LOCAL GOVERNMENT FORUM

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

MAY 2000

CHRISTCHURCH CITY COUNCIL'S DRAFT ANNUAL PLAN 2000/2001

1 Overview

1.1 This submission on the Christchurch 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 Council's largest ratepayers.

1.2 A prime concern of business organisations over the last few years has been the cumulative increases in the Council's expenditure, rates and compulsory charges as a consequence of its failure to focus on core activities, exit from other activities and implement more efficient funding arrangements. Unless the Council reconsiders its approach and adopts business organisations' suggestions, ratepayers will be confronted by continuing and unsustainable rate increases.

1.3 The core business of local authorities should be funding and – in justifiable circumstances – providing local public good outputs that cannot be better provided by firms, households and non-profit organisations.[1] Local authorities should also administer appropriate local regulation. This role is derived from a principled analysis of how territorial councils can best promote the overall wellbeing of their citizens.

1.4 While there are improved trends as a consequence of debt repayment from the proceeds of capital repatriation from LATEs, the Council's budget for

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1 Public goods are those that have non-exclusivity and non-rivalry characteristics. Non-exclusivity exists when it is either very costly or impossible to exclude individuals from the benefits of consumption. Non-rivalry exists when consumption by one person does not detract from other people enjoying the good at the same time. Because of this it may be undesirable to exclude individuals from the benefits of public goods. Street lighting is commonly cited as a service that may come close to satisfying both properties of pure public goods.

2000 shows its spending continues to expand, thereby forcing ratepayers to forgo personal consumption and savings to fund activities that provide dubious economic and social benefits.

1.5 A significant proportion of the Christchurch population is in the low-income bracket. At the 1996 census 72 percent of Christchurch's population aged 15 years and over had personal income equal to or less than $30,000. This compares unfavourably with the greater urban areas of Auckland and Wellington (both 64 percent).[2]

1.6 A contributing factor to low Christchurch incomes is that the Council is using resources in activities that yield a lower return to the community than they would in the private sector, thus reducing overall incomes and employment. Christchurch needs more private sector investment, not endless spending on new and/or improved recreational, cultural and other facilities where the net benefit to the community is doubtful. One way to encourage this is to ensure that the city maintains its comparative cost advantage in the provision of essential infrastructural services because of its highly favourable topography. Council spending and ongoing rate increases are undermining existing advantages while the comparisons with other territorial councils' levels, which are used to justify the trends, are naïve. The Council must abandon its self-defeating strategies to offset the detrimental effects of its actions on the welfare of its poorer citizens and on the rate of job creation in the private sector. On the one hand, on the basis of spurious claims of indirect benefit, the Council is inflicting substantial and unjustified cost on the commercial sector to avoid user charges and/or mitigate the level of rates that would otherwise be levied on low-value properties. Such costs lead to less business activity and investment and fewer jobs than otherwise. On the other hand, the Council is directly subsidising employment and economic activity in the private sector in a futile attempt to counteract the damaging effect on private sector investment and job creation of its rating and regulatory policies.

[2] As defined by regional council boundaries.

1.7 Incorrect and inconsistent interpretation and application of the funding principles contained in the Local Government Amendment Act (No 3) 1996 have resulted in a continuation of inequitable differential rating of the business sector. The de facto differential rate has avoided the politically uncomfortable consequences of applying the more efficient funding mechanisms contained in the Act. The treatment of road carriageway depreciation is the most blatant example of flawed application of the principles as it allocates almost the total amount to commercial ratepayers and adopts an approach that is inconsistent with that applied to other assets such as libraries and swimming pools.

1.8 However, the Council's incorrect application of the funding principles extends to all ratepayers. Ratepayers are required to fund Council services provided to identifiable individuals, including non-residents, based on claims of illusory indirect benefits. For example, almost 80 percent of the operating costs of pools and art exhibitions are to be funded by rates while for libraries the percentage contribution is 93 percent. This implies that most of the benefits of these services accrue to non-users. If this were true it would imply that the location of the facilities is immaterial. However, inequitable geographic distribution of these facilities has been advanced as the justification for the significant increases in expenditure.

