Consultation on a rates target model for New Zealand
Submission of Taituarā – Local Government Professionals Aotearoa

What is Taituara?

Taituarā — Local Government Professionals Aotearoa (Taituarā)[1] thanks the Department of Internal Affairs (the Department) for the opportunity to provide feedback on the rates target model for New Zealand ('the model').

Taituara offers managerial and technical insights and perspectives into the policy process.

Taituarā is Aotearoa New Zealand's leading membership network for professionals working in and for local government. Our thriving membership base consists of chief executives, managers, and staff from across all 78 local authorities.

What unites Taituarā members is our commitment to being our professional best, supporting local government excellence through connection, collaboration, and care for the well-being of our communities.

Taituarā strengthens the local government sector by using our members' insight and experience to influence the public policy debate. We encourage thought leadership by enabling our members to step back from the day-to-day agenda, share wisdom, create value, and build knowledge.

We are a managerial organisation. It is for others to provide Ministers and others with political advice. We focus on the consequences of the policy decisions that have been taken and how a rate model might be better implemented.

Funding issues go to the heart of the relationship between councils and the communities they serve. One of the core strengths of New Zealand's local government sector is that it historically has had a high level of independence in the way it raises a high percentage (generally around 80 percent) of its revenue (with much of it coming from rates). This is fundamental to local accountability and local choice. Restrictions on the ability of the sector to raise revenue raise financial, legal, and constitutional issues – central government should exercise extreme caution in designing and implementing such a policy.

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[1] Taituarā is the trading name of the New Zealand Society of Local Government Managers (SOLGM) conferred upon us in January 2021 by the (then) Ministers of Defence and Local Government, the Hon Peeni Henare, and the Hon Nanaia Mahuta.

Infrastructure costs are the true drivers of cost increases.

"Ratepayers deserve councils that live within their means, focus on the basics and are accountable to their community. The Government's decision to introduce a cap on rates will support that ambition and protect local government's social license for the long term."

Hon Simon Watts, Minister of Local Government[2]

The rates model and the proposed changes to the purpose of local government are all grounded in the proposition that local government is spending excessively on services outside a (Government-defined) set of core services.

Ministerial comments from the same press release as the epigraph that opens this discussion further states *"A minimum* (rates) *increase is necessary so councils can continue to provide essential services like rubbish collection, council roads maintenance and the management of parks and libraries."*

We begin our commentary on the rates model by examining these propositions further. That rates have increased faster than inflation in recent years is not in dispute, nor is the fact that in the last three years rates increases have had a measurable impact on the CPI.[3] But any contention that this is being driven by expenditure on what the Government terms as 'nice to haves' (sic) is wide of the mark.

The general policy statement that preceded the Local Government (System Improvements) Bill also notes (quite correctly) *"Rate rises are being driven primarily by rising council costs, particularly for critical infrastructure."*[4]

Research by Te Waihanga – the New Zealand Infrastructure Commission has revealed that.

""We analysed several decades of price data for construction inputs to understand how they are affected by both global and local factors" .

"We found that infrastructure providers have limited control over their input prices. Price changes mostly reflect the impact of things that are happening outside of the New Zealand construction sector.

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2 Hon Simon Watts, Getting Rates Under Control for Ratepayers, media release dated 1 December 2025, retrieved on 30 December 2025 from https://www.beehive.govt.nz/release/getting-rates-under-control-ratepayers.

3 The reported level of increase in rates in the year to June 2025 (12.2 percent) would have shifted the CPI by around 0.3 percent (three index points).

4 Local Government (System Improvements) Bill, page 1.

"For labour costs, we found that construction wages closely track wages elsewhere in the New Zealand economy. In the short term, high demand for construction workers can push wages a bit above this trend, but construction wages tend to return to trend within two years,"

"Global factors are the primary driver of material prices, especially for traded commodities like structural steel, timber, and diesel fuel. Changes in global prices flow through to New Zealand very quickly. Even when we produce or source some materials here, prices are still based on global markets," he adds.

"The exception is materials like concrete and aggregates that are too heavy to ship long distances. Regional factors, like limits on setting up new quarries near major projects, are likely to play a stronger role for those materials."[5]

Research undertaken by Infometrics highlights that capital cost escalation had accelerated substantially over 2021-2023, with the overall capital goods price index peaking at 13%pa, and civil construction costs at 15%pa. In greater detail, transport capital cost escalation peaked at 19%pa (with bridges peaking at 29%pa!), and water systems peaking at 15%pa.

