Attachment J: Rates capping Briefings DIA to Minister

UNCLASSIFIED

Department of Internal Affairs

Proactive release of briefing papers related to rates capping
22 December 2025

The following documents have been proactively released:

Briefing: Options and timeframes to design and implement a revenue capping system for New Zealand (LG20244204)

Briefing: Reflections on the NSW Rate Peg system and considerations for a NZ System (LG20245259)

Briefing: Overview of non-rate cap interventions in Australia, broad options for controlling council spending and initial design choices for a rate cap system (LG20244970)

Briefing: A rates band: a proposed model for consultation with delegated Ministers (LG20259157)

Briefing: Rates band: transition and regulatory design issues (LG20259387)

Briefing: Approval to begin Ministerial consultation for a rates capping Cabinet paper (LG20259913)

Some parts of this information release would not be appropriate to release and, if requested, would be withheld under the Official Information Act 1982 (the Act). Where this is the case, the relevant sections of the Act that would apply have been identified. Where information has been withheld, no public interest has been identified that would outweigh the reasons for withholding it.

Where information has been withheld for other reasons consistent with advice, it has been annotated with an asterisk. This information may in some cases be accessible under the Official Information Act 1982.

Key to Redaction Codes:

- ***Section 6(b)(i) – information withheld to avoid prejudicing the entrusting of information to the Government of New Zealand on a basis of confidence by the Government of any other country or any agency of such a Government.***
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- ***Section 9(2)(h) – maintain legal professional privilege.***

Te Tari Taiwhenua
Internal Affairs

Local Government briefing

Hon Simeon Brown
Minister of Local Government

Title:	**Options and timeframes to design and implement a revenue capping system for New Zealand**
Date:	3 October 2024

Key issues
You have asked that revenue capping policy thinking be advanced as a way to potentially limit council spending and ultimately contributing to rates affordability. There are three options that could be progressed: a rates cap, a revenue cap, or a system that limits councils' expenditure. Developing and implementing a new system in New Zealand will take time for the policy work and for councils to transition to a new system. It can be done in two-phases, with the first phase laying a foundation for a new system and sending a signal to councils that a limitation on their revenue or expenditure is coming. A second phase would see a new system in law.

Action sought	Timeframe
Note the options and timeframes highlighted in the briefing; **Note** that an optimal path for delivery of a new system to cap councils revenue collection or to limit their expenditure would see the elements in phase 1 completed, specifically purpose of local government and reporting metric changes; **Discuss** with officials: • The purpose of this work: to reduce rates increases; limit councils' expenditure on 'nice-to-haves' or both; • What you would like included in phase 1 beyond purpose changes and benchmarking; and • The Department of Internal Affairs undertaking targeted consultation on designing a new system.	At your next officials' meeting on 7 October

Contact for telephone discussions (if required)

Name	Position	Contact Number	Suggested 1st contact
Rowan Burns	Policy Manager	9(2)(a) [redacted]	✓
Olivia Krakosky	Senior Policy Analyst	9(2)(a) [redacted]	

Return electronic document to:	9(2)(a) [redacted]
Cohesion document reference	TWCXRFFVDW2E-1255692133-35
Ministerial database reference	LG20244204

Purpose

1. This briefing outlines the options and proposed timeframes for the design and implementation of a system for local authorities that will improve rates affordability and limit councils' spending on certain activities.

Executive Summary

2. As part of the system improvements work you have prioritised work on a revenue cap to increase rates affordability and to limit councils' expenditure, among other changes to the local government system.

3. We seek your views on how best to achieve the desired outcomes. The options are to cap rates only, to cap all council revenue outlined in section 103(2) of the Local Government Act 2002 (LGA02), or to limit councils' expenditure.

4. We also outline a phased approach to this work to ensure that councils have enough time to plan for the significant change to their revenue or spend, to ensure councils will be able to adjust to a new system without having to implement it in between planning cycles, as well as give a new system the best opportunity to endure.

5. A first phase would lay a foundation for a new system that will affect how local authorities spend their money. This phase will also send a signal to councils so they can begin to embed the change into their planning processes. The timing for phase one is your first system improvements Bill to be introduced to Parliament in June 2025. A second phase will see a new system implemented in legislation, possibly in 2026 or 2027.

6. An update on this work will be included in your November system improvements Cabinet paper. We will seek policy decisions from Cabinet in February, to feed into the June 2025 Bill.

Background

7. On 18 July 2024, we provided you with an overview of the rate capping system in Australia [LG20243225]. This briefing highlighted the purpose of rate capping as a response to the cost-of-living crisis, the different paths New South Wales and Victoria took to implement their respective systems, and a review of the system with its potential unintended consequences.

8. You asked for further advice on what a revenue cap on councils' non-core expenditure[1] in New Zealand would look like, which we provided on 25 July 2024 [LG20243436]. This detailed the policy problems officials would need to work through to design an efficient and successful system in New Zealand.

9. At the Local Government New Zealand (LGNZ) Conference on 21 August, the Prime Minister announced the system improvements work programme, including that Cabinet has agreed to investigate options to limit council expenditure on 'nice-to-haves'.[2]

[1] Core and non-core activities, services or expenditure are not yet defined.

[2] Speech to LGNZ SuperLocal conference | Beehive.govt.nz

10. As part of phase 1 of the system improvements work programme, we are investigating options to improve rates affordability and limit council expenditure, such as through a revenue cap. Phase 1 of the system improvements work also includes changes to the purpose of local government, benchmarking local authorities on key metrics, reviewing council transparency and accountability rules, and discrete changes to improve the LGA02.

Defining what we are capping

11. The Government has outlined that the main purpose of this work is to address significant rates increases and their impact on communities. A secondary consideration is to limit councils' expenditure on 'nice-to-haves'. These issues could be managed in a number of ways, depending on the ultimate purpose of this work. Options include a revenue cap, capping rates or limiting councils' expenditure on certain activities.

12. We seek a discussion with you to confirm your preferred approach to what should be capped. **Appendix A** includes high-level analysis of the different options for your consideration.

13. For the purposes of this section, we do not use core or non-core activities, but rather exempt and non-exempt activities, as core activities have yet to be defined.

Capping rates

14. Under a system of rates capping, councils' funding from general rates, uniform annual general charges and targeted rates could all be capped, but not other forms of revenue. A central agency would set a maximum increase in each council's general income for the financial year or other time period. This is the model used in Australia.

15. Focusing a cap on rates allows councils to continue to raise revenue in other ways to help pay for non-exempt activities. Other revenue sources are outlined in section 103(2) of the LGA02 and include grants and subsidies, fees and charges, interest and dividends, borrowing, proceeds from asset sales, development and financial contributions.

16. With a rates cap, councils could seek to offset lost revenue through raising revenue through these other means. This could add more pressure to communities if raised revenue affects community services or if councils take on more debt. Service level standards on non-exempt activities may decline.

17. A rates cap could also encourage councils to diversify their funding sources away from rates for those non-exempt activities, which could have a positive effect on rates affordability.

Capping revenue

18. Through a revenue cap, all sources of local government revenue included in section 103(2) of the LGA02 would be covered when used for non-exempt activities, including rates. It would direct councils to focus most of their revenue on exempt activities.

19. Under a revenue cap, councils will not be able to offset their lost income for non-exempt activities. It reduces councils' flexibility in being able to access funding sources and service levels of these activities would decline. These could be activities that the community has determined that they need and/or where there has been market

failure and other actors including central government or the private sector are unable to fill the gap.

20. Reducing this flexibility might also mean councils and communities seek more central government funding for activities that are not exempt but still deemed important for the community.

Limiting expenditure through an indexing process

21. Another approach is to limit councils' expenditure towards non-exempt activities. For example, for certain activities councils could be directed to spend only a certain percentage of their overall budget. This percentage could be determined by assessing cost increases and other factors relevant to individual councils.

22. This could have the effect of reducing the overall rates burden and refocus council spending on exempt activities.

23. Councils would be unlikely to increase revenue through other means as their expenditure on non-exempt services would be limited. Like with a revenue cap, service levels of non-exempt activities would decline.

Taking a phased approach

24. Given the long-term (10-year at least) nature of local government planning processes, it is important that any significant changes made to the local government system have an appropriate transition time to allow councils to adjust their plans.

25. Capping council's revenue or limiting their expenditure would be a significant change to the local government funding system in New Zealand. It will change how they are able to raise and spend revenue on certain activities, many of which will already have been planned out to 2034 (given the 2024 long-term plans). Developing and implementing a new system will take time, both from a policy development and legislative drafting perspective, but also to allow councils time to adjust to a new system within their planning cycles. For a system to be implemented effectively from the start, it will need to feed into councils' long-term planning processes.

26. To best ensure this, we recommend a two-phase approach to developing and implementing a revenue capping or expenditure limiting system in New Zealand, to feed into councils' 2027 and 2030 long-term planning processes.

27. This approach is designed to best ensure that councils will be able to adjust to a new system without having to implement it in between planning cycles. If the change was to come into effect between long-term planning cycles, councils would need to undertake lengthy and expensive consultation processes.

28. As well, the more time that is given to councils to plan and embed a new system, the more likely it is that the new system will endure.

29. Advice from the Treasury on a revenue cap has been it will take time to develop to ensure we avoid unintended consequences such as supressing the supply of net beneficial local public goods and negatively impacting council borrowing ability or credit ratings.

Phase 1: sending a signal to the local government sector and laying the foundation for a new system

30. For a revenue cap[3] to be implementable and successful, we first need:

    30.1 A clear sense of what activities the cap applies to and what it does not apply to (what activities will be exempt); and

    30.2 Accurate and up-to-date reporting of councils' performance metrics to get a better picture of current council spending, and to monitor a revenue cap.

31. Through the first phase of your system improvement workstream, with legislation to be introduced in June 2025, you will address these areas and lay a foundation for a revenue cap. Through the new section 10(b) of the LGA02 you will refocus the purpose of local government and you will define the core work of councils in reinstating section 11A (briefing LG20244080 refers). These changes can help determine which council activities should be exempt from a revenue cap.

32. You will also require councils to better report performance metrics through your work on benchmarking (briefing LG20244282 refers). This will ensure a revenue cap is able to be implemented, monitored and enforced.

33. Alongside these changes, you have options to include legislation specifically on revenue capping to better build the foundation for a system to be later implemented.

    33.1 You could include in the LGA02 high-level, aspirational principles that would guide a new system. As far as we know, principles were not a feature of the Australian system, but they are consistent with our local government system. More policy work is needed to assess whether the existing principles in section 14 LGA02 could be tailored and built upon to guide a revenue capping regime. Any amendments to the LGA02 could happen in time for your first system improvements' Bill.

    33.2 You could include a short list of council activities that will be exempt from a revenue cap in your first system improvements' Bill. In New South Wales they exempt charges on stormwater, waste collection, and water and wastewater activities so that there are no limits on what councils can charge for those. A list in New Zealand could be based on activities included in the reinstated section 11A.[4] Should you wish to include this, we can work on further advice for you in coming weeks.

34. Councils will be finalising their next long-term plans in mid-2027. The most strategic time to influence councils' planning would be in the beginning of 2026 as this would give councils sufficient time to plan and consult on their activities for their 2027 long-term plans. We should aim for the changes outlined above to be in legislation early enough in 2026 to feed into council planning processes.

35. Phase 1 will lay a foundation for a revenue cap and send a signal to the sector that it is coming, so they are best able to prepare and plan. Through purpose changes and metrics, there will be downward pressure on rates. Along with principles of a revenue

[3] For the purposes of this section and for simplicity, "revenue cap" is used as an overarching term that could also be "rates cap" or "expenditure limit/index".

[4] Which you have indicated would include network infrastructure; public transport; waste management and minimisation; risk reduction of, the readiness for, response to, and recovery from natural hazard risks; libraries, museums, reserves, and other recreational facilities and community amenities.

cap, and a list of exempt activities, councils will be able to adjust their 2027 long term plans, before a full new system is introduced, helping the transition be most effective.

Phase 2: implementing a new system

36. In phase 2, a rates or revenue cap, or expenditure limit can be introduced. There are a number of policy questions to be worked through on what a new cap or limit system would look like. These include:

- Which core activities of councils should be exempt?
- Who would administer and review the system?
- How would the new system be monitored and enforced?
- What is needed in law to create and implement a new system (e.g. regulation or legislation)?
- How other Ministerial portfolios would be affected?
- How to ensure the right balance between ratepayers' interests and councils' financial positions?
- How would a cap or limit be determined and set, and how often?
- Could councils apply for further activities to be exempt based on their specific circumstances?

37. Time is needed to fully explore the design of a new system so that it is successful in increasing rates affordability and limiting councils' expenditure.

38. 9(2)(f)(iv) [redacted]

39. To be an enduring and impactful change to the local government system, councils need time to plan and consult. In their 2024 long-term plans, councils will have signed up to a number of projects and committed spending for the next few years. To provide the best chance for success, to ensure councils would not have to consult on existing long-term plans, and to ensure councils have enough time to transition to the new system, we recommend that phase 2 be in force ahead of councils planning for their 2030-2040 long term plans. This could be implemented through a second system improvements bill in 2026 or 2027 to give councils a long transition period.

Next steps

40. We will discuss the phased approach and options for phase 1 with you at an officials' meeting. Further advice on key policy questions will be provided in coming weeks.

41. An update for information will be included in your November system improvements Cabinet paper, with policy decisions being sought from Cabinet in February. This is to allow the policy work for phase 1, including preparing a list of exempt activities, and principles to guide a cap, to be completed. We consider that seeking policy decisions in February will still give enough time for drafting ahead of a June introduction.

42. Phase 2 policy work will continue and we will seek your direction as that develops.

Consultation

43. Consultation with the sector will be important as we work on the policy design of a new system impacting councils' ability to raise revenue or limit their expenditure. The sector will be able to help us better understand how a new system could work in practice, especially given the size difference of various councils. While we are only at the start of a design phase, some targeted engagement with local government sector bodies and experts would be beneficial.

Recommendations

44. We recommend that you:

   a) **note** the options and timeframes highlighted in the briefing;

   b) **note** that an optimal path for delivery of a new system to cap councils' revenue collection or to limit their expenditure would see the elements in phase 1 completed, specifically purpose of local government and reporting metric changes;

   c) **discuss** with officials;

      i. The purpose of this work: to reduce rates increases; limit councils' expenditure on 'nice-to-haves' or both;

      ii. What you would like included in phase 1 beyond purpose changes and benchmarking; and

      iii. The Department of Internal Affairs undertaking targeted consultation on designing a new system.

Rowan Burns,
Policy Manager

Hon Simeon Brown
Minister of Local Government

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Appendix A – Scoring of options to implement a revenue capping system

1. The table below scores rate capping, revenue capping, and expenditure capping, against the objectives of improving rate affordability and focusing councils on core service delivery.
2. We have also included community affordability and service level standards on non-core services as additional criteria.

++	High confidence in achieving the objective
+	Some confidence in achieving the objective
0	About the same as doing nothing/the status quo
–	Some confidence in a perverse outcome
– –	High confidence in a perverse outcome

	Rate Capping	Revenue Capping	Expenditure Capping
Rate affordability	++ General rates, uniform annual general charges, and targeted rates are capped, improving rate affordability.	+ Local government funding sources, including rates and user charges, are capped. Councils will adjust a mix of rates and other income to stay within the cap.	+ Expenditure on non-core services is capped. Councils will have smaller rates increases and/or refocus on core-services.
Focus on core services	+ A regulatory oversight body would help ensure councils focus on core service delivery.	+ A regulatory oversight body would help ensure councils focus on core service delivery.	++ Core services would be exempt from a expenditure cap.
Community affordability	– Councils may look to increase fees to offset lost revenue, affecting affordability of community services.	0 Councils would not be able to offset lost revenue.	0 Councils would be unlikely to increase revenue through other means as their expenditure on services would be capped
Service level standards on non-core services	– Service levels may decline, likely through deferred maintenance and/or reduced operating hours of community services.	– – Service levels would be forced to decline, likely through deferred maintenance and/or reduced operating hours of community services.	– – Service levels would be forced to decline, likely through deferred maintenance and/or reduced operating hours of community services.

The Ministry of Social Development have notified the Department of an update to the Briefing *Approval to begin Ministerial Consultation for rates capping Cabinet paper - Appendix B: Summary of Departmental feedback.*

The update is: *Please note, in regard to the feedback provided by the Ministry of Social Development, we have been advised that the rates changes will likely only have a positive impact on a small specific group of MSD clients, who are recipients of the Accommodation Supplement that own their own home.*

Te Tari Taiwhenua
Internal Affairs

Local Government briefing

Hon Simeon Brown
Minister of Local Government

Title:	**Reflections on the NSW Rate Peg system and considerations for a NZ System**
Date:	13 December 2024

Key issues
New South Wales (NSW) has had a 'rate peg' since the late 1970s, which has been effective at limiting rates increases and keeping councils' expenditure low. However, recent reviews of the rate peg model have found that the system requires significant overhaul. Alternatives to a rate peg have been mentioned in a review by the NSW Parliament's Committee on State Development. With the NSW system being reviewed, it is an opportune time to assess the effectiveness of the rate peg model. Should the Government wish to proceed with a rate cap model for New Zealand, there are key lessons from the NSW experience highlighted in these reviews that will help in the design of a New Zealand model.

Action sought	Timeframe
Note the contents of the briefing; and Should you wish, **seek** further advice from officials on options to limit councils' revenue from rates other than a rate index.	At your earliest convenience

Contact for telephone discussions (if required)

Name	Position	Contact Number	Suggested 1st contact
Rowan Burns	Policy Manager	9(2)(a) [redacted]	✓
Olivia Krakosky	Principal Policy Analyst	9(2)(a) [redacted]	

Return electronic document to:	9(2)(a) [redacted]
Cohesion document reference	3W2DU3RAJ5R2-371630908-967
Ministerial database reference	LG20245259

Purpose

1. This briefing provides an overview of the New South Wales (NSW) 'rate peg' model, reflecting lessons from further research and engagements with NSW stakeholders.

Executive summary

2. NSW has had a system to limit councils' revenue from rates since 1977. Their rate peg limits the percentage by which councils can increase their total rates revenue. Officials have been learning more about the NSW system, including through a visit to NSW in late November to meet with NSW councils and the NSW Government.

3. The rate peg has recently been under review, including by a NSW Parliamentary Inquiry, whose final report was issued on 29 November. The report found that the rate system has contributed to financial sustainability issues faced by councils in NSW today and recommended that the NSW Government redesign the local government rating system, including reassessing council base rates. It also mentioned alternative options to a rate peg, which officials can provide further advice on, should you seek it.

4. The key lessons for establishing a rate capping system in New Zealand are:

   4.1 The local government system needs to be ready for a rate cap, including through establishing an independent economic regulator, and having standardised and centrally collated reporting metrics.

   4.2 A rate cap needs to be designed carefully to ensure councils' actual and reasonable costs can be funded, either through a rate cap, or another form of funding (if excluded from a rate cap); and be forward-looking rather than backwards focused.

   4.3 An exemption process is necessary, but it should not be relied on to address financial sustainability issues like it is in NSW. It should also provide some level of flexibility and not lock councils in. It should also endeavour to be as unbureaucratic, efficient and cheap as possible for councils and government.

Background

5. As part of the work to investigate a system to limit councils' revenue from rates, we provided you with an overview of the rate-capping system in Australia on 18 July 2024 [LG20243225]. The briefing outlined the different paths New South Wales and Victoria took to implement their respective systems.

6. You asked for further advice on what a revenue cap on councils' non-core expenditure[1] in New Zealand would look like, which we provided on 25 July 2024 [LG20243436].

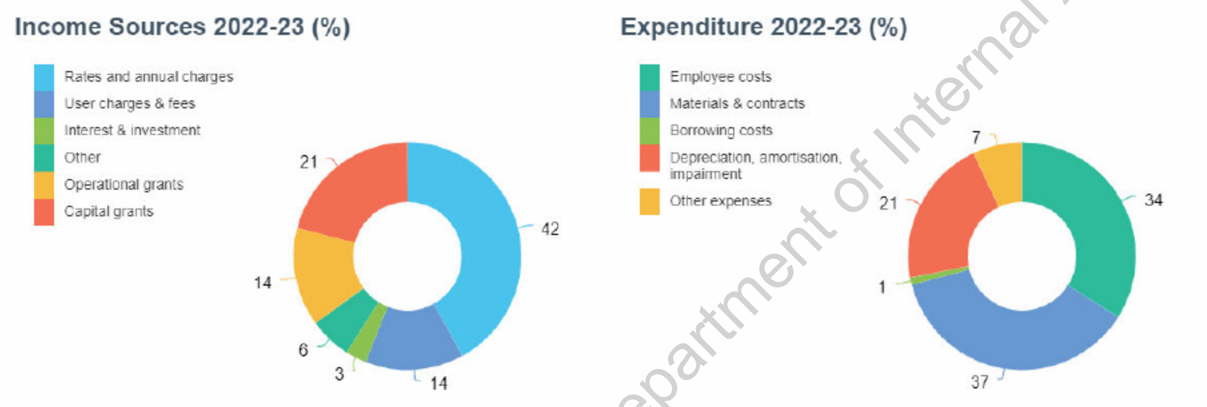
7. On 3 October 2024, we provided you with options and timeframes for designing and implementing a capping system for New Zealand [LG20244204]. On 18 November Cabinet noted that you would report back to them in early 2025 with proposals to limit council expenditure, possibly by implementing a similar system to the NSW 'rate peg' [ECO-24-MIN-0257]. Based on this, we are progressing work to design a rate capping system for New Zealand.

[1] Core and non-core activities, services or expenditure are not yet defined.

8. Officials have undertaken further research to better understand the NSW model, including visiting NSW to speak with a range of different councils, the Office of Local Government within the NSW Government, and the Independent Pricing and Regulatory Tribunal (IPART).

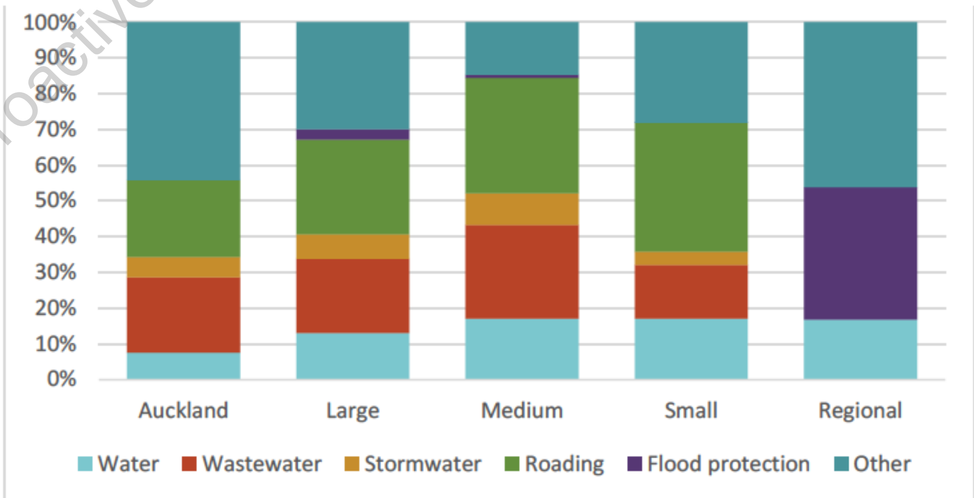
NSW local government income and expenditure

9. NSW has 128 local authorities who have the power of general competence, with elections every four years. Their main activities are services to property (roads and footpaths, flood protection and stormwater, community amenities, waste and for some, water and sewer). Their revenue comes from rates, state or federal grants, and user fees and charges. Debt is rarely used. Most expenditure is on employee costs; materials and contracts; and depreciation, amortisation and impairment. Income sources and expenditure for 2022-2023 is shown below:



10. While difficult to compare as we do not have standardised reporting on expenditure, we can say that local governments in New Zealand's main activities are roading, three waters infrastructure, flood protection, and regulatory and community activities. Their revenue comes from rates, grants and subsidies, regulatory, development and financial contributions, sales, dividends and interest. New Zealand councils also have a greater appetite for using debt than NSW councils.

11. Below is a breakdown of New Zealand council's activity planned expenditure as percentages of total expenditure for 10 years from 2024 as outlined in the 2024 LTPs. **The most significant difference is that most NSW councils do not undertake water or wastewater services, just storm water.**



NSW's rate peg has been under review

12. NSW has had a rate peg since 1977. It only applies to councils' total revenue from rates, not to individual ratepayers' rates. Some services, which are funded through annual charges, are excluded from the rate peg. These are domestic waste management services, drinking water and wastewater services, and coastal protection services. Income for these services is ringfenced and can only be used to fund the services for which it relates to. An internal Department research paper on the NSW rate peg is attached at **Appendix A**.[2]

13. The NSW rate peg has been under review recently, with IPART's review of the rate peg methodology,[3] and NSW Parliament's inquiry into the ability of local government to fund infrastructure and services.[4]

14. These reviews show that the rate peg appears to have met the objective of keeping rates increases at a minimum and keeping councils' expenditure low. However, over the long term, many councils have been facing financial sustainability issues.

