

RATES!

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1. Executive Summary

The aim of my project, “Rates!”, is to review the basis from which rates demands are calculated. The question to be asked: is a property value base in fact the most equitable basis for assessing rates? Many agricultural regions of New Zealand are under pressure from changes to alternative land use. This is therefore reflected in the Capital Value of that land, as Capital Value is based on current market value. As rates are a “fee for service” provided by the councils, the question remains if Capital Valuation reflecting a proposed land use change, is an equitable base to be used for establishing rates, when the demand for service from the existing use has not changed?

My objectives are to understand the terms of the rating act and the powers that currently exist within the local bodies to apply a differential rating system. I also will look at how this issue has been addressed in America by use of differential rating formulas, including Agricultural assessments.

My main findings are that the rating act allows for up to 30% of the rates take to come from uniform charges and other non property value based formulas. There is power within the local bodies to apply a differential rating system. There have been many examples of this throughout New Zealand, both historically and currently. In America the use of Agricultural assessments has helped to keep agricultural land in production, with rates reflecting the actual demand for services.

My recommendations are that this issue is reviewed in a “big picture context” by the pertinent local authorities. I therefore hope to create discussion and debate on the subject of the basis of how rates are funded.

2. Introduction

Rates are collected by District Councils and Regional Councils. These are a “fee for service” collected to fund the “activities” of the Councils. Most rating formulas used today are based on the Capital Value of a property or on a combination of the Land Value and Capital Value of a property. The question I am posing is whether this method of determining rating formulas is in fact the most equitable?

Historically, the Capital Value of agricultural land has been linked to its production capabilities. Recently, there has been an increase in the Capital Value of some land as a result of market forces other than production capability. This is especially noticeable with high country stations, land near towns, and coastal properties. Market forces set land values based on purchasers being willing to pay for scenic beauty, proximity to town, and potential changes of use (even within agriculture). Is it then fair to base the rating formula on an inflated capital value, since rates are actually a fee collected for funding current activities and services provided by the council?

What could be some alternative ways of funding the Council’s mandate to provide services? What is currently allowed within the Local Government Act and the Rating Act? Is it possible to have differential rating formulas? Ratios between Capital Value and Uniform Charges used by two Councils will be explored. Also, with roading fees being the primary component of rural rates, are road user charges or fuel surcharges in fact a more equitable way of distributing the roading costs among the road users? Should some of the services currently funded by rates actually have a radically different funding base? For example, based on an economic activity such as G.S.T.? How is the issue of collecting rates from some agricultural land, (without a high demand for services) achieved in the US?

There has always been debate about rating formulas, but a series of recent changes in law and changing economic forces may be having some unintended consequences.

3. The Local Government Act - 2002

The Local Government Act of 2002 states the purpose and powers of the Regional Council and Territorial Local Authorities. The Act also promotes the accountability of the Local Authorities to their communities. (Part 1, section 3) Under the section on status and powers, the Local Authorities have the power to carry on or undertake any **activity**, for the benefit of its area. (Part 2, section 12, subsection 2, 4, and 5.)

“An **activity** means a good or service provided by, or on behalf of, a local authority or a council - controlled organization; and includes –

- a) the provision of facilities and amenities; and
- b) the making of grants; and
- c) the performance of regulatory and other governmental functions”

(Part 1, section 5, subsection 1)

4. The Local Government Rating Act – 2002

The Local Government Rating Act – 2002 states that the purpose of the act is-

- a) “to provide local authorities with flexible powers to set, assess, and collect rates to fund local government **activities**. (emphasis added)
- b) ensuring that rates are set in accordance with decisions that are made in a transparent and consultative manner:
- c) Providing for processes and information to enable ratepayers to identify and understand their liability for rates.”

(Part 1, subpart 1, section 3)

5. Kinds of Rates

General Rates

“A general rate may be set –

- a) at a uniform rate in the dollar of rateable value for all rateable land; or
- b) at different rates in the dollar of rateable value for different categories of rateable land under section 14.

For the purposes of this section, the **rateable value** of the land-

- a) must be-
 - i. the annual value of the land; or
 - ii. the capital value of the land; or
 - iii. the land value of the land; and
- b) must be identified in the local authority’s annual plan as the value for setting a general rate.”

(Part 1, subpart 2, section 13)

A general rate is collected and spread across the general activities that the council undertakes. It is used where there is not an obvious user pays relationship or where it is hard to determine obvious benefit. This can be collected evenly or differentially.

