# Submission

**By**

BusinessNZ
The voice of business

to the

## Department of Internal Affairs

on the

## Development Contributions Review Discussion Paper

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PO Box 1925
Wellington
Ph: 04 496 6555
Fax: 04 496 6550

# DEVELOPMENT CONTRIBUTIONS REVIEW DISCUSSION PAPER SUBMISSION BY BUSINESSNZ[1]

## 1.0 INTRODUCTION

1.1 BusinessNZ welcomes the opportunity to make a submission on the *"Development Contributions Review Discussion Paper* (the "Discussion Paper"). BusinessNZ considers the Discussion Paper provides a very useful background to the current situation, highlighting the weaknesses, including inconsistent approaches, in the use of development contributions throughout NZ.

1.2 The issue of development contributions is important for business. BusinessNZ, as a member of the Local Government Forum (LGF) and in association with the Property Council of NZ, commissioned a comprehensive report (*"Taxing Growth and Development – A critical Review of Development and Financial Contributions" - 2010)* on development contributions which we would recommend to Internal Affairs (see link below to report).[2]
http://www.localgovtforum.org.nz/LinkClick.aspx?fileticket=ahvAjzVk3gg%3d&tabid=1539&mid=3017

1.3 While BusinessNZ is not opposed to development contributions per se, it is important that these are soundly based and not simply used as a revenue generating mechanism to fund general community developments, unrelated to direct development costs. Nor is it appropriate for development contributions to be used as a signal influencing urban design as espoused by the whim or fancy of some urban planners. Much stricter criteria are required on the use of development contributions, including appeal rights for developers who consider that development contributions fall outside best practice.

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[1] Background information on BusinessNZ is attached as Appendix 1.

[2] The Local Government Forum comprises organisations that have a vital interest in the activities of local government. Its members include BusinessNZ, Electricity Networks Association, Federated Farmers of NZ, The NZ Initiative, NZ Chambers of Commerce and NZ Retailers' Association. The Forum was established in 1994 to promote greater efficiency in local government and to contribute to debate on policy issues affecting it.

The Forum's members are each significant representatives of ratepayers in their own right but the Forum's perspective is to advance community welfare through the advocacy of sound public policy. We believe that local government can best serve the interests of the community and ratepayers by focusing on the efficient provision of public goods at a local level.

1.4 The Discussion Paper states that in 2011, local authorities had an operating income of approximately $7.3 billion, $142 million (approximately 2.0 percent) of which was received from development and financial contributions.

1.5 The Discussion Paper notes (p.17) that although contributions currently make up around 2 percent of all local authority operating income, contributions to individual councils can be much higher. For example, in 2008, development contributions made up between 10 and 20 percent of income for at least 10 individual territorial authorities, while in 2013 four territorial authorities are expected to get over 7 percent of their income from development and financial contributions.

1.6 The submission is in two sections. Section one identifies broader funding issues beyond development contributions which BusinessNZ considers should be considered as part of a comprehensive reform of local government funding. Section two focuses on the specific options outlined in the Discussion Paper.

**Recommendations**

BusinessNZ **recommends** that:

1. **There be greater clarity in distinguishing between the following:**

   a. **A user charge that constitutes an appropriate price for services supplied by a local authority;**
   b. **A tax on a subset of a local authority's ratepayers justified as funding local public goods of clear benefit to those ratepayers;**
   c. **An appropriate tax to fund local public goods that benefit all residents; and**
   d. **Justified charges to internalise external costs imposed on people or firms.**

BusinessNZ **recommends** that:

2. **Councils receive better guidance (via the Treasury or perhaps through the establishment of a technical advisory group (TAG)) on the use of available funding tools to ensure greater consistency across the country, underpinned by an economically principled approach to funding various Council activities.**

BusinessNZ **recommends** that:

3. **Developers have the right to appeal against any requirement to fund public goods. This is presently the case for financial but not for development contributions.**

BusinessNZ **recommends** that:

4. **Internal Affairs examine in detail the substantial report commissioned by the Local Government Forum (LGF) and Property Council of NZ, *"Taxing Growth and Development – A Critical Review of the Role of Development and Financial Contributions" (March 2010),* which looks at some of the concerns arising from the current approach to development and financial contributions.**

## 2.0 Section 1: Funding issues associated with Local Government

2.1 While BusinessNZ welcomes the discussion paper on development contributions, it is important to consider the funding of local government in a broader context. Development contributions are only one part of the package.

