RESEARCH NOTE

FUNDING THE FUTURE: THE CASE FOR SPECIAL PURPOSE BONDS

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DR ERIC CRAMPTON

THE NEW ZEALAND INITIATIVE

www.nzinitiative.org.nz

About the Author

Dr Eric Crampton is Chief Economist with the New Zealand Initiative in Wellington and Adjunct Senior Fellow with the Department of Economics and Finance at the University of Canterbury.

Eric covers policy areas ranging from local government and infrastructure funding and financing, to earthquake preparedness and climate policy. His economic policy commentary features regularly across New Zealand's major media outlets.

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Cover Image

Wellington City Heritage's archives include this photo and description of Ngaio's Town Hall.

"Ngaio was once part of Onslow Borough, which was inaugurated in 1890. The borough was disestablished in 1919, when the suburbs under its jurisdiction became part of Wellington City Council. The Onslow Progressive Association was formed as a response to the change in territorial authority, and was later (1922) split into Ngaio and Khandallah Progressive Associations.

The newly formed association strongly supported the building of the Ngaio Town Hall, a much needed local facility for public and social occasions. The association had strong community support and the hall was funded by a special rating of local residents who voted that they should pay higher rates for the next 10 years to repay the £5000 loan. Construction started in 1924 and the building was opened by Mayor Charles Norwood, on 1 August 1925."

Image: 1930 - Town Hall, Ngaio, Wellington. Negatives of the Evening Post newspaper. Ref: EP-2486-1/2-G. Alexander Turnbull Library, Wellington, New Zealand. http://natlib.govt.nz/records/22453381

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Infrastructure funding and financing contributes to housing shortages…

There are no silver bullets in housing and infrastructure policy. Too many separate problems compound, resulting in a severe housing shortage and some of the world's least affordable housing.

But, to steal a line from Treasury principal economist and housing expert Chris Parker, there may be silver buckshot.

Many separate problems require as many separate and targeted solutions. None of them, on their own, can solve the entire problem. But each one matters.

Making it possible to fund and finance the infrastructure necessary to support urban growth matters.

Councils have used their zoning and consenting functions to protect their balance sheets against the costs they perceive in accommodating urban growth.

Councils at their debt limits find it difficult to provide infrastructure.

Problems in funding and financing infrastructure compound existing issues in council finances.

It has resulted in dysfunctional housing policy. Rather than setting infrastructure to suit the needs of a city's residents, councils have instead had to force development to fit into tight infrastructure constraints.

This brief note highlights an alternative approach. It is no silver bullet, but it could be an important piece of silver buckshot. Other critical pieces of silver buckshot, like those highlighted by the Infrastructure Commission on infrastructure corridor designation,[1] are beyond the scope of this note.

It draws upon work undertaken by the Urban Land Markets Group, an informal group of subject-matter experts convened by Associate Minister for the Environment Phil Twyford, with authorisation of Environment Minister David Parker, to provide independent advice to the Minister in the context of resource management system reforms. The author of this summary research note was a member of the group.

In November 2021, the Urban Land Markets Group produced a research report titled "How we supply infrastructure makes housing unaffordable: Introducing a new approach to funding and financing our cities". In April 2023, the report was published by Auckland University's Economic Policy Centre.[2]

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[1] Dodge, N., et al. 2023. "Protecting land for infrastructure: How to make good decisions when we aren't certain about the future." *New Zealand Infrastructure Commission*. April.

[2] Blaschke, B., et al. 2021. "How we supply infrastructure makes housing unaffordable: Introducing a new approach to funding and financing our cities." Report to the Associate Minister for the Environment, November.

The Urban Land Markets Group's report argues that institutional barriers have prevented infrastructure supply from responding to growth and have contributed to housing shortages. It warns that resource management reform is at risk without new models of infrastructure funding and financing. And it proposes shifts in infrastructure funding and financing so that infrastructure can be delivered.

The change it proposes, to project-based financing options in which those benefitting from infrastructure projects cover the project costs over time, is hardly novel. It is how council infrastructure projects were funded and financed a century ago and continue to be funded and financed in the United States of America.

New Zealand has neglected its past,[3] and current lessons from overseas.

…and makes for an ugly problem.

New Zealand's housing shortage is, at its base, and infrastructure funding and financing problem combined with a council funding problem.

When a city grows, central government enjoys substantial increases in income tax revenue, GST, and company tax. Local council sees none of that upside benefit. Council's ratings base will be stronger, so council can increase the overall level of expenditure supported by that base over the longer term. But the up-front costs of accommodating that growth are high.

And while growth provides council with a larger ratings base across which to spread its budget, it also has a thorny infrastructure funding and financing problem.

While council debt limits are not hard and binding constraints, breaching them increases council borrowing costs. Those costs would then be spread across the council's ratings base.

Options that would sheet the cost of new infrastructure to the beneficiaries of that infrastructure do not work well when a council is at its debt limit.

Councils can set special ratings areas that levy properties benefitted by new infrastructure. But infrastructure should be financed over the decades of its expected life.

Imagine a council at a 280% debt-to-income limit. If a new pipe would cost $280 million, the special ratings area financing the pipe's debt would have to quickly deliver $100 million in annual revenue to avoid breaching council's debt limits.

The annual revenue from new development enabled by infrastructure might be able to cover the cost of that infrastructure if that cost is spread over the decades of its life, but not over the much shorter period required by council debt limits.

[3] For more excellent lessons from New Zealand's history, see Birchall, M. 2023. "Paving the Way: Learning from New Zealand's Past to Build a Better Future". *The New Zealand Initiative.*

In short, the bulk of the benefits of urban growth accrue to central government while local councils bear the bulk of the cost of accommodating urban growth. Poor outcomes should not be surprising.[4] Neither should urban planning cultures that treat growth with disdain.

The Urban Land Markets Group warned that a vicious cycle results when councils cannot properly fund and finance infrastructure and turn to zoning policy to contain costs.

