RESEARCH NOTE

'REVENUE SHARE' FOR HOUSING

AUGUST 2024

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THE NEW ZEALAND INITIATIVE

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Executive summary

This paper examines three options for providing financial incentives to local councils in New Zealand to enable more housing development:

1. Payments based on estimated GST on new residential builds.
2. Payments for residential consents above historical averages.
3. Payments are based on estimated GST rates.

The analysis evaluates these options against criteria including incentive strength, funding boost for councils, distribution effects, predictability, and potential for inflating payments.

Key findings:

- Option 1 provides a substantial funding boost but moderate incentives for housing development.
- Option 2 offers strong incentives but with more volatile funding.
- Option 3 is not recommended due to weak incentives and potential negative consequences.

The paper recommends proceeding with Option 1 or 2, or a combination thereof. It suggests refining these options to ensure robust data, strong incentives, and minimised risks of gaming the system.

Additional considerations include extending payments to non-residential buildings and tailoring payments for councils participating in city and regional deals.

The paper emphasises that new revenue sources should complement, not substitute for, fiscal responsibility in local government. It recommends that the government refine the preferred options; keep these options separate from city and regional deal arrangements that can be structured around their existence; and not proceed with payments based on estimated GST on rates.

In return, local government must demonstrate commitment to fiscal responsibility and efficient provision of local infrastructure and services. Participation in city and regional deals and the use of ratepayer referenda for major projects or large spending increases would help.

Overall, this approach aims to better align the financial interests of councils with national housing supply goals, potentially creating a virtuous cycle of growth and development.

Introduction

Local government funding has long been a subject of debate and concern. This year's council long-term plans have signalled ballooning spending, rates, and debt over the coming decade. Councils are facing increasing financial pressures from high inflation, costs of regulation, growing infrastructure needs, and expanding service demands. Some have made poor decisions leading to wasteful spending on frivolous projects coupled with poor management of their core activities.

Whatever their cause, financial pressures cause councils to treat growth as a cost to be mitigated through zoning and consenting rather than as a benefit to be sought. There is broad consensus that changing those incentives matters.

Central government is looking at reforming water infrastructure and infrastructure funding and financing, making it easier for councils to enable growth. It is developing a framework for city and regional deals to address challenges and opportunities facing councils and groups of councils. Deals will need new funding for councils to succeed, but letting all councils share more directly in the benefits from enabling growth also matters.

This has led to calls for central government to 'share revenue' with councils. A revenue share means central government provides funding to support councils in meeting their obligations and fostering economic and community development.

There are many ways to 'share revenue', but this analysis examines three main options: (1) payments to councils based on estimated GST on new residential builds, (2) payments to councils for new residential consents above the average of preceding years, and (3) payments to councils based on estimated GST on rates.

The first option was proposed in 2023 by ACT in a Members Bill, the *Housing Infrastructure (GST-Sharing) Bill*. The second option was also proposed in 2023 by the National Party prior to the General Election in its *Going for Housing Growth* policy.

Options 1 and 2 are both catered for in the National-ACT Coalition Agreement" which committed the government to *"introduce financial incentives for councils to enable more housing, including considering sharing a portion of GST collected on new residential builds with councils"*. [1]

The third option was recommended by the Review into the Future for Local Government and the local government sector has since promoted it.

The first and third options seek to provide payments to councils equivalent to a portion of estimated GST revenue, but their focus, implementation, and potential impacts differ. The second option is a fixed payment for residential building consents above councils' preceding five-year averages.

We also look at an additional option of payments for non-residential building work.

This analysis will explore each option's mechanics, pros and cons, and potential implications for local and central government. A particular focus is on whether the options would improve incentives for councils to encourage growth and development.

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[1] National Act Coalition Agreement, November 2023, https://www.national.org.nz/national_act_and_new_zealand_first_to_deliver_for_all_new_zealanders

Fiscal context

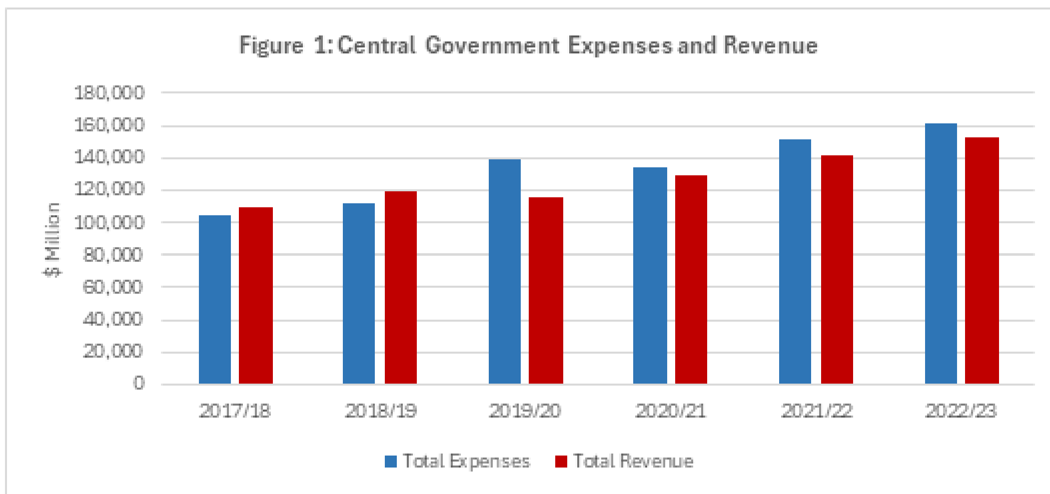
Before discussing the options, it is important to consider the fiscal context of both central and local governments.

Over recent years, both tiers of government have experienced strong spending growth, with revenue growth not keeping pace. Both tiers have been running large operating deficits and have had significant increases in debt to finance their operating deficits and capital investment in infrastructure.

