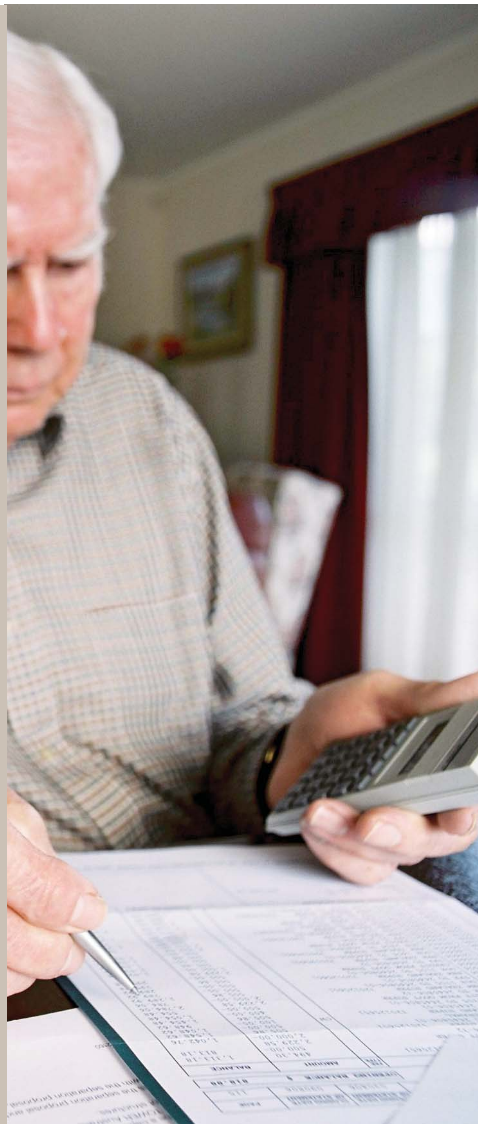
Controller and Auditor-General
Tumuaki o te Mana Arotake

Performance audit report

Residential rates postponement



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Residential rates postponement

This is the report of a performance audit we carried out under section 16 of the Public Audit Act 2001

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Foreword

In recent years, rates in many areas have been increasing above the rate of inflation. Paying these higher rates can cause difficulty for ratepayers on fixed incomes – for example, people who rely on New Zealand superannuation. Many areas of New Zealand have also experienced rising property values. This has created significant equity for many property owners, but equity in a property is not generally available to meet expenses such as rates.

The Local Government Act 2002 gives local authorities wide powers to set rates postponement and remission policies. Rates postponement policies allow ratepayers to defer paying their rates, with the debt being secured against the equity in their property. Some councils have retained their pre-2002 residential rates postponement policies, allowing ratepayers to postpone their rates on the grounds of hardship only. In addition, a group of councils has formed a consortium to offer a different form of residential rates postponement that does not involve hardship criteria – "optional rates postponement".

I felt it would be timely to undertake a performance audit of both these types of residential rates postponement policies, so that lessons regarding optional rates postponement can be learned early and best practice can be shared among councils that currently offer, or are considering offering, residential rates postponement.

My report draws on an assessment of the rates postponement policies and administration of six councils – four that are part of the optional rates postponement consortium, and two that offer rates postponement on hardship grounds only.

Overall, councils' rates postponement policies are well designed, and councils are administering them in the interests of their communities. However, I have identified some areas where councils could improve their rates postponement policies and procedures.

I thank those councils that participated in the audit, as well as McKinlay Douglas Limited and Relationship Services.

K B Brady
Controller and Auditor-General

13 November 2006

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Summary

Introduction

Since the Local Government Act 2002 was introduced, local authorities have adopted a variety of rates postponement policies. The Act allows local authorities to determine their own rates postponement policies – unlike previous legislation, which specified the grounds on which postponement could be offered. Under rates postponement policies, councils allow ratepayers to defer paying their annual rates until a future date.

This report examines two kinds of rates postponement policies – optional rates postponement and postponement on the grounds of hardship. Both these policies apply only to residential ratepayers. Postponement on the grounds of hardship was allowed under previous legislation. However, optional rates postponement is a new development, enabled by the 2002 legislation.

A group of councils and a private management company have formed a consortium to offer optional rates postponement. The consortium currently has 14 member councils. All councils offering optional rates postponement are part of the rates postponement consortium.

The concept of rates postponement is straightforward, but designing and implementing a rates postponement policy requires councils to consider complex legal, ethical, and financial issues. Councils need to take into account the interests of ratepayers who may wish to postpone their rates and the interests of other residents. While we have provided our view on a range of issues affecting residential rates postponement, it should be noted that this is general advice, and councils may wish to seek their own advice for specific situations.

Why we did the audit

At the moment, the total number of ratepayers postponing their rates under either policy is very small. However, optional rates postponement is being promoted to councils around the country, and the number of ratepayers postponing their rates is expected to increase. For this reason, we considered an audit on rates postponement was timely.

Our findings

Councils' rates postponement policies are generally well designed, and councils are administering them in the interests of ratepayers.

Optional rates postponement allows ratepayers who are asset rich but income poor to use the equity in their properties to guarantee the future payment of rates. These ratepayers can then use the income they would have spent on rates for other purposes.

Hardship policies are designed to relieve extreme financial hardship. However, we note that eligibility criteria for these policies are generally fairly strict, and only a very small number of ratepayers take them up.

The decision-making and consultation process followed by councils that have adopted optional rates postponement policies adequately complied with the provisions in the Local Government Act. The consortium as a whole has done a good job of assessing and managing the risks associated with offering optional rates postponement.

Overall, the structure and management of the rates postponement consortium seems reasonable. However, there are some areas that will need to be refined as the number of councils and ratepayers participating in optional rates postponement grows.

We have identified some areas where councils could improve their rates postponement policies and procedures. For example, it would be good practice for councils offering rates postponement on the grounds of hardship to advise applicants to seek independent advice before they sign up for rates postponement. Further specific recommendations are included in the body of the report.

Part 1
Introduction

1.1 In this Part, we explain:

- rates postponement;
- why we audited rates postponement;
- our audit objective and performance expectations; and
- how we carried out the audit.

Rates postponement

1.2 Most local authorities offer some kind of residential rates postponement. However, the number of ratepayers currently postponing their rates is low.

1.3 Rates postponement means that a council allows the ratepayer to delay paying their rates. Ratepayers still have to pay postponed rates, but at a later time. In some cases, rates may be postponed for a set number of years. In other cases, rates may be postponed until a certain event occurs, such as the ratepayer selling their property or dying.

1.4 The council supplements the existing security it has for postponed rates (deriving from rates being a statutory charge against the land they are levied on) by registering a notification of charge on the title to the ratepayer's property. This means the property cannot be sold without the council being notified. The notification of charge also alerts anyone searching the title that rates on that property have been postponed.

1.5 The final debt the ratepayer owes the council will be larger than just the postponed rates. The council will usually also add interest and other fees to the amount owed. As well as each year's rates being added to the debt, the interest compounds. This means even quite small initial debts can become large over a period of years.

Home equity conversion

1.6 Home equity conversion, also known as equity release or a reverse mortgage, involves the home owner receiving one or more cash payments from the lender. These payments, with interest added, are recorded as a debt against the property. Generally, no payments, even of interest, are required until the property is sold or the owner dies. The whole amount of the loan must then be paid. Home equity conversion is usually available only to people aged at least 60. In New Zealand, home equity conversion is available through some banks and private finance companies.

1.7 In contrast, residential rates postponement allows ratepayers to defer paying their rates, using the equity in their property as security. Under rates postponement policies, ratepayers do not receive cash from the council. Instead, they retain money they would otherwise have spent paying their rates.

The Local Government (Rating) Act 2002

1.8 Section 87 of the Local Government (Rating) Act 2002 gives local authorities the freedom to set any rates postponement or remission policies they decide. This is a change from previous legislation, which prescribed limited circumstances under which postponement could be offered.

1.9 Councils must adopt postponement policies using the special consultative procedure outlined in the Local Government Act 2002.[1] Councils may amend the policy only as part of an amendment to their Long-Term Council Community Plan (LTCCP).[2]

Types of rates postponement

1.10 Around the country, councils have adopted rates postponement policies to cover different situations, including:

- to help businesses that will bring economic development to the area;
- for special land categories – for example, farmland near urban areas;
- for ratepayers who own their own properties and wish to use their current income for purposes other than paying rates ("optional rates postponement"); and
- for residential ratepayers experiencing financial hardship.

1.11 This report covers only residential rates postponement – that is, optional rates postponement and postponement on hardship grounds. It does not cover rates remission policies, rates rebates, or other forms of rates postponement policies.

Optional rates postponement

1.12 In 2003, four councils and a private company, McKinlay Douglas Limited (MDL), agreed to work together to design and deliver a rates postponement scheme offering postponement to older ratepayers who own their own properties. The four councils were Far North District Council, Rodney District Council, Thames-Coromandel District Council, and Western Bay of Plenty District Council. Gisborne District Council and Waikato Regional Council joined the group in 2004. MDL set up a dedicated company, R P Scheme Managers Limited (R P Scheme Managers), to manage the rates postponement scheme. We refer to this grouping of the

1 Section 102(2).

2 Section 102(6).

councils, MDL and R P Scheme Managers as "the rates postponement consortium". We refer to councils that are members of the consortium as either "the consortium councils" or "councils offering optional rates postponement".

1.13 Eight other councils have recently joined the consortium.[3]

1.14 Under the consortium policy, any ratepayer who meets the council's age and residency criteria and has enough equity[4] in their property to provide security for the postponed rates may postpone their rates. There is no income or asset testing involved.

1.15 So far, all councils offering optional rates postponement have become part of the rates postponement consortium.

Rates postponement for hardship

1.16 Before the legislative change in 2002, financial hardship was one of the prescribed grounds on which councils could offer rates postponement. Many councils have retained a policy to postpone rates if ratepayers can show that having to pay rates will cause them financial hardship. This is a need-based policy, and involves income and asset testing.

Why we did the audit

1.17 Over the last few years, New Zealand has experienced a substantial increase in property prices. This increase has particularly affected the values of coastal property and properties in many traditional "retirement" regions. In addition to this, rate increases by many local authorities exceed the rate of inflation. A particular problem for ratepayers may arise when the rate of increase in property values varies significantly across a district. This would mean that rates for certain ratepayers will increase more than rates generally across the district. Some ratepayers, retired people in particular, are on low or moderate fixed incomes, and may struggle to pay the increased rates. However, these ratepayers may also own valuable properties, particularly in areas where property values have risen substantially. These ratepayers can therefore be described as "asset rich but income poor". The optional rates postponement consortium is, in part, a reaction to these circumstances.

1.18 Participation in optional rates postponement is currently low. However, participation could grow quickly if more councils join the consortium and more ratepayers elect to postpone their rates.

3 Ashburton District Council, Kapiti Coast District Council, Marlborough District Council, Masterton District Council, Nelson City Council, Queenstown-Lakes District Council, Rotorua District Council, and South Wairarapa District Council.

4 In this report, unless the context indicates otherwise, the term "equity" ignores the existence of any mortgages, because rates have priority over mortgage debt. In most cases of rates postponement, there will be no mortgage.

1.19 We have chosen to audit optional rates postponement now, so lessons can be learned early and best practice can be shared among councils considering joining the rates postponement consortium or offering other similar rates postponement policies.

1.20 We have included rates postponement hardship policies in our audit as a comparison to optional rates postponement, and to provide assurance about the design and administration of both kinds of residential rates postponement schemes.

Our audit objective and performance expectations

1.21 The overall objective of our audit is to provide assurance to Parliament that councils are administering rates postponement policies in the interests of their communities – both ratepayers who postpone their rates and other residents.

1.22 In addition, our audit aims to:

- provide Parliament and local authorities with a clear understanding of the nature of current rates postponement policies;
- provide assurance over the design and administration of rates postponement policies;
- provide recommendations for those councils that currently have rates postponement policies or are considering adopting such polices, including joining the optional rates postponement consortium; and
- describe the structure and management of the rates postponement consortium.

1.23 We had expectations relating to:

- decision-making and consultation (Part 3);
- risk identification and management (Part 4);
- application processes (Part 5); and
- ongoing administration (Part 6).

1.24 We have attached the full set of expectations as Appendix 1.

1.25 We describe the rates postponement consortium in Part 7.

How we carried out the audit

1.26 In conducting our audit of the optional rates postponement scheme, we:

- visited four of the six councils that are part of the original rates postponement consortium (Far North District Council, Gisborne District Council, Rodney

District Council, and Western Bay of Plenty District Council), to review documents and conduct interviews with relevant staff;

- met with staff of Relationship Services, the independent organisation that provides decision facilitation services to optional rates postponement applicants;
- met with staff of R P Scheme Managers, the firm responsible for managing the consortium; and
- analysed documents relating to the consortium, including the Heads of Agreement for Rates Postponement Project, Joint Committee Agreement for Rates Postponement Project, and the management agreement between the Joint Committee and the management company.

1.27 In conducting our audit of hardship policies, we:

- visited two councils that offer rates postponement on hardship grounds only (Christchurch City Council and Wellington City Council), to review documents and conduct interviews with relevant staff;
- undertook a telephone questionnaire involving another six councils that offer rates postponement on the grounds of hardship;
- reviewed the policies of all 55 councils that offer rates postponement on the grounds of hardship; and
- considered the hardship postponement policies of the four councils that offer optional rates postponement where relevant.

1.28 We also engaged an actuary to model a range of rates postponement scenarios as well as to review a selection of results from the actuarial model used by members of the consortium.

Part 2
Rates postponement policies

2.1 In this Part, we:

- describe optional rates postponement policies;
- describe postponement policies on the grounds of hardship;
- note the effect of territorial authorities acting as collecting agents for regional councils; and
- describe the effect of rates postponement on ratepayers' equity.

2.2 Appendix 3 lists issues that councils adopting a rates postponement policy may wish to consider when designing the policy.

Description of optional rates postponement policies

2.3 The four councils offering optional rates postponement that we audited have between 2 and 29 ratepayers currently postponing rates. These councils were unsure whether they would receive a substantial number of applications for rates postponement in the future. Several councils commented that their optional rates postponement policies were not yet well known or understood by ratepayers. They also considered that the current generation of retired people had an aversion to getting into debt, which might discourage them from participating in the scheme. Several councils commented that the number of applications might increase as the "baby boomer" generation move into retirement. All councils involved in the optional rates postponement scheme told us that they saw it as a valuable way of offering ratepayers another choice about how to pay their rates. They also said they saw it as a "long-term" policy that required an upfront investment, but that would not necessarily have a large number of participants until some time in the future.

Eligibility criteria

2.4 Optional rates postponement is generally open to ratepayers who are over 65. For these ratepayers, postponement is indefinite and payment is required on the death of the ratepayer or sale of the property. Ratepayers who are younger than 65 can also apply, but will have a set term of postponement of up to 15 years.

Equity

2.5 All applications are run through an actuarial model. The model estimates how much the ratepayer will owe in postponed rates (including interest and fees) at the end of their statistically determined life expectancy, as well as the likely value of their property at that time. Rates postponement is granted only if the model suggests that the postponed rates will not accumulate to more than 80% of the ratepayer's equity in the property.

2.6 If the model predicts that the postponed rates will exceed 80% of the equity in the property, the ratepayer may be able to postpone only a portion of their rates.

2.7 Because rates have priority over mortgage debt, any mortgages against the property are not taken into account when assessing the equity available for rates postponement. However, ratepayers who have an outstanding mortgage against their property need to seek the consent of their mortgagee before rates postponement will be granted.

2.8 If, when the property is sold, the price realised is less than the amount of postponed rates owed to the council, the council will not seek to recover the difference from the ratepayer or their estate. This "no negative equity" clause guarantees that a ratepayer or their estate will never have to pay the council more than the value of their property when it is sold. Councils charge an annual reserve fund fee to cover the potential for loss on any such properties, and this fee is added to the postponed rates.

Decision facilitation

2.9 All ratepayers who wish to postpone their rates are required to attend at least one decision facilitation session with a decision facilitator from Relationship Services. Relationship Services is contracted by R P Scheme Managers to provide this service in all the areas where councils offer optional rates postponement.