> *To reduce costs, often urban planning policies further restrict development opportunities. Urban land prices escalate. But as land prices escalate, developers delay bringing homes to market in order to reap greater profits later. A fear of missing out from escalating capital in turn increases demand, creating a brutal dynamic from which only landowners profit.*
>
> *This vicious cycle is particularly resilient to change, because increasing land prices also increase the costs to supply public infrastructure. These escalating costs stress the willingness and ability of local and central governments to financially support the planning system, fostering cost saving over value creation.* [5]

Council debt limits are typically not hard and fast constraints, but instead are limits triggering higher interest rates if exceeded. Those costs are also difficult to ring-fence to beneficiaries of specific pieces of infrastructure.

Nothing prevents councils from setting debt that is backed by revenues from a specific project or from defined revenue streams. But perceived risk that council would back special purpose bonds with general revenues in case of distress means those bonds may not be considered separate from council main balance sheet.

It is also an underlying problem in water infrastructure reform, where complex governance arrangements are proposed as mechanism for achieving balance sheet separation.

When all council debt counts toward council debt limits, including debt with designated revenue streams from beneficiaries of funded infrastructure, infrastructure funding and financing becomes far more difficult.

Because councils do not have the tools enabling them to spread infrastructure costs among the beneficiaries of infrastructure over time, it instead must spread those costs them over a far shorter period of time across a much broader set of ratepayers – including those who do not directly benefit.

At the same time, use of general obligation debt means council, and ratepayers overall, bear risk of a failed infrastructure project.

All of it creates a political economy constraint against enabling growth.

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[4] See discussion in Blaschke et al, op. cit., section 3.

[5] Blaschke et al, op cit. p. 15.

Box A: The financing environment

The Local Government Funding Agency (LGFA) enables council borrowing at competitive rates …

The LGFA helps councils raise debt on international markets making longer-term borrowing available and providing more competitive loans than if councils raised debt.[6] The LGFA is a Council Controlled Organisation owned 80% by councils and 20% by the Crown.[7]

… but also imposes fiscal discipline though debt ceilings

The LGFA requires fiscal discipline in relation to debt in order to maintain very high credit ratings needed to access funds at a discount. This burden is passed on to councils by way of financial commitments (covenants), which councils freely and collectively accept (they are not fiscal constraints imposed by central government).

The covenants impose limits on councils' debt ceilings in the form of net debt to revenue ratios that typically must be below 250% ($2.50 of debt per $1 of annual revenue). [8] The councils experiencing the strongest growth rates and most in need of infrastructure tend to be nearing their debt ceilings.

Adapted from Urban Land Markets Group, pp 37-8.

The Urban Land Markets Group pointed to urban growth boundaries as a likely example of constraints imposed by councils because of funding and financing barriers.

Services provided by the private sector, like telecommunications and energy, tend not to hold up urban development. Those infrastructure providers can finance viable projects using project revenues.

But council-provided infrastructure becomes a barrier requiring staged release of land for growth and development, both through the Auckland Unitary Plan process and in Auckland's Future Land Supply Strategy.[9]

The problem has emerged again in Auckland's proposed Future Development Strategy, which rules out private plan changes that threaten Council's preferred sequencing of development.[10]

But staged slow release of land for development maintains high land prices.

[6] Vammalle, C. & Bambalaite, I. 2021. "Funding and financing of local government public investment: A framework and application to five OECD countries." OECD Working Papers on Fiscal Federalism No. 34.

[7] Local Government Funding Agency. "About LGFA". www.lgfa.co.nz/about-lgfa

[8] The infrastructure funding and financing implementation pilots covering the Hamilton to Auckland Corridor and Eastern Bay of Plenty demonstrate how funding sources for infrastructure projects are pooled and packaged into bespoke tools for public and private delivery models. See PwC & Department of Internal Affairs, 2020a, 2020b.

[9] Blaschke et al, op cit., pp. 22-3.

[10] Crampton, E. 2023. "Government has allowed councils to block new development." *Newsroom*. 9 May. Available at https://www.newsroom.co.nz/govt-has-allowed-councils-to-block-new-development

As the Urban Land Markets Group summarised:

> There are many barriers that can limit willingness or ability of public bodies to responsively supply services. Some affect both central and local government. They can be broadly grouped into three categories: **incentives, finance** (including risk) and **tools**.
> - Current *incentives* do not motivate decision makers to proactively drive development.
> - *Finance* is limited to public debt because risk cannot be transferred to third parties and public debt is constrained.
> - Even if decision makers are motivated, their *tools* are limited by their link to public debt.

Blaschke et al., p.28.

The financial challenge facing councils is large.

The Urban Land Markets Group found a range of estimates of the infrastructure investment cost per dwelling in Auckland City from 2017 through 2019, with all estimates substantial.

Figure 3: Estimates of infrastructure investment costs per dwelling in Auckland City

Source	Approximate scope of services	Value
Auckland Council[11]	Costs include public infrastructure (excluding Waka Kotahi's share of transport)	$135,000
MBIE and MfE[12]	Costs include public infrastructure as well as private installation costs of on-site development to connect site with the wider network	$100,000–$133,000
Treasury[13]	Costs include: • public infrastructure (share of $95,000) including three waters • transport (including regional arterial transport and major transport network expansion such as motorways and mass transit, excluding Waka Kotahi's share of transport) • schools, as well as a 15% contingency for cost escalation, but excludes healthcare facilities. Costs also cover private on-site development (share of $95,000) including three waters, local roads, energy, telecommunications, pocket parks and professional services fees)	$95,000–$190,000

Blaschke et al., Figure 6, p.22.

