



Local Government

February 2020

Insights

NEW ZEALAND
PRODUCTIVITY COMMISSION
Te Kōmihana Whai Hua o Aotearoa



The New Zealand Productivity Commission
Te Kōmihana Whai Hua o Aotearoa¹

The Commission – an independent Crown entity – completes in depth inquiry reports on topics selected by the Government, carries out productivity related research and promotes understanding of productivity issues. The Commission aims to provide insightful, well-formed and accessible advice that leads to the best possible improvement in the wellbeing of New Zealanders. The New Zealand Productivity Commission Act 2010 guides and binds the Commission.

Information on the Productivity Commission can be found on www.productivity.govt.nz or by contacting +64 4 903 5150.

How to cite this document: New Zealand Productivity Commission. NZPC (2020) Local government insights. Available from www.productivity.govt.nz

Date: February 2020

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ISBN: 978-1-98-851942-5

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¹ The Commission that pursues abundance for New Zealand.

Foreword



The Productivity Commission has repeatedly been asked to look into areas of local government performance, by successive governments. Five out of our 14 inquiries to date have focused specifically on various aspects of local government regulation, planning and funding. We've learnt quite a few things from these studies. Time and again we have come to the same conclusions about what the problems are, and what needs to change.

So the purpose of this report is to bring it all together, highlighting the key lessons for both local and central government. It lays down a challenge to both sectors, about what they need to get right, how to do things differently, and the benefits from doing so.

The report makes no comment on the scope and responsibilities of local government, as none of our inquiries has asked us to take a look at this.

I would like to acknowledge the influence of Rob Forlong, Chief Executive of Whangarei District

Council and a regular commentator/submitter on the Commission's work in local government. Rob encouraged us to undertake this summary of our local government-related inquiries and highlight the key themes that have emerged.

Let me also acknowledge the authors, Jo Smith and Ron Crawford, and the inquiry teams that have produced this body of work. Each of the five local government-related inquiries has been led by Steven Bailey as Inquiry Director. Steven and his various teams have worked tirelessly and with great skill to bring fresh insights and balanced perspectives to the complex array of issues encountered in these inquiries. They have served us very well.

Murray Sherwin
Chair, Productivity Commission
February 2020

The five inquiries covered in this report are:

Local government funding and financing (2019)

Better urban planning (2017)

Using land for housing (2015)

Towards better local regulation (2013)

Housing affordability (2012).

They are available on the Commission's website at: www.productivity.govt.nz/inquiries/.

The Commission has also produced a number of working papers that have informed our analysis of local government issues. These include research on the evolution of work in New Zealand's cities and towns, the implications of complexity theory for urban planning, and the effect of Auckland's Metropolitan Urban Limit on land prices. These and other research reports by the Commission are available at: www.productivity.govt.nz/research/.

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Part **1**



**The unique
New Zealand**

context

1 The unique New Zealand context

Local government scope and spending

New Zealand's 78 local authorities are set up under legislation to enable democratic local decision making by their communities, provide local infrastructure and undertake regulatory functions. Under the Local Government Act 2002 (LGA), promoting the four wellbeings of communities (social, economic, environmental and cultural) is a main purpose of local government.

Regional councils are responsible for the physical environment and cross-boundary functions that require an integrated approach, which include regional land transport, flood protection, biosecurity, civil defence and some resource management. The functions of territorial authorities (city and district councils) are broader, encompassing physical infrastructure such as roads, water supply, wastewater and stormwater, recreation and cultural activities and amenities, land-use planning, building standards and some public health and safety functions. A unitary authority is a territorial authority that also has all the responsibilities of a regional council.

Local authorities are accountable to and largely funded by their own communities. The LGA provides local authorities with the power of general competence, which is the ability to choose the activities they undertake to fulfil their statutory role and how they undertake them, subject to public

consultation. The LGA and other Acts set out the power of councils, including the power to make local bylaws and raise revenue, and councils' planning and accountability requirements.

The scope of local government in New Zealand is much narrower than in most other developed countries. Many of the functions of local government in other countries, such as health services and education, are funded centrally in New Zealand and provided locally through Crown entities (such as District Health Boards and schools). Local government in New Zealand spends a much smaller proportion of total government spending than in most other jurisdictions.

Even so, the scale of local government is significant. In June 2018, local government owned fixed assets worth \$123 billion, and had a yearly operating expenditure of \$10.3 billion and an operating income of \$9.9 billion. Local government employed 25 300 staff (full-time equivalent) in June 2017.

Physical infrastructure provision dominates local government operating and capital expenditure, though the details vary greatly across councils. Rates provide the largest source of revenue (just under 50%). Grants and subsidies (particularly from central government for roading and other transport costs) and fees and user charges are also important.

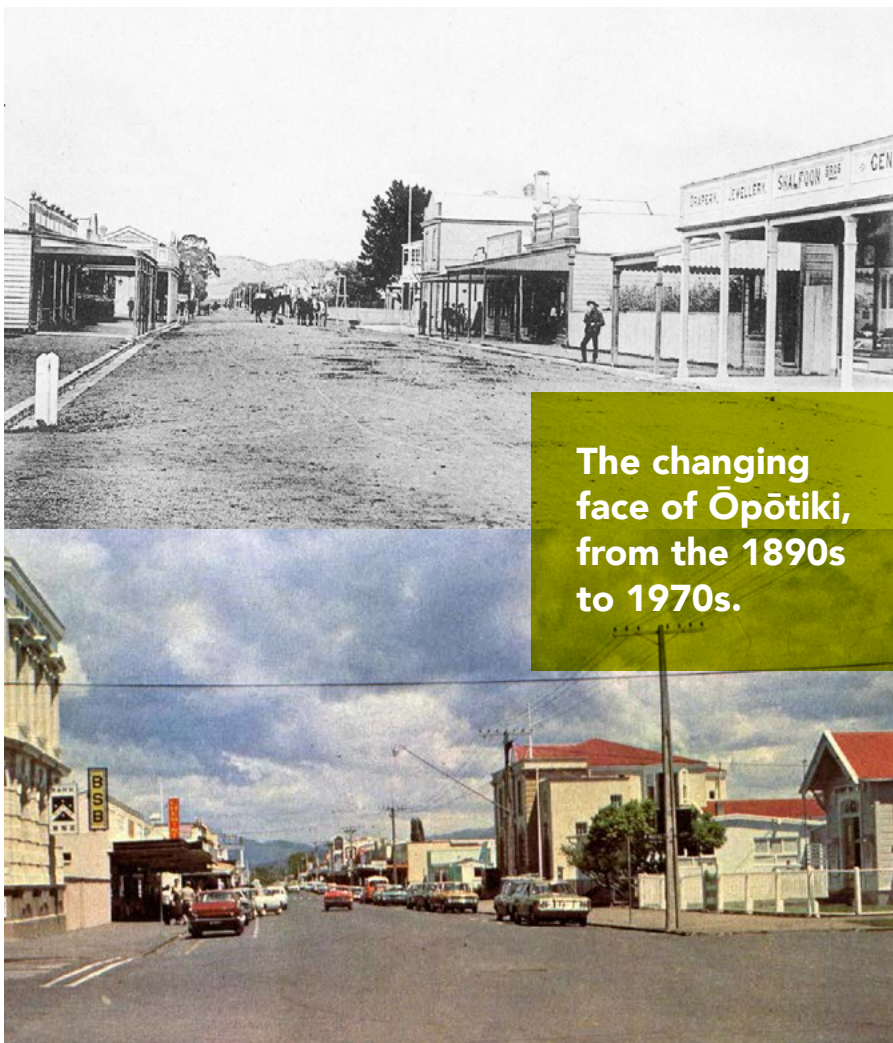
Growth and decline of cities and towns

Local authorities have widely different circumstances. Physical resources and industry structure vary across the country, driving different infrastructure requirements, and creating varying conditions for economic growth.

