Controller and Auditor-General
Tumuaki o te Mana Arotake

Discussion paper

Using development contributions and financial contributions to fund local authorities' growth-related assets

Using development contributions and financial contributions to fund local authorities' growth-related assets

This is a discussion paper issued under section 21 of the Public Audit Act 2001.

August 2013

ISBN 978-0-478-41026-6 (online)

Contents

Auditor-General's overview

In their long-term plans, local authorities set out their forecast growth, proposed land use, and the infrastructure that might be needed in at least the next 10 years. In December 2012, I published a report discussing matters arising from our audits of those long-term plans. In this discussion paper, my staff have reviewed how five local authorities use "growth charges", such as development contributions and financial contributions, to fund the assets that they will need for the growth they expect.

Funding growth is expensive. In the 10 years to 2021/22, the 77 local authorities have forecast that they will collect more than $3.4 billion in development contributions and financial contributions, and spend more than $7.0 billion to create assets to meet additional demand.

Growth charges enable local authorities to get developers to contribute up-front for the costs of developing the associated infrastructure services. Developers may carry these charges until sections are sold, and the charges are then passed on to the buyers of the developed land.

A financial strategy of using growth charges is a matter of local authority judgement. A local authority may choose to recover all, some, or no growth-related costs from developers, or to fund them in other ways (such as from existing ratepayers).

Local authorities that have high growth are more likely to use growth charges to fund their growth-related assets. The rationale that local authorities use is that growth should pay for growth – those who cause the need for the new infrastructure and services should pay, rather than the existing community. However, it is not always that simple – sometimes, the existing community also benefits from the new infrastructure and services.

Economic and population growth drives the need for new capital expenditure to meet that growth. It is essential for local authorities to have good growth forecasting models because they are the basis for forecasting future revenue (rates, growth charges), finance costs (debt, debt servicing), and capital expenditure required to meet the additional demand and asset renewals.

According to the five local authorities discussed in this paper, it is essential that their planning policies align with their funding policies. Although the five local authorities had some views and practices in common, it was also clear that practices and interpretations vary. Discussions on areas such as calculating the total cost of capital expenditure, non-residential development charges, and refunds of money or land would help to improve the application and understanding of development contributions and financial contributions as funding tools. These matters warrant consideration by the local government sector and other stakeholders interested in the use of such funding tools.

Other matters, such as managing levels of services and cost, and apportionment of capital costs relating to growth, are opportunities for local government managers to reflect on current practices and compare them with other local authorities to see whether improvements could be made.

I thank the five local authorities that contributed or provided information to this discussion paper.

Lyn Provost
Controller and Auditor-General

9 August 2013

Part 1
Introduction

1.1 In this discussion paper, we have reviewed how a small group of local authorities[1] use growth charges, such as development contributions and financial contributions, to fund growth-related assets.

1.2 Development can take place through intensification or infill of existing developed areas or through new development in "greenfield" (previously undeveloped) areas. Development in greenfield areas typically requires totally new infrastructure, while infill development typically requires the existing asset capacity to be upgraded.

1.3 We took a case study approach by selecting five local authorities for review. The five local authorities were Tasman District Council, Tauranga City Council, Western Bay of Plenty District Council, Marlborough District Council, and Timaru District Council (the five local authorities). We selected the five local authorities because each has adopted a different approach to funding growth-related assets.

1.4 For each of the five local authorities, we sought to understand:

- their funding choices and the rationale for their choices;
- the integration of their funding choices and rationale in their financial strategies; and
- issues arising in applying the chosen policies.

1.5 A territorial authority[2] can charge a development contribution under the Local Government Act 2002, and a financial contribution under the Resource Management Act 1991, but not for the same purpose for the same development.[3]

1.6 The purposes of development contributions and financial contributions are slightly different. Development contributions fund the costs of infrastructure, reserves[4], or other community facilities arising from new housing or commercial developments. A financial contribution can be imposed as a condition of a resource consent granted under the Resource Management Act 1991 for a purpose set out in a local authority's regional or district plan (including offsetting any adverse environmental effects of a development or activity).

1 A local authority means a regional council or territorial local authority.

2 A territorial authority means a city council or a district council named in Part 2 of Schedule 2 of the Local Government Act.

3 Section 200 of the Local Government Act – Limitations applying to requirement for development contribution.

4 "reserves" is not defined in the Local Government Act, but typically includes areas designated for parks, sports, and recreation.

1.7 Regional councils[5] can charge financial contributions but not development contributions.

1.8 In the remainder of this Part, we show the forecast development and financial contributions revenue, and the capital expenditure to meet additional demand, reflected in the local authorities' 2012-22 long-term plans.

1.9 In Part 2 we provide a summary for each of the five local authorities, their forecast development and financial contribution revenue, the capital expenditure to meeting additional demand, their approach to funding growth-related assets, and the basis for how they set their growth charges.

1.10 In Part 3 we discuss matters that the five local authorities have highlighted to us about development contributions and financial contributions to fund growth-related assets.

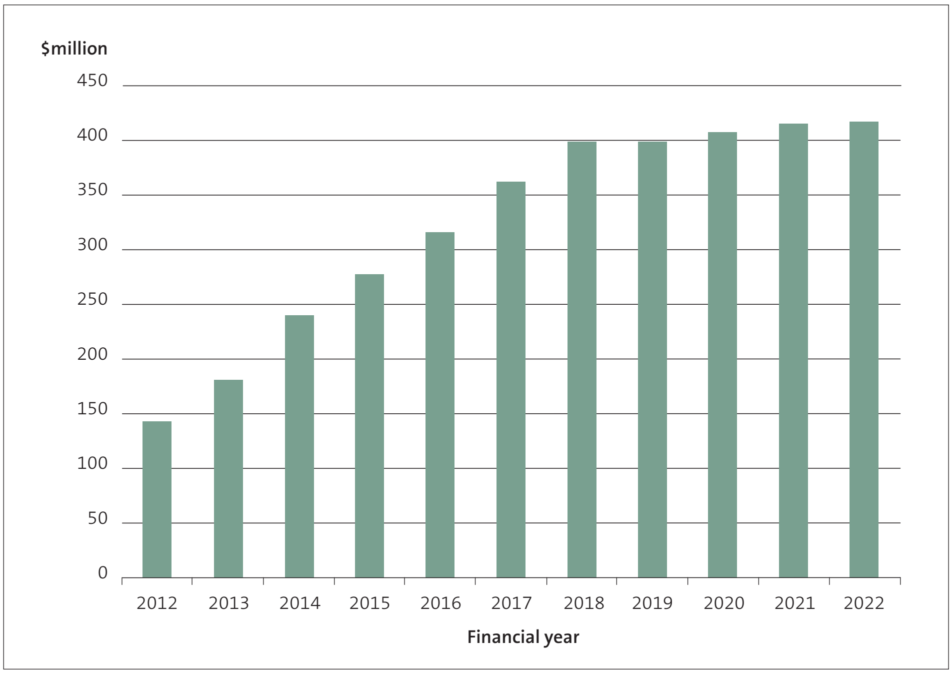
Development contributions and financial contributions forecast in the 2012-22 long-term plans

1.11 Local authorities forecast to receive \$3.4 billion[6] in development and financial contributions in the 10 years from 2012/13 to 2021/22 based on their 2012-22 long-term plans. Figure 1 shows forecast development and financial contributions in each of the next 10 years (as well as the 2011/12 estimated actual development and financial contributions revenue from the 2012-22 long-term plans). Figure 1 also shows that the year-on-year increase in contributions is greater in the early years than in the later years.