This year central government has been seeking to curb its spending to close its deficit and fund tax cuts. However, this seems less the case for local government, where reports suggest most councils' spending and rates will continue to grow strongly in 2024/25 and beyond.[2]

Central Government[3]

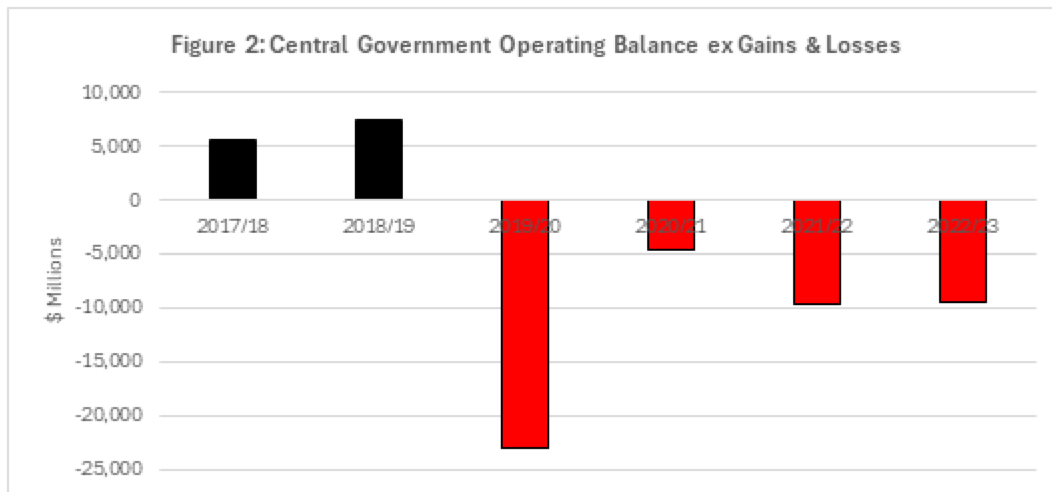
- GST revenue in 2022/23 was a net $28.13 billion (i.e., after refunds).
- Total Crown tax revenue was $111.72 billion and total Crown revenue was $153.01 billion. Total Crown expenses were $161.82 billion (Figure 1).
- Operating balance, excluding gains and losses in 2022/23, was a deficit of $9.45 billion. (Figure 2)
- Gross core Crown debt of $135.79 billion. (Figure 3)



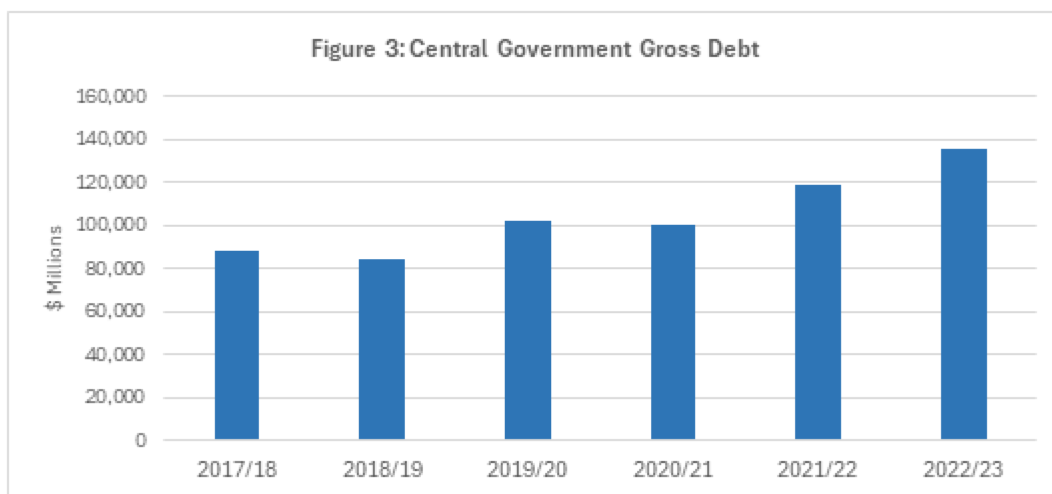
Source: Financial Statements for the Government of NZ, the year ended 30 June 2023

[2] For example, the NZ Taxpayers Union's Rates Dashboard 2024, released 15 July 2024, https://www.taxpayers.org.nz/taxpayers_union_releases_2024_rates_dashboard

[3] Financial Statements for the Government of New Zealand for the Year Ended 30 June 2023, NZ Treasury, October 2023, https://www.treasury.govt.nz/publications/year-end/financial-statements-2023



Source: Financial Statements for the Government of NZ, the year ended 30 June 2023

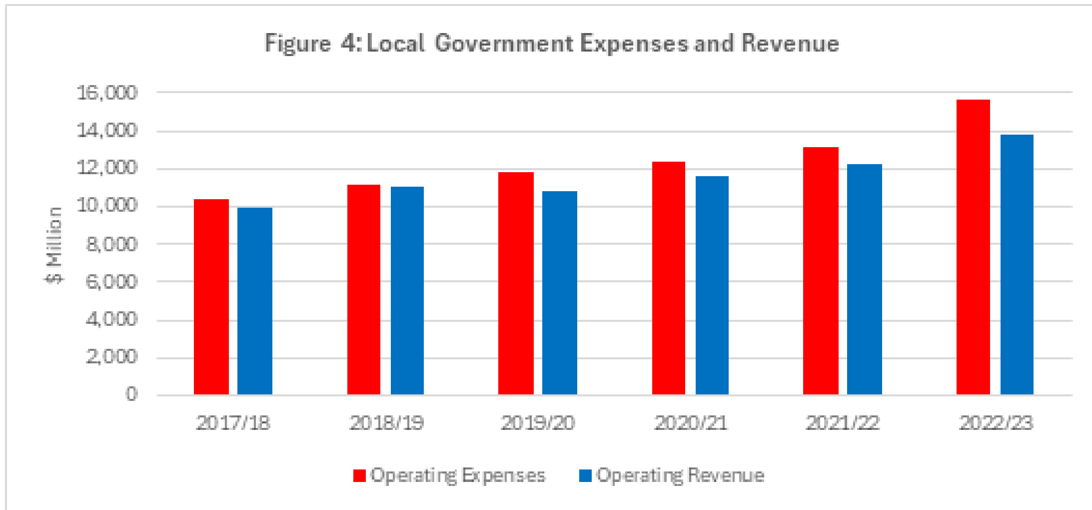


Source: Financial Statements for the Government of NZ, the year ended 30 June 2023