15. The NSW Parliamentary inquiry's report found that:

    15.1 Some NSW councils are facing financial challenges that can't be resolved by fiscal discipline alone.

    15.2 The rates system as it currently stands has a significant impact on the long-term financial sustainability of the sector. It restricts councils' ability to raise and adjust rates in line with actual cost increases and community service demands and expectations. It also fails to recognise the unique and diverse cost pressures faced by different council types.

    15.3 The rate peg has largely failed to match the cost increases borne by local government. It has not kept pace with the level of income councils require to adequately meet the needs of their communities.

16. A key recommendation from this report was that the NSW Government redesign the local government rating system, including reassessing council base rates. In doing so, the report asks the NSW Government to provide local government greater flexibility to set rates in response to actual cost increases and community service demands and expectations, while ensuring sensible safeguards to keep rates affordable.

17. However, the report could only look at the system up to 2023. Relatively recent changes to the rate peg model, such as IPART taking over the system in 2010, and the new methodology for calculating the peg for 2025/26, are likely to have a positive impact on financial sustainability for councils.

18. The NSW Government report also mentioned alternatives to a rate peg, such as:

    18.1 Using benchmarking councils' rates increases against a Local Government Cost Index and reinforced by a power for the Local Government Minister to intervene when necessary. This is similar to an oversight system in Tasmania and South Australia.

[2] This was developed to aid our understanding before engaging with NSW stakeholders and has been updated to reflect additional information learnt through those engagements.

[3] Final Report - Review of the rate peg methodology - August 2023 | IPART

[4] NSW Parliament Standing Committee on State Development *Ability of local governments to fund infrastructure and services*

18.2 Make councils meet specified requirements before they can raise rates. This is used in some other Australian states.

19. To date we have explored only one option to limit councils' revenue from rates – the NSW rate peg model. Should you be interested in considering other models, we would be able to provide advice in the new year.

New Zealand can learn lessons from the NSW experience

20. Officials from the Department of Internal Affairs (the Department) visited NSW in late November 2024 to engage with a variety of NSW councils, the NSW Government and IPART, to learn more about the rate peg and its effectiveness.

21. 6(b)(i) [redacted]

Getting the local government system ready for a rates cap

22. Stakeholders highlighted the importance of getting the local government system ready for a rates cap through having an independent economic regulator, and standardised, centrally collected and publicly reported metrics.

23. IPART as an independent economic regulator, implements the rate peg with delegated authority from the NSW Minister of Local Government. It sets the rate peg and advises the government on how the methodology for the peg could be improved. It also undertakes consultation with councils and ratepayers.

24. NSW has standardised and centrally collected reporting from councils on certain financial metrics. These help IPART understand the different fiscal position of councils. This links with your work on benchmarking performance metrics within the Local Government System Improvements' work programme. It will be difficult to set a rate cap that balances rates affordability with councils' financial sustainability, without a clear picture of councils' fiscal positions.

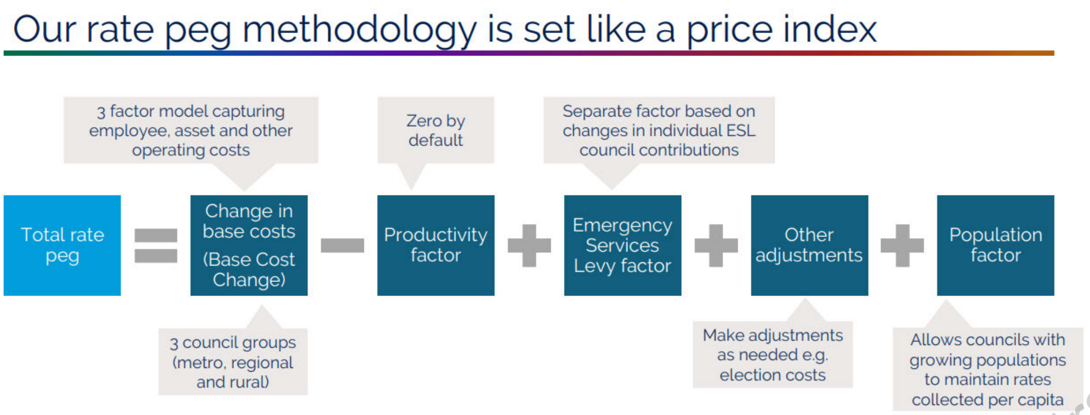
A rate cap needs to be designed carefully

25. A rate cap needs to be carefully designed to best balance the objective of rates affordability with the financial sustainability of councils.

26. In NSW, previous rate peg methodologies applied the same percentage increase to all councils in a 'one-size-fits-all' approach, and did not reflect actual costs or diversity of councils. It was backwards looking, which meant councils' rate pegs were set against the previous two years' economic activity. During 2020-21 there was very little economic activity due to COVID, which meant the rate pegs for 2022-23 were significantly lower than even the cost of inflation.[5] 6(b)(i) [redacted]

27. However, councils were cautiously optimistic about IPART's new base cost change methodology for calculating the rate peg (designed in 2023 and applied for the 2024-25 financial year). The methodology is more forward looking and includes:

[5] The rate peg was set at 0.7% based on a Local Government Cost Index, which was significantly lower than councils had forecast. Australia's inflation rate reached 7.8% in the December 2022 quarter. Some councils with large population growth projected had a rate peg set up to 5% due to the addition of the population factor.



The benefit of this model is that other adjustments or factors could be included. NSW councils suggested the model would be improved if it could factor in:

27.1 Costs outside councils' control, but are able to be projected, such as insurance;

27.2 A margin added to the rate index for use specifically for economic shocks such as natural disasters;

27.3 More specific adjustments alongside the population factor to reflect costs associated with different types of growth;

27.4 Adjustments to accommodate things like peak seasons of tourism;

27.5 Depreciation of assets.

28. As well as designing the methodology, consideration needs to be given to the starting point for a rate peg. The rate peg is based on total rates revenue for each council, but did not include a look at the costs of delivering core services for each council. This led to many councils relying on the exemption (special rate variation) system to essentially reset their starting point to be able to meet their infrastructure costs. Appropriately estimating the starting point of a peg system would involve knowledge of each councils' asset base, including a steady state amount of maintenance, the expected maintenance costs while councils catch up on past deferred maintenance spending, particularly on water assets, and how these structures differ by council.

There needs to be an exemption system, but it shouldn't be relied on

29. Of the 128 councils, we understand 127 have applied for a special rate variation (SV) since 2010. Many councils use the SV to reset their total rates revenue, in response to financial sustainability issues. Councils reported that this process is bureaucratic, onerous and costly. It involves considerable evidence gathering and community consultation to demonstrate why a larger rate increase was needed.

30. Costs for putting in an application for a variation were large, 6(b)(i) [redacted] for external costs such as consultation and consultants to assist in putting together an application. One council suggested that with internal staff time and resources 6(b)(i) [redacted]

31. The SV itself is also inflexible. Councils also reported that the SV locked them into expenditure for 10 years, and any change to that needed to go through another SV process.

32. Assuming the starting point for a rate cap is right, and the index methodology is designed to accommodate councils' differences, there should be fewer applications for exemptions, saving councils and government time and money.

Next steps

33. We are preparing further advice for you on considerations on including or excluding certain "core" council activities from a rate cap. This is the first of several significant questions that are needed to design a system to limit councils' revenue from rates for New Zealand. The difficulties lie in there not being a clear definition of what councils' "core" activities are, and there are potentially significant changes needed to the funding of certain activities, even if they are excluded from a rate cap, particularly if there is some cross subsidisation from rates to other activity classes. We are currently engaging with Local Water Done Well, the Treasury, Ministry for the Environment, the New Zealand Transport Agency, DPMC and others as needed, to ensure that we understand how councils' main activities like waste, water, roads, risk reduction and flood protection, are currently funded. This information will be included in this advice. We propose to have a workshop with you in the new year on this question.

34. In the new year, we can provide you with further advice on alternative options to limit councils' revenue from rates outside of a rate cap, should you wish to receive it.

Consultation

35. We have engaged with NSW councils: Strathfield Council, North Sydney Council, City of Canada Bay Council, Narrandera Shire Council, Hornsby Shire Council. We have also engaged with the NSW Government Office of Local Government and the IPART.

Recommendations

36. We recommend that you:

a) **note** the contents of this briefing

b) should you wish, **seek** further advice from officials on other options to limit councils' revenue from rates. **Yes/No**

Rowan Burns
Policy Manager

Hon Simeon Brown
Minister of Local Government

____/____/____

Appendix A: Research paper the New South Wales rate peg system

Appendix B: NSW council profiles

Strathfield Council : (for 2022/23)	
Population (ratepayers)	40,000 (20,000)
Geographic size	14.1 km^2
Average costs for households (2023/24)	Rates; $1200 Waste: $590 Water: $1200
Main expenditure for council from rates (2022/23)	Employee costs Materials and contracts (36%), including Roads and footpaths Depreciation, amortisation and impairment (16%) Other (6%)
Total revenue (2022/23)	$60m
Revenue sources other than rates (2022/23)	Capital grants (22%) User charges and fees (8%) Operational grants (5%) Interest and investment (2%)
SV application	93% increase in total rate revenue over 3 years (about 30% per year). Total rate revenue will increase from $20m to $40m. Plan to revert to rate peg in Year 4.
Driver for SV application	Asset renewal Roads and footpath maintenance. Stormwater assets' condition are being investigated now and could be costly.
6(b)(i) [redacted]	[redacted]
6(b)(i) [redacted]	[redacted]

North Sydney (metro) [North Sydney - Your Council NSW](#) (for 2022/23)	
Population (ratepayers)	70,000 (35,000)
Geographic size	10 km^2
Average costs for households	Rates: $1040 Waste: ? Water: $430
Main expenditure for council (2022/23)	Employee costs (36%) Materials and contracts (37%) Depreciation, amortisation and impairment (20%)
Total revenue	$150m
Revenue sources other than rates (2022/23)	Fees and charges (21%), including parking fees (inner city) but they have declined post covid)

	Capital grants (17%) and operational grants (4%)
SV application	75% in one year
Driver for SV application	Cost blow out of a pool project 6(b)(i) [redacted] Asset backlog Financial deficit (from pool and loss of car park revenue) Improved governance and administration (using very old IT systems)
6(b)(i) [redacted]	[redacted]
6(b)(i) [redacted]	[redacted]

City of Canada Bay Canada Bay - Your Council NSW (2022/23)	
Population (ratepayers)	Almost 100,000 (50,000?)
Geographic size	19.9km^2
Average costs for households	Rates: $1600 Waste: $460 Water $450
Main expenditure for council (2022/23)	Employee costs (39%) Materials and contracts (37%) Depreciation, amortisation and impairment (15%)
Total revenue	$145m
Revenue sources other than rates (2022/23)	Capital grants (27%) User charges and fees (12%) Other (11%) Operational grants (6%)
SV application	Year 1: 15.49% Year 2-4: 4.8% (based on a forecast rate peg of 2.5%. with new model it's 3.7%)
Driver for SV application	Population growth and the need for enhanced and improved services. Environment and management of open spaces. Aging infrastructure – have a big seawall. Small amount of budget repair.
6(b)(i) [redacted]	[redacted]
6(b)(i) [redacted]	[redacted]

Narrandera Shire (rural) Narrandera - Your Council NSW (2022/23)	
Population (ratepayers)	6000 (4000) – declining population
Geographic size	4116km^2
Average costs for households	Rates: $750 (farm $1500)

	Waste: ? Water: $330
Main expenditure for council	Employee costs (35%) Material and contracts (37%) Depreciation, amortisation and impairment (26%)
Total revenue	$7.5m with rate increase; $3.5m for water and sewer
Revenue sources other than rates	Operational grants (41%) Capital grants (16%) User charges and fees (11%) Debt ($5m)
SV application	45% over two years Year 1: 25% Year 2: 15%
Driver for SV application	Upgrade to stormwater system. Asset renewals
6(b)(i) [redacted] 6(b)(i) [redacted]	[redacted]

Hornsby Shire Hornsby - Your Council NSW **(2022/23)**	
Population (ratepayers)	150,000
Geographic size	460km^2
Average costs for households	Rates: $1668 Waste: $680 Water: $665
Main expenditure for council	Materials and contracts (46%) Employee costs (34%) Depreciation, amortisation and impairment (16%)
Total revenue	$160m
Revenue sources other than rates	Capital grants (14%) Operational grants (11%) User fees and charges (8%)
SV application	30% over four years. Year 1: 7.5%
Driver for SV application	Repair and maintenance of assets.
6(b)(i) [redacted] 6(b)(i) [redacted]	[redacted]

THE NEW SOUTH WALES RATE PEG SYSTEM

Why does it exist?

How does it work?

Is it achieving its purpose?

DIA – Te Tari Taiwhenua,

Local Government Branch - Ue Te Hinātore

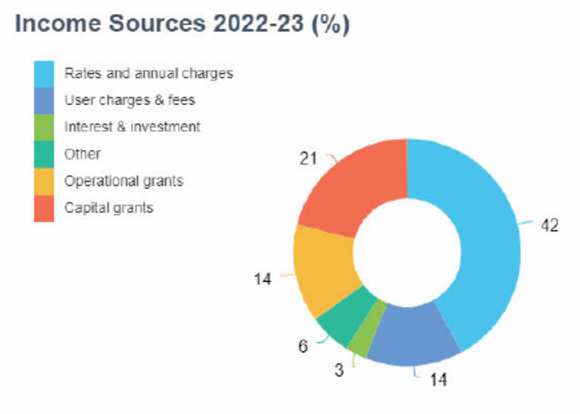
November 2024

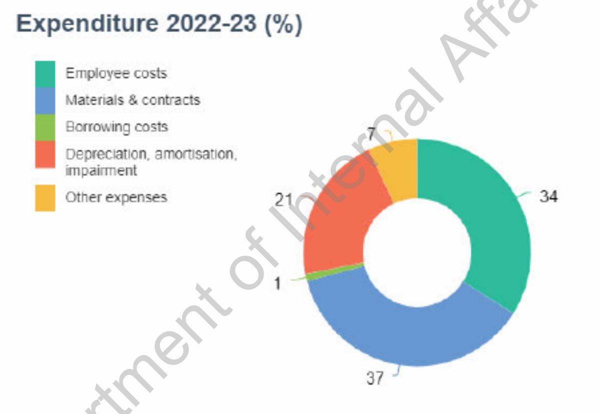
Table of Contents

Executive Summary

LG in NSW in a nutshell:

- 128 local authorities, divided in 5 categories based on broad demographic variables: Large rural, metropolitan, metropolitan fringe, regional town/city, and rural.
- Four-year electoral terms
- The main local government regulation is the Local Government Act 1993.





The Australian local government system is focused largely on **'services to property'** (domestic waste, wastewater management, local roads, parks and garden) and providing limited 'services to people' (particularly in aged care), though the last decade showed a greater emphasis on services to people.

Since 1977, councils have been limited in how much they can increase their total rates revenue through a 'rates peg'. The current peg, contained in the Local Government Act 1993, involves the Independent Pricing and Regulatory Tribunal (IPART) **setting a yearly percentage increase for councils' ordinary rates based on a cost index**. For a long time, the percentage increase was the same for all councils and based on the Local Government Cost Index (LGCI).

In 2023, IPART conducted **a broad review of the system**, involving comprehensive consultation with stakeholders (including ratepayers and councils). The review led to a **new methodology** (Base Cost Change) applied for the first time for financial year 2025-26. It is simpler (fewer variables) than the previous LGCI and designed to more accurately represent the diversity of councils across New South Wales. It includes labour, productivity, population growth factors as well as costs like emergency services levies and election costs.

The rate peg does not apply to all council revenue. While the legislation allows for some provisions, the peg essentially only covers ordinary rates (rates from land).

Some services, financed through **annual charges**, are excluded from the peg, these are:

- Domestic waste management services.
- Drinking water and wastewater services (these are provided by State owned entities in metropolitan areas (Greater Sydney and Hunter Valley, or councils in regional areas.).
- Coastal protection services.

The rate-pegging system has succeeded in keeping rates increases consistent, and therefore benefits from public support. It may also have influenced councils to operate more efficiently. However, the research on the outcomes of limiting councils' revenue is unanimously critical. There are a number of unintended consequences that have been identified, which are likely to have been caused by both the previous unsophisticated rate peg methodology alongside political decisions such as zero percent rates increases. These are:

- A backlog in infrastructure maintenance: 50.8 per cent of councils in New South Wales (65 councils) reported that their required asset maintenance expenditure in 2020-21 was greater than their actual asset maintenance expenditure. This suggests that many councils do not have the funding to meet their asset maintenance requirements each year.
- Shifts in services where less visible activities (such as aged or disabled care) are reduced or discontinued.
- Reduced efficiency due to employment constraints.
- Cost shifting: There is growing evidence that state governments are shifting services to councils without commensurate resourcing.
- 127 out of 128 councils have applied for a special rate variation, as a costly, burdensome method of mitigating the limitations of the rate peg system.

The consensus, which IPART has tried to address with the new rate peg methodology, is that **a 'one size fits all' policy does not work**, and the diversity of situations councils are finding themselves in must be considered, be it from the urban/rural perspective, existing debt levels, existing revenue from own assets, and population growth.

This research has been compiled for internal use only using open source materials and following discussions with New South Wales councils and government. It is not New Zealand Government policy.

1 An overview of local government in New South Wales

1.1 People and governance

As of 2023, over 8.3 million people live in New South Wales (NSW)[1], forming 3.4 million households, 26% of which speaks a language other than English at home. The median age is 38.7, and over 2.3 million people were born overseas.

There are 128 local authorities in New South Wales. The Office for Local Government divides them into five categories based on broad demographic variables: large rural, metropolitan, metropolitan fringe, regional town/city, and rural.

1.2 The legislation – how are councils financed?

The main local government regulation is the Local Government Act 1993 (the Act).

Chapter 15 of the Act[2] details how councils are financed, and what rates and charges cover.

NSW local authorities have six main sources of revenue:

- two types of rates: ordinary and special rates;
- charges;
- fees;
- grants;
- borrowings; and
- investments.

Councils calculate and apportion rates among four defined categories (that can be further divided into subcategories) of rateable properties in their respective local jurisdictions:

- farmland;
- residential;
- mining; and
- business.

The relative contribution by rating categories varies significantly between councils, and is influenced by factors such as location, economic activity, council policies and land valuation.

Every council must strike and levy an ordinary rate each year on all rateable land within its jurisdiction. By contrast, a local council can exercise discretion on whether to levy a special rate under section 495 of the Act. Special rates are aimed at financing projects, such as specified local infrastructure, but must be applied to all ratepayers if the project will benefit the entire local government area.

For each category of property, rates can be calculated in one of three ways:

- entirely on the land value of the property (calculated as an amount per dollar of unimproved land value);

[1] New South Wales | Region summary | Data by region | Australian Bureau of Statistics

[2] Local Government Act 1993 No 30 - NSW Legislation

- on a combination of the land value of the property and a fixed amount per property; or
- entirely on the land value, but subject to a minimum amount.

Councils must make and levy annual charges for **domestic waste management services** for each parcel of land for which the service is available.

A council may also make and levy annual charges for:

- the **provision of stormwater management services** for each parcel of rateable land for which the service is available, unless the land is:
    - owned by the Crown (and not under a lease for a private purpose); or
    - held under a lease for private purposes granted under the Housing Act 2001 or the Aboriginal Housing Act 1998.
- **coastal protection services** for a parcel of rateable land that benefits from the services.

Councils can impose an annual charge for the following services:

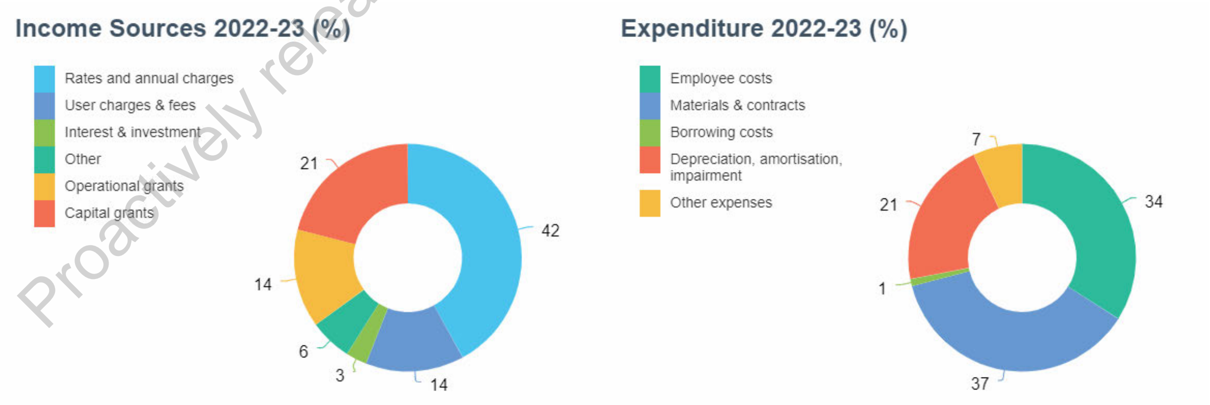
- water supply
- sewerage services
- drainage services
- waste management services (other than domestic waste)
- any other services prescribed by legislation.

A charge may be made in addition to an ordinary rate, and in addition to or instead of a special rate.

Councils must not apply income from an ordinary rate towards the cost of providing domestic waste management services. Income to be applied by a council towards the cost of providing domestic waste management services must be obtained from the making and levying of annual charges or the imposition of charges for the actual use of the service, or both. Income obtained from charges for domestic waste management must be calculated so as to not exceed the reasonable cost to the council of providing those services.

1.3 Councils' principal sources of income and expenditure[3]

TABLE 1 - INCOME SOURCES AND EXPENDITURE 2022-23 (%)



[3] All data and facts in this section are from [Finances - Your Council NSW]

In the financial year 2022-23, the main source of income for local government was rates and annual charges (42%).

- **Rates** include residential, business, farming and mining rates, along with any special rates charges by councils.
- **Annual charges** include domestic waste, other waste charges, water and sewer (in areas where these services are provided by the council) and stormwater management.

Capital grants is the second biggest source of funding (21%), followed by **operational grants** (14%) and **user charges and fees** (also 14%).

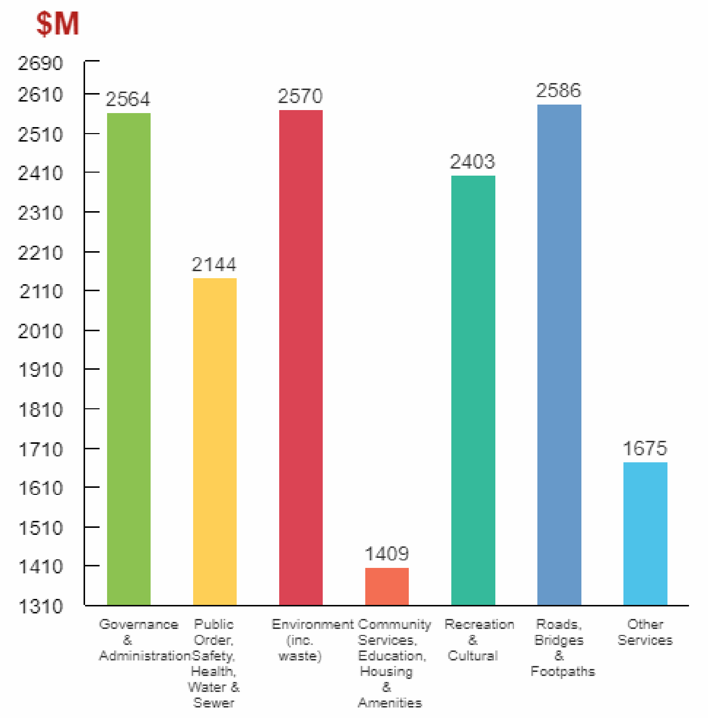
Services delivered and associated expenditure

Councils' functions are conferred or imposed by the LGA and include:

- Raising revenue
- Providing services to the community (including community health, recreation and education facilities, information services, environmental protection, waste removal and disposal, as well as land, property, industry and tourism development and assistance
- Regulatory obligations
- Enforcement for breaches of the LGA, prosecution of offences and recovery of rates and charges
- Ancillary functions that assist the carrying out of councils' service and regulatory functions
- Administrative functions for the running of the council.

Councils provide a variety of services that are ultimately at the discretion of each council, in consultation with its community. Some are provided on a user pays basis, while others are funded through a council's rating income and grants. Table 2 breakdowns the amount spent for each area of service in the financial year 2022-23

TABLE 2 - EXPENDITURE FOR EACH AREA OF SERVICE



Compared with other OECD countries, Australian local government systems focus largely on **'services to property'** (domestic waste, wastewater management, local roads, parks and garden) and provide limited 'services to people' (particularly in aged care), though the last decade showed a greater emphasis on services to people. The table below outlines the percentage of total expenditure NSW councils spend on different categories of services.

