

11 May 2007

Christchurch City Council  
Civic Offices  
Tuam Street  
Christchurch

**Submissions on LTCCP – Development Contributions Policy 2007 Amendments**

We **enclose** submissions on behalf of the following:

- 1 Apple Fields Limited
- 2 Trans Tasman Properties Limited
- 3 Canterbury Land Trust Limited
- 4 Clearwater Resort Limited
- 5 Fulton Hogan
- 6 Laing Property Holdings
- 7 Reefville Properties Limited
- 8 A Concerned Group of Developers, Planners, Lawyers, Economist, and other Consultants

Please note the text of these 8 submissions are all in identical terms.

We also **enclose** submissions on behalf of the following (the text of these 2 submissions being identical and including further text not in the 8 submissions above):

- 9 Property Ventures Limited
- 10 Luneys

Yours faithfully  
**Goodman Steven Tavendale & Reid**



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**SUBMISSION ON LTCCP - DEVELOPMENT CONTRIBUTIONS POLICY 2007  
AMENDMENTS**

Name of submitter: **FULTON HOGAN**  
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Christchurch  
Attention: Graham Causer

**A. SYNOPSIS OF SUBMISSION – PROCEDURAL GROUNDS**

- 1 The Christchurch City Council ("the Council") has failed to carry out consultation around the amended DCP for the LTCCP in accordance with the special consultative procedures under the LGA. In particular, and given the similarities in the methodology used by the Council in the preparation of its DCP to that used by the North Shore City Council, it has failed to prepare an amended DCP to the LTCCP that brings to account the errors of law found by the judgment in the *North Shore City Council* case.
- 2 The Council's proposal to consider the implications of this case in the context of its DCP and to produce a further amended draft through the submission process will result in a document that is put to the Council for adoption that has not been the subject of the consultative process under the Act.
- 3 It's consultation process is thus unlawful and amenable to judicial review. The submitters are being asked to make submissions on a document that is flawed and is one that the Council is intending to further amend. It is that latter document that is the one that should be notified and consulted upon in terms of the procedures required under the Act. Council's actions expose it to judicial review.
- 4 It is further submitted that the approach contemplated which is to postpone a complete review of the capital works programme contemplated in the LTCCP amounts to a dereliction of Council's statutory obligations of financial management under the LGA. Its proposal to incrementally phase in the amended DCs ahead of a complete review of the capital works programme and in circumstances where there are uncertainties as to how the expenditure is to be funded (whether through DCs or rates or by some other means) is contrary to the Act, including but not limited to Sections 106, 101(3) and Sections 201 and 202.

**B. SYNOPSIS OF SUBMISSION – ECONOMIC GROUNDS**

- 5 The Council has employed an arbitrary levying of its ratepayers on the basis of a wrong interpretation of the Act that will have dire short and long term consequences.
- 6 It has not been established that there is direct link between the expenditure needed to meet the projected growth in population and the proposed new levies as the Council has failed to apportion that expenditure on a marginal or incremental cost basis.
- 7 The Council's models are flawed and problematic, use simplistic assumptions and ignore the internationally recognised economic mechanisms applied in the analysis of monopoly services. For example the model used will not accurately predict growth in households, business floor areas and impervious surfaces, which are the principal factors dictating the Council's own capital expenditure programmes, while GDP, trends in dollar values, export competitiveness, the cost of capital and the likely growth and mix of industry and immigration are ignored.
- 8 The means of estimating the capital expenditure required to meet growth is inadequate, shown in the wild fluctuations between the 2004 and 2006 forecasts and those coming to light as the 2006 forecasts are scrutinised, for example the levy on commercial and industrial developments is to be slashed following the realisation that this would have recovered three times the sum originally calculated.
- 9 The Council's model, although it purports otherwise fails in a number of respects, namely:
- 9.1 to identify expenditure already required compared to that arising from population growth,
  - 9.2 to calculate operating advantages to existing infrastructure from additional major projects in terms of declining marginal costs for all users,
  - 9.3 to avoid double dipping, as new ratepayers make both capital contributions and fund depreciation through rates and
  - 9.4 to recognise the need to promote conservation of the resources supplied, which would be served by charging existing and new users the same amount for services, as is the case in the private sector.

10 The Council should employ modern funding and operating methods so as to utilise present growth to reduce, rather than increase, operating costs such that:

10.1 development levies are restricted to essential expenditure directly related to servicing new development,

10.2 development levies are calculated on the basis of incremental or marginal cost pricing;

10.3 ratepayers benefit from market based efficiencies thus obtaining better and cheaper services (e.g. if Council could use the opportunity to introduce LATES).

### **C. SYNOPSIS OF SUBMISSION – SEEKING AMENDMENTS**

11 This submission is made without prejudice to the primary submission that the Council's process of procedure is unlawful and contrary to the Act and/or that the Council's DCP contains errors of law and has not applied the proper criteria under the Act.

12 The submission seeks specific amendments as set out in Part C of this submission particularly in relation to inner city development.

## **DISCUSSION**

### **A. SYNOPSIS OF SUBMISSION – PROCEDURAL GROUNDS**

#### **Background to submission - Working Party Process/Recommendations**

13 The submission is that the Proposed amendment to the DCP in the LTCCP fails to adopt recommendations of the DCP Working Party (DCPWP). The DCPWP found that the increased level of DCPs approved in 2006 amounted roughly on average to a doubling in the charges faced by developers (ultimately passed on to purchasers).

14 Their concern was that this level of increase may well have an impact on the level of development that takes place albeit that the size of that impact was unable to be calculated. This uncertainty nevertheless gives rise to a significant risk.

