15 February 2019

Local government funding and financing inquiry
New Zealand Productivity Commission
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Issues paper: Local government funding and financing

Meridian Energy is New Zealand's largest renewable electricity generator. We are also a major nationwide retailer. Collectively Meridian and our subsidiary Powershop supply electricity to over 298,000 customer connection points. Our hydro stations generate enough electricity to power around 1.4 million homes each year and our wind farms generate enough electricity to power around 152,000 homes each year. Listed on the New Zealand and Australian stock exchanges Meridian is 51% owned by the New Zealand Government.

Our generation assets are located in a range of different local government jurisdictions in the Waikato, Manawatu, Wellington, Canterbury and Southland and we have offices in Auckland, Wellington, Christchurch, Masterton (Powershop) and Twizel as well as at many of our generation sites. We are a significant local government rate payer.

Meridian has constructive relationships with the local authorities in the areas where we operate. Our generation assets are long-lived meaning that, in each area we operate, we are making at least a 50-year commitment to that community and to that area and typically longer. We take a strong interest in and commonly make submissions on the development of relevant local authority Long Term Plans and, because we value the relationships we have with the communities in which we operate, we want to ensure we contribute fully and fairly to the day to day functioning of the relevant local authorities and the services they provide to their communities.

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Against this background we are pleased the Government has asked the Productivity Commission to undertake an inquiry into local government funding and financing and, where shortcomings in the current system are identified, to examine options and approaches for improving the system.

Meridian considers this to be a worthwhile line of inquiry given the changing role of local government over the past decade. This Meridian submission is focused on:

- rates growth and the added impact of differential or targeted rates;
- the role of local government and potential for greater efficiency;
- systems of rating based on land value; and
- oversight and accountability for rating decisions.

Each of these matters are discussed further below.

Rates growth and the impact of differential or targeted rates

As noted by the Commission on page 21 of the issues paper, local authority operating and capital expenditure has grown significantly since 2000 – much faster than population growth and (as noted on page 27) faster than both GDP and the CPI. Similar tends are expected over the next decade, particularly for operating expenses.

The Commission has identified several of the key drivers behind these increases including:

- demographic changes;
- tourism;
- expansion of local government responsibilities;
- Treaty of Waitangi settlements;
- climate change and other natural hazards; and
- rising input prices – the Local Government Cost Index has risen faster than the CPI in the past decade.

These are all key drivers behind the increases. Alongside increases in the level of expenditure Meridian has also noticed significant shifting of costs between rate payers meaning that for Meridian the increase in costs referenced by the Commission has been significantly exacerbated by a shifting in allocation of costs towards businesses like ours typically achieved through targeted rates and/or differentials.

Meridian's national rates bill for our main generation sites[1] in the 2011/12 financial year was $2,252,782. By the 2017/2018 financial year this had grown to $4,205,916, a cumulative increase of 86% (compare this with the 28% average total rates increase across all councils over the same period[2]).

Part 6, Subpart 3 of the Local Government Act 2002 sets out requirements for the financial management of local authorities and at section 101(3) states that:

> *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 the activity contributes; and*
>
> *(ii) the distribution of the benefits between the community as a whole, and any identifiable part of the community, and individuals; and*
>
> *(iii) the period in or over which those benefits are expected to occur, and*
>
> *(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 cost and benefits, including consequences for transparency and accountability, of funding the activity distinctly from other activities; and*
>
> *(b) The overall impact of an allocation of liability for revenue needs on the community.*

Based on those legislative requirements and consistent with the principles of efficiency, equity and fairness identified at page 48 of the Commission's issues paper – when setting a targeted or differential rate, Meridian considers it best practice for the local authority to demonstrate that there is:

- a different level of service; or
- a different share of benefits; or
- the cost of providing the service to one group is different to the cost of providing that same service to others.