5 A regional council means a local authority named in Part 1 of Schedule 2 of the Local Government Act 2002. Regional councils are primarily concerned with environmental resource management, flood control, air and water quality, pest control, and, in specific instances, public transport, regional parks, and bulk water supply.

6 This amount is for 77 local authorities, excluding Christchurch City Council, which did not prepare a 2012-22 long-term plan. The Department of Internal Affairs collated all the financial information in the final 2012-22 long-term plans and made the information available to us for further analysis.

Figure 1
Forecast development and financial contributions revenue, 2011/12 to 2021/22



1.12 The 10 local authorities with the highest forecast development and financial contributions revenue expect to collect $2.9 billion (84%) of the total contributions revenue over the 10 years. Auckland Council alone is expecting to collect $2.0 billion (59%) of the total contributions revenue.

1.13 Figure 2 shows the 10 local authorities with the highest forecast revenue from development and financial contributions, and the percentage of this revenue source to total operating income.

Figure 2
The 10 local authorities with the highest forecast development and financial contributions revenue over the period 2012/13 to 2021/22

	Local authority	Forecast development contributions and financial contributions revenue, 2012-22 $million	Forecast development contributions and financial contributions revenue, as a % of total operating income, 2012-22
1	Auckland Council	2,017	5%
2	Tauranga City Council	209	10%
3	Western Bay of Plenty District Council	109	11%
4	Waimakariri District Council	104	11%
5	Waikato District Council	84	7%
6	Hamilton City Council	82	4%
7	Selwyn District Council	73	8%
8	Queenstown-Lakes District Council	71	6%
9	Thames-Coromandel District Council	62	6%
10	Hastings District Council	53	4%

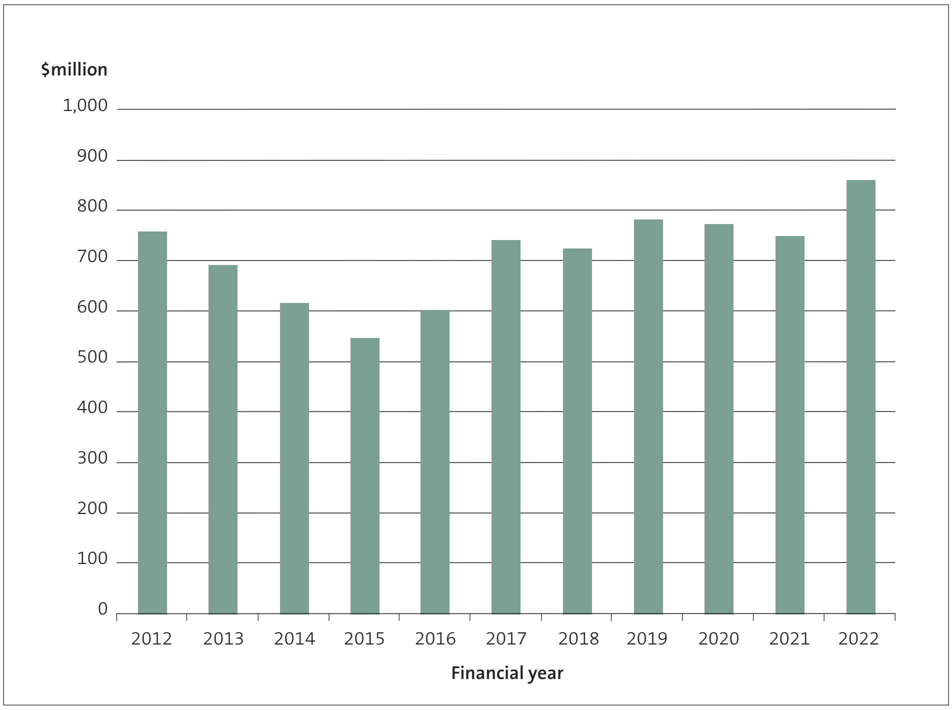
1.14 Twenty-three (30%) local authorities have forecast that they will receive no revenue from development and financial contributions during the next 10 years. Eleven of them are regional councils.

Forecast capital expenditure to meet additional demand in the 2012-22 long-term plans

1.15 Based on the 2012-22 long-term plans, local authorities have forecast spending $7.076 billion[7] on capital expenditure to meet additional demand in the 10 years from 2012/13 to 2021/22. Figure 3 shows forecast capital expenditure to meet additional demand in each of the next 10 years (as well as the 2011/12 estimated actual capital expenditure to meet additional demand from the 2012-22 long-term plans).

7 This amount is for 77 local authorities, excluding Christchurch City Council, which did not prepare a 2012-22 long-term plan.

Figure 3
Forecast capital expenditure to meet additional demand, 2011/12 to 2021/22



1.16 Twenty (26%) local authorities have forecast no capital expenditure to meet additional demand during the next 10 years. Nine of them are regional councils.

Forecast revenue and expenditure profile

1.17 Figure 3 shows a different pattern to that for the development and financial contributions revenue in Figure 1. There could be several reasons for this, including:

- a number of local authorities have forecast not to receive any development or financial contributions (growth charges) towards capital expenditure to meet demand;
- it typically takes less time to build an asset than it takes to recover the cost of the asset through growth charges;
- local authorities can require a growth charge for growth-related expenditure already incurred in anticipation of a development (reflecting past development), as well as for forthcoming development; and
- receipt of growth charges is not linear each year – the forecast growth charge is based on the forecast pace of development in the community or units of

demand (names commonly used include HUE, HEU, or HUD).[8] Some local authorities have forecast that the rate of growth and therefore forecast development, will take more time to recover from the recent recession. Because of this, growth charges will reflect a similar recovery pattern.

1.18 A financial strategy of using growth charges to fund growth-related assets is a matter of local authority judgement. A local authority may choose not to recover all or even any growth-related costs from developers, but to fund them in other ways (such as from existing ratepayers). Local authorities have a number of funding tools available and set a funding mix that best suits their local circumstances.

8 "units of demand" is not defined in the Local Government Act 2002, so definitions vary. For example:

- Tauranga City Council defines units of demand as "the number of household units, household equivalents, gross floor area, additional allotment of subdivision, or site area".
- Marlborough District Council said that units of demand provide the basis for distributing the costs of growth. They illustrate the rates at which different types of development use capacity. The Council has adopted the household equivalent unit (HEU) as the base unit of demand, and describes the demand for capacity from other forms of development as HEU multipliers.
- Tasman District Council calculates contributions based on household units of demand (HUD) for both residential and business units.

Part 2
The five local authorities

2.1 This Part sets out, for each of the five local authorities:

- the forecast development and financial contributions revenue and capital expenditure to meet additional demand for the 10 years to 2021/22;
- the approach to funding growth; and
- the basis for how growth charges are set.

Local authorities' forecast growth charges and capital expenditure to meet additional demand

2.2 Figures 5 to 9 reflect the forecast development and financial contributions revenue, and forecast capital expenditure to meet additional demand from the five local authorities' 2012-22 long-term plans. We extracted these amounts from the funding impact statements[9] in those long-term plans. Each local authority has different forecast revenue and expenditure profiles over the 10 years to 2021/22, and we have already highlighted several possible reasons for this in paragraphs 1.17 and 1.18.

2.3 In addition, we note the following:

- The forecast development and financial contributions revenue in the funding impact statements align with each local authority's development and/or financial contribution policies.
- The capital expenditure to meet additional demand in the funding impact statements may be different from that reflected in each local authority's development and/or financial contribution policies.

