PUT A LID ON IT?

A look at New Zealand's proposed local council rate cap.

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CONTENTS AND AUTHOR

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PROPOSED NEW ZEALAND LOCAL COUNCIL RATES CAP

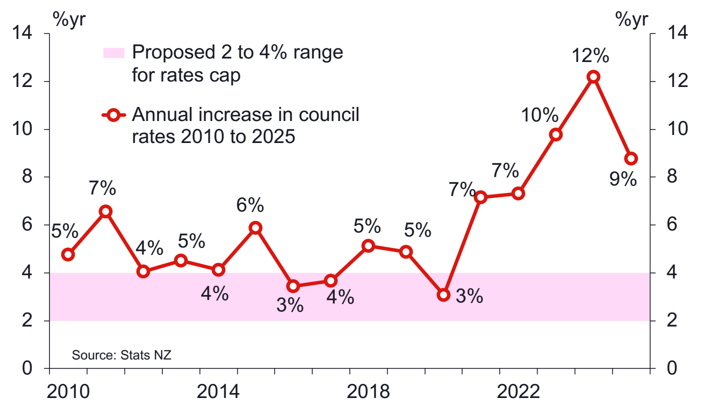
Key takeouts.

- The New Zealand Government has announced plans to limit the extent of local council rates increases to 2% to 4% per capita, per year. The proposed policy would have a long lead time, with a transition period beginning in 2027 and the policy taking full effect in 2029. That aims to give councils time to adjust their financial plans.
- There is still a great deal of uncertainty about the final form of this legislation. The Government is aiming to pass the proposed legislation next year, and we may see changes in response to feedback from councils and other parties.
- This proposal follows large increases in council rates in recent years, with the average rates bill rising by 88% over the past decade. Over the same period, average hourly earnings have risen by around 50%. That's seen mounting concern about the resulting financial pressures on households and housing affordability, especially for those on fixed or lower incomes.
- Much of the increase in local council rates has been related to funding for infrastructure and council services. Combined with increases in other operating costs, this has seen growing pressure on councils' financial positions, with debt levels effectively doubling since 2017.
- The introduction of rates caps would still leave councils with the challenge of how to fund planned infrastructure investment and operational spending. Consequently, there could be related trade offs with regards to the provision of infrastructure or services. There could also be changes in how councils fund their activities, including a shift to more user pays charges.
- We think the proposed caps would limit some of the cost increases that households have been grappling with in recent years. However, some of those potential savings for households could be offset if councils shift to 'user-pays' systems to fund some activities.

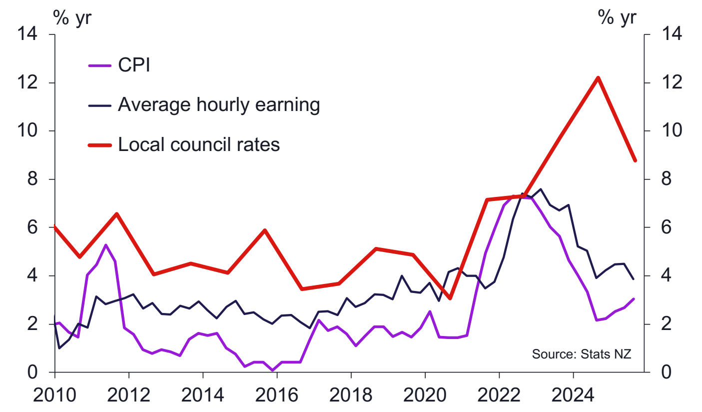
WHAT HAS BEEN PROPOSED?

- On 1 December the Government agreed to progress legislation to limit annual increases in local council rates to a range of 2% to 4% per capita. Total council rates revenue can grow by more than this, to the extent that population growth drives an increase in the number of ratepayers.
- The proposed cap would apply to all sources of rates revenue – general rates, targeted rates and uniform annual charges. It would exclude water charges and other non-rates revenue like fees and charges.
- The policy aims to ensure the cost of council rates remains affordable for households, while still allowing for revenue growth necessary for the provision of public services.
- The proposal allows some limited scope for councils to increase rates beyond the upper end of the proposed range, for instance in extreme circumstances like natural disasters or catching up on past underinvestment in infrastructure. Such exemptions would require permission from a regulator appointed by central government, and councils would need to show how they will return rates increases to the target range.
- The Government aims to have the required legislation enacted in 2026 and for it to be law from 1 January 2027. A transition period will begin on 1 January 2027, during which councils will be required to consider the impact of rates caps on their long-term plans. The policy is intended to have full effect by 2029.

Annual increases in local council rates



Local council rates, wages and CPI



HOW DOES THE PROPOSED CAP COMPARE TO HISTORY?