TABLE 3 - COUNCILS' EXPENDITURE PER SERVICE TYPE[4]

Service type	% of total expenditure	Description of services
Governance & administration	17%	Council's role as a democratic government including elections, members' fees and expenses, meetings of councils and policy making committees, area representation, public disclosure and compliance, corporate support and other support services, engineering works and any council policy compliance.
Environment	17%	Noxious plants and insect/vermin control, environmental protection, solid waste management, street cleaning, drainage and stormwater management. *Note: coastal protection services are excluded from the rate peg, as are fire and emergency service levies (the latter is included in the calculation of the rate peg)*
Recreation and culture	16%	Libraries, museums, art galleries, community centres, halls and performing arts venues, sporting grounds and venues, swimming pools, parks and gardens and other sporting and recreation facilities.
Roads, bridges & footpaths	16%	The provision of roads, bridges and footpaths. *Local roads are not included in the rate peg*
Public order, safety and health + water & sewer	14%	Fire services, fire protection, emergency services, beach control, enforcement of local government regulations and animal control. The provision of water and sewer services. *Water and sewer services are paid by annual charges.*
Other services	11%	Services such as caravan parks, economic activities, agriculture, building control, aerodromes and communication.
Community services, education & housing	9%	Administration and education, social protection (welfare), aged, disabled and children's services, public cemeteries and conveniences, street lighting, town planning and other community amenities.

[4] Services - Your Council NSW

A note about water services

Some care needs to be taken when drawing conclusions about these results. While water and sewer services represent 10% of average expenditure, only 66% of councils provide either one or both of these services. No metropolitan councils provide water and sewer. These services are provided by two main State-owned entities – Sydney Water and Hunter Water. Outside of the metropolitan areas, the local water utilities are local government owned, and in some regional and rural areas, these services are provided by county councils. They are funded by annual charges, therefore excluded from the rate peg.

Expanding role of local government

Local government in NSW have had their roles and responsibilities expanded for a number of reasons:

- Delegation of responsibility or cost shifting from other levels of government to local government (it is estimated that NSW councils have over 120 additional regulatory functions, involving over 300 separate regulatory roles, emanating from over 60 State Acts).
- Needing to deliver essential services and infrastructure where there has been market failure or lack of private providers, including medical practices, childcare and aged care, and bus/transportation services.

Financial assistance grants

In place for nearly half a century, Financial Assistance Grants (FA Grants) from the Commonwealth Government were originally conceived as a base-load mechanism for horizontal fiscal equalisation in local government. That is, the FA Grants were intended to assist all councils but with a particular bias towards those that must contend with 'exogenous' revenue raising constraints or additional service delivery costs.

The value of FA Grants as a share of total Commonwealth government expenses has declined from approximately 0.8 per cent to 0.4 per cent between 1999-00 and 2022-23.

Recurrent government transfers to local government, such as FA Grants, are typically indexed to CPI. This does not accurately reflect movements in input costs for services provided by Councils. These are largely dependent on construction, material and wage costs. In 2014 to 2016, indexation of FA Grants was frozen. Although restored in 2017, the impact of the freeze is still felt on the base level of grants[5].

2 The rate-pegging system in New South Wales

Councils in NSW are limited in the amount of income they can raise through the Local Government Act 1993.

The rate peg is the maximum percentage amount by which a council can increase its general rates income for the year.

[5] Australian Local Government Association, 2022

The limit applies to:

- General income (income from ordinary rates, special rates and annual charges)

This excludes:

- water supply special rates and sewerage special rates
- charges for water supply services and sewerage services
- annual charges for waste management services, including annual charges for domestic waste management services
- annual charges referred to in section 611 (annual charge on rails, pipes etc)
- annual charges for stormwater management services
- annual charges for coastal protection services
- fire and emergency service levies payable under the Fire and Emergency Services Levy Act 2017
- annual charges made and levied towards the cost of providing domestic waste management services
- annual charges made and levied towards the cost of providing stormwater management services.

The Minister may specify the percentage by which councils' general income for a year may be varied. They may specify different percentages for different areas of councils, or a methodology for calculating a percentage (rather than specifying a particular percentage), including by specifying a base percentage to which an additional figure may be added in specified circumstances.

2.1 Background and context of the establishment of the system in NSW

The rate peg system was introduced in 1977…

NSW local authorities first experience with some sort of rate pegging system dates to 1901. The system was discontinued in 1952 due to its "impracticality"[6].

Rapid rates rise in the 1970s saw the genesis of the current policy resurface. Over the period 1973 to 1976, rates had increased on average by 188%, largely as a consequence of increased local government expenditure, whereas average weekly earnings over the same period rose by 75 per cent and the rate of inflation was 56 per cent[7].

The Minister for Local Government was responsible for setting the peg percentage, until the establishment of the Independent Pricing and Regulatory Tribunal (IPART) in 1992 who became in charge of administering, reviewing and auditing the system.

…with no major review before 2008

The rate-pegging system has not been reformed since its inception in the late 1970s. In 2008 a report from IPART, reviewing the system, suggested two alternative approaches:

- Option A would retain rate pegging for all councils but link it to a new local government cost index and establish a 'medium term' cap on rates to allow for some revenue certainty.

[6] Brian Dollery, Rate-pegging in New South Wales Local government.

[7] Ibid.

- Option B would add to Option A: under Option B councils which demonstrated sound financial performance (as measured in accounting terms) would be exempted from rate pegging altogether for periods up to four years.

At this time, the NSW Government chose to retain the rate pegging system but with some modifications. The determination of the rate peg was transferred to IPART, now in charge of setting the rate peg annually. IPART was also placed in charge of 'special rate variation requests' that councils can apply for should they wish to increase rates beyond the set peg,[8] as well as 'variations for essential and community infrastructure'. Prior to this, the Minister for Local Government was directly in charge.

The introduction of the Integrated Planning and Reporting (IPR) framework called for the need for a stable rate-setting regime in NSW

From the financial year 2010/11 onwards, this framework obliged councils to prepare a long-term (at least 10 years) Community Strategic Plan, a four-year Delivery Program to implement that plan and annual Operational Plans and Annual Reports.

2.2 What is the rate peg and what does it do?

The rate peg is the maximum percentage amount by which a council can increase its general rates income for the year.

Councils can increase general rates income by up to the rate peg. If a council does not apply the full rate peg increase, it will be able to catch up on the shortfall in general income over any one or more of the next 10 years. Councils have discretion to determine how to allocate the rate peg increase between different ratepayer categories. From speaking with councils, we understand that the rate peg just covers councils' basic costs, nothing extra, so if a council chooses to not apply the full rate peg, it is likely to have financial sustainability issues in the future.

A council can only increase its general income by more than the rate peg if it has an approved special variation (SV) or is catching up on previously foregone increases.

The rate peg applies solely to ordinary rates, however there is provision in the Act for it to apply to special rates and annual charges that are not specifically excluded in the Act.

2.2.1 The establishment of IPART and its role within the rate-pegging system

IPART (Independent Regulatory and Pricing Tribunal) oversees regulation in water, gas, electricity and transport industries in NSW. It was established in 1992 by the Government of NSW to regulate the maximum prices for monopoly services by government utilities and other monopoly businesses, such as public transport. It is defined by several state legislative acts, including the Independent Pricing and Regulatory Tribunal Act 1992.

IPART's role is to help NSW residents get 'safe and reliable services at a fair price'[9].

For most councils, ordinary rates income represents around one third of NSW councils combined total income. On average, for some rural councils, ordinary rates income represents around 11%, and for some metropolitan councils, up to 41%.

Some of IPART's core functions related to rate pegging are to:

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[8] See p 14 for further detail on the special variation

[9] About IPART | IPART

- maintain the Base Cost Change index;
- determine the maximum percentage increase in local government general revenue (rate peg);
- determine special rate variations; and
- review Council development contributions plan.

Separately to the rate peg, IPART also decides each year whether or not to set a maximum percentage (‘waste peg’) by which NSW councils can increase their domestic waste management (DWM) annual charges[10].

IPART conducts reviews and investigations to advise the NSW government and its agencies on a range of economic and policy issues, such as pricing, efficiency, industry structure and competition. They report yearly on their performance to the NSW Parliament.

IPART sets the rate peg under delegation from the Minister for Local Government and has done so since 2010. The rate peg has two purposes:

1. It allows all councils to automatically increase their rates income each year to keep pace with the estimated change in the costs of providing their current services and service levels to their community.
2. It also limits the impact of these automatic increases on ratepayers, by ensuring councils cannot increase their rates income by more than the estimated change in their costs, without consulting with their communities through the special variation process.

2.3 Anatomy of the rate peg

Before 2023 the rate peg was calculated using a Local Government Cost Index (LGCI), which included 26 cost components, each of which was weighted to reflect its relative contribution to councils’ total costs. It was backward looking and relied on historical data. It also was applied across all councils, regardless of their specific circumstances or costs.

This year (2024) is the first year that the rate peg will be calculated using a new formula that came out of a review that IPART conducted. For the first time since its establishment, IPART consulted extensively with stakeholders (mainly councils and ratepayers), held a ratepayer workshop and established a Council Reference Group (CRG) to hear stakeholders’ views and identify any unintended consequences that would arise from the implementation of the new rate peg methodology. IPART continues to have ongoing consultation with ratepayers, councils and other stakeholders through workshops and a Council Reference Group.

Following the 2023 review, the LGCI was replaced by the Base Cost Change (BCC) model with three components: employee costs, asset costs and other operating costs.

Separate BCC models are used for the different council groups (metropolitan, regional and rural) to better reflect the diversity of NSW councils. Each of these separate models weighs the three cost components according to the spending pattern of the average council in each group. Although the components vary in weight for each group, the same measures of change are applied to each component. For example, while asset costs might have a larger weight for rural councils than metropolitan councils, both asset costs components would be forecast to change by the same amount.

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[10] For Ratepayers | IPART

IPART will release rate pegs for councils around September each year, for the upcoming financial year. The two-year lag under the old rate peg methodology did not allow for changes in council costs to be reflected in a timely manner in the rate peg. This could be problematic during periods of cost volatility.

2.3.1 How is the new rate peg set?

Under the new rate peg methodology, the rate peg is typically based on a range of variables:

- **The Base Cost Change (BCC)**. It is a forward-looking price index that measures changes in councils' base costs. It has three components:
  - **Employee costs**, which are measured by changes in the Local Government State (NSW) Award (the Award) when available or the Reserve Bank of Australia's (RBA) forecast change in the Wage Price Index (WPI).
  - **Other operating costs**, which are measured by the RBA's forecast change in the Consumer Price Index (CPI).
  - **Asset costs**, which are measured by the change in the Producer Price Index (PPI) for road and bridge construction.
- **A productivity factor** set to 0% as a default. Since 2011, IPART's rate peg methodology has included an explicit factor to account for productivity gains in the local government sector. In 2018-19, they set the productivity factor to zero as a default to recognise that productivity gains were reflected in Australian Bureau of Statistics (ABS) data they used in their methodology at the time. In 2023, following the review of the rate peg methodology, they decided to keep the productivity factor and set it at 0% as a default, unless they had evidence to depart from this approach.
- **A population factor** based on each council's population growth. The change in population and the supplementary valuations percentage are based on data that is lagged by three years. The Estimated Residential Population (ERP) is as of 30 June, sourced from the ABS. NB: In the 2021 IPART Review of the rate peg, the decision was made to include population growth. IPART decided to true–up the population factor based on updates to the Census data. A true–up was decided on because the ABS retrospectively recalculates its intercensal estimates of population once the Census data has been obtained. The population true-up reflects this and mitigates the impact of intercensal errors. IPART also decided that they would apply the true–up for any amount and to all councils for the rate peg for the 2024-25 financial year, because to the uncertainty with ABS population estimates due to the impact of COVID-19.
- **An Emergency Services Levy (ESL) factor** the ESL factor reflects the annual change in the ESL contribution of individual councils, lagged by one year (after sharing arrangements between councils within some rural fire service districts). ESL factors are not the simple increase in a council's ESL contribution. Instead, they reflect the additional change to total permissible income that is needed for a council to meet its ESL obligations after this income has been adjusted by the BCC, the population factor and any specific (non-ESL related) adjustment factors.
- **Other adjustments** designed to better respond to changes in council costs. IPART's methodology makes provision for other adjustments for each council, to be decided when they set the rate peg each year.

  For example, 'other adjustments' for the financial year 2025-2026 include:

  - an adjustment to allow councils to catch up on some of the historical increases in the ESL not captured in previous rate pegs when they were subsidised
  - a temporary adjustment for the costs of running the 2024 elections
  - a population factor adjustment for COVID-19 impacted populations (impacting 13 metropolitan councils).

The formula:

RATE PEG = BASE COST CHANGE (BCC) – PRODUCTIVITY FACTOR + POPULATION FACTOR + EMERGENCY SERVICES LEVY (ESL) FACTOR + OTHER ADJUSTEMENTS

IPART has discretion over the rate peg percentage and can adjust the rate peg above or below the percentage produced by the BCC, productivity factor, population factor and ESL factor, if they consider this appropriate.

2.3.2 How does the rate peg affect individual rates?

The rate peg sets the maximum increase in each council's general income for the financial year. The rate peg applies to general income in total, and not to individual ratepayers' rates. As long as its general income remains within the set maximum increase, councils may increase categories of rates by more or less than the rate peg.

Individual rates are also affected by other factors, such as land valuations, which can affect percentage changes to rates alongside the rate pegging process. The rate peg affects some other council fees in addition to household and business rates. The rate peg (or SV) does not apply to individual ratepayers' rates. As long as the increase in total general income does not exceed the rate peg (or SV), an individual ratepayer's rates may increase by more or less than the rate peg, or be reduced. Councils have discretion when setting rates to distribute the impact of rate changes among ratepayers. Councils may increase categories of rates by more or less than the rate peg.

2.3.3 Special variations exist if councils want a higher increase

If councils want or need to increase their general income by more than the rate peg (even if by a small amount) – for example so they can introduce new services, improve service quality or become more financially sustainable – they can apply to IPART for a special variation (SV). This would allow them to increase general income above the rate peg on a temporary or permanent basis for a given number of years. Councils can also apply to IPART to increase their minimum rates above the statutory limit. However, increases to minimum rates do not increase total general income but change the way rates are distributed.

The application will be considered against the guidelines set by the NSW Office of Local Government, including the level of community awareness and how efficiently the council has been managing its finances. Council requests for SVs are often in order to develop or maintain essential community services or regional projects. IPART can grant a general income variation for a single year, or up to seven years. Over that time the council can set its own rates and fees as long as its total general income from those sources stays within the agreed increase.

Assessment criteria

IPART assesses SV applications against criteria set by the Office of Local Government. These criteria require councils to:

- demonstrate the need for the additional revenue;

- provide evidence that the community is aware of the need for and extent of a rate rise (the community does not have to agree with the rate rise);
- exhibit relevant planning documents;
- explain council's productivity and cost containment actions and plans; and
- establish that the impact on affected ratepayers is reasonable.

IPART may also consider other relevant matters.

Even when a council decides to submit an SV application, it may be withdrawn or not applied due to community opposition, or the politics of the sitting councillors.

Conditions for the approved special variations

Conditions for SV approvals include spending the additional income on the specific purposes outlined in the application. Although the SV does not have to be tied to a particular project or series of projects.

They will also be required to report to the community about how their additional revenues are spent.

The SV and minimum rate increase determination reports, instruments (for councils that were approved a SV or minimum rate increase) and councils' completed application materials are publicly available. Non-confidential submissions can also be accessed.

The SV process in practice

Councils consider the SV process to be onerous, inflexible and costly.

- 127 of the total 128 councils in NSW have applied for an SV since 2000.
- Costs for putting in an SV application are large – 9(2)(g)(i) [redacted]
- The timing of the process is difficult, with applications take about 18-20 months. Decisions by IPART can come out up to a week before the new budget begins, depending on how many applications they get. Therefore, councils reported having to plan using two budgets, one with, and one without approval for a SV.
- Because the SV requires a 10-year forecast of expenditure, councils are then locked into that for 10 years, which binds future councils into that expenditure plan.
- The SV relies on predictions of future inflation rates, which are difficult to accurately forecast,
- The SV that is approved is fixed and does not apply to the new rate peg, which IPART calculate annually for every council, including those with SVs. If the rate peg is higher than forecast, it means the council does not receive the amount it needs to. This is because it's difficult to know the inflation rate in advance.
- There are examples of councils doing repeat SV applications.

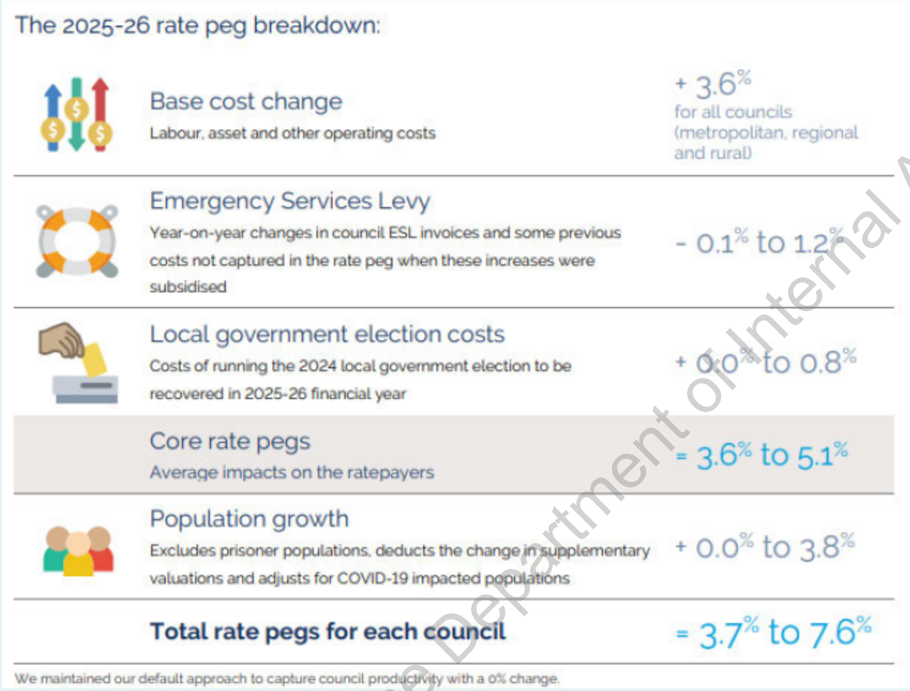
Example: the rate peg calculation for the 2025-26 financial year[11]

The following rate peg breakdown shows the outcome of the calculation and the maximum amounts

[11] Information Paper - Rate pegs for NSW councils for 2025-26 - 1 October 2024

by which each NSW council can increase its general income from 1 July 2025 to 30 June 2026 (unless the council has an approved special variation to exceed its rate peg). The rate pegs do not apply to individual ratepayers' rates.

The rate pegs for 2025-26 range from 3.6% to 5.1% before adjusting for each council area's population growth (i.e. the core rate pegs). When this adjustment is made, the total rate pegs range from 3.7% to 7.6%. These rate pegs reflect the forecast increases and actual changes in the main cost components shown below:



The core rate pegs provide a better indication of the average impacts on ratepayers than the total rate pegs because they exclude the population factor. This factor is applied to allow councils to increase their total income to cover the costs of providing the same level of services to additional people. It doesn't increase rates collected per person. The core rate pegs for 2025-26 are lower than those for last year (3.6% to 5.1% compared with 4.5% to 5.5%).

The Base Cost Change (BCC)

The BCC for 2025-26 is 3.6% for each council group, which is lower than last year (3.9%). The BCCs for each group were the same (after rounding) because the differences between council spending patterns and the differences between changes in each cost component were relatively small.

This was also the case for the 2024-25 rate peg. The following table shows the change in the BCC components and their weights. For the 2025-26 financial year:

- Employee costs in the BCC will rise by 3.5%, which is lower than last year.
- Asset costs are forecast to rise by 4.0%, which is the same as last year.
- Other operating costs are forecast to rise by 3.5%, which is higher than last year

The Council Reference Group (CRG) suggested including more components in the BCC for audit costs, costs of Valuer General land valuations, and elections costs, this might be added at a later stage.

	Employee costs	Asset costs	Other operating costs
Change in costs	3.5%[a]	4.0%[b]	3.5%[c]
Weightings by council group			
Metropolitan	40%	18%	42%
Regional	35%	23%	42%
Rural	34%	25%	42%

a. This is based on an increase of 3% from 1 July 2025 as per the Local Government (State) Award. We also included an increase of 0.5% for changes in the superannuation guarantee from 2024-25 to 2025-26 (from 11.5% to 12%).
b. This is based on the average of RBA forecasts to December 2025 and June 2026 from the August 2024 Statement on Monetary Policy of 3.5% and an 0.5% adjustment based on the average difference between the PPI (Road and bridge construction, NSW) and the CPI (All groups, Sydney) over the most recent 5-year period.
c. We use the average of the RBA's forecast change in the CPI to December and June for year the rate peg applies.

Increases of up to 1.2% were allowed to reflect ESL costs

For the 2025-26 rate peg, IPART has set ESL factors consistent with their methodology, inducing an increase of up to 1.2% was allowed to reflect ESL costs.

Temporary election cost adjustment of 0% to 0.8%

NSW councils must fund the costs of running local government elections. This is mostly done by the NSW Electoral Commission (NSWEC) but can also be done by private operators. IPART considers that the rate peg should allow councils to recover these costs to avoid trade-offs with current services.

The adjustment reflects the difference in election costs from the elections held in either 2016 or 2017 adjusted for inflation, and the 2024 local government election costs. Adjusting for this difference avoids overcharging ratepayers as the rest of these costs are in councils' cost bases.

To make it temporary, IPART will make a downward adjustment in the next rate peg.

The election cost adjustment for 2025-26 is council-specific and is based on NSWEC's estimates of election costs for each NSW council. These range from $27,000 to $2.5 million.

Of the 128 councils in NSW, 125 councils received this adjustment in their rate peg, ranging from 0% to 0.8%.

The population factor increases up to 3.8% to account for population growth

The final rate peg for the 2025-26 financial year for each council (i.e. after applying the population factor) ranges from 3.7% to 7.6%.

IPART adjusted population factors for 13 metropolitan councils due to COVID-19 population trend

A one-off adjustment for 2025-2026 was made to the population factors for 13 councils with unusual population trends following COVID-19 and where this would have led to large population factors and rate peg increases, under the current population factor methodology. These councils' populations declined notably from 2019 to 2021 and then rebounded between 2022 and 2023.

Under the population factor methodology, IPART did not reduce these councils' rate pegs when their populations declined. However, as the populations have increased in the post-COVID-19 years, the methodology would now cause an increase to their rate pegs that they found may over-burden ratepayers and increase rates per capita which is not the purpose of the population factor methodology.

These councils should have the capacity to cater for the rebound in their population using their existing rates income.

The adjustment means that the affected councils receive an increase in income to match the net population change between 2019 and 2023. This is the 'effective population growth' since 2019. This adjustment is a negative number that reflects the difference between the unadjusted population factor and the effective population growth. These adjustment factors range from -5.1% to -0.8%.

The population adjustment for COVID-19 impacted populations is a one-off adjustment for councils that were materially affected and would have had large population factors in 2025-26. A similar adjustment to the rate peg may be made in future years for other councils that may be similarly affected. IPART also anticipate reviewing the rate peg methodology in four years' time.

The 0% default for productivity was maintained

IPART has maintained the default of 0% for the productivity factor in the rate peg for the 2025-26 financial year. They consider that further analysis is required to develop measures of productivity. This includes considering the outcomes of the NSW Parliamentary Inquiry on the ability of local governments to fund infrastructure and services and the work the Office of Local Government is completing around council performance benchmarking.

Stakeholders expressed concerns about the productivity factor at the ratepayer workshop. They raised the point that the productivity factor should not be set to zero as this would not provide an incentive for councils to become more productive. In contrast, IPART heard from the CRG (consistent with council stakeholder views they've heard in the past) that the productivity factor should be removed or maintained at 0%. Their view was that it would penalise councils for productivity gains that would be reinvested into providing services to the community.

IPART decided to retain a productivity factor to encourage councils to be more efficient in the costs they can control. Councils are encouraged to reinvest any efficiencies in council services to the community.

While a default is in place, they consider that there is merit to further investigate how productivity gains can be incentivised but recognise this may include avenues broader than the rate peg. Before considering any departure from the default of zero, further consultation with stakeholders is needed.

2.4 How is the local government sector doing in NSW?

2.4.1 The own source revenue ratio

The own source revenue ratio indicates the degree of reliance of councils on external funding sources such as grants and contributions received by councils.

The ratio is calculated by total continuing operating revenue (excludes fair value adjustments, net gain/loss on sale of assets, net share/loss on joint ventures) less all grants and contributions divided by total continuing operating revenue (excludes fair value adjustments, net gain/loss on sale of assets, net share/loss on joint ventures) inclusive of capital grants and contributions.

