Wellington Chamber of Commerce
Submission to the Wellington City Council on the Annual Plan 2019/20 Consultation Document

May 2019

Document Overview

Introduction

The Wellington Chamber of Commerce (the Chamber) welcomes the opportunity to make a submission to the Wellington City Council (WCC) on its Consultation Document on the Annual Plan 2019/20 ("the Annual Plan").

The Chamber has been the voice of business in the Wellington region for 163 years since 1856 and advocates policies that reflect the interests of the business community in the city and region and further the development of the region's economy as a whole. The Chamber advocates for the views of its members, obtained through regular surveys.

For the purposes of this submission, it is important to note that Wellington region businesses pay the highest share of rates in the country. Businesses pay 44 per cent of the total rates collected by Wellington City Council while taking up only around one-fifth of the total rateable property. Regionally, businesses pay around one-third of the rates collected by Greater Wellington Regional Council. Therefore, as the largest contributor to Wellington City's and the Wellington region's rate-take, and paying the highest proportion in the country, businesses have a real stake in what happens to rate money.

To this end, it should be noted that in May 2018 the Chamber put in an extensive submission[1] on the five areas highlighted by the WCC in their draft long-term plan (2 018-28), namely: Resilience and Environment, Housing and Community Wellbeing, Transport, Sustainable Growth, and Arts and Culture. It is not necessary to revisit the content of that submission again in respect to the five priority areas, but this submission particularly concentrates on rating policy (particularly rates differentials) as outlined on p.17 of the Annual Plan.

The Chamber would welcome the opportunity to discuss its submission with the WCC and requests to be heard orally.

Chamber position on changes to the 2018-2028 Long-Term Plan proposed by the 2019/2020 Annual Plan

With respect to the major changes proposed, those that alter the Council's previously adopted Long-term Plan, the Chamber hold the following views:

- ☒ We **oppose** the 3.9 per cent rates hike. At twice the rate of inflation, it is unjustifiably high to households and businesses.

- ☒ We **oppose** the increase to the business rates differential from 2.8 times to 3.25 times, which means <u>a triple increase in rates for business</u> – property values have increased, the general rate is proposed to increase, and the business multiplier calculation is proposed to increase. **It is of considerable concern to the Chamber that not only has the WCC reneged in their general support for removing rating differentials over time but has proposed that the general rates differential be adjusted from 2.8:1 (currently) to 3.25:1 (for 2019/20). We expand on this further, pages 11-12.**

- ☑ We **support** the changes to progress several significant capital projects proposed under the three waters work programme: Omaroro Reservoir, Moe-i-te-Ra Bell Road Reservoir, and the Kilbirnie storm water pump station. We also support increasing the Built Heritage Incentive and Resilience Fund, and the

[1] https://www.wecc.org.nz/__data/assets/pdf_file/0007/146392/17052018-Chamber-sub-to-WCC-on-Our-10-Year-Plan-Consultation-Document.pdf

changes to increase the budget to ensure resilience improvements for marine and coastal structures and the Oriental Bay Band Rotunda.

☑ We **support** in principle the increases to fees and user charges. We expand on this further, page 10-11.

☑ We **support** the changes to the six traffic resolutions. We have submitted separately on these resolutions as part of that consultative process. However, we note that much more must be done to address the Chamber's concerns about parking. Council needs to urgently undertake a stocktake of car parking and put in place a CBD-wide strategy.

☑ We **note** the information provided in the transport section about changes ahead, and look forward to any consultation required about funding changes to the LTP once the "Let's Get Wellington Moving" programme is announced. This must be announced and agreed to with urgency.

☒ We must **record** our serious disappointment that the same cannot be said for the Petone-Grenada link road, despite being referenced as a future project in the draft annual plan documentation. We strongly urge the Mayor and Councillors to continue to make representations to NZTA and the Minister, as Wellington needs this transport project. Government must explain its lack of commitment to fixing the Wellington region's transport congestion issues, including the recent decisions made for the Melling Interchange project. Business is seriously concerned about this Government's priorities on transport across the region, and that includes the ongoing delays to the Let's Get Wellington Moving project.

