

Who Pays? And How?

Making Revenue and Financing Policy

A New Zealand Experience

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Dunedin

- South east part of South Island
- Population 120,000
- Magnificent harbour setting, beaches, walks, wildlife.
- University City, rural hinterland, engineering, tourism
- 30" rain every year, invigorating climate
- DCC does water, sewage, stormwater, roads, land use planning, regulatory (noise, food, parking), recreation (parks, arts).
- Owns trading enterprises (revenue \$150 m, same as Council).
- Half revenue from rates, 35% fees and charges, central government, 15% investments



Today's Discussion

- Revenue and Financing Policy
- Legislative Requirement
- How it works
 - In theory
 - In practice
- What it means for Financial Management
- How it ensures that the most appropriate funding source is determined for Council services
- Balanced budget and generally accepted accounting practice (GAAP).

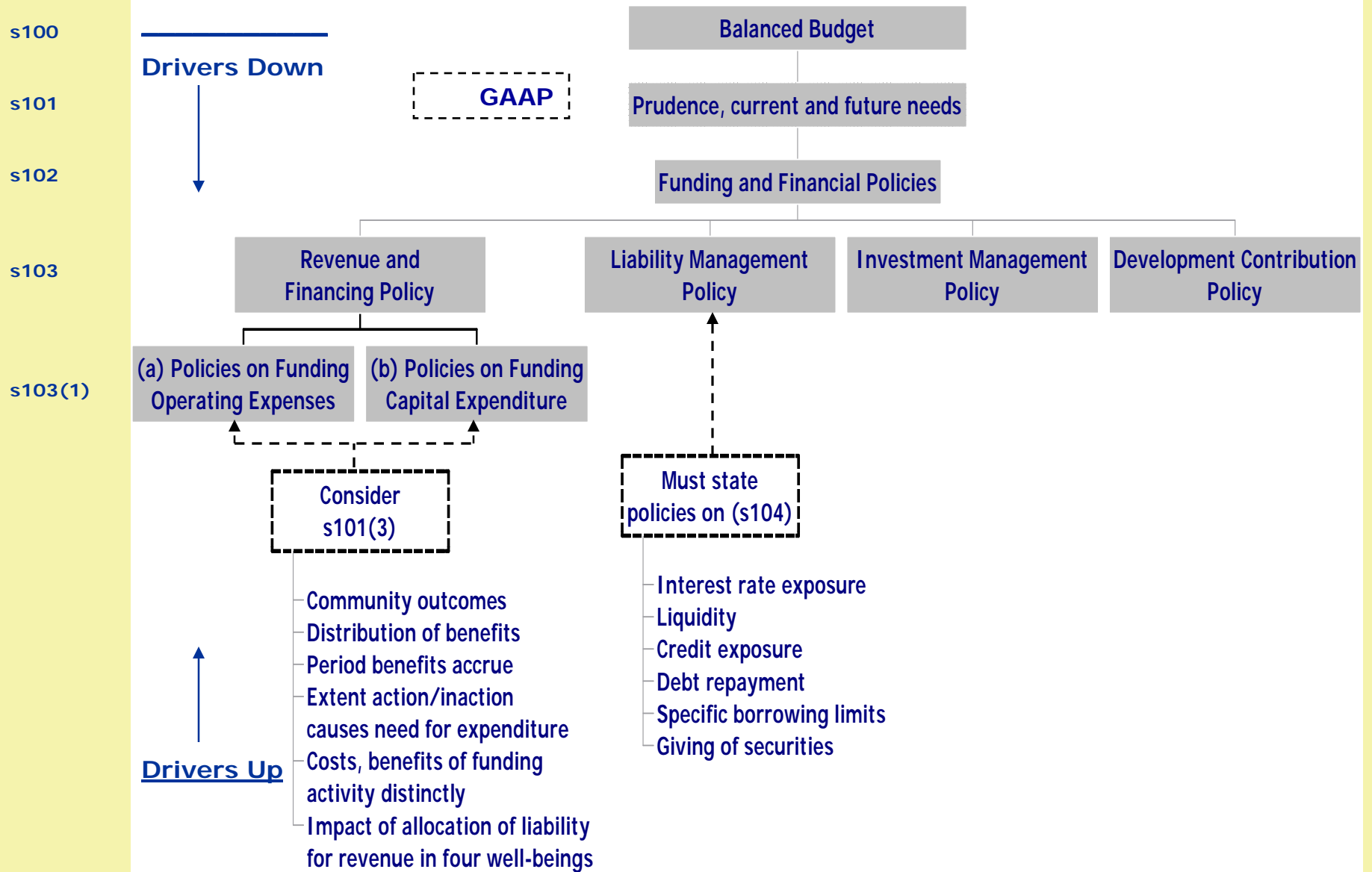
Legislative Requirements

- Context and history
 - Woolworths v Wellington City Council
 - Differential “excessive”
 - National Government receptive to proposal for legislative guidance
- 1996
 - Established a rigorous 3 step process for establishing who should pay
 - Step 1: Strict economic allocation (including exacerbators)
 - Step 2: Modification for fairness and equity, transitional impacts
 - Step 3: Practicalities, options of how (rates, user charges), efficiency

2002: Revisions to 1996 Funding Policy

- Generally watered down imperative language of 1996 Act
 - “Shall” replaced by “consider”
 - Strict 3 step sequence replaced by a set of general considerations in no order or priority
 - Identification of “principles” of 1996 replaced by a list of things to consider
- Indicative of political views of day
- Paradox:
 - Staff prefer the rigours of 1996
 - Still a tendency to use it
 - Leaves Councils with considerable flexibility

Financial Management - New Zealand Local Government



The Theory Public v Private Goods

Public Goods:

- Services no one else would or could provide at an economic return - libraries, art galleries, footpaths
