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Revenue Streams Health Check

1. Introduction

This purpose of this report to the Kaikōura District Council (the Council) is to consider existing funding options against the following criteria:

- Current good practice in the principles of the Local Government Act 2002
- Appropriate allocation of benefits (including issues of equity and fairness) between residential, business and rural properties
- Maximum use of fees and charges including the use of financial and development contributions
- The use of debt including borrowing from LGFA.
- Efficiency of collection
- Suitability of the funding for Kaikōura District

2. Key findings

Following the 16 November 2016 earthquake, the focus of the Council has changed since the Revenue & financing policy was developed. In addition, the Council should consider the future direction of the district. This should include considering the impact on the district from tourism, growth and development. Currently the Revenue & financing policy does not specifically consider the effects of tourism, growth and development.

As a first step Council must identify costs associated with tourism, growth and development as well as business as usual. Then knowing the costs, consider the allocation of benefits (including issues of equity and fairness) between residential, business and rural properties.

The Council is dependant on rates as its primary income source as based on the financial model developed for the Three year plan. The average of rates to total revenue for years 3 to 10 is approximately 70%. In addition, while the rates levied by the Council are relatively low compared with other territorial authorities, as demonstrated in the Three year plan consultation process, there is little community appetite for significant rates increases in the future.

Therefore the Council needs to ensure the following:

(i) That the Revenue & financing policy is reviewed to comply with the requirements of the Local Government Act 2002 and to ensure the current rates are appropriate and consistent with the policy. This should include the impact and rationale of the Uniform Annual General Charge.

(ii) That the fees and charges for the following activities are reviewed to ensure the Council receives the appropriate level of income and are consistent with the Revenue & financing policy:
   - Airport activity
   - Building control
   - Dog Control
   - Harbour activities
   - Resource consents

(iii) That it reviews its Development contribution policy to ensure legal compliance and considers the use of Financial contributions.

(iv) That the Council considers its debt levels and joining the Local Government Funding Agency.

3. Assessment of robustness of benefit assessment, equity and fairness matters between residential, rural and business shares

All local authorities are required to have a Revenue & financing policy which complies with sections 103 and 101(3) of the Local Government Act 2002 (LGA). While it is not a requirement to allocate benefits between residential, rural and business shares, the Council does acknowledge that the rural areas receive less benefit for some activities and therefore has applied a differential to a number of capital value rates to rural properties.

Council's Revenue & financing policy does ***not*** allocate any additional benefit to any group of ratepayers, other than for activities where it can identify users, and then it uses either fees & charges, or applies targeted rates. It has applied a commercial rate to all commercial activities including accommodation providers for specific expenditure. The Council through its Revenue & financing policy has identified activities where there are parts of the community, individuals or identifiable groups that receive a different benefit than the whole of the district, however the actual funding that has been used in the 2018/19 Three year plan is different. This is discussed below in section 4.

Section 101(3)(b) LGA requires the Council to consider the overall impact of any allocation of liability for revenue needs on the community. The Revenue & financing policy does not comply with this requirement.

Following the 16 November 2016 earthquake, the focus of the Council has changed since the Revenue & financing policy was developed. In addition, the Council should consider the future direction of the district. This should include considering the impact on the district from tourism, growth and development.

The table below reflects the number of rating and capital values in each of the categories used by the Council against the rates levied on an allocation basis.

Rating category	SUIPs		Capital Values			
	No	%	Value	%	Rates	%
Urban	1948	61.1%	688,363,351	46.3%	2,728,513	57.3%
Semi Rural	708	22.2%	412,025,702	27.7%	1,086,213	22.8%
Rural	518	16.3%	348,194,352	23.4%	875,893	18.4%
Utility	12	0.4%	37,299,000	2.5%	72,544	1.5%
	3186		1,485,882,405		**$ 4,763,163**	
Commercial included within urban	243	7.6%	155,489,501	10.5%	883,517	18.5%

The detail of all rates is set out in appendix 1

Recommendation

That the Council reviews its Revenue & financing policy to ensure there is a clear rationale for the funding tools it proposes to use.