A council is considered to have improved financial flexibility with a higher level of own source revenue (raised from rates, annual charges and user fees and charges). The benchmark for this ratio is 60% or more. In 2022-23, councils' own source revenue ratios ranged from 20.6% to 87.4%, with an average of 56.7%. Rural and large rural are well below the benchmark with a ratio of 45.9% and 36.3% respectively, indicating that it is more challenging for rural local authorities to raise their own revenue, and they are more dependent on Financial Assistant Grants provided by the Federal Government.

Over half (72 councils; 56%) of New South Wales councils in 2021-22 had an own source revenue percentage under the benchmark, compared to 44 councils (29 per cent of the then 152 councils) in 2014-15. This suggests that a growing proportion of New South Wales councils are dependent on transfers from other tiers of government.

2.4.2 The rates & annual charges outstanding ratio

Another measure, is the rates and annual charges outstanding ratio. This ratio assesses the impact of uncollected rates and annual charges on liquidity and the efficiency of councils' debt recovery. Some councils may have agreements in place to assist ratepayers to reduce the debt owed to council. The benchmark for outstanding rates is <5% for city and coastal councils and <10% for regional and rural areas.

Councils' outstanding rates and annual charges ratios ranged from 1.2% to 16.3%. The amounts outstanding ranged from $154,000 to $19.9 million. Total rates and charges outstanding for the sector was $495.1 million in 2022-23, compared to $494.8 million in 2021-22. This ratio is calculated by rates and annual charges outstanding divided by rates and annual charges levied by council.

Total operating income for all councils in 2022-23 was $15.4 billion ($19.5 billion including capital grants and contributions) and total expenditure was $15.1 billion, translating into a net operating surplus of $284 million. This compares to a total net operating deficit of $416 million in 2020-21.

2.4.3 Councils' dependence on grants from higher tier of government

Many councils in NSW are highly dependent on grants from other tiers of government[12]. Long-term growth in local governments' own-source revenue has stagnated relative to state and Commonwealth revenue growth. Without financial assistance grants and other contributions, a significant proportion of councils would not meet conventional tests of financial sustainability.

Regional, rural and remote councils, with sparse populations, large geographic areas and a small rate base, are particularly dependent on grants funding, given the limited capacity in these councils to raise own-source revenue. In these areas, grants can account for more than 50% of council revenue.

Federal Financial Assistance Grants can be given to councils for general purpose needs, or specifically for roads. State grants can be for operational or capital purposes, and tied to particular services, programmes, infrastructure or projects. They may stipulate clear prescriptions on how a council can spend money.

2.4.4 Asset maintenance has been increasingly challenging

A significant proportion of councils cannot properly maintain assets due to revenue constrains. Australian councils managed over $588.6 billion worth of non-financial assets in 2022-23. Councils should aim to renew assets at a rate equal to or greater than depreciation. Spending on asset renewal is not keeping pace with the rate of asset deterioration for a significant number of councils. The cumulative impacts of these renewal gaps are significant.

Based on available data for 2020-21:

- 50.8% of councils in NSW (65 councils) reported that their required asset maintenance expenditure in that year was greater than their actual asset maintenance expenditure. This suggests that many councils do not have the funding to meet their asset maintenance requirements each year.

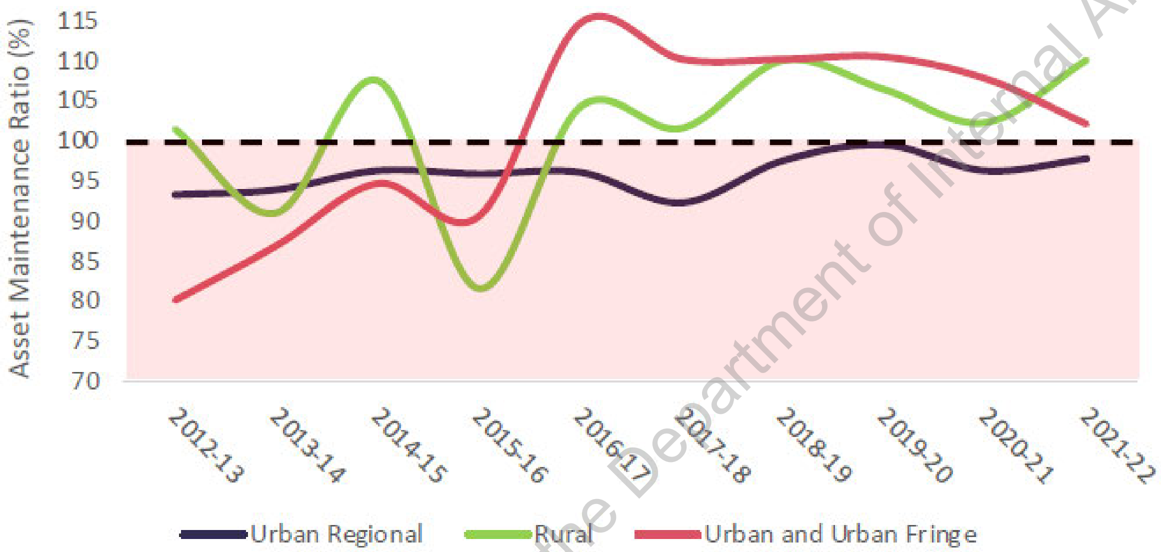
- While rural and urban councils have generally met this target over the years, urban regional councils have consistently fallen short over the past decade. The figure below shows the average asset maintenance ratio across all NSW councils by regional classification. A ratio

[12] SGS-report-Long-term-trends-in-Australian-local-government-financial-sustainability.pdf

equal to or greater than 100 per cent indicates that sufficient funds are being directed towards asset maintenance and renewal.

According to the Institute of Public Works Engineering Australia (IPWEA) (refer to ALGA State of the Assets Report by IPWEA), 1 in 10 of all local government assets across the nation need significant attention, and 3 in every 100 assets may need to be replaced. IPWEA also estimates that replacing poor quality infrastructure will cost $51 billion and replacing infrastructure in fair condition will cost between $106 billion and $138 billion. It concludes an “infrastructure renewal gap is prevalent”, where assets deteriorate faster than councils can fund maintenance/ renewal works. The IPWEA suggest that revenue constraints will drive local government to reduce asset levels to save on

TABLE 4 - AVERAGE ASSET MAINTENANCE RATIO BY REGIONAL AREA, NSW (2013-2022)



Source: NSW Office of Local Government.

maintenance and depreciation costs, leading to a reduction of community infrastructure. They further observe that capacity and capability deficits can also increase inefficiency and costs.[13]

2.4.5 Growing cost shifting practices

There is growing evidence that state governments are shifting services to councils without commensurate resourcing. Cost shifting occurs when State and Commonwealth governments transfer responsibilities for programs, services and infrastructure to local government without sufficient funding, or when grants for the provision of these services are allowed to fall below actual costs over time.

The NSW Minister for Local Government recently initiated an inquiry into the ability of councils to fund infrastructure and services, with a focus on the impact of cost shifting and the effect of the rate peg. Local Government NSW’s latest cost shifting report highlights a $1.36 billion cost shift to councils in 2021-22. While metropolitan councils face the highest amount of cost shifting, ratepayers of large rural councils experience the highest cost shift per ratepayer.

[13] Final-Report-SGS-Research-Aug-2022.pdf

TABLE 5 - COST SHIFTING TO NSW LOCAL GOVERNMENT BY COUNCIL CLASSIFICATION

Classification	Total cost shift ($m)	Cost shift per ratepayer ($)
Metropolitan	638.3	456.6
Metropolitan Fringe	213.0	420.9
Regional Town/City	416.5	434.6
Large Rural	85.8	490.1
Rural	10.3	$590.8

Source: LGNSW (2023).

Cost shifting arises in a range of ways. Examples include changes to emergency service contributions and to the waste levy, forced rates exemptions, additional regulatory functions under legislation that are administered by councils, axing or inadequately funding services (e.g. library subsidies, flood mitigation program, road safety funding program), councils having to provide pensioner rebates, and councils providing services as a provider of last resort to fill service gaps. Other areas of cost shifting include a road reclassification program which increased the amount of roads for councils to maintain, and the state government requiring a transfer of revenue generated from council managed crown reserves.

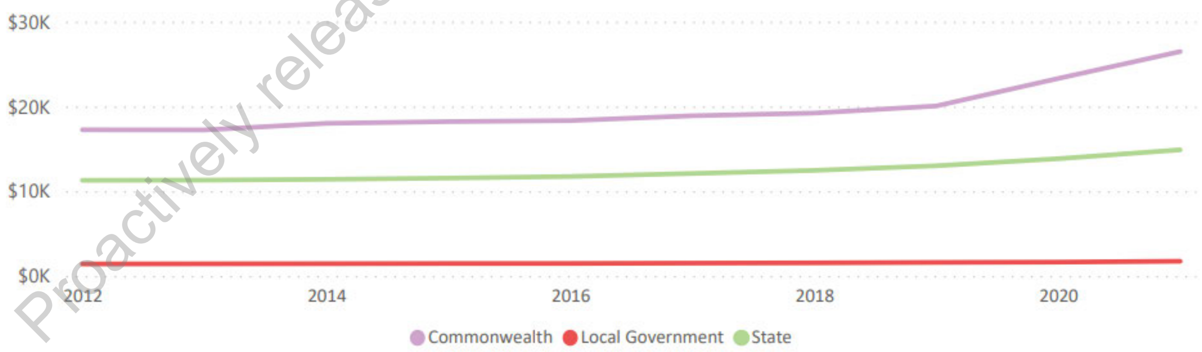
Local Government NSW estimated that cost shifting and responsibility transfers from State and Federal government in the 10-year period before 2021 'imposed a cumulative burden of $6.2 billion' for local governments in NSW[14].

2.4.6 Doing more with less

Over the past decade, total expenditure per capita by local government has flat-lined. This is despite a period of rapid population growth and escalating demand for volume, quality and reliability in public services[15].

Meanwhile, outlays per capita by the Commonwealth have escalated sharply, and those of State and Territory Governments have grown steadily. These are trends which pre-date the Covid-19 Pandemic.

TABLE 6 - GOVERNMENT EXPENDITURE PER CAPITA, BY AUSTRALIAN GOVERNMENT SECTOR (2012-2021)



Source: SGS, 2022

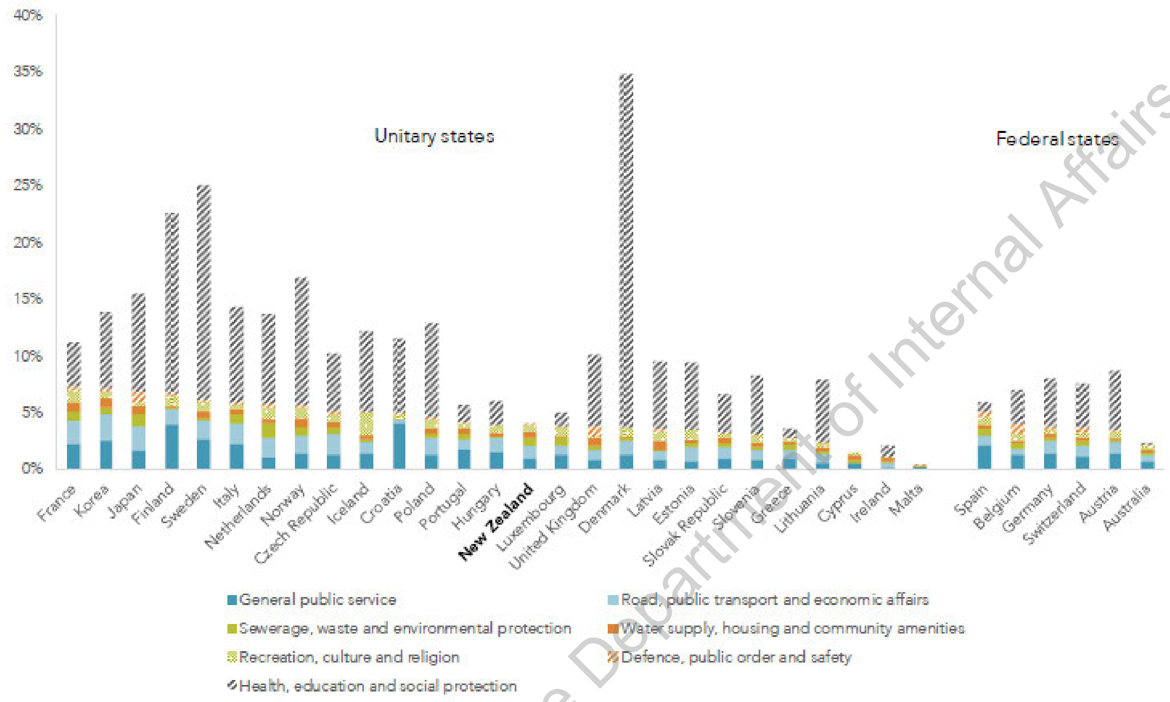
By international standards, investment in Australian local government is small, forcing local councils to operate with very modest resources.

14 Final-Report-SGS-Research-Aug-2022.pdf

15 Ibid.

Once you correct the differing scope of local government across nations, by netting out the provision of health, education and social services, Australian local governments share of GDP ranks amongst the very lowest of comparator nations, behind New Zealand.

TABLE 7 - LOCAL GOVERNMENT EXPENDITURE BY FUNCTION AS A PERCENTAGE OF GDP[16]



3 Critics of the rate-peg system

3.1 The opposition from the local government sector

The local government sector is, and always has been, opposed to the system. While the sector recognises that 'it needs to improve its financial sustainability'[17], rate pegging is seen as one of the major causes of the issue.

Reviews of the financial sustainability of the sector[18] found that many NSW councils were financially unsustainable in the long run under current policy settings and structural arrangements. This was characterised by a large sectoral infrastructure renewal backlog of $7.2 billion, an asset maintenance gap of $389 million and a net sectoral operating deficit. NSW Treasury Corporation's assessment of the financial sustainability of NSW councils undertaken in 2013 indicates that 'existing revenue

[16] Ron Crawford and Hamed Shafiee (2019) Scope and funding of local government: an international comparison. New Zealand Productivity Commission Staff Working Paper 2019/2. Available from www.productivity.govt.nz/inquiries/local-government-funding-and-financing

[17] LGNSW' submission to the Inquiry into Local Government in New South Wales, 2015:11

[18] Financial Sustainability of the NSW Local Government Sector, 2013, TCorp (Treasury of New South Wales)

restrictions (including rate pegging), severely hamper councils' ability to fund current, let alone future, levels of service'[19].

Local Government New South Wales (LGNSW) is the peak body representing New South Wales local councils and associate members, including county councils, joint organisation, and regional organisations of councils. They attribute the causes of the unsustainability of the local government financial system to 'systemic flaws', in NSW but also at a national level. An independent panel at the time recommended amalgamation as a solution, however LGNSW found funding to be the real issue. They made three recommendations that they believed would improve the system:

- End rate pegging: this has caused NSW to have the lowest per capita council rates of any jurisdiction other than the Northern Territory (which relies heavily on Commonwealth funding). Increasing rates to the national average would be sufficient to address deficits and backlogs.
- Financial Assistance Grants were frozen at the time of the report. This ended in the year 2017-18 but induced a permanent reduction in the grants base, as feared.
- Cost shifting: cost shifting onto Local Government in the financial year 2011/12 amounted to $521 million which accounted for 5.6% of Local Government's total income before capital amounts.

In 2021, in another submission to 'NSW Government Consultation Paper — Buying in NSW, Building a Future', the LGNSW reiterated their recommendation to remove the rate pegging permanently for the following reasons:

- The implementation of Integrated, Planning & Reporting under the Act (Community Strategic Plan, Long Term Plan, Resourcing strategies, etc.) made the system redundant and obsolete.
- The NSW Independent Local Government Review Panel in its 2013 Final Report found there was mounting evidence that around a third of all NSW councils suffer from weak revenues and infrastructure backlogs connected this with rate capping. According to the Review Panel, over the period 2001/02 to 2010/11, growth in total revenue of NSW councils was 5.7% per annum, compared to an average of 8.0% for the other mainland states, pointing to "revenue foregone" in rates of well over $1 billion over that period.
- Rate pegging leads councils to impose higher user-pays charges which could result in pricing inequalities.
- Rate pegging increases reliance on infrastructure contributions creating property market distortions.
- Rate pegging distorts the operation of a land valuation-based rating system. Valuations do not raise net revenue but merely redistribute the rate burden within a council area.
- Councils are democratically accountable, and this keeps rates in check.
- They also recommended to replace the ESL as they argued that emergency services needed to have a stronger funding base.

3.2 Outcome from academic research

Various research projects analysing the rate-pegging system and its impacts on the local government sector have come to the same conclusions as LGNSW. The NSW system has been in place for close to 50 years, and has been well-studied, with the consequences clearly identified. Researchers have

[19] Ibid.

looked at the financial sustainability of local government over the years and have also conducted comparative studies with other Australian states. South Australia considered establishing such a system, but quickly decided against it. The most recent research focusses on Victoria where a rate-capping system has been in place since 2016. The authors outline their findings, which they explain are consistent with the outcomes of older research based in New South Wales.

3.2.1 Purpose and background, why impose a rate cap on local authorities?

From a policy perspective, state-imposed limitations on municipal income and expenditure are one of the strictest measures available. In local government systems worldwide, public concerns over municipal expenditure levels as well as revenue raising activities has put pressure on higher tiers of government to act on it.

State imposed restriction on local fees, charges and taxes are common in the USA. In fact, most of the empirical literature that exists on the concept of limiting local government's income and expenditure and the impact it has is focussed on American local government systems. The consequences the regime has however are less known.

In the context of Australian local governments, which tend to be among the more highly regulated in comparison with other local government systems, two broad policy instruments have been utilised to impose restrictions on revenue raising activities:

1. Placing constrains on municipal fees and charges, such as parking fines, often in response to public pressure.
2. State-wide limitations on the rate of property tax increases[20] to restrain the 'spatial monopoly power' of local authorities to raise property taxes[21].

Yarram, Dollery and Tran[22] outlined two theories to explain the reasons behind property tax limitations such as rate capping:

1 - The agency theory

This theory postulates that local citizens worry that 'agency failure' by local authorities can result in excessive municipal outlays. In this context, local residents embrace state intervention through rate capping to limit excessive expenditure by local councils.

2 - The four types of expenditure and revenue limitations in local government

The authors further identified four types of perspectives to explain rate capping:

1. The 'agency loss theory': voters express a desire to constrain 'wasteful spending'.
2. The 'regret theory': voters who at first assumed excessive expenditure later regret the severity of the constrains they imposed.
3. The 'demographic differences theory': voters despise the amount of money spent on demographic groups 'different from themselves'.

[20] New South Wales refers to such system as a 'rate peg', whereas Victoria uses the term 'rate cap'

[21] Drew, J., Kortt, M. and Dollery, B. (2015) What determines efficiency in local government? A DEA analysis of NSW local government, *Economic Papers: A Journal of Applied Economics and Policy*, 34(4): 392

[22] Yarram, S.R., Dollery, B. and Tran, C. D.T.T. (2021) The impact of rate capping on local government expenditure, *Policy & Politics*, vol 49, no 3, 393

4. The ‘personal finance theory’: voters assess municipal efficiency in terms of their ‘individual tax burden’.

3.2.2 Expenditure remains the same but there is a shift in spending sources

Research shows[23] that introducing rate capping systems doesn’t induce a reduction in total expenditure. However, a shift in expenditure is observed as a direct result of rate capping, where less ‘visible’ services to local residents (such as aged and disabled services) fall. This is more pronounced in rural councils with a 9.2% decline compared to a 3.5% fall in urban councils. The rate cap also has a negative association with expenditure on family and community services in urban councils.

3.2.3 Councils in NSW are more constrained compared to councils in other states

The international empirical literature on rate capping identified two types of impacts that also apply to Australian local government:

1. Property tax limitations stimulate affected local councils to seek additional revenue from other sources.
2. Rate capping doesn’t seem to have a uniform effect on all municipalities in a given local government system. Instead, its impact appears to depend on the specific characteristics of councils, especially restricting expenditure in small poor local authorities.

The situation in Australia allowed for state comparison studies between states under rate capping systems (NSW, Victoria) and those who aren’t. In a study comparing Victoria pre-cap and NSW, the authors[24] found that NSW showed:

- inferior revenue effort equity;
- higher debt on a per capita basis;
- worse infrastructure maintenance; and
- weaker operational efficiency.

3.2.4 A ‘one size fits all’ policy is unlikely to achieve its goal to influence expenditure patterns

The research on the impact of the rate capping system in Victoria shows the need to tailor policies to meet the specific circumstances of the various sub-categories of local councils in terms of different types of expenditure. This is because the impact of rate capping on the various types of municipal expenditures is uneven between the different categories of councils.

Given the differential impact of rate capping on different categories of local council and on different components of expenditure, from a public policy perspective this suggests that if a rate capping regime is imposed on a local government system, then it should not simply be a ‘one-size-fits-all’ rate capping, but rather tailored to meet the specific circumstances of the different kinds of local authorities.

Moreover, if the primary motivation behind rate capping centres on concerns that property taxes are disproportionate to household incomes, then specific policy remedies exist such as rate concessions for pensioners, unemployed people and other target groups, and property tax deferral schemes for elderly ratepayers. Policies of this kind are often based on national or state government subsidies.

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[23] Ibid. 407

[24] Drew, J. and Dollery, B. (2015) Careful what you wish for: rate-capping in Victorian local government, *Journal of Australian Taxation*, 17: 139.

Alternatively, if the rationale underpinning a rate capping regime is the minimisation of 'wasteful' expenditure, then enhanced transparency measures in municipal expenditure could be legislated and oversight agencies could publish regular reports on inter-municipal comparisons of expenditure instead of heavy-handed uniform rate capping.

3.2.5 Limiting revenue growth

Intended to protect residents and businesses from municipal fiscal recklessness, rate pegging has instead worked to diminish local living standards according to the Australia Institute (2021). Negative impacts of rate pegging include lower levels of service delivery, decreased employment and/or wages within local government, higher user fees for municipal services and lower expenditures flowing back into local private sector businesses. The Institute argues that rate capping in Victoria has disrupted a historical trend whereby local government services have expanded and improved in line with population and economic growth.

The Australia Institute[25] further estimates that rate caps have reduced employment in Victoria (counting both direct local government jobs and indirect private sector positions) by up to 7,425 jobs in 2021-22, with an estimated GDP reduction of up to $890 million in 2021-22. This figure is expected to grow if the policy is maintained. Currently, fewer than half of Victorian local government workers are permanent, full-time employees.

Additional empirical evidence from Yarram et al (2021) indicates that rate capping in Victoria significantly reduced total expenditure for rural councils. Negative effects of spending cuts were identified for particular program areas such as aged and disabled services in both rural and urban councils, and family and community services in urban councils.

This evidence would suggest that the practice of capping rates speaks more to political expediency exploiting misconceptions in the local government sector, than to improving efficiency or trust in the sector's performance.

Note that rate capping does not apply in many Australian states/territories. This further highlights the lack of a consistent approach to managing fiscal risks across the country.

3.3 Assessment of the pros and cons arguments

3.3.1 Three arguments in favour of a rate increase limit

1. Rate pegging has achieved its basic objective of slowing increases in NSW council rates over time relative to other Australian jurisdictions.
2. The constraints imposed on council revenue by rate pegging may have enhanced the administrative efficiency of NSW councils and reduced their overheads, at least in comparison with NSW State government departments
3. Rate pegging has enjoyed ongoing and strong public support which appears to demonstrate the operation of an efficient 'political market' in NSW.

3.3.2 Three arguments in opposition

1. Rate pegging has depressed the rating effort by NSW councils more than it intended since it has had a broader 'dampening' impact on rates in particular, and local government finance more generally, due to the limited use of the special variation option.

25 Putting-a-Cap-on-Community-WEB.pdf

2. The existence of rate pegging has partly absolved local councils of full responsibility for their own financial affairs, with numerous deleterious consequences, not least a lack of long-term planning.
3. Rate pegging has undermined the democratic bedrocks of 'local voice' and 'local choice' in local government and thereby reduced local autonomy.

3.3.3 Refuting IPART's favourable arguments

IPART's arguments in favour of rate pegging	Researchers' analysis
Revenue regulation through rate pegging prevents the abuse of monopoly power in the provision of basic local services	It is not at all obvious that rate pegging can have any positive influence on the supply of local services under argument; indeed it seems more likely to curtail their supply by restricting funding.
Rate pegging assists in controlling 'cross-subsidisation' and imposes restrictions on the 'provision of non-core services and infrastructure that might prove unsustainable to ratepayers'	Similarly, it is hard to appreciate why rate pegging will dampen cross-subsidisation. Quite the opposite may occur if fees and charges are increased to counteract the impact of rate pegging. Along analogous lines, this argument does not meet with empirical reality regarding 'non-core' local services. For instance, Dollery, Wallis and Allan (2006) have demonstrated that an ongoing shift in all Australian local government jurisdictions has taken place away from 'services to property' towards 'services to people', including NSW. Much the same objection can be levelled here as against last argument. The NSW Treasury also found all four arguments largely unconvincing.[26]
Rate pegging manages the risk of poor governance in the local government sector	*No arguments provided other than "The NSW Treasury also found all four arguments largely unconvincing"*
Rate pegging limits the ability of councils to divert funds from essential infrastructure to other projects as well as expenditure on 'marginal services' that are better provided by the private sector.	*No arguments provided other than "The NSW Treasury also found all four arguments largely unconvincing"*

[26] An assessment of rate-pegging in New South Wales local government (researchgate.net)

Te Tari Taiwhenua
Internal Affairs

Local Government briefing

Hon Simon Watts
Minister of Local Government

Title:	**Overview of non-rate cap interventions in Australia, broad options for controlling council spending and initial design choices for a rate cap system**
Date:	13 February 2025

Key issues

The introduction of a rate cap system would fundamentally change the nature of local government financial controls and decision making, moving from a broadly flexible cost recovery system to a more limited system where decisions are made within legislated financial constraints.

