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LOCAL GOVERNMENT NEW ZEALAND SUBMISSION

Development Contributions – Discussion Paper

To the Department of Internal Affairs

11 MARCH 2013

Submission by Local government New Zealand

IN THE MATTER OF:

Development Contributions Review – Discussion Document

To the Department of Internal Affairs

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Introduction

1. *Local Government New Zealand* (LGNZ) welcomes the opportunity to submit on the Development Contributions Review Discussion Document.

2. LGNZ is a member based organisation representing all 78 local authorities in New Zealand. LGNZ's governance body is the National Council. The members of the National Council are:
   - Lawrence Yule, President, Mayor, Hastings District Council
   - John Forbes, Vice-President, Mayor, Opotiki District Council
   - John Bain, Zone 1, Deputy Chair, Northland Regional Council
   - Richard Northey, Zone 1, Councillor, Auckland Council
   - Meng Foon, Zone 2, Mayor, Gisborne District Council
   - Jono Naylor, Zone 3, Mayor, Palmerston North City Council
   - Adrienne Staples, Zone 4, Mayor, South Wairarapa District Council
   - Maureen Pugh, Zone 5, Mayor, Westland District Council
   - Tracy Hicks, Zone 6, Mayor, Gore District Council
   - Len Brown, Metro Sector, Mayor, Auckland Council
   - Dave Cull, Metro Sector, Mayor, Dunedin City Council
   - Stuart Crosby, Metro Sector, Mayor, Tauranga City Council
   - Brendan Duffy, Provincial Sector, Mayor, Horowhenua District Council
   - Stephen Woodhead, Regional Sector, Chair, Otago Regional Council
   - Fran Wilde, Regional Sector, Chair, Greater Wellington Regional Council.

3. This submission has been prepared under the direction of the National Council. Councils may choose to make individual submissions. The LGNZ submission does not derogate from these individual submissions. Many councils have indicated that instead of submitting in their own right, they will rely on this LGNZ submission.

4. The final submission was endorsed under delegated authority by Lawrence Yule, President, LGNZ.

5. The Development Contribution Review examines development contributions as a local government finance source. The Minister for Local Government has questioned the effect infrastructure costs may be having on housing affordability and made the assertion that charges on developers to recoup the cost of infrastructure adversely impacts on affordable housing. LGNZ completely refutes this assertion based on the information in the Government's own Discussion document.

Conclusions

6. LGNZ would emphasise that development contributions fund the growth in infrastructure that enables development to proceed. It is applied with considerable rigour and care under the requirements of the Local Government Act 2002.

7. LGNZ argues strongly that development contributions are not the principal cause of increasing house prices. At best they have only a minor, yet justifiable, impact on the cost of a house. The Government's figures themselves support this position. The Government should be focussing on the areas where the greatest gains are to be made. That is in the area of building and labour costs.

8. Following on from that point, LGNZ notes that the example given in the discussion document "Development Contributions Review" (page 21) states that development contributions on an average 145 square metre house in Auckland make up only 4% of the total cost. This is a comparatively small proportion of the total cost of a house build with the majority of the costs being land, materials and labour (85%).

9. LGNZ is unaware of any evidence that reducing development contributions would even reduce house prices or improve housing affordability. It is equally plausible to argue that the gain would be absorbed into a developer's margins. What is sure, however, is that infrastructure costs must be paid. If the causer of those costs does not pay, then the costs will be socialised through the rate base. This is patently inequitable and contrary to the Government's own incessant rhetoric that rate rises must be constrained.

10. LGNZ emphasises that changes to legislation that provide clarity and reduce ambiguity are to be welcomed but "one size fits all" approaches seldom work, as evidenced by the Productivity Commission's recent work.

11. LGNZ asserts that merit based challenges for specific development contributions undermine the methodology used to create a development contributions policy in line with the LGA 2002.

12. LGNZ stresses that there is an intrinsic link between development contributions, rates and the level of investment in providing infrastructure for growth. Any changes to one element in the financial mix will impact on the others.

13. LGNZ notes that the developer pays policy is based on beneficiary pays. Removing development contributions would shift the burden onto other sources of infrastructure funding including rates. The primary legislation in Better Local Government stressed the need to avoid substantial increases in rates and in fact this set of reforms will produce fiscal thresholds on rate increases.