2 Decisions arising from last year's annual plan

2.1 In their submissions on the 1999 annual plan, business organisations raised a number of issues that have subsequently being fully or partially resolved by the Council. The decision to dispense with the "intersector transitional modifier", which transferred $933,300 of rates from the residential to the commercial sector, is endorsed. The modification of rates as a consequence of invoking s122G had no rational basis and was generated by an excessive level of spending. We applaud the decision of Orion Group Ltd to exit from the North Island gas distribution and retailing business, as ratepayers were exposed to high and unacceptable commercial and regulatory risks. Subject to the qualification below, we approve of the Council's decision to quash the proposed $40 million economic development fund. A reduction in debt is a superior use of Southpower's proceeds as it lowers the cost of doing business in Christchurch and encourages long-term sustainable investment and jobs. However, we do not support the resolution to replace the proposal by a small-scale fund, financed from so-called savings in interest costs resulting from debt repayment.

3 Comments on the Plan

3.1 Expenditure forecasts

3.1.1 There are both positive and negative aspects to the Plan's 10 year expenditure forecast. The Council is to be congratulated on reducing its forecast 'total operating expenditure' by $18 million and capital expenditure by $24 million for the period 2000/01 to 2008/09 compared with the 1999 prediction. However, the fact that the change is due to $30 million savings in interest and $14 million in depreciation charges and does not include internal operating costs, which in fact have increased by $27 million, is of concern.[3]

3.1.2 While the rise in 'total operating expenditure' for the 2000/01 year is relatively small (ie $1.92 million or 0.82 percent), there are disturbing features within the total expenditure budget. The modest increase is due to reduced depreciation and interest expenses rather than reduced operating expenditure. 'Operating expenditure' increases from $176.58 million to $182.47 million, or by 3.3 percent, while capital expenditure jumps $20.16 million (22.61 percent) to $109.32 million. 'Total operating and capital expenditure' increases by 6.82 percent, which is unacceptable in a low inflation environment. The new bus exchange is the main capital item responsible for the large increase.

3.1.3 The background to the approval of this project is disappointing for several reasons. First, it was a late addition to the annual plan consultation process. The $20 million capital outlay associated with the project is large as it is in excess of 20 percent of the current year's capital budget while there are significant ongoing operating costs associated with it ($1.17 million in its first

3 Expenditure comparisons are generally based on draft budgets.

part year of operation).[4] Ratepayers were denied adequate opportunity to consider and have their say on the proposal due to the Council rushing the annual plan consultation process which parliament has deemed to be important. Secondly, the project was promoted as being rate-neutral as a consequence of the elimination of expenditure from other areas. However, the fact that such large savings could be found at short notice implies that these other areas were of dubious value and/or that budgets were padded. Savings resulting from a reduction in low priority expenditure should not be advanced as a reason to increase spending elsewhere. Thirdly, the background to the bus exchange project implied a number of options for using the funds were never canvassed, namely reducing rates and/or debt.

3.1.4 We have a number of concerns with specific areas of the Plan's expenditure. The magnitude of the increases, which are predominantly funded by rates and/or compulsory user charges, is unacceptable. These include the operating budget increase for the art gallery (19.7 percent), sport, leisure and events (13 percent), library and information services (6.6 percent), waterways and wetlands (4.6 percent) and community services (3.9 percent). With the exception of waterways and wetlands they comprise non-core activities while the benefits accrue to identified persons who can be excluded should they not wish to pay. The Council is poorly placed to make informed judgments about people's preferences for more services in these areas because it has no reliable way of measuring them. Before additional expenditure is committed to non-core areas, user charges should be employed to test the strength of demand for such services.

