

FUNDING THE COST OF GROWTH

LONG-TERM OPTIONS

BACKGROUND DOCUMENT FOR COUNCIL WORKSHOP

July 2011

PURPOSE AND BACKGROUND

At the first growth funding workshop in June 2011 it was agreed that long-term options for funding growth infrastructure costs that would require legislative change or a significant change in Council policy direction would be addressed in a separate workshop. This workshop is taking place in the Council Chambers from 9am to midday on Friday 28 July.

It was also agreed that the idea of setting up a 'growth funding taskforce' would be discussed at this workshop.

The purpose of this background paper is to provide some basic information about the following range of alternate approaches to the funding of growth infrastructure costs to assist the discussion at this workshop:

- Water and/or wastewater volumetric charging
- Watercare Services (Auckland model for the delivery of water and wastewater)
- Private provision of water / wastewater services
- Regional fuel taxes
- Tolling / congestion charges
- Tax increment financing
- Municipal utility districts
- Value uplift levy
- Targeted rates
- Regional infrastructure fund
- The case for a greater funding contribution from Central Government
- Reducing the cost of infrastructure.

The background paper does not address the following growth funding approaches which are widely understood and are the subject of discussion through the review of Council's review of its current 'growth pays for growth' philosophy:

- Development contributions (LGA 2002) and financial contributions (RMA 1991)
- Rate funded loans
- Direct developer funding.

Alternate growth funding approaches to rates and development contributions may need to be given serious consideration in the future. Large rate increases to fund growth costs are generally unacceptable to ratepayers. On the other hand, high upfront development contribution charges can have significant adverse implications for the feasibility of development and for the affordability of housing.

It should be noted that the Productivity Commission which was recently set up by central government has been asked to look into the appropriateness of development contributions as a means of funding growth infrastructure and whether there are other fund approaches that would be more equitable and efficient. This work is being done as part of a broader inquiry by the Commission into housing affordability.

The following link is to the Productivity Commissions' housing affordability issues paper which is out for submission at the moment http://www.productivity.govt.nz/sites/default/files/NPC3189-Housing-Affordability-Issues-Paper-June2011_2.pdf.

The majority of the options outlined in this report would require a legislative framework to be developed. As such they would need to be progressed at a national level. There is some opportunity to do this through the various sector wide groups of which Council elected members and staff are part. The proposed review of the LGA 2002 may also be an appropriate forum to raise these types of issues.

1. WATER AND/OR WASTEWATER VOLUMETRIC CHARGING

Typically network utility operators in industries like telecommunications, electricity reticulation or gas reticulation fund the majority of their network expansion through user charges.

Council's water and wastewater networks are similar in many regards to these other types of network utility businesses. If Council wished, it could fund some or all of the cost of expanding its water and wastewater networks through user charges i.e. volumetric charges based on how much water was used / wastewater generated.

This would necessitate an increase to Council's current water charges and/or the introduction of a new charge for wastewater (which would be based on a percentage of the total amount of water consumed).

This approach would have the additional benefit of providing financial incentives for the whole community to reduce water consumption. Ultimately this would result in Council being able to reduce or defer water and wastewater capital expenditure (and also the additional operating costs that come with new infrastructure).

Currently, volumetric water meter charges fall within the ambit of the Local Government (Rating) Act 2002 but volumetric wastewater charges do not. This does not prevent Council from implementing wastewater charges but it would mean that the collection remedies available under the Local Government (Rating) Act 2002 would not be available. This might mean that private debt collection agencies would have to be used to recover overdue accounts.

The mechanism of volumetric charging and pricing for water and wastewater is on the topic list for discussion through the 2012-22 TYP.

2. WATERCARE SERVICES

At the first growth funding workshop developers raised the Auckland model for the delivery of water and wastewater services as one which Tauranga City should explore.

Watercare Services Ltd is a Council Controlled Organisation (CCO) of the Auckland Council. It delivers water and wastewater services to the greater Auckland City area.

How is Watercare funded?

Either through debt or through its user fees and charges. Because it is a CCO its debt is ultimately part of Auckland Council's debt.

Is Watercare an example of a Public Private Partnership?

No.

How does Watercare fund the cost of growth in its water / wastewater networks?