15 The options identified by the DCPWP were:

15.1 for the Council are to proceed as planned,

- 15.2 settle for a lesser proportion of cost recovery,
- 15.3 abandon the proposed increase or
- 15.4 spread any adjustment over a longer period of time.
- 16 Each of these options have implications for the level of rates and the services available to the city's residents. At the end of the DCPWP process, there are still many of the same issues previously identified that appear to be unresolved. This is particularly so in relation to the methodology employed.
- 17 Notably a recommendation of the working party was that prior to adoption of the 2007 LTCCP the Council allow for a review of the Council's capital works programme.
- 18 The concern of the submitter is not only whether (for instance) the ratepayer should be burdened with unnecessary projects, (for example the visitor centre and upgrade to the Botanic Gardens; the \$10 million upgrade for Hagley Park and the new multi-million aquatic centre following the closure of Edgeware Pool) but whether items are really attributable to growth, (for example charging new residents 100% for the cost of upgrading existing sewerage treatment when environmental standards already demands such measures or charging new residents a significant percentage of the cost of swimming pools and new bus exchange which will be available to all residents).
- 19 A further concern is that there have been mistakes in both the estimates of the major items of capital expenditure making up the LTCCP and also the calculations as to what will be collectable from developers.
- 20 The submitter understands that through the DCPWP process, many capital works projects were reviewed and often calculations were found to be wrong. Mistakes have lead to a significant increase in the proposed sewer water and waste levies. The concern is that the costs of council's projects are now known to be so unreliable and seriously in error that the LTCCP must be completely reassessed.
- 21 Councillors need to be satisfied that the policy that ultimately adopted is accurate. If not satisfied, the Council must defer the introduction of the levy for a further year in order to allow the LTCCP to be rectified, and following an independent review,

- 22 The DCPWP agreed with this course of action and called for the funding of all major items, and a sample of minor items, to be independently reviewed. It was wrong of the Council to reject this recommendation.

**The Council's position on a review of the capital works programme is rejected**

- 23 Although not all of the expenditure in the capital works programme is recoverable by way of a development charge, a significantly higher proportion is now sought to be funded through DCs than in the past. Although there is a connection between the capital works programme and the level of DC to be included in the LTCCP the Council has not reviewed the capital works programme.
- 24 The Council's position is that "... while it's usual to intertwine our capital programme and DCP, it is important that Council separates the issues and determines firstly what is a proper capital programme to meet the community outcomes and its vision for the city, and then secondly to look at how the programme can be funded as development contributions are but one component with the largest funding source being depreciation."
- 25 It has further said that as a result of the DCP adjustments, "Council may wish to reconsider the balance of the ten year capital programme in light of the impact that the latest DCP will have upon rates".
- 26 Officers accept that "[a] review of the capital programme is a complex matter and it will take time to understand the implications on service levels etc and if changes are made that do impact on levels of service, then there is a high probability that [the Council] would be required to undertake a full LTCCP process and far more detailed consultation and audit than our present process allowed."
- 27 The Council declined to undertake a proper review of the capital programme before Council signing off on the 2007/08 Annual Plan. A full review of the capital programme with the objective of either producing a further amended LTCCP in 2008/09 or reviewing the capital programme with the intent of making adjustments for the 2009/19 LTCCP.
- 28 The Council has already acknowledged that .the new DCP triggers an amended LTCCP, such that it "would be required to show the impact of the new policy on the plan and in particular be required to produce a new financial overview. The statement was made that "this would show an increase in the forecast rates up to and including 2015/16 resulting from the change".

- 29 Instead, the advise was that Council make a statement that it is intending to review its capital programme for the 2008/09 year or 2009/10 LTCCP with the objective of bringing back rate increases in line with that originally projected in the 2006/16 LTCCP.
- 30 This approach has been discussed with the Office of the Auditor General which believes that it is a sensible approach and would not trigger a "full LTCCP".
- 31 In the case of the contributions sought for the proposed Bus Exchange, officers have recalculated the amount attributable to growth and therefore subject to a DC charge. This amount is now estimated at \$5m. This will result in a further \$18m being funded by ratepayers through the capital programme (approximate 1.5% rate increase).The Council clearly needs to consider different approaches to funding the Bus Exchange and options identified include:
- 31.1 Discuss funding opportunities with Ecan
  - 31.2 Seek further funding from Central Government
  - 31.3 Look for substitutions.
  - 31.4 Consider this project as part of its review of the capital programme.
- 32 There are significant legal questions hanging over the robustness of the underlying asset costings that make up the LTCCP, on which the proposed DCP and DCs are based, and which both the DCPWP and LECG have said require independent review.
- 33 Mistakes on both the estimates of the major items of capital expenditure making up the LTCCP and also the calculations as to what will be collectable from developers are now known to be so unreliable and seriously in error that the LTCCP must be completely reassessed. The Bus Exchange is one such example.
- 34 Because the DPC and therefore the DCs are aligned to the Council's ten year capital programme for infrastructure as set out in the 2006-16 LTCCP, any consideration of the Council's alternative funding options, and of the introduction to an amended DC regime must be contemporaneous with a review of the capital works programme in the LTCCP.
- 35 The LTCCP cannot be established until there has been an independent review as to the funding of the major assets has taken place. Only then can consultation take place and the DCs be calculated and established.

### **Residents should not have to pay for Banks Peninsula upgrades**

- 36 A further issue of concern to (discussed through the DCPWP process) relates to the inclusion of Banks Peninsula in the Christchurch DCP. Whilst there is a need for the Peninsula to become part of the City and share infrastructure and costs there must be a causal connection between growth demand and capital expenditure.
- 37 If there is no clear connection to growth in Christchurch, and the expenditure required in the Peninsular, Christchurch developers should not fund those works. The Council will only open itself up for legal challenge on the basis that the causal connection cannot be established.
- 38 The submission is that unless there is a clear connection between expenditure on the Peninsula and levies charged to Christchurch development a general charge is not appropriate.