The previous Minister of Local Government started this work, having been invited by Cabinet to report back on an investigation of a rate cap system. This briefing follows up on earlier advice on investigating the New South Wales (NSW) and Victoria systems, seeking confirmation of a direction of future work. We:

- outline the time to implement a rate cap system,
- provide a summary of options available (including other approaches in Australia),
- outline policy considerations beyond affordability to take into account in deciding the direction,
- outline the impacts of moving from our current system to either a rate cap system or a form of guidance and review, and
- set out a range of future policy choices that will need to be made in developing a rate cap system.

Action sought	Timeframe
Discuss the contents of this briefing with officials; **direct** officials to progress from investigating a rate cap system to either develop a rate cap system or some other option to control council spending; and **advise** on your preferred approach for engaging with your colleagues on this project, and the support you require from the Department.	At your earliest convenience

Contact for telephone discussions (if required)

Name	Position	Contact Number	Suggested 1st contact
Rowan Burns	Policy Manager	9(2)(a) [redacted]	✓
Daniel McAuliffe	Senior Policy Analyst	9(2)(a) [redacted]	

Return electronic document to:	9(2)(a) [redacted]
Cohesion document reference	TWCXRFFVDW2E-1255692133-35
Ministerial database reference	LG20244970

Purpose

1. This briefing is the next in a suite of papers seeking your decisions on the Local Government System Improvements programme. A map of decisions across the programme is attached as **Appendix A.**

2. This briefing focuses on councils getting back to basics, focused on their core purpose[1], through options to limit the council revenue and consequently council spending on nice-to-haves. It includes:

   2.1 a summary of the path to implementation of a rate cap system;

   2.2 a summary of the options available, including an outline of the models in Australian states;

   2.3 a range of other policy considerations to take into account;

   2.4 an outline of the impact of moving from our current system to one of more consistency and clarity, through either a cap or guidance; and

   2.5 a range of future policy choices that will need to be made.

Executive summary

3. To help address the cost-of-living crisis, the government has initiated work on options to limit council revenue from rates.

4. The previous Minister of Local Government directed us to investigate the rate peg model used in New South Wales (NSW). Under this model, general rates are capped and councils' rating income is restricted, though councils can still collect revenue from other sources (such as fees and charges, and government grants). Councils must decide what is reasonable for their communities, within a limited funding window. The revenue restriction impacts all spending, with councils making trade-offs between categories of spending. There has been some reduction in infrastructure spend in NSW as a result of these policies.

5. There are two broad options for taking this work forward that add to our existing system and build on the first phase of decisions:

   5.1 A **rate cap**, of some form, ranging from a rate targeted to just nice-to-haves (where councils are free to use rating tools for specific costs that are core activity), to a broad rate cap that covers all council activity that is funded by rates;

   5.2 **Rates guidance and review** – would provide some centralized view of reasonable rates increases, based on changes in cost indexes and particular events within a territorial authority, a review function that supports the good planning process of councils, and uses the context of local government intervention powers as a backstop.

6. Both of these options are viable, with different trade-offs. The question we have focused on is ultimately how to improve affordability for ratepayers (through

[1] Councils has a range of responsibilities under the Local Government Act. A new s11A of core services will be included in the first System Improvements bill to be introduced in 2025 and includes network infrastructure (roads and other transport, water services, and waste management facilities), public transport services, waste management, the management of hazards and risks across the areas of reduction, readiness, response, and recovery, and libraries, museums, reserves, and other recreational facilities and community amenities. This list is not finalised and is subject to consultation with Parliamentary Counsel Office.

restricting spending on nice-to-haves that are outside of the Government's vision for the core purpose of local government), without limiting the work that is at the core of council activity that delivers pipes, roads and other essential services for their communities.

7. To establish a system that endures and leads to better decision making, we consider that it is reasonable that a cap is incorporated through the 2030 long-term plan process. This would build on the more consistent information in 2027 long-term plans that the policy decisions to standardise and centralise reporting requirements will deliver, and make a cap easy for councils and ratepayers to understand.

8. This briefing provides information to help you make a decision on direction:

   8.1 **part one** of this briefing provides a summary of the path to implementation of a rate cap system;

   8.2 **part two** of this briefing provides a summary of the options available, including an outline of the models in Australian states;

   8.3 **part three** provides a range of other policy considerations to take into account in determining the direction. Addressing the cost-of-living crisis is a key driver of this work, though not the only priority of the Government;

   8.4 **part four** outlines the impact of moving from our current system to one of more consistency and clarity, through either a cap or guidance; and

   8.5 **part five** of this briefing sets out a number of future policy choices that will need to be made in developing a rate cap system.

9. Whatever your choice, there is substantial policy work to do. For instance, either a cap or effective rates guidance and review would:

   9.1 influence council decision making and have impacts on a range of operational choices in councils that relate to other Ministerial portfolios, such as tourism support, and

   9.2 need support from a regulatory agency – for example, incorporated into the Commerce Commission alongside other functions such as the economic regulation of the Local Water Done Well reforms.

10. A rate cap would flow through council level decision making into almost every portfolio where councils play a role in delivery, including hospitality and tourism support, local economic development, and environmental management. In particular, the Treasury considers that a rate cap is likely to affect a number of Ministerial and government objectives, around infrastructure investment, housing, and fiscal objectives (such as enabling local government to better fund itself to reduce calls on Crown funding).

11. We wish to meet with you and discuss options for how policy work progresses.

Background

Council rates increases, Investigation of a rate cap system, and principles for design

12. In his speech to the Local Government New Zealand Conference in August 2024,[2] the Prime Minister outlined that we are investigating options to limit council expenditure on 'nice-to-haves'. He added that we need to ensure the right balance between

[2] Speech to LGNZ SuperLocal conference | Beehive.govt.nz

ratepayers' interests and councils' financial positions, and that councils need to fund "core responsibilities". The November System Improvements Cabinet paper also noted that you are investigating "options to limit council rates rises or expenditure on 'non-core' activities" [ECO-24-SUB-0257].

13. On 18 November 2024, Cabinet noted that the Minister of Local Government would report back in early 2025 with proposals to limit council expenditure, seeking policy approval to lay the foundation for a system to limit councils rates revenue, possibly by implementing a similar system to the NSW 'rate peg' [ECO-24-MIN-0257]. Based on this, we are progressing work to design a 'rate cap' system for New Zealand. Further information on the NSW model was provided to the former Minister of Local Government in December 2024 [LG20245259]. This included some of the issues with a cap as enacted in NSW, and the review of a recent parliamentary inquiry, which reported that the rate system has contributed to financial sustainability issues faced by councils in NSW today. The inquiry recommended that the NSW Government redesign the local government rating cap system, including reassessing council base rates, shifting from a rate cap to a more flexible system, such as rates guidance.

14. Following this briefing, the former Minister of Local Government asked us for further information on the systems that other Australian states use for influencing or controlling council rates, and alternative options to help control council rates revenue.

15. We also provided a draft list of principles to guide a system to limit councils' revenue from rates in New Zealand on 5 December 2024, with approval of these principles by the previous Minister of Local Government on 17 January 2025.[3]

16. The Government position has focused on investigating a rate cap system, with some media interaction focused on a targeted cap on some spending, noting that we need to ensure that councils have adequate revenue to pay for core responsibilities.

Part one: summary of the path to implementation

17. We briefed the previous Minister of Local Government [LG20244204], on the need for a phased approach to this work. This would mean having a rate cap signalled early and flow into council work on their 2027 and 2030 long-term plans (LTPs). This approach will ensure that councils will be able to adjust to a new system without having to implement it in between planning cycles, resulting in additional consultation and costs. It will also give us time to develop the policy work mentioned above.

18. The first phase could send a signal to local government and lay the foundation for a new system. The first System Improvements Bill, scheduled for introduction in June 2025, includes principles to guide a system to limit councils' revenue from rates. It will also progress work on changes to council performance measurement, including required activity classes for reporting, and benchmarking, which will feed into the setting of a price index for a rate cap system.

19. The activity classes are particularly important if the rate cap is targeted to nice-to-have expenditure, rather than all council spending funded by rates. We would need a

[3]These principles are:
Independent – *The rate cap will be determined by an independent authority;*
Transparent – *The rate cap will be simple for councils and their communities to understand;*
Cost-reflective – *The rate cap will accurately reflect cost changes for councils;*
Localised – *The rate cap will take into account differences between councils across the country;*

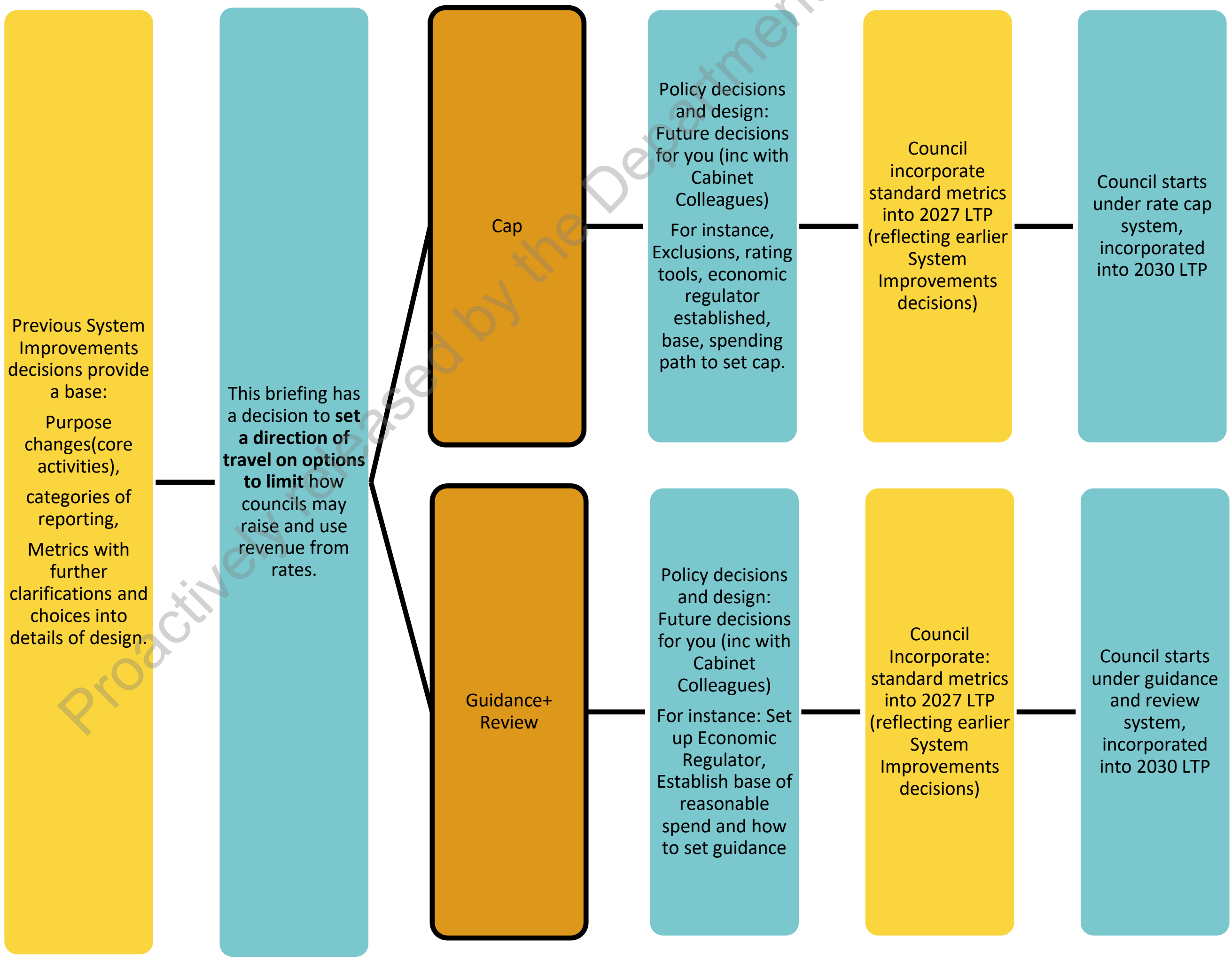
mechanism for determining what activity falls into, or out of a cap; be able to separate out the expenditure and revenue sources for non-capped activity (as we will be able to do through Local Water Done Well for water related spending); and have a baseline in place to build a cap from.

20. The subsequent phases toward implementation are still in development, with a range of policy decisions for you to make (outlined in **part five** below), but we would aim to have a system in place for councils to consider in developing their 2030 LTPs, noting that councils start work on these in 2029.

21. A summary of the forward work program and how it will impact council implementation of Cabinet decisions is set out below. Previous decisions to change the purpose of local government, develop standard metrics, and improve classes of activity will help establish a consistent baseline of spending in 2027. Your decision from this briefing will set a direction of travel for our work, building on earlier decisions in the System Improvements work programme.

22. Cabinet's previous decisions (in yellow) have set basic parameters of what the programme will do, with further work on ensuring this is implemented effectively.

Picture One: How this decision fits into the System Improvements work programme



Part two: Australia and summary of the options available

Context: Federal support for Local Government in Australia

23. The Australian systems that place a restriction on the amount of rates revenue (NSW and Victoria) feature substantial grants to local government. In the 2024/25 financial year, $2.28 billion was allocated for general purpose grants to local councils across Australia.[4] Councils can use these grants for any purpose based on consultation with their communities. This gives local governments flexibility in performing tasks – including additional responsibilities placed on them by state and federal governments – within a system of a rate cap. In total, grants make up roughly a third of council revenue in Australia, compared to approximately a sixth in New Zealand. In New Zealand, these are typically for funding particular activities (for instance, roads) rather than general purpose grants.

Australian states and territories – existing models

24. All Australian states or territories have a broadly similar cost recovery model where rates fund the gap between expenditure and the revenue expected from fees and charges, federal grants dispersed by the state, and other revenue.
25. Most Australian states have, or are moving towards, a system of open reporting and data requirements that complement the annual reports of councils.
26. Broadly, Queensland and Western Australia (WA) operate similarly to New Zealand, with a framework for local government spending and revenue (in place in Queensland, in development in WA), with councils determining the level of spending and choice of rates as a result of engagement with communities.
27. South Australia and Tasmania have firmer guidance and oversight. There is no financial limit on rates, but additional oversight and reporting requirements are in place, with an independent body providing advice on the appropriateness of long-term plans and asset management in South Australia. Independent review committees provide this same function in Tasmania.
28. More prescriptive methods are in place in NSW and Victoria [LG20243225 refers], which both have rate cap systems of differing complexity and maturity.
29. A more complete summary of these processes is attached at **Appendix B.** As a desktop exercise, this is shorter than our full investigation of the NSW system.

Alternative options raised through NSW Parliamentary Inquiry

30. The New South Wales Inquiry into the Ability of Local Governments to Fund Infrastructure and Services[5] included consultation on the impact of the rate cap. As well as raising issues with the cap as instituted, submitters proposed alternative options to meet the goal of placing downward pressure on rates without legislatively limiting council rates revenue. These options were:

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[4] Financial Assistance Grant to Local Government | Department of Infrastructure, Transport, Regional Development, Communications and the Arts.

[5] NSW Legislative Council, Report 52, Ability of local governments to fund infrastructure and services

30.1 **Rates guidance**:[6] an independent economic body would provide a benchmark rate of growth for rates for each council, taking into account the cost indices weighted for assets and the structure of spending, asset maintenance plans and stage in the infrastructure lifecycle, and any particular events (for example, natural disasters and response).

30.2 **Ministerial power[7]** to intervene in unjust rate increases: before the universal rate cap, NSW had a power for their Minister to intervene in unjust rate increases.

30.3 **Strategic oversight**: an independent body would oversee the spending plans of councils, and comment on suitability of a plan and asset management, with the council required to respond to feedback on their plan. Some part of this is delivered in New Zealand through the Office of the Auditor-General (OAG) in their audit of long-term plans, and would be similar in structure to the systems in SA and Tasmania.

Overview of options for helping councils to get back to basics

31. As an illustration of alternatives, we have summarised broad options in **Appendix C**. These range from the current system where councils operate under broad constraints to balance budgets, and with flexibility for councils on the level of activity (and subsequent rates bills) based on the desires of their constituents, to a system with a prescribed amount of total rates collected by a local council.

32. These options broadly incorporate the concepts used by Australian states and options raised in the NSW inquiry, and could be adapted to include other proposals, such as an explicit consultation process for specific activities or classes of spending.

Part three: other policy considerations

33. In developing these options, we have considered that the Government has a wide range of expectations for councils. In addition to a focus on affordability, the Prime Minister outlined that the Government wants councils to do the basics brilliantly, including addressing the infrastructure deficit and spending appropriately in their role in climate adaptation to address challenges in the least cost manner, so that council and central government assets are protected to minimise fiscal risk to the Crown.

Differences with Australia

34. There are features that make a comparison between local authorities in New Zealand and councils in Australia difficult to compare when estimating the likely impact of a rate cap. There are different responsibilities through the federal and state system. Most substantially, as outlined in part two above, Australia has a system of unconditional grants to councils.

[6] This is referred to as benchmarking. As there is substantial work on benchmarking as a stream of the system improvements work focused on standardised public reporting, we have referred to this as guidance, for clarity.

[7] Under part 10 of the Local Government Act 2002, you have a range of powers as a Minister to intervene in local government, including stronger powers such as appointing commissioners. The regime of powers in NZ is generally set to intervene in particular ways, rather than for particular purposes.

The nature of general rates in funding renewal of infrastructure

35. New Zealand has a well acknowledged infrastructure deficit, built up over time from insufficient public investment.

36. Rates are –and have historically been – the primary revenue tool for local government, particularly for operational expenditures such as depreciation and maintenance expense. Rate revenue as a share of GDP has been relatively constant at 2% over the past 100 years. When rate revenue dipped below this long-term trend during the early 1990s through mid-2000s, this coincided with a failure to maintain and renew assets, particularly for water.[8]

37. As part of a broader research programme investigating the fiscal sustainability of infrastructure investment, the New Zealand Infrastructure Commission (the Commission) is examining the importance of rates for long-term infrastructure investment needs like renewals and maintenance.

38. While we are shifting to a more complete focus on alternative financing for the first time infrastructure is put in place (through development contributions, infrastructure levies or Special Purpose Vehicles, and the charging system envisioned by the utility services model of water entities), rates will still need to be sufficient to cover the maintenance, servicing and renewal costs that are not easily attributed to a particular group or new development. Stringent limits on rates, applied broadly may exacerbate infrastructure issues, as it has done in NSW.

Impact of major weather events, shocks, and impacts on the Government's fiscal position

39. New Zealand has the second-highest exposure to natural hazards of any country in the world.[9] In addition to renewing and upgrading infrastructure, councils need to invest in new infrastructure to manage the risk from natural hazards – including those exacerbated by climate change. Climate change is accelerating the need for resilient infrastructure and triggering the need for greater protection, such as to closed and existing landfills.

40. Broadly, we need councils to spend to develop and protect assets, using general rates when the assets are council-owned and serve public interests, and are not easily attributed to individual ratepayers through a targeted rate. Any rate cap system would need to be flexible enough to account for the substantive increase in costs anticipated as climate impacts increase in scale and frequency; account for uncertainty; and support changes to the ways councils recover costs for activities, such as shifts to beneficiary pays fees and charges.

41. Increased risk of extreme weather events due to climate change exacerbates the impact of under-investment. There is evidence of under-investment in flood resilience assets in at least some areas. Councils are generally responsible for 100 percent of this cost, while the Crown is increasingly relied on to meet post-disaster recovery costs. Under the status quo approach to emergency response for infrastructure cost-sharing the Crown contributes to 60 percent of the post disaster recovery costs. This dynamic (where the Crown acts as an 'insurer of last resort') creates incentives for councils to

[8] See the Commission's *Build or Maintain* Research Insights report: https://media.umbraco.io/te-waihanga-30-year-strategy/djkmtwj4/build-or-maintain.pdf Figure 13, shows the value of water and waste assets declining in real terms, indicating that depreciation exceeded capital investment during throughout the 1990s and early 2000s.

[9] Lloyds, A world at risk: Closing the insurance gap, 2018. https://www.lloyds.com/worldatrisk

underinvest in infrastructure resilience. Creating a cap on councils' ability to collect revenue from rates will almost certainly exacerbate lobbying efforts, resulting in even more pressure on the Crown. Councils will be able to publicly lobby for additional Crown funding to make up deficits due to the constraints imposed by central government.

Affordability – how much can we save...?

42. Reducing council spending on nice-to-haves in order to increase affordability of rates is part of your broad direction to respond to the cost-of-living crisis.

43. Given the need to improve and renew our infrastructure networks, we consider that affordability may be hard to achieve while also achieving the Government's infrastructure objectives, particularly in relation to housing supply and climate resilience. While there is room for improving affordability through shifting to alternative funding and financing models, most of the drivers of rates rises are through infrastructure and core services that you want to see maintained. For instance, Mayors have raised[10] that most of their spending is ultimately on "core" activities:

    43.1 Clutha: 92 percent of operating expenditure on three waters and roading;

    43.2 Gisborne: 92 percent of expenditure goes on flood-protection, roads, water, waste, environmental management; and

    43.3 Upper Hutt: 84 per cent of capital budget on water and transport.

44. An alternative estimate of the proportionate scale comes from Statistics New Zealand's Local Authority financial statistics. 16% of spending in the 2023 financial year was on other activities (i.e, community development, economic development, recreation and sport, and culture). This proportion has been decreasing over time.

Local Government Financial Statistics: Proportion of spending, nationally, by category[11]

	Category of Spend	2018	2019	2020	2021	2022	2023
Core activites	Roading	15%	15%	14%	15%	15%	16%
	Transportation	13%	14%	14%	14%	13%	13%
	Water supply	5%	5%	5%	5%	5%	6%
	Wastewater	8%	9%	9%	9%	9%	9%
	Solid waste/refuse	3%	4%	4%	4%	4%	4%
	Environmental protection	3%	3%	3%	4%	3%	3%
	Planning and regulation	7%	7%	8%	7%	7%	7%
	Governance	3%	2%	3%	2%	3%	3%
	Property	5%	5%	5%	5%	5%	5%
Nice-to-haves	Community development	2%	2%	2%	2%	3%	2%
	Economic development	3%	3%	3%	2%	3%	2%
	Recreation and sport	9%	9%	8%	8%	9%	8%
	Culture	4%	5%	5%	5%	5%	5%

10 Taken the local out of local government': Councils react to crackdown | RNZ News

11 Local Authority Financial Statistics (LAFS), produced by Statistics NZ. The data is presented for "Total (excluding Museums)" as this includes Auckland Transport and other Auckland entities.

	Other activities	18%	17%	18%	17%	17%	16%

45. Without a line-by-line review, or full incorporation of your views of what is core or non-core, we consider that approximately 8 – 20% of council spending would be covered by a cap on nice to haves.

46. The Treasury considers that, based on historical levels of underinvestment by local government, local authorities as a whole should be investing more in infrastructure, not less.

47. A cap on only non-core expenditure would only limit a small portion of council spending, and while it would control council spending on nice-to-haves, it would not limit the major components that have driven rates rises. While every bit counts in combating inflation, we would have to determine whether the costs of additional regulatory oversight, ultimately paid for by ratepayers or taxpayers would be worth the reduction in council spending.

48. We can give greater **predictability** of rates, using benchmarking, an independent regulator that determines an appropriate level of infrastructure, and a consistent long-term plan of infrastructure development (such as through including aspects of the Infrastructure Commissions' 30-year pipeline) to reach this point. This would mean that households can budget with more certainty and be less shocked by a rates bill. To an extent, this is the value of information moving from publicly available, to easily accessible and commonly known.

49. While this would improve predictability, we would not be able to give perfect forward guidance of the costs to every ratepayer. Councils are substantially price takers in paying market prices for goods including insurance.

Better data will help us clarify how much impact this will have

50. The metrics and benchmarking stream of work will help clarify what councils spend money on. At present, apart from five prescribed groups,[12] councils are free to group activities into areas that make sense for them, with no standardisation. As part of the System Improvements programme, we will be developing activity classes that councils must report on, aiding comparability of councils and accessibility for ratepayers.