Watercare charges the equivalent of a development contribution which is called an infrastructure growth charge of approximately \$7,000 in total for new residential connections to both the water and wastewater networks within the metropolitan area. This charge increases significantly for areas outside the metropolitan limits e.g. the infrastructure growth charge for connecting to just the wastewater network in Kawakawa is approximately \$26,000.

Staff are unsure whether these infrastructure growth charges are set at a level to recover the full costs of expanding the water / wastewater networks to accommodate growth or whether some of these costs are funded in other ways e.g. through volumetric charges.

Does Watercare have volumetric charges for wastewater?

In some instances it does. It is quite common for non-residential wastewater charges to be charged on a volumetric basis in Auckland and in some instances volumetric charging is also applied to residential dwellings.

The varied nature for charging is a hang-over from the merger of the seven Councils in Auckland into one. Staff are unsure about Watercare's future direction in terms of volumetric charging for wastewater.

Do Watercare charges count as rates for collection purposes?

No. As such, the collection remedies available under the Local Government (Rating) Act 2002 are not available to Watercare Services.

3. PRIVATE PROVISION OF WATER AND WASTEWATER SERVICES

The LGA 2002 allows Council to contract out the delivery of water and/or wastewater services to the community for a period of up to 35 years. This provides scope for Council to enter into public private partnerships for the delivery and funding of growth-related water / wastewater assets if it wished to. This would allow private investment to occur which could ease pressure on Council's debt envelope.

The most relevant sections of the LGA 2002 are set out below for your convenience:

124 Interpretation

water services means water supply and wastewater services

136 Contracts relating to provision of water services

(1) Despite [section 130\(2\)](#), a local government organisation may enter into contracts for any aspect of the operation of all or part of a water service for a term not longer than 35 years.

(2) If a local government organisation enters into a contract under subsection (1), it must—

- (a) continue to be legally responsible for providing the water services; and
- (b) retain control over the following matters:

- (i) the pricing of water services; and
- (ii) the development of policy related to the delivery of water services.

(3) This section does not limit contracts in relation to water services that are entered into solely between local government organisations.

It is likely that Council staff would only ever recommend that Council considers private involvement in the provision of water or wastewater services if this reduced the cost of providing these services. It should be noted that while there may be some efficiencies gained, private provision of these services brings with it the need to be tax, the need to earn a financial return (profit) and a higher cost of debt.

4. REGIONAL FUEL TAXES

The previous Labour Government proposed to introduce regional fuel taxes. The tax would have been a way for regions to raise funds for specific transport capital projects that are a regional priority and which would not otherwise attract funding within the timeframe desired. The regional fuel tax could have been as much as 10 cents per litre although the amount that could be spent on roading projects was capped at 5 cents per litre. The National Government abolished the proposed regional petrol taxes in 2009 and the amendment to the Land Transport Management Act announced in June 2011 proposes to formally repeal statutory provision for regional fuel taxes.

A regional fuel tax would have been a means of funding (or partly funding) some of the growth related transportation projects that the city and the region faces e.g. Papamoa East and Mangatawa Interchanges on the TEL.

Interestingly, Part 11 Local Authorities Fuel Tax of the LGA 1974 was never repealed. It seems to provide scope for Tauranga City Council to introduce a local fuel tax of up to 0.66 cents per litre. Staff are unsure whether or not this would provide a substantial funding source for transportation projects. The relevant sections of the LGA 1974 are sections 181 to 200.

5. TOLLING & CONGESTION CHARGES

The only toll road in Tauranga is Route K. This will soon be joined by the TEL which will be tolled between the Papamoa East interchange and Paengaroa. Tolling may be viable option for fund other transportation projects in the city e.g. the Papamoa East interchange.

Congestion charges are a relatively new concept which have not yet been implemented anywhere in New Zealand. Congestion charges are applied to vehicle traffic that enters an area where high congestion exists. They are generally applied at peak times where congestion is at its greatest.

They have two advantages. Firstly, they act as a disincentive to use vehicles thus reducing congestion. Secondly, they raise funds which can be applied to projects that alleviate congestion.

Congestion charges may in future be an appropriate tool in addressing the most congested parts of Tauranga's roading network e.g. the harbour bridge. However legislation would need to be passed to allow congestion charges to be applied.