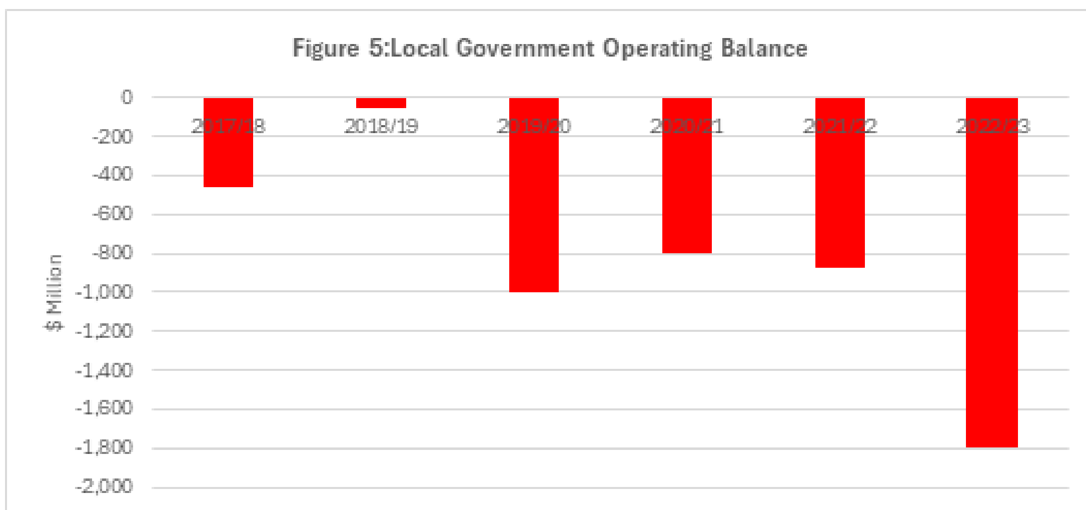
Local Government[4]

- Rates revenue in 2022/23 was $7.96 billion.
- Operating revenue, which includes subsidies, user charges and investment income, was $13.82 billion. Operating expenses were $15.61 billion. (Figure 4)
- Operating balance in 2022/23 was a deficit of $1.79 billion. (Figure 5)
- Total debt of $26.24 billion. (Figure 6)

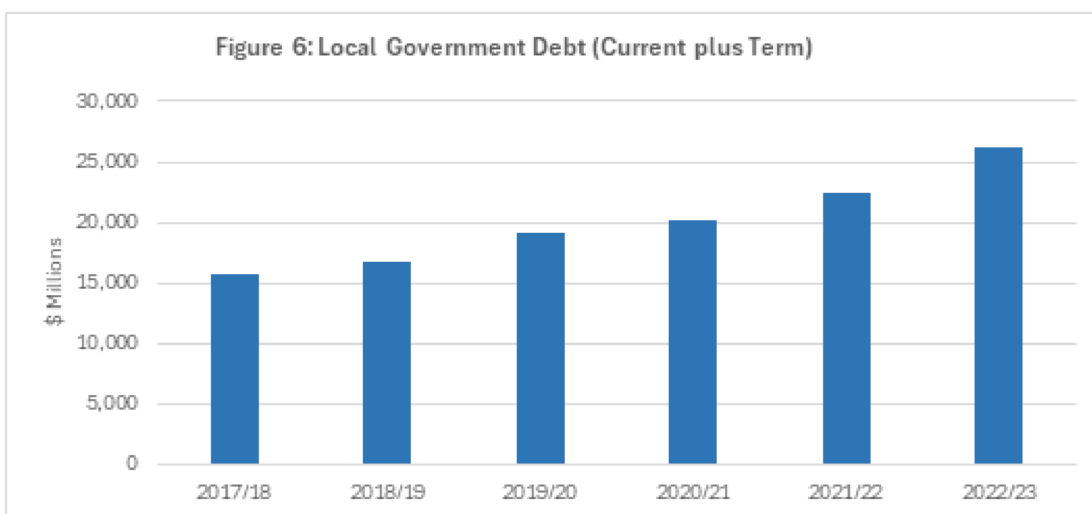
[4] Statistics NZ Local Authority Financial Statistics, Year to June 2023, https://www.stats.govt.nz/information-releases/local-authority-financial-statistics-year-ended-june-2023



Source: Statistics NZ Local Authority Financial Statistics



Source: Statistics NZ Local Authority Financial Statistics



Source: Statistics NZ Local Authority Financial Statistics

Many councils are facing acute financial pressures from high inflation, costs of regulation, growing infrastructure needs, and expanding service demands. Some have made poor decisions leading to wasteful spending on frivolous projects coupled with poor management of their core activities. Of course, much the same could be said of central government as well.

The charts above are historic but this year's councils' long-term plans indicate further large increases in spending, revenue, and debt over the coming decade.