2.10 The decision facilitator must certify that the ratepayer understands the implications of postponing their rates before the council will grant postponement.

Security

2.11 Rates assessed, including postponed rates, are a statutory charge against the property they are levied on.[1] When postponing rates, councils register a notification of charge on the title of the property concerned. This notification of charge acts as an alert to anyone searching the title that rates may have been postponed. The notification of charge on the title also prevents the property being sold without the council being notified.

2.12 It is a requirement of optional rates postponement that ratepayers insure their houses, to further protect the council's interest.

Fees and interest

2.13 Fees and interest vary with each consortium council's individual postponement policy.

2.14 Most councils charge a once-only application fee of $50. All councils charge a once-only decision facilitation fee of $300.

1 Section 59 of the Local Government (Rating) Act 2002.

2.15 All councils charge an annual management fee of 1% on the outstanding balance. All councils also charge an annual 0.25% reserve fund fee on the outstanding balance. This goes into a “reserve fund”, which each council manages individually. The purpose of this fund is to cover the council’s costs if the amount of rates postponed on a given property exceeds the value of that property when it is sold. Some councils also charge an annual administration fee of between $50 and $100.

2.16 All consortium councils charge interest on the balance of postponed rates, usually at the council’s rate of borrowing (that is, the interest that the council pays to service its own debt).

2.17 The interest and all fees, including the once-only fees, are usually added to the postponed rates. However, the ratepayer can, if they choose, pay any amount of the outstanding balance of their postponed rates (including fees and interest) at any time without incurring a penalty.

Cost to other ratepayers

2.18 All consortium councils state in their policy objective that the full cost of rates postponement should be met by the ratepayers who are postponing their rates. Accordingly, no part of the cost of rates postponement schemes is borne by other ratepayers.

Description of hardship rates postponement policies

2.19 Fifty-five local authorities (out of a total of 85) offer rates postponement on grounds of financial hardship. This number includes nine of the 14 councils that currently offer optional rates postponement.

2.20 We visited or spoke to staff of eight councils that offer rates postponement on hardship grounds only. These councils have between none and 10 ratepayers currently postponing their rates. One council commented that they had received only one application for rates postponement in 25 years. None of the councils anticipated an increase in the number of applications for rates postponement on the grounds of hardship. Several councils noted that the recent changes to the central government rates rebate scheme would help low-income ratepayers who might otherwise apply for rates postponement.[2]

Eligibility criteria

2.21 All councils that offer rates postponement on the grounds of hardship require applicants to disclose their income and assets. Some councils have a set formula

2 The rates rebate scheme was established in 1973 to provide a subsidy to low-income homeowners on the cost of their rates. The rates rebate thresholds were changed with effect from 1 July 2006. The maximum rebate has increased from $200 to $500, and the income threshold has increased from $7,400 to $20,000.

for deciding whether ratepayers are eligible to have all or some of their rates postponed, based on their income and assets. At other councils, staff assess applicants to decide whether they are suffering financial hardship. At the two councils we audited that offer rates postponement on hardship grounds only, the rates postponement files showed that the applicants were in extreme financial hardship, with low incomes, and with very few assets other than their properties.

2.22 Other eligibility criteria in some councils' policies include:

- that ratepayers have substantial equity in their properties;
- that ratepayers are aged over 60 or 65;
- that ratepayers provide evidence of having sought budgeting advice; and
- that ratepayers have lived in the district or their house for a minimum length of time.

Term of postponement

2.23 Some councils require that ratepayers apply separately for the postponement of each year's rates. Other councils require only one application, and then automatically postpone the ratepayer's rates until either the ratepayer's property is sold or the ratepayer requests postponement to cease.

Which rates are eligible to be postponed

2.24 Council policies fall into one of three options:

- ratepayers are able to postpone all current and future rates; or
- ratepayers are able to postpone a portion of current and future rates, but are still required to make a minimum annual payment (usually $520 a year – that is, $10 a week); or
- ratepayers are able to postpone arrears, but are required to make arrangements for the payment of future rates.

Security

2.25 All councils that offer rates postponement on hardship grounds have a policy of registering a notification of charge on the title of the ratepayer's property to indicate that rates may have been postponed and to ensure that the property is not sold without the council being notified.

2.26 Some councils require that the ratepayer insure their house.

Interest and fees

2.27 Rates postponement policies generally state that councils will charge interest on postponed rates, calculated at the council's rate of borrowing.

2.28 Councils vary as to whether they charge an initial application fee and/or an annual administration fee or no fees.

Territorial authorities acting as collecting agents for regional councils

2.29 Some regional councils collect their own rates, while others have their rates collected for them by the relevant district or city council. Several regional councils whose rates are collected by territorial authorities match their rates postponement policies with the policies of their collecting agent(s). In our view, this is good practice.

The effect of rates postponement on ratepayers' equity

2.30 Figures 1 and 2 illustrate the effect of rates postponement on two sample properties using different interest rates (6% and 9%)[3] and different rates of property value growth (1% and 5%, and 4% and 8%). The figures illustrate the effect on the equity in the sample properties after 10, 20, and 30 years. We have chosen scenarios that reflect a wide range of situations to show the effect of compounding debt on equity, rather than choosing scenarios that reflect actual rates postponement situations.

2.31 The figures were produced using a model created by our actuary. The model uses the Department of Statistics New Zealand life tables 2000-02. The full data sets these diagrams were generated from are shown in Appendix 5.

2.32 As can be seen from the figures, differences in interest rates and rates of property value growth create significant differences in the outcome, particularly over the longer term.

2.33 Relatively low rates of increase in property values along with higher interest rates could lead to a situation where the value of the postponed rates exceeds the final sale value of the property (the example in Figure 2 with shading under the house). If that happened, the council would not be able to recover the full value of the postponed rates, and the ratepayer or their estate would not receive any money from selling the house.[4]

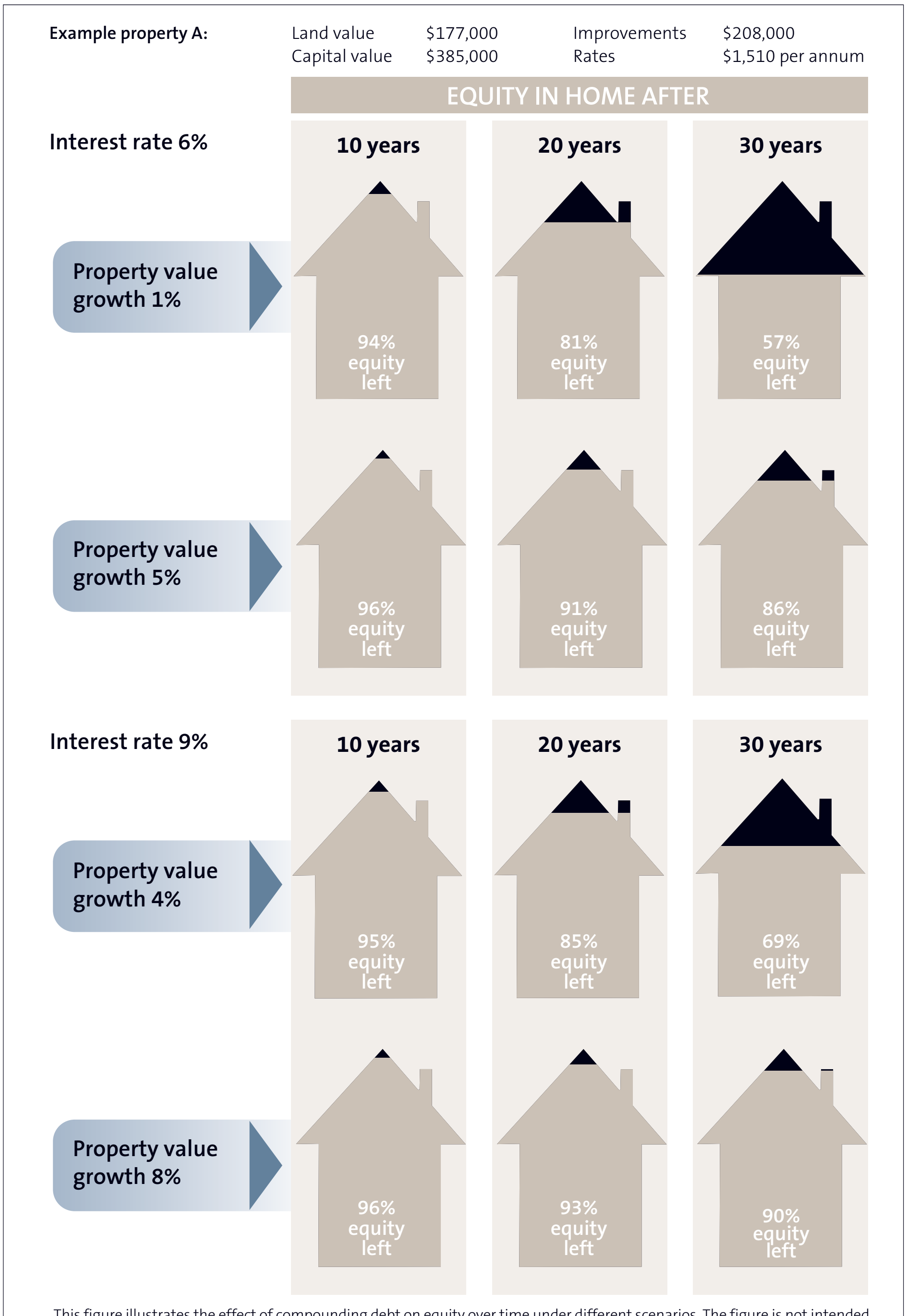
3 The interest rates used represent assumptions about the councils' rate of borrowing, which will be passed on to the ratepayer as the interest rate charged on postponed rates. The consortium's current fees have been taken into account in calculating the results shown in Figures 1 and 2.

4 The rates postponement consortium charges a levy on postponed rates that is intended to cover the council's loss if this situation occurs.

2.34 Conversely, high increases in property values can partially offset the cumulative effect of postponed rates and interest. In that situation, not only would the council be able to recover the full value of postponed rates on sale of a property, but there would also be a substantial portion of the sale proceeds left for the ratepayer or their estate.

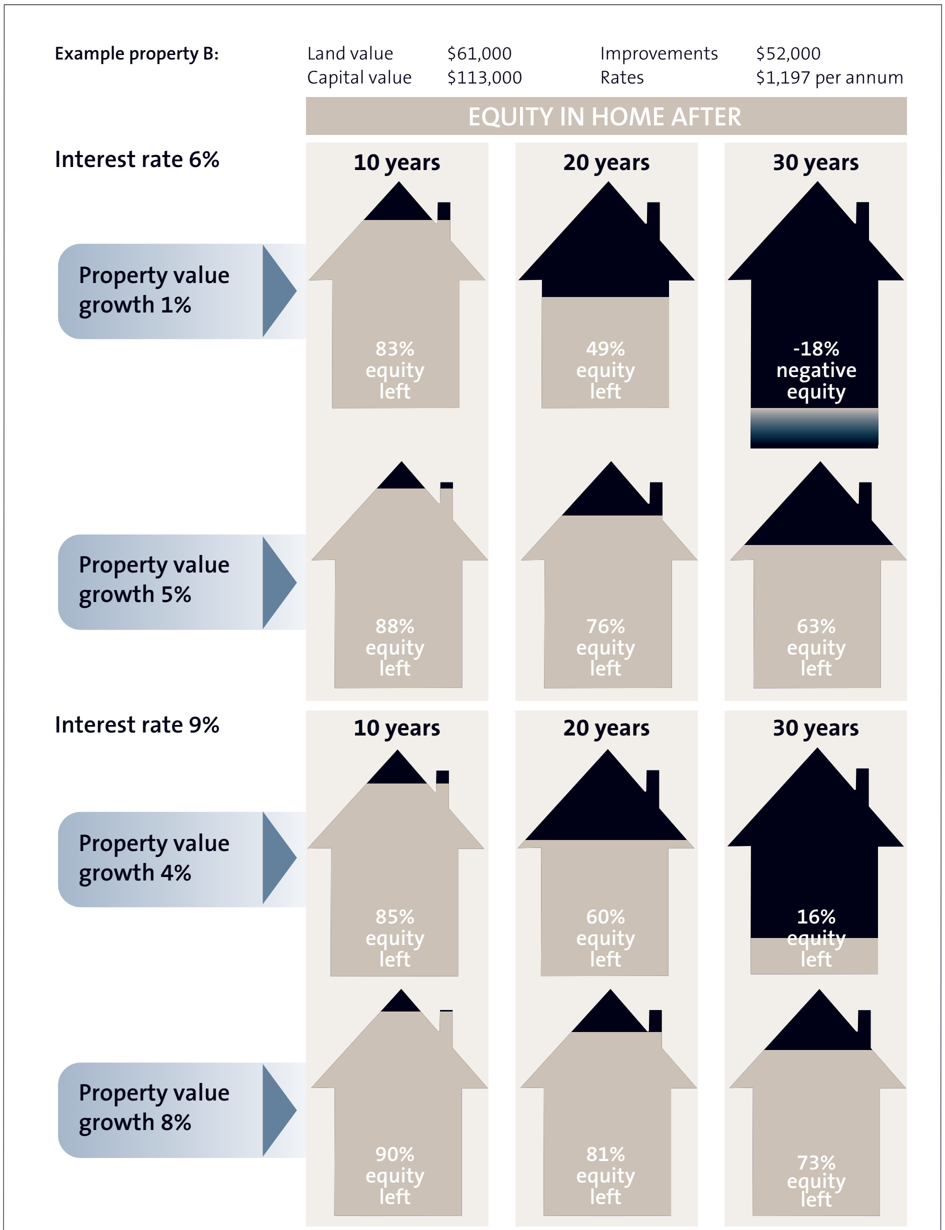
Figure 1

Effect of rates postponement on equity in example property A



This figure illustrates the effect of compounding debt on equity over time under different scenarios. The figure is not intended to reflect an actual rates postponement situation. The interest rates and rates of property value growth are nominal.

Figure 2
Effect of rates postponement on equity in example property B



This figure illustrates the effect of compounding debt on equity over time under different scenarios. The figure is not intended to reflect an actual rates postponement situation. The interest rates and rates of property value growth are nominal.

Part 3
Decision-making and consultation

3.1 In this Part, we:

- outline certain requirements of the Local Government Act 2002;
- state our expectations; and
- assess councils against our expectations.

The Local Government Act 2002

3.2 The overriding requirement for a local authority in making any decision is to satisfy itself that the decision accords with the purpose of local government set out in section 10 of the Act and the principles relating to local authorities set out in section 14 of the Act.

3.3 Supporting this purpose, there are a number of sections in Part 6 of the Act setting out the obligations of local authorities when making decisions.[1]

3.4 The Act allows councils to make judgements about how to apply the decision-making requirements in proportion to the significance of the matters affected by the decision.[2]

3.5 Section 77 of the Act requires councils, in the course of the decision-making process, to identify all reasonably practicable options for achieving the objective of a decision. It is implied that councils will need to identify their objective before considering their options for achieving that objective.

3.6 Councils must assess those options, taking account of:

- the benefits and costs;
- the effect on community outcomes;
- the effect on the council's ability to provide for present and future needs; and
- any other matter the council thinks relevant.

3.7 As part of their decision-making, councils may be required to undertake consultation. Provision for consultation is also contained in Part 6 of the Act.

What we expected

3.8 We expected that councils, in designing and choosing to adopt a rates postponement policy, would have adequately complied with the consultation and decision-making sections in the Act.

3.9 Rates postponement affects councils' income streams because they are not receiving the postponed rates until a later date. Councils may need to borrow to make up the shortfall. If a significant number of ratepayers choose to postpone

1 Sections 76-81 of the Local Government Act 2002.

2 Section 79 of the Local Government Act 2002.

their rates, funding of rates postponement could become a major source of debt for the councils involved. We therefore expected that councils would accurately and reasonably inform their communities about the potential implications of their rates postponement policy, including the potential effect on the council's debt and how the council intends to manage this.