Development Contributions Review

Local government in New Zealand's view of the current situation

14. The analysis of the current situation on development contributions outlined in the review document shows that development contributions as a percentage of total income is around 2%. This does not seem excessive.

15. The critical factor that needs to be acknowledged is that New Zealanders expect to have a range of basic services when they buy a house or open a new business. Services such as sewage, drainage, water, sealed roads, access to public transport, parks and community facilities are what we expect in a 21st century country.

16. Trunk sewers, water mains, and pumping stations provided by local authorities are the most expensive part of the network infrastructure.

17. Development contributions are based on developer pays. "For most local infrastructure, development contributions are both a fair and efficient charge."[1]

18. Development contributions are efficient because developers face the full costs of the infrastructure required to support their development, so they thereby internalise more of the true costs into their decisions.

19. Development contributions are fair because current ratepayers do not face the incremental costs of the new infrastructure that will mostly benefit new ratepayers.

20. The developer pays policy gives rise to concerns that the affordability of new housing is reduced. However removing development contributions would shift the burden onto other sources of infrastructure funding. The primary legislation in Better Local Government stressed the need to avoid substantial increases in rates.

21. LGNZ believes that the current situation being analysed in the context of housing affordability is not providing a holistic review of development contributions in relation to New Zealand as a whole. It is focussing the debate on the Auckland issue around housing affordability. LGNZ believe that the problems experienced by Auckland are more complex, are related to the implementation of their Unitary Plan, and are not solely related to the application of their development contributions policy.

22. Development contributions properly designed and administered generally meet the principles of good public finance.

Examining the issues

Issue 1-Housing affordability

23. The Covec (2002)[2] analysis show that development contributions make up a comparatively small proportion of housing costs. It is stated in the discussion document that the development contribution component is about 4% of the total cost of building an average 145 square metre house in Auckland, whilst 36% of the cost relates to land and 49% of the costs are for materials and labour.

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[1] NZIER – *Report to LGNZ on Development Contributions (March 2013)*

[2] The development contribution figure is derived from Covec(2012) and Quotable Value average house sales price data for July 2012

24. Applying the same ratio to a house of $1.6m the development contribution would be 4% or $64,000, which was stated as an outlier in the discussion document. The type and range of houses at this price would probably feature in the outer suburbs of a large metropolitan area, but ultimately they would not be paying a bigger ratio than other ratepayers. These higher charges are more likely reflect higher costs in providing infrastructure to areas not previously settled and serviced, as stated in the discussion document.
25. Development contributions in New Zealand are comparable with other countries such as Canada where the average charge is $26,163.

Issue 2 – Timing of payments

26. In discussing the timing of development contributions it is important to realise that local authority infrastructure often needs to be put in advance of land being developed to ensure that health, environmental standards and customers expectations are met.
27. Developers would find it harder to sell subdivisions where large scale infrastructure was being retrofitted. Most house buyers nowadays expect "ready to go" serviced sites to build on.
28. Providing infrastructure in advance of development can incentivise developers to proceed within a certain timeframe.
29. In order to provide the infrastructure the local authority may have to take out loans and will incur the costs of servicing the debt. Delaying the payment of development contributions could increase the cost of interest repayments the local authority would have to pay.

Issue 3 – Incentives to build smaller more affordable housing

30. It is interesting to note that the New Zealand Productivity Commission (2012) noted that the new house market was tending towards more expensive houses. This accentuates the issue is less to do with the cost of development contributions and more to do with the market making choices.
31. The costs of providing infrastructure to a site remain the same no matter what structure eventually materialises on that site.
32. Affordability is in relation to the cost of land, materials and labour and geographical situation, compared to the income and the other associated living costs. Development contributions are only a small piece of the complex subject of "affordability".

Issue 4 – Variability and inconsistency

33. It is important to note that development contributions relate to the true cost of providing infrastructure. Therefore some areas are more expensive to service than others due to several factors such as hazards, geographical situation, topography etc.
34. Some standardisation may be beneficial where it improved understanding, however there still needs to be sufficient flexibility to allow for local needs and circumstances to be reflected.

Option analysis

Overview

35. Before analysing the various options it is important to understand that the development contributions are a component part within Section 101 Financial Management LGA 2002.