There have been complaints that existing funding and financing tools are becoming 'less sustainable' and are causing them to discourage housing and economic growth. This has driven calls for central government to 'share revenue' with councils. While there may be a case for funding transfers to councils in certain circumstances, care is needed so transfers do not create distortions or perverse incentives. In particular, it is important to ensure that councils are not given a signal that they will be 'bailed out' if they make poor decisions.

Following are some examples (not an exhaustive list) where revenue sharing is already in place or might be appropriate, subject to being carefully designed and implemented:

- Funding from the National Land Transport Fund to assist councils with maintenance and improvements to local transport infrastructure (e.g. local roads, cycling and pedestrian) and services (public passenger transport);
- Recovery from large-scale natural disasters (e.g. the North Island Severe Weather Event);
- Support in meeting obligations from nationally-imposed regulations (i.e. addressing the 'unfunded mandate');
- Devolved funding lines where councils take on delivery of outcomes normally run by central government (e.g. through city and regional deals and social investment initiatives);
- Incentives alignment where central government faces large costs if councils follow incentives currently before them (e.g., housing – the subject of this research note);
- As part of any much broader devolution agenda in the more distant future, to avoid problems that might otherwise emerge due to differences in fiscal capacity across councils. This would matter if councils took up a much broader set of responsibilities currently funded through broad-based central government taxation.

It is also very important that any new revenue provided by central government should not be a substitute for stronger fiscal responsibility in local government. Councils must focus better on efficient and effective provision of local infrastructure, local regulation, and local public services. Without such an effort, central government will be less inclined to share revenue.

City and regional deals, with binding agreements in return for new funding, have potential to improve fiscal responsibility. However, for councils unable to participate in deals, another option might be to use ratepayer referenda for major projects or large spending increases.

Option 1: Payments to Councils based on Estimated GST on New Residential Builds

This policy aims to create a direct financial link between new housing development and council revenue, incentivising councils to facilitate and support housing growth in their areas. The New Zealand Initiative first promoted this policy in 2013.

In 2023, ACT MP Brooke van Velden introduced a Members Bill, the *Housing Infrastructure (GST-Sharing) Bill*.[5] It proposed payments equivalent to 50% of GST estimated against the value of new residential building work to be assessed and paid at the end of each financial year. The Bill failed at its First Reading, with Labour voting against it (all other parties voted in favour).

ACT's policy has had a renewed lease of life after being included in the National-ACT Coalition Agreement, which committed the government to *"introduce financial incentives for councils to enable more housing, including considering sharing a portion of GST collected on new residential builds with councils"*.

It is important to understand that describing payments as a 'share of GST' or a 'return of GST' is inaccurate. It is more accurate to call them payments based on a fraction of the value of covered building activity. This is because it is impossible to tie GST to revenue from any particular place; companies can submit GST returns from one head office to cover activity from across the country.

There is also nothing magical about a 50% portion of the current 15% rate of GST. The portion could be larger or smaller depending on how generous the government wants to be in incentivising councils to enable housing. However, we use the Members Bill's 50% portion for this analysis.

According to Statistics NZ's quarterly Business Activity Survey (BAS), the total value of new residential building work completed for the year to June 2023 (i.e., 2022/23) was $20.9 billion, exclusive of GST.[6] GST's 15% rate on this amount would have been $3.13 billion, so a 50% portion would be $1.56 billion.

If it had applied in 2022/23, the payment would have cost central government 1.4% of its total tax revenue. That would be a 'static' impact, but if it had increased economic activity, it would be expected to generate more tax revenue for central government.

For local government as a whole, payments would have added 11.3% to its operating revenue and closed most of its 2022/23 deficit, assuming spending was not increased or other income (e.g. rates) was not reduced.

Statistics NZ does not publish data from the BAS for cities or districts and only does so at a limited regional level (Auckland, Waikato, Wellington, the rest of the North Island, Canterbury and the rest of the South Island).

For this approach to be used, data on the value of building work completed for city and district councils would need to be robust. As it is based on modelled administrative data supplemented by a sample survey, the BAS in its current form is not appropriate for the basis of a funding mechanism.[7]

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5 NZ Legislation, https://www.legislation.govt.nz/bill/member/2022/0154/latest/whole.html

6 Statistics NZ Building Activity Survey, https://stats.govt.nz/information-releases/value-of-building-work-put-in-place-march-2024-quarter/

7 Statistics NZ note on methodology for Value of Building Work Pt in Place, https://www.stats.govt.nz/help-with-surveys/list-of-stats-nz-surveys/about-the-building-activity-survey/

A better approach would be for councils to report data from codes of compliance, which are submitted at the end of construction. But work would be needed to ensure that reported values of completed work are accurate and not able to be 'gamed' by councils seeking to maximise payments based on estimated values.

If the data is up to the task, this incentive payment would confer what economists call 'rents' – payments for activity that would have happened anyway. Some building that would have happened regardless of the change in policy would draw payment. One basic tradeoff in this policy area is whether to provide a smaller per-dwelling payment, or a larger payment for dwellings built above some threshold. The two options could be designed to cost central government the same amount of money. But, setting a threshold correctly can be tricky and cause other incentive problems. In any case, the incentive here provided to enable the next house to be built would be more moderate than if payments were based on building above some threshold level.

Variation 1: Value of Building Consents Issued

An alternative approach would be payments equivalent to 50% of GST estimated against the value of new residential building consents issued by city and district councils. As mentioned above, there is nothing magical about a 50% portion. The portion could be larger or smaller depending on how generous the government wants to be in incentivising councils to enable housing.

This would be a measure of intent to build rather than actual work completed. There is no guarantee that the work consented will be built, but because there is often a lag between consent and construction, let alone completion, consenting data provides a useful forward-looking indication of demand for council infrastructure and services.

