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Te Tari Taiwhenua
Internal Affairs

Local Government briefing

Hon Nanaia Mahuta
Minister of Local Government

Hon Phil Twyford
Minister for Urban Development

Title: **Policy Briefing: Infrastructure Levy Model - Development Contributions**

Date: 09 August 2019

Key issues
Since Cabinet decisions were made in June 2019 on the Infrastructure Levy Model, officials have undertaken further work and suggest a revised position on the treatment and application of development contributions under the Levy Model. This paper seeks your agreement to revisit the previous decision, noting that any change will require agreement from Cabinet. The revised position involves enabling development contributions to be collected for infrastructure that is being funded by the Levy. If this approach is implemented, it will involve trading away several Infrastructure Funding and Financing and Urban Growth Agenda objectives. A related issue regarding the treatment of previously collected development contributions from properties that are subject to a Levy is also considered. This paper seeks your agreement to enable options as to how previously collected development contributions are applied.

Action sought	**Timeframe**
Agree to the recommendations;	**16 August 2019**
meet with officials to discuss how development contributions interact with the Levy Model and Infrastructure Funding and Financing objectives; and	**28 August 2019**
discuss this briefing with Urban Growth Agenda Ministers.	**12 September 2019**

Contact for telephone discussions (if required)

Name	**Position**	**Direct phone line**	**After hours phone**	**Suggested 1st contact**
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Cohesion reference	3W2DU3RAJ5R2-2117073613-873
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Purpose

1. This briefing provides advice on reconsidering the current application of development contributions (DCs) under the Infrastructure Levy Model (Levy Model). DCs are currently precluded from being collected from properties liable for an Infrastructure Levy, however our commercial advisers have suggested that, in some instances, DCs may be favourable.
2. This briefing sets out the emerging strategic risks and policy trade-offs that will need to be considered when determining whether to enable DCs under the Level Model, and when assessing a project application for the Levy Model. We recommend a discussion to workshop these trade-offs and risks with you.

Executive summary

3. Previous advice to Ministers, and subsequent Cabinet decisions, preclude DCs being collected from Levy payers once an Order in Council is in place. Cabinet also agreed that DCs collected on infrastructure that is subsequently funded by a Levy must be transferred to the Special Purpose Vehicle (SPV).
4. Further analysis of DCs by officials raises two issues:
    a) whether to enable DCs to be collected from Levy payers to support an Infrastructure Funding and Financing (IFF) project; and
    b) how to apply and account for DCs collected from Levy payers for infrastructure that is subsequently funded by a Levy.

Issue one:

5. Examination of potential pilot projects indicates that, in some circumstances, DCs may be a necessary tool to secure sufficient capital to allow a project to proceed if you do not want to charge a Levy above a certain level.
6. The Department of Internal Affairs (the Department) considers that the use of DCs is not a determinant of whether a project is viable. The use of DCs in the financial structuring of an IFF project is a choice between meeting costs upfront via DCs, or recovering these costs via the Levy over time. Regardless of this choice, the cost of the infrastructure will be recovered from landowners.
7. Enabling DCs for a project involves several trade-offs with IFF and Urban Growth Agenda (UGA) objectives, particularly in respect of overcoming the local authority financing constraint and improving the affordability of urban land.
8. While there are trade-offs associated with enabling DCs to be used as a funding tool for IFF projects, on balance, we favour permissive legislation that will allow use of DCs, where appropriate. This will ensure the Levy Model is accessible for a range of project types.
9. If you agree, Cabinet endorsement will be required to overturn its previous decision.
10. Regardless of your decision, the application of DCs has highlighted that the structuring of a Levy will involve trade-offs between IFF objectives. Officials would like to workshop this with you and understand the direction you wish to follow.

Issue two:

11. Any DCs previously collected from properties subject to a Levy must be transferred to the relevant SPV, if that SPV is delivering the infrastructure that was to be funded by the previously collected DC.

12. However, through the development of the drafting instructions to support the IFF Bill, officials have investigated this approach further. We now consider that an additional option of returning the previously collected DC to the landowner should be enabled.