While the costs of servicing a section with infrastructure are high, so too are the gains from allowing more sections to be developed. The Infrastructure Commission, in 2023, estimated that Auckland's urban growth boundary adds over $600,000 to the cost of land for a 500 square metre section at the edge of town.[14]

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[11] The Treasury derived this figure from the Auckland Plan. See Auckland Council. 2018. "Auckland Plan 2050". Available at https://www.aucklandcouncil.govt.nz/plans-projects-policies-reports-bylaws/our-plans-strategies/auckland-plan/about-the-auckland-plan/docsprintdocuments/auckland-plan-2050-print-document.pdf

[12] MBIE & Ministry for the Environment. 2017. "National Policy Statement on Urban Development Capacity: Price efficiency indicators technical report: Rural-urban differentials." Available at https://www.hud.govt.nz/assets/Urban-Development/NPS-UDC/34f4e7cf0b/National-Policy-Statement-on-Urban-Development-Capacity-Price-efficiency-indicators-technical-report-Rural-urban-differentials.pdf

[13] The Treasury, 2019. Unfunded costs of development infrastructure to catch up to Auckland's population growth. T2019/2929.

[14] New Zealand Infrastructure Commission. 2023. "Urban land prices – a progress report". Available at https://www.tewaihanga.govt.nz/assets/Uploads/Urban-land-prices.pdf

Adding urban zoning to a section of rural land adds over $600,000 to that land's value: more than three times the highest cited estimate of the average infrastructure cost per dwelling in Auckland. Even if infrastructure at city fringes costs more than the city's average, there seems to be substantial value that could be unlocked if only infrastructure could be delivered.

But it requires funding and financing mechanisms that discover which infrastructure investments can pay themselves off over their lifetime, and that allow those investments to do so.

We do not need to look far to find such mechanisms.

We can look to New Zealand's past to help build its future…

Historically, New Zealand funded and financed infrastructure differently. Individual infrastructure projects were funded by specific debt. This debt was financed, over time, by revenues that came from the funded project – whether direct revenues, user fees, or special rates assessed on properties benefitting from the infrastructure.

The Local Bodies' Loans Act 1913[15] authorised councils to raise special loans backed by levies on properties benefitted by the funded works.

The local authority needed to publicise the purpose of the loan; the sum to be borrowed; the proposed security and provision for repayment; and whether the cost of the loan, or the interest and sinking fund for the first year, were proposed to be covered by the loan.[16]

Then, a poll of ratepayers was taken. If at least three-fifths of cast ballots agreed, the proposal was enacted. If the proposed works and levies for debt repayment applied to a smaller number of properties, a tighter majority threshold was required: the consent of three-fourths of affected ratepayers was required, and the capital value of agreeing properties needed to exceed the capital value of dissenting properties.[17]

The effect of this kind of double-majority requirement is discussed in a more modern context in Box B, below.

Assent of affected ratepayers was needed because the loans could be backed by a special rate on those properties; the works themselves as well as the revenues therefrom could also stand as security, as well as other properties or revenues of the local authority.[18] Revenues already pledged as security against other debt could not be re-pledged.

From the ratepayers' perspective, there would be a simple test. If the combination of the project and the special levy to finance it provided net benefits, those benefits would be

[15] See http://nzlii.org/nz/legis/hist_act/lbla19134gv1913n30235/
[16] Section 9, Local Bodies' Loans Act 1913.
[17] Section 16(e), Local Bodies' Loans Act 1913.
[18] Section 19, Local Bodies' Loans Act 1913.

reflected in their property's value. So a ratepayer might vote for the proposal if the ratepayer's property would be likely to increase in value.

You can consequently think of a special ratings area as equivalent to a value uplift charge spread over time. The cost of infrastructure was recouped, over time, from the uplift in value that the infrastructure provides to serviced properties.

In today's terms, the loans would not have achieved full balance sheet separation.

If a special loan were secured by a special rate over a portion of the district, council could decide, with the consent of the Audit Office, to pay off that loan through a loan from the general fund – provided that the annual cost not exceed one hundred pounds.[19]

Council's potential liability for a special purpose loan was limited and was small relative to the size of the special purpose loans.

Consider, for example, the Avondale Borough Council's notification of its intention to take on debt to fund sewerage works and street improvements, financed by a special rate of two pence and one-tenth of a penny in the pound sterling on the rateable value (on basis of the unimproved value) of all rateable property in the North Ward of the Borough.[20]

Had council wished to take this debt onto its main balance sheet through a loan from the general fund, it could have done so – so long as the total cost of taking on the loan of eighteen thousand pounds did not exceed one hundred pounds in any year.

Infrastructure for Avondale was funded by special purpose debt, financed by a small annual levy on benefitting properties over thirty-six and a half years, and authorised by the assent of affected ratepayers.

And Avondale is hardly the only example. The 5 March 1924 issue of the New Zealand Gazette in which Avondale's North Ward's debt for improvements was notified included notifications for similar debt from the Mount Wellington Road Board, the Franklin Electric-Power Board, the Wairau River Board, the Pukeokahu-Taoroa Rabbit District, the Otorohanga County Council, two projects for Masterton County Council, and two additional projects from Avondale Borough Council.

After 1926, the Local Government Loans Board provided oversight and scrutiny of local government borrowing.[21] The Board's assessment of the loan proposal then needed to be provided to ratepayers before any ballot on the project.[22]