- Services communities consider should be available, even if they don't use them themselves, eg botanic gardens, art galleries, museum. (Existence values, Prestige values, Option values)
- Services, facilities they consider will benefit next generation (Bequest values)
- Services where beneficiary cannot be identified, eg parks, reserves, bush, footpaths, street lighting

The Theory continued

Private Goods:

- Beneficiaries identifiable, user pays (eg rubbish bags)

Exacerbators

- Polluter pays (landfill charges)

Period of Benefit

- Long lived assets – each generation should contribute (means debt for 100 year water treatment plant, road extension)

The Practice

- Triennially (more frequently if you want) – review Funding Policy for each Activity of Council
- Dunedin has 28 Activities, 28 Funding Policies
 - Example: Swimming Pools
- Questions:
 - Who benefits from provision?
 - What are the public benefits? (Kids off the streets, away from TV, lower impact on the public health system)
 - What are the private benefits? (Personal health, fitness, competitive success, learn to swim)

Answers: There are no right answers

- Dunedin says the benefits are about 50:50, Public:Private
- So pool user admission fees cover 50% of the Pool's costs.
- But a gymnasium inside the Pool recovers 100% from admission. Why?
- Service is provided by private sector suppliers providing private benefits so no Existence or Option or Bequest values.

But Manukau City's View

- Very keen to get kids active so considered benefits 100% Public.
- Low income area
- Result: no admission charge to kids.

- Dunedin Public Art Gallery:
 - No charge to locals or visitors.
 - Community strongly of the view that Existence, Prestige values so high that there should be no barriers to entry.
 - Note: Special Exhibitions on tour charge admissions – at least partial cost recovery.

Example: Funding Tourism (Promotion and Effects)

- Recent email traffic revealed 6 councils with different ways of viewing funding of tourism promotion.
- All valid reflections of the local community's view of who benefits, who should pay and how they should pay.
- Same with impact on roads of logging trucks.
- Questions are prescribed, answers are not.
- Debates are frequent, lively, usually productive.