Context – Urban Growth Agenda and Infrastructure Funding and Financing

13. The IFF work programme is an integral pillar of the Government's UGA, of which the primary goal is to improve housing affordability, underpinned by affordable urban land. The UGA seeks to achieve this by removing barriers to the supply of land and infrastructure.

14. In September 2018, Cabinet directed the Treasury and the Department to report back on alternative financing models to fund local infrastructure and any associated legislation that would be required to underpin these models [CAB-18-MIN-0466 refers]. The goal of alternative financing models is to free infrastructure investment from local authority financial constraints and decision making [Treasury Report T2019/72].

15. The use of alternative financing models is being explored because most high growth councils are close to their maximum debt levels (with debt at 250 per cent of revenue). This constrains their ability to borrow to deliver infrastructure. Without appropriate financing and funding tools, infrastructure supply cannot meet housing demands.

16. Therefore, the alternative financing model is intended to create a system where:

    a) the provision of **infrastructure is financially sustainable**, without a need for substantial or ad-hoc Crown/council support, and that finance is readily available;

    b) the **viability of projects becomes the key determinant** on whether they proceed;

    c) a much greater quantity of **debt can be leveraged from revenue streams** than would be possible through a local authority;

    d) the **costs of growth are properly allocated**, so that they fall on the communities and homeowners who benefit from the new infrastructure;

    e) there is **greater rigour and transparency** in the allocation of risk and costs to the appropriate parties; and

    f) **price signals are provided** to help ensure investment occurs where the market demands are.

17. In April 2019, officials provided advice to Ministers[1] on the alternative financing mechanism [Treasury Report T2019/72 refers]. This mechanism was subsequently confirmed by Cabinet in June 2019 [CAB-19-MIN-0263 refers] and is now referred to as the **Infrastructure Levy Model** (**the Model**).

[1] The Minister of Finance (Hon Grant Robertson), the Ministers for the Environment (Hon David Parker) and Infrastructure (Hon Shane Jones), and the Associate Minister of Transport (Hon Julie-Anne Genter).

18. The core of the Model involves the setting of a multi-year infrastructure Levy, which is paid by beneficiaries (or Levy payers) of local infrastructure projects. The Levy will be enabled by legislation and can only be struck following an Order in Council, which will set out terms of the Levy. The Levy will be levied by a SPV, which is responsible for financing all or part of the project and has the power to collect the Levy.

19. The Levy is used to service financing raised by the SPV to cover the costs of the infrastructure. In most cases the SPV will be responsible for construction of the infrastructure assets. Once constructed, the infrastructure will then vest with the relevant local authority or public body for nil consideration.

20. Importantly, the Model separates the financing decision for the specific infrastructure from the councils usual financing processes and constraints.

Background – development contributions, what are they?

21. Councils have several tools to recover the costs of infrastructure. In respect of growth infrastructure, they commonly employ DCs. DCs *"enable territorial authorities to recover from those persons undertaking development a fair, equitable, and proportionate portion of the total cost of capital expenditure necessary to service growth"* (section 197AA of the Local Government Act 2002).

22. DCs may be levied by a council in accordance with a policy framework authorising and defining such contributions. The DC may be levied on a person developing, when a council is granting a resource consent, a building consent or an authority to connect to a network. Developers typically pay DCs to a council at the time of residential subdivision. This lump sum at the time of subdivision creates issues:

    a) **For local authorities:** Uncertainty of timing as they are only paid when development occurs. This timing issue means that general ratepayers fund the infrastructure in the interim and take on development risk.

    b) **For developers:** Slower development, as the land value typically increases faster than holding costs of land. This weakens the incentive to develop land. In fact, they can serve as an incentive to land-bank as they are only charged when development occurs.

    c) **For homeowners:** Higher upfront costs as the DC is a lump sum, added to the cost of a section, increasing upfront costs to new home owner.

23. Under the DC regime, councils typically borrow the cost of the infrastructure and recover a portion of this from DCs, based on an assumed development profile. This carries several risks, mainly due to the council carrying development uptake and timing risks (which are then borne by ratepayers), cost escalation risk, and the debt appearing on their balance sheet. Consequently, a council may be unwilling or unable to borrow the capital to pay for the infrastructure in the period between infrastructure construction and timing of DC collection.