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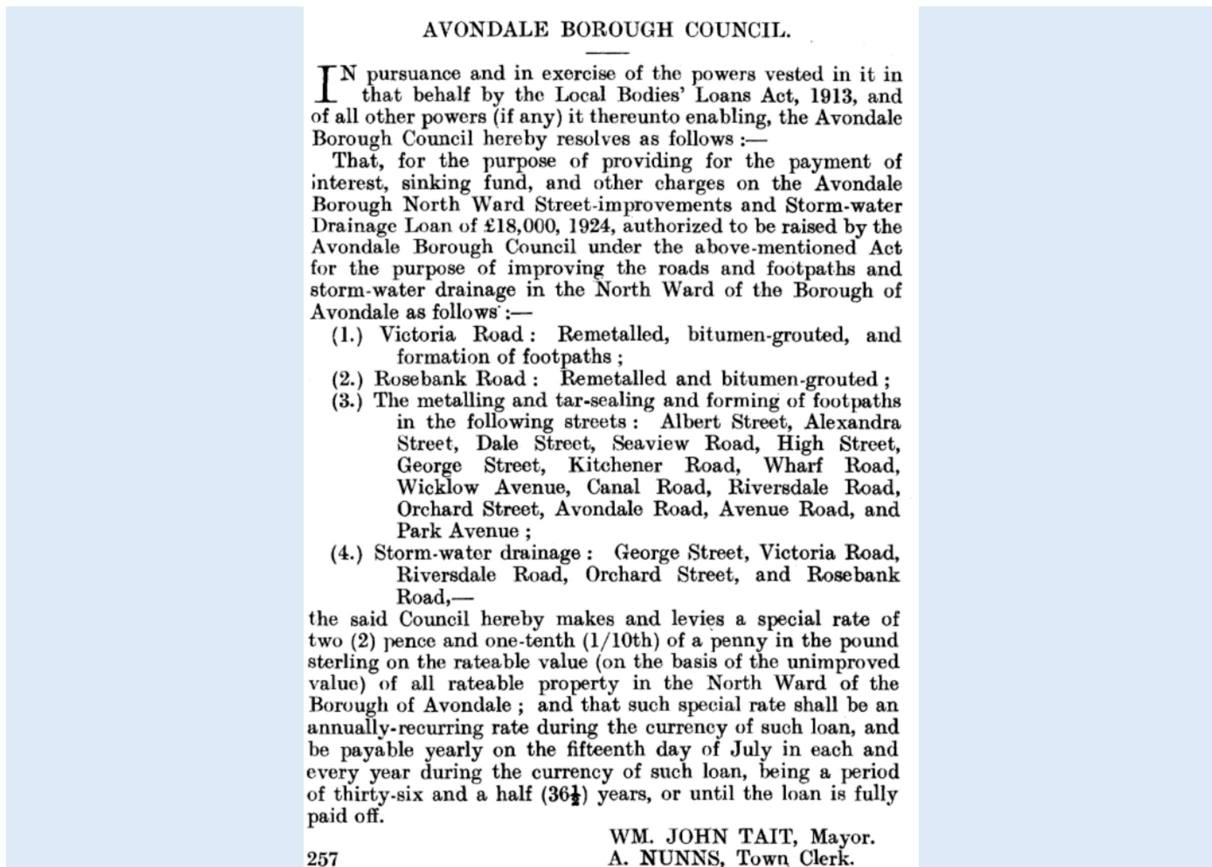
[19] Section 21(2), Local Bodies' Loans Act 1913.

[20] *The New Zealand Gazette*, Wellington, Thursday March 5, 1925, www.nzlii.org/nz/other/nz_gazette/1925/16.pdf . Noted in Blaschke et al., p. 69.

[21] Luiten, J. 2011. "Local Government in Te Rohe Potae: A Report Commissioned by the Waitangi Tribunal" reports that "in the 13 years from 1930-31 to 1943-4 it is estimated that applications for some £8.5 million worth of loans were declined by the board or referred back for further consideration." Available at https://forms.justice.govt.nz/search/Documents/WT/wt_DOC_792796/Wai%20898%2C%20A024.pdf

[22] Section 8, Local Government Loans Board Act 1926.

Figure 4: Avondale Borough Council (NZ) raises special purpose debt in 1924 to pay for infrastructure



AVONDALE BOROUGH COUNCIL.

IN pursuance and in exercise of the powers vested in it in that behalf by the Local Bodies' Loans Act, 1913, and of all other powers (if any) it thereunto enabling, the Avondale Borough Council hereby resolves as follows :—

That, for the purpose of providing for the payment of interest, sinking fund, and other charges on the Avondale Borough North Ward Street-improvements and Storm-water Drainage Loan of £18,000, 1924, authorized to be raised by the Avondale Borough Council under the above-mentioned Act for the purpose of improving the roads and footpaths and storm-water drainage in the North Ward of the Borough of Avondale as follows :—

(1.) Victoria Road : Remetalled, bitumen-grouted, and formation of footpaths ;
(2.) Rosebank Road : Remetalled and bitumen-grouted ;
(3.) The metalling and tar-sealing and forming of footpaths in the following streets : Albert Street, Alexandra Street, Dale Street, Seaview Road, High Street, George Street, Kitchener Road, Wharf Road, Wicklow Avenue, Canal Road, Riversdale Road, Orchard Street, Avondale Road, Avenue Road, and Park Avenue ;
(4.) Storm-water drainage : George Street, Victoria Road, Riversdale Road, Orchard Street, and Rosebank Road,—

the said Council hereby makes and levies a special rate of two (2) pence and one-tenth (1/10th) of a penny in the pound sterling on the rateable value (on the basis of the unimproved value) of all rateable property in the North Ward of the Borough of Avondale ; and that such special rate shall be an annually-recurring rate during the currency of such loan, and be payable yearly on the fifteenth day of July in each and every year during the currency of such loan, being a period of thirty-six and a half (36½) years, or until the loan is fully paid off.

WM. JOHN TAIT, Mayor.
257 A. NUNNS, Town Clerk.

A special rating area need not be the sole source of financing.

The Auckland Harbour Bridge was funded by a bond financed by drivers' toll charges over subsequent decades.

As Matthew Birchall summarised:

> *"The bridge's funding and financing model and its workings were so successful they can inform infrastructure decision-making even today. The Auckland Harbour Bridge Authority [AHBA] financed the bridge largely by issuing revenue bonds. Investors purchased these bonds and loaned money to the AHBA to fund construction and maintenance. In return, investors received regular interest payments and the principal when the bond matured. Toll revenue, meanwhile, helped the AHBA pay back the bondholders and finance its other debt.*
>
> *It was an attractive proposition. The first public issue for £375,000 was floated in December 1954 and was quickly subscribed. That would hold true for all subsequent bond issues."*[23]

[23] Birchall, M. Op Cit. pp. 30-1.

Revenue bonds and their equivalents funded the construction of iconic, and more mundane, bits of New Zealand's historic infrastructure.

A century ago, New Zealand had a flexible way of funding and financing infrastructure projects, backed by the assent of affected ratepayers who covered the project's cost over time.