“Categories of rateable land for setting general rate differentially: For the purpose of section 13 general rate b (above), categories of rateable land are categories that-

- a) are identified in the local authority’s annual plan as categories for setting the general rate differentially; and
- b) are defined in terms of 1 or more of the matters listed in Schedule 2. (see below)

(Part 1, subpart 2, section 14)

Schedule 2

“Matters that may be used to define categories of rateable land

- 1) The use to which the land is put.”

(Schedule 2, clause 1)

Uniform Charge

“Uniform annual general charge. A local authority may set a uniform annual general charge for all rateable land within its district, being-

- a) a fixed amount per rating unit; or
- b) a fixed amount per separately used or inhabited part of a rating unit.

A uniform annual general charge is a rate for the purposes of this Act.

(Part 1, subpart 2, section 15)

Uniform charges are collected evenly on each rating unit and can only be collected that way. This is used for funding activities where the benefit is not clearly related to land value.

Targeted Rates

There also are targeted rates for specific services such as water supply or sewerage. These are quite clearly user pays, where those receiving the benefit pay for the service.

Restrictions

“Certain rates must not exceed 30% of total rates revenue. The rates revenue sought by a local authority in any year from the rates described in subsection 2 (above) must not exceed 30% of the total revenue from all rates sought by the local authority for that year.

The rates are-

- a) uniform annual general charges that are set in accordance with section 15 (above); and
- b) targeted rates that are set on a uniform basis...

Subsection 2 does not apply to targeted rates that are set solely for water supply or sewage disposal.”

(Part 1, subpart 2, section 21)

6. Rating Valuations Act – 1998

It is interesting to note that the many “special provisions relating to determination of rateable values” (Part 3) present in the 1998 Rating Valuations Act were repealed in the Local Government Rating Act of 2002. (Schedule 4 – Amendments to Rating Valuations Act 1998) Sections repealed include “Rates-postponment values of farm land” and several sections on special rateable values.

7. Capital Value/Uniform Charges Rating Ratios used by Masterton District Council

The Masterton District Council, our local council, exercises their ability to assess a uniform charge. In the 2004-2005 Masterton District Council Annual Plan it states that the “overall percent of uniform charges to total rates is 27.9%”, nearly the full 30% allowed under the Local Government Act. Masterton District Council uses a combination of Land Value and Capital Value to make up its rating formula. There is also a different rating formula used between Urban and Rural areas. (p.70 MDC Draft Annual Plan 04-05).

8. Capital Value/Uniform Charges Rating Ratios used by the Wellington Regional Council

By comparison our regional council, the Wellington Regional Council, does not make use of uniform charges. Although the Wellington Regional Council is subject to the same guidelines within the Local Government Rating Act of 2002, their non-target rates are still based on 100% Capital Value assessment, with no uniform charge component. This is particularly interesting given that the Wellington Regional Council in March 2004 adopted the “Wairarapa Coastal Strategy”. The vision of this strategy is “To provide for sensitive, sustainable development and management of the Wairarapa Coast which recognises and retains its special qualities.” (Wairarapa Coastal Strategy March 2004) By the very

nature of this vision, the Capital Value of coastal land should increase. The demand for services however will not necessarily increase with an increase in Capital Value. The Coastal Strategy will restrict land use and development on the coast. It therefore seems inequitable to have the rating base for this land based on 100% Capital Value assessment, as the rates will increase but the demand for services will not increase and the ability to pay may actually be decreased.

9. An Example of Case Law

The issues of rates equality have been debated for many years. One case that stands out is The Electricity Corporation of New Zealand Ltd. (ECNZ) versus the Mackenzie District Council (1990). “The case concerned the rating of ECNZ dams. The dams had not been rated before but became rateable on their transfer to the new State Owned Enterprise (SOE). The dams in Mackenzie made up about three quarters of the potential new rateable value of the district. An unmodified extension of existing rating policies to the dams would have roughly quadrupled Mackenzie’s rates take.” (p.6 Economics and the Law on Local Authority Funding(Draft), Whiteman 1995). One has to wonder what the dams demand for services would be?

There were many cases throughout New Zealand of “inner and outer ridings”. These were hotly debated in the Courts.