24. Other DC regime issues raised by stakeholders include:

    a) varying approaches to developing and implementing DC policies and, in some cases, concerns about a lack of transparency and/or strict compliance with the law;

    b) difficulties in accurately calculating DCs in complex situations, with brownfield developments being most challenging (relative complexity of the regime);

c) inability to capture development-related operating and administration costs as part of the DC;

d) financial risks to local authorities if development is delayed and/or most growth occurs in locations other than was anticipated; and

e) capability and capacity issues – a shortage of expertise for assessment work and to develop the evidential base that supports cost attribution and the quantum of the DC.

Application of development contributions to the Levy Model, as agreed by Cabinet

25. DCs are used to fund growth infrastructure. Consequently, it is possible that a local authority may have already begun collecting DCs for a specific infrastructure, which is subsequently funded by the Levy and delivered via an SPV. This presents a risk of 'double charging'.

26. To mitigate the risk of double charging, officials recommended that a council be required to:

a) **cease collecting compulsory DCs** on infrastructure to be funded by the Levy, and from properties subject to the Levy; and

b) **transfer the relevant proportion of any DCs already collected** from Levy payers within the project area to the SPV delivering the infrastructure.

Analysis and Comment: Interaction of development contributions with the Levy Model

There are two issues for you to consider:

27. Subsequent analysis of the interaction of DCs with the Levy Model raise two issues for you to consider:

a) **DCs to support an IFF project:** Where a Levy funding a project is considered 'unaffordable' and prevents a project from proceeding, the use of a council contribution (funded via DCs) to supplement a Levy may mean that project becomes viable.

b) **Previously collected DCs:** Where a local authority has previously collected DCs from properties for infrastructure that is subsequently delivered via the Levy Model. These previously collected DCs need to be appropriately utilised and recognised against the relevant Levy payer's liability.

Issue one: development contributions to support an IFF Project:

28. Further work with commercial advisers has led officials to reconsider whether compulsory DCs should be permitted in respect of an IFF project. This would enable councils to make a financial contribution towards an IFF project. A council would recover its contribution via DCs from Levy payers who are already part-funding the same infrastructure via the Levy.

29. The commercial advisers' view has been motivated by a perceived desire to keep Levies at a similar level to the 'Milldale charge' of $1000 per year, per household.

30. Maintaining a Levy at a level similar to Milldale would require a council to make a financial contribution to a project for there to be sufficient capital (see table one, overleaf).

31. A council may contribute to an IFF project and not recover this via DCs. For example, if there are identifiable spill-over benefits, such as a significant level of service increase, a council may be expected to fund this non-growth component from general rates.

There are trade-offs with using development contributions to support an IFF project

32. While DCs are widely used, they carry with them a number of issues that do not align with the UGA or IFF objectives. These are illustrated in **Appendix A** and summarised below:

    a) The cost of **DCs are capitalised into the purchase price of land**. This increases the upfront cost of section prices.

       A small levy may not be priced into section prices as efficiently as a larger one, thus producing a de facto developer subsidy. Anecdotal evidence from Milldale suggests that the 30-year, $1000 annual charge is not being reflected in the sale prices of those sections. This is likely to result in a windfall gain to developers.

    b) The use of DCs for IFF projects **reintroduces the council debt constraint**, and the decision to proceed is tied to these constraints.

       Requiring a council contribution keeps the project reliant on council financing decisions and trade-offs. This does not support creating competitive tension for land owners.

       There is timing uncertainty of revenues for the council. This is because a DC is only charged when development occurs, and will likely mean that any associated debt will remain on a council's balance sheet for an unknown period. This transfers development risk to existing ratepayers.

    c) **DCs do not incentivise growth and development**, and often result in the drip feeding of land due to the incidence of the charge often being at the point of development or subdivision.

       If a Levy is artificially low, due to the application of DCs in a project area, development is unlikely to be incentivised.

33. The points raised in paragraph 32 send a signal that the level at which a Levy may be deemed as 'affordable' needs consideration. This will have a significant influence on how the Model is implemented and the extent to which IFF objectives are achieved.

