



SOLGM

NEW ZEALAND SOCIETY OF
LOCAL GOVERNMENT MANAGERS

THE PRICE IS RIGHT – THE KIWI VERSION

LOCAL AUTHORITY CHARGING FOR SERVICES

NOVEMBER 2009



FOREWORD

Welcome to *The Price Is Right – The Kiwi Version*, the second of the *Dollars and Sense* series of guidance. These guides have the overall objective of enhancing day to day financial management in local authorities. The first, *Developing Local Authority Revenue Systems – An Update* (also known as the Green Book), was released in November 2008.

The Price Is Right discusses an often neglected component of local authority funding reviews, and of the funding mix in general – prices, fees and charges. Local authorities have more flexibility to set these than is commonly appreciated, and they account for a significant proportion of local authority revenues, yet it is often rates that receive all the community and media scrutiny.

One of the often cited reasons for not exploring charging is that the legal requirements make it unclear what can and cannot be recovered by way of a charge. This document will explore the legal and constitutional issues involved with charging and should remove these doubts.

Charges are more than just a device for raising revenues/recovering costs, with some thought they can become an important policy instrument in and of themselves. The guide which follows shows you how your local authority can use its charging policy to achieve other objectives.

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Disclaimer

This Guide has been compiled to assist local authorities in setting charges under the authorities of the Local Government Act 2002 and other legislation.

This Guide is not intended to be a substitute for the legislation, or for the policy judgements of elected members backed by appropriate policy, legal and other advice from their officials.

Every effort has been made to ensure that the document is as accurate as possible. However, the Courts are the final arbiter of what the law actually means.

For this reason, neither SOLGM nor any of the other individuals and groups involved in the preparation of this Guide accepts any liability for any loss or damage arising to any organisation from the use of the material contained herein.

Reading or using the material beyond this point constitutes acceptance of the contents of this disclaimer.

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SUMMARY: CHARGING FOR THE TIME-CHALLENGED

This Guide develops some good practice principles and guidelines when setting user charges. User charging covers fees, charges, and prices – in effect anything where the user pays some amount of money in direct return for receipt of a service.

Charging is Not Just a Tool for Raising Revenue

With careful design, a charge can be more than a device for recovering the costs of providing a service. When a charge is set to recover the full costs of an activity it provides a signal to users of the true cost of an activity. By changing the structure of your charging, your local authority can use that economic signal to further its policy objectives. Charging enables your council to:

- target the funds raised through rates at priority objectives
- design any subsidies for council services at priority objectives and groups
- build a better understanding of community and user needs and priorities - paying directly for a service empowers the user to challenge costs and levels of service
- support the long-term council community plan, annual plan, and annual report accountability loop as a demonstration of the value.

Making a decision to charge can generate robust debate in the community – there are valid arguments both for and against charging. These can be overcome with some thought to the:

- objectives for charging
- rationale for charging
- needs and views of the user and the 'market' for the service
- manner in which issues are presented to the community (especially how the objectives for, and benefits of, charging are communicated)
- design of the charging scheme itself (including any subsidies or concessions).

A decision to charge is not something to take lightly or as an incidental decision to the setting of rates.

Defining Objectives

Sensible charging policy requires clear objectives. Without clear objectives there is a risk that charging for different activities may send contradictory signals or even actively work against the achievement of other objectives.

Those objectives may be drawn from the strategic priorities of council (including community outcomes), from service objectives or from financial and asset management policies. They will generally relate in some way to your local authority's rationale for delivering the service in the first instance.

Charging policy, in the first instance, something to be determined by activity managers. However, the individual policies do need some form of centralised review to ensure they align and meet corporate priorities.

Setting clear targets for charging helps determine how successful the introduction of charging has been. Many of these may be drawn from the information activity managers use to monitor performance.

Understand the Legal Framework

As with other funding decisions, a decision to charge should emerge out of your local authority's consideration of the funding principles of *section 101(3) of the Local Government Act 2002*, and be documented in a revenue and financing policy.

Fees for services that a local authority is under legal obligation to provide cannot be set without legal authority. The exact scope of the legal authority for charging varies from enactment to enactment – make sure you understand the specific framework for your proposed fee or charge before you begin.

Fees should bear proper relation to the cost of providing a service. A fee that does not meet this test may be a tax in disguise especially if the fee is mandatory, levied for a public purpose and enforceable by law. Where the fee differs from the cost of performing the service, a clear policy rationale should be established.

Statute generally permits recovery of the direct costs of performing functions by way of a charge. Cross-subsidisation between services is generally not permitted. Care should be taken if incorporating indirect costs, where recovery of these costs is permitted.