In these historic cases, sometimes special-purpose debt was issued by council for a specific purpose. Sometimes, a special purpose local board was established to fund, deliver, oversee, and finance the infrastructure.

Provision for these special-purpose boards was removed in 1989.

Historically, ratepayers agreed to works that they expected would provide net benefits. The debt that funded the works was financed by special levies on properties benefitted by the works.

The Local Government (Amendment Number 5) Act 1995 revoked the architecture that required ratepayer authorisation for debt and that had aimed to ensure that the beneficiaries of works were the ones who financed those works over time.[24]

Principles of ratepayer assent have largely been lost, except in the case of business improvement districts discussed in Box B, below.

But similar practice remain common overseas.

…while also looking abroad to places that still use project-based financing.

Project-based financing through revenue bonds remains common internationally. Indeed, in the United States, it is the norm. The General Obligation bonds that are the current norm in New Zealand make up only 28% of municipal debt in the United States. Revenue bonds make up 68% of the market.[25]

MunicipalBonds.com tracks American municipal debt, listing the issuers of municipal bonds in each state – large and small.

In March of 2023, New York City's Municipal Water Finance Authority issued $1.3 billion in bonds extending through 2047 payable solely from and secured by a pledge of and subordinate lien on the gross revenues of the water system.[26] In February, Fitch rated those

[24] See Local Government Amendment Bill (No. 5) 1995 (69-2D). Available at http://www.nzlii.org/nz/legis/hist_sop/lgab51995692potlglrb6911996206847/

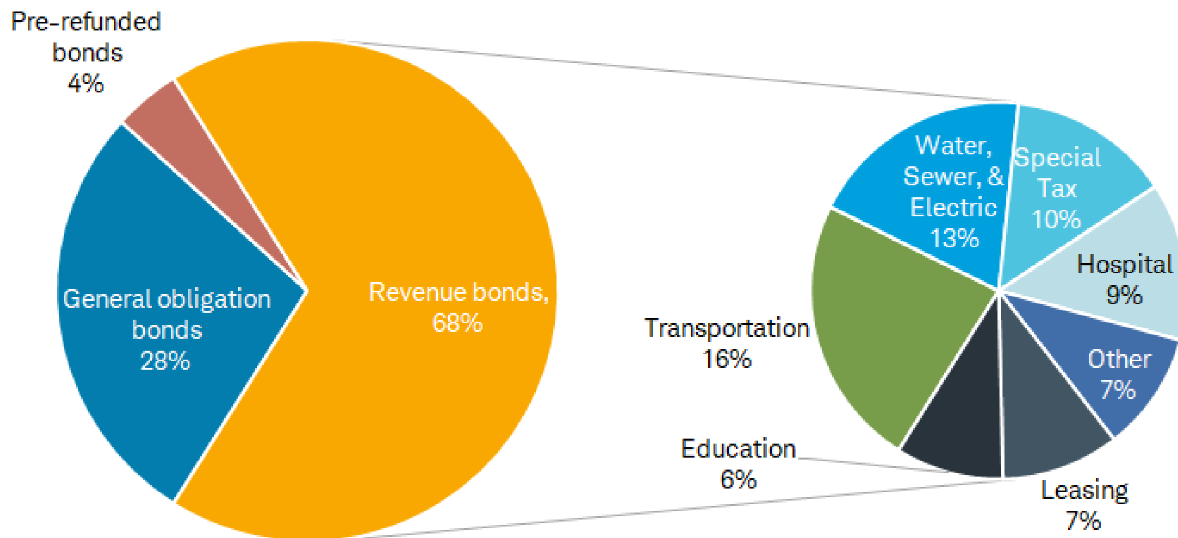
[25] Howard, C. 2023. "Choosing Municipal Bonds: GO or Revenue?". Charles Schwab. 18 January. Available at https://www.schwab.com/learn/story/choosing-municipal-bonds-go-or-revenue

[26] New York City Municipal Water Finance Authority. 2023. "Water and Sewer System Second General Resolution Revenue Bonds Fiscal 2023 Series DD." Bond Statement, New York City Municipal Water Finance Authority. https://www.nyc.gov/assets/nyw/downloads/pdf/bond-statements/nyw-2023dd.pdf

water system bonds AA+.[27] In doing so, it noted that the water authority was viewed as bankruptcy-remote from the city, so the city's financial position posed little risk to the creditworthiness of the water authority.

New York City is enormous. It is no surprise that its giant water system can raise large amounts of money on debt markets.

Figure 5: Composition of the American municipal bond market



SOURCE: COMPONENTS OF THE BLOOMBERG MUNICIPAL BOND INDEX, AS OF 10/1/2023, AS CITED BY CHARLES SCHWAB.[28]

But Albany, the capital of New York state, has a population of just under 100,000 people – a little smaller than Dunedin.

In 2001, Albany's parking authority issued $28 million in bonds to fund construction of the Quackenbush Square Public Parking Facility.[29] In 2019, $13.3 million in outstanding bonds, backed by revenues from the parking authority, earned an A- rating from S&P.[30]

A century ago, New Zealand councils were able to raise debt for critical infrastructure, with debt financing tied to payments over decades from the beneficiaries of that infrastructure. One ward of Avondale Borough paid off sewerage and street works with a special rate that financed debt over a period of more than three decades.

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[27] Fitch Ratings. 2023. "Fitch rates New York City Muni water Finance Auth's Revs 'AA+'; Outlook stable." 28 Feb. https://www.fitchratings.com/research/us-public-finance/fitch-rates-new-york-city-muni-water-finance-auth-revs-aa-outlook-stable-28-02-2023

[28] Howard, C. 2023. Op. cit.

[29] Capitalize Albany Corporation. No date. "Albany Parking Authority". Available at: https://capitalizealbany.com/partners/business-improvement-districts/albany-parking-authority/

[30] ParkAlbany.2019. "Albany Parking Authority's Bond Rating Raised to A-". Press release. 12 February. Available at: https://dev.parkalbany.com/index.php?option=com_content&view=article&id=72:quackenbush-lot-parking-information&catid=17&Itemid=130

Now, New Zealand councils at their debt limits face substantial difficulty in raising debt to cover the cost of infrastructure that could easily pay its own way, if given time to do so.