? We still have **strong reservations** about the costs involved in the earthquake strengthening of two key heritage venues, the St James Theatre and the Town Hall. We note that the St James Theatre costs have now doubled, from $14.9 million in last year's LTP to the proposed figure of $31.3 million. Add to this that the Town Hall costs have grown to $112.4 million from an original $46 million – combined, that is a similar amount to what the City would have contributed to extend Wellington's runway. The Chamber would ask, is it buying the City the return it needs? Council needs to decide exactly where the Town Hall fits into its venues strategy, alongside the Michael Fowler Centre, the St James, and the new convention centre. What's going to be the full use and what's the business case stacked alongside the other venues? Clarity around that will help determine the return on investment and the Town Hall's value to the city. We live in an earthquake zone and we can't preserve everything. We have to make hard choices, and this is one of them. The public purse stretches only so far. We can't keep increasing rates forever. The Council must reconsider recycling of assets to fund new construction.

☑ We **support** in principle the changes to rates remission, to provide remission of targeted rates on property under development or earthquake-strengthening. We have provided further comments below in the next section.

☑ We **recommend** that Council look at alternative funding methods and mechanisms, through asset recycling, ground leases, and other options outlined in our submission - rather than increasing the business differential in this unfair and disproportionate manner.

Funding Policy

Local government has a vital role to play in advancing the overall well-being of New Zealanders. However, that role is not all-encompassing but needs to be established on a principled basis and properly circumscribed.

The Chamber considers it desirable for local government to focus on the provision of local public goods, since the likelihood is their provision will otherwise be inadequate. There is little incentive for the private sector to provide goods and services where the return on investment is likely to be low or in the worst case, non-existent.
While rates will likely be the cornerstone of local government funding for some time, they will need to be complemented and possibly eventually displaced by other revenue sources. This is to ensure they better reflect the needs and costs of communities, noting that pricing mechanisms and availability of real-time data are improving by the day.

The Chamber has actively supported the concept of a Productivity Commission inquiry into the costs and revenue base of local government, given the pressures the sector is currently experiencing. This is true of both high-growth and low-populated areas, with, in the latter case, infrastructure upgrades needed, although ratepayers' ability to pay is squeezed.

There are strong perceptions that local government is not as efficient and effective as it should be. This is reflected in Local Government New Zealand's own research which shows that *'local government does not have a strong reputation with business and the public*[2].

[2] Local Government NZ, *Building a Stronger Local Government for New Zealand – a survey of New Zealanders' perceptions of local government 2015*.

While individuals, businesses, business organisations and ratepayer representatives all have different views on local government, one common thread is a concern over the increasing rates burden. The aggregate rates burden is running at close to twice the rate of inflation with in some cases significant associated inequities. This is essentially a nationwide issue, although the problem is greater with some councils than others.[3]

The business sector pays about half the country's rates bill and the level of rates paid is often disproportionate to the level of services received. The situation is exacerbated by the widespread use of business/commercial rating differentials despite strong evidence supporting their removal. Where councils have agreed to reduce the differentials, they have often been tardy in doing so, tending to incremental change due to 'expenditure pressures'.

There are numerous examples of rating differentials and targeted rates imposed with little evidence of rigorous, objective analysis, particularly of access to service and benefits derived. A particularly egregious example is Greater Wellington Regional Council's (GWRC) targeted rate for public transport where Wellington CBD business are considered the primary beneficiaries (rather than commuters) and a 7.5 to 1 differential imposed in 2018 on those businesses.

The Chamber supports moves by the WCC to support greater use of user-pays principles as outlined in the Consultation Document. Nevertheless, we do have some concerns with the appropriate use of user-charges which is outlined below. Also, we believe that the justification for some of rating policies proposed by the WCC are invalid to say the least (particularly in respect to rates differentials as outlined below).

The Chamber believes that WCC should receive better guidance on the use of available funding tools to ensure greater consistency with other councils across the country, underpinned by an economically principled approach to funding council activities.