36. Section 101 states that:

    (1) *A local authority must manage its revenues, expenses, assets, liabilities, investments, and general financial dealings prudently and in a manner that promotes the current and future interests of the community.*

    (2) A local authority must make adequate and effective provision in its long-term plan and in its annual plan (where applicable) to meet the expenditure needs of the local authority identified in that long-term plan and annual plan.

    (3) The funding needs of the local authority must be met from those sources that the local authority determines to be appropriate, following consideration of:

    (a) in relation to each activity to be funded:

    (i) the community outcomes to which each activity primarily contributes;

    (ii) the distribution of benefits between the community as a whole, any identifiable part of the community, and individuals;

    (iii) the period over which those benefits are expected to occur;

    (iv) the extent to which the actions or inaction of particular individuals or a group contribute to the need to undertake the activity; and

    (v) the costs and benefits, including consequences for transparency and accountability, of funding the activity distinctly from other activities.

    (b) the overall impact of any allocation of liability for revenue needs on the community.

37. The fact that s101 of the LGA 2002 clearly outlines the requirement for consideration of costs, benefits and transparency, as well as considering the extent that individuals (the developers) require the need for council to undertake the expenditure, is important. Any consideration of changes to this approach, within the context of development contributions, would have an effect on the whole of the financial management provisions of a council.

Option 1 - Improved guidance

38. LGNZ would support updated and improved guidance. The existing guidance to the sector is developed within LGNZ through the Know How training guide. This could be easily expanded and supplemented. LGNZ would expect the Department to work alongside the sector in developing this approach.

39. The guidance would be improved if it also considered the process to follow and the matters to consider for most aspects of the policy.

40. LGNZ would also be keen to ensure the dissemination of this material is undertaken with guidance seminars to the sector.

Option 2 – Clarification of LGA provisions

41. LGNZ would support clarification of the provisions only if these were to be aligned with the guidance being developed to support the changes. LGNZ agrees that the terminology could be clearer.
42. Clarification in legislation may state that development charges for a particular asset or catchment "may be" adjusted in line with the Producer Price Index. Notice of the indexing and new Schedule of Charges should also be "notified" as part of the Annual Plan consultation process.
43. Any changes for clarification should be focused on improving certainty and efficiency.
44. There is a need to recognise that not all the funding tools available to local government are contained solely within the Local Government Act 2002. Financial contributions are within the Resource Management Act and rating powers are within the Rating Act.
45. As previously stated in this submission, caution is needed when changing any aspect of the funding tools available within local government as they are very interdependent and inter-related.

Option 3 - Discounts

46. The option to provide discounts is already available, following community consultation, under the current legislation. Any directive to limit the flexibility of local decision-makers would reduce the flexibility to tailor provisions that suit local circumstances. Local authorities may not know the size and type of house being built at the subdivision stage.
47. The option of discounts based on house sizes has the real potential to create inequity that will lead to inefficient outcomes involving land use.

Option 4 – Purpose and principles

48. As stated earlier in this submission, funding decisions are already governed by section 101 of the Local Government Act 2002. If Option 2 clarified the provisions then alignment with the existing principles within the LGA 2002 on matters of consultation and governance would be required.
49. LGNZ would suggest that the consultation obligations and principles are adequate. We also note that certainty and good practice guidance are of value to both developer and councils alike.
50. LGNZ would support clarity around the reasons for development contributions within the Development Contributions Policy and would argue that this could be achieved through guidance and best practice examples.

Option 5 – Private provision

51. LGNZ recognises that developer agreements have happened outside Auckland. Section 200 is sufficient protection that if such agreements are entered into and services provided by a developer in lieu of council, then a local authority can waive or reduce the development liability accordingly.
52. LGNZ also recognise that there may be concerns regarding the ongoing maintenance and operation of infrastructure provided by a developer. The standards which local authorities

vest in their asset maintenance over the long term may not be the same as that of a developer.

53. The integrity of assets over the long term is something which local authorities take very seriously and in fact are audited against. The same rigour would need to apply to a private partner and it is unlikely that this would be their view over the long term life of an asset.
54. Options regarding creating other bodies to hold responsibility for the infrastructure assets would require a fairly complex set of relationships with the local authority in terms of audit and risk.
55. LGNZ recognises that in terms of limited infrastructure which is not complex or likely to have a high risk in terms of maintenance and renewal over a period of time would be suitable for a developer agreement approach.