The populations of New Zealand's cities and towns have grown at very different rates over the last 40 years. Small provincial centres that relied on specialised rural processing industries have grown slowly, or not at all, as this type of manufacturing has declined. The large urban centres, particularly Auckland, and cities close to them, have grown

rapidly, as service industries, that benefit from locating in big cities, expanded. At the same time, other centres that enjoy more than average sunshine and other natural amenities have also grown rapidly.

Both slow and fast population growth pose challenges for councils. Slow growth is often associated with stagnant incomes and difficulty in affording services and investing in infrastructure. Fast growing cities and towns must invest in infrastructure to keep pace with demand, and avoid over-heated housing markets. Patterns of growth are driven by underlying economic forces that governments (central and local) must work with rather than against to raise the wellbeing of New Zealanders.



How we got here

Prior to European settlement, Māori managed their interests according to custom (tikanga). Kin-based local groups (whānau, hapū and iwi) were responsible for decisions of varying geographic scope and covering the social, economic, environmental and cultural aspects of their communities' prosperity. Early European settlements (with limited geographic scope) had both formal and informal institutions to manage local affairs. In some places (eg, Wellington) voluntary contributions were raised to fund roads; in other areas local government entities were set up with formal rating powers to fund public works.

History has shaped the scope and role of local government in New Zealand.

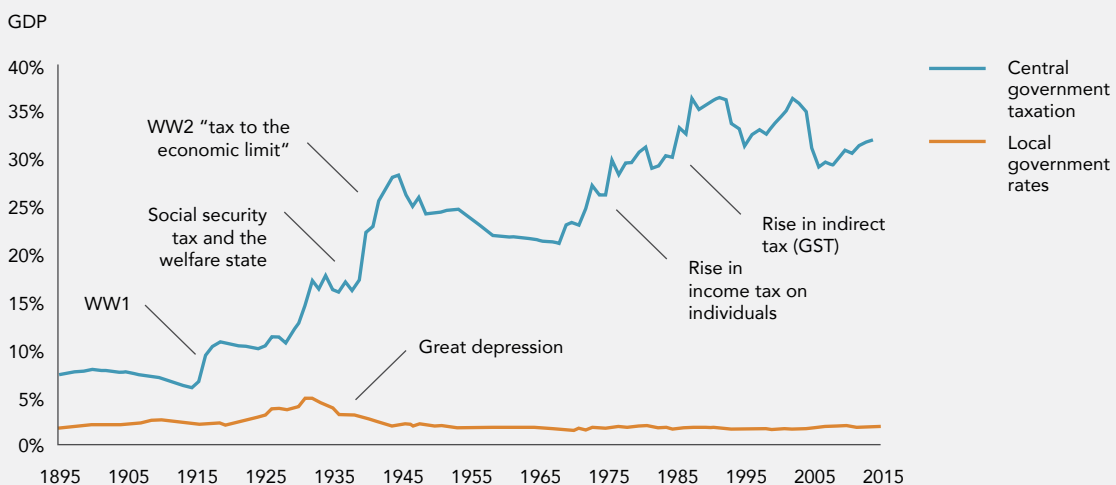
While local government in the 19th century produced a variety of social and economic services, provision of local public infrastructure to support expanding populations of settlers was the central focus. The last 30 years of the 19th century saw a

large proliferation of local government entities, many with statutory revenue-raising powers. In addition to municipal corporations and county councils, there were education boards, hospital boards, rabbit boards, drainage boards, road boards and, eventually electric power boards among others.

Until the 1870s, local government provision of education and health services was rudimentary and heavily reliant on fees and charitable donations. After free primary education and hospital boards were established in the 1870s, central government gradually assumed a greater role in funding and regulating these ever-expanding social services. The introduction of a comprehensive welfare state in the 1930s accelerated these trends. Even so, the last vestiges of local funding for hospital boards survived into the early 1950s.

Over the last 130 years, local government taxation (principally property rates) reached a peak of around 4.0% of GDP in 1930 and has settled at around 2.0% over the last 70 years (Figure 1). In contrast central government taxation (increasingly derived from

Figure 1 Taxation as a percentage of GDP in New Zealand



Source: Chart adapted from Craven et al. (2019), historical data from Goldsmith (2008), recent data (1993 and onwards) are NZPC calculations based on Stats NZ (2018, 2019) and OECD (2019).



Image supplied by: Waikato Regional Council

personal and business income taxes) expanded dramatically from the beginning of the first world war. The introduction of a full-blown welfare state in the 1930s and the urgent needs of the second world war drove central government taxation ever upwards, reaching a peak of around 35% of GDP in 1990.

The proliferation of local government entities existing around 1900 was reduced during the 20th century through successive waves of rationalisation and amalgamation, resulting after 1988 in approximately the current configuration. Entities that carried out commercial activities, such as electric power boards, were privatised or semi-privatised. Other entities, such as health boards, and local school boards evolved to operate outside the local government framework, substantially funded and regulated by central government, though with local democratic constitutions and governance.

Constitutional relationships with central government and with Māori

Local government is a creature of statute. Even so, it operates as a largely autonomous provider of services, funded separately from central government by local property taxation and held accountable by voters. In the absence of well-defined constitutional

or fiscal relationships, local and central government are most accurately regarded as two spheres of a system of collective decision-making, each with revenue-collection powers to fund the implementation of its particular policies and programmes.

The LGA (section 4) signals an intent to give effect to the Crown's obligations under the Treaty of Waitangi. The Act obliges local authorities to facilitate participation by Māori in the decision-making processes of local authorities.

Local iwi have a strong interest in local authority functions. This is especially so for resource management decisions under the Resource Management Act 1991 (RMA). Section 6 of the RMA recognises "the relationship of Māori and their culture and traditions to their ancestral lands, water, sites, waahi tapu, and other taonga" as a matter of national importance. Section 7(a) requires persons exercising functions and powers under the Act to have particular regard to kaitiakitanga, while section 8 requires them to take into account the principles of the Treaty of Waitangi. Kaitiakitanga means "the exercise of guardianship by the tangata whenua of an area in accordance with tikanga Māori in relation to natural and physical resources; and includes the ethic of stewardship" (section 2).