34. There is a trade-off between the Levy amount (as a proxy for the level of finance that can be raised) and the need to rely on a council committing to a financial contribution and recovering this via DCs. Equally, there are financial efficiencies associated with recovering greater amounts of capital due to the establishment and administration costs being relatively inelastic. This is illustrated in table one overleaf:

[37] [38]

35. Table one above illustrates potential Levy scenarios for stage one of the proposed [37] [38] development in [37] [38] It includes the growth component of strategic infrastructure only (waters and road infrastructure).

36. There are other potential downsides with using DCs in conjunction with an IFF project:

    a) It produces a more confusing funding situation for the land owner because they meet capital costs through two paths rather than one.

    b) There is also an efficiency issue. A higher Levy enables further borrowing, which may result in more competitive pricing. It also means a smaller proportion of the Levy pays for administration admin costs, which are largely fixed.

The emerging pilot project data presents a choice for Ministers around how DCs are used

37. Table one highlights the trade-off between the amount of a Levy, and the level of capital that it can support over a given period. This is a decision about whether a Levy is deemed ‘affordable’ and where costs should lie. Every project will be different and face unique circumstances that will influence this view.

38. Nonetheless, this choice remains largely political and can be characterised as:

    a) **Recover the cost of infrastructure (in part) via DCs.** The DCs will be capitalised into the section prices upfront and likely have a lesser influence on a purchaser’s offer price when compared to full recovery via a Levy. This option will require the support and agreement of the council and impact its balance sheet. Given the council will be committing its capital, the council will need to consult and make trade-offs within its capital works programme. This will likely limit the supply of land available.

    OR

    b) **Recover the cost of the infrastructure solely via the Levy**. This will result in higher Levies than option ‘a’ above, and have a higher likelihood of purchasers appropriately discounting this cost when purchasing a section or home. This also removes the need to rely on council financing decisions.

39. Officials do not consider that relying on a council financial contribution (funded by DCs) to support a project should be the standard approach for the Levy Model. This is because it is contrary to the primary IFF objective of enabling infrastructure to be delivered without being limited by local authority financial constraints. Further, a Levy that does not reflect the cost of the infrastructure will send weak or inappropriate price signals to the market and is unlikely influence section prices, undermining a key policy objective.

40. Nevertheless, a more permissive approach to DCs may be appropriate to support the progression of projects that may not be deemed ‘affordable’ without a contribution from the relevant council.

41. Officials would like to meet with you to discuss how DCs interact with the Levy Model and IFF objectives. In particular, we would like to discuss, at a principle level, how potential Levies could be structured.

Issue two: Previously collected development contributions

42. Cabinet has agreed that any DCs previously collected from properties that are subject to a Levy must be transferred to the relevant SPV if that SPV is delivering the infrastructure that was to be funded by the previously collected DC [CAB-19-MIN-0263 refers]. The objective of this approach was to prevent double charging and ensure that a person who has paid DCs directly, or indirectly, is not unfairly disadvantaged.

43. Subsequent to providing you with advice that supported this approach, officials have been working through the practicalities of applying DCs in this manner, including testing the concept with councils.

44. We now consider that the practical application of this approach is significantly more complex than initially thought. There could be quite varied situations between different properties within the project area about what DCs had been paid and for what services. It could lead to levy payments that are highly individualised for different rating units, and that would be difficult to explain to subsequent property owners. It could also make the process of setting and assessing the levy difficult to monitor.

45. In light of this, we consider that where a DC has been previously collected by a local authority for infrastructure now delivered by a SPV, there should be an option to refund it to the current land owner. The current landowner is the appropriate recipient of any refunded levy, as the previously paid DC will have been capitalised into the value of the property.

46. In practice, we expect this will become the predominant treatment of previously paid DCs. If previously paid DCs are substantial, this option may meet with a negative reaction from the relevant local authority, as it may lead to an unplanned expenditure for the local authority. However, this would be offset by a reduction in the local authority’s future planned capital expenditure, as the work to be funded by the DCs would be reduced or removed from the local authority’s budget.

Consultation

47. We have consulted with the Ministry of Housing and Urban Development and the Treasury in the development of this advice.

Next steps

Discuss this briefing with Ministers and officials

48. We recommend that you consult with UGA Ministers on this matter at the next UGA Ministers' meeting.

49. Officials would benefit from Ministerial guidance on what may be considered an 'affordable' Levy. This view will heavily influence the work officials are undertaking with Crown Infrastructure Partners and commercial advisers. Officials would like to meet with you to discuss this, and the interaction of DCs with the Levy Model more broadly.