Option 6 – Tighten the range of funding for infrastructure

56. LGNZ recognises that tightening the range of funding for infrastructure is increasing the risk for local authorities.
57. The options presented in the discussion document increase the level of risk exposure to a local authority because it reduces the "whole of system" view of an infrastructure network.
58. The proposal which limits the use of development contributions for reserves and community infrastructure does not recognise the type of development which currently exists in terms of new subdivisions which have features such as lakes and ponds with other amenities to service a community.
59. There is a recognition that growth areas and serviced subdivisions do create a demand for other community services such as sportsgrounds, libraries etc. However, we do recognise that these services are available to all residents in an area and generally it would be appropriate for the whole community to contribute. Within the LGA there is a requirement to consider who receives the benefit when applying a funding requirement as stated in a local authority's Revenue and Financing Policy.

Option 7 – Delayed charging

60. LGNZ is against this proposal in principle.
61. LGNZ recognises that this is presented as an option to assist the developer in terms of their cash flow and brings the timing closer to the completion of a sale. The problem with this option is that there may be a time lag of months and often years before the development is completed.
62. LGNZ has already stated in this submission the problems likely to arise in delaying the charging of development contributions.
63. In discussing the timing of development contributions it is important to realise that local authority infrastructure often needs to be put in advance of land being developed to ensure that health, environmental standards and customers expectations are met.
64. Developers would find it harder to sell subdivisions where large scale infrastructure was being retrofitted. Most house buyers nowadays expect "ready to go" serviced sites on which to build.
65. Providing infrastructure in advance of development can incentivise developers to proceed within a certain timeframe.

66. In order to provide the infrastructure the local authority may need to take out loans and incur the cost of servicing the debt. Delaying the payment of development contributions could increase the cost of interest repayments which the local authority would have to pay.

67. Although LGNZ is aware that there are local authorities that undertake variants of this approach, we submit that this is a policy decision for each local authority to make in their own area. It should not be a legislated mandate.

Option 8 – Capping development contributions

68. LGNZ would oppose the introduction of a cap on development contributions.

69. It is important to note that development contributions relate to the true cost of providing infrastructure. Therefore some areas are more expensive to service than others due to several factors such as hazards, geographical situation, topography etc.

70. Some standardisation may be beneficial where it improved understanding of how development contributions are calculated, however there still needs to be sufficient flexibility to allow for local needs and circumstances to be reflected.

71. LGNZ strongly advocates against capping because inevitably this will lead to developers not being charged the true cost of infrastructure and ratepayers having to bear the shortfall through rates.

72. LGNZ strongly oppose existing ratepayers subsidising the development community. Fairness and equity is an important principle to protect.

Option 9 – Independent dispute resolution

73. LGNZ questions the efficacy of moving the appellate process to the Environment Court.

74. In other recent government legislation considerations under the RMA reforms questions are being raised as to the efficacy of a hearings process.

75. LGNZ cannot therefore understand the logic of an argument which seeks to introduce further delays and bureaucracy to the development contributions process.

76. Currently a development contribution can be challenged in the High Court and overturned on a matter of law, or on administrative legal grounds where there has been a breach of process or proof of unreasonableness.

Option 10 – Reinstatement of appeals

77. LGNZ is opposed to any merit based appeals to development contributions or any funding and policy decision taken within the application of the Local Government Act.

78. If developers perceive they have recourse through the Environment Court then the situation could easily escalate in terms of volume and result in a costly process for all concerned.

79. There is sufficient case law to deter local authorities from not following the principles of a fair and equitable approach to development contributions. The *Neil*[3] case stands as a precedent where the analysis of fairness and equity is absent from a revenue and financing policy.

[3] Neil Construction Limited & Ors v North Shore City Council

Option 11 – Regulations to promote consistency

80. LGNZ supports the principle of consistency in any regulatory system but would highlight that local authorities need to have the ability to be flexible to meet local needs and respond appropriately to local circumstances.
81. LGNZ would promote consistency in principles and definitions but would question whether this needs to be delivered in the form of regulation.
82. The Productivity Commission[4] recently reported that:

    "There are gaps in the way regulations are made at the central level" and

    "Such gaps can lead to poorly designed regulation."