2.2 BusinessNZ considers there is a need for greater clarity in distinguishing between the following:

- A user charge that constitutes an appropriate price for services supplied by a local authority;
- A tax on a subset of a local authority's ratepayers justified as funding local public goods that clearly benefit those ratepayers;
- An appropriate tax to fund local public goods that benefit all residents; and
- Justified charges to internalise external costs imposed on people or firms.

User charges

2.3 Councils currently provide a range of private goods and services which are often funded via general rates. Putting aside debate on the role of Councils in providing private goods and services, charging for the use of private goods and services would bring greater efficiencies. For example, funding waste disposal out of general rates and supplying every ratepayer with a rubbish disposal bin takes no account of the amount of rubbish generated. To a certain extent this may actively encourage waste generation because effective cross-subsidisation means the full costs of waste disposal are not sheeted home to every household. Water is another good example where clear user-pays pricing principles would encourage greater efficiencies.

2.4 While some councils charge for water and waste on a user-pays basis, many still fund such activities out of general rates, sending strictly limited signals to consumers as to the real costs associated with their behaviour.[3]

Differential and targeted rating

2.5 Differential and targeted rating should only be permitted where a clearly identified community (such as a remote rural area) is provided with a distinctly different level of public goods from that of other ratepayers and the differential or targeted tax reflects the difference in the level of service supplied. There should also be an objective test for benefits received to ensure a consistency of approach. Rating differentials, if used at all, should be used sparingly not, as some councils have done, as a general revenue raising device, on unprincipled and unsubstantiated grounds.

2.6 Sometimes differential rating is applied to the business sector on the unsubstantiated ground that the business sector benefits proportionately more from council services. A number of reports have found such thinking to be groundless, yet councils continue to apply significant differentials simply because they can, rather than on any principled economic basis. Where councils have agreed to reduce such differentials, any reduction has generally proceeded at a snail's pace, councils being mindful not to upset the majority of residential ratepayers who enjoy the advantages of a lower rates burden courtesy of the business sector.

2.7 In the past, a number of people have argued (and many still do) that businesses are advantaged relative to residential ratepayers because they can deduct rates for income tax purposes and claim a credit for GST paid on them. These claims have been discredited by reputable economists for the following reasons. First, a firm can only claim a tax deduction for rates because its income is subject to tax. Nobody could seriously argue it is an advantage to be subject to income tax. Second,

[3] Refer to the Local Government Forum's publication *"Democracy and Performance – A Manifesto for Local Government" (February 2007)* which has a very useful section on Funding of Local Government (p.15-24) explaining the appropriateness of different funding tools. Clearly, given that most local government-supplied goods and services are of a private good nature, user-pays, where possible, is the most appropriate tool to use.

a GST registered person or firm can claim a credit for GST paid on inputs because supplies (outputs) are subject to GST. The net GST collected is paid to Inland Revenue, so a business receives no advantage.

2.8 BusinessNZ is concerned with any reference to the GST status of a business as an alleged justification for imposition of any local government charges. As implied above, we do not consider the tax status (including presumed tax status) of a business to have any relevance to the level of charge that a council can impose. An unprofitable business logically remains as liable for its use of Council provided services as a profitable one, given the cost of providing that service remains.

2.9 BusinessNZ remains concerned about the use of targeted rates (taxes) mainly because there is a danger these can simply be another way of raising needed revenue without taking the full implications of their use into account.

2.10 There may be isolated cases where levying additional rates (taxes) on a particular class of ratepayers is appropriate - for example, where specific local public goods benefit a clearly defined subset of ratepayers, such as schemes to control floods. However, for such taxes to be justified on both economic efficiency and equity grounds, the target group must be clearly identified and share equally in the benefits. Ideally, the consent of the affected group should be sought before any targeted taxes are considered. More importantly, targeted taxes should not be used for tapping previously untapped pockets of revenue-raising potential – a distinct danger in the absence of clear controls on when and how such tools can be used.

Development contributions

2.11 Development contributions appear to be an increasingly used tool, with property developers required to contribute either money or land to be used as a reserve, or for network or community infrastructure.[4] While local authorities wishing to levy development contributions must adopt a contributions policy and incorporate it into their long term plans (LTPs), again there is the potential for the contributions to be used as another form of revenue-raising (although without strong justification). The possibility of development contributions being used for all sorts of activity unrelated to development costs is a concern. Requiring significant contributions from inner city residential developers is a case in point. There must be transparency between income derived from

[4] For example, the average development contribution charge nationally has increased from $3,000 per section to $14,000 per section over the past decade, an increase of 360%.

development contributions and the actual costs of development. In the absence of such information, there is a danger that development contributions may increase in line with the demands of residents not required to pay for such contributions (i.e. free-riders).