Non-core expenditure generally much less than is thought. The Department's own analysis of the data from the Local Authority Financial Statistics compiled by Statistics New Zealand showed that collectively the four largest categories that it classified as 'nice to have' accounted for 17-18 percent of the total spending in local government. And, in fact, given that these categories include the parks and libraries that the Minister and the System Improvements Bill both define as core services the actual figure is probably nearer 10 percent.

In short, the cost of delivering the core services is the primary driver of rates increases. A combination of cost-push and demand-pull factors has driven recent cost increases. The long-term solution to rising local authority costs lies in a combination of investments in supply chain resilience, both nationally and internationally, growing the infrastructure workforce and skills generally, and taking steps to provide the infrastructure sector with a more certain environment to invest.

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[5] Te Waihanga (2023), New research sheds light on the infrastructure workforce and drivers of infrastructure costs. Downloaded from https://tewaihanga.govt.nz/news-events/new-research-sheds-light-on-new-zealand-s-infrastructure-workforce-and-drivers-of-construction-costs on 8 August 2025.

The model falls well short of the Government's intended design principles as it stands.

If there is to be a rate-capping model, then the Government's four design principles are a good place to start. We probably would have added a fifth around efficiency – that is to say that the model should be low-cost to administer both for local authorities and any regulator.

However, we do not consider that the proposal as it stands delivers on several of the design principles.

- *iindependent – determined by an independent authority*. We strongly agree that the band must be set independently of Ministers, and there are strong hints that there will be an independent economic regulator. But we temper this by noting that this regulator has not been identified. Based in the level of redactions in the documentation on this topic it seems that has not been decided. We also observe that Ministers have apparently reserved the right to define what constitutes an 'extreme circumstance', and that the most likely regulator (Commerce Commission) must give effect to Government policy.
- *transparent – simple for councils and their communities to understand. While* some of the variables in the model formula are instantly recognisable (such as the CPI and economic growth), the formula has not been put together in a way that the layperson would understand. Perhaps this is why Ministers have belaboured the so-called 2-4 percent range.
- *cost-reflective – accurately reflects cost changes for councils.* The reliance on the CPI as the measure of price change underestimates the actual movement in infrastructure costs. We will observe later that there are other variables that may provide better reflection of cost change.
- *localised – considers differences between councils across the country.* The only identifiable degree of 'local circumstance' in the present proposal is the suggestion that an unspecified number of councils may have a growth component added. The reliance on economic indicators points to a single 'band' applied nationally with population growth the only point of difference.

We concur with Treasury comments about the impacts of the headline policy.

Treasury's advice to the Minister in June highlighted the risks to local government's financial sustainability. The Treasury comments that
"successive underspending by local councils over the last 35 years, in the face of pressure to keep rates low and rate rises to a minimum, means that rates are significantly below the level that they need to be in order to be considered sustainable. Given that providing essential infrastructure dominates both capital and operating spending by local government, and infrastructure delivery underpins a significant

number of the Government's objectives and targets, central government policies should focus on how to allow rates to rise to sustainable levels."[6]

Treasury notes that New Zealand's local governments are more indebted than their global counterparts yet benefit from a higher level of predictability and certainty of revenue streams. Arbitrary limits to local authority revenue raising could have implications for lenders' overall assessment of the sector, and the credit ratings of individual local authorities. Treasury commented "that central government work programmes should focus on enabling and encouraging local government to use the funding and financing tools available to them."[7]

Standard and Poor's most recent communication (3 December 2025) reinforces this concern – the risks appear to be all 'downside".[8] They comment that they has assessed 10 of 24 councils as having 'above-average fiscal flexibility relative to domestic and international peers, reflected in a positive adjustment to their budgetary performance assessments. This could be removed if a strict rates cap were enacted." And further "if councils are inhibited in their ability to lift future rates, they could further struggle to balance the books or lean more heavily on debt to finance capital expenditure. This will weigh on credit quality."

Overseas evidence strongly suggests that rate-capping reduces the overall level of investment in infrastructure.

"(The Infrastructure Commission) is concerned that the delivery of centra government priorities and local authority maintenance, renewal and growth demands will be constrained …"
"The design of the bans could have significant effects on potential investments in roads and public transport, affecting safety, productivity, and resilience of the transport network."

(Two comments from Crown agencies on the rate model).

Opponents of rate-capping suggest that stringent limits on rates may lead to a reduction in investments in infrastructure. This would be the very opposite of the Government's objectives in housing, urban development and economic growth and development.