2.4 In preparing their 2012-22 long-term plans, local authorities had to classify their capital expenditure into three categories in the funding impact statement: meeting additional demand, improving levels of service, or replacing existing assets. A local authority first had to work out, for each capital project, the percentage attributable to each of the three categories. A local authority then had to classify the project according to its "primary purpose" or the category with the highest percentage. For example, if 50% of the project is to meet additional demand, 40% to improve levels of service, and 10% to replace existing assets, then the project is classified in the funding impact statement as 100% to meet additional demand.

9 The funding impact statement shows the forecast amount of funds to be raised from each source of funding, and how those funds will be applied.

Summary of typical growth charges for four local authorities

2.5 In Figure 4, we have set out for four[10] of the five local authorities their typical growth charge for an infill and greenfield development based on constructing a three-bedroom house in a residential urban area. The typical charges reflected in Figure 4 are indicative only. The actual growth charge will vary depending on the type of development, geographical location, and services available to that development.

Figure 4
Typical growth charges for four local authorities

Transport $	Water supply $	Waste water $	Storm water $	Reserves $	Community infra-structure $	Ecological protection $	Total growth charge $
Tasman District Council							
Infill and greenfield development							
894	6,596	8,118	5,149	*	*	0	20,757
Tauranga City Council							
Infill development							
292	3,474	7,404	0	418	757	0	12,345
Greenfield development							
5,391	5,150	8,604	4,419	1,247	955	0	25,766
Western Bay of Plenty District Council							
Infill and greenfield development							
9,296	4,103	6,608	4,846	6,753	0	501	32,107
Marlborough District Council							
Infill development							
524	4,322	7,050	650	4,696	2,700	0	19,942
Greenfield development							
786	4,322	7,050	650	9,391	2,700	0	24,899

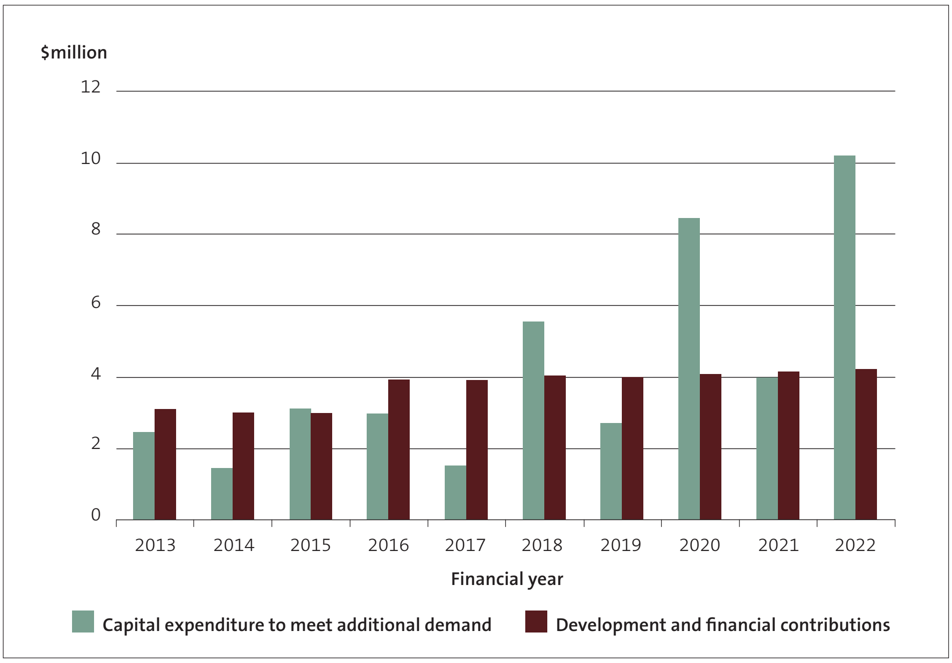
* The reserves and community infrastructure financial contribution charge is based on 5.62% of the value of the new lot created. Maximum charge assuming one household unit of demand. No financial contribution payable on residential buildings if nothing was paid at the time the lot was created.

10 Timaru District Council chose not to provide us with a typical growth charge for this discussion paper.

Tasman District Council

2.6 Tasman District Council has forecast that it will collect $42.2 million in development and financial contributions, and will spend $37.2 million on capital expenditure to meet additional demand, during the next 10 years (see Figure 5).

Figure 5
Tasman District Council's forecast capital expenditure to meet additional demand, and development and financial contributions, 2012/13 to 2021/22



2.7 The average development and financial contributions revenue as a percentage of total operating income for the next 10 years is 3%.

2.8 The typical growth charge for each household "unit of demand" is $20,757[11] for a three-bedroom house (same charge for infill or greenfield development in a residential urban area). This charge assumes that all services are available and provides no credit for prior payment or any allowance for the bare titles.

How Tasman District Council approaches funding for growth

2.9 One of the Council's main sources of funding for growth-related assets is development contributions. The Council intends that developers bear the cost of the increased demand that development places on the district's infrastructure.

11 Plus a reserves and community infrastructure financial contribution charge, where applicable.

2.10 The Council's development contributions methodology apportions costs to reflect those who cause the need for the growth-related infrastructure and those who benefit (for example, existing ratepayers) from new or additional infrastructure or infrastructure with increased capacity. Hence, development contributions allocate the cost for expanded infrastructure services away from general ratepayers to developers and new home builders – those who drive the need for new infrastructure or infrastructure with increased capacity.

2.11 New subdivisions are charged for services, including roading, water, wastewater, and stormwater when available. The Council recently made changes to its policy and does not charge on residential buildings, except where no prior contribution had been received at the time of title creation.

2.12 The Council imposes financial contributions for reserves and community infrastructure purposes under the Tasman Resource Management Plan.

How Tasman District Council sets its growth charges

2.13 The Council has a district-wide approach to growth charges rather than a "per catchment" or community-by-community approach. The Council considers that this is more appropriate for its geographically large and relatively dispersed population, where costs vary considerably between different communities. This approach results in some cross-subsidisation between communities. The Council charges connection fees as well as development contributions. These fees are designed to recover capital costs already incurred by the Council.[12]

2.14 Contributions are based on household units of demand (HUDs). Multiples of HUDs are charged for commercial and larger residential developments where appropriate.

2.15 The Council adjusts the value of the development contribution on 1 July each year using the annual change in the Construction Cost Index. The Council intends to use the Producers Price Index[13] to annually adjust the value of the development contribution charges when it next reviews its development contributions policy.

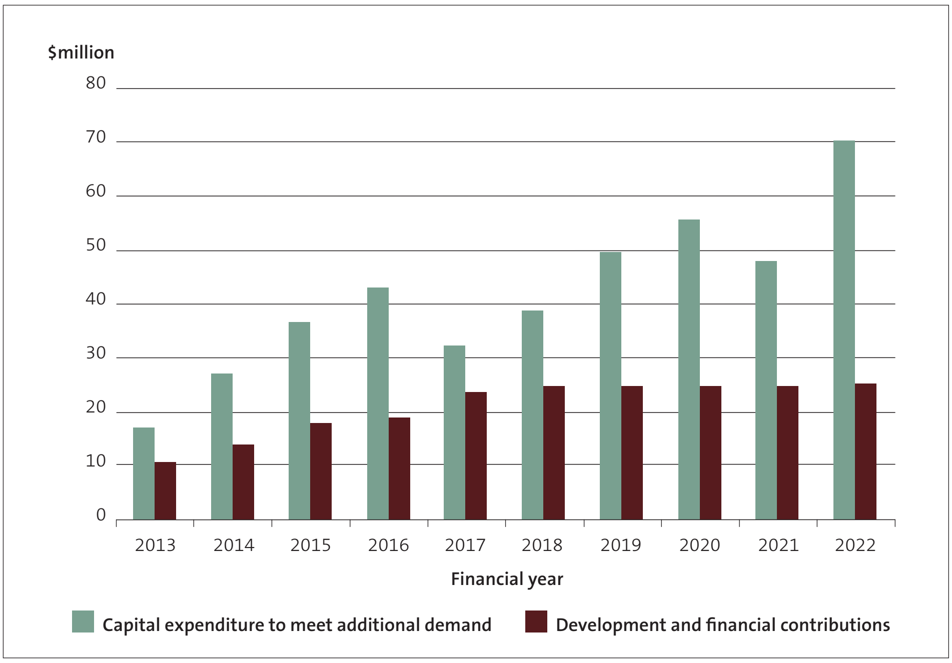
12 The Council states in its development contribution policy that connection fees will continue to apply in addition to the requirements to pay development contributions, except where a development contribution for water supply in the Coastal Tasman Area was paid prior to 1 July 2009, in which case the development contribution included a component for a connection fee.