6. TAX INCREMENT FINANCING

Tax increment financing (TIF) is a method that is widely used in the US to fund the costs of growth related infrastructure. TIF is permitted in 49 of the 50 States in the US. It is now being introduced into the UK and is under consideration in Australia.

In simple terms it works as follows:

1. An area is ring-fenced e.g. Wairakei.
2. As the area is developed the additional taxes generated in this area are used to fund the infrastructure for this area instead of going to Council or to the government. The infrastructure is funded by raising bonds which are backed by this future tax revenue.
3. As these additional taxes are collected they are used to progressively repay the bonds.
4. Once the bonds are fully repaid the tax revenue being generated in the area goes back to Council or to the government.

Without central government involvement TIF is unlikely to be successful in New Zealand because local government does not have the tax revenue streams to support it that they have in the US where local authorities and State Governments commonly levy sales taxes (i.e. gst). Council would only have rate revenue to work with and this would not provide a sufficient revenue stream to repay the cost of infrastructure in an area like Wairakei.

7. MUNICIPAL UTILITY DISTRICTS

A Municipal utility districts (MUD) works in much the same way as TIF does. They are commonly used in the US, especially in Texas where housing has remained incredibly affordable despite huge population growth in cities such as Huston and Dallas.

A MUD is effectively a growth area that is set up as its own mini Local Authority. It has powers to raise taxes (e.g. rates). Based on these powers in can raise finance to build infrastructure. As development takes place it collects taxes to repay debt. Once its debt has been repaid a MUD generally then becomes part of city in which it borders.

This type of approach to urban development and infrastructure funding would clearly require legislative change to be introduced in New Zealand.

8. VALUE UPLIFT LEVY

The rezoning of land from rural land uses to urban land uses generally causes the value of the land to increase substantially. This creates a significant 'windfall' gain to the landowner.

The idea of a value uplift levy is to 'claw back' some of this windfall gain through the levying of a tax at the time the land is sold or developed. This tax revenue can then be used to assist in meeting the cost of infrastructure that is required for the land to actually be developed.

The idea of a value uplift levy was proposed in the 2008 Department of Internal Affairs discussion document titled *Building Sustainable Urban Communities* ([http://www.dia.govt.nz/diawebsite.nsf/Files/BSUCwholedocument/\\$file/BSUCwholedocument.pdf](http://www.dia.govt.nz/diawebsite.nsf/Files/BSUCwholedocument/$file/BSUCwholedocument.pdf) - refer pages 21 to 25). This discussion document did not progress beyond the submission stage due probably to a change in government. The relevant part of the Summary of Submissions from this discussion document is set out below.

This method of infrastructure funding is used in some jurisdictions around the world, including in Canada. It seemingly has significant merit in providing a funding source for growth infrastructure that would not be ultimately have to be funded by the developer, Council or Central Government.

It would require legislation to be passed for it to be implemented. Although, interesting, s326 of the LGA 2002 which has not been repealed provides for the taking of a value uplift levy (referred to as 'betterment') in relation to the increase in land value associated with Council provided roads. This section is set out below for your convenience. Any betterment which is taken must be used toward to cost of building or widening the road in question.

Extract from summary of submissions on Building Sustainable Urban Communities discussion document

Q: To partly or fully fund sustainable urban development, do you support a value uplift levy to capture 'unearned' gain resulting from public actions to increase scope for development? Please explain your view.

General support

Views were polarised on the question of value uplift as a tool. Around half of submitters supported such a tool being available.

Among the submitters who considered there is merit in a value uplift levy, support was often qualified. Submitters primarily supported a broader suite of funding mechanisms for sustainable urban development areas, and value uplift was seen as a possible component of an expanded suite of tools. It is within this context that 'value uplift' was seen to merit further consideration.

Submitters who fully support the concept pointed to its use overseas and believed that value uplift could be an appropriate tool to 'sheet back' the costs of development to those generating them.

The general view of value uplift was that it has potential to partly fund urban development. It was described by some submitters as an 'incremental' source of funds, and submitters pointed out that it cannot address the key issue of lack of 'front end' investment needed to get the first phases of urban development underway.