10. Roothing

Roothing constitutes the greatest component of the rural rates bill. For Castlepoint Station in 2004/2005, the component for rooothing represented 68% of the non- targeted charges. Castlepoint Station also has a separate rating unit, a small plot of land with a house on it. The farm pays thirty five times the amount in rooothing rates as the house. The separate house would be the equivalent of some of our neighbors who commute an hour each way to town every day for work. The farm has four houses on it, so

at best should we not be paying four times the roading rate? People use the roads, not land.

Since the value of roading is in its function as a network, does it make more sense for the costs to be distributed nationally rather than locally through rates? This could be achieved through an increase in Road User Charges for diesel powered vehicles, an introduction of Road User Charges for petrol vehicles or an increase in the Excise Duty paid on petrol. This would only be effective if all of the revenue collected actually went towards the costs of maintaining and building roads. It would also be imperative that the allocation of expenditure be deemed to be equitable. These forms of funding would also quite nicely handle the issues involved with different forms of road usage, generated by different land useage, which are currently quite contentious. Forestry, which only uses roads very heavily for a short period of time at very long intervals, when harvesting trees. Dairy, which has a heavy truck collecting milk on a regular basis. Other forms of agriculture would have heavy trucks on an intermittent basis.

11. A Different Funding Base?

Should a radically different funding base be considered? Would a base built on economic activity such as G.S.T. make more sense? Or another form of “across the board” charges?

“The choices of funding mechanism have frequently been driven by pragmatic and political concerns rather than economic principles. Local Authority funding systems have features which make them economically inefficient. Commonly cited faults are:

- There is not enough debt funding. Local authorities generally carry very little debt in relation to their assets. This is especially so when it is considered that most assets are infrastructure which has a very long lifetime and is ideally funded largely by debt.
- Differential rates can be used to target relatively rich elements of local authority rating bases, such as central business districts. This can occur to an extent which goes beyond the demand for Council services made by those ratepayers, and beyond their need to contribute to activities which are public goods.

- Uniform annual charges (a flat per property tax) may be used when public good theory would prescribe a tax on property as a proxy for wealth...
- Inefficient mechanisms can be used to fund particular services. For instance, the provision of water is still often funded from rates levied on property values. These bear no relation to the demand for the service.
- Systems can be manipulated for reasons that have no basis in principle. The main examples are changes to compensate for the effects of altered property valuations and to maintain the relative contributions from particular sectors or parts of a district.”

(p.4-5, Economics and the Law on Local Authority Funding(Draft), Whiteman 1995)

Some elements of “normative economic theory” might include

- “Systems should be designed around the economic character of the functions being funded.
- One main aim of funding systems should be to be allocatively efficient
- Where other criteria such as equity are being pursued, the aims should be clearly articulated and the costs in terms of efficiency should be clearly appreciated.
- An analysis of externality effects could provide a measure of how reasonable the funding mix for a particular function is.
- Public good theory (and assessments of the public good content of particular services) can provide a useful technique for assessing how far tax elements should be present in the funding of particular services (and ultimately how much a rates bill might exceed the cost of services of direct benefit to a ratepayer)

The issue of public goods is especially important since the supply of public goods is one of the reasons for the existence in the first place.”

(p.11-12 Economics and the law on Local Authority funding, Whiteman 1995)

It is interesting to note that although “Economics and the law on Local Authority funding”, by Brendon Whiteman was written in 1995, well before the Local Government Act of 2002 was adopted, the principles still apply and are worthy of discussion.

Should G.S.T be increased to fund more local services? Would it be more equitable than the current rating formula? Would an increase in the amount collected from uniform charges make more sense? Would some form of per capita charge as opposed to per household (uniform charge) be more equitable still?

12. Rates Postponement

One can apply to the Council for rates postponement. This is a delay in paying the portion of rates which are due to an increase in value because of other potential uses. If the land use changes then the Council can claw back the postponed rates. If the land use does not change, then the postponed rates are forgiven. The conditions for this have become more narrowly defined with the repealing of the “Rates postponement – values of farmland” clause in the Local Government rating act of 2002. Now rates postponements are only granted in cases of severe (financial) hardship. Within the Masterton District Council, the only times that rates postponement has been granted since 2002 was for land developers who wanted to pay their rates once the subdivided land had been sold, and therefore they had revenue to be able to pay.