13 The Producers Price Index reflects the change in the general level of prices for the productivity sector of New Zealand.

Tauranga City Council

2.16 During the next 10 years, Tauranga City Council has forecast that it will collect $209.0 million in development and financial contributions, and will spend $418.4 million on capital expenditure to meet additional demand (see Figure 6).

Figure 6
Tauranga City Council's forecast capital expenditure to meet additional demand, and development and financial contributions, 2012/13 to 2021/22



2.17 The average development and financial contributions revenue as a percentage of total operating income for the next 10 years is 10%.

2.18 The typical growth charge for each household unit equivalent is $12,345 (infill development) and $25,766 (greenfield development) for a three-bedroom house in a residential urban area.

How Tauranga City Council approaches funding for growth

2.19 The Council's main method for funding growth-related assets is development contributions. The Council's underlying rationale is that those who cause growth should pay for it. In other words, growth should pay its own way.

2.20 The Council considers that growth charges ensure that new development contributes fairly to the funding of Tauranga's infrastructure and service requirements:

> *The Council also recognises that it needs to take a fair and equitable approach when considering benefits. The Council's development contributions policy states that the Council:*
>
> *... regards in relation to each activity – the distribution of any benefits between the community as a whole, any identifiable part of the community and individuals, and the period over which benefits are expected to occur. This is reflected in the cost allocation methodology. For example, where people in the existing community may get benefit from an improved level of service.*[14]

How Tauranga City Council sets its growth charges

2.21 The Council charges both city-wide development contributions and local development contributions (that is, catchment-based development contributions). The city-wide development contributions are charged to recover the capital costs for assets that service growth across the whole city. Local development contributions are charged to recover the capital costs for assets that service growth in particular catchments.

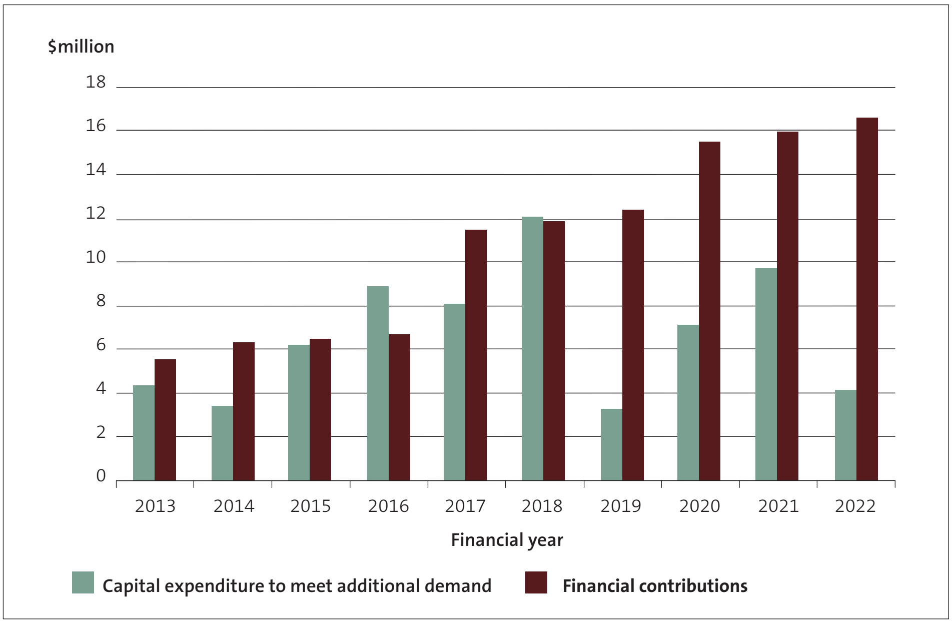
2.22 City-wide development contributions are differentiated based on a range of development types. The development types are: one-bedroom houses, two-bedroom houses, three-bedroom (or bigger) houses, business activities, low-demand business activities, and community organisations. Local development contributions are differentiated based on geographical catchment. There are 10 catchments, each having their own individual local development contribution charges.

14 Tauranga City Council, Development Contributions Policy, page 6.

Western Bay of Plenty District Council

2.23 Western Bay of Plenty District Council has forecast that it will collect $108.8 million in financial contributions and will spend $67.2 million on capital expenditure to meet additional demand during the next 10 years (see Figure 7).

Figure 7
Western Bay of Plenty District Council's forecast capital expenditure to meet additional demand, and financial contributions, 2012/13 to 2021/22



2.24 The average financial contributions revenue as a percentage of total operating income for the next 10 years is 11%.

2.25 The typical growth charge for each household equivalent is $32,107 for a three-bedroom house in the Katikati urban area (same charge for infill or greenfield development).

How Western Bay of Plenty District Council approaches funding for growth

2.26 The Council's approach is that growth should pay for growth. This is consistent with its general funding policy of recovering costs from users of a service or from those who create the need for a service. Financial contributions are a key part of this approach – making sure the new development is not subsidised by the wider community and that costs are fairly allocated between present and future ratepayers.

2.27 Financial contributions serve several other objectives as well, including:

- efficient utilisation of the district's infrastructure; and
- influencing the timing of development to ensure that it does not outstrip the Council's ability to fund infrastructure.

2.28 The Council's policy includes a provision to reduce or waive financial contributions if it can be demonstrated that there would be detriment to the community in applying the charges under the policy.

2.29 The Council charges financial contributions for the effects of development on water supply, wastewater, stormwater, transportation, recreation, and ecological protection. The Council does not charge a recreation financial contribution on commercial and industrial development.

How Western Bay of Plenty District Council sets its growth charges

2.30 The Council's financial contributions are based on catchments for network infrastructure. This approach clearly links development to the need for infrastructure and the cost of providing it, and reflects the mix of small towns and rural areas in the district. This is because rural properties do not have access to reticulated wastewater or stormwater networks and may not have access to Council water supply.

2.31 The Council also charges district-wide financial contributions for strategic transport links, recreation facilities, and ecological protection. This recognises that the benefit of this expenditure is not confined to particular properties or local catchments.