### **Proposed Amendments to the DCP following the *North Shore City Council* decision**

- 39 A specific recommendation of the DCPWP is that the Council ensure that only the costs attributable to new developments are recovered by way of development contributions. All growth factors not causally connected to new developments should be removed in the calculation of DCs. The staff response (accepted by the Council) was that the SPM methodology was validated by LECG and accepted by the working party.
- 40 Subsequent to that the High Court issued its decision in the *North Shore City Council* case and the methodology employed by the Council in that case was found to be flawed. There are similarities in the methodology used by the Council in this case. The High Court decision must then be brought to account **before** proceeding to amend the LTCCP.
- 41 To illustrate the flawed approach in this case, the staff response notes that Section 199(3) provides that the cumulative effects of a development, taken in combination with another development can be considered in assessing the effects of a development on the demand for new infrastructure and reserves. This is in fact the basis of the argument for the North Shore City Council in the High Court case that was rejected by Potter J.
- 42 The Summary of the proposal produced by the Council also identifies a legal error identified in the North Shore case where it states that DCP as proposed to be amended affects anyone who:



- Subdivides their land or section.
  - Constructs additional residential units (except one family flat per residential unit and people altering their existing home).
  - Constructs additional non-residential buildings (commercial, retail or industrial).
  - Anyone who changes their business activity or requests a service connection.
- 43 This explanation is inconsistent with the Court's interpretation of Sections 197, 198 and 199 of the LGA and is suggested that the Council's DCP is based on the same error of law as was found to exist in the *North Shore City Council* case.
- 44 The Council is proposing to review the recent High Court decision on the North Shore City Council DCP and that any necessary amendments to the Christchurch City Council's draft amended DCP as a result of the North Shore City decision will be addressed **as part of the consultation and submission process**.
- 45 The process the Council **must** use to adopt the revised policy is the special consultative procedure under the LGA. See Section 93(5). The special consultative procedure is set out in Section 83. It requires preparation of a statement of proposal and a summary of the information in the proposal. The statement of proposal must include a draft of the amendments proposed to be made to the LTCCP plus consequential amendments. See Section 84(2).
- 46 The summary including the draft amendment must then be circulated for consultation in accordance with Section 89. It is that document that is open for submission. It goes without saying that any further amendment resulting in changes to the proposal must go out for further consultation.
- 47 Otherwise the consultation process is being undertaken on the basis of a draft that no longer reflects the amendments proposed to be made by the Council to its LTCCP. The submission is that it is unlawful to attempt to amend the proposed draft amendment to the LTCCP DCP through the submission and consultation process in the manner that the Council is proposing to do.
- 48 Not only is it inconsistent with the special consultative procedure under the Act, given the high public interest in the outcome of this process following the judgment of Potter J, it is incumbent upon the Council that this process is transparent. It is no answer to this case (as Council has

said) that the officers will take into consideration the distributions of benefits when it considers submissions.

49 Finally, the DCPWP had expressed some desire for the CCC to obtain an alternative legal opinion about the North Shore decision, given that the CCC use the same legal advisers as North Shore and the same consultants, i.e. LECG and SPM Consultants.<sup>1</sup> Although initially satisfied with the review by LECG of its methodology, not only is that review challenged, the Council must have cause to reconsider its position in this regard in light of the North Shore decision which post dated LECG's review.

50 As to the LECG report, it sets out the four principles they said they adopted to evaluate the efficiency of the council's DC policy and allocations (refer page 19, 4.2.1). The first principle, the incremental cost principle is the same as marginal cost pricing. But the SPM states that marginal cost pricing hasn't been used. This is mentioned elsewhere in this submission.

51 The common cost principle also supports a marginal or incremental cost approach to allocating growth's share. Therefore, while there may be no issue with the economic principles that LECG put forward in their report, a challenge is taken to their claim that they have been applied.

### **North Shore City Council Case**

52 The High Court has ruled that North Shore City Council's development contributions policy is inconsistent with the requirements of the Local Government Act 2002. The Court found that North Shore City Council:

... made an error of law in failing to ensure that its development contributions policy complies with the requirements of the Act to assess development contributions against a "development" (as defined as s197) that generates a demand for reserves, network infrastructure and community infrastructure.

53 And that:

... [it] made an error of law in adopting a narrow concept of economic efficiency in the causative approach it has applied to the assessment of development contributions, and excluding appropriate consideration of the distribution of benefits and equitable and proportionate allocation.

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<sup>1</sup> Chris Jenkins from SPM Consultants Ltd has provided the methodology {SPM Funding Model} to the City Council and many other New Zealand councils to help embed the new DCP. David Moore and Sally Barnes of LECG are the economists who have undertaken an independent review of the SPM methodology and economic impacts of the DCP.

54 Finally it concluded:

It follows that the Council has made an error of law in failing appropriately to explain in its development contributions policy, as required by s106(2)(c) why in terms of s101(3) it has determined to use development contributions as a funding source.

### **The Legal Position under the Local Government Act 2002**

55 The Local Government Act 2002 (LGA) Section 198 states that a territorial authority **may** require financial contributions when granting a resource consent under the RMA 1991 for a development, a building consent under the Building Act 1991 and an authorisation for a service connection with respect to capital expenditure set out in Section 199, namely, reserves, network infrastructure, and community infrastructure fund and may include development contributions.

56 The contributions **may** be required **if** the effect of the developments is that new, additional, or increased capacity assets are required, including past expenditure in anticipation of new developments.

57 It is now apparent from the recent judgment that the effect of Sections 199 and 197 is that to qualify as a development a subdivision or other development must **generate a demand for infrastructure**. Section 199(3) states that if the effect of the development either by itself or cumulatively with another development is to require new or additional assets or assets of increased capacity that may justify the imposition of a development contribution.

58 However whilst councils **can take account of** the cumulative effects of developments in assessing whether capital expenditure will be incurred, the **preliminary identification** as to whether the particular project is a **development in terms of Section 197 must first be made**.

59 An approach that includes all development aggregated over the period of the development contribution policy and the cumulative effect of that in terms of placing a demand for new infrastructure was rejected by the Court as unlawful.