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6 Treasury (2025), *Treasury Report: Meeting Between the Treasury and the Minister of Local Government*, 18 June 2025 at para 8.
7 Treasury (2025) at para 12.
8 See Standard and Poors (2025), New Zealand Local Government Brief: Rates Cap Tightens the Financial Screw,.

The Department's own investigation of the New South Wales experience with rate-capping revealed that *"a significant proportion of councils cannot properly maintain assets due to revenue constraints … 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."*[9]

The NSW Independent Price and Regulatory Tribunal (IPART) last review of the rate-peg itself found that overall more than half of councils did not meet the state's benchmark for infrastructure renewal, the infrastructure backlog ratio.[10]

The Victorian experience also supports this contention. In the 2023/4 financial year, regional road resurfacing dropped by 95 percent, from 9 million square metres to around 420,000 squares. Road maintenance funding fell from $201 million to $38 million (81 percent).

Rate-capping would undermine the relationship between central government and local government.

The major challenges our communities face – responding to climate change, the cost of living, housing, infrastructure, inequality, and social inclusion – require urgent and transformative action now. They demand that central and local government work together in partnership, which we understand as cooperatively, respectfully, and with a shared purpose. Rate-capping of any form would weaken this relationship between central and local government.

The proposed rate model contains no allowance for, or measure of, the quality and quantity of services provided by local authorities. Using Statistics New Zealand's price indices as the measure of cost-change does the cost of meeting defined levels of service Indeed, Statistics New Zealand generally applies strict quality-control[11] principles to the production of many of its price indices.

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[9] Department of Internal Affairs (2024), The New South Wales Rate Page System, pp 19-20.

[10] Defined as the value of deferred maintenance as a percentage of the total asset value. The state's Office for Local Government sets a benchmark of 2 percent, the average ratio was 3.7 percent. Although a slight improvement over the five prior years, IPART concluded that the result was the result of long-run systemic sustainability issues.

[11] Quality control this context means that, wherever possible, only changes in the price of the measured goods and services are captured in the index by excluding changes in the quality and quantity of the measured goods. Ironically, local authority rates are one of the few components of the CPI that are not quality controlled.

A centrally government mandated change in levels of service, for example by increasing a particular regulatory standard or by requiring local authorities to undertake a particular activity would not be reflected in the formula. All things being equal then, a central government decision to increase a level of service might well see some 'crowding out' of locally set levels of service.

The likely response then would be an unwillingness on the part of local government to accede to central government's requests without funding from central government or without the means of recovering the full costs of the activity outside the rating system. Comments from the Ministry of Regulation in the supporting package of documents show that central government policy does not always identify these costs in the policy process.

We noted the comments that various of the Government agencies made in response to proposals in supporting package of documents that echo these concerns. For example, the Ministry of Tourism expressed concerns that ratecapping would reduce investment in tourism initiatives and thereby undermine delivery of Government policy in the so-called Tourism Growth Roadmap. The Ministry of Culture and Heritage suggested any cap would see significant reduction in funding for arts, heritage and culture, potentially shifting the cost burden onto central government. Sport New Zealand asked for an exception on funding for funding major sports events.[12] That same document also noted a potential unwillingness to sustain partnerships with central government such as the New Zealand Police.

Restricting local authorities' ability to raise revenues from local sources will also incentivise (and even add impetus to) sector efforts to secure funding from central government. Evidence from New South Wales suggests that growth in the revenues the sector receives from its own sources has stagnated relative to state and federal revenues.

In essence, there is a substantial risk that rate-capping will make local government's problems and issues, central government's concerns and issues. Central government might mitigate this risk, at least in part, by providing the regulator with some ability to adjust the cap in cases where an exogenous event not reflected in the cap variables has had a systemic impact on local authority costs.

To support that, either the regulator or the Department should be required to prepare an annual report identifying any new responsibilities or obligations imposed

[12] Department of Internal Affairs (2025), *Ministerial Briefing – Approval to begin Ministerial consultation for a rate-capping Cabinet paper*, pp8-9.

on the sector (and what steps have been taken to mitigate this). Such an approach also has the advantage of discouraging central government from cost-shifting – few Ministers would want responsibility for additional rates increases laid at their door!

Recommendations

That the final legislative design provide the regulator with the ability to adjust the cap to allow for adjustments where there have been events exogenous to the formula that have imposed costs on the sector.

That either the regulator or the Department of Internal Affairs be required to prepare an annual report identifying any new responsibilities imposed on local government, and any steps taken to mitigate the additional cost imposed by those new responsibilities.