There should also be greater clarity in distinguishing among the following:

Appropriate pricing and user charges for local authority services. Charging for the use of private goods and services would bring greater efficiencies. For example, while some councils charge for water and waste on a user-pays basis, many still fund

[3] It is noted that a publication by the Controller and Auditor-General 'Local government: Results of the 2013/14 audits' (February 2015) had the following to say on rating practices. '*In our report last year, we highlighted some rating practices that did not comply with statutory requirements. Some local authorities justified these practices as being pragmatic. We stated our view that a pragmatic approach was an unacceptable risk, particularly given that the power to set rates is a power to tax people for services provided. Rating practices needed to improve.' (p.5)*

such activities out of general rates, sending strictly limited signals to consumers as to the real costs associated with their behaviour.

Taxes imposed on a subset of a local authority's ratepayers to fund local public goods of clear benefit to subset members. 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.

An appropriate tax to fund local public goods of benefit to all residents. The administrative costs of council operations could fall into this category, along with other public goods such as footpaths and street lighting.

Charges justified as internalising external costs imposed on people or firms. For example, these could include emission charges.

Councils should not be in the business of income redistribution. Unlike central government (with the information it has through income tax), local authorities have no information on residents' incomes so any decisions made to assist people in this regard will inevitably be flawed. If central government wishes to provide relief through a rates rebate scheme, then this should be administered centrally through Work and Income rather than by councils.

While the motivation for a rates rebate scheme is clearly understood, the wider business community is generally concerned the scheme can be only a short-term stop-gap measure. It would not effectively address the real issue: protecting people from an ever-growing rates burden.

Clearly, the focus needs to shift to ensuring local authorities constrain their rate rises by focusing on their core business, having activities funded by those who benefit from them, and providing ratepayers with transparent information.

In respect to rates remission and postponement notices, it is understood that while most local authorities offer some kind of rates postponement options, the number of ratepayers currently postponing their rates is low.

While conceptually the Chamber is not opposed to the use of rates postponement options, we question the need for activity of this sort to be undertaken by local authorities rather than by the private sector through reverse mortgages and the like. Increasingly, the private sector is providing this type of arrangement for those who are effectively asset rich but income poor as a means of ensuring people can continue to live in their family home while being aware the payments are a debt against their property or assets.

However, as indicated above, **the Chamber believes that the WCC's proposal to provide remission of targeted rates on property under development or earthquake-strengthening makes good sense**. We see sense in the policy objective to provide rates relief for property temporarily not fit for purpose due to the property undergoing development or earthquake strengthening. We believe this will support and incentivise, or at the very least provide fairness to, building owners for getting on with this work.

The Chamber sees some merit in the greater use of relatively new financial instruments such as reverse mortgages or home equity conversions as a way of enabling people on lower incomes, but with an asset base, to deal with the many cost pressures affecting them.

However, given a noticeable reluctance to adopt reverse mortgages (for a number of reasons), it might be desirable to market these to the general public as mechanisms for shifting expenditure and revenue streams over time. But apart from providing general advice to ratepayers, the Chamber does not see this as a core role for councils; councils should not become involved in the process of setting up reverse mortgages and the like. Private sector institutions, mainly banks, are in a better position to market and manage such instruments.

Whether more people will seek rates postponement will depend on several factors, including ratepayers' current and future income and assets, the cost of delaying payment as opposed to up-front pay-as-you-go, household responsiveness to risk, financial literacy, and the threshold criteria for postponements. It is quite likely, given the competitive nature of financial markets, that new and innovative products capable of meeting consumers' needs will come on to the market in due course. Therefore, it is possible that in time many more people will look to different payment options, depending on their particular circumstances.

The Chamber supports much greater use of user-charges where practicable. There is scope for increasing, if not completely removing, the 30 percent cap on the Uniform Annual General Charge (UAGC). It is noted that use of the UAGC varies widely across the country, with some councils utilising it to the full 30 percent provided for and others not using it at all.