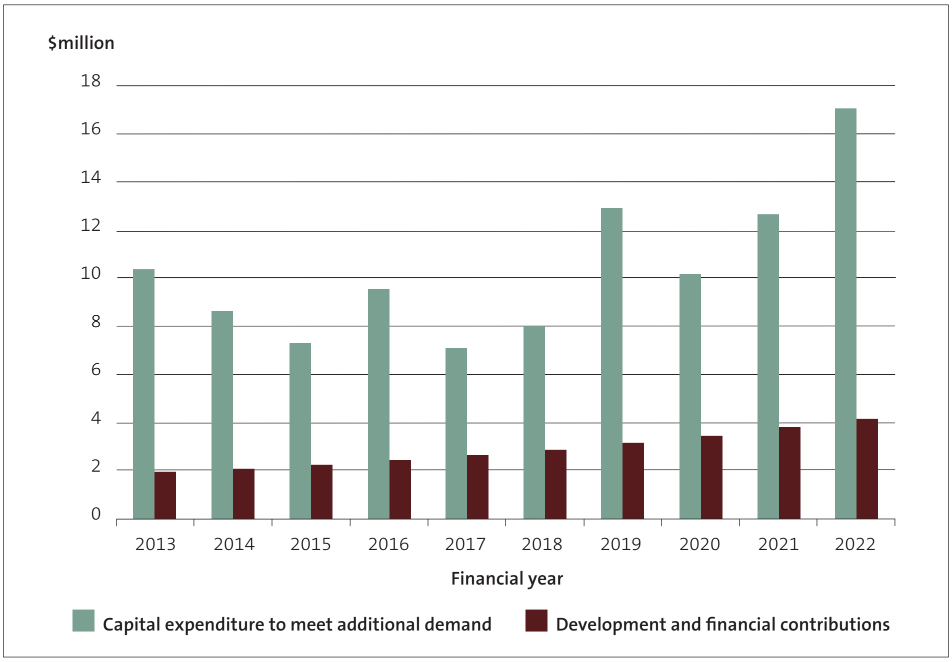
Marlborough District Council

2.32 Marlborough District Council has forecast that it will collect $28.8 million in development and financial contributions, and will spend $103.8 million on capital expenditure to meet additional demand, during the next 10 years (see Figure 8).

2.33 The average development and financial contributions revenue as a percentage of total operating income for the next 10 years is 3%.

2.34 The typical growth charge for each household unit equivalent is $19,942 (infill development) and $24,899 (greenfield development) for a three-bedroom house in a residential urban area. In addition, the Council currently remits 34% of the difference between the amount charged for development contributions and financial contributions reflecting the transition from charging under the financial contribution policy approach to a development contribution policy approach.

Figure 8
Marlborough District Council's forecast capital expenditure to meet additional demand, and development and financial contributions, 2012/13 to 2021/22



How Marlborough District Council approaches funding for growth

2.35 The Council primarily uses development contributions, but also uses financial contributions in particular circumstances (see paragraph 2.37). The Council believes that costs should be borne by those who cause them, and that recovering those costs encourages efficient allocation of resources in the district. If developers are aware of the costs of the community facilities required for new developments in advance, they can take those costs into account when making development decisions.

How Marlborough District Council sets its growth charges

2.36 The Council charges development levies for commercial and industrial purposes, for residential purposes, and to fund reserves. Growth costs are apportioned over time so that members of the growth community pay only for the capacity they use, and so an appropriate proportion of those costs are allocated to future generations.

2.37 The Council charges financial contributions to government departments and Crown entities that are not bound by the Local Government Act for:

- connections and upgrades to sewerage reticulation;
- water supply and stormwater collection and disposal networks;
- roads; and
- reserves.

2.38 In situations where there are multiple developers looking to develop in a particular area, the Council has undertaken the activities that developers normally undertake to achieve more:

- integrated and structured development;
- efficient construction of services; and
- consistent standards of development.

2.39 The Council recovers those costs by also charging zone levies under the Resource Management Act. Zone levies are generally not applied to single-developer subdivisions, as developers usually meet the normal costs of subdivision. The exception is where the demand for a piece of infrastructure is generated solely by the development in question. The cost of this infrastructure is excluded from the calculation of development contributions so the developer is not charged twice for recovering the infrastructure cost.

2.40 The Council intends to charge development contributions instead of financial contributions for most parts of its district, except for its north-west zone (area) and parking contributions. The Council's development contributions policy took effect on 1 July 2009.

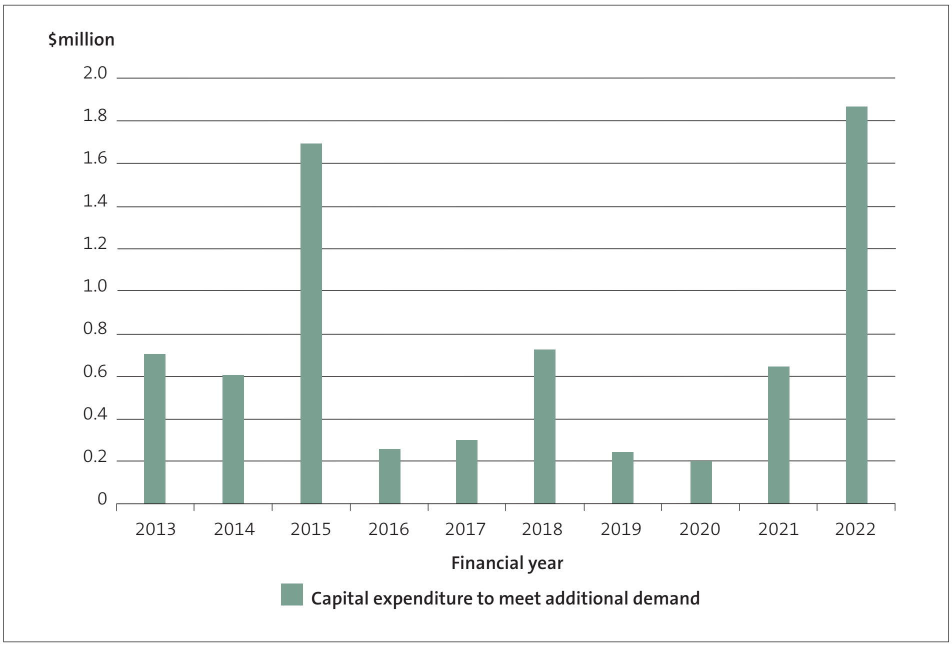
2.41 The Council calculates its charges for each catchment area and each activity, based on the expected scale and timing of the capital works needed to service growth.

2.42 Development contributions are adjusted annually in line with movements in the Producers Price Index.

Timaru District Council

2.43 Timaru District Council has forecast that it will spend $7.2 million on capital expenditure to meet additional demand during the next 10 years. The Council has forecast to collect $200,000 of financial contributions in total for that period. However, because of the scale on the graph, we have not shown the forecast $20,000 revenue each year in Figure 9. Figure 9 reflects the forecast capital expenditure to meet additional demand only.

Figure 9
Timaru District Council's forecast capital expenditure to meet additional demand, 2012/13 to 2021/22



How Timaru District Council approaches funding for growth

2.44 The Council has a financial contributions policy, under which financial contributions would be used to offset or mitigate any adverse effects on the natural and physical environment, including utilities, services, or a new development.

2.45 The Council considered adopting a development contributions policy when it was preparing its draft 2012-22 long-term plan. However, it decided not to proceed with this because of the Government's pending review of development contributions. The Council told us that it will consider adopting a development contributions policy with a view to amending the 2012-22 long-term plan after the Government's review.

How Timaru District Council sets its growth charges

2.46 Under the Council's financial contributions policy, it applies charges for water supply, wastewater, stormwater, and open space and recreation.

2.47 The Council differentiates growth charges based on boundaries, and urban or rural or industrial development.

Part 3
Matters that the five local authorities have raised

3.1 In this Part, we discuss some of the practical matters that the five local authorities have raised with us. We have grouped these matters into:

- forecasting growth and calculating capital expenditure to meet additional demand;
- different approaches in calculating development contribution charges;
- challenges with preparing the financial forecasts in the long-term plan;
- non-residential development charges;
- approaches to funding reserves;
- refunds or return of land if development does not take place;
- financial management; and
- other matters.

3.2 Although those matters warrant consideration, we do not make any specific recommendations about them. Where appropriate, we have included the five local authorities' views to explain and/or illustrate the matter.