13. NY State (USA) Agricultural Assessment Law

In New York State (USA) an Agricultural assessment law has been created so that the land is taxed in relation to the services required. Although, it is a slightly different situation from New Zealand, in that New York State collects taxes for education from property tax, the principles still apply that agricultural land does not require the same level of services that “developed land” does and therefore should be taxed accordingly.

“The Real Property Tax Law specifies that land used in agricultural production must be assessed and valued under provisions of the Agriculture and Markets Law relating to agricultural districts. Under those provisions, agricultural assessment values are calculated and certified annually. The commissioner of agriculture and markets establishes and maintains an agricultural land classification system based on soil productivity and capability, and distinguishing between mineral and organic soils. The commissioner certifies the soil list to the state board of equalization and assessment. Annually, the state board is required to calculate a single agricultural assessment value for each of the mineral and organic soil groups, which must be applied uniformly throughout the state. A base agricultural assessment value must be separately calculated for each soil group and must be assigned as the agricultural assessment value of the highest grade mineral and organic soil group. The assessor utilizes the certified agricultural assessment values per acre in determining the amount of the assessment of lands eligible for agricultural assessments by multiplying those values by the number of acres of land utilized for agricultural production and adjusting such result by application of the latest state equalization rate or a special equalization rate as may be established and certified by the state board for the purpose of computing the agricultural assessment.” (New York State Taxation and Assessment Law 1998 clause 318)

In New York, “Assessors are charged with the duty of properly assessing real property for purposes of taxation...” It is interesting to note that in the section on potential use, “Property should not be assessed based on some future potential use or possibilities...”(New York State Taxation and Assessment Law 1998 clause 300, 313)

Our family farm in New York State had an agricultural assessment. There are strict criteria for the annual gross revenue generated from the property

in terms of primary products. There are also severe penalties for a change of use occurring during the commitment period. One frustration that we experienced, was the requirement to rollover from year to year vs. the timeframe of the commitment period. For example, every year you must sign up for seven years. Therefore, you must be able to plan at least seven years in advance for a use change or be subject to a penalty of triple the difference in the back taxes. The agricultural assessment also gives tremendous “subjective” powers to the assessor. We found that although the assessment on the farm land did go down, the assessment on the houses and buildings actually increased.

14. Perceptions

A perception that persists is that the owners of high value properties have the ability to pay in excess of the fees for services received. Historically, when agricultural land sold only for its productive value, this may have been true. However, when production value is not the main driver of market value, which is currently the case for some agricultural land and is certainly the case for all residential property, this perception causes problems. If someone has owned a residential property for a long time in an area that suddenly gets “hot”, property values can skyrocket. Since generally only small areas of a district get “hot”, then the rate take from that area will increase, and the rates for individuals in that area can increase dramatically. If someone is retired on a fixed income this can be devastating. This particularly affects property, which was purchased when land values and therefore rates were low. As property values have increased, one cannot assume that the wealth of the owners and therefore the ability to pay has increased at a commensurate rate. For agricultural land, there are market forces at work, that have decoupled the market value of some land from its productive value, particularly high country, coastal, or properties in close proximity to town. Therefore, market value of property is no longer a good indicator of ability to pay rates, in excess of fee for service. The perceived ability to pay was based on production.

One has to wonder the impact of a recent high country sale to DOC. The sale was at three times the going rate for that class of country. Since it was destined for public parkland, its value to the purchaser was not tied to its productive value. Unfortunately for existing high country landowners, that sale will be considered when establishing market value next time their properties are valued. To add insult to injury for the neighbors, because the land went to DOC it will no longer be part of the rating base

for the district, so their rates will have to increase. Additionally as tax paying citizens, they will have to pay for weed and pest control on the new DOC land.

15. Conclusions

I am intentionally not drawing any conclusions on this issue, as my paper is about the questions that Councils and the general public need to ask themselves. There definitely needs to be a “big picture review” of the ramifications of the current rating formulas and policies.

- Should the Councils rate ahead of a use change, or does that in fact force the hand of change?
- Is the current system equitable?
- What alternative systems could be considered?
- Should differential rating bases, such as agricultural assessments, be considered?
- Should rates postponement in a broader sense than currently exists be considered?
- Should rates be based on the value of buildings rather than the buildings and land?
- Should there be an increase in the percentage allocation allowed from uniform charges?
- Should there per a per capita charge (poll tax)?
- Should an economically driven base such as G.S.T. be used instead?
- Should costs of roading be shifted to users via road user charges and excise duty?

This is all food for thought and healthy debate!

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