Example: Funding Tourism (Promotion and Effects)

Council	Basis	Comments
1. Waitaki District Council	<p>General Rate (based on property value)</p> <p>No differential ie all property owners contribute.</p>	<p>Farmers don't like it – say they don't benefit.</p> <p>No success with Tourism businesses who also don't like it.</p> <p>Investigating targetted rate.</p>
2. Hutt City	<p>Separate differential for Accommodation providers.</p> <p>Pan charges (water, sewerage)</p>	
3. Gisborne District Council	<p>Special Tourism rate</p> <ul style="list-style-type: none"> -35% cost by UAGC, paid by all ratepayers equally. -35% cost by Commercial, based on Capital Value. -30% by Retail and Accommodation, based on Capital Values -Pan charges \$60 each -Sewerage connections \$250 	<p>Offices (part of commerical sector) complain; says no benefit.</p> <p>Undifferentiated capital value captures large forestry, farms (not beneficiaries or exacerbators) – why should they pay?</p>

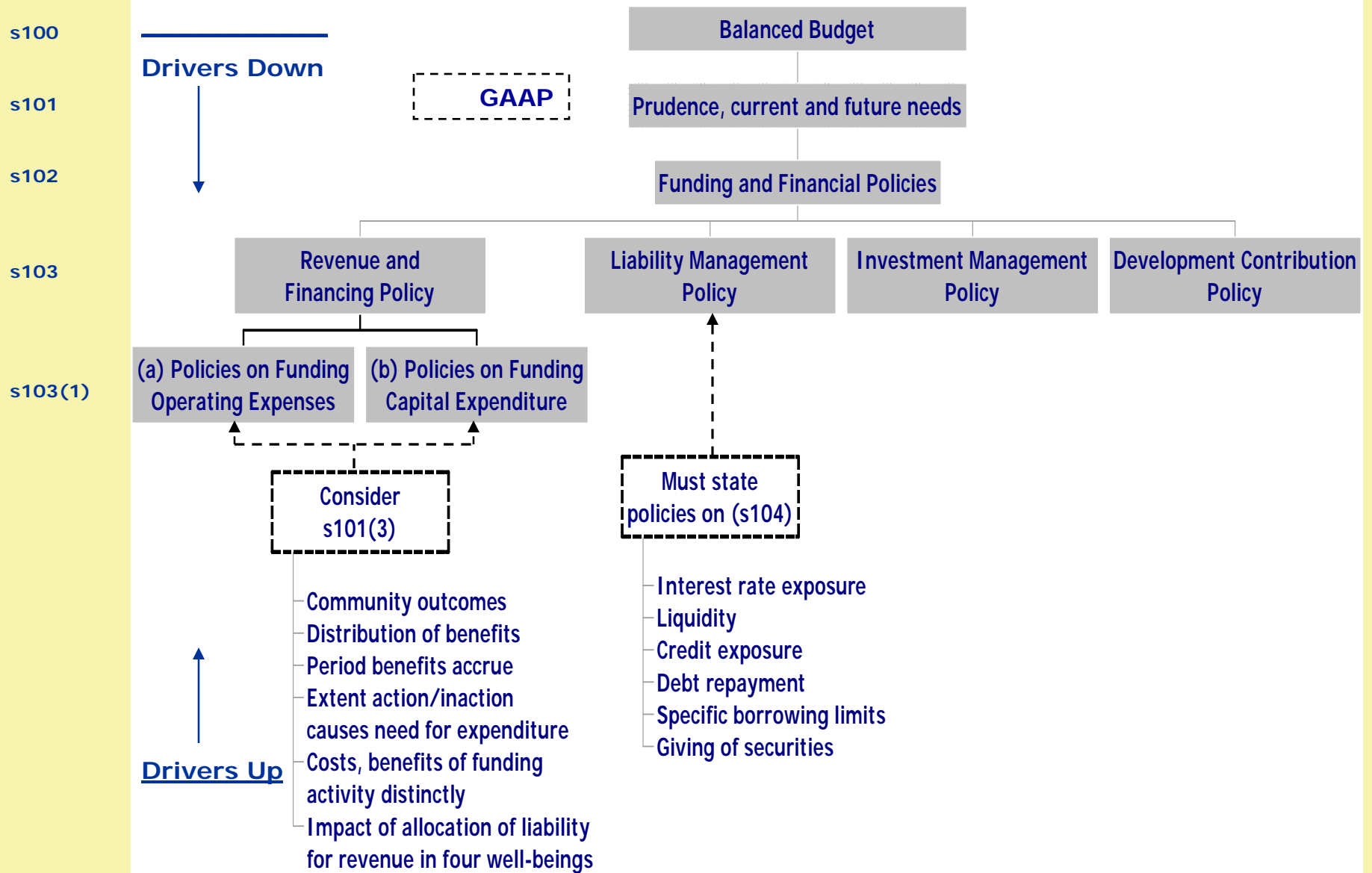
Example: Funding Tourism (Promotion and Effects)