Forecasting growth, and calculating capital expenditure to meet additional demand

Ability to forecast growth is important

3.3 Economic and population growth drives the need for new capital expenditure to meet that growth. It is essential for local authorities to have good growth forecasting models because they are the basis for forecasting future revenue (rates, growth charges), finance costs (debt, debt servicing), and capital expenditure required to meet the additional demand and asset renewals. The five local authorities emphasise the importance of asset management plans. An asset management plan is a plan for managing a local authority's infrastructure and other assets to deliver agreed levels of service, and also reflects assumptions on growth.

3.4 In preparing their financial strategies for their 2012-22 long-term plans, local authorities had to state the factors they expected to have a significant effect on them during the 10-year period of the plan. Those statements had to include expected population changes, the use of land in the district or region, and the capital and operating costs of providing for those changes. Those financial strategy requirements mean that local authorities have to consider likely growth in their districts and regions, consider land availability and use, and set out likely costs. Tauranga City Council states in its Development Contributions Policy that:

> *Under the SmartGrowth Strategy, Tauranga City has to accommodate approximately 70% of the anticipated sub-regional household growth plus significant business development, for the next 50 years. This growth will be accommodated through a mix of greenfield (approximately 70%) and intensification (approximately 30%).*[15]

3.5 The five local authorities told us that it is essential that their planning policies align with their funding policies. Tasman District Council assesses the specific growth capacity of each of its settlements and the areas within them. The Council carries out this exercise every two years, ahead of preparing the long-term plan, for residential development, and considers commercial development needs every three years. The Council said that current population forecasts for its district show that the number of people in each household is lower than previously expected, and there is an increase in the number of holiday homes. For each settlement, the Council forecasts the number of expected household units and the infrastructure investment required.

3.6 Marlborough District Council said that, for the Marlborough area, directly projecting dwelling numbers produced plausible estimates. Logarithmic trends were fitted to census dwelling counts for 1991, 1996, 2001, and 2006, and subsequently extrapolated to 2051.[16]

3.7 Marlborough District Council noted that current forecasts indicate that its population will continue to increase and will peak around 2045. However, the forecasts show variability in the future growth profile between settlements and may result in the Council holding back on investing in new infrastructure in some settlements. The Council said that:

> *Accurate growth projections are a fundamental component of any development contributions policy. They help determine the extent of capital works required to service growth as well as the demand over which the resulting costs should be spread. Unfortunately, however, growth projections are often difficult to generate with any reasonable degree of accuracy.*[17]

3.8 Marlborough District Council is also seeing an emerging trend of a reduced number of people in each household.

15 Tauranga City Council, Development Contributions Policy, page 7.

16 Marlborough District Council, *2012-22 long-term plan*, Financial/Development Contributions Policies, page 245.

17 Marlborough District Council, *2012-22 long-term plan*, Financial/Development Contributions Policies, page 245.

3.9 Across the five local authorities, there are differences in the methods used to forecast growth in residential and non-residential[18] developments. For residential developments, several methods are available. All seek to project the number of households (dwellings). One method is to project population to convert to households using average household size. Another is to extrapolate building consent trends. Yet another is to extrapolate the number of dwellings directly.

The calculation of the "total cost of capital expenditure"

3.10 In calculating the maximum development contribution for a community facility or an activity or group of activities for which a separate development contribution is to be required, a local authority must first:

(a) identify the total cost of the capital expenditure that the local authority expects to incur in respect of the community facility, or activity or group of activities, to meet increased demand resulting from growth within the district, or part of the district, as the case may be; and

(b) identify the share of that expenditure attributable to each unit of demand, using the units of demand for the community facility or for separate activities or groups of activities, as the case may be, by which the impact of growth has been assessed.[19]

3.11 We found that the practice differs between local authorities in the calculation of the "total cost of capital expenditure". Some local authorities have included debt-servicing costs within the total cost of capital, because those costs form part of the total cost of providing the infrastructure. Other local authorities have excluded debt-servicing costs from their total cost of capital expenditure calculation.

3.12 Community facilities, and particularly network infrastructure, typically take a long time to plan and build. Often a local authority will not have the funds to pay for this infrastructure up-front and will borrow to initially pay for the asset. This means that a local authority will incur the associated debt-servicing costs (interest). This debt-servicing charge will need to be funded. Because the debt is for growth-related assets, some local authorities fund it through development contributions as part of the capital expenditure costs.

3.13 Some of the five local authorities have in their development contributions policy, an allowance for price changes to recognise higher construction costs where assets are built later. This is because in practice, costs generally escalate,

18 "non-residential" is not defined in the Local Government Act. Tauranga City Council in its development contribution policy has defined non-residential activity to mean any activity that is not defined in its policy as a dwelling unit, household unit, or residential activity. It includes, but is not limited to, a business activity, a low-demand business activity, or a community organisation.

19 Schedule 13 of the Local Government Act 2002.

particularly the price of construction materials. For example, Tasman District Council's policy provides that "the value of the development contribution shall be adjusted on 1 July each calendar year using the annual change in the Construction Cost Index". Marlborough District Council also adjusts its development contributions annually by the Producers Price Index.

There are complexities with managing levels of service and cost

3.14 For cost-effectiveness, local authorities aim to design and build network infrastructure, provide reserves, and provide community infrastructure that can service that area, catchment, or type of development at its maximum occupancy. For example, network infrastructure will most likely be designed to meet peak periods of demand, taking into account an influx of temporary visitors to the area.

3.15 Local authorities also take into account that the facilities need to meet environmental, health, and safety standards. Tasman District Council said that new assets must comply with the Council's engineering standards and be consistent with the service levels reflected in its asset management plans.

3.16 The five local authorities said that there can be inconsistencies between developments in their districts, and this reflects the service levels of their communities. In general, local authorities consider the minimum legislative compliance standards that they need to meet – for example, New Zealand Drinking Water Standards (NZDWS). However, service levels may differ between areas in the district. Using the NZDWS as an illustration, the service standards can legally be lower in an area that services a smaller population than in an area that services a larger population. At the same time, a local authority needs to take community views into account. A new community may want higher standards of service than existing communities in the district. This can mean that, to provide the desired higher service levels, infrastructure required to service the new community may cost more than is required to meet current legislative standards.

3.17 It is also important to recognise that local authorities receive assets from developers in the form of "vested assets".[20]

3.18 Although local authorities effectively receive these assets at no cost, they become responsible for the future operating costs.

3.19 Overall, local authorities have to balance a number of matters when it comes to designing and building their growth-related assets, these affect the calculation of growth charges. As illustrated, local authorities have to consider how, when, where, and what assets should be built, as well as managing expectations about

20 Vested assets are assets that are transferred to a local authority at nominal or zero cost. Typically, they might result from a situation where a developer has installed assets when developing a site and, after completion, the developer passes them to the local authority. The fair value of these assets has to be determined and is then recognised as revenue in the year of transfer. The assets are then integrated into the local authority's asset information system so that they can be appropriately managed.

the levels of service to be provided, how the assets will be funded, and future maintenance of the assets.

Apportioning the capital costs relating to growth is not straightforward

3.20 A development contribution must be used for, or towards, the capital expenditure of the reserve, network infrastructure, or community infrastructure for which the contribution was required, but must not be used for the maintenance of the reserve, network infrastructure, or community infrastructure.

3.21 The five local authorities look at each project to consider what portion is growth-related and calculate the growth charges based on that percentage. However, even this approach has its challenges.