3.10 We expected that councils would include the effect of rates postponement in their financial projections if the amount of postponed rates was significant for the council.

Decision-making and consultation by councils with optional rates postponement policies

3.11 Councils that offer optional rates postponement have adopted this as a new policy since the 2002 legislation.

3.12 The four councils offering optional rates postponement that we audited were part of a group of councils that pioneered optional rates postponement. These four councils decided to be part of the rates postponement consortium when both the rates postponement scheme and the consortium itself were in the early stages of development.

3.13 In preparation for forming the consortium, Western Bay of Plenty District Council spent some time considering whether there was a need for rates postponement and how this need might be met.

3.14 After the consortium was formed, the councils collectively considered a variety of policy options for delivering rates postponement. They also formulated an objective reflecting the purpose of the policy.

3.15 As part of the process of designing the optional rates postponement policy, the consortium considered the costs and benefits of various features that could be included in the policy.

3.16 The final consortium policy was designed to allow older ratepayers to choose to postpone paying their rates. The councils considered that this furthered the four "well-beings" for their district. Specific benefits identified included:

- allowing older ratepayers to use the money they would have spent paying rates on enjoying a higher standard of living or staying in their own home;
- allowing older ratepayers to avoid the stigma attached to applying for rates postponement under hardship provisions; and
- reducing the resistance to rates rises on the part of older ratepayers.

3.17 Under the consortium policy, ratepayers who postpone their rates pay interest and fees on the postponed rates. These charges are intended to cover the costs of the postponement, and make rates postponement financially neutral for other ratepayers.

3.18 The policy developed by the consortium includes risk management strategies. The consortium has also identified funding paths that protect councils' ability to provide for present and future needs.

3.19 The four councils consortium we audited included the optional rates postponement policy in their 2004-14 LTCCP (or 2003-13 LTCCP in the case of Western Bay of Plenty District Council), and so complied with the special consultative procedure in the Local Government Act.

3.20 At present, only a small number of ratepayers are choosing to postpone their rates under optional rates postponement policies. Therefore, offering optional rates postponement does not currently have a significant effect on councils' finances.

3.21 Any significant growth in postponed rates will require councils to borrow extra money to cover the shortfall in annually collected rates. As we will discuss in Part 4, councils may investigate using on-balance sheet borrowing or securitisation to fund the rates postponement debt (see paragraphs 4.21-4.26).

3.22 Gisborne District Council told us that they had included an amount for rates postponement in their cashflow modelling for their 2006-16 LTCCP.

3.23 However, none of the four councils informed ratepayers about the potential implications of optional rates postponement for council borrowing, either in their 2003-13 or 2004-14 LTCCPs or in their 2006-16 LTCCPs.

Recommendation 1

We recommend that councils include the effect of optional rates postponement in the financial projections in their LTCCPs and Annual Plans when the amounts of money involved become significant.

Recommendation 2

We recommend that councils inform ratepayers about the potential implications of optional rates postponement for council borrowing in their LTCCPs.

3.24 The consortium and the associated rates postponement scheme were still in development when the six original councils decided to join the consortium and offer optional rates postponement. Given these circumstances, in our view, their decision-making and consultation procedures adequately complied with the requirements in the Local Government Act.

3.25 In the future, however, we would expect councils that identify a need for rates relief to assess whether the optional rates postponement scheme offered by the consortium is the best option for achieving their objective before they choose to join the consortium.

3.26 A robust decision-making procedure would involve formulating a high-level objective first, then identifying and assessing potential options for achieving that objective, including joining the consortium.

Decision-making and consultation by councils with hardship rates postponement policies

3.27 Under local government legislation before 2002, financial hardship was one of the prescribed grounds on which rates postponement could be offered. Wellington and Christchurch City Councils, the two councils we audited that offer rates postponement on hardship grounds only, have not changed their rates postponement policies since the Local Government Act 2002 came into force. However, their existing hardship policies have been included in their LTCCPs, and have therefore been subject to a degree of council and public scrutiny.

3.28 Given that these councils had not changed their policies since the Local Government Act came into force, we did not examine the decision-making processes that were followed when the policies were adopted. However, we would expect that any council reviewing or changing their rates postponement policies in future would follow the decision-making principles in the Act.

3.29 Given that the total amount of rates postponed on the grounds of hardship is small for all of the councils we audited or surveyed, we do not consider that councils need to take action to inform ratepayers about the financial implications of this form of rates postponement. However, if councils found they had significant growth in the number of people applying for rates postponement on the grounds of hardship, the recommendations we have made in this Part for optional rates postponement would apply.

Part 4
Risk identification and management

4.1 In this Part, we:

- state our expectations;
- describe the main risks;
- assess councils' risk management strategies; and
- consider the application of certain Acts to rates postponement.

What we expected

4.2 We expected that, in developing a rates postponement policy, councils would have:

- identified both short-term and long-term risks associated with the policy; and
- put in place strategies to manage these risks.

Main risks of rates postponement schemes

4.3 During our audit we identified several significant risks. This section describes how these risks apply to rates postponement generally. Paragraphs 4.16–4.48 describe the councils' risk management strategies.

Risk of reduced cashflow

4.4 When councils allow ratepayers to postpone rates, they are reducing their cashflow by the amount of rates postponed every year. Currently, none of the councils we audited has more than $130,000 in outstanding postponed rates. Although this represents reduced cashflow, the amounts are small enough to be comfortably covered by existing cashflows and borrowing arrangements. However, if the number of ratepayers postponing their rates increases substantially, councils will need to have a way of forecasting and funding the reduced cashflow.

Risk that properties that rates are postponed against are not insured

4.5 Postponed rates are secured against the equity in the ratepayer's property. If an uninsured property suffered a fire or other catastrophic event, the value of the property would be reduced and the council might not be able to recover the full value of the postponed rates.

4.6 Related to the insurance risk is a maintenance risk. The value of improvements can be eroded by a lack of maintenance. This may be a particular risk in the case of ratepayers suffering financial hardship.

4.7 It is unlikely that the current value of any postponed rates on an individual property owed to the councils we audited exceeds the unimproved value of the property. In these cases, the value of the land would be enough to pay the postponed rates. However, over time, the amounts owed by individual ratepayers are likely to increase and may exceed the unimproved value. Councils therefore need to have systems in place to check ratepayers' house insurance.

4.8 As well as risks of a financial nature, there is a risk to councils' reputations. In the event that an uninsured house on a property that rates had been postponed against suffered a catastrophic event, the council would have a valid legal claim on the value of the land and would thus be entitled to recover at least a portion of the postponed rates. However, recovering the postponed rates might leave very little or no equity for the ratepayer. If this situation arose, councils could be exposed to adverse publicity and accusations that they had acted against the interests of the ratepayer by allowing them to postpone their rates but not requiring them to insure their house.

Risk that the value of postponed rates may exceed the final sale value of the property that they are postponed against

4.9 Councils postpone rates in the expectation that the rates will eventually be collected when the property that they are postponed against is sold. The council will lose money if the value of the postponed rates exceeds the value of the property when it is sold. Councils therefore need, at the time of application, to assess the likely total of postponed rates, and then monitor individual accounts so they can consider ceasing to postpone rates if the value of postponed rates approaches the value of the available equity.

Risk of challenges to the validity of individual rates postponements based on claims of coercion by the council or failure to fully inform the ratepayer

4.10 For many older people, their property is their major asset. Ratepayers who postpone their rates are effectively converting a portion of the equity in their property into debt. This means that the ratepayer does not have that equity available to buy another property or to pay for other needs such as healthcare. Rates postponement may also affect ratepayers' families, who may receive less inheritance because a portion of the estate will be used to pay postponed rates.

4.11 Issues such as compounding interest and the fees that are added to the postponed rates could potentially cause misunderstanding or confusion for some ratepayers.

4.12 For these reasons, there is a risk that ratepayers or their families or estates might challenge the legitimacy of individual rates postponements by suggesting that the ratepayers were coerced into postponing their rates, or that they did not fully understand the implications of rates postponement. This issue is particularly sensitive for councils because, as public entities, they are expected to uphold high standards for dealing with the public.

4.13 Should a council face a claim by the ratepayer or their family of undue influence or unconscionable behaviour, a strong factor in the council's favour would be that the ratepayer had received independent advice.

4.14 Councils also need to be aware that some properties may have multiple owners. All owners should be aware of, and agree to, rates postponement before the postponement proceeds.

4.15 We consider councils' management of this risk as part of our discussion regarding informing ratepayers, in Part 5. See paragraphs 5.30-5.45 for a discussion of how consortium councils manage this risk, and paragraphs 5.60-5.66 for a discussion of how this risk is managed by the two councils we audited that offer rates postponement on hardship grounds only.

Risk management strategies of councils with optional rates postponement policies

Risk of reduced cashflow

4.16 We discussed with the consortium councils how they intended to forecast and fund the reduced cashflow that results from rates postponement.

4.17 None of the four consortium councils we audited, nor the rates postponement consortium as a whole, had devised a robust method to forecast the effect of postponed rates on their future cashflow, although Gisborne District Council did include an estimate of outstanding postponed rates for the next 10 years in its 2006-16 LTCCP.

4.18 The reduction in council cashflow may stabilise over the long term, as roughly equal numbers of ratepayers enter the scheme (begin postponing their rates) and exit the scheme (pay the total amount of rates that have been postponed against their property). However, this could not be expected to happen for a number of years, given the current growth of the scheme. Furthermore, even if the reduction in cashflow stabilises, councils will still have an amount of postponed rates outstanding at any one time and will need to fund that deficit.

4.19 Because the value of postponed rates is so low at present, councils are managing the reduced cashflow within their normal cashflow arrangements.

4.20 There are various options councils may consider in the future for funding the reduction in cashflow created by rates postponement. However, current rates of participation in optional rates postponement mean that councils are unlikely to need to make a decision on this issue for some years.

On-balance sheet borrowing

4.21 Some councils told us that, if the number of ratepayers postponing their rates grew substantially, the amount of borrowing needed to fund the deficit could be inconsistent with borrowing limits in their current liability management policies.

4.22 However, the consortium told us that councils may consider making amendments to their liability management policies to enable additional on-balance sheet borrowing to fund the deficit caused by rates postponement. The liability management policies could be amended so that this borrowing is separate from borrowing for normal capital purposes.

Securitisation

4.23 During the audit, some councils indicated that they may not wish to fund the deficit through on-balance sheet borrowing. If this is the case, one option councils might investigate is securitising the debt.

4.24 The consortium has discussed securitisation as a way of funding the cashflow deficit. Securitisation involves a council selling securities to the third party, using the outstanding postponed rates as collateral. Ratepayers still owe their rates to the council, but the council then owes the money it collects in postponed rates to the third party. This arrangement provides councils with a predetermined annual cashflow to cover the cashflow lost through postponed rates. By selling the debt to a third party, it may be possible for councils to stay within any borrowing limits set out in their liability management policies.

4.25 We were told by the consortium management company that securitisation may become a realistic option if the total amount of postponed rates reaches $5 million across the consortium as a whole. Once that initial parcel of debt has been securitised, councils may be able to issue further securities in tranches of approximately $2.5 million.

4.26 Securitisation may involve changes to the cost of borrowing. Under their policy of user pays, councils offering optional rates postponement would pass on the cost changes to the ratepayers in the scheme.

Recommendation 3

We recommend that councils that experience a substantial growth in the number of applications for rates postponement devise a method of forecasting the effect of rates postponement on their future cashflow and make provision for funding this deficit.

Risk that properties that rates are postponed against are not insured

4.27 It is a condition of optional rates postponement that ratepayers insure their houses. This helps to protect the council's security. However, only one of the four consortium councils we audited planned to regularly check that ratepayers had current insurance.

Recommendation 4

We recommend that all councils that offer optional residential rates postponement require ratepayers to provide annual proof that their house is insured as a condition of continued postponement.

4.28 The rates postponement consortium is currently finalising a basic insurance policy, which will be offered to ratepayers who wish to postpone their rates but who do not have insurance on their house. The councils intend to add the premiums for this policy to the outstanding rates.

4.29 Councils need to ensure that the way they charge ratepayers for the premiums for this insurance policy complies with the provisions in the Local Government (Rating) Act 2002 regarding charging fees for postponing rates.

4.30 One council suggested to us that they might recover the cost of this insurance through a targeted rate. In our view, this would stretch the purpose of targeted rates and is unlikely to be practical.

4.31 However, we consider that, if the council pays the insurance premiums, the cost should be recovered from the ratepayer concerned as part of the administration costs of rates postponement.

Recommendation 5

We recommend that councils organise insurance arrangements so that the premiums for a council-organised insurance product can be legally added to the postponed rates.

Risk that the value of postponed rates may exceed the final sale value of the property that they are postponed against

The actuarial model

4.32 The rates postponement consortium has developed an actuarial model that, used with standard New Zealand life expectancy tables, enables councils to estimate how much equity will be left in a given property at the end of a ratepayer's estimated life expectancy.

4.33 The councils use the results from the model for two purposes:

- to assess whether an applicant is likely to have enough equity to meet the council's eligibility criteria; and
- to inform the ratepayer about the likely effect of rates postponement on their equity.

4.34 The details of all applications are run through this model using the council's default assumptions regarding the interest rate, the rate of growth in property values, and the rate at which rates will increase. As shown in figures 1 and 2 (following paragraph 2.34), the results are sensitive to different assumptions about interest rates and rates of property value increase.

4.35 Rates postponement is granted only if the model suggests that total postponed rates (including interest and fees) will not accumulate to more than 80% of the equity in the property. If the total is likely to exceed 80%, partial rates postponement may be offered. In this way, councils manage the risk of the value of postponed rates exceeding the value of the property they are postponed against.

4.36 For the purposes of determining eligibility, it is reasonable for councils to use assumptions that reflect the most likely scenario.

4.37 However, there is a risk that applicants may have an unjustified sense of comfort about the certainty of the actuarial results generated by the council.

Recommendation 6

We recommend that councils using an actuarial model ensure that applicants understand that the results from the model are a forecast only, and depend on the accuracy of the assumptions used to generate them.

Recommendation 7

We recommend that councils using an actuarial model ensure that applicants have seen and understood both "high effect" and "low effect" results from the model.

Recommendation 8

We recommend that councils using an actuarial model regularly review the default assumptions used in the model to ensure that they reflect the best available information.

4.38 We discuss the actuarial model, choosing appropriate assumptions, and generating "high effect" and "low effect" results further in Appendix 4.

The reserve fund fee

4.39 Despite the use of the actuarial model, in individual cases, selling the property may raise less than expected or the ratepayer may live much longer than expected. In some cases, this could mean that there is a shortfall between the rates that the council is owed and the proceeds of selling the property. The council would have to bear any such shortfall, because optional rates postponement comes with a "no negative equity" guarantee for the ratepayer. No matter how much the debt is, the ratepayer or their estate does not have to pay the council more than the amount raised from selling the property.

4.40 To offset the risk of these individual cases, councils charge all ratepayers who postpone their rates an annual 0.25% reserve fund fee, which is added to the postponed rates. This reserve fund is insurance for the council. Each consortium council manages its own reserve fund.

4.41 The current rate of the reserve fund fee is provisional, based on initial predictions of the appropriate rate to adequately cover the risk of bad debts. The consortium intends to have the fee reviewed by an actuary in two to three years, when the scheme has been running for longer and there is more data to base projections on.

4.42 As reserve funds build up, the consortium will need to consider creating guidelines for how these funds should be managed.

Risk management strategies of councils with hardship rates postponement policies

Risk of reduced cashflow

4.43 The two councils we audited that offer rates postponement on hardship grounds only are able to cover the current low value of postponed rates from their existing cashflows and borrowing arrangements. This situation appears unlikely to change in the short term.

4.44 If these councils were to experience a significant increase in the number of ratepayers postponing their rates on the grounds of hardship, they would need to:

- forecast the likely total of outstanding postponed rates to assess the possible effect on cashflow; and
- consider the funding implications, including what is permitted by their liability management policies.