2.12 The main recommendations of the LFG and Property Council commissioned report – "*Taxing Growth and Development – A critical Review of the Role of Development and Financial Contributions"* are as follows:

- *Prices rather than development and financial contributions should be charged for goods and services where they are feasible and appropriate.*

- *There are grounds for imposing the cost of some genuine local public goods on landowners who benefit. The cost of supplying public goods such as neighbourhood parks, reserves, outdoor recreation facilities and stormwater systems that exclusively or predominantly service or enhance a development and are located within a development, may be appropriately imposed on relevant households and businesses by requiring the developer to pay for, or provide, the facilities. There should be a close connection between the subdivision or development on the one hand, and the relevant infrastructure and facilities on the other.*

- *Developers should have the right of appeal against the requirement to fund public goods, as is presently the case for financial contributions but not for development contributions.*

- *Consideration should be given to making a value for money test a criterion for establishing the reasonableness of council requirements and charges. If that approach is not adopted, the maximum level of development contributions should be capped, as is generally the case in Australia, and the principle of capping financial contributions should be retained." (p.58)*

<u>Other funding Issues</u>

2.13 A number of BusinessNZ members have issues in respect to funding which relate specifically to their sector which are worth mentioning in the context of the current development contributions review.

A key one is where large scale manufacturers are required to install pipes and other capital equipment beyond the boundary of a property that would be a capital and operating cost that would otherwise pass to the Council or Council Controlled Organisation (CCO). The concern is that changes in Council policy or charging regimes can then make such investments largely redundant, without any compensation to the affected parties.

## 3.0 Section 2: Specific comments on options outlined in the discussion paper

3.1 It is noted that the discussion paper considers whether development contributions are still an appropriate method to fund infrastructure, the impact they have on housing affordability and businesses, and whether there are better options than the current system.

3.2 The ten development contribution issues identified in the discussion paper revolve around 5 main themes:

1. The impact of development contributions on housing affordability;
2. Variability and inconsistency in the use of development contributions;
3. Fairness and equity regarding the use of development contributions;
4. Complexity and efficiency regarding development contributions policies; and
5. Dispute resolution (current challenge and dispute resolution mechanisms are expensive, time consuming and can lack transparency).

3.3 The discussion paper sets out 14 options to address the above issues, ranging from minor changes to options that would require major changes to the current system:

***Solutions requiring minimal legislative change***

- Updated and improved guidance on development contributions
- Consolidation and clarification of existing Local Government Act 2002 development contribution provisions

***Solutions requiring moderate legislative change***

- Explicit discounts for housing types and locations with lower demands for services
- New purposes and principles for development contributions
- Facilitating increased private provision of infrastructure through enhanced developer agreements
- Tightening the range of infrastructure that can be funded from development contributions
- Delaying when development contributions can be charged
- Capping developing contributions

- Independent dispute resolution hearings
- Reinstatement of appeals to the Environment Court
- Regulations to promote greater consistency

***Solutions requiring significant legislative change***

- Percentage-based infrastructure levy as an alternative financing tool (based on value of completed development)
- Abolition of development contributions as a financing tool
- Infrastructure bonds as an alternative financing mechanism

3.4 Each of the above options is discussed briefly below.

***1. <u>Updated and improved guidance on development contributions</u>***

3.5 The Discussion Paper correctly notes that development contributions in NZ are used to fund a much broader range of infrastructure when compared with development contributions in Australia, the United States, the United Kingdom and Canada (see Appendix D of the Discussion Paper). In Australia, only New South Wales and Victoria use development contributions for a broader range of assets.

3.6 While updated and better guidance on development contributions might be an improvement on the status quo, BusinessNZ considers it important to place strong incentives on territorial authorities to ensure development contributions are narrowly focused on the direct costs associated with the development and where the private beneficiaries can be clearly identified. This would exclude wider uses of development contributions to fund or partially fund parks and libraries etc. where the broader public is the beneficiary.