3.22 Some of the five local authorities said that, in reality, no growth-related project is 100% attributable to growth. This is because some element of the expenditure will improve existing levels of service. For example, growth may trigger an increase in the size and standard of an existing piece of road. Because growth does not occur all at once, the new capacity on the road is a service-level improvement for existing users. However, one local authority commented that the service-level improvement is only temporary and is not required by the existing users, who should therefore not contribute towards funding the cost for the improved service level.

3.23 Other local authorities have a different view. For example, Tauranga City Council has many projects in its development contributions policy that are 100% attributable to growth. Likewise, Western Bay of Plenty District Council has many projects that are 100% attributable to growth, particularly greenfield developments.

3.24 In many instances, installing new growth-related infrastructure can also bring forward repairs and maintenance. For example, a local authority might carry out renewal work on road assets while installing new wastewater pipes to meet growth. This type of opportunity for efficiency can cause an acceleration of maintenance or renewal work. But it can also cause difficulties in the allocation of costs and create short-term cost pressure from a financial management perspective.

Different approaches in calculating development contribution charges

3.25 Local authorities that wish to charge development contributions must have a development contributions policy. The policy must contain a schedule of the development contributions payable in the district or parts of it. It must also explain and justify the way each development contribution is calculated and the significant assumptions underlying the calculations.

3.26 Clause 2 of Schedule 13 of the Local Government Act states:

> *For the purpose of determining in accordance with section 203(2) the maximum development contribution that may be required for a particular development or type of development, a territorial authority must demonstrate in its methodology that it has attributed units of demand to particular developments or types of development on a consistent and equitable basis.*

3.27 The five local authorities have taken different approaches in terms of whether the development contribution or financial contribution is to fund growth-related assets on a catchment or defined area of growth basis and/or a district-wide basis. The five local authorities have said that the approach they have individually adopted best reflects their district planning and financing strategies, and the geography and catchments of their district.

3.28 Marlborough District Council calculates its charges based on each catchment area and each activity on the expected scale and timing of capital works required to service growth.

3.29 Tasman District Council applies development contributions on a district-wide basis for transportation, water supply, wastewater, and stormwater. Growth charges are charged only to those service connection areas that benefit from the service. The Council's rationale is that this is more appropriate for a geographically large and relatively dispersed population. This approach means that there is a subsidy for the smaller development areas.

3.30 Tauranga City Council charges a city-wide development contribution for assets that service growth across the whole city. The Council also charges a local development contribution for assets that service growth in particular catchments.

3.31 Western Bay of Plenty District Council charges financial contributions based on catchments for network capital expenditure with district-wide charges for transportation, recreation, and ecological protection.

Challenges with preparing the financial forecasts in the long-term plan

Projections and growth beyond the 10-year long-term plan time frame

3.32 A local authority's long-term plan is required to cover a period of at least 10-years. There is currently a mix of approaches to including or not including growth-related projects beyond the 10-year time frame in long-term plans. Some local authorities have included only growth-related projects that fit within the 10-year time frame in their long-term plans, and the development contribution charges are calculated based on only those projects.

3.33 Other local authorities have included growth-related projects that are within the 10-year time frame as well as projects beyond the 10 years into their development contributions calculations. This is because network infrastructure can take many years to plan and build. For example, development of individual catchments (that is, new suburbs) will generally take more than 10 years from when development commences to when it is substantially completed. The local authority and its community would benefit from knowing in advance the assets planned to cater for growth and for the district, and also how they are going to be funded and financed.

Non-residential development charges

Growth charges on non-residential development

3.34 The development contributions regime enables local authorities to recover the growth-related costs of network infrastructure, reserves, and community facilities as a result of growth.

3.35 There is debate in the local government sector about whether local authorities should charge for growth-related costs arising from non-residential development, specifically in relation to reserves and community infrastructure. One view is that, if additional jobs are created from non-residential development, then the growth-related costs of reserves and community facilities/infrastructure can be recovered from development charges for new residential development. Another view is that non-residential development creates a need for new infrastructure and therefore should share in funding the costs of those assets.

3.36 Marlborough District Council's development contributions policy on non-residential activities states:

Non-residential subdivisions will attract development contributions on each additional allotment created. If the intended land use is known at the time of subdivision, development contributions will be based on (i) each lot's planning gross floor area and (ii) the intended land use.[21]

3.37 The Council includes a table that shows the factors used to convert non-residential demands to HEUs. The Council states that "unless a separate assessment shows demand is created for the activities of reserves or community infrastructure, development contributions for non-residential activities are not charged for these activities". This means that the Council charges non-residential subdivisions for growth-related costs on network infrastructure, including roading, water supply, wastewater, and stormwater.

3.38 Tasman District Council states in its development contribution policy:

Where there is a subdivision for a non-residential land use or non-residential building development, an assessment will be carried out to determine an appropriate unit of demand. This will be based on a comparison between the demand for network infrastructure generated by the non-residential development and the assumptions made in calculating the household unit of demand or such other criteria as may be relevant.

3.39 Similar to Marlborough District Council, Tasman District Council may charge non-residential developers to fund growth-related costs on network infrastructure where the services are available. Tasman District Council also charges financial contributions to fund reserves or community infrastructure where the building cost is greater than $50,000. Western Bay of Plenty District Council does not charge financial contributions for recreation on commercial and industrial development.

Approaches to funding reserves

The approach to funding reserves is different from the approach to funding network and community infrastructure

3.40 The development contributions for reserves must not exceed the greater of:

- 7.5% of the value of the additional allotments created by a subdivision; and
- the value equivalent of 20 square metres of land for each additional household unit created by the development.[22]

3.41 The development contributions for network and community infrastructure must not exceed the amounts calculated using the methodology set out in Schedule

21 Marlborough District Council, 2012-22 Long-term Plan, Financial/Development Contributions Policies, pages 250-251.

22 Section 203(1) of the Local Government Act 2002.

13 of the Local Government Act. Typically, the development of city-wide reserves – for example, sports fields and open spaces – is a strategic planning issue with defined service standards. Applying the rules on funding for reserves based on a percentage calculation means that a local authority might not receive the same amount of funding through development contributions to cover the capital cost of such reserves. On the other hand, an increase in land value may result in more development contributions for reserves being receivable when calculated on a percentage basis.

Refunds or return of land if development does not take place

3.42 We found that high-growth local authorities might have significant accumulated contributions previously collected to be applied towards future growth-related assets in their balance sheets. This is because, with the economic downturn, the pace of development has slowed compared to forecasts and those changes have a significant effect on when (and where) development should take place. The growth-related projects will typically have a 'trigger point' before it is economically viable for the project to commence. This means that, in many instances, the development of the growth-related assets is deferred and some may not even take place.

3.43 Contributions of money or land for reserves must be used within 10 years after the local authority receives that contribution. This applies only to development contributions, not to financial contributions. If the contributions are not used for the specified reserve purpose as intended, then the local authority must refund the money or return the land acquired for the reserve purpose to the person who paid the development contribution or contributed the land. Some of the five local authorities have said that the process is not as simple as it may seem. This is because it can be difficult to identify the person who paid the development contribution if the subdivided reserve land has changed ownership several times. This dilemma also applies with having to refund amounts paid towards network or community infrastructure for which a development contribution was required but the infrastructure development does not proceed as expected.