Part **2**

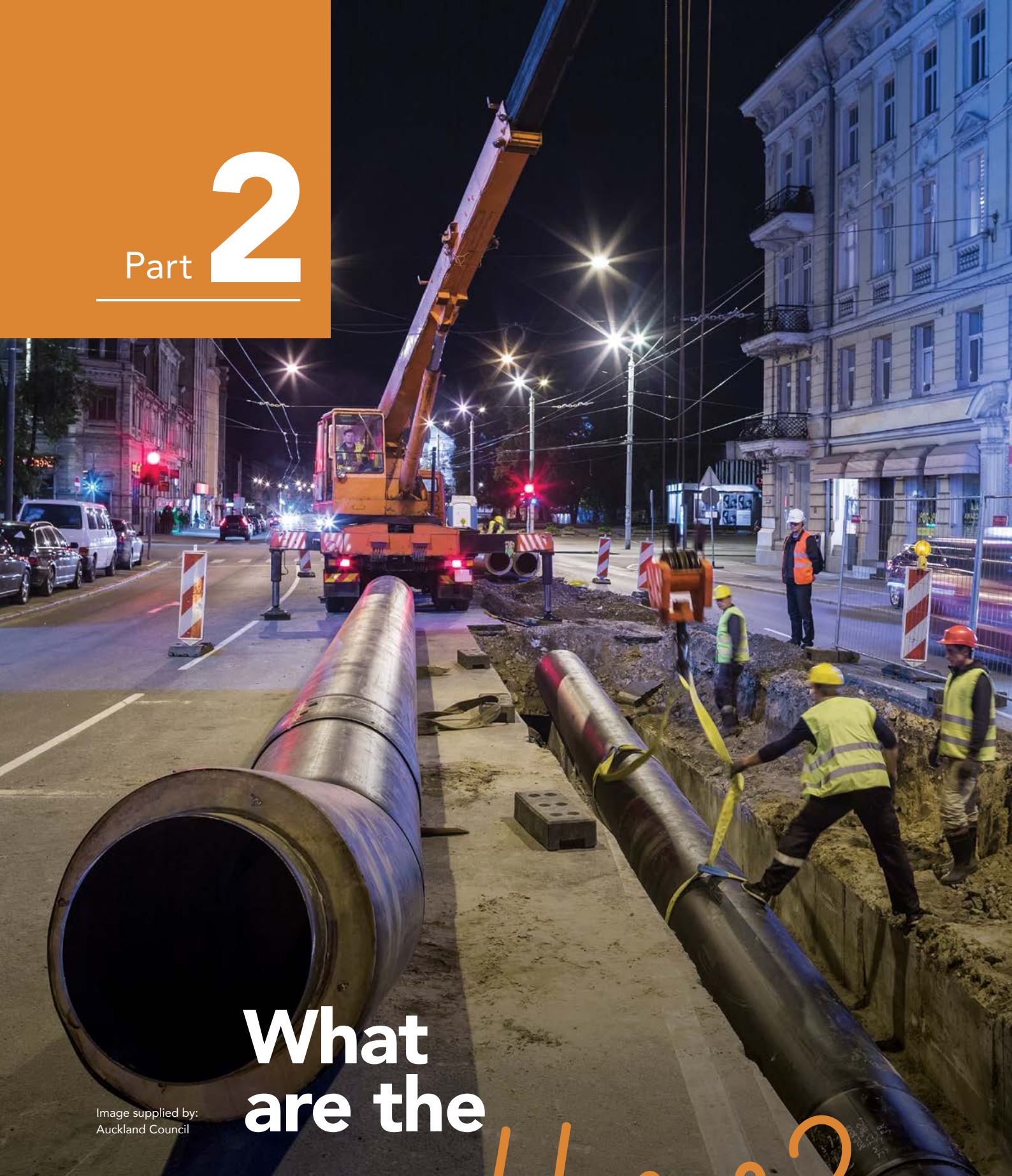


Image supplied by:
Auckland Council

**What
are the**

problems?

2 What are the problems?

Through successive inquiries, the Commission has analysed a range of problems with the way local government is operating, that are contributing to some serious social, economic and environmental impacts.

2.1 The symptoms

Lack of affordable housing

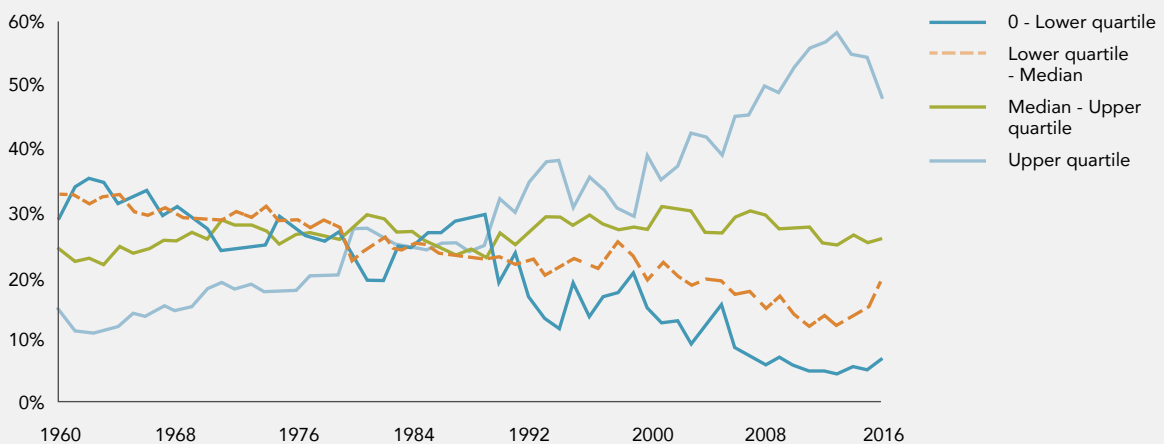
Strong population growth in some of New Zealand’s major cities, particularly Auckland, has helped fuel a boom in the demand for housing. A number of things affect the supply of housing, but one of the most important is the supply of land and the planning rules around it.

Councils have a major influence at all stages of housing supply, including the planning and zoning

of land, provision of infrastructure, and house construction. However, in cities experiencing rapid population growth, councils’ response to the growing demand for housing has been inadequate. Councils have been too slow to unlock land for housing developments, and reluctant to provide the necessary infrastructure such as roads and three waters (drinking water, wastewater and stormwater services). The slow pace of consenting has added further delays and costs.

The shortage of residential land has pushed up land prices, leading to construction of larger, more expensive houses to match the cost of the land. Investment in affordable houses has lagged. The light blue line in this chart shows the growth in housing at the top end of the market, compared to the declining growth in houses at the lower end.

Figure 2 New housing investment - value distribution



Notes:

For each year, the data show the share of new houses that are valued within each quartile of the value distribution for the existing housing stock.

Source:

Productivity Commission calculation using QV data

The nature of New Zealand's residential construction industry has also contributed to high house prices. The industry is essentially a fragmented "cottage industry" dominated by very small independent builders constructing bespoke homes. Most builders construct one house at a time, and many firms build just one house a year. And houses are often built using a staged step-by-step approach, with individual trades working sequentially in isolation from each other. This can result in time delays and associated holding expenses caused by sub-contractors not being on site when required, as well as the need for re-work. Projects are plagued by budget overruns, and non-compliant or defective work. Other problems include lower quality materials which have a shorter lifespan and require higher levels of maintenance.

As houses have become less affordable, home ownership rates have dropped, and rents have risen. Potential buyers now have to spend more of their income on rent and find it harder to save for a deposit.

People most affected by housing unaffordability are those who are younger, single, have lower incomes and wealth, live in Auckland, or belong to an ethnic group other than New Zealand European.

The lack of affordable housing has significant economic and social consequences. These include financial pressures from high housing costs, overcrowding, tenure insecurity and homelessness, family instability and obstacles to people accessing the jobs they want. At the same time, it can also be an obstacle to firms employing the staff they need.

Environmental degradation

The current planning system is failing to protect important parts of New Zealand's natural environment. There is evidence of significant damage to some freshwater bodies, and water quality is generally lower in waterways that run through urban areas. Contributors include urban stormwater discharges and sewer leaks, as well as the well-publicised agricultural sources.