- The Government's proposed cap would limit annual rates increases to a range of 2 to 4%.
- Prior to 2020, the average annual increase in rates was around 4%. However, since 2020 local council rates have been rising by around 8% a year.
- That pattern of larger rates increases since 2020 has been seen across the country, with particularly large increases in Wellington (some of which is related to 'catch up' spending on waste water infrastructure).
- Auckland has recorded more modest rates increases than other main centres in recent years. However, in contrast to most other parts of the country, Auckland has separate charges for water services.

Average council rate increases (% yr)

	2015-2019	2020-2025	Average: 2015-2025
Auckland	4.2	5.9	5.1
Hamilton	6.2	8.9	7.7
Tauranga	5.7	9.4	7.7
Wellington	4.0	11.3	8.0
Christchurch	5.8	5.4	5.6
Dunedin	4.2	9.2	6.9
Nationwide	4.5	8.0	6.4

Source: Westpac estimates based on data from Stats NZ and other publicly available data. Information from council reports was used where available. However, media reports used where data could not be sourced from official sites. As a result the estimated averages may differ slightly from official data.

HOW DOES THE PROPOSED CAP COMPARE TO SPENDING PLANS?

- For some of our larger councils, the proposed rates cap would be lower than the rates increases assumed in their long term plans, especially in the near term.
- In later years, councils generally anticipate smaller rate rises (though in some cases, like Hamilton, Tauranga and Dunedin, the assumed increases are projected to exceed the top of the proposed rates cap for some time).
- However, part of the reason some councils have assumed smaller rates increases in later years is because those increases build on top of larger assumed rises in the near term. If councils were unable to raise rates to the extent they anticipated in the near term, they could face greater longer term funding pressures.
- Importantly, even though councils are generally assuming that rate rises will slow over time, recent years have actually seen rates increase by more than had been assumed in some councils' longer term plans.

Average planned rates increase

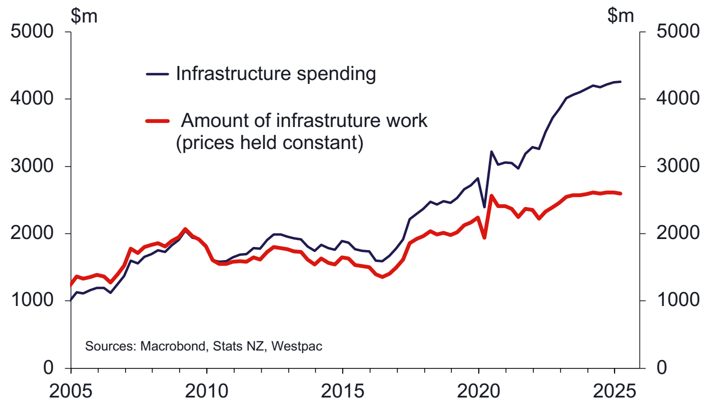
	2026-2027	2028-2030
Auckland	6.9	3.5
Hamilton	14.1	10.2
Tauranga	10.4	9.3
Christchurch	4.7	4.1
Dunedin	10.8	8.3

Source: Local council long term plans.

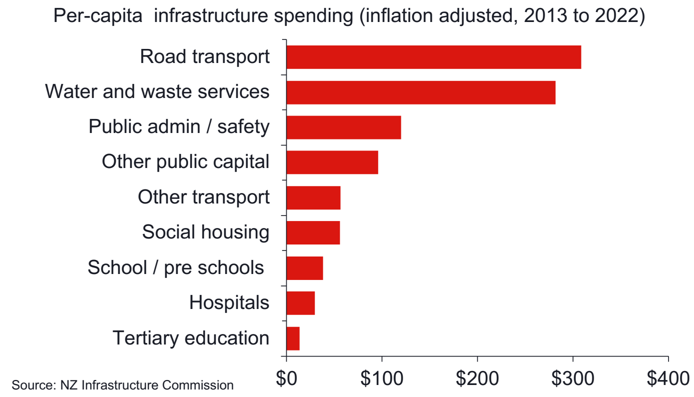
RISING DEMANDS FOR COUNCIL SPENDING

- The large increases in local council rates in recent years in large part reflect growing demand for local government services and infrastructure. Councils have also been spending more to address underinvestment in previous years.
- Infrastructure spending by both central and local government has increased rapidly in recent years. And with a growing population and demands of a growing economy, continued investment will be needed. There is a significant pipeline of work planned by local councils, including large amounts of work related to transportation (both local roads and public transport) and water networks.
- In addition to new spending, a significant amount of spending is required just to keep up with depreciation, and in some cases renewal spending has fallen behind depreciation rates.
- Reinforcing the challenges faced by local councils when providing infrastructure have been significant cost increases. Since 2010, building costs in the infrastructure sector have risen by around 60%, with most of that increase occurring since 2020. Those pressures have been compounded by increases in other operating costs.