4. The use of various rating tools, such as UAGC, target rating, General rate in the $.

The Council uses a number of rates to recover expenditure. Including capital value, differential capital value and an extensive number of targeted rates based on activity, location, use and ability to connect to Council services. These are listed in appendix 2.

General rates

The Council uses capital values and a Uniform Annual General Charge (UAGC) to allocate the General rate using a differential of 0.9 for rural properties. Council does acknowledge that the rural areas receive less benefit from some activities and therefore has applied a General rate differential to those properties. Unlike some other local authorities, the Council does not have a differential for commercial properties.

General Rate is used to fund the general operations of Council, including general management, community services, communications, strategy & policy, economic development, environmental planning, the net costs of statutory planning, building control, dog control, community facilities, general parks and reserves, the airport, and a portion of public toilets and traffic control.

As noted above there are some inconsistencies between the Revenue & financing policy and the rates set. The Revenue & financing policy states the following:

Airport activity	100% individuals or identifiable groups benefit, and the commercial sector benefits the most from the provision of airport facilities. The 2018/19 rate requirement is $99k with current operational costs of $217K.

Building control	80% individuals on a user pays basis, 20% community as a whole, on a property basis. Building consents are fully funded by the applicant. The 2019/20 rate requirement is $231k with current operational costs of $520K.
Dog control	80% individuals (dog and stock owners), 20% community as a whole (protection from wandering dogs and stock). The 2019/20 rate requirement is $68k with current operational costs of $100K.

Recommendation

That these activities need to be assessed to identify potential income (i.e. additional fees & charges) to ensure consistency with the Revenue & financing policy.

Uniform Annual General Charge (UAGC)

Generally, there are two methods of setting the value of the UAGC. The first is applying a fixed amount which a Council believes is appropriate considering the impact or incidences of rating. A Council using this approach often considers section 101(3)(b) LGA for the overall impact of any allocation of liability for revenue needs on the community.

The second method is to allocate by each activity a percentage of the rate requirement to the UAGC. This is the current approach by the Council which is used to fund the general operations of Council, including landfill and recycling operations, governance, library services, sports fields, playgrounds, cemetery, walkways, public halls, swimming pool, general environmental health and civil defence preparedness.

A further refinement is the consideration when setting the UAGC based on either a fixed amount per rating unit; or a fixed amount per separately used or inhabited part of a rating unit (SUIP). Council is currently using a SUIP.

Council's current fixed rate percentage is 29% of a maximum of 30%[1]. This high value increases the rates to low value properties and decreases the rates to high value properties. The reasons for this are not clear in the Revenue & financing policy.

Targeted rates

As noted above there are an extensive number of targeted rates and these include rates that over the all the district or may have a high public good benefit which is often recovered using the general rate in other local authorities. This rates are:

- Roading Rate $699,028
- Footpath & Streetlights Rate $241,097
- District Planning Rate $267,780
- Town Centre Rates $100,649

[1] As limited by section 21 Local Government (Rating) Act 2002

- Civic Centre Charge $179,022
- Earthquake Rate $171,219
- Earthquake Levy $118,604
- Harbour Rate $72,689
- Commercial rate including accommodation rate $417,268
- Public Rubbish Bin Charge $32,000
- Registered Premises Charge $36,636
- Stock Control Rate $25,414

These rates are discussed further below.

Like other rural or provincial local authorities, the Council has targeted rates based on either location or ability to connect to Councils service. These rates include:

- Stormwater Rate $133,010
- Kerbside Recycling Charge $133,010
- Rural Recycling Charge $36,000
- Sewer differential rates $684,384
- Water differential rates $1,056,582

a) Roading rate and Footpath & Streetlights rates

The Roading rate is set using capital values, while the Footpath & Streetlights rates are set using differential capital values of 1.0 for all urban properties (including commercial) 0.5 for semi-rural and 0.2 for rural. Based on average values, the average commercial property would expect to pay approximately 30% more than the average district property for the Roading rate and approximately 16% more than the average urban property for the Footpath & Streetlights rates. However semi-rural properties would pay 22% less and rural would pay 64% less than the average urban property for the Footpath & Streetlights rates.

