LOCAL GOVERNMENT FORUM

SUBMISSION ON THE WELLINGTON CITY COUNCIL'S DRAFT ANNUAL PLAN 2000/2001

MAY 2000

WELLINGTON CITY COUNCIL'S
DRAFT ANNUAL PLAN 2000/2001

1. Introduction

1.1 This submission on the Wellington City Council's draft annual plan 2000/2001 (the Plan) is made by the Local Government Forum (the Forum). The Forum comprises business organisations that have a vital interest in local government (details are attached). The members of those organisations are among the Wellington City Council's largest ratepayers.

1.2 In submissions over the past few years business organisations have called on the Wellington City Council (the Council) to focus on its core business, exit from other activities and implement more efficient funding arrangements. Unless such policies are adopted, ratepayers will be confronted by continuing rate increases and Wellington City will be a less attractive city than otherwise to locate businesses.

2. Refocusing on core activities

2.1 The Council should divest its interests in the following activities that should be undertaken in the private sector:

- its shares in Wellington airport. Key charges at Australian airports have typically fallen following privatisation, with no deterioration in the quality of service. The Council's refusal to sell its shares can only be regarded as ideologically driven;
- its ground leases;
- the bulk of its rental housing stock. The private market is able to supply accommodation for most people, including those on low incomes. The problem of income adequacy, which is a responsibility of central government, is better addressed through income supplements than the provision of subsidised housing. Many people on low incomes obtain their housing in the private market;

– fitness centres and the Evans Bay marina;

– off-street parking facilities;

– waste disposal facilities; and

– the Wellington Festival and Convention Centre.

2.2 The Council should also consider divesting its water and wastewater distribution businesses. Failing this, it should tender the franchise to operate these activities.

2.3 The Council should exit from the promotion of commercial property development in Lambton Harbour. The Council's main role in relation to the development of the area arises from its regulatory responsibilities under the Resource Management Act. It should also contract for the provision of open spaces or other public amenities that pass a cost-benefit test. The benefit to the community of additional open space should be weighed against the high opportunity cost involved (namely, the value of land that would otherwise be available for development). The Council should not generally own land, promote or engage in property development, or invest in commercial buildings to achieve urban development goals.

2.4 The Council should not, in general, be involved in the provision of private or club goods.[1] It should look to divest all services with these characteristics. Failing divestment of ownership, it should consider tendering contracts to operate those activities that it continues to own. With or without tendering, the Council should move to full, or near full, user charges. These comments apply to activities such as libraries, art galleries, museums, the zoo, swimming pools, dedicated sports facilities (including stadiums) and conference and entertainment venues. Users of those services are clearly the main beneficiaries.

2.5 The Council's funding policy includes increased charges for commercial users of landfill and for rubbish bags. Other user charges are unchanged. The subsidy

---

[1] Unlike the case of a public good, with a club good people who do not pay for access to the club's facilities can be excluded. However, as long as there is excess capacity, a club good may share the public good characteristic that the use of its facilities by any one member does not detract from the ability of any other member simultaneously to enjoy those facilities.

from ratepayers to users of galleries and museums is equal to 100 percent of the cost while that for users of libraries, swimming pools and the zoo is 90, 67 and 60 percent respectively. These subsidies are well beyond the levels that could possibly be justified on valid public policy grounds. For example, the proposition that non-users of libraries derive 90 percent of the benefits of library services is absurd.

2.6 Any subsidies for private or club activities on the grounds that they provide benefits for the wider community should be limited to the level supported by a valid public policy analysis, be explicit and be made available to private providers of closely substitutable services.

2.7 The Council's agreement to provide an annual grant to Te Papa of $2.5 million a year has expired. The Council proposes to give Te Papa $1 million in 2000/2001. It has made no provision for grants in subsequent years. Te Papa is an example of a central government activity that should be largely, if not wholly, funded by user charges. There are no compelling grounds for complaining that the ratepayers of Wellington City benefit from Te Papa but do not contribute sufficiently to its costs when admission is free. This encourages the free riding that is complained of. The solution to Te Papa's funding problem rests with central government.

2.8 The Council should cease funding the following non-core activities:

– business attraction and facilitation ($1.2 million);

– tourism promotion – Totally Wellington ($3.9 million); and

– domestic recycling ($1.4 million).

2.9 The Forum supports the privatisation of the CitiOperations unit. Competition has reduced the cost of services and should be strengthened. The Council unit should be sold thereby enabling it to compete for Council and other work on a neutral basis.

2.10 The Plan provides little information on the activities that the Council undertakes. The water reticulation and sewage networks, for instance, constitute major businesses that involve very large investments. Minimal information is provided in the Plan on how these businesses are being run, what state the assets are in and whether adequate maintenance is being carried out. There is no information on their business strategy or governance and little information on options that are being explored (eg the joint franchising of all the water businesses in greater Wellington). The lack of accountability for these businesses is a concern.

3. Depreciation

3.1 The Council proposes to reduce the level of depreciation that is funded from rates by $4.6 million. The Council intends to charge depreciation at the level judged to be required ($49.2 million in 2000/2001) but to budget for an operating deficit of $4.6 million in every year from 2000/01 until 2009/2010. It acknowledges that this approach "is technically a breach of legislation" but argues that it will not result "in any disadvantage to future generations of ratepayers."

3.2 The Local Government Act 1974 (the Act) refers to depreciation as the decline in the service potential of an asset (sections 122J(f) and 122L(a)). This reflects the traditional accrual accounting view that a depreciation charge is required to match costs with related revenues. It is not directly or primarily related to the funding of replacement assets as suggested on page 14 of the Plan. Most assets wear out or become obsolete. Unless their initial cost is charged against revenue over their lives, operating expenses will be understated while operating balances will be overstated. Depreciation like wages is a cost incurred in undertaking council operations. While the level of depreciation is a matter of judgment, the Council estimates that cost to be $49.2 million in 2000/01.