According to Statistics NZ's monthly Building Consents Issued (BCI), the total value of residential building consents for the year to June 2023 (i.e., 2022/23) was $18.9 billion, inclusive of GST.[8] This was significantly below the actual work put in place that year. There are likely to be several reasons for this. Consent values are based on estimates submitted by developers and builders who may be incentivised to understate estimated values to reduce development contributions and/or building consent fees. Additional reasons might include inflation in building costs between the times of consent and completion and differences in methodologies between the BAS and the BCI.

The estimated GST component of the $18.9 billion value of residential building consents would have been $2.47 billion. A 50% portion of estimated GST would be $1.24 billion.

If it had applied in 2022/23, the payment would have cost central government 1.1% of its total tax revenue. That would be a 'static' impact, but if overall economic activity increased as consequence, it would be expected to generate more tax revenue for central government.

For local government as a whole, the payments would have added 9.0% to its operating revenue and closed around two-thirds of the sector's deficit for 2022/23, assuming spending was not increased or other income (e.g. rates) was not reduced.

Unlike the BAS, Statistics NZ publishes BCI data for individual city and district councils. The payments would vary significantly between councils. In 2022/23, it would have been most material for Selwyn (37% of its operating revenue) and Queenstown-Lakes (29%). It would have been least material for Chatham Islands, Wairoa, and Kawerau (all less than 1%).

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[8] Statistics NZ Building Consents Issues statistics, https://stats.govt.nz/information-releases/building-consents-issued-may-2024/

Although some councils would do better than others, that is the point of the policy. If it more actively incentivises councils to embrace house building more, it should result in more consents in areas that have not had much activity in the past.

The $1.2 billion Regional Infrastructure Fund would be an alternative funding source for low-growth councils. It would benefit rural and provincial councils that might not benefit as much from a GST share on new residential builds.

A downside to this variation is that, as mentioned above, a building consent's value is an estimate and not a precise measure of a completed project's value, opening the possibility for 'gaming' payments. This might require monitoring and potential auditing by central government and the ability to cap payments per consent if necessary. Also, if consented projects do not proceed within a certain period, there might need to be a 'clawback' mechanism on payments made. A fixed payment per consent might be a better approach.

In terms of incentives, this policy would reward councils for building work. However, as with the original option and its other variants, councils would get payments for dwellings that would have been constructed even without the policy, meaning that payments for going above and beyond the status quo would be smaller and incentives would be less sharp – if the government kept to a fixed budget. It is, therefore, a moderate incentive rather than a strong one.

Variation 2: fixed payment per building consent

A further variation to Option 1 would be to pay councils a fixed amount for each build, say $25,000 (the same amount as Option 2's payment). $25,000 is a little below 50% of the estimated GST value of the nationwide average value of a residential building consent ($28,750 in 2022/23).

Again, there is nothing magical about a $25,000 payment. The payment could be larger or smaller depending on how generous the government wants to be in incentivising councils to enable housing.

The BAS does not report the number of buildings completed (only the value). However, the BCI does report data on the number of consents issued. With 44,529 new residential building consents issued in 2022/23, a $25,000 payment per consent would have cost $1.11 billion. This is a little less than the estimated cost for 50% of the estimated GST on the value of these consents.

If it had applied in 2022/23, the payment of $25,000 for each new residential building consent would have cost central government 1.0% of its total tax revenue. That would be a 'static' impact, but if the policy grew economic activity, it would be expected to generate more tax revenue for central government.

For local government as a whole, the payments would have added 8.0% to its operating revenue and closed around two-thirds of the sector's 2022/23 deficit, assuming spending was not increased, or other income (e.g. rates) was not reduced.

Again, the payments would vary significantly between councils. It would have been most material for Selwyn (33% of its operating revenue), Queenstown-Lakes (19%), and Waipa (18%). It would have been least material for Chatham Islands, Wairoa, and Kawerau (all less than 1%).

The biggest plus for a fixed payment approach would be its simplicity. It would also address issues with uncertainty over the accuracy of consent values and potential for 'gaming' payments. A downside is that a fixed per consent payment's real value would erode over time, but the amount could be periodically adjusted to inflation.

In terms of incentives, this policy would reward councils for building work. However, as with the original option and its other variants, councils would get payments for dwellings that would have been constructed even without the policy, meaning that payments for going above and beyond the status quo would be smaller and incentives would be less sharp – if the government kept to a fixed budget. It is, therefore, a moderate incentive rather than a strong one.

Variation 3: Hybrid– fixed payment per consent and ad valorem payment on building work completed

A funding mechanism should encourage councils to process consents and sign off completed work efficiently.

A potential problem of having a single payment based either on building consents issued or building work completed is that councils would put their effort into part of the process that would provide them with the payment, potentially under-resourcing other parts of the process.

A potential solution would be a hybrid system of a fixed payment per building consent issued and a value based payment for building work completed. A fixed payment per consent issued would address the risk of gaming by overestimating predicted values. In contrast, an ad valorem payment for completed work would be appropriate where that building has a final value. As mentioned above, the BAS in its current form is not fit for this purpose, so policy work would be needed to ensure that councils collected and reported the value of completed work and that the final values can be audited. If that is too difficult, then there could be a fixed payment for both the consents issued and the work completed.

As mentioned above, if the Government has a specific quantum in mind for funding, it need not choose among variants based on affordability. If it prefers the expected incentive effects of one of the options more than the other, it could scale the per-build, per-value, or combination up to the quantum of funding.

In terms of incentives, this policy would reward councils for building work. However, as with the original option and its other variants, councils would get payments for dwellings that would have been constructed even without the policy, meaning that payments for going above and beyond the status quo would be smaller and incentives would be less sharp – if the government kept to a fixed budget. It is, therefore, a moderate incentive rather than a strong one.

Option 2: Payments for above-average consenting

This policy also aims to create a direct financial link between new housing development and council revenue, incentivising councils to facilitate and support housing growth in their areas.