Risk that properties that rates are postponed against are not insured

4.45 Not all policies of rates postponement on the grounds of hardship require that ratepayers insure their houses as a condition of postponement. Of the two councils we audited that offer rates postponement on hardship grounds only, Wellington City Council requires ratepayers postponing their rates to insure their houses, but Christchurch City Council does not.

Recommendation 9

We recommend that all councils that offer residential rates postponement outside the rates postponement consortium require ratepayers to provide annual proof that their house is insured as a condition of continued postponement.

Risk that the value of postponed rates may exceed the final sale value of the property that they are postponed against

4.46 The two councils that we audited offering rates postponement on the grounds of hardship only did not undertake a formal assessment of the likely total debt the ratepayer would incur through rates postponement. They were therefore not able to accurately assess the risk of the value of postponed rates exceeding the value of the property that they are postponed against.

4.47 Hardship policies have explicit social objectives, and the numbers of ratepayers postponing their rates on the grounds of hardship are likely to remain low. It is therefore reasonable for councils to accept the risk that the value of postponed rates may exceed the value of the property that they are postponed against. We do not consider that councils offering postponement on the grounds of hardship need to instigate a reserve fund fee on postponed rates.

4.48 However, it is important for councils to be aware of the likely total amount of postponed rates, including interest and fees, over the time individual ratepayers continue to postpone rates. This will allow councils to:

- inform ratepayers more accurately about the implications of postponing rates; and
- assess more accurately whether the ratepayer is likely to have enough equity in their property to cover the postponed rates.

Recommendation 10

We recommend that councils offering rates postponement outside the rates postponement consortium assess the likely total amount of postponed rates, including interest and fees, for individual ratepayers at the time of application.

Rates postponement and certain Acts

4.49 In this section, we consider whether the Credit Contracts and Consumer Finance Act 2003, the Bill of Rights Act 1990, and the Human Rights Act 1993 are relevant to both types of residential rates postponement policies.

Credit Contracts and Consumer Finance Act 2003

4.50 The Credit Contracts and Consumer Finance Act 2003 imposes various disclosure and other requirements on a "consumer credit contract".

4.51 In our view, the Credit Contracts and Consumer Finance Act does not apply to rates postponement, on the basis that section 11(d) of the Act – in the definition of a "consumer credit contract" – does not apply to councils. Section 11(d) refers to the creditor carrying on a business of providing credit, or making a practice of providing credit in the course of carrying on a business.

4.52 By offering a rates postponement scheme, a council may be in the practice of providing credit, but not in the course of a business carried on by the council. The scheme is being offered in connection with councils' statutory powers to set, assess, and collect rates. While a council has full capacity to undertake any activity or business (subject to the Local Government Act and other applicable law), we do not think that collecting rates constitutes a "business" as such.

New Zealand Bill of Rights Act 1990 and Human Rights Act 1993

4.53 Some councils offering rates postponement offer it only to ratepayers over a certain age – generally 65 but, in one case, 60. Other councils offer rates postponement to younger ratepayers, but only for a set term of up to 15 years.

4.54 Age (over the age of 16 years) is a prohibited ground of discrimination under the Human Rights Act 1993. The right to freedom from discrimination, including on the grounds of age, is affirmed in the New Zealand Bill of Rights Act 1990.

4.55 Section 5 of the Bill of Rights Act places justifiable and reasonable limitations on the rights and freedoms contained in that Act, such as the right to freedom from discrimination. This means that different treatment on the grounds of age will not be improper if it can be objectively and reasonably justified.

4.56 Councils target rates postponement to older ratepayers because older ratepayers:

- are likely to be retired and on modest fixed incomes;
- are likely to have significant equity in their properties; and
- have a shorter life expectancy, resulting in the debt being postponed for a relatively short period of time.

4.57 Offering rates postponement to ratepayers over the age of 65 years is consistent with the eligible age for New Zealand superannuation, and 65 may therefore be an appropriate age to differentiate between different groups of people for this purpose. However, selecting an age other than 65 (such as 60) is more arbitrary, and may be difficult for councils to justify if challenged.

4.58 Another potential issue is that, if a person in a comparable situation to older ratepayers – for example, a 55-year-old unemployed person with significant equity in their property – was denied rates postponement because of their age, they might be able to argue that discrimination had occurred.

4.59 Those councils that have a suggested age limit, but note that exceptions are possible, would be able to make an exception to cover such a case. Councils that offer limited-term postponement to ratepayers under their age limit would also be able to accommodate this situation.

Part 5
The application process

5.1 In this Part, we assess councils against our expectations of:

- informing ratepayers about the existence of rates postponement policies;
- the application process; and
- informing applicants about the potential implications of rates postponement.

5.2 We also discuss the need for ratepayers to notify mortgagees that they are considering postponing their rates.

What we expected

Informing ratepayers about the existence of rates postponement policies

5.3 Section 45(1)(l) of the Local Government (Rating) Act 2002 requires that rates assessments must identify whether councils have rates postponement policies. Councils that do have rates postponement policies are required to include a brief description of the criteria for rates postponement under each policy. We expected that councils would be complying with these legislative requirements.

5.4 We expected that councils would have their rates postponement policy or policies, and clear supporting information, easily available in hard copy and on their website.

5.5 Where councils have more than one residential rates postponement policy, we expected that interested ratepayers would be informed of all the policies that they might qualify for rates postponement under.

Application documentation

5.6 We expected that application documentation would capture all the necessary information for councils to make a decision about whether to grant rates postponement to the applicant.

5.7 We expected that initial application forms and other information provided to prospective applicants would accurately reflect the criteria used by the council to determine eligibility.

5.8 We expected that councils would have robust application and acceptance documentation that incorporates the detail of the rates postponement policy.

Informing applicants about the implications of rates postponement

5.9 We recognise that it is not the role of councils to act as financial advisers to ratepayers. However, as public bodies, councils may be seen as having a greater obligation to ensure that their conduct is, and can be seen to be, ethical at all times, especially when dealing with potentially vulnerable older ratepayers.

5.10 We therefore expected that, as part of the application process, councils would ensure that applicants are informed about the implications of rates postponement. In particular, we expected that councils would:

- ensure that ratepayers are informed about the potential effect of rates postponement on their equity; and
- advise ratepayers to seek independent advice before choosing to postpone their rates.

5.11 We expected that ratepayers who are postponing their rates would be informed of any changes to the council's rates postponement policy that might affect them.

5.12 In Appendix 6 we have set out a list of issues that councils may need to inform ratepayers about when they apply to postpone their rates.

Application process for optional rates postponement

Informing ratepayers about the existence of rates postponement policies

5.13 The four councils offering optional rates postponement that we audited all noted their rates postponement policy or policies on their rates assessments.

5.14 Other strategies used by these councils to inform ratepayers about the optional rates postponement policies include:

- discussion at public meetings;
- distribution of brochures;
- articles in council publications; and
- information on the council website.

5.15 However, neither Gisborne District Council nor Rodney District Council had information about the rates postponement policies available on their website, except as part of their LTCCPs.

Recommendation 11

We recommend that all councils with residential rates postponement policies make the policy or policies, and clear supporting information, available both in hard copy and on their websites.

5.16 Three of the four councils we audited that offer optional rates postponement – Western Bay of Plenty, Gisborne, and Rodney District Councils – also offer postponement on the grounds of hardship. Hardship policies include conditions, such as asset testing, that are more restrictive than optional rates postponement policies. They generally have fewer costs than the consortium scheme, as they do not include the 1% management fee or the 0.25% reserve fund fee. Councils need to ensure that ratepayers who enquire about rates postponement are told about both policies, so that ratepayers can choose the most appropriate policy for their circumstances.

5.17 Each of the three councils had information available about both policies.

Application documentation

5.18 Councils with optional rates postponement policies use a standard initial application form that requires basic information from the ratepayer. Information available about the scheme notes that ratepayers need to meet the equity criteria before they will be granted rates postponement.

5.19 After establishing an applicant's eligibility for postponement, the council sends the ratepayer a conditional offer to postpone their rates.

5.20 The council's offer is conditional on:

- the ratepayer getting a certificate from the decision facilitation service and providing it to the council; and
- the ratepayer's agreement to continue to insure the house on the property and to provide a copy of the current insurance policy.

5.21 The offer becomes unconditional when these conditions are fulfilled. Ratepayers sign and return an acceptance form to activate the postponement.

5.22 The initial application form and information available to ratepayers in most cases accurately reflects the processes councils use to determine eligibility.

5.23 However, Western Bay of Plenty District Council's policy allows ratepayers under 65 to apply for optional rates postponement, but this is not noted in their application material or the additional documentation available.

5.24 Rodney District Council charges an annual administration fee of $50, which is not noted in the brochures available about the scheme, although ratepayers are advised of it before they apply.

Recommendation 12

We recommend that all councils offering residential rates postponement ensure that publicly available information regarding rates postponement, including the application form, accurately reflects their policies.

5.25 The letter of offer sent by the councils to each applicant refers to the "rates postponement scheme", but does not detail the nature of the scheme nor specifically incorporate the actual terms of the scheme. Only Rodney District Council's letter refers to the fact that various costs and fees will be payable under the scheme.

5.26 It would be preferable for the letters of offer to clarify the full terms of the agreement, and clearly identify the applicable policy. Councils may wish to include a copy of the policy with the letter of offer.

5.27 It is a condition of rates postponement that ratepayers keep their house insured. However, the application and acceptance documents do not explain the implications for the ratepayer if they fail to meet this condition in the future. The documentation also does not specify what kind of policy is required.

5.28 There is no provision made, in the policies or in the documentation sent to ratepayers, for councils to inform ratepayers of future changes to the policy that may affect them.

5.29 In our view, the offer letter should specify:

- when and under what circumstances postponed rates will become payable;
- any and all fees payable;
- that interest is payable and the current interest rate;
- the implications for ratepayers if they fail to continue to insure their house;
- the type of insurance coverage required; and
- how the council will notify ratepayers of any changes to the policy that may affect them.

Recommendation 13

We recommend that the consortium councils' offer letter specify the terms under which rates postponement will be granted.

Informing applicants about the potential implications of rates postponement

5.30 As discussed in Part 4, the rates postponement consortium has developed an actuarial model that shows the effect of rates postponement on ratepayer's equity. Ratepayers are sent a copy of the results from this model.

5.31 Councils that offer optional rates postponement require applicants to attend a decision facilitation session to ensure that they are informed about the implications of rates postponement.

5.32 Before their application can be approved, applicants must obtain and provide to the council a certificate stating that they have undergone independent decision facilitation, and that they understand the consequences of rates postponement.

5.33 Decision facilitation is provided by Relationship Services, which uses professional, specifically trained decision facilitators to provide the sessions.

5.34 Decision facilitation involves the facilitator reviewing the results from the actuarial model with the applicant to ensure that they understand that:

- they are using the equity in their property;
- the interest on postponed rates over time can be quite substantial; and
- rates postponement limits their future options – for instance, if they wish to move, the equity they will take forward to their next property is not the full sale price but the sale price less postponed rates (including fees and interest).

5.35 Decision facilitators also:

- verify the applicant's age;
- explain that there is no obligation to apply for the scheme after decision facilitation;
- clarify any technical questions the person might have about their individual situation;
- discuss any issues that arise from the applicant considering rates postponement; and
- ask the applicant whether they wish their family to be involved in the decision.

5.36 Decision facilitators are entirely independent of the council, and do not have an interest in whether the applicant chooses to proceed with postponement.

5.37 Decision facilitation training is customised to individual regions, so that facilitators are well informed about the individual aspects of councils' policies.

5.38 After the decision facilitation session, facilitators certify that applicants have understood the information provided to them. Facilitators have specific training on how to judge whether applicants have understood the information, including being trained to sign the certificate only if they believe applicants have fully understood the information provided.

5.39 Applicants can have up to three sessions of decision facilitation.

5.40 As part of our audit, we reviewed the feedback Relationship Services had received on the decision facilitation sessions. Some applicants had suggested that the decision facilitation session was not necessary, and that they would prefer to sign a waiver rather than attend the sessions.

5.41 We consider that decision facilitation is an important protection for the councils, and that the current requirement for applicants to attend should not be able to be waived.

5.42 Independent decision facilitation sessions fulfil our expectations regarding informing applicants. The independence of Relationship Services from councils is a particular strength of this process.

5.43 Councils need to be aware that some properties may be held in some form of multiple ownership. In these cases, not all owners may be involved in the initial application for rates postponement. Furthermore, some owners may not be resident at the property or in the local authority's area.

5.44 The rates postponement consortium is preparing a desk file to assist with managing postponed rates. The desk file includes procedures for seeking permission to postpone rates from all owners.

5.45 In our view, it is important that all owners receive information about optional rates postponement and sign the acceptance of conditional offer. Non-resident owners should also be informed about the decision-facilitation service.

Recommendation 14

We recommend that all consortium councils ensure that all owners of a property receive information about optional rates postponement and sign the acceptance of conditional offer.

Application process for hardship rates postponement

Informing ratepayers about the existence of the rates postponement policy

5.46 Wellington City Council's rates assessments state that ratepayers experiencing financial hardship may have their rates postponed. Christchurch City Council includes a brochure with its rates assessments that outlines its rates postponement policy.

5.47 Both Wellington and Christchurch City Councils have their rates postponement policies available on their websites.

5.48 Wellington City Council also told us that they discuss their rates postponement policy with Grey Power, as a way of helping to inform older ratepayers about the policy.

Application documentation

5.49 Wellington and Christchurch City Councils have similar processes to document rates postponement applications and acceptances:

- The ratepayer submits an application to join the scheme.
- Council staff review the application against the eligibility criteria.
- The council sends a letter advising the ratepayer whether postponement has been granted.

5.50 The application forms of both councils capture enough information to determine whether the applicant meets their criteria.

5.51 Christchurch City Council's application forms and supplementary information accurately reflect the criteria the council uses in considering whether to grant postponement.

5.52 Wellington City Council's rates postponement policy includes a requirement that the applicant has tried all other avenues, including seeking a reverse mortgage from their bank, to fund their rates. In line with this policy, the application form requires that applicants attach a letter outlining why their application for a mortgage or reverse mortgage has been declined. However, staff told us that, in practice, they do not check that this requirement had been complied with when deciding whether to grant rates postponement.

5.53 In our view, this requirement in the policy and on the application form may be unnecessarily deterring eligible ratepayers from applying for rates postponement. In addition, if this requirement were enforced, it could be interpreted as the council recommending the use of reverse mortgages. The council may wish to reconsider this provision.

5.54 Staff at Wellington City Council also told us that one ratepayer had been declined postponement because the level of existing mortgages over the property meant that the council did not consider there was adequate security for postponed rates.

5.55 It is prudent for councils to assess the security available before granting postponement. However, this criterion is not currently included in Wellington City Council's rates postponement policy or application documentation.

5.56 Staff at Wellington City Council also told us that ratepayers need to have their houses insured to be granted rates postponement. However, this requirement is not mentioned in either the policy or the information supplied to the applicant.

5.57 Because of their process, both Wellington City Council and Christchurch City Council treat the application form as their agreement with the ratepayer regarding postponing rates. This means that it is especially important that the application form and supporting information accurately reflect the policy and the criteria used by the council to determine eligibility.

Recommendation 15

We recommend that all councils offering residential rates postponement ensure that publicly available information regarding rates postponement, including the application form, accurately reflects their policies and the criteria used by the council to determine eligibility.

5.58 Neither Wellington City Council nor Christchurch City Council has a provision in either their policy or the documentation supplied to applicants for advising ratepayers of changes to the policy.

5.59 In our view, when councils advise ratepayers that their application for rates postponement on the grounds of hardship has been approved, they should specify:

- when and under what circumstances postponed rates will become payable;
- any and all fees payable;
- that interest is payable and the current interest rate;
- the implications for ratepayers if they fail to continue to insure their house;
- the type of insurance coverage required; and
- how the council will notify ratepayers of any changes to the policy that may affect them.

5.60 Councils may wish to include a copy of the policy with their letter to the ratepayer.

Recommendation 16

We recommend that councils offering residential rates postponement outside the rates postponement consortium specify the terms under which rates postponement has been granted when they advise ratepayers that their application for rates postponement has been approved.