51. At present, for instance, we can state that:

    51.1 64 percent of local authority revenue was from rates nationally[13],

    51.2 payments to staff working on three waters plus roading were 17 percent of total operating expenses[14],

52. While required to report on water supply, sewerage treatment and disposal of wastewater, stormwater drainage, flood protection and control works, provision of roads and footpaths, councils are free to determine the method of allocating some related costs, such as governance and overhead.

[12] Water supply, Sewerage and treatment and disposal of waste, stormwater drainage, flood protection and control works, provision of roads and footpaths.

[13] Local Authority Financial Statistics, https://infoshare.stats.govt.nz/ViewTable.aspx?pxID=c4746e62-4bb5-41b1-b03d-0e97975719e5

[14] DIA Analysis of Council Annual reports for FY2023

53. We would need comprehensive, consistent information for a well-informed base of a rate cap. That should come from improved requirements for consistent reporting of key council metrics.

Part four: The impact of moving from our current system

54. Our current system is broadly flexible. It allows councils to set total amounts and types of activity with broad focus reflecting the preferences of local voters, to take direction by central government on the responsibilities they have as councils, and recover costs through rates.

55. There are trade-offs in moving from the current system. A change to provide less flexibility to councils to determine which activities to undertake by limits on the level of revenue (such as a rate cap) would require process changes in how central government create obligations for local government, either to ensure that a cap could adjust to changes in requirements, or accept that councils may be unable to meet all requirements. This is of particular concern if a cap is broad in coverage and would limit spending on activities that are legislative requirements.

56. Broadly, we consider that there are two options moving forward:

    56.1 a **rate cap**, of some form, ranging from a rate targeted to just nice-to-haves (where councils are free to use rating tools for specific costs that are core activity), to a broad rate cap that covers all council activity that is funded by rates; or

    56.2 **rates guidance and review** – provide some centralized view of reasonable rates increases, based on changes in cost indexes and particular events within a territorial authority, a review function that supports the good planning process of councils, and uses the context of local government intervention powers as a backstop.

A rate cap

57. Ultimately, if you want a strict cap on spending, and for councils to move from a cost recovery system of setting rates, to a system where the level of activity is set within a fiscal window, a legislative cap on rates revenue would be needed. It is the strongest form of financial control.

There are a range of design choices for how a rate cap could work

58. It is critical to councils' financial sustainability that they can continue to fund certain activities, such as investing in infrastructure. This needs to be balanced against the impact of rates rises on ratepayers and rates affordability – the overall objective of this project.

59. If you decide to progress with work on a rate cap, we seek to discuss with you the implications of excluding or not excluding certain "core" activities from a rate cap. There are a range of factors that impact this question, not the least that it will depend on a definition of what a "core" activity is, and how involved central government wants to be in answering that question. Other factors include how simple we want the system to be, how any excluded activities are to be funded, and whether that funding is ringfenced.

60. Items are easier to exclude from a rate cap where they can be fully identified as a separate source of both funding and expenditure. We consider that as a process to

separate out funding and revenue sources, the work to define activity classes, with councils having an obligation to report on a more consistent set of measures, may provide a mechanism.

61. Indicatively, we see the options as **excluding**:

a) water services only;

b) water and road services only;

c) water, road, waste, and natural hazard risk management services;

d) all activities listed in a reinstated s 11A (core purpose) of the Local Government Act 2002, or

e) all activities listed in a reinstated s 11A (core purpose) of the Local Government Act 2002 and all activities that are a legislative requirement from a cap.

62. Each of these categories can be refined, and there are adaptations that may arise easily in future. For instance, some legislative requirements (such as building and resource management consenting) may easily be attributed to individual users, and a user pays system may mean rates revenue is not needed for these functions, with the costs covered by fees and charges.

63. In addition to what categories of expenditure are included or excluded, there are also linked choices as to which categories of council revenue would be covered by any cap. A rate cap like that in NSW would apply to general rates income, not separate revenue sources for councils like user fees and charges, though there are choices around how the broad structure of rates (including targeted rates and uniform annual general charges) would need to be adapted. The greater the range of revenue tools that are included in any cap, the greater the reduction in flexibility for councils and central government.

Rates guidance and review

64. There are strong options for increased prescription, oversight and accountability without a legislative cap on rates. A combination could include:

64.1 a rates guidance system, with reasonable increases set by an economic regulator (accounting for the local government contribution to necessary infrastructure), and some baseline expectation on the expenditure of councils. Ministers would have input into the considerations for a guidance tool, and power to confirm the guidance rate;

64.2 a review process, whereby the regulator assessed the suitability of the council long-term plans, providing publicly available feedback on the suitability of the plan (including rates revenue as a funding sources) and councils were required to respond to this feedback. This would be a separate function from the current LTP audit requirement, allowing an economic regulator into policy decision making with guidance arising in the development of long-term plans, rather than in review of the plans from an accounting perspective. This would complement to the review process of the Office of the Auditor-General in their summaries of audited annual reports; and

64.3 Ministerial powers to intervene. If a council had failed to control its spending you could use intervention powers with a clear evidence base.

65. A system where councils work under a reinstated core-purpose and these systems were in place would substantially add to the level of clarity and consistency of local authority spending without running into issues that arise out of a rate cap system.

66. Any economic regulatory functions for local government, such as guidance and review function set out above, would be developed alongside other work on price regulation, such as through the infrastructure levy work that will replace the development contribution system. That regulator will need a range of technical skills, and different streams of work will require staff time at different points in a decision-making cycle. It will be important to determine how these functions relate so the organisation can be right-sized to efficiently deliver services.

Nice-to-haves – process and opportunities for enhanced community engagement

67. Decisions to spend on items that are non-core activities (nice-to-haves) are determined by council in consultation with their communities, reflecting the views and decision-making of elected members. A rate cap, or guidance, would have the effect of making it less likely for spending on these activities.

68. There are likely to be cases of non-core, net beneficial activity, that local ratepayers want in their communities, and are willing to pay for that would be positive for the growth of New Zealand. A rate cap would limit these as well. We consider that regardless of the cap or guidance choice, it is sensible to ensure processes can force an effective conversation about trade-offs, and allow a well-informed consideration of the impact of any additional spending on rates bills.

69. For smaller public good items, at a suburb or neighbourhood level, we think maintaining the option for a community to opt to levy themselves through targeted rates would be useful. This could include community halls or playground upgrades, allowing local nice to haves without imposing a cost on more distant ratepayers within a territorial authority.

70. We could develop specific process requirements for councils to approve nice-to-have expenditure at scale. Councils already have consultation processes in place, for a range of activities, though there may be a case to build on the prescribed consultation process already in place to ensure that groups opposed to changes could raise, in a formal manner the downsides of proposals, and force consideration, via council voting or through prescribed processes (e.g, referenda) the opposition to issues.

Part five: considerations for implementing a rate cap

The local government system needs to be ready for a rate cap

71. If you decide you want to pursue the option of a rate cap, the system needs to be set up for durable success.

72. For a cap to be effective and implementable, policy work is needed to get the wider system prepared. An overview of the timing and implementation is provided in **part one** of this briefing.

73. This includes, but is not limited to:

    73.1 work on any excluded activities. If any activities are to be excluded from a rate cap, their funding will need to be separated from general rates and ringfenced.

Those activities will also need to be clearly defined, and able to be funded separately without subsidisation from rates covered by a cap;

73.2 depending on the choice of excluded activities, determining how we limit the use of targeted rates and Special Purpose Vehicles where these are used for purposes that would be covered by the rates cap;

73.3 determining how an economic regulator would administer the rate cap system, and determining the scale of a regulator for this role. As demonstrated by NSW, the economic regulator plays a crucial role;

73.4 determine how this reform is paid for, and the intersection with other components of the local Government oversight system (for instance, within the Department, the Office of the Auditor General, and 9(2)(f)(iv) [redacted]

73.5 getting a clearer overall picture of all councils' fiscal situation to reduce the risk of causing financial sustainability issues. Through work on benchmarking performance metrics, there will be more standardised and centrally collected metrics. Time is needed to set up this reporting system before a rate cap can be in place;

73.6 getting a clearer picture of councils' regulatory functions and how they are funded will be important. There are a range of obligations passed from central to local government, oftentimes requiring funding or subsidisation from rates. Understanding this will ensure we do not cause unintended consequences to those obligations through a rate cap;

73.7 understanding of other, non-legislatively required work, where councils contribute to broad public policy outcomes, such as partnerships with the New Zealand Police;

73.8 we need to understand how councils use other forms of revenue beyond rates, and the barriers that might exist to using those revenue sources. More development of beneficiary-pays funding tools (such as time of use charging, toll roads and reform of the development contribution system) may allow a reduction in the proportion of funding from rates revenue;

73.9 considering how general revenue (such as from dividends from shares) should be attributed to spending, to determine how a base should adjust if more (or less) of this revenue is spent on non-core services;

73.10 ensuring a new system does not have unintended consequences such as supressing the supply of net beneficial local public goods, and negatively impacting council borrowing ability or credit ratings; and

73.11 developing an exceptions system so that councils could have options to exceed the cap in situations where costs were estimated incorrectly, or severe weather events and need for recovery placed pressure on rates revenue that could divert us from a least cost to New Zealand system that exists under the adaptation framework.

74. Each of these relates largely to an implementation choice. In addition, we need to develop cost benefit analysis to consider in a complete, and thorough manner the effects on ratepayers / taxpayers of this change.

Risks from a broad rates cap that covers more than nice to haves

75. Reflecting the experience in NSW, both the Treasury and the Department foresee risks to a number of work programmes, particularly around infrastructure development. NSW has experienced this even with a system of significant system of unconditional federal grants that buffer the impact of any change in rates revenue. We do not have a comprehensive, predictable series of unconditional grants in place to local councils in New Zealand, and establishing such a system would be unlikely to progress in the context of New Zealand's current fiscal outlook.

76. We need to consider how this risk to infrastructure could hamper the economic growth mission outlined in the Prime Minister's state of the nation speech.[15] Stagnation of infrastructure development that may result from a rate cap would hamper local economies, and consequently the national economic activity, in any area where infrastructure development was delayed. Pending design choices, there are risks to other government objectives, such as those relating improving natural hazard resilience under the Adaptation Framework and Emergency Management System Improvement programme.

77. Any announcement to move in the direction of a cap would be incorporated into the views of ratings agencies, and we anticipate this would reduce their confidence in the institutional framework of councils, reduce confidence in the ability of councils to repay their debt (with constrained borrowing), with the potential for decreases in credit ratings and subsequently, higher cost of capital for external borrowing. Consultation more directly with other work programmes in the Treasury may help us ascertain the extent.

Next steps

78. This briefing sets out a range of options for this stream of the System Improvements work. We would like to meet to get your direction on how you wish for us to continue on from **investigating** a rate cap system. This could be either **developing** policy options for a rate cap, or some other option (or, group of options) on guiding and reviewing council activity.

79. If you decide to progress with work on a rate cap, we recommend that you engage with your Ministerial colleagues around the design of any exclusions. In particular, the Treasury considers that a rate cap is likely to affect a number of Ministerial and government objectives around infrastructure investment, housing, and fiscal objectives (such as enabling local government to better fund itself to reduce calls on Crown funding). We recommend you engage with the Ministers of Finance, Infrastructure, Housing, and Transport, at a minimum.

80. The Infrastructure and Investment Ministers Group (IIMG) meeting (chaired by the Minister for Infrastructure) may be a useful forum for this discussion.

[15] Economic growth the key to better days ahead | Beehive.govt.nz

Consultation

Limited external consultation so far

81. This briefing has been prepared at pace, so as to keep progress with the overall system improvements legislative plan, and provide options for your consideration. We have consulted proactively in limited circumstances where we needed to understand a specific item of our advice.

82. The Treasury, the National Emergency Management Agency, Ministry of the Environment (waste and climate adaptation teams) and the Infrastructure Commission have been involved in discussions that informed this advice.

83. As this work develops, we consider it appropriate to consult broadly with a wide range of Government agencies who are responsible for policy areas that will be impacted by a rate cap, and through confidential conversations with external bodies, such as LGNZ.

Recommendations

84. We recommend that you:

a) **note** that this briefing provides a summary of alternative options, and trade-offs in moving from our current system to a rate cap system;

b) **note** that officials consider that there are broadly two options in progressing work – a legislative rate cap, or a system of guidance and review;

c) **note** that officials from the Department and Treasury would have concerns if a cap was broad in coverage and included caps on revenue for infrastructure;

d) **EITHER**

i. direct officials to begin work on developing a rate cap system; **Yes/No**

OR

ii. agree to discuss your preferred alternative with officials; **Yes/No**

e) **agree** to discuss your preference for how officials support your engagement with Ministerial colleagues, including on the consideration of exclusions from a cap and the impact on other portfolios. **Yes/No**

Rowan Burns
Policy Manager

Hon Simon Watts
Minister of Local Government

_____/_____/_______

Te Tari Taiwhenua
Internal Affairs

Appendix A: Local Government System Improvement Programme – High-level summary of policy initiatives

Initiative	Area	In Bill?	Purpose	Current status	Upcoming decisions by MOLG to be made in February 2025
1. **Purpose of local government**	DM	Yes	Guide council decision-making with restored focus on local services and infrastructure	Approved by Cabinet	None
2. **Regulatory relief**	DM	Yes	Support efficiency and reduce costs by modernising outdated law	Approved by Cabinet	Make final decisions about audit fee requirements
3. **Performance management and reporting**	SP	Yes	Empower ratepayers with consistent information on council performance	Approved by Cabinet	None
4. **Limiting rates revenue**	FF	Yes	Limit how councils may raise and use revenue from rates	Awaiting Cabinet approval to issue drafting instructions	Determine direction of development of rate cap system.
5. **Codes of conduct**	TA	Yes	Provide consistency and certainty on roles, responsibilities and professional standards	Awaiting Cabinet approval to issue drafting instructions	None
6. **Model standing orders**	TA	Yes	Provide consistency and certainty on council meeting procedures	Awaiting Cabinet approval to issue drafting instructions	Possible costs decision.
7. **Mayoral and councillor advisory staffing**	TA	Yes	Ensure members have the advice and support they need to carry out their roles	Awaiting Cabinet approval to issue drafting instructions	None
8. **Written questions system**	TA	Yes	Ensure members have the information they need to carry out their roles	Awaiting Cabinet approval to issue drafting instructions	None
9. **Timing of official council business**	TA	Yes	Ensure members can balance council meetings with other commitments	Awaiting Cabinet approval to issue drafting instructions	None
10. **Governance principles and local governance statement**	TA	Yes	Set expectations of good local governance and provide vehicle for delivery to be demonstrated	Awaiting Cabinet approval to issue drafting instructions	None
11. **Procurement policy**	DM	Yes	Ensure consistency and certainty for procurement	Awaiting confirmation of Minister's decision	Possible policy decisions on the Cabinet direction
12. **Consultation and decision-making**	DM	No	Consultation and decision-making requirements will be reviewed next term. Options to fast-track council planning and reporting exemptions in special circumstances will be considered in emergency management system reforms.		
13. **Bylaws and infringements**	SP	No	A bylaws system review is underway. Changes will be progressed through another bill. We will brief you separately.		
14. **Shared services**	SP	No	Work will be progressed through Local Water Done Well, building consent system reforms, and resource management reforms.		
15. **Fees and charges**	FF	No	Work will get underway later this year alongside further work on the bylaws and performance management systems.		
16. **Insurance**	FF	No	This initiative is being led by the Treasury, 9(2)(f)(iv) [redacted]		
17. **Lending**	FF	No	This initiative will be progressed through other programmes including Local Water Done Well and Going for Housing Growth.		

Appendix B: Overview of Australian systems for setting rates

While there is variation between Australian systems as state and territorial governments make decisions on design, councils in Australia generally capture rates on property, making decisions on appropriate level of expenditure, taking into account required infrastructure spending and providing some level of other services to communities. Rates fund the difference between expenditure and the level of revenue from other sources, including fees and charges, and federal and state grants.

Most states have a system of open data where councils are required to report in a standard format, which acts as a complement to the information in annual reports.

Queensland[16] - a framework with flexibility

Queensland has a local government sustainability framework that provides guidance and oversight on a range of financial and non-financial performance measures, including recommendations for the level of asset renewal spend.

Local councils are expected to act within this framework, then cost recover, including via rates after following a process where they:

- evaluate and determine the range of services it needs to support the community for example, waste management, local roads and suburban care;
- decide how much money is needed to fund services and infrastructure;
- establish how much funding it can expect to receive from the federal and state governments and other income sources;
- determine how much money is required from rates and charges to cover the balance of expenditures; and
- decide on the best mix of rates and charges to provide services to the community.

Western Australia

Western Australia (WA) has a rates system where councils recover to meet costs.

The Western Australia Minister for Local Government has a range of areas to approve rules for rates, including specific methods for valuing mining land. Grants to councils are made on horizontal equity basis to equalise services in a number of given standards of expenditure, to ensure that all ratepayers have some level of access to community and cultural activities.

WA has recently begun a reform of local government,[17] instituting principles into the Local Government Act (including community engagement and financial management), and ensuring that local councils have a rates and revenue policy. This was proposed to:

85. increase transparency for ratepayers by linking rates to basic operating costs and the minimum costs for maintaining essential infrastructure;

- provide ratepayers with a forecast of future costs of providing local government services; and

[16] https://www.localgovernment.qld.gov.au/for-councils/finance/rates-and-charges
[17] https://www.dlgsc.wa.gov.au/department/publications/publication/full-reform-proposals

- reflect the Asset Management Plan and the Long-Term Financial Plan, providing a forecast of what rates would need to be, to cover unavoidable costs.

South Australia – review from economic regulator

South Australia has a system where councils can set rates taking into account the needs of their communities and meeting their responsibilities.

South Australia was considering instituting a rate cap scheme, with a proposed Bill in 2018 (called a rates oversight scheme). The State Government of South Australia ultimately did not proceed, taking into account community feedback on the proposed Bill, alongside a 2016 legislative inquiry that recommended not instituting a rate cap.

The South Australia State Government ultimately decided on a system of commission advice to each of the 68 councils, that covers:

- appropriateness, and effective maintenance and implementation of the council's long-term financial plan and infrastructure and asset management plan, including any material amendments proposed or made in respect of those plans; and
- appropriateness of proposed financial contributions by the council's ratepayers under those plans.

The advice is published, and councils must address the advice, whether or not they have adjusted their plans as a result.[18]

Tasmania – independent audit committee, broad oversight

Rates in Tasmania are set as a cost recovery mechanism, with rates set to capture the residual amount of income not funded by federal and state grants and other revenue sources.

Tasmania has a broadly similar system in function to South Australia. The oversight is provided by an independent audit panel for each council, that can make recommendations to council on revenue and expenditure policies.

All councils in Tasmania have open data requirements, with consolidated data on a range of metrics (financial and asset management, roads and bridges data, etc) published through the State Government of Tasmania.

Tasmania has recently completed a review into local government.[19] Relevant to rates, there is a new requirement on the content of rates notices to include:

- an explanation of the landowner's year-on-year change in general rates payable, and what has driven that change (for example, rating policy change or property valuation);
- the average year-on-year general rate change for a property in the municipality, expressed as relative change; and
- a simple break-down of how a council's rates have been applied to categories of functions and services provided to the community.

[18] https://www.escosa.sa.gov.au/projects-and-publications/projects/advice/local-government-advice-framework-and-approach

[19] https://www.dpac.tas.gov.au/divisions/local_government/the-governments-response-to-the-future-of-local-government-review

Victoria[20]

In 2016, Victoria instituted the Fair Go Rates System, which imposes a rate cap on councils, which is anchored around an inflation measure, with most rate caps since introduction broadly in line with inflation.

The Essential Services Commission provides advice to the Minister for Local Government on a rate cap, setting out:

- a recommendation for any adjustments to be applied to consumer price index in setting the cap for all councils, a grouping of councils or any individual council;
- the rationale for any adjustment; and
- a preferred option.

This advice is based on analysis of council finances (for example, changes in debt sustainability and cash on hand) and costs (changes in alternative cost indices, such as construction cost indexes) inflation, and other economic forecasts (forecast economic growth, etc).

Individual councils can apply for a higher rates variation.

As the rate cap is anchored around inflation, in practice, we consider this is likely to work similarly to that of the early stages of the NSW rates peg system.

The Victoria Essential Services commission publishes biennial reports on the state of council finances, largely finding that financial position remains stable, with increases in grants from the federal Government offsetting the changes in rates revenue.

Australian Capital Territory

The Australian Capital Territory does not have a separate system of local government. The normal functions of state and local governments in Australia are both undertaken by the Territorial Government.

The Territorial Government makes decisions on how to fund activities and appropriate levels of funding and expenditure within the limitation on powers of what to tax set out by the constitution.

[20] https://www.localgovernment.vic.gov.au/our-programs/council-rates-and-charges

Appendix C: Options for helping councils to stick to the basics

	Current state	Purpose changes are completed	And…benchmarking / reporting with standard categories of activity	And…guidance and independent review is in place And Ministerial powers to intervene	And…rate cap that excludes all 11A activities and legislatively required functions	Rate cap 2 – only water excluded	Strict rate level: must change at designated rate
	Currently in place or decisions have been made to progress			For you to determine direction, in consultation with Ministerial colleagues			
Description of broad system	Broad range of responsibilities, guided by working towards the purpose of local government that includes the four wellbeings, alongside the general role of councils as a statutory body, and a requirement to comply with all other legislation.	Broad range of responsibilities, guided by a purpose statement that no longer includes the four wellbeings, guidance to focus on the core activities of local government in a revised section 11A, alongside the general role of councils as a statutory body, and a requirement to comply with all other legislation.	Broad range of responsibilities, guided by focus on the core activities of section 11A. Benchmarking allows comparison across councils of categories of spending and performance.	Increased Benchmarking / reporting, and guidance An **independent regulator** sets a rate for councils that total rates *should* increase by, based on council profile and cost structure.	In addition to guidance from the regulator on core activities excluded from a cap, a cap is in place for non-core, non-legislatively required activity.	An independent regulator sets a maximum rate increase for councils that total rates *can* increase by based on council profile and cost structure, flexibility to charge a lower amount There is a legislative maximum limit on rates revenue.	An independent regulator sets a rate increase for councils that total rates increase by, based on council profile and cost structure. There is a legislative limit on rates revenue. Councils would not have discretion to set lower rates (for instance, in time of region specific economic downturn, etc, though this may be accounted for by a regulator.)
How is the level of activity decided?	Council determines appropriate level of activity in consultation with their communities and then **recovers costs**.				Councils would be capped on nice to haves, free to choose on core activities, Council determines best mix of restricted activities within a tight constraint.	Council determines best mix of activities within a given level of revenue, makes trade-offs between core and non-core activity.	
How predictable are rates?	Historically, predictable for a short period.		Should be more predictable, with additional clarity on spending structure allowing comparison that Helps constituents hold councils to account.	Guidance on what rate increases should be to fund activity and catch up on a reasonable portion on infrastructure deficit. Room for change in circumstances (disaster response, etc) without any exception process.		Very predictable – Reported maximum in advance, variation based on assessment of assets.	Very predictable – Reported level in advance, variation based on assessment of assets.

	Current state	**Purpose changes are completed**	**And…benchmarking / reporting with standard categories of activity**	**And…guidance and independent review is in place** **And Ministerial powers to intervene**	**And…rate cap that excludes all 11A activities and legislatively required functions**	**Rate cap 2 – only water excluded**	**Strict rate level: must change at designated rate**
	Currently in place or decisions have been made to progress			For you to determine direction, in consultation with Ministerial colleagues			
How does this limit spending on nice-to-haves?	Actions that fit within the four wellbeings are possible, up to councils to decide within broad framework, in consultation with their communities.	Actions that are within core purpose should be prioritised.	Actions that are within 11A should be prioritised, benchmarking illustrates variance between councils that is contributing to a rates rise.	Guidance is focused on increases related to core activities. Can increase to cover nice to have, but must explain clearly why an increase is above guidance, and if caused by -essential expenditure could trigger advice for intervention. Relies on political pressure to reduce spending, particularly requiring a direct conversation on trade offs when at the level of rates guidance.	A rate cap would apply and councils must make clear trade offs between non-core activities.	Strict cap / level would have strongest limit on nice to haves, make trade offs within broad spending, where they should focus on core activities.	
What is the impact on council borrowing and debt?	No change.			There is no restriction on rates revenue and councils would still have freedom to determine rates choices. We consider it likely that councils may opt for a slightly higher focus on debt, in the short term, to ensure they stayed within a guidance window.	There would be a very minor impact on council revenue raising levels.	9(2)(g)(i) [redacted] 9(2)(g)(i) [redacted]	
How consistently is spending communicated to ratepayers?	Broad categories in legislation, not always easy for ratepayers to understand, or compare activity of councils		Councils are required to report on a standard series of metrics, summarised annually by the Department.				