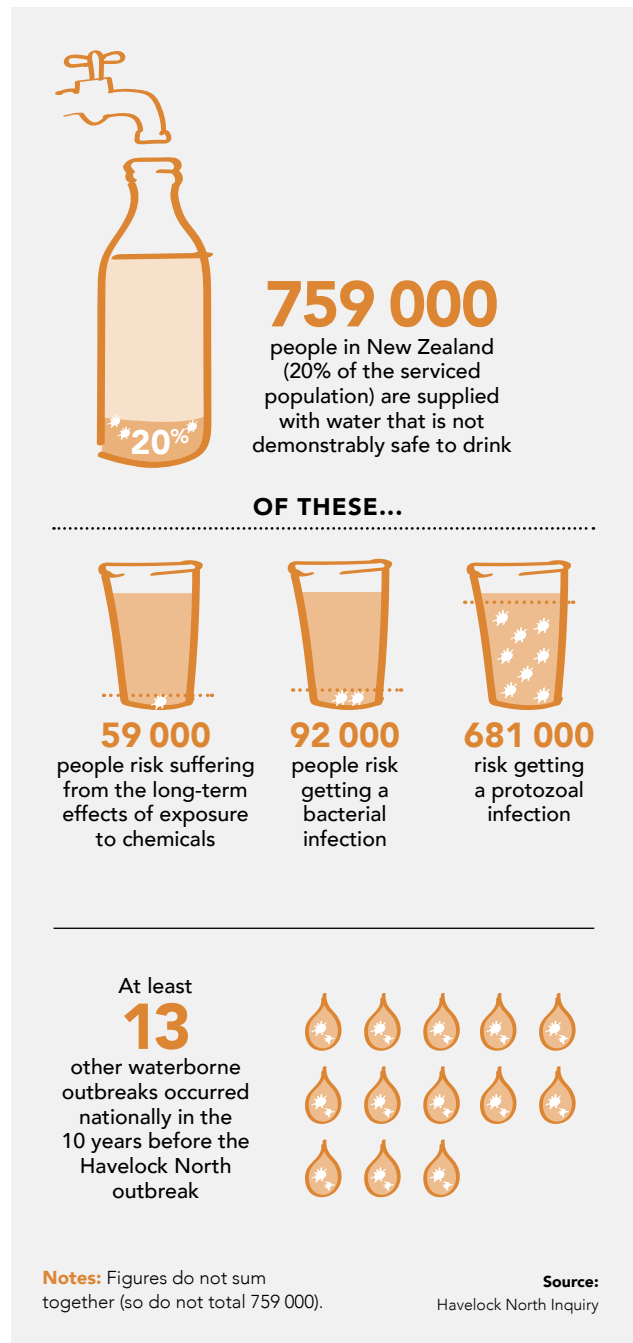
There is a lack of good data about the condition of council wastewater and stormwater systems, and their impact on the environment. We do know that some council wastewater plants are degrading freshwater and coastal-water quality, and sewage outflows are occurring too often for some communities to tolerate. More comprehensive information would likely expose many hidden problems.



Risks to human health

Council drinking water supplies are also performing poorly, with significant consequences for human health. The Havelock North contamination incident in 2016 brought problems with drinking water to national attention. It was associated with four deaths, long-term chronic health problems and widespread outbreak of illness in the area.

Many drinking water supplies are not fully compliant with current standards. In 2017-18, 23 councils had to issue boil water notices at some point, including at some tourism hotspots. Residents and tourists alike want better quality of service from councils.



2.2 Contributing factors

There's a number of factors contributing to these problems. The main factors can be summarised as:

- problems with the major pieces of legislation guiding councils' planning decisions, in particular the RMA;
- a lack of direction and guidance from central government;
- weak incentives on councils to meet and enforce minimum environmental and health standards; and
- wide variation in practices and outcomes across councils.

Complex legislation that is not working as intended

There are three main pieces of legislation governing local government planning and infrastructure investment: the RMA, the LGA and the Land Transport Management Act 2003. Together, these Acts and their various amendments have created a complex web of legislation that is poorly integrated, hard to administer and not delivering the intended outcomes.

The RMA was designed to be enabling, allowing development to occur, subject to controls to ensure environmental limits are not exceeded. This "effects-based" approach heralded a significant change from the traditional prescriptive, rules-based approach to planning. However, council planning has failed to adapt and respond to this new approach, instead adopting a risk-averse approach to development.

Overly prescriptive planning rules have been introduced, with insufficient consideration of their costs and benefits. This has resulted in excessive restrictions on building activities and undue regulatory burdens, while in some cases failing to provide the environmental safeguards that were intended by the Act.

Aversion to the risks of development means urban planning has not been responsive to the needs for housing and urban development. This has been reinforced by local politics. Existing homeowners tend to oppose new development that they feel

would impinge on their neighbourhood amenity and property values, and that may involve increased infrastructure spending and rates rises. Homeowners have a strong influence on council decisions, as they are more likely to vote in local elections. Council decisions are therefore likely to favour the interests of existing homeowners, at the expense of prospective new residents and broader, national interests around housing affordability.

A lack of direction and guidance from central government

The RMA lacks clarity, which has caused ongoing confusion as to its purpose and how to implement it. It was expected that central government would provide direction and guidance through National Policy Statements (NPSs) and National Environmental Standards (NESs), but such guidance was slow to emerge. The first NPS came into effect in 1994 (replaced in 2010); and it was not until 2008 that the second was introduced. The first NES came into effect in 2004, 13 years after the introduction of the RMA.

Since then, there has been a flow of NPSs and NESs. Many more are in development. They will require councils to change their existing plans and policies, which were developed in the absence of national direction. These national directives also typically come without funding streams for councils, or adequate support from central government to understand and implement the requirements. A risk exists that the increasing number of national guidance instruments will create inadvertent conflicts and so fail to clarify priorities for councils.

Poor incentives to meet enforce and meet minimum standards

Councils face weak incentives to enforce environmental regulation, particularly where this would create costs or economic losses for existing residents and ratepayers. The lack of sufficient controls on land-use, combined with patchy monitoring and enforcement, has contributed to the degradation of freshwater bodies.

To date, the regulatory regime has imposed weak incentives on council-led water suppliers to meet

health and environmental minimum standards, and provided no independent oversight of supplier charges or costs. Regulators have pursued no prosecutions for breaches of health standards and have allowed too many suppliers of wastewater treatment services to continue operating with expired consents.

Wide variation in council practices

Practices and outcomes vary widely across councils. The lack of national consistency in planning and investment approaches is perhaps unsurprising given the legislative complexity and lack of national direction. But it also reflects the diversity of circumstances across councils, and the autonomy of councils to respond to their local needs and preferences as they see fit.

There is an inevitable tension between national and local interests, and between national consistency and local autonomy. The current institutional settings do not fully acknowledge these tensions, or allow them to be resolved efficiently, effectively and fairly.

2.3 What's really at the heart of it

Underpinning these issues are systemic problems with the nature of decision making, at all levels of government.

Poor relationship between central and local government

A recurrent theme across the Commission's inquiries has been the poor state of relations between central and local government. This failure arises from a lack of understanding of each other's roles and of the constitutional status of local government.

Local authorities are sometimes characterised as agents of central government, required to implement national priorities and central government directions, and accountable to central government. In reality, the nature and extent of councils' relationship with central government is context-specific, depending on the particular regulatory framework.

The powers invested in local authorities span a spectrum – from powers that confer substantial discretion and autonomy, through to delegated powers to implement regulation with little or no discretion. Some regulatory frameworks (such as for building) specifically provide that a local authority is accountable to the relevant minister or government department. But unless explicit in legislation, a local authority is not accountable to central government when exercising its powers.

Local authorities are ultimately accountable to, and largely funded by, their local communities.



The poor relationship between central and local government manifests in a number of ways. One of the major concerns from local government is the continuing flow of “unfunded mandates” – where additional roles and responsibilities are passed to local government without adequate means to fund them. This reflects both a misunderstanding of local government’s role and status, and inadequate policy analysis.

Central government analysis of policy and regulatory proposals often fails to correctly define the problem being addressed, underestimates the costs to local government, and shows little understanding of the practical implications for councils across their diversity of circumstances.