60 The proper line of inquiry when considering whether a development contribution may be has now been stated by the Court<sup>2</sup>:

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<sup>2</sup> At para [113]

I consider the relevant provisions of the Act inter-relate to require of councils the following stepped process and line of inquiry when considering whether a development contribution or development contributions may be required:

Step 1 Is the subdivision or development a "development", i.e. does it generate a demand for reserves or infrastructure? (s 197 definition)

Step 2 Does the development (either alone or cumulatively with another development) require new or additional assets or assets of increased capacity to provide for reserves or infrastructure which will cause the council to incur capital expenditure (s 199(1)) or has already caused the council to incur capital expenditure for the development? (s 199(2))

Step 3 Is there an alternative source of funding? (s 200)

61 It is therefore clear that there will be some applications involving a development in the broad sense of the term that do not justify the imposition of a development contribution because it is not a development in terms of Section 197 of the Act.

62 The Court held that the North Shore City Council had erred in law in failing to ensure its development contribution policy complied with the statutory requirement to consider whether there is a development and a direct causal nexus between that development and the demand for infrastructure either alone or jointly with another development.

63 The Court's approach necessarily requires the Council in this case to determine as a preliminary point on a case by case basis whether a particular project is a development as defined in Section 197. The implications of this aspect of the judgment are potentially significant in this context, both in terms of the proposed amendment (i.e. whether they go far enough or address the issues at all), and in terms of the capital works programme (which will likely need to be altered).

### **Court's Findings on Economic Considerations**

64 The Court held that by Section 103(3), a council is required to show in its LTCCP how in relation to the sources of funding identified in its revenue financing policy, it has complied with that section and is required by Section 106(2)(c) to explain in terms of principles under Section 101(3) why funding should be from this source.

65 In discussing an overview of the development contribution regime under the Act the Court notes at paragraph [46] that:

- like general rates a development contribution is a funding tool for councils;
- it is not a revenue tax which may be imposed to balance a council's budget, it is not a specific cost recovery tool as in the case of a user charge;
- rather, it is to be tied to expenditure required of a council for capital works to support infrastructure incurred by a development or developments.

66 Finally the Court concluded that a development contribution policy must comply **strictly** with the relevant provisions of the Act which are the sole source of the council's power to exact a development contribution. This is particularly relevant because there is no objection/appeal right. The only recourse is by way of judicial review.

67 There are a number of economic considerations that councils should have regard to, as they will determine how successful development contributions are in collecting the desired funds and what harm it may cause the local economy.

68 The Court held that Section 101(3) establishes a critical filter through and by which the funding sources in relation to each activity must be determined. Section 101(3) requires the council's consideration of matters set out therein in relation to each activity to be funded including:

- (i) the community outcomes to which the activity primarily contributes; and
- (ii) the distribution of benefits between the community as a whole, or in part, and individuals in the community; and
- (iii) the period in or over which the benefits are expected to occur ("intergenerational equity principle"); and
- (iv) the extent to which the actions or inactions of particular individuals or a group contribute to the need to undertake the activity ("exacerbator pays principle"); and
- (v) the costs and benefits of funding the activity distinctly from other activities.

69 The Court held that a council cannot single out and adopt a causation or exacerbator pays approach generally. Although it does not direct councils to any particular outcome it held that **all elements** in Section 103 must be weighed and factored in in respect of each activity.

- 70 The council is therefore not entitled **to elect** a particular approach, i.e. a causation based approach, and to reject others, i.e. a benefits based approach. It went on then to criticise the statements in the council's LTCCP under Cost Allocation Methodology in that they did not adequately take account of the council's obligations under Section 101(3).
- 71 The Court held that statements in its LTCCP did not accord sufficient recognition to the separate driver or component in the cost methodology attributable to the distribution of benefits between the community as a whole, any identifiable part of the community and/or individuals.
- 72 Finally the Court held that section 101 requires a consideration of the overall impact of allocating funding from any particular source or mechanism on the four wellbeings current and future. Having considered those five factors the Council must stand back and consider **the overall impact of any** allocation of liability on the current and future wellbeing of the community from social, economic, environmental and cultural perspectives.
- 73 It must then consider or be satisfied overall as to the impact of each funding source, determination on the four wellbeings as part of its broad role and purpose in promoting those wellbeings.

## **B. SYNOPSIS OF SUBMISSION – ECONOMIC GROUNDS**

### **Summary of economic problems with the proposed financial contribution policy and methodology**

- 74 Due to the limited time and the lack of information on the proposed financial contribution methodology, it is only possible to scratch the surface in terms of the economic issues that should be considered and the problems inherent in the council's Development Contributions Policy as presented in the Draft Long Term Community Plan, particularly in light of the *North Shore City Council* decision.
- 75 The submissions here were made to the 2006 and are repeated in relation to the proposed amendments. In essence, the amended DCP has not adequately addressed any of the issues and the submission continues to be of relevance and must be addressed. The problems lead to view that the Council must review its funding policies in their entirety.
- 76 The major problems with the policy are as follows:

- 77 First, the required causal link (s.199 LGA) between expenditure resulting from growth and what is proposed to be collected by way of financial contributions has not been made out as the methodology fails to allocate expenditure on a marginal or incremental cost basis.
- 78 The first stage of the recently contracted sewer upgrade, which will provide additional capacity, was required irrespective of potential population growth.
- 79 Second, the quantum of financial contribution is so large that it will cause the forecast level of development to vanish to such an extent that the targeted amount will not be collected (i.e. the forecast taxable base will shrink, if not disappear),
- 80 This will force the council to ultimately increase rates to cover the shortfall. This is because financial contributions are effectively an "avoidable single commodity tax applied to development which will ultimately be passed on by developers to the end consumers of those developments.
- 81 Third, and related to the second point, the policy contradicts its own objective, namely, to ensure that the level of the contribution does not generally discourage development.
- 82 While the level of reduced demand and production will be determined by the responsiveness of consumers to price change (i.e. elasticity of demand) there has been no study of the likely impacts as required under Section 101 LGA 2002.
- 83 Other obvious consequences include:
- Increased demand for existing property relative to new property pushing the price of existing housing and commercial and industrial property by a function of the total increased costs caused by development contributions. That is, there is potential for substantial property inflation;
  - Increased demand for new housing/commercial/development in adjacent districts (e.g. Waimakariri district). This will depend on the comparative change in financial contributions of both districts;
  - Fewer domestic visitors to Christchurch as some potential visitors choose other alternative locations with cheaper accommodation;