Informing applicants about the potential implications of rates postponement

5.61 The two councils that offer rates postponement on the grounds of hardship only that we audited do not model the effect of rates postponement on the ratepayer's equity. They are therefore not in a position to fully inform the ratepayer about the potential implications of rates postponement in their individual case.

5.62 Both Wellington City Council and Christchurch City Council told us that their staff discuss rates postponement with applicants. It was clear to us that staff at both councils understood the importance of thoroughly discussing rates postponement with applicants. One council also commented that approaches regarding rates postponement often came through the applicant's solicitor.

5.63 Regardless of the quality of the advice offered by council staff to applicants, there is no formal record of this advice – nor is it independent.

5.64 We consider that councils that do not explicitly recommend that ratepayers seek independent advice are potentially exposing themselves to accusations that they have acted improperly or failed to ensure that ratepayers are fully informed about rates postponement.

5.65 Both councils also produce information sheets that outline their policies, including how interest rates are set, the registration of a notification of charge on the property title, and the applicant's right to pay their rates at any time. Wellington City Council's information sheet also states when postponed rates will become payable.

5.66 Some other councils' policies require that applicants for rates postponement see a budget adviser before applying for rates postponement. However, it is not clear whether the budget adviser is required to specifically discuss the implications of rates postponement with applicants.

Recommendation 17

We recommend that councils that offer residential rates postponement outside the rates postponement consortium advise ratepayers to seek independent advice before deciding to go ahead with the postponement.

5.67 As noted above, some properties may be held in some form of multiple ownership. In these cases, not all owners may be involved in the initial application for rates postponement. Councils offering postponement on the grounds of hardship need to ensure that all owners of a property are aware of, and agree in writing to, the rates being postponed.

Recommendation 18

We recommend that all councils offering residential rates postponement ensure that all of the owners of a property are aware of, and agree in writing to, the rates being postponed.

Notifying mortgagees regarding rates postponement – optional and hardship

5.68 Postponed rates take priority over other charges on a property, including mortgages. In many cases, ratepayers over 65 applying for rates postponement will not have mortgages. However, those ratepayers who do have mortgages may breach contractual obligations to their mortgagee if they do not notify them of the rates postponement. This applies to both optional and hardship forms of rates postponement.

5.69 Councils offering optional rates postponement require ratepayers with mortgages to notify their mortgagee that they wish to postpone their rates. Postponement will not be granted without a letter from the mortgagee acknowledging that the mortgagee agrees to the council registering a notification of charge on the title. The consortium has reached an agreement with the Banker's Association and the Financial Services Federation that, unless the mortgagee believes there is a real risk to its security, it will consent to the rates on the property being postponed without requiring any change to the terms of the mortgage.

5.70 Neither Wellington City Council nor Christchurch City Council requires ratepayers to notify mortgagees that they are applying for rates postponement.

Recommendation 19

We recommend that all councils offering residential rates postponement advise applicants to notify any holders of a mortgage over their property that they intend to postpone their rates.

Part 6
Ongoing administration

6.1 In this Part, we assess councils against our expectations of:

- record-keeping;
- fees and interest;
- monitoring; and
- ceasing to postpone rates.

What we expected

Record-keeping

6.2 We expected all councils to ensure that documentation is properly completed and filed.

Fees and interest

6.3 Section 88(2) of the Local Government (Rating) Act 2002 allows councils postponing rates to charge a fee not exceeding the financial and administrative costs to the council of the postponement. We expected that all councils would comply with this requirement.

6.4 Councils offering rates postponement on the grounds of hardship may decide to subsidise ratepayers' access to this service by absorbing any extra administration cost. However, councils offering optional rates postponement state in their policies that ratepayers who choose to postpone their rates will bear the entire cost of postponing rates. We therefore expected that these councils would:

- charge administration fees that reflect any additional set-up and ongoing administration costs of individual postponements; and
- charge a rate of interest that reflects the cost of the council's borrowing to cover their cashflow shortfall.

6.5 We expected that all councils that charge interest and/or fees on postponed rates would have a procedure for accurately calculating and recording interest and fees.

6.6 We expected that these councils would regularly and accurately inform ratepayers of the balance of their individual rates postponement accounts, including a breakdown of rates, interest, and fees.

Monitoring

6.7 We expected that councils would maintain an accurate overview of the total of outstanding postponed rates owed to the council at a given time.

6.8 We expected that councils would monitor individual accounts so as to be able to make informed decisions about whether it is prudent to continue to grant rates postponement to individual ratepayers.

Ceasing to postpone rates

6.9 We expected that all councils offering rates postponement would have clear policies regarding when postponed rates become due.

6.10 We expected that all councils offering rates postponement would allow ratepayers to pay all or part of their postponed rates at any time without penalty.

6.11 Some councils offering optional rates postponement state in their policy that ratepayers are able to transfer the value of their postponed rates from one property to another. We expected that these councils would have established a legal mechanism for implementing such a transfer.

6.12 We expected that all councils offering rates postponement would have clear procedures for ensuring that the postponed rates are paid, including having considered when it is appropriate to release the notification of charge over the property.

Administration of optional rates postponement policies

Record-keeping

6.13 Generally, necessary documentation was on file and files were in good order.

6.14 However, one council offering optional rates postponement had not registered the notifications of charge until the week before our visit. Another council did not have a signed copy of one ratepayer's acceptance letter on file.

6.15 The rates postponement consortium is creating a database and preparing a desk file to assist with managing postponed rates. The desk file contains detailed instructions for all steps of the rates postponement process.

6.16 It is intended that the database will:

- have a "process" form for recording that all the steps in the process of postponing rates have been completed;
- generate standard letters;
- have templates for special issue letters;
- link to the actuarial model;
- have a decision form for council staff to complete; and
- link to a spreadsheet that can be used to calculate interest.

6.17 The consortium is also considering including a "pop-up" to remind council staff to do an annual insurance check.

6.18 This database will be distributed to members of the consortium when it is complete, and will help councils cope with larger numbers of postponements in the future. We encourage councils to use this resource, as well as the desk file being prepared by the consortium.

6.19 We were told that council rating databases are not designed to record information relating to postponement, so need to be updated manually each year.

Fees

6.20 The costs to the consortium councils associated with individual accounts are:

- the cost of the decision facilitation session(s);
- a fee payable to Land Information New Zealand to register the notification of charge (currently $50);
- a fee payable to Land Information New Zealand to release the notification of charge when the postponed rates have been paid (currently $50); and
- staff time to process applications and undertake ongoing administration.

6.21 There was significant variation between the four consortium councils we audited regarding whether they charged fees to cover each of these costs.

6.22 Councils offering optional rates postponement also charge ratepayers:

- an annual 0.25% fee as a reserve fund fee; and
- an annual 1% management fee, which is paid to R P Scheme Managers, the company that manages the rates postponement consortium.

Decision facilitation fees

6.23 Councils charge ratepayers who are granted optional rates postponement a fee of $300 to go towards the cost of decision facilitation. Ratepayers who undertake decision facilitation but choose not to proceed with rates postponement are not required to pay the $300 fee. Ratepayers are entitled to up to three decision facilitation sessions. Relationship Services charges councils $133 for each session.

6.24 Councils set the $300 fee based on an estimate of ratepayers requiring an average of 2.3 sessions of decision facilitation. So far, only one ratepayer has required more than one decision facilitation session.

6.25 We were told that the fee paid by those ratepayers who choose to go ahead with the scheme partly goes to offset the costs of decision facilitation sessions undertaken by ratepayers who then choose not to postpone their rates. We were also told that the ratepayers who have so far applied for rates postponement are "early adopters", who quickly understood the benefits of the scheme for them personally and had already decided that they wished to join before attending a decision facilitation session. However, future applicants might be less certain about their decision, and therefore require more facilitation sessions.

6.26 We discussed the fee level and the number of decision facilitation sessions with Relationship Services. Relationship Services told us that it is very important that applicants have access to more than one session, so that, for example, they can return with family members if they wish to.

6.27 Given that the actual number of decision facilitation sessions required by ratepayers has been below the expected average, we think that councils should review the $300 flat fee.

Recommendation 20

We recommend that the rates postponement consortium councils review the fee charged for decision facilitation, to ensure that it is fair to applicants and covers councils' costs.

Fees for registering and releasing land charges

6.28 Land Information New Zealand may charge a fee for registering or releasing a notification of charge on a title. The current fee for each service is $50.

6.29 Far North District Council, Gisborne District Council, and Rodney District Council charge ratepayers a $50 application fee, which was originally intended to cover the cost of registering the notification of charge.

Recommendation 21

We recommend that councils whose rates postponement policies state that the costs of postponement will be borne by the ratepayers concerned charge an initial fee to cover the cost of registering a notification of charge, and add a fee to postponed rates when they are paid to cover the cost of releasing the notification of charge.

Annual fees

6.30 Councils estimated that administering individual postponed rate accounts took two to five hours of staff time for each account each year. They considered that, with the small numbers currently involved, administration could easily be absorbed by existing staff. However, if the numbers of ratepayers postponing rates grew substantially, they might need to employ part-time staff to administer the scheme.

6.31 Far North District Council and Gisborne District Council both charge a $50 annual administration fee, which is added to the postponed rates. Rodney District Council and Western Bay of Plenty District Council do not charge an annual administration fee.

Recommendation 22

We recommend that councils offering optional rates postponement monitor the administration load created by rates postponement, and consider imposing an annual administration fee to cover the cost of staff time spent on rates postponement where they do not already do so.

The reserve fund fee

6.32 Councils offering optional rates postponement add 0.25% to ratepayers' outstanding balance each year. This fee is intended to cover the cost of any cases where the value of postponed rates is greater than the amount realised by the sale of the property that they have been postponed against.

6.33 In our view, it is reasonable for councils to charge this kind of fee, because the general rating base would otherwise bear the risk of postponed rates not being paid.

6.34 We were told that the level of this fee will be reviewed in several years, when there will be more data available to make a more reliable estimate of the fee needed to offset the risk to the council of bad debts.

Management fees

6.35 Consortium councils add 1% each year to ratepayers' outstanding balance. This fee covers the councils' payments to the company responsible for managing the rates postponement consortium.

6.36 Currently, the management costs are absorbing the whole of this fee. However, once the initial management costs have been paid, councils may be able to remit a portion of this fee back to the ratepayers.

6.37 We discuss the use of this fee further in Part 7.

Interest

6.38 All four councils we audited charged interest on postponed rates to cover their financial costs.

6.39 Councils varied in how they set this interest rate, but all councils aimed to approximate it to their cost of borrowing.

6.40 In the future, councils offering optional rates postponement will be able to use the database currently being created to assist staff in calculating interest.

6.41 The councils we audited continue to send rates invoices to ratepayers who have postponed their rates. These invoices show the total amount of rates outstanding, including postponed rates, interest, and fees. However, they do not separately show interest and fees that have been charged to the account.

6.42 The rates postponement administration database will include a facility for generating annual statements for ratepayers that will show interest, fees, and regional and district/city council rates separately. It is intended that each ratepayer will receive a copy of this statement at the end of the financial year.

Compliance with section 88(2) of the Local Government (Rating) Act 2002

6.43 As noted in paragraph 6.3, section 88(2) of the Local Government (Rating) Act allows councils postponing rates to charge a fee not exceeding the financial and administrative costs to the council of the postponement.

6.44 Councils offering optional rates postponement set their fees in accordance with the information available at the time they adopted the policies. However, financial and administrative costs incurred by councils for rates postponement may change over time. For example, councils' cost of borrowing may change, and the costs associated with management of the consortium may vary over time. We have noted that the decision facilitation fee needs to be reviewed to ensure that it complies with section 88(2) of the Local Government (Rating) Act. Councils therefore need to regularly review all fees and interest to ensure that they continue to comply with section 88(2).

Recommendation 23

We recommend that all councils offering residential rates postponement regularly review all fees and interest to ensure that they continue to comply with section 88(2) of the Local Government (Rating) Act 2002.

Monitoring

6.45 All the councils offering optional rates postponement were able to provide us with information about the total amount of postponed rates currently outstanding.

6.46 As optional rates postponement has been offered for only two years, no ratepayers have substantial outstanding postponed rates. Therefore, the risk of any ratepayer's outstanding rates nearing the 80% equity cap is currently very low. However, as the scheme continues, councils will need to ensure that they are monitoring individual accounts, so they can consider stopping postponement if the value of outstanding rates is likely to breach the 80% cap.

6.47 Gisborne District Council has an "equity check" spreadsheet that compares the current postponed rates to the equity in the property, to check the 80% equity cap has not been breached.

6.48 It would be good practice for all councils offering optional rates postponement to have similar equity check mechanisms, and make sure these are updated on a regular basis.

6.49 We note that Gisborne, Western Bay of Plenty and Far North District Councils' optional rates postponement policies explicitly state that "Council reserves the right not to postpone any further rates once the total of proposed rates and accrued charges exceeds 80% of the rateable value of the property as recorded in Council's rating information database". In our view it is sensible for councils to include this explicit provision in their policies.

Recommendation 24

We recommend that councils offering optional rates postponement monitor individual accounts so that they can consider stopping postponement if the value of outstanding rates is likely to breach the 80% equity cap.

Ceasing to postpone rates

6.50 The four councils offering optional rates postponement that we audited had clear statements in their policies regarding when postponed rates become due. In the case of death of the ratepayer, the policies allow between three and 12 months for the rates to be paid.

6.51 All four policies explicitly stated that ratepayers could pay their postponed rates at any time without penalty.

6.52 Gisborne, Western Bay of Plenty, and Far North District Councils all have provisions in their policies allowing ratepayers to transfer the value of postponed rates from one property in the district to another. So far, none of these councils have been approached by a ratepayer wishing to exercise this option. Rodney District Council does not have this provision in its policy.

6.53 It is not yet clear what mechanism councils could use to transfer debt from one property to another.

Recommendation 25

We recommend that councils whose policies allow ratepayers to transfer the balance of postponed rates to a new property clarify the mechanism they would achieve this through, to confirm that their policy is practical and legally sound.

6.54 Councils register a notification of charge on the title of properties that they have postponed rates against. This notification of charge needs to be released once the council receives payment of the postponed rates. If the rates are paid without the property being sold, councils can release the notification of charge after receiving payment.

6.55 The desk file being prepared by the consortium includes a section detailing the procedure for councils to follow when releasing a notification of charge if a property is being sold. This procedure requires the council to find out the settlement date and calculate the total payment, including interest, that will be due on that date. On settlement day, the council should confirm receipt of payment and then, on that same day, send the notice of release of notification of charge. This procedure ensures that the notification of charge is not released until the postponed rates are paid.

Administration of hardship rates postponement policies

Record-keeping

6.56 The files we examined at Christchurch and Wellington City Councils were in good order and contained all the documents we expected to see.

6.57 Wellington City Council has a thorough desk file that records the procedures for processing rates postponement applications. The council also has a deadline for approving or declining applications 15 working days after receiving them.

Fees and interest

Fees

6.58 Wellington City Council charges a $200 application fee for the first year a ratepayer applies to postpone their rates. This fee can be paid separately or added to the postponed rates. We were told that this fee is to cover administration costs. There is no annual administration fee.

6.59 Christchurch City Council does not charge any application or administration fees for rates postponement.

Interest

6.60 Wellington City Council and Christchurch City Council both charge interest on postponed rates. They set the interest rate based on the councils' respective borrowing rates.

6.61 Both Wellington and Christchurch City Councils calculate interest manually on postponed rates. They told us this system was practical for them, as they had very small numbers of ratepayers postponing their rates.

6.62 Christchurch City Council sends its ratepayers a rating invoice, showing the total outstanding rates. The invoice is annotated to show the amount that has been added for the year. Interest is not noted separately.

6.63 Wellington City Council sends each ratepayer a full breakdown of their account every year, in addition to their rates invoice. The additional breakdown shows the interest rate and the accrued interest.

Recommendation 26

We recommend that all councils offering residential rates postponement send ratepayers an annual statement showing:

- the total amount of postponed rates outstanding;
- the interest rate(s) for the year;
- interest accrued; and
- any fees charged during the year.