The estimated contribution for the commercial properties is approximately 10% of both rates. Compared with analysis undertaken for other local authorities, I would have expected a greater contribution as the demand for service from commercial properties is generally significant higher than urban and rural properties.

b) District Planning Rate

The District Planning Rate is set using capital values across all rateable properties within the District and is consistent with allocation of public good. There needs to be a separate targeted rate, and not included within the General rate because the General rate is set using differential capital values. However, like some other activities within the General rate there are some inconsistencies between the Revenue & financing policy and the rate set.

Resource consents (Statutory planning)	80% individuals on a user pays basis, 20% community as a whole, on a property basis. The 2019/20 rate

requirement is $125k with current operational costs of $235K.

c) Town Centre Rates

The Town Centre rates are set using differential capital values of 1.0 for all urban properties (including commercial) 0.5 for semi-rural and 0.3 for rural. Based on average values, the average commercial property would expect to pay approximately 21% more than the average urban property, but because of the low dollar value to be recovered this is approximately only $7. However semi-rural properties would pay 22% less and rural would pay 55% less the than average urban property.

I would have expected a greater contribution as the demand for service from commercial properties is higher than non-commercial properties.

d) Earthquake Rate, Civic Centre Charge and Earthquake Levy

The Earthquake levy and Civic Centre charge are recovered from all rateable properties within the District based on a fixed amount, apart from a transparent rationale both these rates could be included with the UAGC as the impact of the rates remains the same. However the Earthquake rate is set using capital values across all rateable properties within the District and is consistent with allocation of public good. The reasons for these rates to be set using fixed amounts and capital values needs more rationale within the Council's Revenue & financing policy.

e) Harbour Rates and Commercial rate including accommodation rate

The amount required from rates for the Harbour activity is $145,277 and this is recovered 50% from the Harbour rates and 50% from the Commercial rate.

The Harbour rates are set using differential capital values of 1.0 for all urban properties (including commercial) 0.5 for semi-rural and 0.3 for rural. Based on average values, the average commercial property would expect to pay approximately 21% more than the average urban property, but because of the low dollar value to be recovered this is approximately only $7. However semi-rural properties would pay 22% less and rural would pay 55% less the average urban property.

The Revenue & financing policy states the following:

Harbour activities:	35% community as a whole, on a property basis, 65% individuals and operators, on a user pays basis benefit and commercial operators have the most need for this activity, and the greatest demand on the level of service

Tourism & development	100%	commercial premises, but individuals to benefit from employment and economic development
Economic development	80% community as a whole, 20% commercial sector.	

The Commercial rates recovers the following:

- Visitor Centre $10,000 (100% of grant)
- Harbour $72,689 (50% of rates required)
- Public Toilets $42,368 (30% of rates required)
- Traffic Control $5,863 (50% of net costs)
- Economic Development $95,117 (60% of costs)
- Tourism & Marketing $191,232 (100% of costs)

The Commercial rate is recovered from all properties in the District which are used principally or exclusively for commercial and/or industrial purposes using Capital values and amounts to $353,610 or an average of $1,455 per property. The amount recovered from all rateable properties providing accommodation for commercial reward using a fixed value per SUIP, but not meeting the criteria of a commercial property is $63,052 or an average of $347.83 per SUIP. However, depending on the number of SUIPs per property, the total rate could be more than a typical commercial property. This is a potential issue that needs further investigation.

Council also needs to reassess the benefit analysis for the Harbour activity to ensure the level of fees and charges including lease income as the Harbour is providing significant benefit to the commercial operators.

f) Public Rubbish Bin Charge, Registered Premises Charge and Stock Control Rate

These are low value rates and are likely to be appropriate for the Council.

In my opinion the Council as a priority needs to consider the benefit of the activities of Council and validate the reason for the associated rates and the groups of ratepayers who are paying those rates.

5. Fees and Charges

Council has fees and charges income from both property and services provided to individuals. Lease income is considered in the report on Strategic review of assets and investments.

As noted above the Airport, Building, Dog control, Harbour activities and Resource consents fees & charges need to be reassessed to ensure that the users are making the appropriate contribution. If the fees are increased to the levels stated in Revenue & financing policy, together with a move to cost recovery from the Harbour, then the combination of increase in fees and charges will make a significant contribution to Council's overall income.