3.1.5 The budget proposes a 4 percent rise in expenditure on public accountability. This is difficult to justify, particularly as the process of dealing with submissions on the proposed district plan, which was the reason earlier advanced for a large increase, has been completed. It is noteworthy that while the activities of the Council and the number of councillors remain much the same, public accountability operational expenditure in 2000/01 has

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4 The amount, if any, that relates to depreciation is unclear.

increased by 90 percent compared with 1994/95 (ie from $4.82 million to $9.16 million).[5]

3.1.6 The Plan proposes very large rises in the net operating cost of the outputs of some significant activity budgets. Examples include: waterways and wetlands plans and policy statements (109 percent); parks customer services (68 percent) and support (20 percent); city streets output agreement administration (15 percent); environmental plans and policy statements (14 percent) and policy advice (12 percent); art gallery exhibitions (22 percent); water supply information and advice (21 percent); and community building advocacy and funding (8 percent). These are essentially ongoing activities which, in the absence of abnormal events, should not vary significantly from year to year. The need for substantial increases in environmental policy advice, plans and policy statements, for example, is particularly difficult to justify given the additional work generated by the review of the proposed district plan is largely complete. The net increase in the cost of these outputs is $2.5 million or 52 percent of the proposed increase in total rates.

3.2 Revenue increases

3.2.1 The Plan proposes increasing the total rates take from $123.96 million to $128.76 million, namely a rise of 3.87 percent. The average increase per property is 2.38 percent. This translates into an increase of 2.25 percent for residential ratepayers, a reduction of 1.41 percent for rural ratepayers and a 3.04 percent increase for commercial ratepayers. While interest and dividends from Christchurch City Holdings Limited (CCHL) are projected to rise by $4.01 million to $28.8 million (16.18 percent), the estimate was made prior to the sale of Southpower's shares in Enerco. Given the capital gain associated with the sale it is probable that the return on investment will rise and that this forecast understates the likely result. The Forum welcomes the fall in rural rates but believes rates should be reduced in all sectors.

5 Draft annual plan.

3.2.2 While the budget forecasts a fall in expenditure for the period 2000/01 to 2008/09 compared with the 1999 plan, paradoxically revenue forecasts are up $34 million for this period. Compared with the previous year's plan, rates increase by $14 million, interest and dividends by $18 million while ordinary revenues fall by almost $2 million. It is notable that the financial forecasts show ordinary revenue in the 2009/10 year as being only 6 percent higher than in 1999/00 while rates increase by 53 percent, a compound growth rate of 4.3 percent. As a consequence, the percentage of total revenue contributed by rates rises from 51.8 percent to 59 percent over the period of the financial forecasts while ordinary revenues, which include avoidable user charges, fall from 35 percent to 27.8 percent.

3.2.3 The Forum strongly objects to this planned shift in the ratio of rates to total revenue. It urges the Council to undertake a review of its proposed expenditure and significantly increase its reliance on user-charge funding mechanisms. The proposed change in the proportion of revenue raised from rates will increase costs to businesses, discourage investment in the district by reducing profitability, reduce households' real disposal income and damage private sector job creation. We also object to the ad hoc decision to change the method of funding the subsidy to the Convention and Entertainment Centre to capital value rating. The change would appear to be generated by the need to redistribute rates as a consequence of growth in expenditure rather than a correction of a previous erroneous decision. The beneficiaries of these centres are their users while the value to businesses in general is nebulous. The centres are engaged in business activities. In some cases they are in direct competition with private firms. There are no special reasons that justify the provision of subsidies to these Council businesses. If the 'externality' benefits to business are real there should be little problem in acquiring financial sponsorship to maintain the activities of the centres.

3.3 Increased operating surpluses and use of depreciation reserves

3.3.1 The decision to produce an annual operating surplus so as to fund new capital expenditure out of current income, and thereby reduce interest cost, has stopped rates falling. The impact that the operating surplus is having on the level of rates collected is highlighted by the decision outlined in the Plan to increase the amount of capital expenditure funded from depreciation and operating surpluses to 60 percent, phased in over the period 2002/03 to 2006/07. To conform with the policy change, additional funds of $5.44 million are required in the budget year, or the equivalent of a 4.39 percent rise in rates. The $10.48 million surplus is the equivalent of 8.14 percent of the proposed 2000/01 rates. The financial forecasts show the operating surplus rising to the equivalent of 12.31 percent of rates in 2009/10.