83. LGNZ believe that a hasty conclusion to rush towards regulation on the matter of development contributions would in fact result in a poorly designed response.

Option 12 – Percentage based infrastructure levy

84. LGNZ has not seen any evidence that this has been applied on a large scale.
85. There is a danger with a percentage based approach that the cost of providing the infrastructure will not be fully funded and in essence this breaks the rationale of demand driven payments and beneficiary pays.
86. If a council saw wider benefits in encouraging smaller dwelling units it could do this within the existing frameworks and consult with the community before adopting the approach. This is a far more robust and transparent process.

Option 13 – Removal of development contributions

87. The example referred to in the discussion document which shows 29 local authorities not using development contributions because they are smaller centres or centres with low growth would indicate that the current system is being used appropriately.
88. If development contributions were removed then this would place an unfair burden on existing ratepayers or a reversal back to financial contributions in the existing RMA process.
89. A reversal to financial contributions would result in higher costs due to the need to create changes through the District Plan.
90. There would be less flexibility with respect to who pays and when.
91. If the costs had to be covered by existing ratepayers then this would be contrary to Section 101 of the LGA 2002.

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[4] Productivity Commission Report – Towards Better Local Regulation (2012)

Option 14 – Bonds as an alternative funding mechanism

92. The option presented in the review discussion document suggests that local authorities borrow the funds to provide infrastructure then levy the principal plus interest against the owner's property in the development. It is unclear whether this would require the consent of the developer or the owner of the property. Property owners would then repay the loan, most likely through a targeted rate.

93. LGNZ would argue that the debt would be carried by the council, perhaps for a long period of time, and this ultimately would have an impact on rates paid by current ratepayers not future ratepayers. This is against the provision of beneficiary pays within most revenue and finance policies which comply with the LGA 2002.

94. LGNZ see this approach as an option and an additional financing tool but not as a replacement for development contributions.

Conclusions

95. LGNZ would emphasise that development contributions fund the growth in infrastructure that enables development to proceed. It is applied with considerable rigour and care under the requirements of the Local Government Act 2002.

96. LGNZ argues strongly that development contributions are not the principal cause of increasing house prices. At best they have only a minor, yet justifiable, impact on the cost of a house. The Government's figures themselves support this position. The Government should be focussing on the areas where the greatest gains are to be made. That is in the area of building and labour costs.

97. Following on from that point, LGNZ notes that the example given in the discussion document "Development Contributions Review" (page 21) states that development contributions on an average 145 square metre house in Auckland make up only 4% of the total cost. This is a comparatively small proportion of the total cost of a house build with the majority of the costs being land, materials and labour (85%).

98. LGNZ is unaware of any evidence that reducing development contributions would even reduce house prices or improve housing affordability. It is equally plausible to argue that the gain would be absorbed into a developer's margins. What is sure, however, is that infrastructure costs must be paid. If the causer of those costs does not pay, then the costs will be socialised through the rate base. This is patently inequitable and contrary to the Government's own incessant rhetoric that rate rises must be constrained.

99. LGNZ emphasises that changes to legislation that provide clarity and reduce ambiguity are to be welcomed but "one size fits all" approaches seldom work, as evidenced by the Productivity Commission's recent work.

100. LGNZ asserts that merit based challenges for specific development contributions undermine the methodology used to create a development contributions policy in line with the LGA 2002.

101. LGNZ stresses that there is an intrinsic link between development contributions, rates and the level of investment in providing infrastructure for growth. Any changes to one element in the financial mix will impact on the others.

102. LGNZ notes that the developer pays policy is based on beneficiary pays. Removing development contributions would shift the burden onto other sources of infrastructure funding including rates. The primary legislation in Better Local Government stressed the need to avoid substantial increases in rates and in fact this set of reforms will produce fiscal thresholds on rate increases.

103. LGNZ would emphasise that development contributions fund the growth in infrastructure that enables development to proceed. It is not applied without considerable rigour and analysis as is required by the LGA 2002 with revenue and financing policies.