6. The use of Capital funding mechanisms

a. Development contributions

While the Council is currently focusing on rebuilding damaged infrastructure, it is likely the need to fund growth expenditure will become a focus in the future. While development contributions are the current tool to recover the cost of growth, these contributions can only recover a share of the capital expenditure that the Council has incurred. This will limit the amount that can be recovered. The current Development contributions policy appears to have been developed in 2015 and needs to be updated.

While it was the policy of the previous Government to remove Financial contributions, the current Government has signalled that a bill will be introduced in 2019 reinstating the provisions to the Resource Management Act (RMA). The purpose of Financial contributions is to mitigate the impact of growth through a financial payment. The impact does not have to relate to either previous or proposed capital expenditure. Financial contributions provide more flexibility so as to recover the impacts of growth rather than just the share of capital expenditure that is a of direct benefit to growth.

Recommendations

(i) Council needs to consider the appropriateness of both Development contributions and Financial contributions
(ii) Update its Development contributions policy to ensure that it is current.

b. Loans debt

The maximum level of debt of local authority should be based on its ability to service the debt. Therefore, the ability to service its debt must be based on its revenue. While the Local Government (Financial Reporting and Prudence) Regulations 2014 (LG Regulations) has a Debt servicing benchmark of borrowing costs for the year equal or a less than 10%[2] of its revenue, more prudent ratios are based on borrowing costs to rates and total debt to rates. One ratio measures ability to service the borrowing or interest cost, while the other measures the ability to repay the debt. The reason for these ratios using debt rather than revenue is the ratepayer will always be liable to all Councils debts. Prudent ratios for the Council would be 12.5% of borrowing costs to rates and total debt to rates to 150%.

Current ratios are:

[2] Revenue is defined as all revenue excluding development contributions, financial contributions, vested assets, gains on derivative financial instruments, and revaluations of property, plant, or equipment for the year.

	Jun-19	Jun-20	Jun-21
Debt to rates			
As per Three year plan	133%	129%	119%
Recommended limits	150%	150%	150%
Borrowing costs to rates			
As per Three year plan	8%	8%	7%
Recommended limits	12.5%	12.5%	12.5%
LG Regulations Debt servicing ratio			
As per Three year plan	2%	3%	5%
Regulation limits	10%	10%	10%

Using the recommended ratios, the Council has capacity to increase its debt, however debt must be used only for projects where the expenditure benefits ratepayers in the longer term.

Currently Council uses banks for funding its debt, the Local Government Funding Agency (LGFA) offers lower rates than banks with less costs and greater certainty of funds. By using LGFA saving of approximately $500K could be achieved.

Recommendation

(i) The Council therefore needs to develop a business case to consider moving from its current funding arrangement to the LGFA.

c. Subsidies including PGF options

Currently the Council receives significant subsidies to assist with the costs with the earthquake recovery. By 2020/21 the Council is only forecast to receive subsidy from NZTA for the roading activity.

As most subsidies are based on a proportion of capital expenditure, a small local authority when considering any subsidy must have the capacity to fund the on-going operational and ultimate capital replacement. Capital subsidies are not necessarily always in the best financial interest of a local authority. Any future subsidies must be based on future expenditure and supported by a business case process, however the Council needs to be aware there is often a significant time investment required from staff to complete applications.

The Government recently announced a change to the tourism infrastructure fund which will provide for operating and maintenance costs, this change may be of benefit to Council.