Council	Basis	Comments
4. New Plymouth District Council	General rate, undifferentiated, based on Capital of Commerical properties	Argues large proportion of accommodation users not tourists.
5. Kalkoura District Council	Differentiated general rate on Capital Value on Commerical sector only.	
3. Dunedin City Council	Differentiated general rate on capital value of all properties, (residential, non-residential, farms)	About 15% of costs found from some hotels, airlines.

Funding Policy - Summary

- To a degree funding policies intuitive. Their formalisation in 1996 caused conscious changes in rating policy, eg Wellington, Auckland differentials.
- On the whole we like it.
- Can shape a position with confidence.
- There is a degree of rigour, intellect behind it.
- Based on ground level examination of benefits of an activity.
- Yet still room for political preferences.
- If funding policy is the foundation of rating, the balanced budget and GAAP are the roof.

Financial Management - New Zealand Local Government



Balanced Budget and GAAP

- At the heart of the New Zealand policy position is S100 – The Balanced Budget Requirement.
 - Can resolve not to balance, but there are hoops to go through
 - *“A local authority must ensure that each year’s operating revenues are set at a level sufficient to meet that year’s projected operating expenses.”*
- S101 reinforces, with policy statements, general principles:
 - Prudence, outcomes served, public and private good, intergenerational equity, exacerbator/polluter pays
- GAAP (Generally Accepted Accounting Practice)
 - Tucked away in S111
 - Balancing budget and GAAP = potent combination for financial sustainability

History and Context

- New Zealand GAAP – effective 1991
- All but one New Zealand Council Audit qualified in 1991 – inability to disclose adequately depreciation expense, infrastructural assets.
- New Zealand situation more complex by virtue of water, sewerage, stormwater, roading (except State Highways)
- 100 years of Cash Accounting – what assets did Councils own? (Most buried as reticulation networks).
 - What condition were they in?
 - When would they need replacing?
 - How would their replacement be funded?
 - How would new levels of expectation, standards be funded?