Rate-capping will incentivise the use of non-rate revenue, with changes in incidence at local level.

"When Barnet Council in north London set out to rein in council costs and rates increases, it did so by shifting rapidly to user charges. First it proposed to treble the price of burying small children in council cemeteries. That was averted by a public outcry. Then it upped the ante by outsourcing almost all its services to a private provider, which hiked parking fees and other charges. It even looked at chips in household rubbish bins to charge for excess weight.

Barnet became popularly known as EasyCouncil, for its budget airline-inspired regime of providing a minimal viable service, then charging through the nose for every possible add-on."[13]

There is substantial empirical evidence that one of the main impacts of rate-capping is that local authorities shift from capped to non-capped revenue sources i.e. from rates to fees and charges.

[13] Newsroom (2025), Councils prepare to hike fees, under threat of rate-capping, report dated 22 July 2025. Retrieved on 28 December 2025 fromhttps://newsroom.co.nz/2025/07/22/councils-prepare-to-hike-fees-under-threat-of-rates-capping/

In a report for the South Australian Local Government Association[14], Dollery summarises four American studies thus
"Limitations on property taxes can cause councils to increase income from revenue sources other than rates. For instance, in his study of 29 American states, Shadbegian (1999) established that many local councils substituted foregone property tax income with funds raised under 'miscellaneous revenue'. In his analysis of the same question, Skidmore (1999) found similar results for 49 American states. In an analogous study Kousser, McCubbins, and Moule (2008) discovered that a majority of US states had raised fees and charges following the implementation of property tax limitations. Along similar lines, Mullins and Joyce (1996) scrutinized 48 American states over the period 1970 to 1990 and found that whereas tax limitations lowered local taxes, this was offset by increases in fees and charges. In their study of 1,400 American local authorities, Preston and Ichniowski (1991) showed that property tax limitations decreased rates revenue but served to escalate 'other revenue'."

Moving from rates to fees and charges creates a shift in the incidence of local government funding from property owners to the users of services (including those who rent rather than own property). Beyond this, it is not possible to draw any general conclusions about the net effect on households and cost-of-living pressures – some will be better off, others will not.

Moving to user pays will see charges to access recreational and cultural facilities increase (such as pools, sports grounds and museums) and some possible reductions in ancillary levels of service (for example, reducing the opening hours in libraries). But these services have strong public good elements that support the achievement of public good objectives. For example, pools and sports grounds support active lifestyles with a health outcome. Libraries and museums play a role in supporting the education system – both through their roles as a repository of knowledge and through education programmes. The removal of low-cost leisure opportunities may also have an impact on crime, especially youth crime.

We also observe that the pressure to move to non-rate revenue sources (such as fees and charges) will lead to local authorities seeking to recover actual and reasonable costs on all fees and charges set under statute. This includes the removals of those limits that remain. The 2024 *Forward Work Programme* Cabinet paper signalled the

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[14] Dollery, An Empirical Assessment of the Impact of Rates-pegging on South Australian Local Government, page 8. Retrieved on 28 December 2025 from https://www.lga.sa.gov.au/__data/assets/pdf_file/0018/551250/empirical-assessment-rate-pegging.pdf

Government was reviewing these - nothing further has been heard as of time of writing.

The most significant of these remains permits and licences under the Sale and Supply of Alcohol Act 2012. Others still in effect include licences for hawkers, peddlers and mobile shops, fees for the inspection of amusement devices, and various permits under the Land Transport Act 1962.

Crown agencies have resisted previous attempts to remove or amend limits on grounds that full cost recovery might impede government policy initiatives. Rate-capping will require that central government prioritise which is more important.

Recommendations

The central government should replace all existing limits on local government's ability to set fees and charges for statutory functions with a power to charge actual and reasonable costs. And that actual and reasonable cost be extended to include staff time and overhead.

The cap may undermine prudent risk management.

The cap may undermine risk management in several ways. First, the rapid recent increases in premiums and other terms and conditions (such as excess) may encourage local authorities to move away from insurance as a means of managing risk. Second, councils may be discouraged from or be unable to build or maintain disaster reserves and/or look at options such as self-insurance as a tool. Communities would be left more exposed to natural hazards and the fiscal impacts of recovery.

Early visibility of the linkages between the rates-cap and other aspects of the financial management regime would be welcomed.