Seek agreement from Cabinet

50. If you agree to the recommendations in this paper, you will need to seek Cabinet's agreement to overturn its previous decisions. This briefing could form the basis of that Cabinet paper.

51. Officials can deliver a draft Cabinet to you within a week of your direction. We will work with your office to find an appropriate Cabinet committee meeting to progress the issue.

Interaction with the drafting of the IFF Bill

52. These matters will have a minor influence on the drafting of the IFF Bill. We are confident that, subject to Cabinet agreement, the change in direction can be incorporated into the draft Bill ahead of the Bill being before the Cabinet Legislation Committee in late October 2019 (estimated).

Recommendations

53. We recommend that you:

a) **note** that Cabinet previously agreed to the Infrastructure Levy Model [CAB-19-MIN-0263 refers];

b) **note** that to prevent 'double charging' for infrastructure being delivered by the Levy Model, Cabinet agreed to prevent compulsory development contributions for infrastructure to be funded by the Levy from properties subject to the Levy [CAB-19-MIN-0263 refers];

c) **note** that, preventing compulsory development contributions for infrastructure to be funded by the Levy, from properties subject to the Levy, may mean that a Levy is considered 'unaffordable' and render a project unviable;

d) **note** that officials from the Department of Internal Affairs the Ministry of Housing and Urban Development and the Treasury consider that using development contributions to part-fund a project requires the trading away of core Infrastructure Levy Model objectives. Officials consider that, even if development contributions are enabled, the expectation is that this would not be the standard approach;

e)	**agree** to meet with officials by 28 August 2019 to explore how development contributions interact with the Levy Model and Infrastructure Funding and Financing objectives, and discuss at a principle level how potential Levies could be structured;	**Yes/No**
f)	**agree** that the Infrastructure Funding and Financing Bill should enable a more permissive approach to compulsory development contributions in respect of infrastructure to be funded by the Levy;	**Yes/No**
g)	**agree** that development contributions previously collected from properties that are subject to a Levy may be transferred to the relevant Special Purpose Vehicle, or refunded to the current land owner, and that the Special Purpose Vehicle shall have discretion as to which option is applied;	**Yes/No**
h)	**note** that, if you agree to recommendations (f) and (g) above, this is a substantial policy change from Cabinet's previous resolution noted in (b), and will require a new resolution from Cabinet and amending drafting instructions for the Infrastructure Funding and Financing Bill;	
i)	**direct** officials from the Department of Internal Affairs to draft a Cabinet paper seeking Cabinet's approval to reverse its earlier resolution noted in (b), above; and	**Yes/No**
j)	**discuss** this briefing with Urban Growth Agenda Ministers at the next Ministers meeting on 12 September 2019.	**Yes/No**

[39]

Richard Ward
Partnerships Director
Central Local Government Partnerships Group

Hon Phil Twyford	**Hon Nanaia Mahuta**
Minister for Urban Development	**Minister of Local Government**
____/____/______	____/____/______

Appendix A: Illustration of the potential trade-offs of IFF objectives if supplementing a Levy with Development Contributions

Interaction between Development Contributions and the Levy

Development Contributions	The Levy
Local Authority Debt	
Reintroduces debt constraints Potential for moral hazard	Removed from local authority debt and financial decisions and trade-offs Avoids local authority debt ceiling issues
Housing Affordability	
Capitalised into purchase price, increasing upfront section costs Housing affordability not challenged	Reflected in land prices - stabilise affordability Levied over the term of the Order in Council, fostering intergenerational equity
Urban Growth & Development	
Incentivises land banking and the drip-feeding of land for development	Disincentivises land banking Encourages land to open up for faster, affordable development
Cost of Infrastructure	
Costs are hidden from ultimate homeowner No shift in public understanding of infrastructure value	Costs are transparent and reflect the long-term life of the asset Factor Levy into decision to purchase
Timing of Costs	
Payment made after the development has occurred, creating uncertainty Windfall gain to developers	Steady price signals Greater certainty of infrastructure provision and timing