Appendix 1

Schedule of recommended technical changes

Possible change	Recommendation
Clarify that the total cost of capital expenditure includes the net interest costs associated with council debt to provide infrastructure ahead of development.	Providing infrastructure for growth typically involves building 'lead' infrastructure and taking out debt which is repaid over time as development contributions are collected. Interest costs on this debt can be significant and need to be funded. The current approach of much of the local government sector is to include net interest costs in development contribution charges. This approach is subject to some legal uncertainty due to the current legislation not being clear on this matter. Nonetheless current practice is based on detailed legal and accounting advice. If these costs could not be included in development contribution charges they would become additional and unbudgeted rate funded costs. Interest costs included in development contributions would be restricted to interest on debt anticipated to be repaid through development contributions.
Clarification in legislation that development contribution charges for a particular asset or catchment can be adjusted in line with PPI or CPI.	This policy change would allow development contributions to be set in a manner that allows them to remain relatively constant in real terms over time. This is fair and equitable. Any legislative amendment would need to ensure that this was implemented in a manner that does not lead to development contribution revenue exceeding the "total cost of capital expenditure" i.e. development contribution charges must reduce in early years to compensate for higher charges in later years. Rather than using future projections of the PPI or CPI it may be better to take a long-term average and just apply this going forward to provide certainty to both Councils and developers given that inevitably councils would not be able to accurately predict inflation in the medium to long-term. For example a maximum 2% or 3% p.a. adjustment could be adopted. An alternative to the CPI or PPI would be to base the adjustment on historical household income growth rates which we understand to be around 3% p.a. This approach should insure that charges are keep in line with the populations' ability to pay.

Possible change	Recommendation
Clarify that, for the benefit of calculating development contributions, costs and benefits can include projects beyond the 10 year LTP horizon.	Development contributions are often set for individual catchments based around new suburbs. These new suburbs inevitably take more than 10 years to be fully developed – sometimes 20 or more years. As such it is sensible to allow both project costs and projected growth beyond the LTP period in the calculation of development contributions. If this can't occur there is the potential for growth within the LTP period to incur disproportionately high charges, or for contribution charges to change significantly over time within a particular catchment as projects come in and out of the calculations. It is reasonably easy to accurately identify the entire infrastructure required for the full development of a new suburb through the structure planning and infrastructure modelling processes that occur alongside the rezoning of land for urban development.
Amend definition of 'development" so that it conveys intent without referring to itself. Possible options could include referring to subdivision or building on land.	Suggest change the words "other development" in the definition with the words "land use".
Clarify that, for the purposes of s200, development contributions can still be required where rates are being used to partially fund capital expenditure works required to service growth.	Agree, but the problem doesn't just relate to rates funding but to any other funding source used for part of a project cost e.g. user fees, NZTA subsidies, targeted rates, grants etc. S200(c) needs to be rethought entirely.
Remove the word "the" from section 199(2) or replace the word "development" with "developments"	Agree. The word "another" in s199 (3) should also be replaced with the word "other" for the same reasons.
Clarify that projects beyond the 10 year timeframe of the LTP can be included in the calculation of development contributions provided the charges do not exceed the incremental costs of each new unit of demand.	Development contributions are often set for individual catchments based around new suburbs. These new suburbs inevitably take more than 10 years to be fully developed – sometimes 20 or more years. As such it is sensible to allow both project costs and projected growth beyond the LTP period in the calculation of development contributions. If this cannot occur there is the potential for growth within the LTP period to incur disproportionately high charges or for contribution charges to change significantly over time within a particular catchment as projects come in and out of the calculations. It is reasonably easy to accurately identify the entire infrastructure required for the full development of a new suburb through the structure planning and infrastructure modelling processes that occur alongside the rezoning of land for urban development.
Clarify that development contributions can be charged for building works retrospectively approved through a Certificate of Acceptance process.	If development contributions cannot be charged on Certificates of Acceptance there are incentives for people to undertake illegal building works (i.e. without a building consent) and then to retrospectively get these consented through the Certificate of Acceptance process which is

Possible change	Recommendation
	clearly, in our view, undesirable. Section 97(e) of the Building Act 2004 provides for the payment of any fees, charges or levies on a Certificate of Acceptance that would have been payable if a building consent had been obtained in the first place. Clarification could be added to the Building Act 2004 or in the LGA 2002 that this includes any development contributions that would have been charged.