- Purchase of non-resident-made commodities (e.g. imported from overseas or in other districts with lower financial contributions) in preference to Christchurch-made goods; and/or
- Bias in favour of less expensive development options (e.g. greenfield developments in preference to redevelopment of more problematic/risky heritage buildings.
- An increase in the ratio of land value to total capital value of new developments implying a reduction in the quality of improvements (i.e. the value spent on the building and landscaping) so as to accommodate consumers' budgets. That is, financial contributions will encourage lower quality building developments (e.g. using architectural draftsman in preference to qualified architects); and
- Installation of lower quality fittings (e.g. carpets and curtains).

### Model Complex and Problematic

84 There are effectively four problematic components for calculating development contributions, namely:

- forecasting the physical quantum of demand for relevant activities generated by growth. The problem of forecasting is compounded by the application of development levies and the size of those levies. The proposed forecasting methodology is unlikely to reasonably predict growth in households, business floor area and impervious surfaces as the principal factors that drive growth in council's capital expenditure are not directly predicted (e.g. capital formation, GDP, exports) while no regard is had to the industry growth mix.
- estimating the total expenditure requirements to accommodate the physical growth in those relevant activities;
- identifying the growth component as distinct from the expenditure that is required anyway. Special problems in this area include:
  - weak linkages between growth and projects to be funded;
  - costs of growth not determined on a "with and without" basis;
  - growth expenditure is not discounted;



- costings based on theoretical models; and
- the ignoring the advantage to existing ratepayers of declining marginal costs of providing reticulated infrastructure;
- identifying a means of allocating that expenditure to the new community based on their perceived demand for the expenditure already incurred or to be incurred to meet growth. Problems with the funding model include double dipping, simplistic assumptions about the growth community and it doesn't promote conservation of the city's scarce resources.

85 Effectively, three models are used to determine development contributions, namely, growth, cost allocation and finance.

86 The growth model uses three methods to forecast the quantum of demand that the council will need to cater for, namely:

- forecast growth in households;
- projections of business floor area; and
- forecast growth in impervious surfaces.

87 All are problematic and lead to inaccurate forecasts for the following reasons:

88 SNZ's projections do not incorporate the economic drivers of growth, and can be very wrong. They are likely to be a very poor instrument for estimating the cost of growth to be recovered by development contributions, resulting in either considerable under or over-funding.

89 The council's growth model is to be updated every two or three years as new information becomes available from Statistics New Zealand. If this results in the council amending development contributions to recover the financial consequences of poor forecasting, this is likely to inject considerable uncertainty, risk and inequity into development.

90 The better approach is not to rely solely on demographic based forecasts but to account for the primary of population growth being the forecast of economic growth.

91 The growth model splits forecast growth in households between infill and greenfield development and between mesh blocks. This will add to forecasting errors.

92 A further problem is that in broad terms, the methodology is highly subjective in respect to the many significant assumptions upon which it is based, and wrongly supposes that all new residential developments is directly related to growth. There is no reckoning of the fact that some is to accommodate redistribution of the city population.

***Business floor space projection***

93 Related to the last point, similar incorrect assumptions are made that all new commercial development, for instance, industrial activity that depends on growth in markets external to the district may have little relationship to the district's population growth.

94 Aside from that problem, the business component of the growth model is extremely problematic, as it requires a projection of square metres of business floor area in the city from 2001 to 2041. Floor space is projected according to two main methods. The first assumes that the past annual growth rate for the Central City (16,500 m<sup>2</sup> per annum) applies. The second involves the use of population, regional employment and/or economic activity projections. No information is provided on the latter two and, therefore, the robustness of the methodology cannot be assessed.

95 Regardless, the relationship between growth in floor space, population, or other economic factors will be tenuous at best, as industries do not grow uniformly, while their floor space requirements to accommodate growth will vary substantially. Hence, the same percentage growth rate could generate entirely different demands for floor space depending on the rates of individual industry growth. In addition, the demand for floor space to accommodate growth will depend on the spare capacity within each industry group.

96 Hence, growth in supermarket sales will generate a different demand for floor space than say sales growth in clothing and footwear. Growth in plastic manufacture, on the other hand, will generate a floor space requirement that is entirely different to growth in the retail or accommodation sectors. Hence, the same absolute level of growth could generate different floor space demands depending on which industries are generating the growth.

97 The need to split forecast floor space growth between infill and vacant industrial land and between mesh blocks adds a further problematic element to the proposed development contribution model.

### ***Impervious surfaces component***

98 Forecasting the growth in impervious surfaces is extremely problematic as a background read of the commentary on the growth model shows. Comments such as:

Unfortunately, the results show that there was no relationship strong enough to confidently use this methodology for projecting out impervious surfaces.

And:

Subsequently, it was decided to use a methodology based on proportionately increasing the amount of impervious surfaces based on the proportional growth in either households or commercial building floor area ... this method is based on the assumption that ... this may not be the case in areas that are undergoing significant change, This would need to be investigated in the future...

99 It is obvious that a reasonable method for projecting growth in impervious surfaces has not been found. Because of this impervious surface projections essentially rely on forecasts of either households or commercial building floor area and, therefore, inherit the problems of those other forecasts.

100 By definition, if the physical forecasts of growth are wrong, so will the associated expenditure requirements upon which they will be based be wrong. The implications of this in the context of section 101 of the Act are significant.