To quote Ibis (2025) *"(t)he Local Government Act 2002 and the Local Government (Rating) Act 2002 both enshrine a strong commitment to local autonomy, financial prudence, and community consultation. Councils are legally obliged to operate a balanced budget under Section 100, to consider all reasonably practicable funding options under Section 101(3), and to adopt transparent and predictable funding and revenue policies under Sections 102 and 103. These requirements are not theoretical; they are actively enforced, and councils are audited against them."*

It is not clear how and where adherence to the rates model sits alongside the other financial management obligations in the Local Government Act, especially with the addition of a requirement to have particular regard to the purpose of local government and the core services obligation.

Arguably the obligation to manage all financial dealings prudently and in the current and future interests of the community (section 101) sits at the top of these obligations. But a rate-cap appears to be absolute and therefore overrides the obligation of prudence. A cap would undermine prudent financial management by incentivising short-term behaviours such as reducing preventive maintenance and spending on renewals? Similarly a cap might discourage approaches such as building resilience upon construction.

The Act also requires councils to adopt a financial strategy, including self-set limits on rates and debt. One of the observed phenomena in the two Australian jurisdictions and in England is that local authorities set rates at the maximum levels available under any cap. The rationale being that 'if we don't take it, it's gone forever'.

It is therefore arguable that a strategy that contains limits on rates has any purpose – local authorities will just use the rates limits. With the limits being a hard cap, moving beyond the limit is ultra vires, it seems redundant to require an obligation to report on adherence to the cap in the Financial Reporting and Prudence Regulations and in the pre-election report)

Local authorities will be encouraged to pay more attention to the requirement to provide a reconciliation of limits with their ability to meet existing levels of service and meet additional demands for services.

The role of the regulator, and the nature of the process or seeking variations are critical to the success of the model.

Standard and Poors observe that
"Councils will be able to seek permission from a regulator to exceed the cap "in extreme circumstances, such as a natural disaster" or for "catching up on past underinvestment." But as severe weather events become increasingly common, and with many councils wanting to renew ageing assets, the regulator's amenability to exceptions could be a crucial credit consideration. Councils are not homogenous. A one-size-fits-all cap could heap pressure on those councils that need revenue growth the most."[15]

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[15] Standards and Poors (2025), page 4.

There has been little detail provided on the process for applying for exceptions. The process needs to be timely, especially where it is to meet the cost of recovering from a disaster or economic shock. We understand that it can take 18-20 months for the NSW regulator to approve variations. The regulator should be placed under an obligation to respond to an application within a limited time of receiving a request, no more than say six months.

Legislation should draw a distinction between those applications that are made for disaster recovery purposes and others. In these circumstances the application requirements should be 'lighter touch' with a focus on documenting the need and the proposal to return within the cap. The timeframe for assessment could then be shortened.

We noted one of the more desirable aspects of the variation process applied in NSW is that an application has to provide evidence only that the local community is aware of the need for, and extent of a rates rise. Applications do not have to provide evidence of community support. This does not mean that councils should not engage with the community while preparing an application, or that the regulator ought not assign weight to those applications that come with community support.

It seems likely to us that the regulator will be the Commerce Commission. The Government has recently taken an in-principle decision to make the Commission the regulator of another local authority revenue source – development contributions. Assigning the responsibility for regulating rates to the Commission would make the most of existing regulatory capability, avoid or minimise duplication in report, and minimise risks that two regulators take different approaches to their task. We also observe that the Commission is at arms-length from Ministers, as opposed to having a regulator within the Department.

At the same time, the Commission is also the water services regulator. With many local authorities having retained stormwater 'in-house' we observe that this will mean two quite different regimes for services that are provided by the same organisations. Rates will be subject to the band set under the model based on economic variables. Water services will be based more on the Commission's assessment of asset needs, likely movements in asset costs etc. The differences in approach may create public confusion and pressure for similarity in approach.

Little has been presented on the transition.

We understand and welcome that the rates model will fully commence from 1 July 2029. This gives councils lead time to investigate and introduce alternative strategies such as putting shared services arrangements in place, develop and implement alternative funding and financing strategies, reconsider activity choice, and to revisit asset plans. It will also give central government and the public time to adjust their expectations of the sector.

The proposal suggested that in the interim, local authorities would be required to "consider the rates target when setting rates". Neither the proposal, nor the supporting documentation, explains how a local authority would be expected to demonstrate that it has considered the target, and what steps it needs to take if it wishes to move beyond it.