Depreciation, Valuations

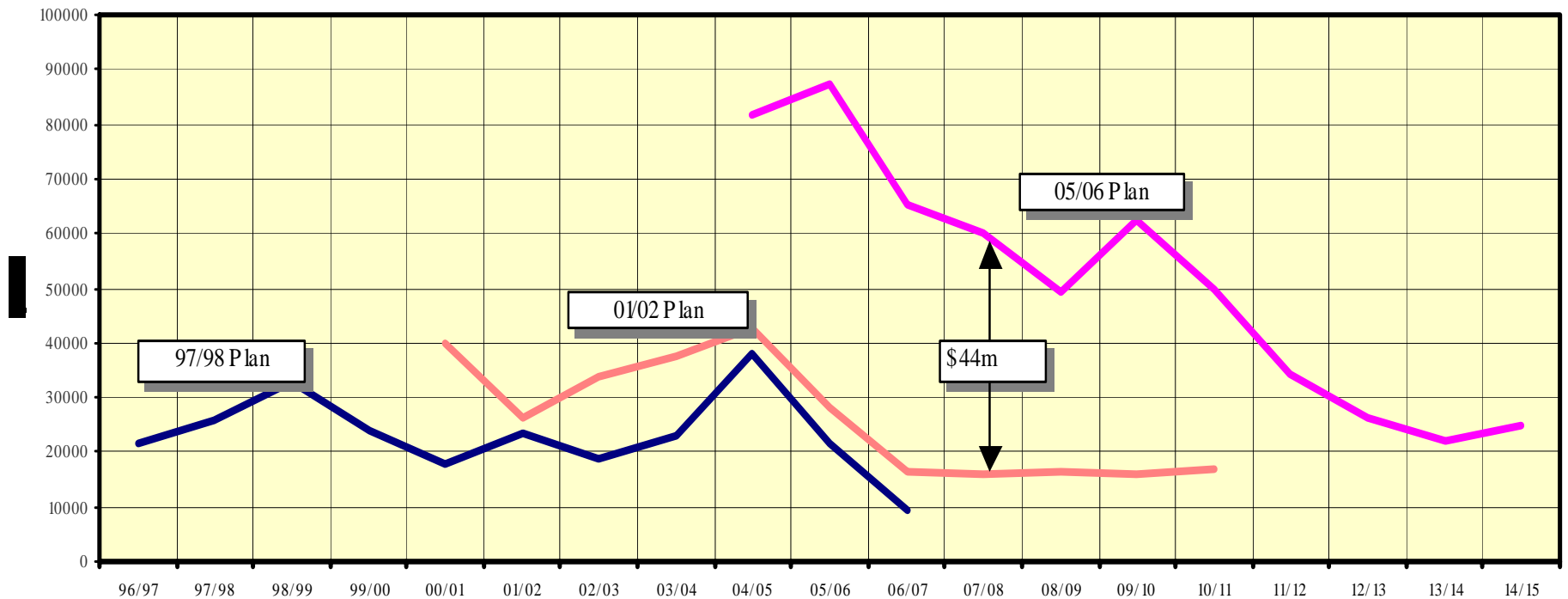
- Depreciation in Dunedin City was \$18m in 1997/98, and is \$35m in 2005/06 (24% total operating expenses)
- Reasons:
 - Finding assets
 - Revaluation because of GAAP valuation basis
 - Infrastructural Assets – Depreciated Replacement Cost (DRC)
 - What would it cost to replace today, allowing for its age?
 - In inflation: DRC rises, depreciation rises and balanced budgets mean the depreciation is funded (rated, charged to ratepayers)
 - For water, sewerage, stormwater, roads: impact big.

Cash Flows and Renewals

- Theory:
 - Funding depreciation will fund replacements and renewals
 - Timing of funding depreciation and asset replacement coincide and are equal
- Practice:
 - Timing of funding depreciation and asset replacement do not coincide, nor are they equal
 - There is a never-ending queue of projects that will use up the cash flows from funding depreciation
 - In 1997/98 we estimated Capital Expenditure in 2006/07 would be \$10m
 - In 2005/06 8 years later, we estimated it at \$65m