The National Party's *Going for Housing Growth* policy for the 2023 General Election included a *Build for Growth* initiative, under which councils would be eligible for a payment of $25,000 for every dwelling they consented above the average of new consents in the previous five years.[9]

The National-ACT Coalition Agreement stated that *Going for Housing Growth* would 'accommodate' sharing a portion of GST collected on new residential builds with councils. Depending on how this is interpreted, payments on estimated GST revenue might be ahead of *Build for Growth*. Nevertheless, this option is still in the picture.

Based on our calculations of consent numbers for the year to June 2023 versus the previous five-year average (2017/18 to 2021/22), *Build for Growth* would have cost $144.0 million. This is only around 0.1% of central government's total tax revenue, making the fiscal impact minor compared to options 1 and 3.

There is nothing magical about a $25,000 payment per consent. It could be made larger or smaller depending on how generous the government wants to be in incentivsing councils to enable housing. But for this analysis, we use *Build for Growth's* payment.

Based on our calculations, the cost based on 2021/22 consenting would have peaked at $378.3 million. This was because 2021/22 was a record high for building consents, pushing most councils above their preceding five-year averages.

As well as the total cost being very volatile, the distribution of payments would be top-heavy. Most of the revenue in 2022/23 would have gone to Auckland and Christchurch, with an increase compared to 2021/22 in ineligible councils (from 9 to 27 by our reckoning). It would likely have been even more extreme in 2023/24 after another softening in consents.

Because payments are not guaranteed for all councils, there would be a stronger incentive effect than for Option 1 and its variants.

However, payments for above-average consenting would be highly sensitive to fluctuations in the housing market. Upswings would make most councils eligible, while downturns (especially if they are prolonged) would make most councils ineligible, regardless of how encouraging they are of development. It could also punish councils that have already been growth-friendly in the past because they would not have much more to gain from the new policy. In fact, the less growth-friendly a council has historically been, the more it would gain.

A different approach, such as using a threshold of consents above a per 1,000 population threshold, would have similar issues but could be investigated.

For example, a threshold could be calculated from a long-term national-level build rate per 1,000 population (e.g. over 20 years). Then, take a rolling average of each council's build rate over 10 years. Downturns outside a council's control should then 'wash out'. If the council's build rate is above the threshold, it would be rewarded, but if it is at or below the threshold, payments would stop. Under

9 NZ National Party Going for Housing Growth policy paper, 2023, https://www.national.org.nz/housinggrowth

this approach, councils which have done a lot of building over the past decade would not be penalised for having already built out their opportunities. They would continue to be rewarded for it, and continue to be rewarded on an ongoing basis if they maintain build rates above that national threshold.

The potential unintended consequences identified in Option 1 from the risk of councils focusing on the consenting part of the process are repeated in Option 2.

Although there are issues with Option 2, the incentive for councils to enable housing is stronger. It could be used as a 'top-up' to Option 1 or as a funding tool within a toolkit for city and regional deals. If the government has a specific quantum in mind for funding, it need not choose between variants of Option 1 and variants of Option 2 based on affordability. If it prefers the expected incentive effects of one of the options more than the other, it could scale them to the quantum of funding.

Option 3: Payments to Councils Based on Estimated GST on Rates

This policy involves payments to local government based on the estimated GST currently received by central government on council rates. Local government rates are subject to GST, collected by central government along with all other GST revenue. The proposal would see the equivalent of this amount paid to the councils that collected it as part of their rates.

This approach was considered by the Review into the Future for Local Government, which recommended: *"In order to prioritise and deliver on wellbeing, central government makes a greater investment in local government through an annual transfer of revenue equivalent to GST charged on rates; and significant funding to support local priorities, place-based agreements, and devolution of roles."*[10]

The key difference between this option and the two preceding options is that Options 1 and 2 are designed to incentivise more housing, while Option 3 would have no incentive effects for housing.

According to Statistics NZ's Local Authority Financial Statistics, rates revenue for the year to June 2023 was $8.0 billion, exclusive of GST. Payment of the estimated GST on rates would have provided approximately $1.19 billion to regional, city, and district councils.

If it had applied in 2022/23, Option 3 would have cost central government 1.1% of its total tax revenue. Unlike more targeted approaches to encourage housing, it is unlikely that this policy would (in itself) boost economic activity. Therefore, there would probably not be an offsetting increase in tax revenue.

Option 3 would have added 8.6% to the operating revenue for local government as a whole and closed around two thirds of its 2022/23 deficit, again assuming spending was not increased or other income (e.g. rates) was not reduced in response.

The amounts paid would vary significantly between councils, ranging in 2022/23 from $0.1 million for Chatham Islands Council to $341 million for Auckland Council, reflecting the different sizes and rate bases of the 78 regional, city and district councils.

The percentage of estimated GST on rates to councils' operating revenue is mostly between 8% and 12%, depending on councils' reliance on rates (versus sales of goods and services, investment income, and subsidies) to fund their operations. However, this is a more even distribution than payments of a portion of estimated GST on new residential builds.

There are some outliers, such as councils on the east coast of the North Island, which received large subsidy payments in 2022/23 from central government in response to damage caused by Cyclone Gabrielle, reducing their percentages of revenue from rates. Chatham Islands' percentage is always very low because it gets relatively little revenue from rates.

The Review into the Future for Local Government was clear that there should not be any strings attached to the returned GST revenue, saying councils should be free to spend as they wish. This would be a tough sell for central government, given concerns about the quality of local government decision-making and efficiency and effectiveness of its spending. There would be no direct incentive for councils to encourage more housing and development.

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[10] Final report of the Review into the Future for Local Government, June 2023, recommendation 13, https://www.dia.govt.nz/Future-for-Local-Government-Review

Rather, Option 3 would incentivise councils to shift existing revenue away from non-rates sources, especially from sales of goods and services ('user pays') onto rates. This would impose more of the funding burden onto property owners rather than users of council services while sharply discouraging people from exercising restraint in use of services like rubbish removal. Neither would be desirable.