Monitoring

6.64 Wellington City Council and Christchurch City Council were both able to provide us with information about the total value of postponed rates currently outstanding.

6.65 Neither council has a cap on the total value of rates that could be postponed, either as a percentage of a ratepayer's equity in their property or as an absolute figure.

6.66 Wellington City Council requires ratepayers to reapply for postponement each year. The balance of outstanding rates and the equity available in the property are scrutinised as part of this process.

6.67 Christchurch City Council has a spreadsheet that allows them to check individual outstanding balances. While the total amount of rates postponed for any one ratepayer is small, we note that the ratepayer's equity is not included on this spreadsheet.

Recommendation 27

We recommend that all councils offering residential rates postponement monitor individual accounts so that the council can make informed decisions about whether it is prudent to continue to grant rates postponement to individual ratepayers.

Ceasing to postpone rates

6.68 Christchurch City Council's policy contains unclear wording regarding the term of postponement. In particular, if a ratepayer ceases to meet hardship criteria, it is not clear whether they need to pay all postponed rates, or whether already postponed rates will remain postponed, even though the ratepayer reverts to paying current rates as they become due.

6.69 Ratepayers who are granted rates postponement by Christchurch City Council are advised the term of their postponement when they are advised the outcome of their application.

6.70 It is clear from Wellington City Council's policy that postponement is for only one year at a time. Council staff told us that most ratepayers reapply annually, and have rates postponement granted on an ongoing basis.

6.71 However, if a ratepayer does not reapply or is not granted further postponement, all postponed rates become payable. This is not clear from Wellington City Council's policy; nor from other available information.

Recommendation 28

We recommend that all councils review their residential rates postponement policies to ensure that it is clear when, and under what circumstances, postponed rates must be paid.

6.72 Councils offering rates postponement on the grounds of hardship do not allow ratepayers to transfer the debt from one property to another.

6.73 Wellington City Council has a clear procedure for releasing the notification of charge on the title, but their practice is to release the notification of charge before the postponed rates are paid.

6.74 We acknowledge that councils have a statutory right to collect rates from a property even if a notification of charge is not registered on the property's title.

6.75 However, the notification of charge on the title acts as an alert to anyone searching the title that the rates have been postponed. In our view, Wellington City Council should consider amending its procedure, to not release the notification of charge until the postponed rates are paid.

Part 7
The rates postponement consortium

7.1 In this Part, we:

- describe the rates postponement consortium;
- describe the consortium's management and funding flows ; and
- give our view on the rates postponement consortium.

Structure of the rates postponement consortium

Consortium member councils

7.2 The six original councils are:

- Far North District Council;
- Rodney District Council;
- Thames-Coromandel District Council;
- Western Bay of Plenty District Council;
- Gisborne District Council; and
- Environment Waikato (Waikato Regional Council).

7.3 The eight new councils are:

- Ashburton District Council;
- Kapiti Coast District Council;
- Marlborough District Council;
- Masterton District Council;
- Nelson City Council;
- Queenstown-Lakes District Council;
- Rotorua District Council; and
- South Wairarapa District Council.

7.4 Each individual council is responsible for administering rates postponement for their ratepayers. They customise and distribute promotional material, receive and process applications, answer queries, and administer the accounts of ratepayers who have postponed their rates.

The Joint Committee and subcommittee

7.5 The Joint Committee consists of two elected representatives from each of the six original councils (which we refer to as Joint Committee councils).

7.6 The Joint Committee is responsible for:

- approving the applications of new councils to join the consortium and setting the joining fee;
- agreeing to admit new councils either as members of the Joint Committee or as "additional councils" that do not hold voting rights on the Joint Committee;
- negotiating with the management company where necessary;
- agreeing to the annual budget for the management company;
- agreeing to the expense budget for the Joint Committee and subcommittee; and
- directing the application of any surplus funds that are generated by the scheme.

7.7 The Joint Committee of elected representatives is expected to meet only once at the beginning of each council term to delegate its responsibilities and functions to a subcommittee of staff representatives from each Joint Committee council. This subcommittee makes decisions under delegated authority on behalf of the Joint Committee. Although we refer to the Joint Committee in this report, in practice it is the subcommittee of staff that meets and makes the operational decisions about managing the consortium.

7.8 Any individual council can choose to withdraw from the consortium at any time. After withdrawing, councils cease to be liable for any further costs incurred by the consortium.

Administering council

7.9 The Joint Committee appoints an administering council that oversees the administration of the Joint Committee, including collecting and holding joining fees and paying invoices on behalf of the Joint Committee.

7.10 This position was initially held by Western Bay of Plenty District Council, but Far North District Council has recently been appointed as the administering council for the next three years. It is envisaged that this role will move around among the Joint Committee councils.

Additional councils

7.11 New councils may be admitted to the consortium either as Joint Committee councils or as additional councils. Additional councils may attend meetings of the Joint Committee, but do not have voting rights.

7.12 All of the eight new councils that have joined have been admitted as additional councils.

R P Scheme Managers Limited

7.13 R P Scheme Managers Limited (R P Scheme Managers) is a wholly owned subsidiary of McKinlay Douglas Limited (MDL), which was set up to manage the rates postponement scheme. The company draws on the resources of MDL to provide its contracted services to the Joint Committee.

7.14 The Joint Committee contracts R P Scheme Managers to manage consortium business. R P Scheme Managers are responsible for activities such as:

- consortium support – generic work for the consortium, such as attending Joint Committee meetings, working on promotional material for councils to use, and monitoring relevant legislation as required;
- council support – drafting policies for new councils and briefing council staff;
- promoting the scheme to new councils; and
- managing contracts and relationships with outside parties, such as the actuary, the decision facilitation provider, and stakeholders.

McKinlay Douglas Limited

7.15 MDL is a Tauranga-based consultancy with a history of involvement in local government issues as well as an interest in home equity conversion.

7.16 MDL manages R P Scheme Managers, and provides the personnel, expertise, and other resources that R P Scheme Managers needs to provide its services to the Joint Committee.

7.17 Figure 3 shows the structure of the consortium, including the agreements that govern the relationships between the members.

Consortium management and funding flows

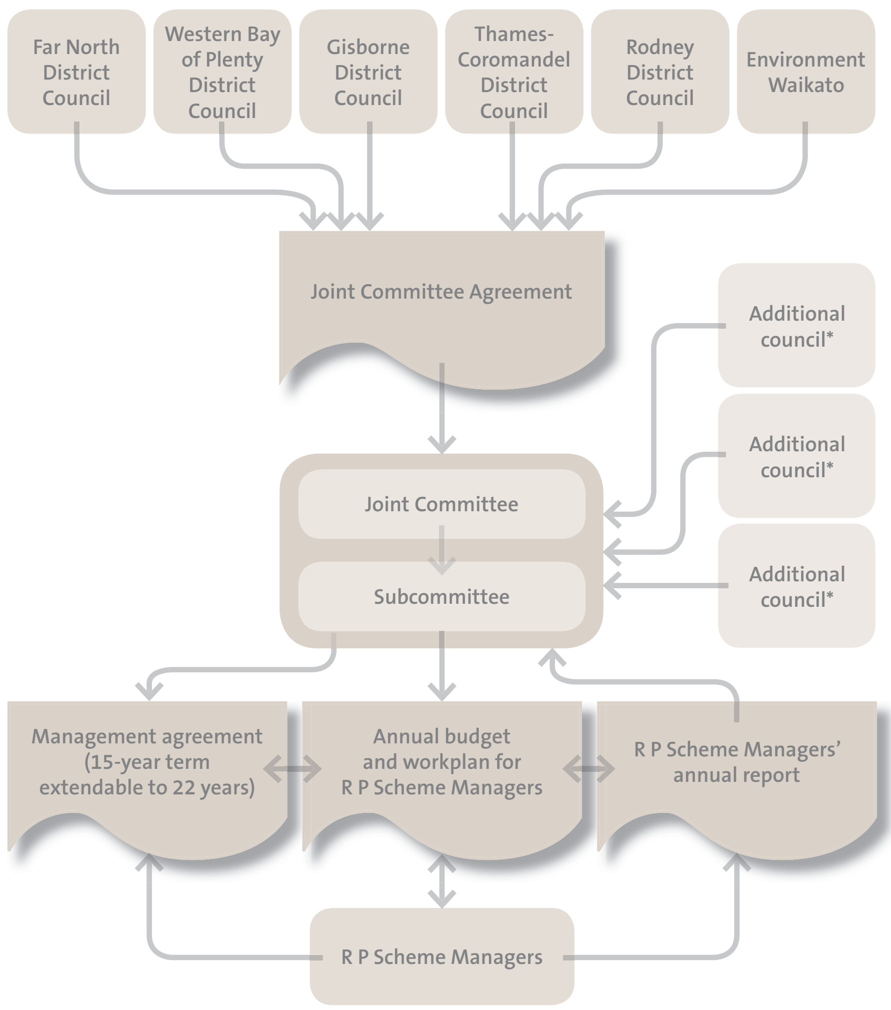
Joining fees

7.18 Each of the six original consortium member councils paid $26,000 to the Joint Committee as a joining fee.

7.19 Some of this money has been used as a part-payment to MDL for time spent developing the rates postponement scheme. The balance of the money has been spent on other expenses – in particular, legal fees and costs for developing the actuarial model.

7.20 New councils will pay a similar joining fee, which will be used to pay expenses but will not be used to make further payments to R P Scheme Managers or MDL.

Figure 3
Structure of the rates postponement consortium



* Additional councils may attend Joint Committee meetings but do not have voting rights

The management agreement between the Joint Committee and R P Scheme Managers Limited

Term

7.21 The management agreement has a term of 15 years from November 2005. R P Scheme Managers and MDL have the right to extend the term of the management agreement by seven years if they wish. The Joint Committee may terminate or renegotiate the agreement if the payments made to MDL exceed the agreed repayment cap (see paragraph 7.33). The Joint Committee may also terminate the agreement if R P Scheme Managers or MDL are in default of the provisions set out in the agreement, or if the ownership of either company changes by more than 25%.

Scope of business

7.22 The management agreement limits R P Scheme Managers' scope of business to specified activities, unless the Joint Committee gives written authority for other activities to be undertaken.

Budget and resources

7.23 R P Scheme Managers works within a budget that is set by the Joint Committee each year. This budget is proposed by R P Scheme Managers, based on an assessment of the work required for the year and the number of days it will take to complete. R P Scheme Managers is entitled to be paid for the number of days agreed in the budget, regardless of whether the actual work done for the year is over or under that amount. If the budget exceeds the value of the management fee for that year, as is currently occurring, R P Scheme Managers will carry the deficit forward.

The 1% management fee

7.24 The management agreement stipulates that each council makes a six-monthly payment to R P Scheme Managers to the value of 0.5% of the current total of postponed rates owed to that council. The councils recoup this money by adding a 1% annual management fee to individual ratepayers' postponed rates.

7.25 R P Scheme Managers is not entitled to any other payments from the Joint Committee or any participating councils, except for reimbursement of expenses such as travel.

7.26 The six-monthly payments to R P Scheme Managers are applied according to the following formula:

- First, to pay R P Scheme Managers for the work it has undertaken for the Joint Committee in accordance with the agreed budget for the current financial year.
- Secondly, to pay any deficit for previous years in which the payments received by R P Scheme Managers from the councils were less than provided for in R P Scheme Managers' agreed budget.
- Thirdly, if all the money owing to R P Scheme Managers to date has been paid, the surplus funds will be split between MDL and the Joint Committee. Of the surplus, 25% will go to MDL (subject to the repayment cap discussed below) and 75% to the Joint Committee.

7.27 There will need to be a significant growth in uptake of the scheme before R P Scheme Managers' deficits are cleared and there is surplus money available for distribution to MDL and the Joint Committee councils.

Financial Risk

7.28 The management agreement is structured so that MDL carries most of the risk of the investment in developing the scheme being more than will be recoverable through management fees. Because R P Scheme Managers' income and MDL's return on investment are generated directly from postponed rates, councils are not exposed to having to pay these fees without being able to recover the costs from ratepayers.

Intellectual property

7.29 The management agreement provides for each of the parties to retain ownership of any intellectual property they develop, but they are also required to grant all other parties the right to use that intellectual property. When the management agreement expires or is terminated, the ownership of intellectual property in the scheme held by MDL or R P Scheme Managers will pass to the Joint Committee.

Surplus management fees

MDL's share of the surplus management fee

7.30 Before the Joint Committee and R P Scheme Managers were formed, MDL was directly involved in developing the optional rates postponement scheme. Working initially with Western Bay of Plenty District Council and then with the other consortium councils, MDL did research and development work for the generic optional rates postponement policy, and oversaw the completion of the consortium arrangements.

7.31 The Joint Committee has made a partial payment to MDL for this work. There is still an amount outstanding.

7.32 This outstanding amount represents MDL's initial investment into the rates postponement consortium. MDL hopes to recoup this initial investment, plus a reasonable return, through its 25% share of the surplus management fee.

7.33 The total amount that MDL can receive from collecting its 25% share of the surplus management fee is capped at a figure that represents repayment of the initial investment, a return on this investment, and an allowance for inflation. This cap was calculated assuming a 15-year repayment period.

7.34 The Joint Committee councils received independent advice to establish the appropriate level for this repayment cap.

7.35 If this repayment cap is reached, MDL will no longer be entitled to any share of any surplus management fees generated by the rates postponement scheme. All revenue not owed to R P Scheme Managers for ongoing work will be returned to the Joint Committee councils.

The Joint Committee councils' share of the surplus management fee

7.36 The management agreement states that the Joint Committee's 75% share of the surplus management fee will be returned to each of the Joint Committee councils, in equal shares.

7.37 The Joint Committee agreement states that all funds received from the management company (that is, the surplus management fees) will be held by the administering council on behalf of the Joint Committee.

7.38 The Joint Committee agreement states that these funds may be applied to:

- expenses incurred by the Joint Committee; and/or
- projects of benefit to local government.

7.39 According to the Joint Committee agreement, if the surplus management fee is not required for these purposes, it is to be distributed to all the consortium councils in proportion to their share of the total outstanding postponed rates.