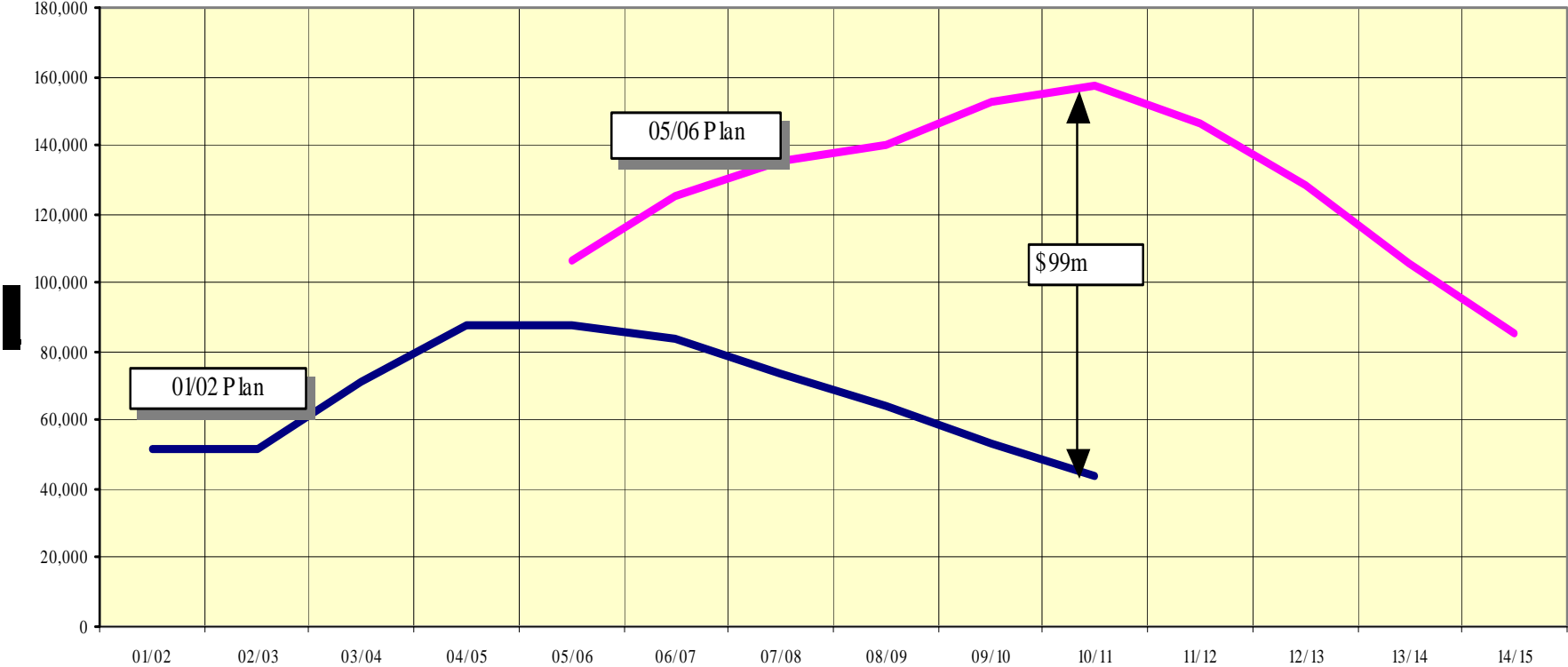
Capital Expenditure

Capital Expenditure Estimates: 3 ten year Plans - Dunedin City



Debt

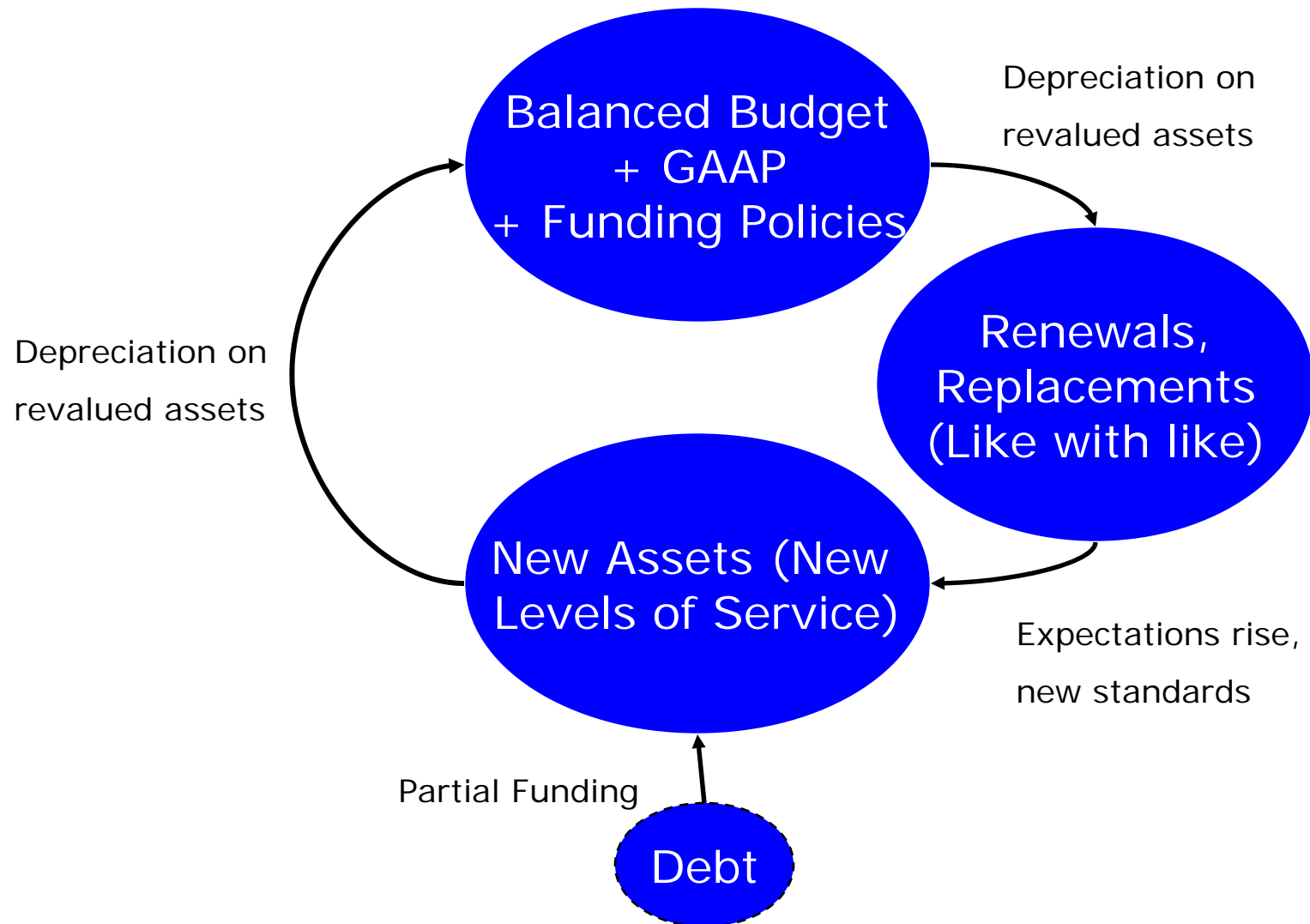
Net Debt: 2 Ten Year Plans - Dunedin City



Levels of Service

- New Drinking Water standards
- New Wastewater Discharge standards
- Effect may be no less on:
 - Swimming Pools – become Leisure Pools
 - Outdoor Sports stadiums – become indoor Events Centres
 - Libraries – become IT Centres, Coffee Bars
 - Art Galleries – become Community Centres, Wedding Venues
 - Museums – just get bigger
 - Town Halls – become Convention Centres
- Need to expect expectations and standards to rise
- Long lived assets need long views, lots of forward thinking
- Need great asset management plans

Is there a Virtuous Circle?



Practical Response

- Deals with ever rising expectations
- May create a virtuous, sustainable funding circle
- Keep debt up to a level that is affordable – (Rates as % of household income)
- Keep an eye on intergenerational equity
- Intensify long term asset management planning

The Future

- Jury still out but it may be that the move from Cash to Full Accrual Accounting, underpinned by annual revaluations and a balanced budget, will provide a level of funding that will:
 - Sustain renewals, and
 - Fund, to a greater or lesser degree, the never ending queue of new assets that every Council faces.