3.3.2 There is no justification for the policy of generating a large operating surplus and using this source of funds and depreciation to fund 60 percent of capital expenditure. The use of substantial operating surpluses to fund the purchase of new assets is clearly contrary to funding principle s122F(a) of the Local Government Amendment Act (No 3) 1966, namely that the costs of any expenditure should be recovered at the time the benefits of that expenditure accrue. The tenor of relevant sections of the Act, such as s122C(1)(f) and s122J, is to ensure operating revenues in any financial year are adequate rather than to encourage the generation of large surpluses. It is also inconsistent with intergenerational equity as today's ratepayers are being required to fund expenditure that generates future benefits.

3.3.3 Similar comments apply to the use of depreciation reserves funded from rates to purchase new assets that are not replacements or renewals.[6] The purpose of funding depreciation from rates should be to spread the cost over time on a basis that reflects the economic life of an asset. Rate funding of depreciation should not be used primarily as a mechanism to fund new and/or improved assets.[7] The Council should not lose sight of the fact that there is a subjective element in the selection of depreciation rates and methods (eg diminishing value, straight line) and that the primary aim is to

6 This is due to the fact that the depreciation funds can be invested so as to realise positive net yields after allowing for depreciation.

7 Although this may be an appropriate investment for surplus funds that accrue from time to time.

match costs with benefits rather than to generate significant surpluses to fund new capital projects.[8]

3.3.4 The Council's justification for generating operating surpluses is that it reduces the cost of financing capital acquisitions. However, from the community's perspective all the policy does is externalise the financial effects of the Council's capital expenditure by transferring the cost to present ratepayers. Ratepayers are forced to fund the Council's operating surpluses by increasing borrowing, reducing savings and/or forgoing personal consumption to finance the higher rating levels generated by the policy. The policy is not aiding accountability as it suppresses the opportunity cost of the Council's new capital spending and encourages expenditure levels that are higher than otherwise. It would be paradoxical if the Council thinks it is financially imprudent for it to incur the debt levels that would flow from acceptance of funding principle s122F(a) while discounting the fiscal implications for individual ratepayers. This highlights the need for more informed appreciation of the economic consequences of the Council's policies and the need to apply appropriate public policy analysis to all significant new expenditure.

3.4 Debt levels

3.4.1 The Forum is concerned about the rapid rise in debt levels. Over the period of the financial forecasts, net debt (which excludes CCHL's borrowing on the Council's behalf) increases from $44.7 million to $178.39 million or by 300 percent due to major projects such as the new art gallery and sewage disposal. Past experience shows that this will drive increases in operating expenditure over and above what is forecast and lead to the need for further rate increases. Our major concern is that the driving factor is the funding from rates of services that predominantly provide private benefits. A change in funding instruments would eliminate the need for much of the planned expenditure.

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8 The use of undiscounted straight line accounting depreciation rates on long-life infrastructural assets (eg roads and sewerage reticulation) will significantly over-recover funds required to replace them.

3.5 Comparison of key CCC trends with other indicators of activity

3.5.1 The financial forecasts reveal unsustainable trends. Over the last seven years (ie 1992/93 to 1999/00), total operating expenditure has increased 37 percent (from about $175 million to $239 million per annum) and capital expenditure by 62 percent (from $55 million to $89 million per annum).[9] Over the same period the rates take rose by $32 million per annum or 34 percent while ordinary revenues, which include user charges, compulsory levies and fines and central government grants, increased by 58 percent.[10] By comparison the city's population increased by around 10 percent[11] and the Consumer Price Index rose by less than 10 percent.[12]

3.5.2 These indicators show that over the last seven years there has been a real increase in the Council's activities. The financial forecasts indicate the trend is likely to continue. Continuing expenditure and rate increases are damaging and adversely affecting economic activity in the private sector. The Council's fiscal and regulatory policies have contributed to many of the social and economic problems of concern to the Council such as unemployment, inadequate investment and the decline of the central business district. A continuation of past trends will only exacerbate these problems.