Gathering Information

Local authorities may find the following information useful when making pricing decisions:

- cost
- council objectives
- legal restrictions
- demand forecasts (or occasionally production forecasts)
- demand patterns
- price elasticity of demand /consumer reaction
- ability to pay and the income elasticity of demand
- supply of the service
- willingness to pay
- current levels of subsidy (both of individuals/groups and from general revenues).

All costs should be identified, even if your local authority is unlikely to agree to (or is prevented from) full cost recovery when charging. The community should have the opportunity to comment on proposed subsidy (if any).

In many cases, recovery of indirect costs is contemplated by legislation. The methodology for allocating these costs across activities should be robust and consistently applied.

It is important to categorise costs into fixed and variable and determine drivers of cost – these may be relevant for the design of charging and concession structures.

Price elasticity of demand is a useful tool for estimating the degree of response that demand for a service may have with respect to changes in the level of charge for the service.

If ability to pay is likely to be an issue then robust statistics on household incomes can be obtained from Statistics New Zealand and Work and Income.

Where competition exists some analysis should be undertaken of the impact of charges on competition.

Setting the Charge

Charges should be set before the good or service is produced. This provides managers with better incentives for cost control.

The initial proposals for design of the charge should ideally be undertaken by the relevant activity manager, and reviewed by policy and/or finance staff for consistency with organisational objectives, correctness of the calculation and the like.

Charges should be set on a “full cost recovery” basis unless legislative or policy considerations dictate otherwise. Full costs include both direct and indirect costs (where recovery of these is permitted) including depreciation, interest, and cost of capital (where a local authority uses this tool). Where full costs are not recovered then the rationale must be made clear and explicit.

Charging structures should be as simple to understand and implement, as is consistent with the nature of the service and the objectives for the charge.

If your local authority has decided to segment users (and current non-users) into target groups and different service is provided to the different groups, then the groups should be assessed different charges (if differential charging would not undermine any policy objectives and is economically and practically feasible),

In a similar vein, if substantially the same service is provided to different categories of user, simplicity in the fee structure suggests that the charge should be the same unless there is a policy reason to charge differentially. In particular, users who demand priority service should be charged a premium price (where this is possible).

Where legally possible and sound on the policy and economic grounds, consideration should be given to differentials for peak and off-peak demand to better spread demand for services (and manage the need for capacity extensions).

Equity considerations are a policy decision for elected members, but need the same level of attention as any other policy objective. Where concessions are granted it should be on the basis of clear objectives and clear and regularly reviewed eligibility criteria.

Ideally collection would take place at the same time as service delivery. Where this is not possible, invoicing should be done on a timely basis.

Non-payment must be followed up immediately. Enforcement mechanisms should be in place before charging starts. Recourse to these should be transparent, consistent and delegated to officer level.

Consultation

Some charging powers include a requirement to consult when introducing or amending a charge. But even in cases where there is no specific requirement to consult, *section 78 of the Local Government Act 2002* places local government under an obligation to consider community views when making decisions, which may require consultation.

A well managed consultation process can help obtain “buy-in” to whatever the final decision is, generate information that is helpful in designing the charge, and generate useful information from the users about how they experience or use the service.

A consultation about charging is not a negotiation towards an agreed structure or amount. It is a two-way exchange of information.

During a consultation on charges, sufficient information should be placed in front of the community to enable it to understand what the rationale for charging is and how the charge will be determined. This may mean placing some information on the cost of the service and the cost drivers.

It is useful to determine who targeted groups are both for charging and any concessions, it may be necessary to use methods to supplement the standard consultation procedures in some cases.

Implementation

Don't overlook the implementation aspects of a decision to charge. A decision to introduce or change a charge will require communication to the community, staff and elected members. New procedures may be required and staff trained in their use – particularly where charging is accompanied by changes to the service. Attention may need to be paid to security aspects.

Review

Charging should be reviewed regularly. At the minimum, charges should be fully reviewed at least once every three years, with more frequent mini reviews if costs and other assumptions are known to change frequently.

A full review of charges should be conducted for all activities. A full review should include the objectives; the legal framework; costs of delivering the service (including the allocation of indirect costs); forecasting assumptions; user perceptions; and concession policy.

1.0 INTRODUCTION

The Price Is Right – The Kiwi Version discusses a common, but underutilised part of local authority funding systems – pricing, or as it is sometimes called ‘user charging’, ‘fees’ or ‘user pays charging’. For convenience we will use the term ‘user charges’ as a catchall term for all of these mechanisms.

This guide provides sound advice that will help you identify how you can use charges to help promote the wider policy and service delivery objectives of your local authority and community. As we’ll see later well designed user charges provide a strong signal to users about the true cost of their use of the service, and can support other objectives.

1.1 Why a Guide on Charging?

Unintended Subsidy: A Cautionary Tale¹

The gross cost of the community leisure activity in a council is approximately \$2.8 million. This is funded by income from fees and charges of \$0.6 million, with the remainder coming from rates.