To illustrate, paying councils an estimate of GST on rates would distort choices between council and private service provision. Consider a council that has currently decided that residents should mow their berms rather than have the council provide the mowing service. If the service were tax-advantaged if provided by council, residents might prefer that the service be provided by the council rather than by their own individual hired garden services.

Other services would be tax-advantaged if provided by councils through rates rather than privately or on a user-charge basis by councils. For example, a council that charges a per-bag garbage collection fee, which can help confront households with the marginal cost of the waste they produce, could decide to bundle waste collection into rates instead because doing so would be tax-advantaged. The same could apply to water and wastewater services.

It is less clear whether the rebate would encourage councils to spend more overall, to draw the refund, or to defer rates increases temporarily in response to ratepayer pressure. To illustrate, if a council has been increasing rates by 15% per year to keep up with its costs, each of those increases its baseline. A new ongoing transfer equivalent to 15% of rates can take the place of one and only one such annual increase. It can not be a substitute for greater fiscal responsibility.

For these reasons, we do not support a revenue share involving estimated GST on rates.

That is not to say that there is not scope for central government to provide local government with funding to address financial pressures. As noted in the 'Fiscal context' section above, there can be good reasons for transfers to councils. However, basing the magnitude of transfers on a fraction of that council's rates revenue is unlikely to achieve useful equity or incentive-based objectives.

Payments for Non-Residential Buildings

The National-ACT Coalition Agreement's commitment does not include payments for non-residential builds. Extending the policy to some or all non-residential building consents might help facilitate wider (non-housing) development and further boost economic growth. It could also avoid encouraging councils to shift consenting efforts from commercial and industrial to residential builds.

As with incentive payments for residential buildings, there are different ways this could be done. Some options are shown below. There is nothing magical about the levels of payments discussed, which are illustrative only. They could be made larger or smaller depending on how strongly the government wants to incentivise councils to enable non-residential building.

Furthermore, if the government has a specific quantum in mind for funding, it need not choose among the options based on affordability. If it prefers the expected incentive effects of one of the options more than the others, it could scale the per-build, per-value, or combination up to the quantum of funding.

Similarly, broadening the base of payments (to include non-residential buildings as well as residential buildings) while lowering the rate of payments could be designed so the policy as a whole is fiscally neutral.

Building Work Completed
The BAS's total value of new non-residential building work completed for the year to June 2023 was $9.44 billion, exclusive of GST. GST would have been $1.42 billion, with a 50% portion being $708 million.

Building Consents Issued
Meanwhile, the BCI's value of new non-residential building consents for the year to June 2023 was $7.84 billion, inclusive of GST. The GST component of this would have been $1.02 billion, with a 50% portion being $511 million.

Fixed payment per consent
There were 4,083 new non-residential building consents issued in 2022/23, so the cost of a fixed payment of $25,000 per consent would have been $102 million. This is much lower than payments based on values because the average value of such consents is nearly three times the average for new residential building consents ($1.15 million versus $0.39 million). However, the payment per consent could be adjusted (up or down) depending on how much the government wanted to spend on the policy.

Summary
In terms of incentives, this policy would reward councils for building work. However, as with Option 1 and its variants, councils would get payments for non-residential buildings that would have been constructed even without the policy, meaning that payments for going above and beyond the status quo would be smaller and incentives would be less sharp – if the government kept to a fixed budget. It is, therefore, a moderate incentive rather than a strong one.

There could also be unintended consequences of councils devoting more resources to the consenting process, but this could be addressed by taking the hybrid approach outlined in Option 1.

Providing a revenue share on non-residential buildings would further increase the fiscal impacts on central government. However, if there is concern about this impact, it could be used as an additional

funding tool for city and regional deals only. Or it could be considered a one-off policy stimulus during an economic downturn to encourage councils to be more welcoming of development.

International Experience

We are not aware of international experience with sharing GST revenue (or equivalent value added or sales taxes) with local government to specifically encourage housing development.

However, sharing GST revenue with lower tiers of government is not unusual internationally. A strong caveat is that overseas systems tend to be very complex, involving formulas to determine how much is transfered.

In New Zealand, because it is not possible to precisely track GST through the system to tag money back to a council, any such 'revenue share' would have to be a payment based on an estimate.

Australia distributes all the revenue raised from its national GST to its states and territories.

A paper by the Commonwealth Grants Commission explains that GST distribution is assessed on "the differences in the fiscal capacities of states. States' economic, social and demographic characteristics differ, affecting their relative expenditure needs and revenue raising capacities. This, in turn, informs the amount of GST each state would need to be able to provide similar services – referred to as a state's 'assessed GST needs'."[11]

The amount of GST revenue to be distributed in 2024/25 was assessed to be AUD89.5 billion. 71% was allocated to New South Wales, Victoria, and Queensland.

Other countries that have GST revenue sharing arrangements and/or grants from central government to subnational governments include Canada, India, Germany, Spain, and Brazil. The specific mechanisms and proportions vary by country, but the general principle is that the central government collects the tax for efficiency and then distributes portions to subnational governments to support their budgets and responsibilities.

There is also international experience of central government making payments to subnational governments to encourage housing, but usually, these payments assist with the provision of affordable or social housing rather than incentivising approvals of house building.

City and Regional Deals

The government is advancing 'City and Regional Deals' to boost economic growth and productivity, with a framework expected to be released soon.