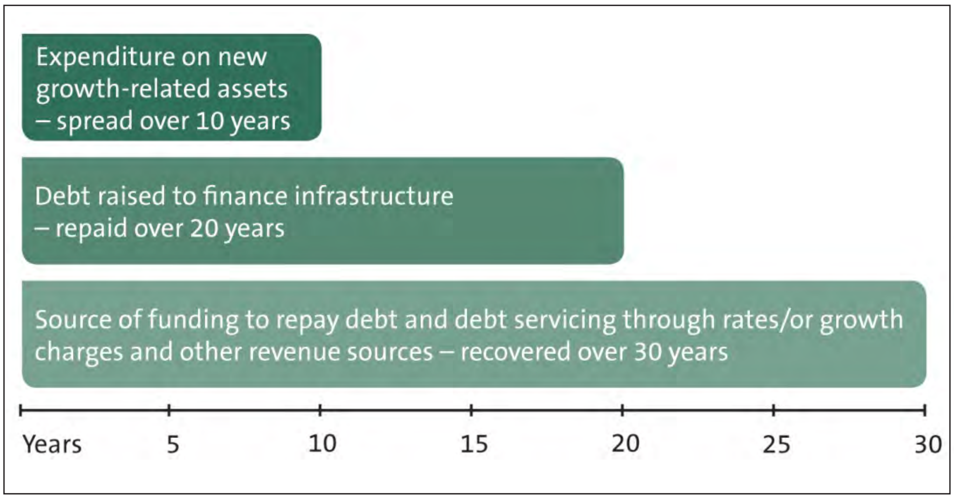
Financial management

Local authorities need to carefully manage their finances

3.44 One of the drivers of new assets is not necessarily timing, but what is affordable and can be funded.

3.45 Some of the five local authorities said that they apply a 10:20:30 financial management guideline, although this ratio varies between local authorities. This means, as shown in Figure 10, that local authorities typically incur capital expenditure over 10 years for any given project. A local authority will typically borrow and repay the debt over 20 years. Then, the local authority typically takes 30 years to recover the total capital expenditure costs from development contributions (or other revenue sources).

Figure 10
Growth-related expenditure, debt financing, and funding



3.46 Other local authorities have a different approach. For example, Tauranga City Council tries to align debt repayments with the time it takes to recover the total costs of capital expenditure. This is because the Council uses development contributions to recover the capital expenditure cost, debt repayment, and debt servicing costs.

3.47 Tauranga City Council said that it can be a challenge trying to balance its books for some developments. For example, the Council's Southern pipeline asset is built to cater for growth for the next 50 years. However, the Council anticipates that it will take 50 years to recover the cost of the asset, including any debt-servicing costs. The Council would borrow to pay for the asset initially. This means that the cost of capital (debt-servicing costs) for projects such as this one could exceed the actual infrastructure construction costs. This reflects the need for lead infrastructure investments and a long debt-repayment period funded through development contributions.

3.48 In addition, Tauranga City Council is always looking at how to manage its balance sheet risk including managing its debt levels. One of the Council's strategies is to take an incremental and just-in-time approach to development (for example, by proceeding with infrastructural development for the Wairakei catchment where the infrastructure costs between $3 million and $5 million and could service 1000 properties, rather than committing to the development for that whole community area all at once).

3.49 For many local authorities, including the five local authorities, growth charges such as development and financial contributions are useful funding tools for recovering the cost of growth-related assets. Although local authorities have other revenue sources, some local authorities regard them as less suitable for capital cost recovery of demand-driven expenditure. For example, targeted rates could be used, but the rate of recovery is slower than using a growth charge. If debt is used to initially finance the asset, then repayment of the debt from targeted rates would take longer and debt-servicing costs would be higher.

3.50 Using debt to finance infrastructure is not new in the local government sector. The spreading of debt repayment and debt servicing over time reflects local authorities' view of intergenerational equity. Western Bay of Plenty District Council said that it:

> *… uses loan funding to spread the cost of infrastructure between current and future ratepayers. By borrowing to pay for assets with a long life, for example 25-50 years, we can recover the cost from ratepayers over the life of the asset. In this way the cost is allocated fairly between current and future ratepayers.*[23]

Misalignment between development and/or financial contributions being due and cash flows

3.51 The five local authorities have noted payment of development contributions could be better aligned with developer cash flows (sale of land and house packages).

3.52 Typically, for subdivision consent, an applicant is notified of the requirement to pay a development contribution at the time the consent is granted. However, the development contribution is not payable until the subdivision (or stage thereof) is completed – marked by issue of the section 224(c) certificate (the subdivision completion certificate) under the Resource Management Act. At this stage, a

23 Western Bay of Plenty District Council, 2012-22 Long-term Plan, chapter 2, page 34.

developer is likely to have titled sections that can be sold. The developer would usually have made a number of pre-sales in order to obtain debt finance.

3.53 The above also holds true for building consents. An applicant is notified when a building consent is granted. Typically, however, payment is not required until the code compliance certificate is granted under the Building Act 2004 (that is, when the building is completed). Tauranga City Council is an exception, as it charges when the building consent is granted.

3.54 Sanctions for non-payment of development contributions include withholding a Resource Management Act completion certificate or Building Act code compliance certificate until payment is made. However, a local authority told us that a building consent applicant is not necessarily concerned with getting the relevant certificate until they want to sell the building. This means that applicants can delay paying the development contribution.

3.55 With service connections, a local authority may withhold the physical service connection to a local authority utility service until the development contribution is paid.

3.56 A local authority is able to register the development contribution as a charge owing under the Statutory Land Charges Registration Act 1928. However, some local authorities have said that this is ineffective because there are no sanctions for non-payment at the due time. Marlborough District Council, in its development contributions policy, allows developers to apply for a postponement of development contribution payments. This is provided that the GST component is paid immediately and the remaining amount outstanding is registered as a charge under the Statutory Land Charges Registration Act against the title at the developer's cost. Postponement has a maximum time limit of five years or the period until the property changes ownership.

3.57 Local authorities take care to balance their books – between consideration of developer cash-flows and also their own finances. Delays in obtaining development contribution income could result in a local authority carrying higher debt and debt-servicing costs. The local authority would then need to consider how to fund the additional debt-servicing costs.

Other matters

Transition period when there are changes to the growth funding approach

3.58 Three of the five local authorities have adopted a development contributions policy, but the other two local authorities continue to apply their financial contributions policy and do not use development contributions.

3.59 One issue for all five local authorities is the need to phase in charges over time, particularly if there are significant changes to the funding approach. For example, where a local authority moves from using a financial contributions approach to a development contributions approach to fund growth-related assets, a transition period would be desirable to provide certainty for all concerned. Such a change might also affect the administrative effort of local authorities who have to work with developers in applying different policies under both the previous and new approaches. The phasing in of changes over a transition period allows developers time to adjust with paying growth charges under one regime to another. A local authority may include a remission or discounting arrangement in its policies to assist with the change.

3.60 Timaru District Council considered adopting a development contributions policy during the preparation of its 2012-22 long-term plan but decided not to. Although the Council has not yet changed its funding approach, the Council did think that, in managing a transition, it would be preferable to have a clean cut-off and apply the new approach on only new projects, and projects that have been undertaken in the last five years that still have debt owing. This would separate, for example, the debt that might have been incurred for projects under the previous approach. This is because there is great complexity involved in calculating cumulative collections.

3.61 Western Bay of Plenty District Council continues to apply its financial contributions policy for the effects of new or intensified development. The Council said that it has a mature approach and works closely with developers to provide them with certainty over funding charges. The Council said that it receives periodic rushes of applications ahead of the release of new plan changes. Because financial contributions are payable when the Council adopts the plan change after public consultation rather than when the plan change is notified, this allows developers and the market to assimilate the new or revised charges.

3.62 When Marlborough District Council adopted a development contributions policy to fund growth-related assets, the Council also introduced a remissions policy to smooth the transition from the previous financial contributions funding approach.

Office of the Auditor-General
PO Box 3928, Wellington 6140

Telephone: (04) 917 1500
Facsimile: (04) 917 1549

Email: reports@oag.govt.nz
www.oag.govt.nz