Greater use of user charges for most service provision might lessen current concerns about the UAGC. Some councils do not fully use the existing cap, sending distorted signals to ratepayers about the costs associated with the provision of services to, and the benefits received by, individual households.

User-charges and recovery of costs

While the Chamber is generally supportive of the greater use of user charges by the WCC as outlined above, the Chamber does have some concerns in respect to how they are used.

First, the potential for such charges to be exorbitant, and second, for funds to be diverted for unrelated purposes.

While the WCC's move towards greater use of user-charges should incentivise individuals and households to better understand the costs and benefits of particular services, more could be done to bring other services, such as water use, into this ambit.

A number of councils have introduced volumetric charging for water use and smart meters for electricity. This has had a significant impact, allowing for significant cost savings by delaying infrastructure upgrades and the need for new expanded infrastructure.

The effectiveness of councils in using new technologies to manage infrastructure assets has, however, varied; some have been proactive, while others have succumbed to political pressure and largely retained the status quo in respect to pricing and asset management.

A rigorous approach to user-pays funding first requires the nature of the services to be determined. If the services in question can be defined as public goods (which include non-rivalry in consumption and non-excludability), they are generally best funded out of general taxation. With private goods (where the benefits and costs are largely of a private nature, with few externalities or spillovers), clearly the cost should be funded as much as possible by means of user charges. Individuals and businesses will then be encouraged to undertake effective and efficient risk minimisation strategies based on known risks.

A significant issue which cuts across all local government services/regulatory enforcement is in defining an appropriate charging/levy regime where there is no contestability in service provision. In normal competitive markets, individuals will make trade-offs between price and quality of service, along with a host of other factors.

Where an agency (in this case the WCC) seeks to recover some or all of the costs of service/regulatory provision from the users or direct beneficiaries of that service, those people need to be assured that the charges set are not excessive in relation to the costs incurred and take proper account of efficiency and equity considerations.

The danger with what is effectively monopoly rights in services provision (and guaranteed funding) appear to be four-fold.

First is the concern that the price of service set by the WCC will exceed the price had the provision of service been contestable.

The second is the potential for the WCC to provide a substandard service in the knowledge that there are effectively no other competitors in the market.

The third (the corollary of the second, and more likely), is the potential for the WCC to provide a "gold-plated" service in the knowledge that any increased costs can be simply passed on to private sector businesses and households through user-charges.

The fourth is the risk that user-charges will be excessive and potentially used to fund "feel good" projects unrelated to the provision of the services where user-charges apply.

In respect to the last point, it is important that where practicable, user-charges should be ringfenced in respect to the goods or services being supplied and not used for unrelated purposes.

This is similar in respect to what should apply in respect to provision for depreciation of assets.

Assets often have a long-term life, and upgrading and renewing them can involve lumpy investments over time. It may in some cases be appropriate for the amount spent on renewing assets to be either low or high depending on particular time frames, population pressures and the like.

In general, it is important to account for depreciation so that the real costs associated with investments are transparent to asset users over time. However, it may also be appropriate to modify depreciation levels depending on the costs associated with asset upgrades e.g. if the cost of new and innovative products is lower and/or if a new product will last longer than the original infrastructure. Other factors also need to be considered when determining depreciation levels. For example, public perceptions of what is an acceptable level of service might change or government (through legislation) might require higher (or possibly lower) standards than are currently in force, requiring a change in local government asset plans.

Given the above, it is suggested that where possible, local decisions should be made by the people most affected by them who have to pay the associated costs. Currently, many decisions are unduly foisted on local government without the provision of adequate compensation. A number of examples can be identified such as drinking water standards and mandatory earthquake strengthening requirements. In many cases these changes have significantly affected local councils' ability to fund upgrades.

Further, unless there are extraordinary reasons for not doing so, all depreciation associated with particular asset classes should be ring-fenced to prevent its inappropriate use for unrelated purposes. Transparent reporting of depreciation is also essential to prevent the risk of funds being improperly used. The Chamber considers that councils should be required to adopt consistent reporting practices in respect to both depreciation and wider reporting of financial management of assets in general.