New policies that impose costs on councils rarely come with adequate means to fund these new obligations.

Few central government staff have sufficient in-depth knowledge and understanding of the local government sector. And administrative processes that should be picking up on poor quality analysis are not working.

Varied and often low capability

Some councils are managing well within the current system. They are able to accommodate growth and development, and make the necessary investments in essential infrastructure. Others are struggling to maintain essential services to acceptable standards, and to balance competing interests.

While successful councils can fly under the radar, those who are struggling can gain nationwide attention through their failures. Kaipara District Council’s experience with its wastewater scheme at Mangawhai is an often-cited example, but there are other instances where matters have become so serious that central government has needed to intervene.

Part of the problem is that many councils lack the necessary systems and skill-mix for making effective decisions. The financial and governance capability of elected members can be an area of weakness.

This means some councils do not have the right skills and experience to effectively manage their infrastructure assets and make the right strategic and investment choices.

One of the ways this shows up is in the perennial misunderstanding around local government debt. It’s common to see councillors campaigning on a platform of low or no debt, as if a council has a budget to be managed like a household’s grocery bill. In fact, debt is an important instrument for sharing the high upfront costs of essential infrastructure across the generations who will benefit from it. Most councils are well below their debt limits, but their reluctance to take on debt can mean necessary investments in essential infrastructure (such as renewals or upgrades) are deferred. Deferring investment can help keep rates growth low in the short term, but passes the costs of inadequate and failing infrastructure down the line to future residents.

Councillors’ lack of understanding of their governance roles can lead to inappropriate involvement in operational decision making, such as regulatory enforcement decisions. Conversely, it can mean that elected members become overly dependent on advice from council staff, which further blurs the lines between governance and management, and weakens accountability.

Lack of scale

A factor for some districts is their small population. Some small councils also face a long-term declining population. While size is not correlated with capability (there are some small councils who are performing well given their circumstances), it can limit the extent of a council’s activities and its ability to fund necessary investments. Small and remote councils can struggle to attract and retain high quality and specialist staff.

Councils that lack sufficient scale face high fixed costs, which must be spread over a smaller ratepayer base. The populations of many small and rural councils also have lower than average incomes and greater social deprivation, which add to affordability problems.

Councils struggling to balance competing interests

The political economy of local government is currently stacked against growth. Councils often face pressure from residents to keep rates low, and therefore to avoid making the necessary investments to provide for both current and new residents.

Moreover, while local government bears the costs of accommodating population growth, much of the fiscal benefit flows to central government (through higher tax revenues).

Parochialism is leading councils to reject opportunities to work together in ways that would save ratepayers money and lead to better outcomes. For instance, few councils work across boundaries to manage their water assets, despite the benefits from scale that this could bring, such as access to specialist expertise.

Some councils are struggling to balance competing interests, and confront the difficult trade-offs that must be made over where and how growth is accommodated. The result is that the interests of existing residents, homeowners in particular, are prioritised over other interests, including renters and new households.

Some existing landowners also seek to influence councils' resource-management decision making and enforcement. Councils face political pressure to categorise land-use activities as permitted (rather than consented) activities, in order to minimise the costs imposed on resource users. Across the sector, compliance monitoring and enforcement is generally weak and under-resourced, and can suffer from political interference in decision making.

These problems arise partly from councils' dual economic development and environmental protection roles (and in the case of unitary authorities, dual roles of regulator and regulated party). This can be exacerbated by a lack of appropriate separation of governance and operations, and elected members' lack of understanding of their governance role.

A democratic deficit at the local level

Homeowners have considerable influence in local body elections and are often strongly represented in community consultation processes. Their influence promotes council decisions that restrict urban intensification and the supply of new land for housing.

By contrast, those bearing the negative outcomes of councils' planning and funding decisions are not well represented in either community engagement or local elections. People who tend to be under-represented include those who are younger (particularly those aged under 25), Māori, Pasifika, and renters – groups more likely to suffer from a lack of affordable housing.

Overall community satisfaction with council performance, and confidence in council decision making are low.

The rate of voter turnout in local elections has been steadily declining for decades, and total participation in community consultation processes is typically very low. This is partly because of people's limited understanding of the roles of councils and their decision-making processes.

Councils' approaches to engagement and consultation often do not encourage broad participation. Some councils are doing a good job – using a variety of innovative engagement techniques and providing clear, accessible material. But others are failing to engage in ways that enable the full range of interests to be heard.

All this is contributing to a democratic deficit, meaning some people's views and interests are not adequately represented and councils are not being adequately held to account for the impacts of their decisions.

Part **3**



Image supplied by:
Hawke's Bay Regional Council

Future
challenges

3 Future challenges

3.1 Major challenges ahead

Local government is facing significant and challenging work in a number of important areas. Councils will need to do better in advancing Māori interests, protecting the natural environment, tackling housing affordability and lifting the performance of essential infrastructure such as three-waters services. Adapting to climate change is a major new challenge facing councils.

Actively promoting Māori interests

Local government decisions and services closely involve local iwi and hapū interests in both the built and natural environments, and impact Māori social and economic outcomes.

Councils have legislative responsibilities to facilitate Māori participation in resource management and other planning processes and decision making. Several Treaty of Waitangi settlements have also created co-governance and co-management arrangements over significant natural resource and reserve lands. Councils, particularly regional councils, play a key role in supporting these arrangements.

The local government planning system has had mixed success in recognising, protecting and advancing Māori interests in local planning decisions. Councils' attitudes and willingness to engage with Māori in their planning processes are varied, as are their knowledge and understanding of Māori perspectives. The best councils are doing well, but some have barely started down this path.

Some councils and iwi face capacity and resourcing constraints to engaging and implementing Treaty settlement arrangements. Both councils and iwi will need to increase capability and apply more resources to proactively advance Māori interests in the post-settlement era. Councils must continue to improve their understanding of Māori perspectives, including local differences in tikanga, environmental and planning issues, and preferences.

It is generally accepted that ultimately the Crown cannot transfer its Treaty obligations and responsibilities. If it does delegate its Treaty responsibilities, for instance through legislation and Treaty settlements, then it needs to do so in a way that ensures its obligations continue to be met. So far central government support for implementing co-governance and co-management arrangements has been ad hoc, time-limited and fallen well short of the costs to councils. Central and local government have not yet reached agreement on who should fund ongoing Treaty-settlement arrangements.

Image supplied by:
Ōpōtiki District Council



Protecting the natural environment

Increasing evidence and concern about the poor state of freshwater bodies in New Zealand has raised questions about the performance of the RMA, and the councils charged with implementing it, in protecting this natural resource. The planning system has struggled to manage water pollution from diffuse (non-point) sources and deal with cumulative effects.

The failure to achieve better water quality through the planning system has been linked to the (until recently) lack of national standards, and local or political resistance to tighter environmental regulation. Councils have therefore had little incentive to establish and enforce hard environmental standards or limits on land-use, or to invest the necessary resources to the task.

Adapting to climate change

Climate change will bring threats to property and infrastructure from sea-level rise and more frequent and extreme weather events (including storms and flooding). This will affect local government infrastructure such as roads and bridges, as well as stormwater, wastewater and flood-protection assets

such as stopbanks. Some councils, such as those in Hawke's Bay, South Dunedin and along the west coast, are already feeling some of these effects.

On top of this, councils are responsible for planning and regulating development on at-risk land. They must manage pressures to allow development on this land, and to invest in defences against sea-level rise and flooding for vulnerable areas. Some areas will become unviable, and councils will be at the frontline of managing difficult conversations with communities about when the inevitable process of "managed retreat" must begin. Some councils are already at that point (Box 1).