7.40 In addition, it was suggested to us that the Joint Committee councils' share of the surplus management fee could be used for some or all of:

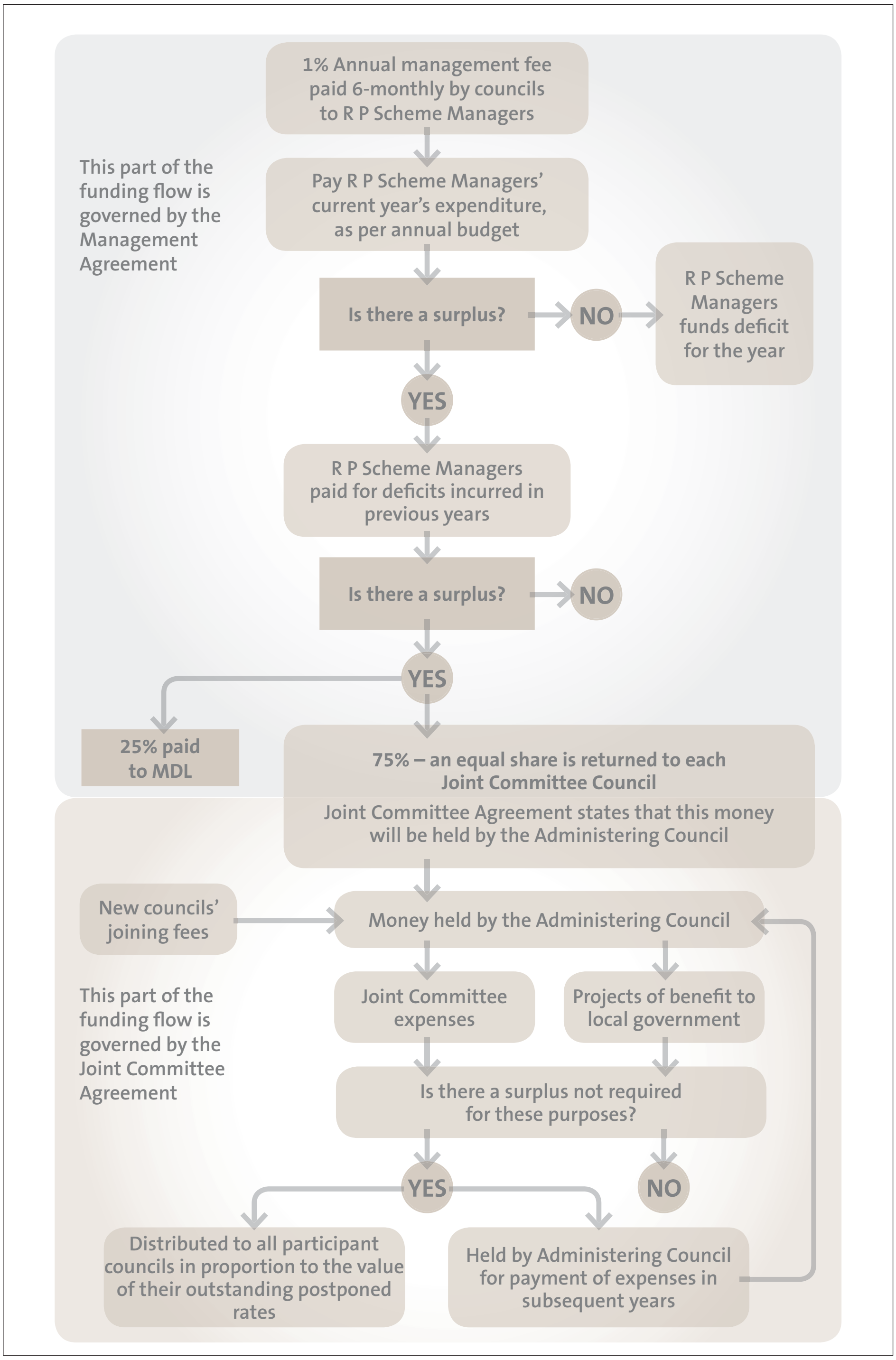
- recouping the costs of councils that made a substantial investment of time and resources in the development of the scheme – for example, Western Bay of Plenty District Council, which was involved in early research and development, and Far North District Council, which is creating the database for use by consortium councils;
- paying for further development of the scheme; and
- remitting all or part of the management fee charged on outstanding balances to the ratepayers who have postponed their rates.

7.41 Figure 4 shows the consortium's funding flows.

Our view on the rates postponement consortium

7.42 MDL and the six Joint Committee councils pioneered optional rates postponement in New Zealand. Optional rates postponement is a complex policy, and required extensive work to formulate. MDL and the consortium councils undertook a significant amount of preparatory work to devise the structure and management of the rates postponement consortium.

Figure 4
Funding flows of the rates postponement consortium



7.43 Overall, the structure and management of the consortium is reasonable and appropriate for the nature of the arrangement. The Joint Committee has appropriate control over decision-making regarding the rates postponement scheme, and over the budget and activities of R P Scheme Managers.

7.44 In our view, there are three areas that will need to be developed or refined. We discuss these areas further below.

The development of performance indicators

7.45 The management agreement states that the annual budget of R P Scheme Managers will include performance indicators that will be reported against in R P Scheme Managers' annual report to the Joint Committee.

7.46 We examined the 2005-06 budget presented to the Joint Committee. The budget states the nature of the work that will be undertaken during the year, and estimates the time required. However, it does not include performance indicators.

7.47 Performance indicators and regular monitoring of performance against these indicators will allow the Joint Committee to determine whether R P Scheme Managers is delivering on the work plan agreed in the budget. Regular monitoring will also provide an opportunity for R P Scheme Managers to inform the Joint Committee about any difficulties that may prevent them from delivering the agreed work.

Estimating resources for consortium management

7.48 The 2004-05 budget authorised R P Scheme Managers to undertake 49 days of activity for the rates postponement consortium. Actual activity for the year was 24.5 days. In view of the substantial difference between the budgeted days and the actual days worked in 2004-05, R P Scheme Managers have offered the Joint Committee a 25% discount on their fees for the 2005-06 year.

7.49 According to R P Scheme Managers, the unavailability of council personnel to consult on and confirm decisions was the main reason the company did not undertake the full amount of work budgeted for and complete its planned work programme.

7.50 Councils do not directly bear the cost of paying R P Scheme Managers. The money to meet this cost will come from the 1% management fee paid by ratepayers who postpone their rates. However, while this arrangement has been agreed as acceptable to the consortium, it means that ratepayers will pay for management services that did not eventuate.

7.51 We also note that none of the four consortium councils we audited included in-house staff time in their analysis of the costs of joining the rates postponement consortium.

7.52 The rates postponement consortium should endeavour to ensure that the actual days worked by R P Scheme Managers approximates the agreed budget.

7.53 In addition, councils considering joining the rates postponement consortium should take into account demands on staff time.

The surplus management fee

7.54 Section 88(2) of the Local Government (Rating) Act 2002 states that councils that postpone rates may charge a postponement fee. However, this fee may not "exceed the administration and financial costs to the local authority of the postponement".

7.55 As noted in paragraphs 7.37-7.38, the Joint Committee agreement states that all funds received from the management company will be held by the administering authority on behalf of the Joint Committee and may be applied to:

- expenses incurred by the Joint Committee; and/or
- projects of benefit to local government.

7.56 In our view, it is unlikely that funding projects "of benefit to local government" could be considered "administration or financial costs" of rates postponement.

7.57 The Joint Committee agreement further provides that, if the surplus management fee is not required for these two purposes, it is to be distributed to all the consortium councils (Joint Committee and additional) in proportion to their share of the total outstanding postponed rates.

7.58 In our view, it would be appropriate for councils to retain their share of the surplus management fees only if they are applying it to administration or financial costs associated with the rates postponement scheme that are not otherwise covered by other fees. Otherwise, we consider that it would be appropriate for councils to remit their share of the surplus management fee to the ratepayers concerned. This would effectively reduce the management fee to reflect the actual cost of management of the rates postponement consortium.

7.59 We understand that councils that have made substantial initial investment into the rates postponement scheme may wish to recoup this investment before the Joint Committee's share of the surplus management fee is distributed to all councils. This would be reasonable, provided the costs they are recovering are clearly recorded and itemised.

Appendix 1
Our expectations

Decision-making and consultation

We expected that councils, in designing and choosing to adopt a rates postponement policy, would have adequately complied with the consultation and decision-making sections in the Local Government Act 2002.

We expected that councils would accurately and reasonably inform their communities about the potential implications of their rates postponement policy, including the potential effect on the council's debt, and how the council intends to manage this.

We expected that councils would include the effect of rates postponement in their financial projections if the amount of postponed rates was significant for the council.

Risk identification and management

We expected that, in developing a rates postponement policy, councils would have:

- identified both short-term and long-term risks associated with the policy; and
- put in place strategies to manage these risks.

In particular, we expected councils to address four main risks:

- the risk of reduced cashflow;
- the risk that properties that rates are postponed against are not insured;
- the risk that the value of postponed rates may exceed the final sale value of the property that they are postponed against; and
- the risk of challenges to the validity of individual rates postponements based on claims of coercion by the council or failure to fully inform the ratepayer.

The application process

Informing ratepayers about the existence of the rates postponement policy

We expected that councils would be complying with legislative requirements regarding having information about their rates postponement policies on their rates assessments.

We expected that councils would have their rates postponement policy or policies, and clear supporting information, easily available in hard copy and on their website.

Where councils have more than one residential rates postponement policy, we expected that interested ratepayers would be informed of all the policies that they might qualify for rates postponement under.

Application documentation

We expected that application documentation would capture all the necessary information for councils to make a decision about whether to grant rates postponement to the applicant.

We expected that initial application forms and other information provided to applicants would accurately reflect the criteria used by the council to determine eligibility.

We expected that councils would have robust application and acceptance documentation that incorporates the detail of the rates postponement policy.

Informing applicants about the implications of rates postponement

We expected that, as part of the application process, councils would ensure that applicants are informed about the implications of rates postponement. In particular, we expected that councils would:

- ensure that ratepayers are informed about the potential effect of rates postponement on their equity; and
- advise ratepayers to seek independent advice before choosing to postpone their rates.

We expected that ratepayers who are postponing their rates would be informed of any changes to the council's rates postponement policy that might affect them.

Ongoing administration

Record-keeping

We expected councils to ensure that documentation is properly completed and filed.

Fees and interest

Section 88(2) of the Local Government (Rating) Act 2002 allows councils postponing rates to charge a fee not exceeding the financial and administrative costs to the council of the postponement. We expected that all councils would comply with this requirement.

We expected that councils that state in their policies that ratepayers who choose to postpone their rates bear the entire cost of postponing rates would:

- charge administration fees that reflect any additional set-up and ongoing administration costs of individual postponements; and
- charge a rate of interest that reflects the cost of the council's borrowing to cover their cashflow shortfall.

We expected that all councils that charge interest and/or fees on postponed rates would have a procedure for accurately calculating and recording interest and fees.

We expected that councils would regularly and accurately inform ratepayers of the balance of their individual rates postponement accounts, including a breakdown of rates, interest, and fees.

Monitoring

We expected that councils would maintain an accurate overview of the total of outstanding postponed rates owed to the council at a given time.

We expected that councils would monitor individual accounts so as to be able to make informed decisions about whether it is prudent to continue to grant rates postponement to individual ratepayers.

Ceasing to postpone rates

We expected that all councils offering rates postponement would have clear policies regarding when postponed rates are due.

We expected that all councils offering rates postponement would allow ratepayers to pay all or part of their postponed rates at any time without penalty.

Some councils offering optional rates postponement state in their policy that ratepayers are able to transfer the value of their postponed rates from one property to another. We expected that these councils would have established a legal mechanism for implementing such a transfer.

We expected that all councils offering rates postponement would have clear procedures for ensuring that the postponed rates are paid, including having considered when it is appropriate to release the notification of charge over the property.

Appendix 2
Our recommendations

Recommendation 1
We recommend that councils include the effect of optional rates postponement in the financial projections in their LTCCPs and Annual Plans when the amounts of money involved become significant.

Recommendation 2
We recommend that councils inform ratepayers about the potential implications of optional rates postponement for council borrowing in their LTCCPs.

Recommendation 3
We recommend that councils that experience a substantial growth in the number of applications for rates postponement devise a method of forecasting the effect of rates postponement on their future cashflow and make provision for funding this deficit.

Recommendation 4
We recommend that all councils that offer optional residential rates postponement require ratepayers to provide annual proof that their house is insured as a condition of continued postponement.

Recommendation 5
We recommend that councils organise insurance arrangements so that the premiums for a council-organised insurance product can be legally added to the postponed rates.

Recommendation 6
We recommend that councils using an actuarial model ensure that applicants understand that the results from the model are a forecast only, and depend on the accuracy of the assumptions used to generate them.

Recommendation 7
We recommend that councils using an actuarial model ensure that applicants have seen and understood both “high effect” and “low effect” results from the model.

Recommendation 8
We recommend that councils using an actuarial model regularly review the default assumptions used in the model to ensure that they reflect the best available information.

Recommendation 9
We recommend that all councils that offer residential rates postponement outside the rates postponement consortium require ratepayers to provide annual proof that their house is insured as a condition of continued postponement.

Recommendation 10
We recommend that councils offering rates postponement outside the rates postponement consortium assess the likely total amount of postponed rates, including interest and fees, for individual ratepayers at the time of application.

Recommendation 11
We recommend that all councils with residential rates postponement policies make the policy or policies, and clear supporting information, available both in hard copy and on their websites.

Recommendation 12
We recommend that all councils offering residential rates postponement ensure that publicly available information regarding rates postponement, including the application form, accurately reflects their policies.

Recommendation 13
We recommend that the consortium councils' offer letter specify the terms under which rates postponement will be granted.

Recommendation 14
We recommend that all consortium councils ensure that all owners of a property receive information about optional rates postponement and sign the acceptance of conditional offer.

Recommendation 15

We recommend that all councils offering residential rates postponement ensure that publicly available information regarding rates postponement, including the application form, accurately reflects their policies and the criteria used by the council to determine eligibility.

Recommendation 16

We recommend that councils offering residential rates postponement outside the rates postponement consortium specify the terms under which rates postponement has been granted when they advise ratepayers that their application for rates postponement has been approved.

Recommendation 17

We recommend that councils that offer residential rates postponement outside the rates postponement consortium advise ratepayers to seek independent advice before deciding to go ahead with the postponement.

Recommendation 18

We recommend that all councils offering residential rates postponement ensure that all of the owners of a property are aware of, and agree in writing to, the rates being postponed.

Recommendation 19

We recommend that all councils offering residential rates postponement advise applicants to notify any holders of a mortgage over their property that they intend to postpone their rates.

Recommendation 20

We recommend that the rates postponement consortium councils review the fee charged for decision facilitation, to ensure that it is fair to applicants and covers councils' costs.

Recommendation 21

We recommend that councils whose rates postponement policies state that the costs of postponement will be borne by the ratepayers concerned charge an initial fee to cover the cost of registering a notification of charge, and add a fee to postponed rates when they are paid to cover the cost of releasing the notification of charge.

Recommendation 22

We recommend that councils offering optional rates postponement monitor the administration load created by rates postponement, and consider imposing an annual administration fee to cover the cost of staff time spent on rates postponement where they do not already do so.

Recommendation 23

We recommend that all councils offering residential rates postponement regularly review all fees and interest to ensure that they continue to comply with section 88(2) of the Local Government (Rating) Act 2002.

Recommendation 24

We recommend that councils offering optional rates postponement monitor individual accounts so that they can consider stopping postponement if the value of outstanding rates is likely to breach the 80% equity cap.

Recommendation 25

We recommend that councils whose policies allow ratepayers to transfer the balance of postponed rates to a new property clarify the mechanism they would achieve this through, to confirm that their policy is practical and legally sound.

Recommendation 26

We recommend that all councils offering residential rates postponement send ratepayers an annual statement showing:

- the total amount of postponed rates outstanding;
- the interest rate(s) for the year;
- interest accrued; and
- any fees charged during the year.

Recommendation 27
We recommend that all councils offering residential rates postponement monitor individual accounts so that the council can make informed decisions about whether it is prudent to continue to grant rates postponement to individual ratepayers.

Recommendation 28
We recommend that all councils review their residential rates postponement policies to ensure that it is clear when, and under what circumstances, postponed rates must be paid.

Appendix 3
Policy decisions for councils to consider when designing a rates postponement policy

Fees and charges

Should the council charge interest, and if so:

- at what rate?
- how often should the rate be reviewed?
- how often should the interest be calculated?

What administration fees should the council charge and how will these be set?

Will the council charge:

- a set-up fee?
- a fee for registering the notification of charge on the land title?
- an annual administration fee?
- a fee to cover bad debts?
- a fee for releasing the notification of charge on the land title?

Criteria for postponement

Should there be an age requirement, and if so:

- what age?
- is the age requirement absolute or discretionary?

Should rates postponement be available to owners of holiday houses?

Will the council offer postponement to ratepayers who also own another property?

Will properties owned by family trusts qualify to have rates postponed?

Will retirement village units qualify to have rates postponed?

Will postponement be available to ratepayers who have mortgages over their properties? If so, what is the council's policy on the ratepayer informing the mortgagee?

Will the council require ratepayers to have been resident in the district or at their property for a certain length of time before they are eligible for rates postponement?

Other issues

Are there any rates that cannot be postponed (for example, water rates)?

Should ratepayers who move from their properties into retirement villages or rest homes, without selling the property that rates have been postponed against, be required to pay their postponed rates?

Will the council require ratepayers who are postponing their rates to keep up the maintenance of their houses, and how would this be monitored?

Does the ratepayer or the council bear the risk of the value of postponed rates exceeding the value of the property that they are postponed against?

Will the council offer partial postponement, and, if so, how will it decide what proportion of the rates to postpone?

Will ratepayers who postpone their rates have an automatic right to continued postponement in the event that the policy changes?