### ***Summary of model implications***

101 Because the growth model is problematic, and fails to have regard to its impact on consumers' choices, the relationship (i.e. causal link) between the required development contributions and forecast growth is likely to be very tenuous.

102 Regardless, the proposed forecasting methodology is unlikely to reasonably predict growth in households, business floor area and impervious surfaces as the principal factors that drive growth in council's capital expenditure are not directly predicted (e.g. capital formation, GDP, exports) while no regard is had to the industry growth mix.

### **Cost allocation model**

103 The cost allocation model is used to split costs into renewal, backlog and growth. The model is problematic for a number of reasons:

- It has no underlying economic logic and fails to recognise economic models and theory specifically designed to address assessments relevant to appropriate contributions towards monopoly and other community services.
- The linkage between growth and projects for which development contributions are to be collected is in many cases very weak. In a large number of cases growth could occur without projects proceeding (e.g. refurbishment of leisure facilities, bus exchange expansion) and, therefore, there is no clear causal link between the project and the cost allocated to growth. This reflects the fact that while the council considers the projects desirable they are not necessary to accommodate growth. This problem is exacerbated by modest forecast growth but a desired contribution to capital expenditure from development that is enormous and out of all proportion to past and current levels of contribution.
- The model fails to assess the incremental cost of growth. That is, it does not determine the growth element of a project by determining cost on a "with" and "without" provision for the increased growth component, i.e. it fails to determine the marginal increase in capital cost.
- Hence, projects such as the installation of new traffic lights are erroneously apportioned between renewal, backlog and growth. But traffic lights are either needed to improve existing traffic safety/movement (i.e. address backlog, replace and existing set) or because growth in traffic flows trigger their need. If the former applies, then the incremental cost of dealing with increased traffic element is zero as their cost is independent of the volume of traffic they control. Conversely, if they are not required until traffic reaches some future level, the full cost is due to growth.
- Another good example is the upgrade of the Christchurch Wastewater Treatment and Disposal System. This is a major item of projected capital expenditure. However, it is driven by regulatory imperatives (the limited duration on the Estuary outfall and the consequential consent for an ocean outfall and improved treatment standards). It is not caused by new development. The bulk, if not all, of the upgrade costs shall be incurred whether or not the City grows over the next 10 years. The provision for growth is unlikely to impose any additional significant cost on the council as it will mainly relate to the size of the pipe.

- An incremental cost of growth approach would generally exclude design and investigation costs, consent cost, and administration and project supervision costs as those expenditures are unlikely to change as a consequence of allowing additional capacity for growth.
- The model's approach to cost allocation is contrary to Section 199 of the LGA. This is because it states development contributions may be required in relation to developments if the effect of the development is to require new or additional assets or assets of increased capacity. Also, if, as a consequence, the territorial authority incurs capital expenditure to provide for reserves, network infrastructure and community development.
- Also Clause 1(a) of Schedule 13 states: "identify the total cost of 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...". From an economic perspective, that wording implies the incremental or marginal additional expenditure which effectively rules out expenditure that would occur anyway in the absence of growth.
- This implies that the model's cost allocations are unlawful as the background paper states that it does not adopt a marginal cost approach to determining the share of cost applicable to growth.<sup>3</sup>
- This problem is compounded by the fact that the cost allocation model does not allow for the timing of projects (i.e. no discounting is applied to future costs to allow for the time value of money), but the timing of expenditure is a factor that determines the "real cost" of projects.
- The cost allocation model relies on costing of theoretical projects to determine cost allocations of projects between growth and non-growth components. which is problematic and likely to produce unfair cost allocations. It ignores the fact that reticulated infrastructure will have declining marginal costs which means that provision of reticulated infrastructure becomes cheaper and cheaper to provide as more and more properties are serviced, i.e. cost per capita falls. Hence, the methodology fails to allow for the financial cost saving advantages accruing to existing ratepayers. This is a fundamental error in the context of the *North Shore City Council* case.

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<sup>3</sup> Refer last para page 5.

### **Household equivalent units**

- 104 The growth model translates growth into units of demand expressed as Household Equivalent Units (HUE). The stated purpose being to recognise that the demand for services in the business community is different from the residential community. The concept is problematic, as demand for services will vary substantially within the business community depending on type of industry and/or activity and therefore there will be a huge amount of cross-subsidisation, both within the business sector and between the business and residential sector.
- 105 The concept will be difficult to apply with respect to property-related services while for some expenditure (e.g. provision of community facilities, transport projects) it will be meaningless. However, the financial development methodology requires such apportionments to be made.
- 106 The amendments proposed do not address the fundamental issue relation to the need for a causal connection and the application of the HUE's (albeit that they have changed) continue to be arbitrary and lead to cross-subsidies.

### **Funding model**

- 107 The third model required to determine financial contributions is the funding model. There are several problems inherent in the model.

### ***Double dipping***

- 108 The SPM paper states that the purpose of the funding model is to ensure an equitable assessment of the funding requirements to support the Development Contributions regime. To its credit, the paper acknowledges the double-dipping problem created by funding projects via development contributions, namely, that rating charges will be applied to the existing and the incoming community as there is no way of ring-fencing new ratepayers from the rate, interest and depreciation charges relating to the non-growth cost of projects. Hence, new ratepayers will be charged twice. The paper states "the rating charge applied to the incoming community will be offset against the development contribution charge".
- 109 This is extremely difficult to do, if it can be done successfully at all, and will increase the complexity of the development contribution calculations. However, it is noteworthy that no allowance for the double-dipping component appears to have been made in the Draft Long-

Term Council Community Plan. This gives rise to issues with respect to Section 198 and Schedule 13(1)(a), LGA, as previously discussed.

- 110 The policy/funding model does not appear to make provision for over-collection if growth rates are exceeded. If this occurs, which is unlikely at the proposed level of contribution, the amount required per household equivalent will have been overstated.