Councils will need to take major decisions about where, when and how to protect assets and land-uses, accommodate the impacts of climate change, or retreat altogether. There is currently a lack of national direction, and robust science and data, to enable them to make good decisions. There is also significant legal uncertainty around who bears the risks of climate-change-related land-use decisions. This means many councils are currently in a no-win situation where either allowing or limiting development on at-risk land might result in litigation.

Box 1 Discussing managed retreat

A number of councils are already considering managed retreat in response to sea-level rise, coastal erosion, river flooding and other natural hazards. For example:

- Whakatane District Council is facilitating voluntary managed retreat for the residents and property owners on the Awatarariki fanhead in Matatā, following a significant weather-induced debris flow in 2005 that engulfed the coastal community. Voluntary property acquisition is being co-funded by the District Council, the Bay of Plenty Regional Council and central government.
- Northland Regional Council's Kaeo flood risk reduction project includes relocating people from high-risk homes, to encourage retreat from the floodplain.
- Hawke's Bay regional and district councils have included managed retreat as one of the options in their *Clifton to Tangoio Coastal Hazards Strategy 2120*.

Tackling housing affordability

The failure of high-growth councils to supply enough land and infrastructure to meet housing demand is a serious social and economic problem that is being felt at a national level.

The social and economic consequences of a lack of affordable housing flow through to central government, for example through increased Accommodation Supplement payments. And they are felt at a national level through poorer social and economic outcomes, and stifled productivity growth.

Councils already have the funding and financing tools they need to provide this infrastructure, in a way that does not burden existing ratepayers. However, the long time it takes to recover costs is a constraint, and a small number of councils are approaching their debt limits. More fundamentally, the local politics around accommodating growth is getting in the way. These blockages must be overcome.

Beyond the supply of land, the construction sector will also have to get its act together, in order to deliver the required housing.

Lifting the performance of essential infrastructure

Providing safe drinking water and cleanly disposing of wastewater and stormwater are key responsibilities of local government. Some councils have taken the tough decisions to improve their performance and make the necessary investments in upgrading their three-waters systems. But in many parts of New Zealand performance is poor in terms of its impact on human health, the natural environment, productivity and costs to consumers and ratepayers.

There is scope for significant efficiency gains in the water sector, through greater scale and volumetric metering and pricing. Water New Zealand reports that water losses amount to more than 20% of the water supplied to systems with known water loss levels. Where applied, volumetric metering and pricing appears to have reduced peak water consumption and wastewater by up to 30%. Yet despite the potential for significant cost reductions for communities, the pace to adopt these measures has been slow.

Councils spend a big proportion of their funds on the three waters. Achieving better safety and environmental records will likely create additional funding and financing pressures on local councils, with some small populations potentially incurring large cost increases. Tackling these pressures requires fundamental reforms that sustainably lift councils' safety and environmental performance as well as productivity and cost effectiveness.

Image supplied by:
Whangarei District Council



3.2 Councils are at the coalface

Confronting these challenges largely rests with local government. A fundamental step-change in performance will be required to deal with the scale and urgency of these challenges. There are huge social, environmental and economic benefits to be gained, from getting these things right. It is therefore critical that councils have the capability, capacity, incentives, funding and support to do so.

Central government also has a key part to play in providing a fit-for-purpose legislative framework for local government, making judicious use of national guidance to provide clarity about priorities, and providing commensurate resources to secure national benefits that arise from effective local government.

3.3 A systems approach

Getting all this right will require a systems approach. This means that central and local government need to understand how they can work together better. They need to agree on their respective roles and responsibilities and build a mutual understanding of how to deliver the required changes. All tiers of government will need to work much more effectively together, and with the private and community-based sectors, to achieve the desired outcomes.

Part **4**



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Whangarei District Council

What needs

to happen

4 What needs to happen

4.1 Building council capability

The mix and depth of skills across councils varies widely. The decisions required by councils are only going to get harder and more complex. In order to prepare councils for the task ahead, there needs to be a significant lift in skills and overall capability across the sector.

Key factors underpinning good decision making include strong and capable leadership, good information to support decision makers, use of independent governance expertise, and effective community engagement.

Local government is approaching a watershed moment. Councils must lift their performance through substantial improvements in capability and productivity.

The Commission has recommended that the sector works to improve elected members' governance and financial skills, through lifting participation in training and professional development. It has also recommended that each council be required to have an Audit and Risk Committee, with at least one independent member, to enhance governance capability.

Effective asset management is vital for making efficient use of funds, making good decisions about service delivery and achieving good quality outcomes. Current areas for improvement include making more effective use of limited specialist asset management expertise, developing good information about asset age and condition, and aligning investment decisions with strategic priorities.

Councils also need access to a wide range of technical capabilities in planning, particularly environmental sciences, economic analysis, and policy analysis and evaluation.

The local government sector should think hard about how it lifts existing capability and grows its future leaders and representatives. Councils should be looking for opportunities to collaborate, to achieve cost savings and access scarce skills, where it makes sense to do so.

4.2 Better engagement and more transparency

Overall, much better engagement with citizens is needed across the local government sector. While there are pockets of good work, much engagement does not reach or engage the range of affected people and interests.

Councils need to get better at explaining what they do, what the big decisions are, and why they matter.

People need to know what the genuine options are and how much they will cost – so they can choose and prioritise what they ask their council to do. Councils need to make it easier for a more diverse range of people to have their say, so they can get a better gauge of community preferences.

Greater transparency around council decision making is also needed, including how councils make trade-offs, and distribute costs across ratepayers. Better engagement and greater transparency of decision making will help build community understanding and buy-in, taking some of the political heat out of decision making.



Image supplied by: Waikato Story

4.3 How to incentivise the lift in performance?

The Commission's 2019 inquiry into local government funding and financing looked in detail at how to incentivise the necessary lift in performance in the three-waters sector. It examined the types of changes that need to occur in this sector, to break the deadlock of local politics and parochialism.

The performance of the three-waters sector would be substantially improved through a new approach that rigorously enforces minimum health and environmental performance standards, but is permissive about how councils meet these standards.

However, the Government should actively encourage councils to adopt better governance and aggregation of council water businesses. It should also consider backstop arrangements to deal with councils that fail to lift performance sufficiently to meet minimum health and environmental performance standards.

The Government should legislate to enable council-owned water businesses to directly charge water users for their services, in the same way that Watercare (owned by Auckland Council) can do so now. It should also allow councils to adopt volumetric charging for wastewater, as is currently allowed for drinking water.

The Government has recently announced that existing drinking water standards will become mandatory for almost all suppliers. It is establishing a new drinking water regulator to monitor and enforce compliance with those standards. It has indicated it may introduce economic regulation in the future. In the Commission's view, independent and effective economic regulation is needed to encourage fit-for-purpose investments to lift the sector's performance and assist with affordability (by minimising costs).

4.4 Actively protecting and promoting Māori interests

The nature of the Treaty relationship is evolving from a phase of negotiated settlements with claimants, to one of ongoing partnership and development with Māori collectives. Councils need to strengthen their understanding of Māori worldviews and the effectiveness of their engagement with Māori.

Māori Treaty interests should be more actively protected and promoted. The Commission has recommended that the government establish in legislation a National Māori Advisory Board on Planning and the Treaty of Waitangi. This Advisory Board would advise central government agencies on how to best give effect to the Treaty principles, and would monitor and audit outcomes.

The Advisory Board would also work with central and local government and Māori communities to develop an NPS on Planning and the Treaty of Waitangi. This NPS would set out the Crown's expectations on recognising and actively protecting Māori Treaty interests in the natural and built environments. The NPS should respect and provide scope for local differences in tikanga, environmental and planning issues and community preferences.