And the special purpose districts that once facilitated this kind of debt, like the Auckland Harbour Bridge Board but also catchment boards, district roads councils, land drainage boards and more, were abolished in local government reforms in 1989.[31]

But Kiwis can buy American long-term municipal debt backed by revenues from all manner of municipal public projects – including bonds backed by fees paid by people using a small city's parking garage.

New Zealand could look to its own past, and across the Pacific to current practice, to solve some otherwise intractable and truly costly problems.

The problem is already well recognised across the political spectrum…

If the first step in solving a problem is recognising that the problem exists, that step has long been hurdled.

In 2017, during debate on the National-led government's proposed Resource Legislation Amendment Bill, Labour's Phil Twyford urged the adoption of an amendment on infrastructure bonds, saying,

"We need to find ways of financing and allowing the provision of infrastructure to support new development, because the current system is broken. It is not possible to get rid of the urban growth boundary and replace it with a smarter way to manage urban growth unless you crack this problem of infrastructure financing. It goes right to the heart of it, because, after all, the urban growth boundary is a proxy for the difference between land that is serviced by infrastructure, or can be serviced by infrastructure, and land that cannot."[32]

The Labour-led government subsequently proposed and passed the Infrastructure Funding and Financing Act 2020 (IFF) intended to solve the problem.

While IFF allows setting a multi-year levy on the beneficiaries of infrastructure to finance special-purpose debt, other design issues have made the structure impracticable.

The Urban Land Markets Group summarised design issues as follows:

- Permission to use the model and strike a levy is granted by Cabinet in consultation with councils that consider whether a levy is affordable to the community. This reintroduces political economy pressures that ration access to finance.

[31] The Urban Land Markets Group tallied some 453 special purpose authorities prior to the 1989 reforms. See Blaschke et al., p.67.

[32] Twyford, P. 2017. "Resource Legislation Amendment Bill – In Committee". *Hansard.* 4 April. Available at https://www.parliament.nz/en/pb/hansard-debates/rhr/document/HansS_20170404_072000000/twyford-phil

- A development incurs a large portion of the costs upfront (around 30%) before applying to use the infrastructure levy for the purpose of raising the needed finance to pay for the project. Councils may need to raise upfront debt and take on development risk to enable this, introducing similar disincentives to development contributions.
- The high establishment and administration costs of the special-purpose vehicle only make this tool economically feasible for projects at or above $50 million.
- The levy cannot be readily applied to brownfield projects because the authorising environment for the use of the levy is not the community that benefits. The model does not have a mechanism built into it that enables beneficiaries to legitimise the levy and safeguard from the misuse of the power to strike the levy.
- Only a portion of developments (the growth aspect) can be funded through the levy, resulting in substantial funding required from council general rates, which burdens debt headroom. Greenfield projects do not completely get around this issue.[33]

For its part, the National Party has proposed expanding Crown Infrastructure Partners into a National Infrastructure Agency that would assess infrastructure proposals while administering an upgraded version of the Infrastructure Funding and Financing Act.[34]

While National's proposed policy has so far remained at a fairly high level, a national-level agency could play a role comparable to the Loans Board set in the 1926 Act.

Even without a proposed expansion into a National Infrastructure Agency, Crown Infrastructure Partners has been thinking about improving the Infrastructure Funding and Financing Act.

At this year's Building Nation's conference, Crown Infrastructure Partners' Deputy Chief Executive Sean Wynne discussed creating a three-tier model of the IFF Act: an off-the-shelf model for high-frequency use; a mid-tier offering enabling councils to bundle many projects together; and, a bespoke tier for more complex projects.[35]

Crown Infrastructure Partners reports that it has been working on streamlining the IFF process for greenfields development for much smaller developments and that there is no minimum transaction size.

They also note that while a large up-front cost is not necessary before applying to use IFF, "a degree of certainty" needs to apply to a development and that land ownership and consenting approvals would improve a development's standing. And while application in brownfields site is not precluded, beneficiary groups need to be identified and levy amounts need to be justified as affordable and reasonable.[36]

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[33] Blaschke et al., p. 35. However, Crown Infrastructure Partners has since reported that growth is not the only aspect that IFF can fund.
[34] National Party. 2023. "Infrastructure for the Future." Available at https://www.national.org.nz/infrastructureforthefuture
[35] Chris Parker, personal correspondence, reporting from the 2023 Building Nations conference.
[36] Sean Wynne, personal correspondence.

National and Labour have both found infrastructure funding and financing to need upgrading. Crown Infrastructure Partners has been working to make the Infrastructure Funding and Financing Act's mechanisms more fit for purpose.[37]

And the Final Report of the Review into the Future for Local Government suggested revenue bonds as example of a useful approach for enabling financing for community outcomes.[38]

…but lessons from the past have yet to be incorporated.

There has seemed to be cross-party consensus that infrastructure funding and financing is one root cause of housing shortages.

But the current Infrastructure Funding and Financing Act misses an important feature of earlier special purpose debt.

The earlier Acts required the assent of affected ratepayers. Doing so ensured that, if debt were backed by a special levy on benefitted properties, the owners of those properties saw the project as worthy.

In greenfields application, consent of those levied is straightforward. People buying new sections assent to the levy when buying the serviced properties.

Assent is more difficult to establish in brownfield application, either for renewing worn out infrastructure or for increasing capacity to enable urban growth.

Current practice requires assent of Cabinet because the associated special purpose vehicle has a form of taxing power. But without the kind of democratic legitimising structure found in the earlier Acts, the IFF structure becomes politically risky for urban intensification.

Achieving unanimous consent for any proposal would be difficult. But where use of IFF requires the assent of neither a supermajority of affected ratepayers nor even a simple majority, legitimacy is difficult to establish. One ratepayer's complaint would look very different if a supermajority of that ratepayer's neighbours had agreed to the levy.