3.3 From an operating perspective, the proposal not to fund $4.6 million of depreciation and thus budget for a deficit is broadly equivalent to a reduction in the level of depreciation. Viewed in this light, the arguments advanced in the Plan for not funding depreciation are doubtful. The level of depreciation is not directly related to the length of any loan to finance the asset (the Clearwater case) or to the issue of whether an asset is to be replaced at the end of its life (the Living Earth Joint Venture). The extent of repairs and maintenance may affect the estimated life of an asset and hence the rate of depreciation that is appropriate but not whether it should be provided. Similarly, roading assets that are owned by the Council and recorded in its balance sheet should be depreciated even if Transfund finances their replacement. This treatment is consistent with the recognition of the Transfund subsidy as operating revenue.

3.4 The Act generally requires local authorities to fund all operating costs from operating revenue on a year-by-year basis (section 122C(1)(f)). This is a central constraint designed to limit the scope for imposing the cost of operating activities on future ratepayers. This could happen, for instance, if operating deficits were recorded.

3.5 Section 122J sets out certain grounds for not funding operating costs from operating revenue. Two possible provisions might apply in this instance. First, a council may fund operating expenses from sources other than operating revenue in order to adjust its equity as provided in its long-term financial strategy (section 122J(e)). The Plan notes that the decision not to fund all depreciation is a departure from the Council's long-term financial strategy. Moreover, any proposal to adjust equity would need to be justified by reference to the impact on current and future ratepayers of changes in the ratios of equity and debt to assets.

3.6 The second possible provision (section 122J(g)) allows local authorities to expend "any operating revenue, including any revenue for the purpose of funding a decline in the service potential of an asset, on maintenance of that asset or to meet the cost of borrowing undertaken for the acquisition or construction of that asset." Although the interpretation of this subsection in the context of accrual accounting is not straightforward, it focuses on the expending of operating revenue. It does not seem to apply in the case at hand where an operating deficit is budgeted (ie operating revenue is not available to be expended for the purposes noted).

3.7 The Council's proposal involves more than a "technical" breach of the legislation. It is inconsistent with a fundamental constraint designed to restrain councils from adopting imprudent financial policies. Moreover, it is inappropriate for a council to deliberately breach the law under which it is required to operate and to give notice of its intention to continue doing so. Disclosure of the proposed action is not an acceptable substitute for compliance with the law. Contrary to the view expressed in the Plan, the proposal disadvantages future ratepayers by imposing part of the costs of current activities on them via a reduction in ratepayers' equity. Ratepayers' equity is forecast to decline from $2,043 million in June 2000 to $1,997 million in June 2010 as a consequence of not fully funding depreciation. The proposed policy should not be adopted. The Council should reduce the impact of its activities on rates by exiting from non-core activities as recommended above.

4. Rates

4.1 Despite a large (9.9 percent) increase in revenue from rates and levies last year, rates remain under pressure. A comparison reported by the Hutt City Council in its draft 2000/2001 annual plan shows that its cumulative increase in total rates between 1995/96 and 1999/2000 was less than 1 percent compared with 11.5 percent for Wellington City. Changes in the relative levels of rates can be expected to affect the distribution of businesses and households between those cities.

4.2 Total rates and levies revenue is forecast to increase by 2.2 percent in 2000/2001. That increase would need to rise to over 6 percent if the budgeted deficit, arising from a proposal not to raise sufficient operating revenue to meet all operating costs including depreciation, were to be eliminated by increasing rates and levies revenue.

4.3 The Forum is opposed to any increase in the level of rates. The Council should instead reduce its spending by adopting the proposals outlined above. This would allow rates to be reduced substantially.

4.4 The Forum welcomes the Council's decision to phase down the differential rate on commercial property. Business organisations have argued for some time that the Council's tax arguments for a differential rate on commercial property were unsound. They were confident that an independent professional assessment of those arguments would confirm that conclusion. The Council's Rates Working Party has endorsed the view of the business sector.

4.5 The Rates Working Party found that the policy of raising 55 percent of general rates from the commercial sector is inconsistent with the financial management provisions of the Act. The proposal to reallocate costs in closer conformity with the Act also contributes to a lower differential.

4.6 The proposed differential of 2.8 to 1 at the end of a ten-year transition period is, however, excessive and the transition period is too long. A number of councils have no differentials for their general rate whatsoever and others are moving to reduce or eliminate them. The Forum believes that the Council should apply user charges where appropriate and generally finance the balance of its expenditure by a uniform rate on all rateable property. While residential rates should be adjusted over a reasonable transition period, the key point is that the rate burden presently placed on the business sector has been found to be unjustified. It should be reduced expeditiously within, say, 3 years. Moreover, lowering council spending and applying user charges where appropriate would reduce the impact on residential rates of the phase-out of the differential.

The Local Government Forum

The Local Government Forum was established in 1994 to promote greater efficiency in the local government sector and to contribute to debate on policy issues affecting the sector.

The Forum comprises business organisations that have a vital interest in the activities of local government. The following organisations are members of the Forum:

– Federated Farmers of New Zealand (Inc.)

– New Zealand Business Roundtable

– New Zealand Chambers of Commerce

– New Zealand Employers Federation Inc.

– New Zealand Forest Owners' Association Inc.

– New Zealand Manufacturers Federation (Inc.)

– Property Council of New Zealand Inc.