Spending on infrastructure (quarterly)



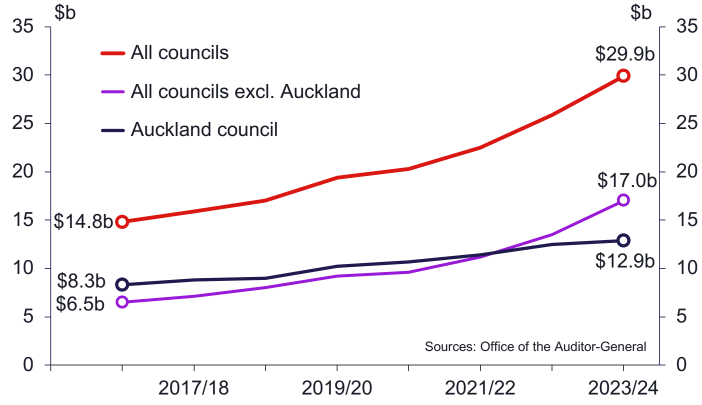
What sectors are local councils investing in?



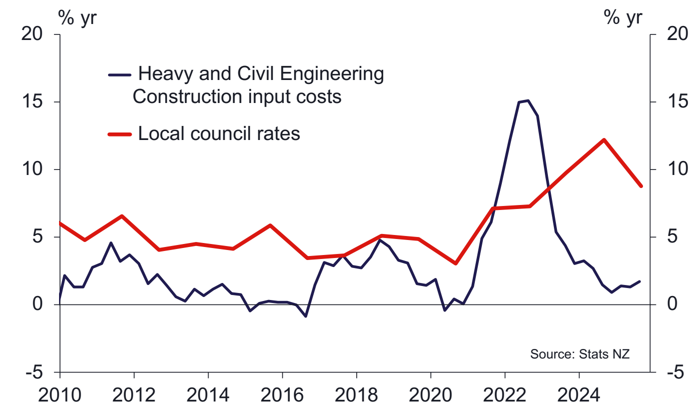
COUNCIL FINANCES ALREADY UNDER PRESSURE

- If rate rises are capped, that doesn't solve councils' existing funding challenges, especially for those councils whose long term plans assumed that rates would increase by more than the proposed cap would allow.
- In some cases, a cap on rates increases could signal a challenge to councils' projections for debt-to-revenue ratios as assumed in their long-term plans. This could be significant for those councils where debt-to-revenue is already projected to approach the 280% limit set by the LGFA.
- A rates cap could also create challenges for some councils in relation to their net interest/annual rates income covenants (which limits how much of annual rates income councils can spend on interest costs).
- Increases in infrastructure spending as well as other expenses have meant that some councils have seen expenditure rising faster than revenue, with related pressure on their financial positions. Total council debt has effectively doubled since 2017, including a 15% increase in the 2023/24 year. That increase in local council debt levels has also seen interest costs rising as a share of total expenditure.

Total council debt



Local council rates and infrastructure construction costs



RATINGS AGENCY IMPLICATIONS

- A rates cap could also have implications for councils' credit ratings. S&P Global have noted "A cap on annual increases in property rates could strain the finances of New Zealand's debt-laden local councils. Unless the cap is matched over time with cuts to spending growth, we believe this will be credit negative for the sector."
- S&P Global noted that it will update its credit views on each council as plans become clearer and that "As councils prepare their next round of budgets, the impact on credit ratings will hinge on the extent to which they can tighten their belts in a revenue-constrained environment."

Local council credit ratings

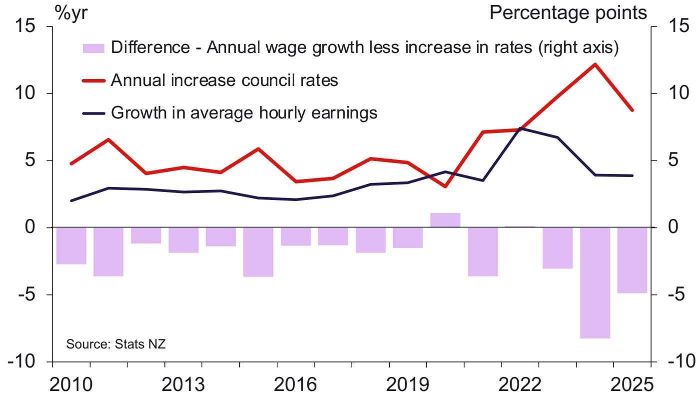
	Long term rating	Short term rating	Outlook
Auckland	AA	A-1+	Stable
Hamilton	A	A-1	Stable
Tauranga	A+	A-1	Negative
Wellington	AA-	A-1+	Negative
Christchurch	AA-	A-1+	Stable
Dunedin	AA-	A-1+	Negative