That legitimising structure remains in place for business improvement districts.

Unfortunately, those districts cannot take on debt backed by their pledged revenues, so are limited in potential scope. But they do show a potential way forward in achieving and demonstrating consent for special purpose rating areas in brownfield locations.

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[37] The IFF Act was passed in 2020. In December 2022, the government announced the first use of the Act for transport infrastructure upgrades in Tauranga. See Ministry of Housing and Urban Development. 2022. "Infrastructure Funding and Financing Act used for the first time." December. Available at https://www.hud.govt.nz/news/infrastructure-funding-and-financing-act-used-for-the-first-time/

[38] Review into the Future for Local Government. 2023. "Final Report". p.61. Available at https://www.futureforlocalgovernment.govt.nz/

Box B: Consent for change

There are opportunities to create value for residents …

Think about a neighbourhood where every property doubles in value if land could be put to a more intensive use and infrastructure to support intensification costs only a fraction of that value uplift. Existing owners would see a substantial increase in value while the cost of housing for new residents would decline as more homes and apartments would sit on the same land area.

It seems like a simple problem to solve. But urban intensification is too easily stymied by difficulties in apportioning infrastructure costs.

… but intensifying urban areas can be politically challenging

If a few existing owners have no interest in redeveloping their properties and cannot bear their share of the infrastructure cost, those owners have a compelling case. They need simply argue that they did not need the new infrastructure, have no interest in it and will be forced to sell their family home because of the charges covering those costs.

Fear of that outcome has meant councils seek to take on infrastructure cost as part of the general rates bill rather than pushing costs back onto the beneficiaries of the infrastructure. That, in part, builds more general opposition to councils enabling growth. Ratepayers take it as a cost rather than a benefit because the costs are spread broadly across many who enjoy no benefit at all.

A simple principle of public economics – the benefit principle of taxation – holds that it is best when those who benefit from an amenity fund that amenity. Without a way of ensuring the consent of those levied to cover costs, it is difficult to tell if the amenity is valued. It is difficult to demonstrate the democratic legitimacy for a rates imposition that comes without that kind of consent, making projects politically vulnerable.

Thankfully, business improvement districts show a path forward

But there is a simple solution, already operating in New Zealand. Our business improvement districts show how to cover the cost of infrastructure upgrades and ensure the consent of those footing the bill.

Brownfield intensification, through mechanisms supported by the Infrastructure Funding and Financing Act, has been considered too politically difficult.

When business owners in a village centre wish to undertake works to improve local amenities, they can set a targeted levy on themselves to cover the cost. Local business owners develop the proposal. If more than 25% of affected businesses support the proposal, a formal process begins.

How might it work in practice?

Wellington Council’s process provides an excellent example.

On securing the indicative support of at least a quarter of affected businesses, the proposers formalise the proposed business improvement district – setting boundaries and developing the business plan outlining the proposed activity, the costs and the targeted rate that would be needed. They can set a flat rate, a rate that varies with property value or a hybrid rate combining the two.

Ultimately, the proposal is put to a vote of existing owners with a double-majority requirement. At least 25% of eligible business owners must vote. If a majority of eligible voters support establishing the district and that majority also represents most of the rating valuation of those voting, the district is established.

The double-majority guards against exploitation

The double-majority requirement offers a unique kind of protection. In a village centre, there can often be a lot of small shops and one or two larger anchor businesses like supermarkets. A majority by capital value would let the local supermarket dictate terms, but a majority by number would let a lot of small shops effectively expropriate the local supermarket. A double-majority prevents both types of exploitation – a small number of large owners cannot exploit a larger number of smaller owners, and a large group of small owners cannot exploit a large owner.

Source: Wellington City Council, Business Improvement District Policy.

Business improvement districts could easily be adapted to deliver residential infrastructure

This kind of mechanism could readily be adapted for consenting to new levies to fund residential infrastructure improvements. If a neighbourhood or street recognised the value that could be unlocked by infrastructure improvements, they could decide to levy their own properties to fund the works. The consent of those so levied would be assured by majority vote.

If a majority of affected properties by number, which also constituted a majority of the affected properties by value, agreed to levy themselves, they could do so. If the proposed levy was relatively high, the support and assent of 60% of properties by number, constituting 60% of properties by value, could be required.

Democratic legitimisation through this kind of double-majority voting system, and especially where proposals come from the affected communities themselves, could make it far easier to fund necessary infrastructure improvements through targeted rates.

Source: Box H, Blaschke et al., p. 58.

A way forward

Councils and council-controlled organisations should be able to issue debt that is backed by specified revenue streams rather than general council revenues. It should be able to structure that debt to be serviced over the lifespan of the funded infrastructure.

Doing so requires reducing the risk that council would want to use its general revenues to support a special-purpose bond if a project were to come under pressure, as outlined in Figure 6, below.

Historic infrastructure financing methods carried less risk of backstop council support.

Ratepayer consent for infrastructure debt reduced the risk of default by making wholly uneconomical projects less likely: ratepayers benefitting from projects also covered the project's cost, over time. And council could not substantially bail out bonds covering works serving only part of a district and backed by a special ratings area on that part of the district.

Restoring aspects of the earlier period's debt authorisation framework, like assent of affected ratepayers, could help in reducing bailout risk.

So too could provisions like those in the 1913 Act that limited the amount of support local authorities could provide for a special project bond.

Separation from council's general revenue could let special-purpose debt backed by specified revenue streams be assessed according to the funded project's merits – without direct effects on council general obligation debt.[39]

The ballot mechanism used in setting business improvement districts could be used in authorising revenue bonds backed by revenues from a special ratings area. Council would propose the project and the distribution of costs; the Local Government Funding Agency would give an indicative assessment of financing; and, the ratepayers whose properties would foot the bills would decide whether the project was likely to add value.

But projects need not be initiated by council or council-controlled entities. Business Improvement Districts can currently establish and levy themselves to fund local works. Those levies could form the revenue stream backing a revenue bond.