[11] Commonwealth Grants Commission Occasional Paper No.11: GST distribution to states and territories in 2024-25, March 2024, https://www.cgc.gov.au/sites/default/files/2024-03/Occasional%20Paper%2011.2%20-%20GST%20distribution%20to%20states%20and%20territories%20in%202024-25%20final%20version.pdf

City and regional deals are formal agreements between central government and local or regional governments, often involving other partners. They focus on specific geographic areas that seek to address challenges and provide opportunities. [12]

An important aspect of city and regional deals is long-term funding commitments in return for agreed commitments and outcomes. A funding commitment by central government could include, within a 'tool kit' of funding mechanisms, one or more of the 'revenue share' options discussed in this paper.

Current city deal arrangements seem designed around infrastructure funding and finance access. Payments from options 1 or 2 could potentially help fund some of those works.

The New Zealand Initiative's Previous Work

Since its inception in 2012, the New Zealand Initiative has advocated for policies providing financial incentives for councils to embrace housing and economic development.[13]

Currently, councils are burdened with the financial costs of development (e.g. costs of infrastructure) but do not share in the financial benefits, which accrue mostly to central government through GST and income tax.

Most recently, in March 2024, the Initiative's Executive Director, Dr Oliver Hartwich, wrote that *"Sharing GST revenue with councils from new housing construction will encourage councils to enable more building, more closely aligning the financial interests of councils with national housing supply goals. Broadening GST sharing to encompass construction more generally will encourage councils to welcome more forms of development, encouraging a virtuous cycle of growth."*[14]

Comparison and Conclusion

New Zealand's local government faces significant funding challenges that hinder councils' ability to meet growing infrastructure needs and service demands. This has generated calls for central government to 'share revenue' with councils.

This analysis has examined three potential options: 1) Payments to councils based on estimated GST on new residential builds, (2) Payments to councils for residential consents above the average of preceding years and (3) Payments to councils based on estimated GST on rates.

The third option, paying the estimated GST on rates, should be quickly rejected as a housing policy. While it would provide a substantial, predictable and more even funding boost to councils, there is no incentive to be more encouraging of housing and other development. Councils could instead be incentivised to keep increasing their spending and rates to maximise the GST payment or defer planned rates increases without cutting spending, in both cases increasing the risk of fiscal irresponsibility. Similarly, councils would be incentivised to move more of their funding from user charges to rates, weakening the efficiency of service provision.

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[12] City and Regional Deals, New Zealand Initiative, May 2024, https://www.nzinitiative.org.nz/reports-and-media/reports/city-and-regional-deals/document/843

[13] For example, *The Local Formula: Myths, Facts, and Challenges* (December 2015), https://www.nzinitiative.org.nz/reports-and-media/reports/the-local-formula/

[14] Housing Policy makes Significant Progress, NZ Property Investor, 5 March 2024, https://www.propertyinvestor.co.nz/housing-policy-makes-significant-progress

The first and second options have more promise, as housing measures. Both provide stronger incentives by letting councils share more directly in the benefits of enabling housing and encouraging economic growth. But each proposal has different incentive characteristics and would involve different trade-offs.

By targeting payments only to councils that exceed previous years' average consents, Option 2 would provide a sharp incentive. However, its payments, although smaller, would be highly volatile, being sensitive to upswings and downturns in the housing market.

Option 1 would provide a substantial funding boost to councils, but its payments would be less evenly distributed than Option 3. Option 1 and its variants would provide payments to councils even if they are not pro-housing, making its incentive moderate compared to Option 2.

By focusing on consents issued, Option 2 would be more forward-looking. However, it might encourage councils to issue consents quickly, but not necessarily to quickly sign-off on the work's completion (as would Option 1's variant using consents issued). This can be addressed by taking hybrid approaches using both completed work and consents issued.

Option 1 and its variants would need improvements in data collection and reporting on the value of building work completed (or consents issued) and the ability to audit values to ensure they are not inflated to attract more funding.

Options 1 and 2 could be adjusted to make them more robust or strengthen incentives. There is nothing magical about the levels of payments discussed, which are illustrative only. They could be made larger or smaller depending on how generous the government wants to be in incentivising councils to enable non-residential building.

Furthermore, if the government has a specific quantum in mind for funding, it need not choose among the options based on affordability. If it prefers the expected incentive effects of one of the options more than the others, it could scale the per-build, per-value, or combination up to the quantum of funding.

Whichever Option 1 or Option 2 (or variations to each) gets chosen has to improve what we have now, but combining them might get the best of both. For example, there could be a 'base' payment from Option 1 and a 'top-up' payment from Option 2.

In return for agreed commitments and outcomes, city and regional deal participants could also get more generous payments or they could also get access to payments for non-residential building work.

Any new revenue sources should not substitute for stronger fiscal responsibility in local government. Councils must focus better on the efficient and effective provision of local infrastructure, local regulation, and local public services. Without such an effort, central government will be less inclined to share its revenue.

City and regional deals, with binding agreements in return for new funding, have potential to improve fiscal responsibility. However, for councils not able to participate in deals, another option might be to use ratepayer referenda for major projects or large increases in spending.

Recommendations

The Government should:

- Proceed with the National-ACT Coalition Agreement's commitment to *introduce financial incentives for councils to enable more housing, including considering sharing a portion of GST collected on new residential builds with councils*.
- Work to refine the two main options to ensure they are based on robust data, the incentives to enable more housing are strong, and potential risks of gaming payments are minimised. This could include combining aspects of each option.
- Consider how housing incentive payments might affect existing and future city and regional deals and fit within a tool kit of funding mechanisms.

In return, local government should demonstrate commitment to fiscal responsibility and a focus on efficient and effective provision of local infrastructure, local regulation, and local public services. Options might include participation in city and regional deals and the use of ratepayer referenda for major projects or large increases in spending.

The New Zealand Initiative is an independent public policy think tank supported by chief executives of major New Zealand businesses. www.nzinitiative.org.nz | +64 4 499 0790 | info@nzinitiative.org.nz

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