***2. <u>Consolidation and clarification of existing Local Government Act 2002 development contribution provisions</u>***

3.7 While some technical consolidation and clarification of provisions in the Local Government Act would be an improvement on the status quo, this would still not deal with the generally expansive use of development contributions to date.

### ***3. Explicit discounts for housing types and locations with lower demands for services***

3.8 BusinessNZ is in generally opposed to this option, although there may be exceptional circumstances where such a discount is justified. For example, there is an argument that “self-contained” resorts where the infrastructure is maintained and continues to be owned by the developer may justify lower development costs.

3.9 Notwithstanding the above, the only test for development contributions should be the direct infrastructure costs associated with the development, not whether houses are small or large. This necessarily requires that development contributions are very narrowly focused, with the costs associated with wider council amenities (e.g. playing fields, libraries etc.) funded on a user pays basis where appropriate or through general rates if possible, where the goods or services cannot be charged for. It needs to be remembered in this context that not all developments relate to housing but can be for industrial sites, supermarkets, rest homes and so on, where the pressure on infrastructure services is likely to vary substantially depending on the nature of the development.

3.10 The Discussion Paper suggests that a discount could be introduced based on potential house size, with the argument made that smaller houses may result in a reduced level of demand for services.

3.11 BusinessNZ considers there is no place for development contributions to be used as a tool to further the whims of urban planners. The key development contributions issues are the total infrastructure cost of the development and whether the beneficiaries of the development can be clearly identified.

3.12 As the LGF report states:

*“There are grounds for imposing the cost of some genuine local public goods on landowners who benefit. The cost of supplying public goods such as neighbourhood parks, reserves, outdoor recreation facilities and stormwater systems that exclusively or predominantly service or enhance a development and are located within a development, may be appropriately imposed on relevant households and businesses by requiring the developer to pay for, or provide, the facilities. There should be a close connection between the subdivision or development on the one hand, and the relevant infrastructure and facilities on the other”.*

### 4. ***New purpose and principles for development contributions***

3.13 BusinessNZ is supportive of Option 4 as it should provide a clear direction for local authorities in implementing development contributions.

3.14 The suggested purpose and principles statement outlined in the Discussion Paper is supported, namely:

- Clarity that development contributions take the form of a charge that is related to the additional demands on infrastructure created by growth;
- Clarity that development contributions can relate to the marginal costs of growth;
- More explicit direction around the need to consider both the cause of the demand on infrastructure and who the infrastructure will benefit when setting development contributions (i.e. public versus private benefits); and
- Clarity about the extent of the consultation required when contributions' policies are developed.

3.15 In addition, BusinessNZ would support developers having a right of appeal against the requirement to fund public goods, as is presently the case for financial but not for development contributions. This would ensure strong discipline on territorial authorities to focus development contributions on those areas where there are clear private, rather than broader public, benefits of development.

### 5. ***Facilitating increased private provision of infrastructure through enhanced developer agreements***

3.16 Conceptually, the ability for territorial authorities to enter into agreements with private developers to build and operate infrastructure (without imposing development contributions) would be desirable and is supported by BusinessNZ.

3.17 This would likely give developers greater flexibility with infrastructure provision, assuming the infrastructure provided met legal environmental and health standards.

3.18 Notwithstanding the above, increased private provision through enhanced development agreements would not necessarily mean developers funded only the immediate costs of infrastructure development, unless legislative constraints were placed on territorial authorities as to what developers could fund.

3.19 Simply giving developers more flexibility in funding activities, without constraining what they *need* to fund, would not meet the objective of achieving greater clarification of the role of development contributions.

### *6. Tightening the range of infrastructure that can be funded from development contributions*

3.20 This option is supported by BusinessNZ; the range of items for which development contributions can be charged will be more tightly defined to align more closely with the degree of benefit to the wider community, whether the item is a public or a private good.

### *7. Delaying when development contributions can be charged*

3.21 This proposal would allow the payment of development contributions in some cases to be deferred for a period to make it easier for a developer to finance the development. It is suggested that development contributions would be payable only upon the issuing of a building consent or when houses were sold etc.

3.22 This proposal needs careful thought. On the one hand, it seems to be a useful way of spreading developers' costs over time to assist with cash flow. On the other, there are potential risks if a developer goes out of business and territorial authorities are faced with unpaid costs which will ultimately fall on a wider range of ratepayers (unless a new developer takes over and progresses the development).