The NPS should provide clear guidance to councils on recognising and protecting sites and environmental features of significance to mana whenua, providing for papakāinga and other kaupapa Māori developments, and developing the capability of iwi and hapū to participate in planning.

Central and local government should work together to accurately identify the costs of this for local government and develop a principled, predictable and fair approach to sharing these costs.

4.5 Fixing the planning framework

The current planning legislation requires a fundamental review and overhaul. Future legislation should set clear limits and standards for both the natural environment and the liveability of the built environment. And it needs to be responsive to community preferences, including Māori interests.

The current government has announced a major review of the resource management system. One of the things the review will consider is whether urban development and environmental management should be considered in a single, or separate laws.

The Commission thinks there should be a single piece of legislation governing both. The new Act should have a separate clear purpose and objectives for each of the natural and built environments, and clearly outline how to manage the interrelationship between the two. This would enable an integrated approach to planning and regulating land-use, investing in transport and other infrastructure, and protecting the natural environment.

Future legislation should mandate planners to be more responsive to the information conveyed in property prices. It should provide for automatic "price-trigger" mechanisms, to guarantee that

councils will release enough land to meet demand for housing and help combat land banking. These mechanisms would be in addition to requirements on councils in the current NPS on Urban Development Capacity. And where appropriate, urban development authorities should be used to assemble and develop inner-city land at a scale that meets business, housing and transport needs. These "designated developments" would have streamlined planning and consenting, and the authorities would have compulsory acquisition powers.

The Commission also sees a key role for statutory spatial planning led by regional councils. Spatial plans would be high-level, strategic documents that lay out a regional vision for development and the protection of the natural environment, with a decades-long horizon. Regional spatial strategies would define transport corridors that provide opportunities for future infrastructure, future open public spaces, and areas of cultural significance and outstanding conservation value. Territorial authorities, central government, iwi, developers and infrastructure providers would all participate in the regional spatial planning process.

These spatial strategies would be the platform for a suite of integrated plans covering land use regulation, transport and other infrastructure planning, and operational plans and budgets. In addition, regional councils would take the lead on developing Regional Policy Statements for the Natural Environment. These would give effect to any relevant NPSs and NESs, as well as planning and resource-management legislation.

Land-use and spatial plans would be subject to review by Independent Hearings Panels (IHPs). IHPs would review planning provisions in spatial and district plans against clear statutory objectives for the regulation of the natural and built environments (including the supply of sufficient development capacity to meet demand, and safeguarding the integrity of the natural environment). Statutory principles would guide IHPs and reduce unnecessary prescription and inappropriate use of discretion. To reduce the time and cost of substantive decisions on plans, IHPs would make final decisions on the substance of plans, with appeal rights limited to points of law.



4.6 Improving environmental outcomes

In the Commission's view, the planning system needs to have a clear and unambiguous focus on environmental outcomes, and on the environmental information required to support good planning decisions. Central government should work with local government to determine what key environmental outcomes are measured, and with regional councils to set up the necessary information systems.

Planning regulations (including NPSs and NESs) should set clear environmental limits and minimum standards within which development can occur. Provided developments do not breach these standards, and are within the rules for the built environment, they should be subject to limited regulation. Councils should also be able to set higher standards than the statutory minimums if that's what their local communities would prefer.

Central government should provide greater non-statutory guidance to help councils meet environmental standards. Councils then need to ensure these environmental standards are achieved, through stronger monitoring and enforcement.

The planning system should also foster the use of adaptive management – an approach whereby planning decisions can be adjusted as more information becomes available. This recognises the uncertainty around environmental processes and the impacts of human activities, including the cumulative impacts. It will require better data and analysis, to measure long-term changes in the environment and the effectiveness of planning approaches.

4.7 Funding tools

The current rates-based system remains appropriate for New Zealand

The current main funding tools of local government measure up well against many of the principles of a good revenue-raising system, including simplicity, efficiency and revenue stability.

The existing framework also provides councils with considerable flexibility in how they raise revenue. Some councils are managing well with the current funding tools, making good use of targeted rates, development contributions and user charges. The best of our councils see few problems with their existing circumstances and are able to meet the needs of their communities without great stress.

However, the diversity of practice across councils is striking. Across the sector, there is clearly a need for better use of the full palette of tools. Simply providing more funding is not a sustainable solution. Collectively, the sector needs to lift its performance. Councils need to make better funding and investment decisions, so that communities can meet upcoming challenges by minimising costs and maximising benefits.

In the New Zealand context, no clearly superior alternative exists to the current system based

on rating properties. Overseas models reflect other countries' unique histories, including the differing scope and role of local governments. Fundamental change to New Zealand's system would be disruptive, costly and uncertain, and could compromise good features such as its efficiency. Importantly, retaining the current system preserves the local autonomy and accountability that are the cornerstones of our system of local government.

However, within the current system, councils have been shifting over time from basing their rates on unimproved land values, to capital values. Economic reasoning tells us that a land value rating system is more economically efficient for raising revenue. The Commission sees it as preferable to a capital value system.

While the current property rates-based system has many advantages, the fact that the Crown does not pay rates on its property significantly constraints its fiscal adequacy. On top of this, several additional pressures are placing strain on councils and the ability of their funding tools to provide them with adequate revenues. These pressures are:

- supplying enough infrastructure to support rapid urban growth;
- the cumulative impact of unfunded mandates passed from central government; and
- the costs of adapting to climate change.



New tools to help fund and manage growth

The Commission has recommended some new tools to help councils fund and manage growth. These include giving councils the power to levy volumetric wastewater charges and road-congestion charges. In addition, the Government's work on Special Purpose Vehicles is a promising tool for high-growth councils that are approaching their debt limits to finance large infrastructure projects.

Together, these funding tools would help give councils the means to efficiently fund the costs of growth. User charges can also help manage demand by increasing the number of people that existing infrastructure can support and extending the useable life of these assets. This can delay the need for new infrastructure investments.

Under existing powers, councils can use targeted rates on properties benefiting from new infrastructure to capture some of the increase in property values resulting from infrastructure investments. There are several examples from overseas of councils using similar tools to partly

fund new infrastructure – including London's Crossrail project, and the Gold Coast and Parramatta light rail systems. Councils could make more use of their existing funding tools to capture the value delivered by new trunk infrastructure. Even so, greater legislative clarity is needed to give councils the confidence to use existing instruments in this way without risk of legal challenge.

More radical changes to the current funding system would pose significant problems. For example, a share of GST or national income tax for local government would not only be complex to implement, it would risk undermining an important feature of local democracy. It would come with more central government intrusion into what the money gets spent on, which would weaken the accountability of councils to their local ratepayers. Moreover, while it may assist high-growth councils, it would exacerbate the funding disparities between high-growth councils and those with small and low-income populations. Councils with small and low-income populations would benefit much less from such a revenue stream. Instead, the Commission recommends a principled approach to deciding whether services should be funded centrally or locally.

4.8 Central government must play its part

Need to reset the relationship between central and local government

Central government needs to substantially improve its knowledge and understanding of the local government sector. Misunderstandings about each other's roles and responsibilities need to be resolved.

Local government is not an "agent of central government", and central government should stop approaching things in this way.

Instead, there needs to be a clear approach for when to set standards and policies nationally and when to leave matters to local decision makers. And there should be an agreed set of principles that apply when central government is developing regulations that impact on local government.

Central government agencies need to significantly improve the quality of their analysis when they are developing policies and regulations that affect local government. This will require better analysis of the problem and the range of options for fixing it, of how things will be implemented on the ground, what they will cost and how they will be funded. And it requires better consideration of the diversity of council circumstances.