In our experience such differences are seldom demonstrated. As an example, Meridian's primary generating assets in the Wellington area are two windfarms at West Wind and Mill Creek. The wind turbines at these sites make up a very small footprint of land (1.5% of the total), with the majority used for agricultural purposes. Despite the small footprint the capital investment in the windfarms is significant. However, unlike other capital investments such

[1] Aviemore, Benmore, Manapouri, Ohau A, Ohau B, Ohau C, Waitaki, Mill Creek, Te Apiti, Te Uku, West Wind, and White Hill

[2] http://archive.stats.govt.nz/infoshare/Default.aspx

as offices, factories, or households, the windfarms do not create demands on council services:

- access to the site is limited and there is no contribution to congestion;
- there is no additional demand for, or benefit from, amenities provided by the Council to the community (in fact the demand and/or benefit would be substantially less than a comparable rural property); and
- the vast majority of the properties is used for farming, and given its zoning, cannot be used for other than rural purposes.

Despite the above, the Wellington City Council considered the wind farms to be separately rateable parts as evidenced by the division of the of the rateable units in two:

- a “wind farm portion” with no land area recorded against it; and
- a rural portion.

The wind farm portion of the rateable units were categorised as commercial rather than rural and a 2.8 times differential applied as a result. The combined effect of this distinction and high capital value assets can be seen in the table below, using Meridian’s 2015 rates as an example. As can be seen, the rates paid for the commercial portions far exceed those of the rural portions, despite no additional demand for, or benefit from, amenities provided by the Council.

Location	Land area	Rates (net GST)	Classification
Makara Road	5.7 ha	$937.20	Rural
Makara Road	724.0 ha	$12,856.16	Rural
Makara Road	260.0 ha	$130,678.02	Commercial
South Makara Road		$154,294.53	Commercial
Mill Creek		$96,434.00	Commercial
Total		**$395,199.91**	

Meridian challenged these rating decisions through judicial review proceedings in the High Court.[3] However, the Court found that the Wellington City Council was within its rights to divide the rateable units into the underlying rural land and the value of the wind farm improvements (with no land identified) and also within its rights to apply a differential commercial rate to the wind farm. The statutory power of a local authority to establish a differential rating scheme is expressed in very broad terms and review is challenging. However, we question whether from a policy perspective it is fair and efficient for local

[3] *Meridian Energy v Wellington City Council* [2017] NZHC 48, available at: http://img.scoop.co.nz/media/pdfs/1702/fileDecision.pdf

authorities to be able to apply such differential rates in the absence of additional demand for, or benefit from, amenities provided by the local authority.

According to the Commission, 40 territorial authorities set business differentials on general rates and the average business differential is 3.2, meaning that businesses pay over 3 times more in rates than households for an equivalent level of capital value.

Meridian is also subject to targeted rates in the Waitaki District, where we operate the Waitaki hydro scheme. The Waitaki District Council sets a targeted rate for the costs of lakes camping areas with 70% of the rates requirement recovered from "Hydroelectric Power Generation Installations" and the remaining 30% from the rest of the district's ratepayers. We question what additional benefits accrue to Meridian from the operation of lake camping areas.

We encourage the Commission to further investigate the comparative rates and rates increases between different groups of ratepayers and the justification (if any) for the differences. At times local Councils engaging in rate setting seem to be strongly influenced by redistributive goals and set rates according to who they perceive is able to pay more, rather than according to whether a ratepayer forms part of a clearly identified group in the community that is getting a different quality or level of public service that would justify it paying differential or targeted rates to reflect that difference. One potential option would be for central government to include a strict, objective test in the legislation which empowers the setting of differential or targeted rates, rather than merely a list of matters to consider.

The role of local government and potential for greater efficiency

An assessment of what is a reasonable level of rating should follow from a proper assessment of what are the appropriate functions and structures for local government. We understand that the Commission will not as part of this inquiry look at the scope of local government functions. However, the Commission could consider making some broader observations about efficiency and the duplication of services across local authorities.