3.6 Use of proceeds of the Enerco sale

3.6.1 Orion has realised $560 million from the sale of its North Island gas network and industrial trading division, with the potential for a further $10 million from the sale of surplus properties. As we understand it, Orion has repaid its entire debt of $270 million, paid a special dividend of $90 million to shareholders and invested the balance on short-term deposit.

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9 1992/93 is the period prior to the implementation of a number of policy changes that have led to significant increases in expenditure.

10 The comparison of expenditure and revenue is distorted by CCHL which did not exist in the base year. As a consequence a proportion of the Council's expenditure and revenue is excluded from the 1999 figures.

11 The population growth over this period was exceptionally high compared with historical trends. The rate of increase declined considerably in the years ended March 1998 and 1999 while growth may be negative for 2000.

12 That is, for the year ended March 1999/00 compared with 1992/93.

3.6.2 The Plan states that no provision has been made for the use of the proceeds of Orion's sale of Enerco and that once the issues are worked through, public consultations will be undertaken before a final decision is made. The Forum strongly urges the Council to use the proceeds from the special dividend to hold rates at the 1999/00 level. We see this as an interim action pending the implementation of the measures outlined in the following sections of this submission. The amount required in rates to avoid an increase on existing properties is only $3 million, which is an insignificant part of the capital repatriated as a consequence of the sale. It is inappropriate for ratepayers to be subjected to a further increase in rates when significant capital repatriation is pending and $230 million has been (or is about to be) received by the Council in relation to previously announced capital repayments.

3.6.3 To date ratepayers have not had a return from the compulsory investments the Council made on their behalf. Present ratepayers underwrote the risk associated with the Enerco investment and therefore it is only appropriate that they should be the principal beneficiaries. Prior to this mid-1990s investment there was no investment in Enerco and therefore there is little substance to the argument that the Council needs to reinvest the proceeds to protect its revenue stream. In fact in the initial stages the net returns were negative, as the share purchase was debt funded. This reduced the potential dividend from Southpower and effectively meant ratepayers paid higher rates to fund the purchase of Enerco shares. For these reasons there is no substance to claims that the Council has an obligation to hang on to the proceeds and preserve them for the benefit of future ratepayers. Other things being equal, it makes little difference whether the Council refunds the full amount of the proceeds and increases rates to compensate for the loss of interest and dividend revenue as ratepayers can effectively use the remitted proceeds to fund higher rates without being made worse off. This would be a more transparent and accountable arrangement than the current practice of funding activities from interest and dividends received from CCHL.

3.6.4 A recent poll undertaken by *The Press* indicates that a substantial percentage of residents favour either directly returning the proceeds to residents or reducing rates and/or debt. These are equivalent approaches from an economic perspective. Only a very small percentage of people favoured reinvestment of the funds and/or new spending. This lends weight to our suggestion that the special dividend be used to avoid increasing rates in the 2000/01 year.

3.7 New initiatives

3.7.1 There is no demonstrable need for the Environment Centre. It is totally inappropriate to commit ratepayer funds to a project prior to a feasibility study, particularly when it is anticipated that business users will fund it. In addition, the Council has significant regulatory powers in relation to environmental matters while the Council's budget in relation to Environmental Policy and Services funded from rates is over $12 million. This project will only impose more cost on overburdened ratepayers.

3.7.2 In previous budget consultations, ratepayers were asked to contribute a maximum of $4 million towards the redevelopment of Jade Stadium so as to provide a facility to host major cricket and rugby games in the City. The public was split on this issue. The need to develop the Village Green cricket facilities at Queen Elizabeth II Park for major domestic and international test matches arose out of problems with the proposed joint use of Jade Stadium. Effectively the Council is breaking its agreement to confine its contribution to $4 million.