General concerns/opposition

Submitters, including several metropolitan councils, did not support the value uplift tool because it:

- could be potentially cumbersome or difficult to administer [submitters 36, 43, 47, 76, 80 and 82]
- does not adequately address intergenerational equity [submitters 47, 51 and 74]
- margins may be insufficient in areas where development is sought to enable an uplift tool to function [submitters 26, 76 and 87]
- has potential to generate considerable legal challenge [submitters 47 and 85]
- raises questions around what occurs in periods of market downturn (i.e. how this fund tool works if values fall) [submitters 11 and 84]
- may discourage investment into areas (canvassed in next section of report); and
- other existing tools are as effective or potentially better in gathering incremental funding [submitters 47, 51 and 69].

Several submitters considered that rather than concentrating on value uplift, the focus should be on the fact that insufficient funding is accessible under current arrangements for the initial phases of getting an urban development project underway – this is the critical funding issue.

“Mechanisms to gain ‘up-front’ funding for urban regeneration projects must be investigated” [submitter 98].

Loans, underwriting, grants and tax incentives were suggested by submitters as more effective tools to focus on for this purpose. Several submitters noted that local government is significantly limited in its ability to provide 'up front' funding via rate sources, and therefore central government needed to be involved.

Submitters' answers to this question are summarised below:

Submitters supporting the idea of value uplift stated that:

“..where public actions increase the scope for development it is not unreasonable for landowners / developers benefiting from such gains to contribute towards the necessary community and strategic infrastructure” [submitter 10]. Examples of systems in use from the UK and Vancouver were cited.

“If successful Australian models could be applied to the NZ context then money from uplift could create a funding pool for master planning projects” [submitter 33].

“The concept of a value uplift levy to capture part (if not all) the unearned value increase from the potential for higher density development is supported, but such a system will need to be carefully thought through to ensure it is fair and equitable as well as simple and efficiently administered” [submitter 75].

Submitter 21 *“...considers value uplift levies have some merit”, as does submitter 6 –*

“Yes absolutely – when new public transport like rail or tram lines are put in, the increased value of properties along that line should be “harvested” to help pay for building the lines”.

“Organised at the regional level, [the council] supports the funding of major investment in regional network infrastructure through the introduction of national legislation that would require territorial authorities to collect an return to regional council, a codified regional betterment levy.”

Submitters with reservations or opposing value uplift comment that:

“Urban redevelopment requires significant upfront funding, not incremental funding as would be delivered through value uplift levies, development contributions, and similar mechanisms” [submitter 26].

“Experience in New Zealand, the United Kingdom and Australia has shown that even where a value uplift levy is supported in principle it has proven difficult to put into practice. This appears to be in part because of the difficulties associated with valuation of the property, both before and after granting of planning permission” [submitter 98].

“Localised betterment levies (at the project / sub regional level) appear to have the potential to have negative or unanticipated flow-on effects that would disincentivise development in the very places where the region desires it” [submitter 98].

“A value uplift levy would result in a difficult system for Councils to implement and would frustrate developers” [submitter 43].

“We... disagree in principle with the underlying concept of a value uplift levy. We submit that it is an unreasonable and unjustifiable charge which raises several issues requiring careful consideration. It effectively amounts to a capital gains tax on an increase in property values at a certain point in time, but these values rise and fall with property cycles. It

also does not take into account that an increase in value is not realised until a property is sold” [submitter 47].

“Not supported – this cost would be passed on to those who can least afford it, those living on low income through increased housing costs – too complicated to administer, could easily be abused” [submitter 80].

What issues would need to be considered when designing and implementing a value uplift levy?

Discussion

Points identified by submitters in considering any additional funding mechanism (including a value uplift levy) included:

- Risk that new funding tools may be disincentives to developing urban areas.
- The vital importance of having a costed and phased ‘spatial growth strategy’ or plan for the specific sustainable urban development area. This is needed to ensure various parties’ commitments are clear.
- Spatial growth strategies or plans require significant upfront investment, plus strong implementation tools to give certainty about delivery timeframes.
- A value uplift (or any new funding mechanism) should be scaleable and able to be adapted to the circumstances of different locations.
- Funding mechanisms should incentivise types of development sought, rather than introducing additional hurdles. It is observed that investment decisions by the private sector often seek to minimise risk and therefore tend to follow the ‘path of least resistance’.
- A cross section of private and public sector expertise in designing funding mechanisms should be used.
- Methodology should be as simple, clear and transparent as possible.
- ‘Whole of life cycle’ costs and sustainability impacts should be included in assessment criteria.

