Planned developments being scaled down or abandoned because of a lack of infrastructure. This would deter investment which will have an adverse effect on economic development.
- An inability to manage growth effectively.
- Dispersed development if there is inadequate supporting infrastructure. This could impact on productive rural land and versatile soils and will ultimately increase infrastructure costs over the longer term.
- Increasing difficulties for existing communities and businesses.
- A number of developments are subject to consent conditions that infrastructure is to be in place before they can go ahead.
- Loss of momentum and increasing costs if projects are delayed.
- Inability to achieve the 30 year land use pattern required by Government to provide transport funding confidence.
- Inability of Councils to meet statutory standards (for example in relation to wastewater discharge).

If Councils are unable to provide infrastructure and services in a timely and relatively low risk manner, this will not only have a significant local impact but also an impact on the performance of New Zealand's regional economies and ultimately a cumulative impact on the national economy.

8. Key Messages

- Growth areas are currently under significant financial pressure due to high growth rates, high infrastructure and service costs, timing lag between investment in growth infrastructure and recoupment through development contributions, and significant increases in operating costs arising from the growth in network infrastructure.

- The financial position of the Councils is not sustainable in the medium to long term. This has become apparent during the preparation of the 2009 - 2019 LTCCPs.

- Local Government has statutory obligations to provide essential infrastructure and services to its communities in order to provide for their economic, social, cultural and environmental well-being.

- Some Councils currently have insufficient borrowing capacity to prudently fund the level of expenditure required, and this will become a greater issue over the medium to long term.

- Significant attempts have been made to reduce expenditure through reprioritising, scaling down projects, deferral and cancellation of some projects. However, there is a limit to how much cost cutting can be achieved.

- Local Government has an important role to play in stimulating local economies, in particular with Central Government support.

- The Councils concerned wish to work with Central Government on the solutions put forward in this paper to ensure the long term financial sustainability of the Councils.

9. Solutions

The growth councils are already actively adopting a number of approaches to manage the current situation. These are detailed in sections 9.1and 9.2 below. The Councils believe that these measures will not by themselves provide sustainable long term funding, hence the request in 9.3 for Government assistance.

9.1 What Local Government is Doing to Manage the Current Situation

In order to address some of the issues raised by this paper the Councils are undertaking the following:

- Deferral of non-essential projects.
- Staging of infrastructure projects.
- Requiring developers to advance fund infrastructure if they want it before a council's budget staging.
- Investigating other funding options such as bonds.
- Looking for alternative solutions to the provision of key projects.
- Sale of land that is surplus to requirements.

9.2 Innovative Funding Methods

Innovative funding methods for key projects are also being investigated. These include

- Public-private partnerships.
- Sharing of services.
- The potential for tolling large roading projects.

9.3 Proposed Financial Assistance Tools

In addition to the Council actions outlined above, this paper puts forward several funding mechanisms that it is believed will ensure the financial sustainability of the Councils while also providing economic stimulus to local economies.

The Councils concerned would like to partner with Central Government in order to achieve a funding solution for the medium and long term.

The proposed funding tools are as follows:

Funding Guarantees
A Central Government funding guarantee for core infrastructure debt which would provide interest rate savings.

Funding Facility
The Reserve Bank to provide an agreed sum funding facility equivalent to a Committed Bank Line or a stand-by facility. This would enable growth Councils to secure a defined level of funding at a cheaper rate and by-pass the increasing line fees being charged by the banking sector.

Zero Interest Loans
Make available zero interest loans to growth Councils for investment in growth-related projects. This will reduce the cost of capital charges to development and helps lower the cost to ratepayers through a reduced debt profile.

Grants, Subsidies and Suspensory Loans
Provide grants to Councils that have growth strategies in place to allow them to offset and cap development contributions for the next three years.
Provide infrastructure grants to growth Councils to ensure that major projects can go ahead.
Suspensory loans could be made where it is possible for the Government to clearly define future expectations which would need to be met before the need to repay the loan was revoked, eg x sites available for residential development.

The Councils would like the Government to determine a policy position in relation to the above and consider some or all of the funding options put forward.

9.4 Financial Assistance Benefits

The benefits of the funding tools outlined above are as follows:

- It would allow important infrastructure projects to go ahead.
- Ensure that LTCCPs will be sustainable over the full 10 year period.
- Provides stimulus to the local and national economy.
- Reduces the debt burden on growth Councils.
- Reduces the cost of borrowing (allows Councils to maintain a good credit rating).
- Reduces the impact on ratepayers.

The building of local infrastructure provides economic stimulus to local areas. It is also of benefit to the national economy in terms of employment, revenue flow and facilitating commerce.

Growth areas themselves make a contribution to the national economy. They are usually areas were there are high levels of development, economic activity and population growth, all of which stimulate the economy.

For these reasons it is essential that local government and central government work together to come up with a solution that is of benefit to local areas as well as the nation as a whole. The funding tools outlined in this section will help to achieve this.

Appendix 1: Debt per Capita[27]

Council	2009/10[28]	2010/11[29]	2015/16[30]	2019[31]
Auckland	1690	2141	2491	2,321
Christchurch	833	1042	1772	2,145
Franklin District	1433	1541	2000	1,886
Hamilton City	2493	2769	3922	3,937
Kapiti Coast District	1981	2145	3428	3,461
Manukau City	749	812	1077	967
North Shore City	2027	1988	2432	2,582
Papakura District	808	1159	1768	1,589
Queenstown Lakes District	4359	4816	10416	12,808
Rodney District	3183	2756	3299	3,288
Selwyn District	845	1856	1704	1,175
South Taranaki District	4069	4493	6238	6,036
Tauranga City	3128	3159	4553	4,124
Waikato District	325	400	581	212
Waimakariri District	842	820	1243	991
Waitakere City	3022	3278	4653	4,119
Wellington City	1721	1780	1611	1,712
Western Bay of Plenty District	3022	3126	4447	3,483

[27] Debt levels sourced from draft long-term council community plans. The 18 Councils listed are there to provide a comparison between each other. The majority of the Councils included are among the top 20 in terms of the highest annual growth rate throughout the country.

[28] With population as at 2006

[29] With population as at 2011

[30] With population as at 2016

[31] With population projected to 2019