Generally speaking**, the Chamber supports the proposed increases to fee and user charges**, for the principled reasons outlined above. We have made a more substantive submission on the six traffic resolutions that are being consulted on as part of this process.

Deficiencies in the Proposed WCC Differential Rating Policy

The Chamber notes the rates increase for 2019/20 is projected to be 3.9 per cent.

Although the Wellington business sector pays just under half of the city's rates bill and regionally businesses pay around a third of the region's rates bill, this level of rates is often entirely disproportionate to the level of services received. The situation is exacerbated by the generally wide use of business/commercial rating differentials despite strong evidence supporting their removal. Where in the past, WCC has agreed to reduce such differentials, it has often been tardy in doing so, tending towards incremental change due to "expenditure pressures".

The business differential set by the WCC is currently 2.8:1, meaning businesses are paying almost 3 times more in rates than households for the equivalent level of capital value. This differential is one of the highest in New Zealand.

Wellington CBD has higher rates for commercial properties than both Auckland and Christchurch. As the Property Council's 2018 Operating Expenses Benchmark shows below that Wellington's rates are 32% more than Auckland and 39% more than Christchurch.

Table 1. Median cost summary of fixed charges (rates and insurance) [4]

Cost Item	Median Cost Summary ($/m² p.a.)				
	Wellington CBD	**Auckland CBD**	**Auckland Non-CBD**	**All Christchurch**	**All NZ Office**
Fixed Charges Rates Insurance	48.35 17.86	36.61 5.86	22.04 4.56	34.63 15.12	34.51 7.10
Total Fixed Charges	**66.53**	**42.40**	**27.00**	**51.85**	**43.17**

This is further evidenced by research conducted by JLL[5], that we have brought to the attention of Council before, which shows that commercial rates in Wellington are considerably higher than Auckland. For example, a commercial property valued at $2 million would pay rates on average $26,000 in Auckland, $16,500 in Hamilton and $32,000 in Wellington. The increase in rates differential will only make the current situation worse.

As the Property Council submission notes, Businesses are paying about 14 per cent of their rental incomes in rates which is ultimately passed onto tenants. However, residents, are paying only about 2.8 per cent of their income on rates. This is inherently unfair and disproportionally burdens the commercial sector.

The rates differential sees the commercial sector pay 23 per cent more than its share of the capital value. Commercial makes up just 19% of capital value, yet pays 44% of the total rates. This means the commercial sector is paying a much greater share of rates than its share of capital value and creates an imbalance with residential properties.

It is therefore of considerable concern to the Chamber that not only has the WCC reneged in its general support for removing rating differentials over time but it has proposed that the general rates differential be adjusted from 2.8:1 (currently) to 3.25:1 (for 2019/20). Council, nor anywhere in the Annual Plan, demonstrates what benefits, if any, there are to the commercial sector.

[4] Source: Property Council Submission on Wellington City Council Annual Plan 2019-20
[5] JLL, *Property Council NZ Rates Research*, December 2015

The rationale given on p.17 of the Annual Plan 2019/20 for proposing changing the differential from 2.8:1 to 3.25:1 defies logic:

"It is proposed that the general rates differential be adjusted from 2.8:1 to 3.25:1 to ensure the rates for 2019/20 continue to be paid in the same proportion by each differential rating category.

"In simple terms, this currently means that commercial property owners contribute 44 percent of total rates revenue in 2018/19 in comparison to 'Base' contributing 56 percent. Due to the change in the relative Rateable Values (which does not necessarily change the relative ability to pay) changing the general rate differential to 3.25:1 will maintain this ratio at 44 percent 'Commercial' to 56 percent 'Base'."

Rates collected from rates differentials need to show direct benefits to businesses. The additional rates that businesses pay through rates differentials should be separated and specifically allocated to projects that support the commercial sector. The Council does not provide information as to where the differential is spent. This results in a lack of confidence and transparency for businesses and the commercial property sector that the additional rates they pay will be spent on projects that benefit economic growth of the city.