Submissions suggested that clarity is required about whether any new funding tool/s is for special circumstances (i.e. a declared ‘sustainable urban development’ area) or a generally available tool. It is evident some submitters have responded to this question on the basis of a value uplift (or any other tool) being used in all urban development circumstances, whereas other submitters have viewed the application of new tools only in relation to declared urban development areas with national / regional significance.

Submitters’ answers to this question are summarised below:

Risk that new funding tools may be disincentives to developing urban areas

Several of the submissions (including a number of councils and local government organisations) cautioned that particular care should be taken to ensure any new funding tools (particularly a new 'uplift levy') do not inadvertently discourage development in areas where it is sought [submitters 22, 26, 46, 50, 57, 63, 69, 73, 76, 80 and 98].

"The active discouragement to investment in an area where investment should be encouraged is the main issue here. The complexity of measuring the value uplift would create a drag on council expenditure where legal challenges would drain council coffers and waste productive staff time on court cases" [submitter 69].

Section 326 of the LGA 1974

326 Betterment arising from creation or widening of a road

(1) Notwithstanding anything in [section 62\(1\)\(f\)](#) of the Public Works Act 1981 or in any other Act, where—

(a) the council—

- (i) forms a new road in the district; or
- (ii) widens any existing road or part thereof in the district; and

(b) for that purpose the council takes or purchases or otherwise acquires any part of any land and the other part of that land will have access or frontage to that road; and

(c) by reason of the formation or widening of the road the value of the remaining part of the land of the owner whose land was taken or purchased or acquired is increased by an amount that exceeds the amount of compensation payable to him, in accordance with the [Public Works Act 1981](#), in respect of his land so taken or purchased or acquired,—

the owner shall pay the amount of that excess to the council by way of betterment to the remaining part of his land.

(2) Where an existing road is widened and land from only one side of the road is taken or purchased or otherwise acquired for that purpose, every owner of land with a frontage to the other side of the road shall, if so required by the council, pay to the council on account of betterment such sum of money as represents the increased value thereby given, or likely to be given, to his land. Where only part or parts of a road are widened, only those owners of land with frontages directly opposite the part or parts being widened may be required to pay betterment pursuant to this subsection.

(3) Any claim for payment of betterment under subsection (1) or subsection (2) shall be made within 1 year from the execution of the work out of which it arose, and shall be made in form 1 in [Schedule 12](#). The amount to be paid to the council shall be ascertained in the manner provided by the [Public Works Act 1981](#), or in a manner as near thereto as in the opinion of the Land Valuation Tribunal the circumstances of each claim will admit.

(4) Any or all claims arising out of the widening of any road or part thereof may, with the consent in writing of all parties, be heard and determined together, and the Land Valuation Tribunal shall have power, on the application of any party, to order that all or any claims under this section in respect of land in which several persons have interest shall be heard and determined together and to apportion the amount awarded on account of betterment and the costs of proceedings against the several persons, in such proportions and in such manner as it thinks fit.

(5) Any person liable may, if he so desires, pay the amount awarded to be payable by him, with interest at a rate per annum as fixed by the council, by equal half-yearly instalments extending over a period of 20 years or less, in which case he shall—

(a) within 14 days after the date of the award, give notice in writing to the principal administrative officer of the council of the period over which he intends to extend payment; and

(b) within 1 month after the date of the award, execute and deliver to the principal administrative officer a memorandum of charge, in form 2 in [Schedule 12](#), upon the estate or interest forming the subject of the charge against him, and pay the costs of the preparation and completion of that memorandum;—

and thereupon the respondent shall have the right to pay that amount by instalments as set forth in the notice and memorandum of charge as aforesaid.

(6) [Repealed]

(7) The memorandum of charge shall, when registered, bind the property therein described, and operate as a first charge upon the estate or interest therein of the respondent, and rank in priority to all estates, encumbrances, and interests created by him or any of his predecessors in title.

(8) Any such charge may be registered without fee in the Land Registry Office or in the Deeds Register Office of the land registration district wherein the land affected thereby is situate.