Meridian considers there to be merit in further investigation of the number and scale of local authorities, duplication of costs across numerous local authorities, and whether local authorities have suitable scale and capacity to deliver on their functions. Having multiple councils results in multiple different regulators for planning and regulatory functions – this

duplicates costs for councils and increases the costs borne directly by ratepayers who must interact with multiple different councils within the same effective area of interest.

Central government seems willing to nationally standardise the regulations administered by local authorities, for example through greater use of National Policy Statements, National Environmental Standards, National Planning Standard, and the potential outcomes of the Three Waters Review. In this context, it would seem an oversight to not also carefully and objectively consider the structure of local government and the costs to duplicate electoral systems, councillors' salaries, ICT, legal, and management structures to perform the same functions. The Commission could consider whether the right balance has been struck in parts of New Zealand between efficiency and the need for local representation.

Systems of rating based on land value

Meridian supports the Commission's further analysis of rating systems based on capital value, annual value, or land value. The Commission notes that under the Local Government (Rating) Act 2002, councils can choose from the following as the basis on which they levy general rates:

- capital value, being the value of land and improvements;
- annual value, which is the greater of either the estimated gross yearly rental less 20% (or 10% if no buildings are on the land) or 5% of the property's capital value; or
- land value, which is essentially a locally applied land value tax.

In recent decades councils have favoured capital value rating. However, available evidence at a national level suggests that a system based on land values may be more progressive, and therefore more equitable, as well as encouraging land to flow to higher value uses and discouraging land banking. Meridian strongly supports these findings from the Commission and encourages further investigation of guidance and potentially direction to local government on the relative merits of land value rating. Switching to land value rating would involve administrative costs and might necessitate a transitional period to manage rating changes. However, we believe the long-term economic benefits would justify this change. Meridian and other electricity generators have high capital value assets on their land and therefore pay extraordinarily high rates, while consuming very little local government services. Rates bills are an input cost for electricity generation and ultimately capital value rates increase the cost of electricity for New Zealand consumers (with potential regressive impacts on those least able to afford electricity and additional costs on the use of electricity to decarbonise our wider economy).

As an example of the unusual incentives and outcomes created by a capital value-based rates system, in the Southland District Meridian owns and operates the Manapōuri hydro scheme and the White Hill Windfarm. Up until 2013, the Southland District Council acknowledged the high capital value of Meridian's assets against a significantly lower demand for the services provided by the Council and used a differential rate in favour of Meridian to recognise this disparity. This was consistent with the legislative intent discussed above, i.e. that local authorities give due consideration to the level of service provided, the benefits received, or the cost incurred in making rates decisions. The impact of the removal of this differential was a 60% increase in Meridian's rates between the 2012 and 2013 financial years. Meridian rates payments based on capital value do not bear any relationship to the costs incurred by Council as a result of our activities, nor in our view can they be considered a fair and reasonable contribution compared to other ratepayers in the Southland District. A land value-based system of rating would address this imbalance.

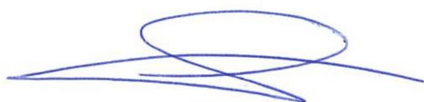
Oversight and accountability for rating decisions

There seems to us to be limited opportunity in the current system to challenge rating decisions. Long-Term Plans, as well as Annual Plans and Annual Reports must be provided to the Auditor General, who is responsible for financial and performance review of local authorities. The Local Government (Rating) Act 2002 also sets maximum revenues for certain types of rates. However, there is limited engagement in long-term planning processes and limited ability to challenge decisions. Meridian suggests that the Commission could usefully investigate:

- how other jurisdictions use restrictions, caps or other directions to local government and assess the merit of such approaches in the New Zealand context – for example, caps on business differentials or objective tests describing how differentials or targeted rates should be applied; and
- options for associated appeal rights in respect of long-term plans.

Please contact me if you have any questions regarding this submission.

Yours sincerely



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