3.23 Finally, as under proposal 5 above, delaying when contributions can be levied would not necessarily factor in whether the scope of the charges was appropriate in the first place. This proposal, by itself, would not address the issue of the appropriateness of the current development contribution policies adopted by territorial authorities.

### *8. Capping developing contributions*

3.24 Provided the rationale for development contributions is sound, capping contributions could be considered inappropriate, although there may be exceptional circumstances which warrant such an approach. A better approach might be to adopt a "reasonableness" test, given that the development of a legislative cap might not necessarily reflect the future size and scale of new developments. If the cap was set very high, then it would likely have no impact. On the other hand, if it was set relatively low, it could encourage perverse incentives in terms of the size of development, with potentially unintended costs.

3.25 BusinessNZ considers any capping of development contributions requires further thought, although it is understood that caps are used in some States in Australia (New South Wales and Queensland).

### *9. Independent dispute resolution hearings*

3.26 Irrespective of any development contributions' policy, independent dispute resolution hearings (and/or appeals to the Environment Court) are important safeguards which should be considered as part of good public policy.

### *10. Reinstatement of appeals to the Environment Court*

3.27 See comments on 9 (above).

### *11. Regulations to promote greater consistency*

3.28 It is hard to see how this proposal differs radically from proposal 6 (outlined above). Notwithstanding the above, the proposal is generally supported by BusinessNZ as a possible option although there may be risk in ensuring that regulations are constructed in such a way to ensure they cater for the various circumstances needing to be covered. While regulations may well provide for certainty, they are likely to restrict flexibility which may be required in respect to some developments.

### *12. Percentage based infrastructure levy as an alternative financing tool (based on value of completed development)*

3.29 This option is not supported by BusinessNZ as the proposal would result in development contributions being reflected as a percentage of the anticipated value of completed development work. This would not necessarily bear any relationship to the costs associated with infrastructure provision, which is what development contributions are intended to reflect. High cost developments would, in general, subsidise low cost developments, irrespective of the nature of infrastructure provision.

### *13. Abolition of development contributions as a financing tool*

3.30 The Discussion Paper notes that according to some reports, twenty territorial authorities do not use development contributions at all. However, it is understood that these territorial authorities are smaller centres or are centres with low growth rates.

3.31 BusinessNZ, as stated in para 1.2, is not opposed to development contributions per se, and sees that, appropriately applied; they have a useful function in terms of partially funding development. But they are merely one of a number of tools which territorial authorities might use.

3.32 Therefore, simply discarding development contributions, without considering the ramifications for general ratepayers, would be a retrograde step at this stage.

### *14. Infrastructure bonds as an alternative financing mechanism*

3.33 The Discussion Paper suggests that a possible option would be to create a replacement infrastructure financing mechanism in the form of infrastructure bonds.

3.34 It is suggested that more explicit permission could be given to allow infrastructure bonds to be sold by a territorial authority or a Council Controlled Organisation to pay for all infrastructure services required to service a development. Payment of the bond principal and interest costs would then be recovered from the purchasers and owners of the new sections and buildings (including houses) through regular instalment payments until the bonds and interest were paid off.

3.35 While BusinessNZ considers that flexibility in funding approaches is desirable, it is important that the nature of the payments is clearly laid out. Otherwise, the same problem, as when development contributions are expanded, could arise. Rather than the developer paying upfront as at present (including costs which are for broader public rather than private infrastructure), such costs would simply be transferred to purchasers and owners of new sections.

3.36 In this respect what is private good infrastructure (the costs of which should be internalised to the extent practicable) as opposed the public infrastructure (where the costs should be socialised) needs to be clearly identified, whatever funding mechanism is developed.

## APPENDIX 1

## BACKGROUND INFORMATION ON BUSINESSNZ

BusinessNZ is New Zealand's largest business advocacy organisation.

Through its four founding member organisations – EMA Northern, BusinessCentral, Canterbury Employers' Chamber of Commerce (CECC), and the Otago-Southland Employers' Association (OSEA) – and 70 affiliated trade and industry associations, Business NZ represents the views of over 76,000 employers and businesses, ranging from the smallest to the largest and reflecting the make-up of the New Zealand economy.

In addition to advocacy on behalf of enterprise, BusinessNZ contributes to Governmental and tripartite working parties and international bodies including the International Labour Organisation (ILO), the International Organisation of Employers (IOE) and the Business and Industry Advisory Council (BIAC) to the Organisation for Economic Cooperation and Development.