	Current state	Purpose changes are completed	And…benchmarking / reporting with standard categories of activity	And…guidance and independent review is in place And Ministerial powers to intervene	And…rate cap that excludes all 11A activities and legislatively required functions	Rate cap 2 – only water excluded	Strict rate level: must change at designated rate
	Currently in place or decisions have been made to progress			For you to determine direction, in consultation with Ministerial colleagues			
Do Ministers have flexibility to make decisions that impact local Government?	Yes. Cost recovery basis of rates setting means can make decisions and councils deliver, adjusting rates and other activities.			Yes – councils can still adjust activity based on ministerial decisions. Rate rise guidance and review does not legislatively limit rises.	Rate cap excludes core activities, meaning Ministers can still make legislative decisions that impact on councils.	Process design needed. Can incorporate changes in council expectations into a rates setting process, would need an 9(2)(f)(iv) [redacted] sets out cost of legislative requirements.	
Will this limit spending on "core" infrastructure?	To the extent it has historically, whereby political pressure from constituents to keep rate rises low has contributed to infrastructure deficit.		We expect that this will provide opportunity for comparison between councils and make councils slightly less likely to underinvest.	We expect that this will provide guidance on what a council should do, and comparison between councils. Setting guidance that rates should cover at a least a base level of infrastructure, informed by the Infrastructure Commission plan should reduce possibility of deferred maintenance.		Other core activities would be within a cap. More so if a rate cap is low enough to influence debt limits generally. NSW experience is a reduction in infrastructure spending, with impact mitigated by grants that compensate councils.	Possibly more so, if rate limit applies to core infrastructure, and is at a low enough level to be binding. NSW experience is a reduction in infrastructure spending, with impact mitigated by grants that compensate councils.
Complexity of policy development – How soon can this be in place? **How much staff time would this require from councils?** **How bureaucratically complex would this be to design and implement?**	Current system	From end 2025 when legislation is place through (System Improvements Bill) Process in place, low bureaucratic cost.	From mid-2025, with improvements on benchmarking developing over time. Some administration costs to change process of reporting, then similar to current. Relatively small bureaucratic cost.	From 2027 – guidance would use weighting from benchmarking and weights of activity classes. Can be earlier as based on change, rather than a cap needing an accurate base. Need to set up regulator for guidance and review function.	Most complex – from 2030. Would need the work for both guidance function, and rate cap function, with some duplication of role.	From 2030 LTP process, using the 2027 LTP as basis for reporting. 9(2)(g)(i) [redacted]	

	Current state	**Purpose changes are completed**	**And…benchmarking / reporting with standard categories of activity**	**And…guidance and independent review is in place** **And Ministerial powers to intervene**	**And...rate cap that excludes all 11A activities and legislatively required functions**	**Rate cap 2 – only water excluded**	**Strict rate level: must change at designated rate**
	Currently in place or decisions have been made to progress			For you to determine direction, in consultation with Ministerial colleagues			
Exceptions process	Not needed – no legislative limit on spending.				To be designed. Historically, expensive in NSW, contributed to lower spending and unwillingness to increase rates, and shifting to alternative, risky sources of revenue. Possible to design something simpler, though requires either design, approval for regulator to make exceptions with limited information, or specific projects.		

Internal Affairs
Te Tari Taiwhenua

Local Government briefing

Hon Simon Watts
Minister of Local Government

Title:	**A rates band: a proposed model for consultation with delegated Ministers**
Date:	11 September 2025

Key issues
Alongside the Independent Reference Group for rates capping, we have progressed work on a rates band model. A summary of the model, for which there has been broad agreement, is provided in this briefing. Councils will be expected to operate within a rates band that would have a minimum (reflecting the need to maintain assets and services), midpoint, and maximum (based on income increases), expressed as a percentage increase for rates. We seek your agreement in principle of this model, alongside the views of the Ministers of Finance, Regulation, and Infrastructure. We will incorporate feedback over the course of the next month as we prepare materials for Cabinet by end of year.

Action sought	Timeframe
Approve in principle the key design aspects of the rates band. **Forward** this briefing to the Ministers of Finance, Regulation and Infrastructure.	Following your discussion with the IRG on 18 September 2025.

Contact for telephone discussions (if required)

Name	Position	Contact Number	Suggested 1st contact
Richard Ward	General Manager Local Government Policy, Partnerships and Operations	9(2)(a) [redacted]	✓
Rowan Burns	Policy Manager – Local Government	9(2)(a) [redacted]	

Return electronic document to:	9(2)(a) [redacted]
Hukatai reference	7B1fc19cbd-c061-4fe6-b6f2-357a03b2a735%7D
Ministerial database reference	LG20259157

Purpose

1. You are required to report back to Cabinet by the end of 2025 with "an update on policy design progress for a rate-capping system" [EXP-25-MIN-0038 refers]. Working with the Independent Reference Group for rates capping (the IRG), we have developed the key design elements of a model for rates capping in New Zealand.

2. This briefing presents a high-level model that moves from a rate capping approach to a "rates band". In April, Cabinet agreed that you would develop a rates capping system alongside relevant Ministers, including the Ministers of Finance, Regulation, and Infrastructure. We suggest that this briefing provide the basis of conversations with those Ministers.

Executive summary

3. Working with the Independent Reference Group for rates capping (the IRG), we have developed the key design elements of a model for rates capping in New Zealand. The model draws on lessons from the New South Wales experience, but has been developed to work within a New Zealand context.

4. The preferred approach is to develop a "rates band" within which total rates (including rates that are attributed to non-waters infrastructure) increases are contained. Councils should increase by at least the minimum of the band, which would be set at a level sufficient to maintain standards. Councils would be able to respond to rising demand for services as incomes rise, up to the maximum of the band. Intervention by a regulator would occur if spending outside this band is significant, and sustained. Higher (or lower) increases may occur, with councils initially explaining why spending was outside the band, and what they will do to return to within the band.

5. We are seeking your broad agreement to this approach, alongside that of the Ministers of Finance, Regulation, and Infrastructure, before proceeding with further policy development towards a Cabinet report back later this year. That further development will consider a number of significant issues, including: transition pathways for councils to move from current spending levels onto the rates band; the establishment of a regulator and its regulatory toolkit; and further detailed design of the model and formula.

Background

Cabinet last considered the issue of rates capping in April 2025

6. In April 2025, Cabinet Expenditure and Regulatory Review Committee (EXP) considered your paper *Local Government System Improvements: Second Tranche of Policy Decisions* [EXP-25-MIN-0038 refers]. Cabinet agreed that:

   6.1 You would develop a rates capping system alongside relevant Ministers, including the Ministers of Finance, Regulation, and Infrastructure (recommendation 3 of the minute);

   6.2 The system would be designed with the following principles in mind (paragraph 17 of the paper):

      6.2.1 **Independent** – Determined by an independent authority;

6.2.2 **Transparent** – Simple for councils and their communities to understand;

6.2.3 **Cost-reflective** – Accurately reflect cost changes for councils; and

6.2.4 **Localised** – Considers differences between councils across the country.

6.3 You would report back to Cabinet at the end of this year with an update on policy design progress for a rate capping system (paragraph 20 of the paper).

7. You directed us to establish the IRG to help guide the policy design process.[1] We established this group in June 2025 and have met with them five times to progress the design work. You have attended two of these meetings to set out your expectations and to hear advice from the IRG directly.

8. We held all-of-government general workshops with policy agencies, and worked directly with interested departments as specific questions and issues have arisen, beginning in April 2025. Subsequently we have been working with the IRG.

We have learned from the New South Wales model, and adapted to the New Zealand context

9. Our initial approach, following the Cabinet agreement outlined above, focused on the development of an 'exclusions-based' model for rates capping, similar to that employed in New South Wales. The model was designed on the principle that the rates cap would apply to all council rates revenue, excluding revenue gathered for certain specific purposes (e.g. core council services like water and roads). The rationale for excluding certain activities in the model was so that a rates cap would not hamper expenditure on core services and inadvertently hamper broader government priorities (e.g. housing development).

10. At its meeting with you on 12 August 2025 the IRG noted that this approach would likely lead to significant unintended consequences and suboptimal outcomes, due to impacts on debt financing (higher interest rates for debt related to capped activities), bureaucratic cost of compliance for councils (particularly small rural councils), and prospective limited savings.

11. In that meeting the notion of rates targeting was raised, which involved setting a band within which rates could be expected to increase by, as opposed to a rates cap.

12. You agreed that the IRG work closely with DIA to develop an alternate model based on a 'rates band'. The model is designed to mitigate the unintended consequences of the 'exclusions-based' model, while still fulfilling Cabinet's key requirements (independent, transparent, cost-reflective, and localised) for the design of the system.

Policy development

The 'rates band' model

13. The suggested model draws on the experience of flexible inflation targeting, a model that has been adopted in New Zealand for more than 30 years, and has evolved over

[1] The members of the group are Malcolm Alexander, Cameron Bagrie, Fiona Towers, Matthew Walker, and Lawrence Yule.

time. This model would increase the rigour and oversight of local government spending relative to the status quo, but be more flexible than a strict rates cap.

14. The key design aspects of the proposed 'rates band' model are:

    14.1 A rates band would apply to total rates revenue (uniform annual charges, general rates and targeted rates), but not to other sources of revenue such as water charges, development contributions (or the growth portion of forthcoming development levies), or fees-funded council services, such as building consents, and other user-charges.

    14.2 There would be a range within which council rates are allowed to increase. The range would have a minimum, midpoint, and maximum, expressed as a percentage increase for rates. The band is not a total revenue target. It represents the price component of council revenue growth.

    14.3 The range could be based on analysis of historical pricing data, and could either be firm (e.g., 2-4% band); or more flexible and set at regular intervals (i.e. triennially, noting IRG members do not favour annual setting). This flexible approach would allow current cost information and market fluctuations to be considered when setting the range. For the model to be credible, it needs to be durable and transparent. A formula agreed by Cabinet would be made publicly available.

    14.4 If a council proposed to increase rates outside the rates band it would be given the opportunity to explain why there is a variance (e.g. to fund recovery from a natural disaster) and how they propose to return to the band.

    14.5 Ultimately, any regulator would assess whether sustained variances are justified. If the variance is assessed as unjustifiable, the council would be instructed to bring its rates revenue back within the band. Enforcement approaches are yet to be determined.

15. The model will require increased transparency and accountability, and alignment with the proposed new purpose of local government. Some of these matters are currently before select committee as part of the Local Government (System Improvements) Amendment Bill.

16. The Department considers that primary legislation would set out the key design aspects of a rate band model, and allow for the formula to be set by secondary regulation. We do not recommend that the formula is set in primary legislation, because we foresee that it may need to be adjusted from time to time as circumstances change.

17. This approach is analogous to the process by which the Reserve Bank New Zealand (RBNZ) remit is set where primary legislation sets out the need for a remit, considerations for monetary policy, and stable prices. The remit itself sets out the precise numbers to be used.

A proposed formula – the "steady state" we're aiming for

18. The basis for the proposed formula is anchoring the rates band based on either per capita, or per rating unit with:

    18.1 a cost-based minimum, expected to reflect inflation;

18.2 expectations for average hourly earnings (wage growth) with a view that continued rises in local authority rates, in excess of the price component of income growth, is not sustainable or politically acceptable;

18.3 historical pricing trends for components of local authority pricing measures; and

18.4 nominal GDP, less an allowance for population growth and productivity.

19. Our preliminary analysis suggests that a 2-4% target band for local authority rates is justifiable as a long-run guide and anchor to where rates increases should be. The proposed formula is expressed in Figure 1, based on a per capita, price basis for a fixed basket of council services.

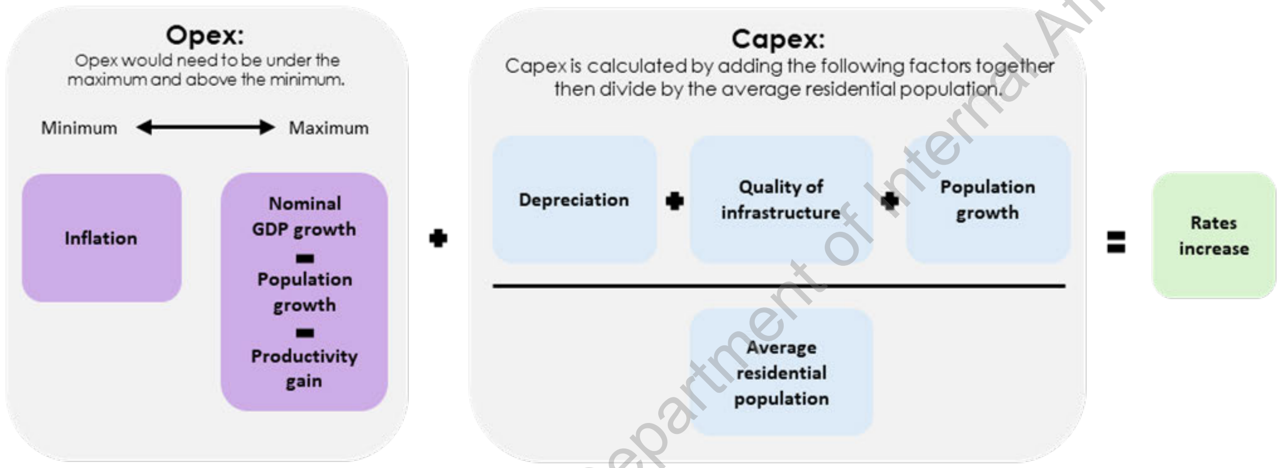

Figure 1: Proposed rates band formula

20. In a future "steady state", where investment is constant as a share of GDP, the infrastructure deficit has been addressed, and the share of operational spending to capital spending is constant, these factors should apply for both capital and operational spending.

21. To allow comparison with a price index, council capital expenditure is based on a per person or per rating unit basis and should be –

21.1 sufficient to replace worn out assets (**depreciation**);

21.2 respond to demand for more and improved infrastructure as income rises;

21.3 in line with GDP (**quality of infrastructure**); and

21.4 increase as **growth** occurs, to cover the need to serve more people.

22. Capital spending to replace worn out assets should be depreciation funded. Rates should cover the increase in standards as GDP increases, and the portion of growth costs that are not recovered from other tools (i.e. from development contributions or the forthcoming development levies regime). This should be in line with the band below.

Explanation of Factors:

23. *Choice of Minimum:* 2% represents the midpoint target band of the RBNZ policy target. The average rate of inflation has been 2.1% since 2002, excluding the Covid-19 inflationary pressure. The average has been 2.6% including Covid. Conceptually, this reflects that councils should be maintaining service standards.

24. *Choice of Maximum*: As a long run anchor we believe council activity should align with national activity/growth, or GDP. Demand for council services should be reasonably in line with rises in GDP. Nominal GDP has increased at an average rate of 5.4% per annum. We analysed growth in population, household formation, and new dwellings (proxies for the rateable base for councils) which were around 1-1.5% per year on average. We also note that productivity growth has averaged to around 0.3% per year for the last decade[2]. Deducting prospective growth in the rateable base, and an allowance for productivity yields around 4% as a per capita/per rating unit increase.

25. Policy considerations to get to that "steady state" are discussed below. As checks on reasonableness:

    25.1 the Sapere Index developed for the Productivity Commission in the Review of Local Government Funding and Finance found that over the ten-year period from 2007-2017, price inflation has been between 28% and 31%, or between 2.51% and 2.75% on a compound annual growth rate (CAGR) basis.

    25.2 average growth in non-tradable inflation since 2002 has been 3.6% (3.3% removing Covid-19 years). RBNZ forecast for the next four years is 3%.

    25.3 average growth in average hourly earnings is 3.6%. RBNZ forecast for the next four years is 3.3% average.

    25.4 compound annual increases for a range of other factors (construction of roads, bridges, water supply systems, local government labour costs) have been within this band.

Factors critical to success

Clarifying the coverage of three waters is essential in accompanying a rates band model

26. The IRG considered it preferable for three waters expenditure to be excluded from rate targeting calculations. A key consideration here was the importance of any new framework having credibility and the ability to transition to the 2-4% target range in a reasonable time frame, which in the view of the IRG is around three years. Additionally, three waters price/quality concerns will be governed by a separate regulatory regime overseen by the Commerce Commission.

A more flexible approach will be accompanied by transparency

27. A rates band provides flexibility. At times there will be reasons for rates to be outside the band, such as responses to major events like floods and earthquakes, and associated temporarily higher spending. However, any movement outside the band should require justification from a council as to why, and how, they will return to within the band, a practice applied to the RBNZ and inflation targeting.

28. The flexibility in a rates band model should be offset by a strength in transparency in a similar fashion to the RBNZ's monetary policy framework. We expect that this will develop through the consistent, more standardised publication of council spending, and improved performance reporting, which is a component of the Local Government System Improvements Work Programme. This could include factors like a benchmark proportion of spending on core services, to help ensure adequate focus.

[2] For a full description of NZs Productivity history, see: [Treasury paper: The productivity slowdown: implications for the Treasury's forecasts and projections - May 2024]

Three pillars of discipline

29. Alongside greater levels of transparency and accountability the success and credibility of the model depends on it operating efficiently across three key levels: self-discipline; market discipline; and regulatory discipline.

Independent credit ratings

30. A rates band or cap has the potential to materially change the way that credit rating agencies see the strength of the institutional framework that supports credit ratings for local government in New Zealand. The IRG understands the sensitivity over council ratings, but also viewed the importance that independent credit ratings and their assessments of councils financial performance have in driving council financial discipline. The IRG is of the view that council ratings should not be protected at sole cost to rate payers. As noted below, this is a risk that needs further exploration.

Outstanding policy issues

31. There are several policy issues that are not yet captured by the proposed model. We are still considering how to accommodate for the impacts of the following:

    31.1 9(2)(f)(iv) [redacted]

    31.2 9(2)(f)(iv) [redacted]

    31.3 9(2)(f)(iv) [redacted]

    31.4 9(2)(f)(iv) [redacted]

[3] Pillar 2: Improving infrastructure funding and financing to support urban growth; and Pillar 3: Providing incentives for communities and councils to support growth.

9(2)(f)(iv) [redacted]

31.5 9(2)(f)(iv) [redacted]

31.6 9(2)(f)(iv) [redacted]

31.7 9(2)(f)(iv) [redacted]

31.8 9(2)(f)(iv) [redacted].

32. Subject to Ministerial comfort with this rates band model, we will continue to work with agencies to clarify and address these issues over the coming weeks.

33. We will also be conducting exercises to stress test the formula with real-world data as part of preparing a Regulatory Impact Analysis (RIA) to evaluate the effects of any proposed regulations.

Regulatory arrangements

34. 9(2)(f)(iv) [redacted]

35. 9(2)(f)(iv) [redacted]

35.1 9(2)(f)(iv) [redacted]

35.2 9(2)(f)(iv) [redacted];

35.3 9(2)(f)(iv) [redacted]

35.4 9(2)(f)(iv) [redacted]

36. 9(2)(f)(iv) [redacted]

37. 9(2)(f)(iv) [redacted]

38. 9(2)(f)(iv) [redacted]

 38.1 9(2)(f)(iv) [redacted]

 38.2 9(2)(f)(iv) [redacted]

 38.3 9(2)(f)(iv) [redacted]

 38.4 9(2)(f)(iv) [redacted].

39. 9(2)(f)(iv) [redacted]

 39.1 9(2)(f)(iv) [redacted]

 39.2 9(2)(f)(iv) [redacted]

 39.3 9(2)(f)(iv) [redacted]

 39.4 9(2)(f)(iv) [redacted]

 39.5 9(2)(f)(iv) [redacted]

40. 9(2)(f)(iv) [redacted].

Risks

41. 9(2)(f)(iv) [redacted]

[4] Infrastructure Needs Analysis | Research & Insights | Te Waihanga

9(2)(f)(iv) [redacted]

42. A rates band model would put soft limits on the ability of councils to raise rates revenue. If councils are unable to respond to future community desires with rates increases, they are likely to lobby central Government for additional Crown funding. This could be somewhat mitigated through a clear process that allows for higher costs through cost shifting, and a clearer process for how and to what extent Government would provide support to local authorities.

43. As well as the possible financial risk to the Crown, more intervention may increase the views of the public that local problems are due to insufficient Government funding, transferring the ballot box accountability from local to national elections.

Next steps

You are required to develop your Cabinet report back in consultation with key Ministers

44. You are meeting with the IRG on 18 September 2025 to discuss this paper.

45. Cabinet agreed that you would develop a rates capping system alongside relevant Ministers, including the Ministers of Finance, Regulation, and Infrastructure. We recommend that you forward this briefing to that group of Ministers and seek their views on the approach.

46. Following agreement from the core group of Ministers to the approach, we will prepare a draft Cabinet paper for you to commence Ministerial and cross-party consultation prior to taking the paper to Cabinet committee in November 2025.

47. We propose that the Cabinet paper seek Cabinet's agreement to:

    47.1 The key design aspects of the model, including the issuing of drafting instructions to develop a bill to give effect to this regulatory framework; and

    47.2 The proposed formula approved for public consultation (which, following consultation, would be made by regulations enabled by the aforementioned bill).

48. The table below outlines next steps and timing:

Action	Date
This briefing: A rates band: a proposed model	10 September
IRG workshop (with Minister of Local Government) to discuss proposed model	18 September
IRG workshop	26 September
Minister of Local Government to consult with key colleagues	October 2025
IRG workshop	28 October
Regulatory Impact Statement finalised	Early November 2025
Draft Cabinet paper for consultation with wider Ministerial colleagues and agencies	Early November 2025
Final Cabinet paper	Mid November 2025
Cabinet committee (EXP)	18 November 2025
Cabinet decisions	24 November 2025

Implementation

There are connections to other key work streams in the portfolio

49. The rates design works connects to broader oversight and regulation of local government spending as part of a number of existing workstreams including:

    49.1 The Local Government System Improvements Programme and the related bill currently before select committee;

    49.2 The Local Water Done Well programme, which creates an economic regulatory function that could provide insights for the rates regulatory function;

    49.3 Forthcoming work to establish interim regulation of development levies.

50. 9(2)(f)(iv) [redacted]

Rollout of a rates band system across New Zealand

51. Following Cabinet decisions in November 2025, a high-level rollout of a rates band model will cover:

    51.1 any subsequent policy decisions and legislation drafting;

    51.2 public consultation on the proposed formula, and drafting regulations for the final formula; and

    51.3 a legislative process.

52. There would be a tight window for influencing the 2027 LTPs, which often start preparations 12 – 18 months before the 1 July adoption deadline (i.e. councils will start LTP preparations in mid to late 2026).

53. 9(2)(g)(i) [redacted]

Consultation

54. This briefing has been developed with input from the IRG with its comments incorporated into this paper.

55. We have also consulted with Ministry of Business Innovation and Employment (Commerce and Consumer Affairs), the Ministry for Regulation, Infrastructure Commission, Ministry of Housing and Urban Development, and the Ministry of Transport.

56. The Treasury, and the Department of Prime Minister and Cabinet were informed.

57. Agencies raised the possible financial and non-financial risks to central Government from intervention, which we have included in the risks section above. Broadly there is preference for clarification of the role of the regulator, including under what conditions higher rates of increases would be allowed (including particular types of spending and processes for community decision making), and the balance of spending in a given year. There are concerns around possibly limiting infrastructure delivery, and the need to carefully manage a transition to the "steady state" to ensure a deficit is not entrenched.

58. Agency feedback, not already included in the paper, is below -

58.1 **The Ministry of Transport** - including transport spending in a rates band system could have significant implications, particularly for land transport. Restricting councils' ability to spend on land transport could risk under-investment in local road and public transport networks could lead to reduced safety, productivity and resilience outcomes on our transport network, as well as expectations that a greater share of central government funding – whether from the Crown or National Land Transport Fund – will be available for projects. The magnitude of these effects will depend heavily on the design of and transition to the rates band, of which a considerable amount of detail is still to be worked through.

58.2 9(2)(f)(iv) [redacted]

58.3 **MBIE** - *Coverage of water*: We support water being excluded from the rates band model on the basis that the economic regime for water services promotes sufficient revenue recovery and investment for water services within that system. A rates cap or band could create conflict between the regulatory regimes. *Role of Minister of Commerce and Consumer Affairs:* If the Commerce Commission is likely to be the preferred regulator, early engagement with the Minister for Commerce and Consumer Affairs should be considered.

58.4 **Ministry for Regulation** – Uncertain that a rates capping regime is sound in principle, but this approach is preferred to the previous, exclusions-based model as it provides a range of acceptable rates increases that will provide councils with agency and doesn't limit local autonomy to the same extent; and limits the amount that councils would have to justify spending. The Ministry for Regulation is keen to understand more about exceptions and the escalating response to non-compliance with a preference for a full range of regulatory intervention (including information disclosure), and how to ensure that there are opportunities for local democracy to remain, such as allowing variation from the band if there is a transparently and credibly costed election promise.

59. We will work with agencies to address these matters and clarify the transition path to the steady state of the rates band.