***Over charges, inefficient and doesn't promote conservation of resource use***

- 111 The proposed policy ignores the fact that growth will reduce the cost per capita of providing reticulated services, in particular, as they generally have declining marginal costs.
- 112 In addition, the concept of trying to ring-fence the cost of servicing existing ratepayers and new entrants is highly inefficient. It fails to recognise that highly competitive markets do not operate in this way.
- 113 Efficient pricing signals the cost of funding growth in demand to **all** (i.e. new and old) consumers before growth in capacity is required. This encourages all consumers to appreciate the real cost of meeting their demand, and very importantly, it encourages all consumers to be less wasteful in their consumption, i.e. it promotes efficiency.
- 114 Price discrimination does occur in highly competitive, efficient markets, but it is always on the degree of the responsiveness of individual classes of consumers (e.g. business travellers) to price change (i.e. their elasticity of demand).
- 115 The concept of arbitrarily determining the total sum required from financial contributions without regard to its effect on relative prices and then working backwards to determine the required levy for individual units of demand is fundamentally flawed. This approach disregards the fact that financial contributions are a tax that will alter demand for the goods and services produced from the taxed developments.
- 116 The proposed policy is very anti growth and encourages unintended consequences (e.g. redevelopment of the CBD). Because of this the council will not be successful in its efforts to raise the proposed amount of financial contributions, namely, \$332M over 10 years as the attempted recovery of this amount of tax will cause the taxable base to shrink dramatically as a consequence of consumers purchasing non-taxed substitutes or not consuming at all.

- 117 Regardless, the proposed tax will cause property price inflation in Christchurch by causing a rise in the price of new subdivision and development, which will encourage a rise in the price of existing property by restricting the total supply of property.
- 118 The adoption of the proposed policy and methodology will unequivocally result in a substantial shortfall in the required level of funds, ultimately forcing the council to increase rates to offset the substantial shortfall that will result.

**Measures required to remedy policy and methodology deficiencies**

- 119 The council should not pre-empt an open debate on how infrastructure expenditure is to be funded or administered, by relegating the issue to a working party process operating within the balm of statutory consultation.
- 120 Rather the process represents an opportunity to usher in modern funding and operating methods so as to utilise present growth to reduce, rather than increase, operating costs. To extract this benefit requires the sustained innovation, flexibility and efficiency that only competition guarantees, while maintaining the present monopoly supply of services inevitably leads to a rapid escalation in rates and the millstone of future capital obligations.
- 121 This can be achieved by ensuring development levies are restricted to essential expenditure directly related to servicing new development, calculated on the basis of incremental or marginal cost pricing so that a level playing field facilitates the entry and competition of third party providers and funders.

***Given the proposed policies do not work what is the alternative approach?***

- 122 Because the proposed contribution policy simply won't work as envisaged (i.e. even if the causal link problem is addressed in terms of Section 101), another approach needs to be adopted involving the following study:
- Determining the best funding options or institutional arrangements for funding capital expenditure by identifying existing, proven and generally accepted economic models for cost recovery.



- Evaluating the level of development contributions that can be levied without causing development to be discouraged. Generally, this will mean restricting development contributions to expenditure directly related to servicing new development.
- Developing an economic model based on incremental or marginal cost pricing principles for funding the element of expenditure that is appropriately funded by financial contributions.
- Ensuring that there is a clear causal link between growth and the need for specific expenditure, i.e. eliminate projects that may be desirable but are not a prerequisite to growth.
- Estimate the growth component by adopting a strict marginal or incremental discounted cost approach to assessing the growth component of proposed expenditure. This involves assessing proposed capital expenditure “with” and “without” provision of the extra capacity required to accommodate growth.

123 **The submission is** that the Council should:

- Determine whether there are better funding options or institutional arrangements for funding capital expenditure, e.g. as has been adopted for the proposed new Civic Chambers. In particular utilising existing, proven and generally accepted economic models for cost recovery in determining the best options for funding services and infrastructure.
- Restructuring council operating activities into LATES would assist this process. Once this is achieved then the resulting companies will look to expand their services and consequently will view growth as a profitable business opportunity, as opposed to the present council departments which propose placing penalties on growth.
- The development funds required to expand the LATES will be acquired largely from financial markets rather than reluctant ratepayers, who, under the existing provision of infrastructure, are forced to be compulsory investors in council services.
- For example, ratepayers are unconcerned about Christchurch International Airport and Lyttelton Port Company's capital investment programme as the money is raised from capital markets, with interest and loan repayments funded by consumers.

- Sewer and water utilities, for example, once restructured as LATES, would readily access the capital required to fund expansion, rather than charging new customers higher prices than existing customers.
- Evaluate the level of development contributions that can be levied without causing development to be discouraged. Generally, this will mean restricting development contributions to expenditure directly related to servicing new development in terms of the *North Shore City Council* case.
- Developing an economic model based on incremental or marginal cost pricing principles for funding the element of expenditure that is appropriately funded by financial contributions.
- Ensure that there is a clear causal link between growth and the need for specific expenditure, i.e. eliminate projects that may be desirable but are not a prerequisite to growth.
- Estimate the growth component by adopting a strict marginal or incremental discounted cost approach to assessing the growth component of proposed expenditure. This involves assessing proposed capital expenditure “with” and “without” provision of the extra capacity required to accommodate growth.
- **Do not railroad proposals through until accurate information has been collected and analysed and the opportunity of instituting the sustainable operation and funding of infrastructure fully evaluated.**

## C. SYNOPSIS OF SUBMISSION – SEEKING AMENDMENTS

### Submission on specific issues

#### **Reserves**

- 124 The recommendation (accepted by Council staff) is for a different approach to the calculation of DCs in respect of reserves. Instead of collecting it as a maximum allowed by the Local Government Act (i.e. 7.5%) a cost based approach has been adopted for the assessment of DCs for reserves. It is considered that this will overcome an issue with the assessment of reserves in areas, for example the central city where land values are highest.