The 2 October briefing *Rates band: transition and regulatory design issues* implies that the rates band might be completed by disclosure against a series of metrics, such as expenditure as a proportion of GDP or rates as a percentage of total income.[16] We observe that local authorities will be well advanced on the preparation of long-term plans, including the financial strategies and revenue and financing policies by June 2026. These metrics must be in place by then.

The announcements noted that DIA would prepare "guidance" in the interim, with an implication that this would relate in some way to the level of rate increases deemed appropriate or acceptable. The earlier such guidance is in place the better. We observe that the higher the degree of 'bind' the more it looks like a rates-cap by another name.

[16] Department of Internal Affairs (2025), Local Government Briefing Rates band: transition and regulatory issues, pp 6-7.

The Model

In this section we consider the rates model itself, including its coverage and the factors that are included (and in some cases excluded from) the formula.

We welcome the Government's acceptance that local authority costs are driven by more than a change in the price of goods and services. An 'inflation alone' measure would have impeded the achievement of urban growth and economic development objectives.

The proposed model contains a mix of measures, some of which appear to be national level measures (such as inflation) and other matters that give a council specific result i.e. population growth, average residential population, depreciation and infrastructure quality. This suggests (sensibly) a cap for each local authority – yet the proposal and supporting documents make no mention of this, one way or another.

The selection of factors for the rates model should be principle-based.

The selection of the right variables is essential to the robustness and acceptance of the model both by the sector and the public. Taituarā offers the following as a set of principles with which to start:

- independently calculated – any factor should be calculated independently from the local government sector. For example, the Local Government Cost Index may better reflect infrastructure costs but is commissioned by Taituarā and paid for by the local government sector.
- forward-looking – factors used in the model should indicate future states rather than reflecting historic costs. This is essential for the long-term planning of infrastructure and services that are both legal requirements and practical necessities. This principle points to use of forecasting methodologies
- robust – methodologies should be documented and peer-reviewed where possible
- reflective of actual cost drivers – there should be a relationship between the variable and local authority cost.

Additionally, it would be desirable if the factors used in the model have a legislative or regulatory precedent for use. For example, the legislation does not use the CPI to indicate movements in the cost of infrastructure, especially capital costs. The existing development contributions provisions of the Local Government Act and the proposed new development levies provisions use measures of movements in construction costs.

A growth component is an essential aspect of any rate-capping model and must apply to all councils.

Government statements commented that *"an additional growth component will be added for some councils"*. One of the core functions of local authorities is to provide infrastructure and services to support population growth and is essential for the model to support the Government's urban growth and economic development initiatives.

It is this aspect of the model that points to an individual rate-band for each local authority. Applying a single national average would penalise those local authorities with levels of population growth above the national average, while providing an allowance for population growth in local authorities that are not experiencing it or experiencing only minor amounts of growth!

Neither the model nor any of the supporting package of information is clear about the application of the population growth aspect. We interpreted the use of the words *"added for some councils"* to mean that it would be applied individually to a limited number of local authorities. For example, that might mean the 19 local authorities that sit within the so-called 'tier one' set of local authorities for the purposes of the National Policy Statement – Urban Development (NPS-UD), or those that qualify for the higher debt servicing limit under the Local Government Financial Reporting and Prudence regulations.[17]

But neither of these explicitly recognises the true extent of growth. In addition to the 19 or so tier one councils under the NPS_UD, there are another 12 or so councils that sit in the second tier of local authorities (lower growth). Additionally, the last Census (2023) showed that all but two territorial authorities experienced some population growth in that intercensal period.[18]

Our preference would be that, as is the case in New South Wales, there should be some allowance for <u>all</u> local authorities experiencing growth. Any local authority that is stable or losing population would have no adjustment, i.e. the band would not be adjusted in a local authority that is depopulating. At the minimum any population growth adjustment should be extended to all local authorities that sit in either tier one or tier two for the purpose of the NPS-UD.

[17] We doubt that it is the latter as the higher benchmark applies to those local authorities with a growth rate higher than the national average.

[18] The 2023 Census showed all but Wellington City and Chatham Islands experienced population growth, with the net loss in the former so minor that it easily sits in the realm of survey error. We also note Wellington City is a tier one council for the purposes of the NPS -UD.

There is a second issue with the use of population growth in the model. How would a forward-looking element be incorporated in a nationally standardized way. Statistics New Zealand prepares subnational-level population projections for each of the 78 local authorities and for each Auckland local board area. These are developed by a n independent reputable source. However, these projections are not developed annually and would need to be for this purpose.