Recommendations

60. We recommend that you:

a) **approve in principle** the <u>key design aspects</u> of the rates band model: **Yes/No**

i. there would be a range within which council rates revenue is allowed to increase;

ii. the range would apply to all council rates revenue other than water related spending

iii. a regulator would set the range on a regular basis;

iv. if a council's rates revenue fell outside the rates band it would be given the opportunity to explain why there is a variance. If the variance is assessed as unjustifiable, the council would be instructed to bring its rates revenue back within the band, or face statutory intervention;

b) **forward** this briefing to the Ministers of Finance, Regulation and Infrastructure. **Yes/No**

Rowan Burns
Policy Manager

Hon Simon Watts
Minister of Local Government

_____/_____/________

Internal Affairs
Te Tari Taiwhenua

Local Government briefing

Hon Simon Watts
Minister of Local Government

Title:	**Rates band: transition and regulatory design issues**
Date:	2 October 2025

Key issues
Following your meeting with the Independent Reference Group (IRG) on 18 September 2025 and ahead of meetings with your Ministerial colleagues, you asked for further information on the transition to, and regulatory design of, a rates band model. On transition to a 'steady state' rates band, we (DIA and the IRG) recommend a three-year period of preliminary arrangements before the band sets in. We provide two options for these arrangements: either prescriptive or non-prescriptive. Our preferred option is a non-prescriptive model of preliminary arrangements. A non-prescriptive model will require greater information disclosure than what is currently in place, connecting to your metrics work programme. On regulatory design, we consider more time is needed to develop a regulatory regime as the issues are complex and connect with your work on development levies and Local Water Done Well. A three-year transition period will allow time for an effective regulatory regime to be designed and implemented.

Action sought	Timeframe
Agree to a three year transition period with preliminary arrangements, ahead of a rates band coming into force; **Agree** to a non-prescriptive model of preliminary arrangements during that transition period; and **Note** that further advice on the design of a regulatory regime will be developed over coming months, with detailed advice coming in early 2026	At your earliest convenience

Contact for telephone discussions (if required)

Name	Position	Contact Number	Suggested 1st contact
Richard Ward	General Manager, Local Government Policy, Partnerships and Operations	9(2)(a) [redacted]	✓
Rowan Burns	Policy Manager – Local Government	9(2)(a) [redacted]	

Return electronic document to:	9(2)(a) [redacted]
Hukatai reference	wb7bcef6383554738a9e219b2dde79004&csf=1&web=1&e=Xef2fi
Ministerial database reference	LG20259387

Purpose

1. This briefing follows your meeting with the Independent Reference Group (IRG) on 18 September 2025 and provides further thinking from the Department of Internal Affairs (DIA) and the IRG on issues discussed during that meeting:

    1.1 the transition to a rates band model; and

    1.2 regulatory design issues relating to a rates band.

2. The briefing is based on the rate band model outlined in our briefing of 11 September 2025 (LG20259157).

3. You are meeting with your Ministerial colleagues (Ministers of Finance, Regulation and Infrastructure) throughout October 2025. This briefing is intended to aid your discussions with these Ministers, prior to commencing formal pre-Cabinet Ministerial and cross-party consultation in November 2025.

Executive summary

4. The implementation of a rates targeting framework will require a transition period. The IRG consider it impractical to immediately transition to a band and recommend a three-year transition period of preliminary arrangements before the band sets in – from 1 July 2027 to 1 July 2030, aligned with council long term plans.

5. We (DIA and IRG) outline two options for preliminary arrangements during the transition period. These arrangements are intended to influence councils' behaviour and drive efficiencies in their spending before the band sets in.

    5.1 <u>Option 1</u>: A non-prescriptive model, where the rates band (e.g. 2-4%) would be recommended but there is more flexibility for councils to go outside the band for years 1-3 of the 2027 long term plan, with variance to the band managed through information disclosure. **[Recommended Option]**

    5.2 <u>Option 2</u>: A firm ("prescriptive") band of increases for years 1-3 of a long-term plan that would be larger (e.g. 3-5%) than the band set for the steady state of 2030 onwards, though with stricter management around this band. This band could progressively fall to the 'steady state' band over the 3 years.

6. A strong information disclosure regime will be required to complement the proposed rates targeting framework to drive the credibility and transparency of the system. This connects with your work on council performance metrics.

7. As we have pivoted from the exclusion-based model, we can no longer directly copy as much of the regulatory system in place in New South Wales. DIA suggest that we work alongside the IRG to progress more work on regulatory design, including links with other local government work programmes, with further advice being provided to you in early 2026. 9(2)(f)(iv) [redacted]

8. 9(2)(f)(iv) [redacted] DIA and the IRG agree that the functions of the regulator should be considered prior to consideration of who regulates, i.e. that we consider what before who.

Background

Proposed rates band model

9. On 11 September 2025 we briefed you (LG20259157 refers) with an outline of a model to drive efficiency within councils' financial management. The rates targeting model would see councils being expected to operate within a minimum percentage rates increase (reflecting the need to maintain assets and services), midpoint, and maximum (based on income increases).

10. The band would be determined using long-run anchors, such as inflation, projected and historical wage growth, nominal gross domestic product less volume growth, and historical pricing trends for capital good prices. By anchoring rate price movements relative to key variables, this model would increase the rigour and oversight of local government spending relative to the status quo. It would be more flexible than a strict rates cap, similar to how the Reserve Bank conducts monetary policy by a flexible approach to inflation targeting.

11. The model would also include a process for councils to vary the band in certain circumstances.

12. You expressed broad support for this model in your meeting with DIA and IRG on 18 September 2025.

Additional areas to be developed

13. The 11 September 2025 briefing noted policy areas that needed further development. These were also discussed on 18 September 2025 and included issues relating to a transition period and regulatory design. These are discussed in this briefing.

Transition to a rates band

Context: significant reform to the local government system

14. The intention of the rates band is to create a framework that drives efficiency and better financial management, including how councils spend and their sources of funding, while allowing some flexibility. It is intended to disrupt the status quo in a way that can be effectively implemented, without adverse consequences.

15. The rate band is designed with long-run considerations in mind. It would operate most effectively in a 'steady state',[1] which we consider is when:

    15.1 the level of rates is appropriate for local governments' functions;

    15.2 councils' spending on infrastructure is stable;

    15.3 the level of infrastructure is adequate;

    15.4 rate rises do not exceed wage or capital goods price growth; and

    15.5 councils are in a sustainable financial position.

[1] A 'steady state' is a hypothetical about the optimal level of rates as a share of GDP. Historically, rates have been approximately 2% of GDP, with infrastructure issues emerging when councils varied below this trend. As some more councils shift to water charges, total rates as a percentage of GDP are likely to need to be lower, though rates + water charges will need to exceed the historic trend for councils and water services to be financially viable and catch up on historic deficits.

16. Particularly for water infrastructure, the level of spending has historically been insufficient, with large increases in water charges needed over the next decade. While these increasing water charges will not be covered by a band, they are important context for the likely decision making of local voters.

17. While New Zealand has an infrastructure deficit, our infrastructure spend is comparable with other high-income countries. However, our infrastructure efficiency lies in the bottom 10% of high-income countries.[2] Catching up on the infrastructure deficit will need to be a combination of spending more and better. The rates band should encourage more discipline and improved efficiency, supporting the Government's other infrastructure initiatives.

18. In addition, central government agencies sometimes place requirements on local government without being clear about how much those requirements would cost and expecting those requirements would be met from rates revenue ("unfunded mandates"). Moving to a rates band will require more discipline in central government allocating responsibilities (and costs) to local government.

Recommended transition approach

19. We consider it impractical to immediately implement a 'steady state' rates band (e.g. of 2-4%), just as the Reserve Bank did not immediately hit the inflation target when inflation targeting was implemented. Both the central and local government sectors will need time to adjust to this new model of how local government funding operates. At the same time, the targeting framework will require credibility, and so the transition should not be extended for a long time.

20. The IRG considered that a period of 3 years was optimal for the transition, starting from 1 July 2027. This aligns with local government long term planning (LTP) cycles, and allows:

    20.1 councils to put in place tools to enable alternative financing vehicles (particularly relevant for not disrupting the Government's housing construction agenda);

    20.2 the next LTP cycle to focus on the significant reform from Local Water Done Well and ensure that the transition to the new water delivery models is effective;

    20.3 future investment and spending decisions to be planned with the band in mind, with this reflected in the 2030 LTP; and

    20.4 central government agencies to adjust their policies in relation to requirements on local government.

21. For the transition period to effectively allow the sector to prepare for a rates band, preliminary arrangements are recommended. The IRG discussed two options for preliminary arrangements during the transition period, with option 1 the preference.

[2] New Zealand's infrastructure challenge: Quantifying the gap and path to close it | Te Waihanga

	Option 1: Non-prescriptive arrangements with information disclosure (recommended)	Option 2: Firm "prescriptive" arrangements
Description	A rates band (e.g. 2-4%) would be recommended but councils have flexibility to go outside the band for years 1-3 of the long term plan. This will be accompanied by more stringent information disclosure to enable transparency.	A firm band of increases for years 1-3 of a long term plan that would be larger than the 'steady state' band (e.g. a band that is defined numerically and progressively falls towards to the steady state rates band over the 3-year period).
Benefits	This model is more flexible. Councils can go outside the band for three years to allow capital works programmes currently in development, and that will be incorporated into the 2027 LTP, cycle to continue.[3] It does not require a regulator to be in place immediately. It is less likely to cause unintended consequences or significant economic disruption.	There is less chance of councils gaming the system. Councils would not be able to put in place a large rates increase and would need to operate within the band, or justify their rates increases.
Risks	Councils might game the system by applying high increases for years 1-3, although they would need to be within the band from Year 4, or justify their rates increases.	It is difficult to numerically identify the transition path given differences across council finances. Unlike the design of a 'steady state' rates band (e.g. of 2-4%) that is anchored in pricing gauges, the choice of figures for a prescriptive band during a transition period would be arbitrary. This model would need relatively precise estimates of the non-waters infrastructure deficit for each council to set a band (which does not exist). A strict transition path could result in greater economic disruption. This model would require the full establishment of a regulator (in both form and function) by the end of 2026, and legislation passed prior to the election in 2026.

22. IRG recommended Option 1 so long as there are mitigations in place to manage risks of councils gaming the system. They recommend that it be accompanied by more

[3] Initial DIA Analysis, based on 2024 Long Term Plans, is that most councils would struggle significantly to meet the band in the years 2027 –2030 for non-water related increases, likely needing to cancel capital programs to meet the band. From 2030 on, most, though not all, councils would be in the band. Based on patterns from the 2012 LTP onwards, future rates increases tend to ratchet up from outyears. We'd expect councils would end up near the top of the band as they worked through new capital programmes, and incorporated actions to new legislative requirements.

stringent information disclosure, which will provide "reasonableness" checks on rates increases and allows for performance benchmarking. It will be important that your changes in how councils report on key metrics and performance benchmarking are in place before the rates band model starts on 1 July 2027.

23. The following variables by councils could form part of the information disclosure regime and be included in your metrics work programme:

    23.1 Council rates as percentage of house prices;

    23.2 Council expenditure as percentage of GDP;

    23.3 Council rates relative to wage income growth;

    23.4 Council rates as percentage of total income;

    23.5 Council salary and wage expenditure as percentage of total expenditure; and

    23.6 Infrastructure deficit estimates.

24. We consider a reporting system that allows comparability and transparency across councils is an essential element to complement the rates targeting framework. Within such a reporting framework allowances would also need to be made for council scale and functions, as we have done in the first set of metrics where councils have been put into 7 groupings.[4]

25. 9(2)(g)(i) [redacted]

26. During the transition period, DIA will provide guidance to councils on alternative funding and financing tools such as those mentioned above.

27. DIA agrees with the IRG that option two would be challenging to implement and is suboptimal as an approach. It would require the full stand-up of a regulator (form and function) by the end of 2026. This is because the regulator would need to be interfacing with councils' draft LTPs (which are in development from the end of the calendar year prior to adoption) in order to give a view on whether variations from the band are allowed. This would require legislation to be passed establishing the rates band model and regulatory functions prior to the election in 2026.

Regulatory design

28. 9(2)(f)(iv) [redacted]

    28.1 9(2)(f)(iv) [redacted]

[4] local government performance metrics - dia.govt.nz

9(2)(f)(iv) [redacted]

28.2 9(2)(f)(iv) [redacted]

29. 9(2)(f)(iv) [redacted]

30. 9(2)(f)(iv) [redacted]

31. 9(2)(f)(iv) [redacted]

We will work on the regulatory design over coming months

32. Designing the regulatory regime is a complex task and can only be completed once Cabinet has made policy design decisions about *what* is being regulated (form follows function). We are advancing the regulatory design work now but Cabinet decisions on regulatory design will need to follow Cabinet decisions on the key system settings.

33. 9(2)(f)(iv) [redacted]

34. With any new system, a regulator will need time to build a knowledge base and experience in using alternative funding and financing tools for the broad range of council services. This will need to be factored into timing for implementation of the new system.

35. We will also assess the marginal costs of regulating the regime, which will depend on the preferred approach to regulation and cost recovery of the services a regulator provides.

36. Over coming months, DIA will work alongside the IRG to progress more work on regulatory design, including links with other local government work programmes, with further advice being provided to you in early 2026.

Specific regulatory design issues to be developed further

37. 9(2)(f)(iv) [redacted]

38. 9(2)(f)(iv) [redacted]

9(2)(f)(iv) [redacted]

39. 9(2)(f)(iv) [redacted]

40. 9(2)(f)(iv) [redacted]

    40.1 9(2)(f)(iv) [redacted]

    40.2 9(2)(f)(iv) [redacted]

Next steps

41. DIA recommends you seek Cabinet policy decisions on the rates band in two stages:

    41.1 **Stage 1, December 2025**: Cabinet decisions on key design elements of the rates band model, including the preliminary arrangements for a transition period, and the draft rates band formula for public consultation, with announcements following shortly after.

    41.2 9(2)(f)(iv) [redacted]

42. DIA suggests public consultation on setting the rates band formula only take place in Q1 2026, following announcements of Cabinet's decisions on Stage 1. More comprehensive public consultation on the rates band model in its entirety can come through the legislative process.

43. 9(2)(f)(iv) [redacted]

44. Officials will provide you with a draft Cabinet paper at the start of November. The Cabinet timeline is outlined below:

Milestone	Date
Briefing to initiate Ministerial consultation	Wednesday 5 Nov 2025
Ministerial consultation	Monday 10 Nov – Thursday 20 Nov 2025
Cabinet Committee (EXP)	Tuesday 2 Dec 2025
Cabinet	Monday 8 Dec 2025

Consultation

45. This briefing has been prepared quickly to ensure that the IRG could provide their views on these issues, in advance of your upcoming meetings with your Ministerial colleagues. DIA will work with officials from relevant agencies to understand their views in more detail, and how the process of a transition may mitigate their, and their Ministers', concerns. DIA will report these views to you as needed.

Recommendations

46. We recommend that you:

a) **agree** to a three year transition period with preliminary arrangements, ahead of a rates band coming into force; **Yes/No**

b) **agree** to a non-prescriptive model of preliminary arrangements during that transition period; and **Yes/No**

c) **note** that further advice on regulatory design will be developed over coming months, with detailed advice coming in early 2026.

Rowan Burns
Policy Manager

Hon Simon Watts
Minister of Local Government

______/______/______

Internal Affairs
Te Tari Taiwhenua

Local Government briefing

Hon Simon Watts
Minister of Local Government

Title:	**Approval to begin Ministerial consultation for a rates capping Cabinet paper**
Date:	29 October 2025

Key issues
This briefing attaches the draft Cabinet paper *A rates capping model for New Zealand*. This follows the incorporation of feedback from departments and your Independent Reference Group. We seek your approval to release the draft Cabinet paper for Ministerial consultation.

Action sought	Timeframe
Note that feedback from departments and the Independent Reference Group has been incorporated into the draft Cabinet paper; and **Agree** to circulate the draft Cabinet paper and draft Regulatory Impact Statement for Ministerial consultation, for comment by Tuesday 4 November.	As soon as possible

Contact for telephone discussions (if required)

Name	Position	Contact Number	Suggested 1st contact
Rowan Burns	Policy Manager	9(2)(a) [redacted]	✓
Olivia Krakosky	Senior Policy Analyst	9(2)(a) [redacted]	

Return electronic document to:	9(2)(a) [redacted]
Hukatai reference	7BFAE99A9C-95AF-450E-8925-069DD4DA5908
Ministerial database reference	LG20259913

Purpose

1. This paper attaches the draft Cabinet paper *A rates capping model for New Zealand*, following the incorporation of feedback received by various government departments and your Independent Reference Group (IRG).

2. It seeks your approval to release the paper for Ministerial consultation, for comment by Tuesday 4 November.

An updated Cabinet paper is attached

3. An updated draft Cabinet paper was produced following the feedback provided by various government agencies. It is attached as **Appendix A,** along with a summary of the feedback provided (**Appendix B)**. Feedback was also received from your IRG in a workshop on 28 October 2025.

Main feedback received from agencies

4. The main feedback from agencies is that while the rates band is preferred to a hard rates cap, agencies are concerned that local authorities will struggle to pay for programmes and obligations within their portfolios.

5. There is an overarching theme from consultation that the Government will need to consider the role of local government in paying for, or co-funding, programmes that facilitate economic growth. Agencies are concerned that the proposed rates band model could lead to significant reduction in funding for certain programmes, potentially shifting the cost burden onto central government. Portfolios involving the funding of tourism, sports, and cultural facilities expressed significant concern.

6. MBIE's Tourism and Hospitality unit provided an example of how this might affect the tourism portfolio.

   6.1 *A portfolio review of the Tourism Infrastructure Fund said that local government co-funding is an important mechanism to ensure that projects are prioritised and committed to, however it did not explicitly state where the funding was coming from. Therefore, it's implied that councils need to provide funding from rates. If local government is restricted in co-funding through the rates-band model, central government would need to bear responsibility for the gap.*

7. Agencies also noted that councils have obligations in legislation that require a certain amount of spending in areas that could be affected by the rates band. One such example is heritage protection responsibilities under the Resource Management Act which requires local authorities to protect historic heritage as a matter of national importance. The assumption is that these obligations are funded by rates.

Changes made because of departmental feedback

8. The following changes were made to the draft paper:

   8.1 Clarification regarding how variations would be applied in situation 2 (revenue needing to be raised for things outside of extreme circumstances). In clarifying, the intention is that this variation is determined by the local authority and permissible if they have met their financial management obligations under the Local Government Act 2002. It is not about listing situations or circumstances in which this variation would apply.

8.2 Some minor changes regarding the language used around aligning regulatory oversight for rates capping with other local government regulation. Minor changes were also made to clarify that the regulatory powers may not necessarily be held by one actor.

Main feedback from the IRG

9. The IRG was concerned that the paper did not accurately reflect the band model, especially in reference to the indication of a 2-4 percent increase. The paper now clarifies that 2-4 percent is on the price component of council revenue growth, not total rates revenue. It also clarifies that 2-4 percent is calculated as *per capita* not overall rates revenue growth for councils. As well, the paper includes that the band is likely to include a growth component for some councils, raising the upper bound of the band.

10. They also had feedback on the second variation situation, including that as initially drafted, it allowed for largely the status quo. Following their advice, the paper includes a requirement that councils *apply* for a variation from a regulator ahead of public consultation on their long-term plans. This would be the process once the full model comes into effect in 2030 and would not apply to the transition period.

11. The paper includes specific reference to "information disclosure" offsetting the model's flexibility, at the suggestion of the IRG.

12. 9(2)(h) [redacted]

Changes made in response to your changes

13. Your office requested the inclusion of a paragraph regarding the savings per household under the rates band compared with the status quo. It is difficult to quantify the average savings per household for a number of reasons, including local authority differentials and land valuations. Instead, we have quantified the average rates per capita for 2024 (excluding water rates), and what a 6% (status quo) and a 4% (rates band)[1] increase would equate to per capita annually. The difference in the first year is $22 ($65 annually under the status quo compared to $43 annually under the rates band).

14. These saving will compound in the following years. This does not equate to per household or rating unit. Because there are fewer rating units than population, we would expect the actual savings for ratepayers would be higher, although this is difficult to estimate given councils' ability to charge differently for different types of land and different land valuations. We could expect savings to be greater over time as councils catch up on underspend and operate closer to the lower end of the band.

[1] 4% was chosen as the top of the band, as allowing for growth, some councils are likely to have roughly a 5% increase under the band.

Page limit

15. The cabinet paper exceeds the 10-page limit set by the Cabinet Office (currently 11.5 pages). Due to time constraints, we have focused on including content rather than reducing length.

Regulatory Impact Statement

16. A draft Regulatory Impact Statement (RIS) is attached at **Appendix C**. It is a Cabinet Office requirement that at least a draft version of the RIS is circulated alongside the Cabinet paper as part of Ministerial consultation.

17. The RIS is currently with the quality assurance (QA) panel for first round of feedback. Due to time constraints, we do not yet have any feedback from the panel. The RIS is likely to change in response to panel feedback.

18. Due to time constraints, we are running a reduced RIS QA process.

Next steps

19. We are working to the following timeline:

Action sought	Timeframe
Ministerial consultation (four working days)	Wednesday 29 October to Tuesday 4 November
Feedback incorporated from consultation	Wednesday 5 November
Cabinet paper lodged	9.00am Thursday 6 November
Paper considered by the Cabinet Economic Policy Committee	Wednesday 12 November
Paper considered by Cabinet	Monday 17 November

20. If you agree, we recommend that you undertake Ministerial consultation from Wednesday 29 October to Tuesday 4 November 2025.

21. Following Ministerial consultation, we will work with your office to incorporate the recommended changes into the final draft of the Cabinet paper.

22. We will then present you with the final draft of the Cabinet paper to be lodged by 9.00am on Thursday 6 November, for consideration at Cabinet Economic Policy Committee on Wednesday 12 November 2025.

23. Cabinet will then make policy decisions at its meeting on Monday 17 November 2025.

Recommendations

24. We recommend that you:

a) **Note** that feedback from departments and the Independent Reference Group has been incorporated into the draft Cabinet paper;

b) **Agree** to circulate the draft Cabinet paper and draft Regulatory Impact Statement for Ministerial consultation by no later than Tuesday 4 November 2025. **Yes/No**

Rich Ward
General Manager
Local Government Policy, Partnerships and Operations

Hon Simon Watts
Minister of Local Government

______/______/______

Appendix A: Draft Cabinet Paper *A rates capping model for New Zealand*

Appendix B: Summary of Departmental feedback

Department	Summary of feedback
Infrastructure Commission	Concerned that the delivery of central government priorities and local authority maintenance, renewal and growth demands will be constrained. Doubtful about the applicability of any single formula.
Kāinga Ora	Potential funding gaps where infrastructure projects may be needed to serve wider community beyond the neighbourhood. Kainga ora would likely have to fill gaps, or projects reprioritised or delayed.
MBIE (Building System Performance)	Cost of some cost-recoverable services may increase where they are currently being subsidised through general rates.
MBIE (Commerce and Consumer Affairs)	9(2)(f)(iv) [redacted]
MBIE (Kānoa – Regional Economic Development)	Need clarity on process for going outside the band. Councils will likely deliver less with a cap, and stifle co-investment in regional infrastructure. The proposed formula doesn't address regional variations.
MBIE (Tourism and Hospitality)	Concerns regarding delivering the Government's targets in the Tourism Growth Roadmap. Reduced investment in tourism initiatives and no recognition of active nature of councils enabling growth. Need to differentiate between council role in investment and in service delivery. Concerns regarding timing for regulatory design and implementation.
Ministry for Culture and Heritage	Concerned that the model could lead to a significant reduction in funding for arts, heritage and culture, potentially shifting the cost burden onto central government. Concerns that Councils won't be able to meet their legislated obligations, e.g.: heritage protection. Less spending on cultural initiatives which positively affect wellbeing, community, identity and economic growth is likely and a concern. There should be mechanisms available that protect these initiatives. Notes challenges with consultation timing over summer.
Ministry for the Environment	Concerned about impact on all households including non-ratepayers of shifting costs to user charges, which could mean no net savings for households. Concerns about formula calculations, particularly capex figures. Paper silent on risks and downsides of proposed model.
Ministry of Housing and Urban Development	Concern that rates band will have negative impact on how councils provide for urban growth. Becomes riskier for councils to free up land for development and invest in infrastructure without rates as cost-recovery option. 9(2)(f)(iv) [redacted] Noted that it is difficult to assess the impact of the proposed rates band on council activities without some examples based on council expenditure. These would help identify what the cost of reduction in rates revenue would be, the potential for using

	alternative funding and financing, and the potential reduction in council activities.
Ministry for Regulation	More clarity needed around the role and requirements of the regulator, and in what cases they could allow exemptions. Questions the role of the band when the electorate wants and permits more spending. Considers the transition period may be too long.
Ministry of Social Development	Notes that there are likely positive effects on MSD clients, including a possible reduction in demand for hardship assistance and more stability in cost increases for ratepayers leading to reduced household costs.
Ministry of Transport	The design of the band could have significant effects on potential under-investment in roads and public transport, affecting safety, productivity and resilience of the transport network. Need to see more data on ensuring that household costs will be reduced and more stability of local government costs will be achieved.
Sport New Zealand	Want an exemption from the band for funding major sports events. Want targeted rates to be excluded from the rates band where there is public support.

Appendix C: Draft Regulatory Impact Statement

Final statement is published separately