We have long been on the record that rating differential and targeted rates should reflect the benefits received and should not be unfairly applied to businesses as a loose and general revenue-raising mechanism. We believe further information could be provided to explain the methodology behind targeted rates, namely, a description of how targeted rates benefit the specific targeted group. We acknowledge the principle that targeted rates should apply to those who will receive the most benefit, however, at times it is unclear how it has been determined that the targeted group is the most benefited party.

Differential and targeted rating should be permitted only 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 services. There should be an objective test in respect to benefits received to ensure consistency of approach. However, in general, rates differentials, if used at all, should be used sparingly and not, as some councils have done, as a general revenue-raising device on unprincipled and unsubstantiated grounds.

Sometimes business-sector differential rating is justified on the spurious argument that the sector benefits proportionally 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, and not on any principled economic basis. Where councils have agreed to reduce such differentials, the reduction has generally occurred at a snail's pace, councils being mindful of not upsetting residential ratepayers who enjoy the advantages of a lower rates burden courtesy of the business sector.

In the past, and to a certain extent still today, some have argued 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 rates. Reputable economists have discredited these claims 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, a GST-registered person or firm can claim a credit for GST paid on inputs because supplies (outputs) are subject to GST. But the net GST collected is paid to Inland Revenue so there is no advantage for businesses.

We wish to support the submission made by the Wellington branch of the Property Council that recommends the following:

- Defer the decision to increase the business rates differential until after the release of the Productivity Commission report into local government funding and financing in November 2019.
- Begin reducing the business rates differential in future years with the ultimate aim that it be phased out.
- Look at alternative funding methods such as targeted rates, public-private partnerships (PPPs), toll roads, the Government's regional development fund.

An alternative to increasing rates

To move the region forward, the Council is looking to improve on the city's assets by building a convention centre and movie museum, an indoor events arena, and to fix the Town Hall and the St James theatre. And all for good reasons. But increasing rates, increasing the business differential and borrowing for these projects is not the best or only option. It is the strong view of the Chamber that Council must reconsider recycling some assets, including review of ground leases, to fund new construction.

The Council's 34 per cent shareholding in Wellington International Airport is one very good example. Last year investment services company Forsyth Barr valued the airport's total shares at $1.1 billion, meaning the council's holding is worth about

$375 million on market value. As a minority shareholder, there is not a lot of influence the council can exert when it comes to making the assets pay. Last year it received just $12.1 million in dividends. The airport company retained most of its earnings for reinvestment.

There's a further question: could that 34 per cent be worth more than $375 million? Forsyth Barr says that in the event of an airport sale, a multiple in the order of 20 times operating earnings would not be out of the question. Using the airport's operating earnings of $90 million and deducting the $400 million or so of debt would value the airport company's total shares at around $1.4 billion. The city's 34% share would return the city around $475 million.

There will be those who say selling an asset that has provided up to $12 million a year of income would be foolish. But selling and paying-down debt from the proceeds would enable the council to make huge savings in loan servicing.
The council is tasked with spending and investing ratepayer money in the most efficient way it can. As ratepayers and business owners, we're advised to pay off our mortgages and debt first, and councils should be no different. Wellington Council should be taking a balanced view and maximising the asset base, including recycling assets and ground leases to achieve the best outcome for all ratepayers.

We also support the Property Council's alternative funding suggestions. Mechanisms such as the targeted rates are more appropriate ways of collecting and rating, for the reasons we have outlined above. Other alternative funding mechanisms include Public-private partnerships (PPPs), toll roads, the Government's regional development fund and potential new funding solutions in the future that the Government is investigating.

Conclusion

Because businesses are a large contributor to Wellington City's and Wellington region's rate-take, businesses have a real stake in what happens with that money. The Chamber would welcome the opportunity to discuss our submission with the Council. In the meantime, we would urge it to revisit its proposal to substantially increase the rates differential for businesses. As this submission has emphasised, the justification for increasing the differential is weak and the logic outlined in the Discussion Document is deficient and defies good funding principles. It should be revisited before the final plan is adopted. If anything, the WCC should be progressively reducing the rating differential over time, as previously promised.