And that option opens additional opportunities. Rather than having to wait for council to initiate projects, neighbours seeking to achieve a common purpose best financed over a longer term could levy themselves to do so.

[39] See discussion at Blaschke et al., p. 27. Note as well that the Local Government Funding Agency would be well-placed to assist in evaluating and marketing this debt. Were a structure like the Local Bodies Loans Board to be re-established, that body could assess whether the cumulative burden of rates and levies on a property introduced undue risk to council rates.

Figure 6: Assessment of time consistency to maintain revenue bonds

Mitigate inclination to bail out by reducing:	**Historic / Traditional** (1867–1995)[40]	**Modern** (1989 – present day)[41]
Chance of default	**Sufficient** – required majority voter approval to strike special tax and pledge it to a special project bond, and for tax to last the life of the bond. Demonstrable willingness to pay. Could have been enhanced by business case processes; the creation of the Local Authorities Loans Board in 1926 may have mitigated this.	Possibly sufficient – no local voter requirement to issue debts or pledge rates as security for debts, so projects undertaken could be uneconomic.
Elected representative incentive to relieve citizens of harm	Low, but **probably sufficient** Receiver of debt could not increase rates or sell property without permission of Supreme Court.	**Low** Receiver of debt can freely increase rates and sell property at will under s115 Local Government Act 2002.
Elected representative incentive to protect public image	**Sufficient** — voter approval required from 1876 to levy tax and issue bonds to insulate elected representatives from culpability. However, the Local Authorities Loans Board's strong powers may have shifted moral responsibility and recourse to the Crown.	**Low** Councils decide which projects to invest in.
Legislative ambiguity of no recourse	**Sufficient** Local Authorities were only liable for the pledged security of special revenues.	Low, but **probably sufficient**. Track record of Central Government transferring risk and liabilities to local governments.
Fiscal ability	**Sufficient** — Local Authorities could generally not significantly repay a special project bond if it was just for a part of their jurisdiction. However, if the project spanned the whole jurisdiction, Local Authorities could pay the whole debt from ordinary/general revenues.	**Low** Councils have somewhat hard budget constraints, but there are no strict limits to raising rates, repurposing spending and issuing new debts.

Source: Blaschke et al., p. 70.

[40] These include the Municipal Incorporations Acts 1867 and 1876, and the Local Bodies/Authorities Loans Acts 1886, 1901, 1913, 1926, 1956.

[41] These include Local Government Amendment (No 5) Act 1995, Local Government Act 2002, and Local Government (Ratings) Act 2002.

Consider Ngaio Town Hall, featured on the cover of this brief research note.

Wellington City Heritage records provide a beautiful story of how that hall came to be.[42]

> "Ngaio was once part of Onslow Borough, which was inaugurated in 1890. The borough was disestablished in 1919, when the suburbs under its jurisdiction became part of Wellington City Council. The Onslow Progressive Association was formed as a response to the change in territorial authority, and was later (1922) split into Ngaio and Khandallah Progressive Associations.
>
> The newly formed association strongly supported the building of the Ngaio Town Hall, a much needed local facility for public and social occasions. The association had strong community support and the hall was funded by a special rating of local residents who voted that they should pay higher rates for the next 10 years to repay the £5000 loan. Construction started in 1924 and the building was opened by Mayor Charles Norwood, on 1 August 1925."

While Crown Infrastructure Partners is working to make the IFF mechanism suitable for use in smaller-scale projects costing from $25 million, £5000 in 1924 is the equivalent of about $600,000 today.

Enabling much smaller-scale projects to take up this kind of funding and financing option enables communities to organise and build themselves.

A return to this kind of infrastructure funding and financing mechanism isn't some foreign imposition. It is a return to the kind of community self-organisation that enabled New Zealand to do wonderful things, without having to plead for council or government assistance in every case.

In modern application, a neighbourhood that preferred to levy itself to pay for flood protection works over the coming decades, rather than retreat from homes they love, would have a way of doing so. And a council less worried about having to cover those costs from general revenues would feel less need to compel a retreat.[43]

Opening up Business Improvement District Policy so that rural and residential properties could set similar districts would start to rebuild the community structures that had formed the basis for many public works prior to the 1989 reforms.

If those districts could issue debt backed by levies they set on themselves, and other specified revenue streams, we would not only unlock the funding and financing mechanisms necessary for dealing with the country's infrastructure deficit. We would also discover which locally-focused works were of greatest priority to their communities.

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[42] Wellington City Council. 2017. "Ngaio Town Hall". https://wellingtoncityheritage.org.nz/buildings/301-450/393-ngaio-town-hall

[43] A not entirely dissimilar mechanism was proposed in Bassett, M., L. Malpass and J. Krupp. 2013. "Free to Build: Restoring New Zealand's Housing Affordability." *The New Zealand Initiative.*

It does not solve every problem hindering development. Council cultures take a long time to change; price-based constraints on councils can help in the interim.[44] Too many people have standing to object to development projects, resulting in vetocracies in which nothing can be done. Regulation inflates the cost of infrastructure projects.

But the mechanism solves several conjoint problems.

Allowing the cost of infrastructure to be spread over time makes it feasible to ring-fence the financing of project-specific debt to the beneficiaries of the funded infrastructure.

The combination of ratepayer assent to levies and a market test on project-specific debt helps to sort viable projects from white-elephants that might later be regretted.

And all of it makes it far easier for councils to start saying yes to new development: one important piece of silver buckshot for restoring housing affordability.

[44] Crampton, E. 2023. "On the housing crisis Labour and National need to grow up (and grow out)." *Newsroom*. 6 June. Available at https://www.newsroom.co.nz/on-the-housing-crisis-labour-and-national-need-to-grow-up-and-grow-out . Please also see Lees, K. 2015. "The price is right: Land prices can help guide land use regulation." NZIER report to Ministry for the Environment and New Zealand Treasury. September. Available at: https://www.nzier.org.nz/publications/the-price-is-right-land-prices-can-help-guide-land-use-regulation

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