- 125 Moreover, it considers that if reserve contributions are in future related to the actual needs (or planned works) in particular catchments, as for other forms of DC, then the central city may also receive some degree of relief – given that it is relatively well provided for in terms of reserves.
- 126 The DCPWP recommendations are supported in principle for what they have achieved. However, the submission is that until the LTCCP is amended so that the reserve requirement is related to the actual needs (or planned works) in particular catchments, development in the inner city will be unfairly charged with contributions for reserves where there is no causal nexus and this is opposed. The present 13ha per thousand set by the Council is a city-wide requirement and takes no account of the differing 'local' catchment needs. There is an adequate supply of parks/reserves in the inner city, many of which are under-utilised and have adequate capacity to cope with additional users.
- 127 The council staff acknowledged this at the 3 May meeting that contributions taken for both community facilities and reserves from inner city developments would **not** likely be spent in the development area but would be applied to city wide projects of no direct benefit to the local area in which the development was occurring.
- 128 Staff also acknowledged that further catchments needed to be developed for some capital works areas such as reserves and leisure facilities to enable contributions to be more appropriately assessed and applied to the local area that the development serves as many of the catchments areas used for capital works allocations were city wide (in fact 4 out of 6).
- 129 This only serves to confirm that there is currently **no direct link** between the development purporting to have caused the growth and the capital project to which the development contributions are to be eventually applied.
- 130 The submission is that there should be a 100% remission on reserve requirements for inner city development (residential and commercial) until the catchments have been devised and included in the LTCCP. An alternative relief is that a PDA tool could be used. There will be occasions where the Council may wish to seek contributions to enhance existing assets/reserves in the city where such works can not presently be funded directly through reserve DCs under the LGA. The PDA is a tool to achieve that alternative outcome.

## Remission for Small Units

- 131 Other changes to the calculation of reserve contributions to achieve this outcome include the new provision for non-residential lots subdivided before 1 July 2004 and the recommended allowance for small units. The change we have recommended to the calculation of DCs in respect of smaller than average units would also help many inner city developments. So too may the transitional provision in respect of undeveloped non-residential lots subdivided before 1 July 2004.
- 132 However and although an objective that is again supported in principle, the graduated remissions for small units in the 60 – 100 m<sup>2</sup> will only encourage 'dog box' type development of low amenity.
- 133 The submission is that the cut off point for the graduated remission should be up to at least 150m<sup>2</sup>. Alternatively, where it can clearly be shown that the apartments will only be two bedroom, this could be resolved through the means of a PDA.

## Transport

- 134 The submission is that the figures for the calculation of the contribution for upgrades to the transport network are flawed. Again the DCs have been calculated on the basis of a city-wide contribution as opposed to being catchment based. This results in DCs that are unreasonable and unfair. This is particularly for inner city development. Dwellers will be in walking distance of facilities that meet their day to day needs.

## PDA's

- 135 The DCPWP recommended that:
- The availability of private developer agreements be more clearly acknowledged, and that clear guidelines be put in place as to when and how PDAs can be used
- 136 The staff response was to recommend the acceptance of the working party's recommendations and that staff be requested to implement this as appropriate.
- 137 That recommendation is supported by the submitter for all the reasons outlined in the DCPWP's recommendation and in the circumstances contemplated by the staff response.

138 In addition to that, it is submitted that the circumstances that previously gave rise to remissions (if the submitter's relief seeking their reinstatement is rejected) in the 2004 policy be listed as circumstances that might give rise to a situation where a PDA is appropriate.

### Remissions

139 The DCPWP has recommended that the Council avoids including in its DC Policy any system of incentives or remissions for social purposes or to give effect to other Council policies. Rather these should continue to be addressed by separate means.

140 This recommendation is opposed. The submitter seeks the reintroduction of remissions in its previous policies.

### Inclusion of review provisions

141 The submitter seeks the inclusion of a **review process** pursuant to which a request for a review can be made in writing within 20 working days of the Council advising that DC is required. It is accepted that there is formal right for a hearing similar to that for a resource consent although it is unreasonable for there to be no provision for any dialogue between the Council and developer in the event that the setting of the contribution is contested.

142 The only remedy at present is to commence judicial review proceedings which for most occasions is simply untenable given the cost and delay.

143 The Act does not give Council the power to take a development contribution unless the development is one that qualifies as such in terms of Section 197 of the Act. The *North Shore City Council* decision illustrates the application of the statutory requirement that before development contributions may be required there must first be a development and secondly a causal connection between the development and its effect in requiring additional assets or increased capacity.

144 The illustrations provided by the Court in the North Shore case are as follows:

Project A – does not generate a demand for reserves/infrastructure. Therefore does not qualify as a development. No development contributions may be required.

Project B -

(i) Generates a demand for reserves/infrastructure and therefore qualifies as a development.

(ii) The effect of the development is to require new assets or assets of increased capacity.

(iii) No alternative source of funding under s 200.

Development contribution may be required.

Project C –

(i) Generates a demand for reserves/infrastructure and therefore qualifies as a development.

(ii) Does not require additional assets or assets of increased capacity (e.g. because existing infrastructure will adequately cope).

No development contributions may be required.

Project D –

(i) Generates a demand for reserves/infrastructure and therefore qualifies as a development.

(ii) Does not require additional assets or assets of increased capacity; but

(iii) The effect of the development cumulatively with the effect of another development is to require additional assets or increased capacity.

Development contributions may be required.

145 There will inevitably be room for Council officer misinterpretation and misapplication of the provisions of its own LTCCP in that a Council officer may incorrectly identify a particular scenario (of the 4 scenarios described above) and incorrectly apply a DC. It is unfair that a developer has to commence judicial review if it disputes the application of the policy in a given case.

**The submitter wishes to be heard at the hearings to be held between Monday 28 May 2007 and Tuesday 5 June 2007.**

**Dated** this 11th day of May 2007.



Person authorised by **Fulton Hogan**