Source: S&P Global

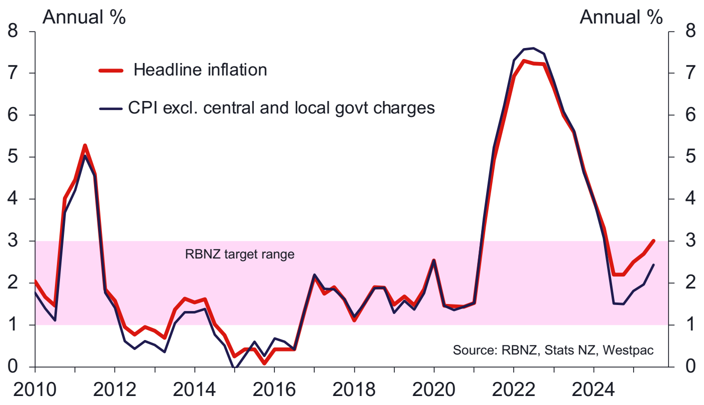
IMPLICATIONS FOR INFLATION

- Over the past decade, local council rates have risen much faster than average wage rates. Since 2015, the average rate bill has risen by 88%. Over the same period, average hourly earnings have risen by around 50%.
- Those large increases in rates have seen mounting concerns about the related financial pressure on households, especially for those on fixed or lower incomes. This has also raised concerns about housing affordability.
- Local council rates rises have also outpaced overall inflation by a sizeable margin. Since 2010, rates have risen by an average of 5.6% per annum. The Consumers Price Index has risen by an average of 2.5% over the same period.
- Recent years have also seen significant increases in construction costs and other operating expenses, with especially large increases in the wake of the pandemic. The potential for another period of significant cost inflation is a key risk for councils' spending plans, especially if their ability to raise rates or other revenues is restricted.
- If implemented, the proposed rates cap would reduce annual inflation by around 0.1 to 0.2ppts per annum depending on the level of the cap.
- However, while the proposed cap might limit the increase in local council rates, some of that reduction is likely to be offset by increases in other household costs (for instance, increases in user pays charges). As a result any reduction in overall inflation is likely to be at the more modest end of estimates.

Increases in wage rates compared to growth in council rates



CPI excluding central and local government charges



NO EASY SOLUTIONS

- Even without a rates cap, councils are facing challenging trade-offs with regards to the provision of infrastructure and services, and how to fund that spending. That may involve looking at alternative funding options or reductions/delays in planned spending.
- For long-lasting assets, **borrowing** may be a possibility. This can help enhance a region's economic capacity and spread the cost of projects across generations, matching the funding of projects with those who receive the benefits. However, there are limits to how much debt councils can carry, and higher debt levels would raise the risks associated with unfavourable interest rate changes. This could also be viewed unfavourably by credit ratings agencies given that many councils already have high debt levels relative to global peers.
- **Targeted funding measures** could be a solution in some cases. This is more suitable where specific groups benefit from an asset or a service (such as infrastructure development contributions related to new residential developments).
- Analogously, there could be greater prevalence of **user pays charges** for services like rubbish collection, sporting facilities and libraries. Such solutions would add to the costs faced by some households, but can also be used to encourage changes in behaviour (for instance water usage charges can help to encourage conservation, while higher rubbish charges might encourage recycling).
- In some cases, **private-public partnerships** could be an option for the construction and operation of infrastructure assets. However, care is needed in the design of such agreements to ensure appropriate risk and cost management.
- Another option for councils is the development of **Special Purpose Vehicles** as part of **the Infrastructure Funding and Financing Act 2020**. This allows councils to establish a stand-alone entity related to specific projects that would be able to raise finance for infrastructure projects and collect a multi-year levy to repay that finance. That levy would be paid by those who are expected to benefit from the infrastructure project for a period of up to 50 years. This funding tool provides council with the ability to ring-fence infrastructure projects from their balance sheet, with the exact details of each project needed to be approved by the Government.
- Related to potential rates caps, councils may consider tools such as the **Ratepayer Assistance Scheme** to help ensure the cost of rates remains manageable for ratepayers.
- Lastly, councils may need to consider reduced services. This is never a preferred option for councils, but may be a necessity if cost and funding pressures become too pronounced. It is likely to be easier to reduce spending on the provision of services than to reduce spending on infrastructure. However, services generally make up a much smaller share of council spending than infrastructure costs.

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