We are also aware that the Statistics New Zealand projection methodologies tend to underestimate the actual growth in the higher growth local authorities (those local authorities where accuracy is most important). Arguably it is also an open question which of the series should be used to adjust rates, the public expectation would most likely be the medium births, medium deaths, medium migration series would apply, which may further 'low ball' the adjustments for higher growth local authorities.

Is there an option where high-growth local authorities submit their population forecasts for an independent review (by the regulator and/or the Government Statistician) and those become the basis of the population element in the formula.

<u>Recommendations</u>

A population growth component be added for all local authorities that are forecast to experience population growth.

That, except as provided below, Statistics New Zealand population projections be used as the basis for determining the population growth element in each council. The expectation would be that Statistics New Zealand's 'medium' range series would be the series used.

That those local authorities defined as tier one for the purposes of the NPS-UD be permitted to use their own population estimates, where these have been certified by the regulator (in consultation with the Government Statistician) as being prepared using robust data and methodologies.

The use of average residential numbers raises significant issues.

The assumption was that this was usually resident population, ignoring those councils that have substantial levels of non-resident ratepayers, and those that have significant tourism sectors. Similarly, the use of a measure of residents in the formula may disadvantage those with substantial commercial sectors.

Using the number of rating units would resolve some of these matters (and is verifiable from the District VR). On the other hand, some rating units (such as a retirement village) can have hundreds of people resident on the property. We considered the number of separately used portions of a property, but use of SUIPs in the sector is far from universal.

***We welcome the proposed inclusion of a measure of quality of infrastructure*.**

The formula includes a measure of the quality of infrastructure. As with the population growth component, a measure of infrastructure quality might vary considerably between councils and points to a band for each council.

Taituarā supports the inclusion of a council specific measure of quality in principle. Such a measure avoids unduly penalising communities and councils where there has been an historic legacy of underinvestment in infrastructure (in other words not penalising current councils for the poor governance decisions of their predecessors).

Our concern with the inclusion of such a measure lies with the difficulty of measuring quality in an objective and comparable way, across the entire range of infrastructure groups and classes. It is not clear to us how the Government intends to assess infrastructure quality, and what agency or agencies will be making the assessment?

As we understand it, the quality of infrastructure assets has two dimensions – asset condition and asset performance. There are well developed and nationally consistent measures for some classes of assets such as the road network (through the New Zealand Transport Agency) and water assets (through Water New Zealand). But it is not clear to us how these might be transparently aligned or manipulated into a composite measure. We suspect that a single proxy measure – such as those for roads will be used.

It is also not clear to us how the quality of regional councils' infrastructure might be captured in this formula.

***Headline inflation does not reflect the reality of asset-intensive council operations*.**

The model includes an allowance for direct cost-change, by including the CPI as one of the variables in the proposed formula. The CPI is the official measure of inflation faced by households and to that extent is a readily recognisable indicator to the public at large. To the extent that some forms of Government social assistance are adjusted using the CPI as a base, it also has some (albeit not strong) link to affordability.[19]

But household inflation and the costs local authorities face are two quite different sets of cost drivers. Commentators such as the Productivity Commission and the Department's own regulatory impact statement on the System Improvements Bill have noted that infrastructure costs have increased at a faster rate than CPI inflation.

Our initial calculations based on the Capital Goods Price Index have suggested that over the past 25 years the rate of increase in the CGPI has been almost double that of the CPI. Even in the past eight years the rate of increase in the CGPI has been, on average 1 percent higher than the CPI.

The model needs more sophistication by distinguishing between asset and non-asset costs.

Earlier in this submission we noted that legislation has recognised the inappropriateness of the CPI as a measure of movements in asset costs. Under the existing Local Government Act local authorities are allowed to increase their development contributions by an amount up to the annual increase in the Producers Price Index (PPI) for Construction without having to consult (a form of indexation). The draft Local Government (Infrastructure Funding) Amendment Bill proposes to do likewise with development levies. One limitation is noted – it does not seem that either Treasury or the Reserve Bank currently publish forecasts of the PPI at any level of aggregation (though both have models that could generate this).

Recommendations

That the CPI component of the model be supplemented by the addition of the the Producers Price Index (Construction) as a measure of movement in asset costs.

Interest rate risk is not adequately accounted for.

Interest rate volatility has material impacts on operating costs: A shift in interest rates from 4% to 6% can absorb the entire permitted increase under the proposed cap. A

[19] We say not strong because not all forms of social assistance are adjusted using the CPI. NZ Superannuation is benchmarked to both the CPI and to average ordinary time weekly earnings (with the rates adjusted by whichever is the larger amount). Jobseeker support is indexed to the CPI, the rates rebate scheme likewise.

measure of debt-servicing costs might provide growth councils an additional margin over headline inflation.