A genuine co-design approach is essential to developing workable solutions that will stick. This will require more constructive engagement, earlier in the policy process. Government agencies need to ensure that small and remote councils can participate in the dialogue, being mindful of their resource constraints.

The Commission has recommended a "Partners in Regulation" protocol that would set all this out. Joint organisational arrangements such as an inter-governmental forum would support the protocol.

If officials develop policies and regulations relevant to local government in line with such a protocol, the policies and regulations would be more likely to solve the identified problems and achieve the desired outcomes. Following the protocol would also help

ensure that local government has adequate funding for any new tasks – either from central government or through the means to recovers their costs.

Better stewardship of the system

Central government needs to take its regulatory stewardship role more seriously. This includes better monitoring, oversight, coordination and capability building across the regulations that are relevant to local government. The stewardship role includes:

- gaining greater visibility of the system, including of all legislative instruments that affect local government;
- systematically and proactively monitoring and reviewing regulatory regimes, to ensure they are and remain fit for purpose;
- better data collection and analysis to inform on-going monitoring of the effectiveness, costs and other impacts of regulatory regimes;
- having processes to act on identified problems and opportunities for improving regulatory design; and
- improving coordination and policy coherence across central government, and the tiers of governments.

Better system stewardship requires central government to lift its capability in engaging with and understanding local government. This includes building knowledge of planning, regulation and local government more generally, across all agencies whose work impacts on the sector. Ways of improving this capability could include training, raising awareness, secondments between central and local government, and implementing the "Partners in Regulation" protocol described above.

All of these should be part of a process of continuous improvement. They should be led and coordinated by a single agency. The Department of Internal Affairs (DIA) leads central government's relationship with local government. DIA is responsible for policy advice to the Minister of Local Government and administers the LGA. It therefore makes sense for DIA to take the lead on lifting central government's stewardship of the system, supported by central agencies such as Treasury and the State Services Commission.

National direction and leadership to prepare for climate change

To help local governments prepare for climate change, central government should take the lead on providing high-quality and consistent science and data, standard setting and decision-making guidance (including around managed retreat), and legal frameworks. National direction is required, to provide clarity for all, and ensure a robust and consistent approach. It makes little sense for councils to be working individually on this – not only do they lack the necessary resources and expertise, but it would produce an ineffective patchwork of approaches.

The Government should also create a climate-resilience agency and associated fund to help at-risk councils redesign, and possibly relocate and rebuild, infrastructure threatened by sea-level rise and more intense flooding due to climate change. This agency should also assist regional councils and communities to lessen river flood risks.

While the timing and impacts of climate change are uncertain, there is considerable urgency in developing a national approach to adaptation. Communities in New Zealand and around the world are already starting to feel the impacts of climate change, and are confronting tough choices.

Circumstances where central government funding is justified

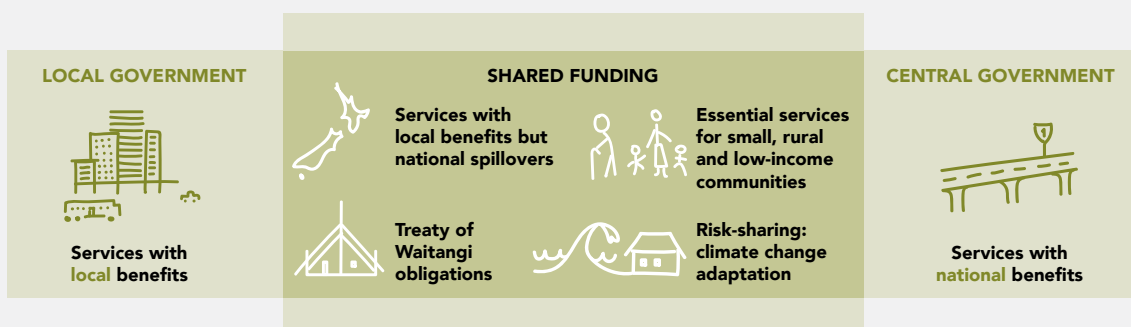
There is no secret pot of gold hiding under the flax bush, to help local government tackle all these challenges. Funding must come either from local citizens and ratepayers, or via central government from across all taxpayers.

It is important to note that ratepayers and taxpayers are broadly the same people. So, if we're going to shift costs from the ratepayer to the taxpayer, there needs to be a good reason to do so, and a principled way of going about it.

There are some specific circumstances where funding support from central government is justified.

- Firstly, risk sharing. The risks to infrastructure from the effects of climate change are concentrated in particular districts. To the extent that local communities are clearly unable to cover the costs, it is fair to share these costs across all taxpayers, through central government support.
- Secondly, some small and deprived areas have no prospect of providing for basic needs from local resources – in particular, safe water and safe wastewater treatment. Some of these communities will need financial assistance from central government to provide essential infrastructure and services to the minimum performance standards. At the same time, councils in this situation will also need to be open to new scalable technologies and organisational arrangements. For some small councils, aggregation may be the only the sensible way forward.

Figure 3 Should central or local government pay for publicly-funded local services?



- Thirdly, where central government places requirements on local government and national benefits flow from these requirements, a good case exists for a central government funding contribution. This is consistent with the benefit principle, which says that those who benefit from, or cause the need for, a service should pay for its costs. Central government funding is also justified where councils are fulfilling the Crown's responsibilities under the Treaty of Waitangi.

Related to the last point, is the matter of Crown land. Most Crown land is currently exempt from rates, aside from a limited set of targeted rates. This includes land occupied by institutions such as schools, universities and hospitals, as well as the conservation estate, which generate nationwide benefits but impose costs that are borne by local authorities. The Commission has therefore recommended that central government should pay rates on its properties, or at the very least cover the cost of council services benefiting these properties. Doing so would significantly relieve the funding pressures on councils, and could help avoid the need for multiple or complex new funding streams to councils.

Many local services provide benefits to both local communities and the nation as a whole. In these cases, shared funding – with contributions from both central and local government – is appropriate. On this basis, the Commission thinks that central government should provide significant additional funding for councils in some areas, including climate change adaptation and meeting minimum standards for water services.

4.9 Benefits of making these changes

Local government influences community wellbeing through many channels. Through their various roles in planning, land-use regulation and infrastructure provision, councils can provide greater access to, and choices of, housing; better protection of New Zealand's natural environment and cultural values; and quality infrastructure at the right time and in the right place. Success in these factors provides the foundations for urban and rural communities that offer a wide range of amenities and are attractive places to live; and where people consume, work, play and create.

On top of this, barriers to successfully growing cities have negative effects on national GDP. The Commission has investigated the impact of house prices on labour market mobility and found that the effect can be significant for movements of people in some industries. US evidence shows that overly restrictive land-use regulation that drives up house prices and dissuades people from moving may have reduced US GDP by as much as 9.5%.

In 2015, the Commission found that unlocking land for housing would catalyse productivity improvements across the housing supply pipeline. Work by the McKinsey Global Institute estimated this could reduce the cost of housing by between 8% and 23%. The figure was even higher for the world's least affordable cities, which include Auckland, at 31%-47%. Productivity improvements in the construction industry could reduce the cost of housing by a further 12-16%.

Better transport infrastructure would improve mobility, the decisions of firms and workers about where to locate, and job matching between firms and workers. Better pricing of infrastructure services would mean less congestion, more efficient decisions by developers about where to locate, and less wasteful use of scarce resources. It would also help councils avoid unnecessary investment and debt costs.

High-performing local government therefore matters a great deal to communities and the wellbeing of New Zealanders. Lifting the sector's performance could deliver substantial improvements across many dimensions of national wellbeing.