(9) Notwithstanding anything to the contrary in any such charge, the council shall accept payment of the whole of the unpaid instalments secured by any such memorandum of charge at any time when the same is tendered, and for the purpose of any such tender interest shall be calculated and paid up to and including the day of tender.

(10) A receipt expressed to be in full for all money secured by any such memorandum, signed by the principal administrative officer and endorsed on the memorandum, shall vacate the charge.

(11) Money received by the council under this section as betterment shall be credited against the cost of the formation or widening of the road or part thereof which includes the acquisition of the land required for the work and the formation, sealing, kerbing, and channelling. Where the money received is more than sufficient to meet the cost of the work, the amount of the excess shall be applied in respect of the widening or formation of any other road within the district.

(12) In this section the term **road** does not include an access way.

9. TARGETED RATES

One of the biggest criticisms of development contributions is that they require the payment of significant upfront monetary payments. One way of getting around this would be to convert a development contribution into a targeted rate which would be paid off over a reasonably long time period.

Council staff have done some preliminary investigation of this idea. Based on a 20 year repayment period to reduce a development contribution by say \$10,000 would require a targeted rate of approximately \$1,000 per annum. This demonstrates that rates for new properties would have to increase significantly if targeted rates were to be used in lieu of some or all of Council's development contribution charges.

10. REGIONAL INFRASTRUCTURE FUND

The BOPRC controls a significant amount of regional wealth through its shareholding in the Port of Tauranga. The BOPRC is in the process of setting up a regional infrastructure fund which will be available to assist in funding the costs of new infrastructure across the whole of the Bay of Plenty.

In time, this may prove to be funding source which can assist in funding the costs of growth infrastructure in Tauranga City. To date, Council has been successful in obtaining \$1.8m of funding from the BOPRC for the rate funded component of the southern pipeline project. An application for further funding for this project will be considered by the BOPRC through its 2012-22 TYP. If this is successful it is likely that again it would only be for the rate funded portion of the project cost.

The BOPRC has not yet confirmed the criteria that will apply to applicants for grants from the regional infrastructure fund.

11. CENTRAL GOVERNMENT FUNDING

Central government funding toward Council provided infrastructure is now limited to NZTA funding assistance which is available to some transportation projects. This funding assistance is however not available for transportation projects which are development contribution funded.

Growth infrastructure that Council provides such as roads and reticulation water / wastewater networks is an integral component to the economic growth of the country and a strong argument could be made that the national benefit that this provides should be recognised through a direct funding contribution from central government.

It is also worth noting that central government directly benefits from the economic activity that Council provided infrastructure permits through collection of increased tax revenue e.g. gst, income tax and company tax.

The present local government funding arrangements mean that growth is effectively a cost to Council because it does not benefit from the additional tax revenue that central government receives as the economy grows. Sure, growth increases the rating base but probably not to the extent that this offsets the additional Council funded capital expenditure and operating expenditure that it brings in a place like Tauranga where surplus infrastructure capacity is pretty much non-existent.

If Council was able to share in the financial benefits of growth, for example through a small share of the amount of gst that is raised locally, then Council would be much more able to support and facilitate growth. This would benefit not just the local economy but the national economy as well.

Typically local and State government's and in the US and in some other jurisdictions have the ability to levy local sales taxes similar in nature to gst.

12. REDUCING INFRASTRUCTURE COSTS

The focus of this background report has, thus far, been on alternate methods to fund the costs of growth. Another way of easing the burden of funding growth infrastructure costs would be to reduce the quantum of these costs. There are two primary means in which costs could be reduced:

1. Reduced levels of service
2. Lower environmental standards.

Reduced levels of service

This could include things like:

- accepting higher congestion on roads
- Accepting lower levels of service for roads that connect to the State Highway network
- removing the requirement for residential streets to have kerb and channel
- allowing roads to be narrower
- reduced treatment of stormwater entering waterways
- accepting lower water pressures in peak demand periods
- support for more on-site treatment approaches rather than urban wastewater and water reticulation
- Provision of less reserve land and / or the development of this land to a lesser standard.

Lower environmental standards

This could include things like:

- Allowing treated wastewater to enter the harbour
- Building more ocean outfalls for stormwater in lieu of large stormwater detention ponds.