Appendix 4
The actuarial model used by the rates postponement consortium

The purpose of the actuarial model

Consortium councils use the actuarial model to assess whether there is likely to be sufficient security available in the applicant's property to cover the estimated total of outstanding rates at the end of the period of postponement. If the model shows that ratepayers are unlikely to have enough equity to cover the total amount of postponed rates, they will either be offered partial postponement to the level sustainable by their equity or have their application denied.

This assessment allows the councils to minimise the risk of allowing ratepayers to postpone a greater amount of rates than they are able to pay using the equity in their property.

Results from the model also allow councils to inform ratepayers about the likely effect of rates postponement on their equity.

How the model works

The actuarial model was developed for the consortium by an actuary. It has since been updated to make it easier to use and to incorporate the new central government rates rebate scheme.

The actuarial model incorporates the following variables:

- annual rates;
- interest rate;
- one-off fees;
- annual fees;
- reserve fund levy;
- insurance premiums;
- annual rates rebate for qualifying ratepayers; and
- rate of increase in property values.

An allowance for inflation is also included.

The model allows different assumptions to be entered for up to five years and beyond five years. Each council changes these assumptions to accord with their district's experience – for example, some districts may expect higher rates of increase in property values than other areas.

The model uses Statistics New Zealand life tables to estimate the life expectancy of the applicant. Where two applicants apply jointly, the longest life expectancy is taken as the term of postponement.

How the model is used

Each council has a default set of assumptions that they use when running the model.

Information regarding an application, such as the applicant's age and the current value of their property, is fed into the model. The result is a spreadsheet showing the cumulative percentage of the ratepayer's equity that will be consumed by postponed rates in a given year if the assumptions used in the model are correct. The final year of estimated life expectancy is highlighted, indicating the total amount of equity likely to be consumed by postponed rates if the ratepayer remains alive until that time.

The councils use the results from the model for two purposes – to assess whether an applicant is likely to have enough equity to meet the council's eligibility criteria, and to inform the ratepayer about the likely effect of rates postponement on their equity.

If the results from the model show that the amount of equity likely to be consumed by rates postponement is under 80%, councils will grant full postponement. If it is over 80%, they may offer partial postponement or decline the application.

A copy of the results spreadsheet is sent to the ratepayer when they are advised of the outcome of their application.

If the application has been approved, another copy is sent to Relationship Services, to allow the decision facilitator to prepare for the decision facilitation session.

Decision facilitators have access to a live version of the model for use during decision facilitation sessions. This means they can show applicants the effect of different assumptions – for example, how much more equity would be used if applicants lived longer than expected, or if interest rates were higher than the default setting used by the council.

The effect on ratepayers' equity of the gap between interest rates and the rate of increase in property values

Under normal circumstances, interest rates will be higher than the rate of increase in property values over the long term. The size of this gap between interest rates and property value increases is the most important factor in determining how much equity will be used up by rates postponement over a given length of time.

The greater the difference between the interest rate and the rate of property value increase, the greater the effect on the ratepayer's equity. This is because the interest will be building up more quickly than the value of the property is increasing.[1]

Conversely, the closer the rate of property value increase is to the interest rate, the less the effect rates postponement will have on the ratepayer's equity. This is because the effect of compounding interest is being mitigated by the increase in the value of the property.

The effect of this gap on the results predicted by the model becomes more accentuated over longer periods of time. Figures 1 and 2 in Part 2 show this effect.

The gap between assumed interest rates and rates of property value increase over the longer term varied widely among councils. Western Bay of Plenty District Council assumed that the rate of property value increase in its district would be 5% lower than interest rates over the long term. Rodney District Council assumed a higher long-term rate of property value increase, creating a gap of only 1.5% between rates of property value increase and interest rates.

Our review of the model

Accuracy of the model

The actuary we consulted prepared an alternative model to test the results generated by the consortium's model. There were no material differences between his results and the results from the consortium's actuarial model.

Using the model to determine eligibility for rates postponement

The actuarial model results show what will happen in a given scenario. However, the results are a forecast – not a set of guaranteed actual outcomes.

For the purposes of determining eligibility, it is reasonable for councils to use assumptions that reflect the most likely scenario.

Currently, assumptions for the actuarial model are generated by individual councils. Property value assumptions are based on recent historical experience and a council's view of likely future property value increases in its district. While this may be a reasonable basis for short-term forecasts, these factors are less likely to be appropriate as the basis for longer-term forecasts of up to 30 years.

Likewise, current and recent interest rates are not necessarily a good guide to likely interest rates over the long term, particularly as there is no market rate for interest beyond 10 years.

1 It should be noted that the value of outstanding postponed rates on which the interest is being incurred will be much less than the value of the property. Therefore, a low percentage increase in the value of the property may be greater, in absolute terms, than a higher percentage increase in the value of the outstanding rates.

An alternative way of generating long-term rates of property value increase and interest rates would be to use inflation (the Consumer Price Index) as a base for estimating future property price increases and interest rates. Using this method, the important assumption is the real rate of property price increase, which is added to the long-term inflation rate to produce the nominal rate of property price increase. Similarly, the assumed nominal interest rate is set by adding assumed real interest rates to the rate of inflation. This approach creates internal consistency between the assumptions, and ensures that the gap between rates of property value increase and interest rates will be within a reasonable range.

It is important that councils continue to review the default assumptions used to assess ratepayers' applications. In our view, councils should regularly discuss these assumptions with other members of the consortium, and seek professional advice if they consider it is required.

We note that the model also requires councils to enter a variable for the rate at which rates are going to increase. Councils should ensure that the level of rates inflation assumed in the model reflects the increases they have planned in their LTCCPs. We were told that consortium councils are currently doing this.

There may be benefit in councils periodically running existing ratepayer accounts through the model, particularly if there are significant changes in the assumptions. This would allow councils to see how the new assumptions affect existing rates postponement accounts as well as new applications.

Using the results from the model to inform ratepayers about the possible effect on their equity

The consortium councils send applicants one set of results generated by the actuarial model. These results are a forecast based on the council's view of the most likely scenario, but they are not a guaranteed result. The accuracy of the results generated by the actuarial model depends on the accuracy of the assumptions used.

In our view, councils need to ensure that applicants understand that the results from the model are a forecast only, and depend on the accuracy of the assumptions used to generate them.

Applicants who choose to continue with rates postponement attend a decision facilitation session at which the decision facilitator has access to a live version of the actuarial model. However, facilitators are not explicitly required to explain that the accuracy of the actuarial model's results provided by the council depends on the accuracy of the council's assumptions. Nor are they required to show applicants the effect of using different assumptions in the model.

As noted above, the gap between the assumed interest rate and the assumed rate of property value increase is the most important factor affecting the results from the model over the long term. Higher interest rates in relation to the rate of property value increase will mean that rates postponement will use a greater proportion of the ratepayer's equity. Less equity will be used if the interest rate is lower or the rate of property value increase is greater.

For example, a council's default assumptions for assessing eligibility might be an interest rate of 8% and a property value increase of 4% (giving a 4% gap between the interest rate and the rate of property value increase). In this case, a "high effect" result could be generated using a property value increase of 2% (giving a 6% gap between the interest rate and the rate of property value increase). A "low effect" result could be generated using a property value increase of 6% (giving a 2% gap between the interest rate and the rate of property value increase).

Councils need to ensure that applicants have seen and understood both "high effect" and "low effect" results from the model.

Appendix 5
Data used to generate Figures 1 and 2

Scenario output

Land value	Improvements	Capital value	Rates
$177,000	$208,000	$385,000	$1,510

Equity in home after 10 years

Property value growth	Interest rate: 5%	6%	7%	8%	9%	10%	11%	12%
-5%	89%	88%	88%	87%	87%	86%	85%	84%
-4%	90%	90%	89%	88%	88%	87%	87%	86%
-3%	91%	91%	90%	90%	89%	88%	88%	87%
-2%	92%	92%	91%	91%	90%	90%	89%	88%
-1%	93%	92%	92%	92%	91%	91%	90%	90%
0%	93%	93%	93%	92%	92%	91%	91%	91%
1%	94%	94%	93%	93%	93%	92%	92%	91%
2%	95%	94%	94%	94%	93%	93%	93%	92%
3%	95%	95%	95%	94%	94%	94%	93%	93%
4%	96%	95%	95%	95%	95%	94%	94%	94%
5%	96%	96%	96%	95%	95%	95%	94%	94%
6%	96%	96%	96%	96%	95%	95%	95%	95%
7%	97%	96%	96%	96%	96%	96%	95%	95%
8%	97%	97%	97%	96%	96%	96%	96%	96%

Scenario output

Land value	Improvements	Capital value	Rates
$61,000	$52,000	$113,000	$1,197

Equity in home after 10 years

Property value growth	Interest rate: 5%	6%	7%	8%	9%	10%	11%	12%
-5%	70%	68%	67%	65%	63%	61%	59%	57%
-4%	73%	72%	70%	68%	67%	65%	63%	61%
-3%	76%	74%	73%	72%	70%	68%	67%	65%
-2%	78%	77%	76%	74%	73%	71%	70%	68%
-1%	80%	79%	78%	77%	76%	74%	73%	71%
0%	82%	81%	80%	79%	78%	77%	75%	74%
1%	84%	83%	82%	81%	80%	79%	78%	76%
2%	85%	84%	84%	83%	82%	81%	80%	79%
3%	87%	86%	85%	84%	84%	83%	82%	81%
4%	88%	87%	87%	86%	85%	84%	83%	82%
5%	89%	88%	88%	87%	86%	86%	85%	84%
6%	90%	89%	89%	88%	88%	87%	86%	85%
7%	91%	90%	90%	89%	89%	88%	87%	87%
8%	92%	91%	91%	90%	90%	89%	89%	88%

Scenario output

Land value	Improvements	Capital value	Rates
$177,000	$208,000	$385,000	$1,510

Equity in home after 20 years

Property value growth	Interest rate 5%	6%	7%	8%	9%	10%	11%	12%
-5%	43%	36%	29%	20%	11%	0%	-13%	-27%
-4%	53%	48%	42%	35%	27%	19%	9%	-3%
-3%	62%	58%	53%	47%	41%	34%	26%	16%
-2%	69%	66%	62%	57%	52%	46%	39%	32%
-1%	75%	72%	69%	65%	61%	56%	51%	44%
0%	79%	77%	74%	71%	68%	64%	60%	55%
1%	83%	81%	79%	77%	74%	71%	67%	63%
2%	86%	85%	83%	81%	78%	76%	73%	69%
3%	89%	87%	86%	84%	82%	80%	78%	75%
4%	91%	90%	88%	87%	85%	84%	82%	79%
5%	92%	91%	90%	89%	88%	86%	85%	83%
6%	94%	93%	92%	91%	90%	89%	87%	86%
7%	95%	94%	93%	93%	92%	91%	90%	88%
8%	96%	95%	95%	94%	93%	92%	91%	90%

Scenario output

Land value	Improvements	Capital value	Rates
$61,000	$52,000	$113,000	$1,197

Equity in home after 20 years

Property value growth	Interest rate 5%	6%	7%	8%	9%	10%	11%	12%
-5%	-57%	-75%	-95%	-118%	-145%	-175%	-209%	-248%
-4%	-27%	-42%	-58%	-77%	-99%	-123%	-151%	-182%
-3%	-3%	-15%	-29%	-44%	-61%	-81%	-104%	-129%
-2%	16%	6%	-5%	-17%	-31%	-48%	-66%	-87%
-1%	31%	23%	14%	4%	-7%	-20%	-35%	-52%
0%	44%	37%	30%	22%	12%	1%	-11%	-25%
1%	54%	49%	43%	36%	28%	19%	9%	-2%
2%	62%	58%	53%	47%	41%	34%	25%	16%
3%	69%	65%	61%	57%	51%	45%	39%	31%
4%	74%	71%	68%	64%	60%	55%	49%	43%
5%	79%	76%	74%	70%	67%	63%	58%	53%
6%	82%	80%	78%	76%	73%	69%	65%	61%
7%	85%	84%	82%	80%	77%	75%	71%	68%
8%	88%	87%	85%	83%	81%	79%	76%	73%

Scenario output

Land value	Improvements	Capital value	Rates
$177,000	$208,000	$385,000	$1,510

Equity in home after 30 years

Property value growth	Interest rate 5%	6%	7%	8%	9%	10%	11%	12%
-5%	-130%	-172%	-224%	-288%	-365%	-461%	-577%	-721%
-4%	-68%	-99%	-137%	-183%	-240%	-309%	-395%	-499%
-3%	-23%	-46%	-74%	-108%	-149%	-200%	-263%	-339%
-2%	10%	-7%	-28%	-53%	-83%	-121%	-167%	-223%
-1%	33%	21%	6%	-12%	-35%	-63%	-97%	-138%
0%	51%	42%	30%	17%	0%	-20%	-45%	-76%
1%	63%	57%	48%	38%	26%	11%	-8%	-31%
2%	73%	68%	62%	54%	45%	34%	20%	3%
3%	80%	76%	71%	66%	59%	50%	40%	27%
4%	85%	82%	79%	74%	69%	63%	55%	46%
5%	89%	86%	84%	81%	77%	72%	66%	59%
6%	91%	90%	88%	86%	83%	79%	75%	69%
7%	94%	92%	91%	89%	87%	84%	81%	77%
8%	95%	94%	93%	92%	90%	88%	86%	82%

Scenario output

Land value	Improvements	Capital value	Rates
$61,000	$52,000	$113,000	$1,197

Equity in home after 30 years

Property value growth	Interest rate 5%	6%	7%	8%	9%	10%	11%	12%
-5%	-528%	-644%	-786%	-960%	-1173%	-1434%	-1755%	-2149%
-4%	-358%	-443%	-547%	-674%	-830%	-1021%	-1255%	-1543%
-3%	-236%	-298%	-374%	-467%	-581%	-721%	-893%	-1104%
-2%	-147%	-193%	-249%	-317%	-401%	-504%	-630%	-785%
-1%	-82%	-116%	-157%	-208%	-269%	-345%	-438%	-553%
0%	-35%	-60%	-90%	-128%	-173%	-229%	-298%	-383%
1%	0%	-18%	-41%	-69%	-103%	-144%	-195%	-258%
2%	26%	12%	-5%	-26%	-51%	-82%	-120%	-166%
3%	44%	34%	22%	6%	-13%	-36%	-64%	-99%
4%	58%	51%	41%	30%	16%	-2%	-23%	-49%
5%	69%	63%	56%	47%	37%	24%	8%	-12%
6%	77%	72%	67%	60%	52%	43%	31%	16%
7%	82%	79%	75%	70%	64%	57%	48%	37%
8%	87%	84%	81%	77%	73%	67%	60%	52%

Appendix 6
Issues councils may need to inform ratepayers about when they apply to postpone their rates

- Whether regional council rates are also postponed.
- The likely effect of rates postponement on the ratepayer's equity.
- Whether postponed rates can be transferred to another property in the district.
- Any rates that cannot be or are not being postponed (for example, metered water rates).
- What happens to postponed rates if the ratepayer moves into a retirement home.
- Under what circumstances the postponed rates will need to be paid.
- Whether the council or the ratepayer bears the risk of the value of postponed rates exceeding the value of the property they are postponed against.
- The consequences for the ratepayer if they fail to continue to meet conditions of postponement, such as keeping their house insured or permanently residing at the property.
- All administration fees and charges.
- What the current interest rate is and how the rate is set.
- That the interest rate is subject to change.
- What the ratepayer's rights are if the policy changes.

Publications by the Auditor-General

Other publications issued by the Auditor-General recently have been:

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- Annual Report 2005-06 – B28
- Advertising expenditure incurred by the Parliamentary Service in the three months before the 2005 General Election
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- Ministry of Education: Management of the school property portfolio
- Local authority codes of conduct
- Local government: Results of the 2004-05 audits – B.29[06b]
- Housing New Zealand Corporation: Effectiveness of programmes to buy and lease properties for state housing
- Inquiry into certain allegations made about Housing New Zealand Corporation
- Department of Conservation: Planning for and managing publicly owned land
- Ministry of Agriculture and Forestry: Managing biosecurity risks associated with high-risk sea containers
- Annual Plan 2006-07 – B.28AP(06)
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