Appendix 1 - Allocation of rates to Ratepayer groups

Name of rate	Method	Area, differential of definition of use	Value of rates excluding GST	Allocation of rates				
				Urban		Semi Rural	Rural	Utility
				Non commercial	Commercial			
Roading Rate	Capital value	All rateable properties within the District	699,028	250,689	73,149	193,836	163,807	17,547
Earthquake Rate	Capital value	All rateable properties within the District	171,219	61,403	17,917	47,478	40,123	4,298
District Planning Rate	Capital value	All rateable properties within the District	267,780	96,033	28,022	74,254	62,750	6,722
General rate	Differential Capital value	Urban 1.0, Semi Rural 0.9 Rural 0.9	1,031,609	395,730	107,952	271,335	229,300	27,292
Harbour	Differential Capital value	Urban 1.0, Semi Rural 0.5 Rural 0.3	72,688	26,068	7,606	20,156	17,033	1,825
Footpath & Streetlights	Differential Capital value	Urban 1.0, Semi Rural 0.5 Rural 0.2	241,097	86,463	25,230	66,855	56,498	6,052
Town Centre	Differential Capital value	Urban 1.0, Semi Rural 0.5 Rural 0.3	100,649	36,095	10,532	27,909	23,586	2,527
Uniform Annual General Charge	Fixed value targeted rates SUIP•	All rateable properties within the District	1,370,146	733,239	104,503	304,477	222,767	5,161
Earthquake Levy	Fixed value targeted rates SUIP•	All rateable properties within the District	118,604	63,472	9,046	26,357	19,283	447
Civic Centre Charge	Fixed value targeted rates SUIP•	All rateable properties within the District	179,022	95,804	13,654	39,783	29,107	674
Commercial Rate**	Capital value	All properties in the District used principally or exclusively for commercial and/or industrial purposes	417,269		417,269			
Public Rubbish Bin Charge	Fixed value targeted rates SUIP•	All properties in the District used principally or exclusively for commercial and/or industrial purposes	32,000		32,000			
Registered Premises Charge	Fixed value targeted rates SUIP•	All rateable properties undertaking a licensed activity, such as premises where alcohol is sold or consumed, food premises, camping grounds, funeral directors or hairdressers.	36,636		36,636			
Stock Control Rate	Capital value	Rural only	25,414			13,774	11,640	
Total rates based on allocation			**$ 4,763,163**	1,844,996	883,517	1,086,213	875,893	72,544
				38.7%	18.5%	22.8%	18.4%	1.5%

Appendix 2 - List of rates used in setting the 2018/19 rates with method and area

Name of rate	**Method**	**Area, differential of definition of use**	**Value excluding GST**
Roading Rate	Capital value	All rateable properties within the District	699,028
Earthquake Rate	Capital value	All rateable properties within the District	171,219
District Planning Rate	Capital value	All rateable properties within the District	267,780
General rate	Differential Capital value	Urban 1.0, Semi Rural 0.9 Rural 0.9	1,031,609
Harbour	Differential Capital value	Urban 1.0, Semi Rural 0.5 Rural 0.3	72,688
Footpath & Streetlights	Differential Capital value	Urban 1.0, Semi Rural 0.5 Rural 0.2	241,097
Town Centre	Differential Capital value	Urban 1.0, Semi Rural 0.5 Rural 0.3	100,649
Uniform Annual General Charge	Fixed value targeted rates SUIP*	All rateable properties within the District	1,370,146
Earthquake Levy	Fixed value targeted rates SUIP*	All rateable properties within the District	118,604
Civic Centre Charge	Fixed value targeted rates SUIP*	All rateable properties within the District	179,022
Commercial Rate**	Capital value	All properties in the District used principally or exclusively for commercial and/or industrial purposes	417,269
Public Rubbish Bin Charge	Fixed value targeted rates SUIP*	All properties in the District used principally or exclusively for commercial and/or industrial purposes	32,000
Registered Premises Charge	Fixed value targeted rates SUIP*	All rateable properties undertaking a licensed activity, such as premises where alcohol is sold or consumed, food premises, camping grounds, funeral directors or hairdressers.	36,636
Stock Control Rate	Capital value	Rural only	25,414
Total rates based on allocation			**$ 4,763,163**
Stormwater Rate	Capital value	All properties with urban area	133,010
Kerbside Recycling Charge	Fixed value targeted rates SUIP*	All rateable properties that have access to the kerbside recycling collection service (including Oaro)	178,873
Rural Recycling Charge	Fixed value targeted rates SUIP*	All rateable properties other than those that have access to the kerbside recycling collection service	36,000
Sewer	Differential value rate based on connections and use	All properties that are either connected or can be connected	684,384
Water	Differential value rate based on connections and use	All properties that are either connected or can be connected	1,056,582
Total rates based on either location or ability to connect			**$ 2,088,849**
Total rates			**$ 6,852,012**