3.7.3 The proposal to make the first hour's parking in Council car parking buildings free is strongly opposed by the Forum unless its cost is totally funded on a voluntary basis by central city businesses and the subsidy is extended to the facilities provided by rival firms. The cost of the proposal is open-ended as the subsidy depends on actual usage which is difficult to predict in advance, particularly as it will discourage the use of on-street parking so as to avoid fees.

3.7.4 Waste minimisation should be confined to schemes that are financially sustainable and can operate on a commercial basis. The existing schemes are heavily subsidised and have caused the cost of waste disposal to increase significantly. The operational cost of processing is 43 percent higher in 1999/00 (72 percent if capital expenditure is included) compared with 1993/94, the year immediately prior to its introduction, while the total volume of waste has increased by only 14 percent. The average cost per tonne of waste handled has risen from about $19 per tonne to $27 in the current financial year. If capital expenditure is included in the per tonne comparisons, the average cost increases to $23 and $35 respectively. Because it cannot operate on an unsubsidised commercial basis, we do not agree with the proposal to extend kerbside collection to include all types of paper and household plastic. We see no reason why waste disposal could not be handled entirely by the private sector.

3.8 Uniform Annual Charges

3.8.1 The Plan states that the 2000/01 funding policy calculations indicate that a Uniform Annual Charge of $124 should apply but that in order to "avoid significant adjustment difficulties, the full impact of the increased charge will be phased in gradually." The amount involved with the application of the full Uniform Annual Charge is less than $19 per annum or 36 cents per week, which is roughly the additional rates generated by the proposed rate increase for many lower value residential properties. This is misuse of s122G(d) of the Local Government Amendment Act (No 3) as it is difficult to claim that the amounts involved could lead to "significant adjustment difficulties" as a consequence of "sudden and significant changes in the total costs allocated." However, the Council's concern does support the fact that the rate of growth of Council expenditure is unsustainable for lower income ratepayers in particular.

4 Refocusing on core activities

4.1 In a number of areas, current delivery and funding mechanisms are inefficient and not giving ratepayers value for the expenditure made. They are encouraging growth in expenditure that ratepayers in general cannot sustain. The Council should refocus on core activities and divest its interests in the following activities that should be undertaken in the private sector:

- its shares in Orion Group Limited, Christchurch International Airport Limited, Redbus Limited, City Care Limited, Lyttelton Port Company and Selwyn Plantation Board Company. Privatisation should improve the competitiveness of these companies. For example, key charges at Australian airports have typically fallen following privatisation, with no deterioration in the quality of service;

- off-street parking facilities, which are loss making;

- waste disposal facilities;

- 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 rather than the provision of subsidised housing, as a large percentage of low income people obtain their housing in the private market. It is central government's responsibility to provide income support to elderly people and others who would otherwise face hardship. The average subsidy to Council tenants is around $50 per week.[13] In addition, ratepayers had to fund an inefficient Council operation and this effectively doubled the subsidy required to house the Council's tenants.[14]

- golf range and courses, camping grounds and leisure centres; and

- Christchurch Convention Centre and Westpac Stadium.

4.2 The Council should also consider divesting its water and wastewater reticulation business. Failing this, it should tender the franchise to operate these services.

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13 See the submission of the New Zealand Business Roundtable on the 1997/98 annual plan.

14 This was measured by the difference between the estimated average market rent and the estimated sum required to cover operating costs and provide a market return on the assets employed.

4.3 The Council should not, in general, be involved in the provision of private or club goods.[15] It should look to divest all services with these characteristics or, failing this, tender contracts to operate 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, museums, swimming pools and dedicated sports facilities. Users of these facilities are clearly the main beneficiaries.

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

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

- visitor and central city promotion and marketing;
- shuttle operations;
- domestic recycling and recovery.

[15] 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 non-rivalry characteristic, namely that use of the facilities by any one member does not detract from the ability of any other member simultaneously to enjoy those facilities.

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 Chamber of Commerce
- New Zealand Employers Federation Inc.
- New Zealand Forest Owners Association Inc.
- New Zealand Manufacturers Federation (Inc.)
- Property Council of New Zealand Inc.