Depreciation has been a major driver of council expenses in recent years, driven off an increase in asset valuations.

The model proposes to include some allowance for 'depreciation' though it is not clear to us how this is determined.

Depreciation expenses have increased rapidly in recent years – often cited as one of the major drivers in expenditure and based largely on movements in asset values. We observe that this factor alone may test the 4 percent upper limit of the target range based on movements in asset values over recent years.

Including a measure of depreciation expense is therefore welcomed with some reservations. This measure would not lend itself well to a single national band. Depreciation as a measure would be only as good as the accounting policies and asset valuation practices that are used to produce the estimate.

To the extent that asset lives, depreciation rates and historic adherence to the balanced budget requirements are all policy choices for local authorities this is an indicator that may be open to manipulation. Ironically, one of the positive incentives that local authorities would have under this model is to close any gaps between book depreciation and that which is actually 'funded'.

Given this is dependent on asset valuations the need for regular asset valuations and the audit requirements may require further thought. The audit process will detect and test any accounting policy decisions that are outside industry norms or otherwise are of concern. A standard set of accounting policies may be one of the outcomes of this change.

Any legislation must be clear as to what is included and excluded from the cap.

Government statements suggest that the model will include *"all sources of rates (general rates, targeted rates, uniform annual charges(sic)[20]), but excludes water charges and water targeted rates, and other non-rates revenue."*

The model expressly excludes water charges and water targeted rates – we suspect that the Government intended to exclude any charges for water <u>services</u> (as defined

[20] We were surprised to see this term in the publicly – uniform annual charges have not existed since 2002, legally what was regarded as a uniform annual charge is actually a fixed targeted rate. We suspect the Government was referring to uniform annual general charges but even these are legally part of the general rate.

in the Local Government (Water Services) Act 2025 to include drinking water, stormwater services and wastewater services).

(As an aside, the model has been developed under the assumption that the financial separation provisions of the water legislation will mean that local authorities fund all water services via targeted rates. That is not necessarily the case – it is legally possible for a local authority to hypothecate a share of the general rate for water services and meet the separation requirements.

Some local authorities set what are referred to as “voluntary targeted rates”. In essence, a ratepayer borrows a sum from the council, which is applied to some expenditure that promotes a public policy outcome, such as the installation of a clean heating option or energy-efficient technologies. The council receives repayment via a targeted rate, and de-risks the transaction through recourse to the collection and enforcement provisions of the Rating Act. The transaction is entirely an ‘opt-in’ on the part of the ratepayer.

The inclusion of these rates in the cap would see local authorities either withdrawing these schemes or making them commercial finance contracts (in essence operating as a finance company).[21] We observe that government agencies (such as EECA) have encouraged local authorities into these schemes.

In recent years, other agencies have been provided with authority to access the rating system, with support from across Parliament. The Urban Development Act 2020 provided Kainga Ora with powers to set levies on properties in defined urban development areas, with those levies being collected via the rating system. Similarly, the Infrastructure Funding and Financing Act 2020, allowed for the creation of special purpose vehicles to build infrastructure ‘off local authority balance sheets’ and to recover the loan via levies through the rating system.

In both instances, it is actually Ministers, rather than local authorities, that have the final approval over these schemes. Including levies under this Act within the model makes local authorities potentially accountable for decisions made by others. It is also arguable that the inclusion of these revenue streams in the model would also undermine the very separation from local authorities that this legislation intended to create.

We are also aware of small numbers of cases where local authorities rate on behalf of other local authorities. These situations occur when a local authority undertakes work in its own area that has a cross-boundary benefit, with the other local authority

[21] Including voluntary targeted rates in the model would not sit well with the Government’s previous policy decisions to relax some requirements of consumer credit legislation to encourage local authorities to provide these schemes.

rating on behalf of the first. It is not uncommon with works such as land drainage schemes.

Each of these circumstances should be clearly excluded from the model. The same principle would apply for any other levy or charge levied by a third party (for example, if fire service levies were ever collected in whole or part through the rating system).

Recommendations

That the so-called voluntary targeted rates be excluded from the model.

That rates set under the authority of the Urban Development Act 2020 and the Infrastructure Funding and Financing Act 2020 be excluded from the model.

That any other levy or charge set by a third party and collected via the rating system be excluded from the model.