But there are only 10,000 regular users, or about 4 percent of the population of the local authority. In other words, the ratepayer is shouldering almost 80 percent of the cost for a service less than one in twenty residents actually use.

Regular users have their use subsidised to the tune of around \$220 per year, some heavy users of the service receive an even larger subsidy.

The council estimates that the low income users make up around 3 percent of the 10000 regular users, so the subsidy from rates benefits middle and upper income users.

Is this the end result that a council would want to intentionally promote?

Local authorities, and the sector generally, are under increasing public pressure to minimise levels of rates increase. The average increase in the total rate take over the ten years covered by the 2006-16 long-term council community plans was 60 percent, some local authorities signalled increases of more than 100 percent².

With that scale of rates increase, it would be expected that local authorities had also looked to make the maximum use of other streams of revenue. Yet analysis of local authority financials suggested that this may not be the case. The Office of the Auditor-General noted that rates were projected to account for 59 percent of operating revenues in 2016, up from 53 percent in 2006³.

¹ This has been adapted from a real-life council cited in Audit Commission (1999), *The Price Is Right: Charges for Council Services*.

² See Central/Local Government Funding Project (2006), *Local Government Funding Issues – An Update*, for further details. Note however that the less well developed nature of capital programmes in years 7-10 of many plans probably means the true level of increase would be higher.

³ Office of the Auditor-General (2007), *Matters Arising from the 2006-16 Long-Term Council Community Plans*, page 27.

The Office also speculated that:

“to meet critical non financial objectives (charges) might not be set to recover total operating costs (including depreciation).”⁴
 and
“It is also possible that there may be an element of conservatism in the forecasts for (charging) revenue streams, or that local authorities have given limited consideration to the appropriateness of non-rates revenue requirements in the later years of the LTCCP ...”⁵

The average local authority collects approximately 18 percent of its revenue from charges⁶ - though the median is around 14 percent⁷. However there are eight local authorities that receive less than 5 percent of their revenue in this way, and two that receive less than 3 percent of their revenue from charges. While a conscious policy decision (or set of decisions) to fund in this way is a perfectly valid approach to take – one has to ask whether a decision has actually been taken, or is there some degree of historical accident.

With increased rates of economic growth in the early years of the decade, and the consequences of a changing pattern of settlement in New Zealand, some local authorities are finding significant increases in demand for their services. The traditional local government response has been to meet increased demand by providing additional capacity – demand management, including pricing to manage demand is not in common use (with the exception of water and trade wastes in some local authorities)⁸.

The purpose of this guide therefore is to help local authorities to design charging systems that make the optimum contribution to their objectives. It is a tool for helping local authorities set more robust charges, it does not represent a SOLGM view that local authorities must, or even should, charge.

1.2 Scope and Content of the Guide

This guide is mainly focussed on the cases where local authorities are empowered to charge, but the processes, criteria, or recovery is not elsewhere regulated by legislation.

The guide does briefly cover the main charging powers regulated by other statutes (such as those under the *Dog Control Act*), and in particular it covers the scope and limits of those powers.

The guide does not cover development contributions for two reasons:

1. development contributions are the subject of another upcoming guide and
2. development contributions, while technically a charge, aren't exactly a user charge in the classical sense. The charging methodology and list of recoverables from development contributions is tightly prescribed.

⁴ Office of the Auditor-General (2007), page 27.

⁵ Office of the Auditor-General (2007), pp 27-28.

⁶ Source: Statistics New Zealand – note that unlike the *Independent Inquiry into Local Government Rates* (2007) we have included only that income from sales of good and services, regulatory income (another 5 percent) has been excluded as it is not possible to separate out revenue from fees from other regulatory income such as fines.

⁷ Nine local authorities collect more than 30 percent of their revenue in this way – including one (West Coast Region) where 60 percent of revenue is from the sale of goods and services.

⁸ See for example, *Independent Inquiry into Rates*, page 165, although in fairness it should also be pointed out that some of the services where the Inquiry saw a role for what it called ‘price management’ are subject to legal restrictions (especially tolling on roads).

This Guide also deliberately excludes infringement fees. These are fines and as such are not generally transaction related. The level of the infringement fee is almost always controlled by legislation.

1.3 What is a User Charge?

“Price – the amount of money for which a thing is bought or sold”⁹

What is a user charge?

This might seem like a trite question to ask – many of the general public would say, in the local government context, it’s a device for recovering the cost of services not paid for out of rates. And clearly that is the first, and probably the most important function of a user charge.

When charges are set at the correct level (typically they will not be when legislation constrains them) then a charge functions as an economic signal or communication tool. A price is an indicator of the true cost of providing a good or service to your local community. Economic theory tells us that when potential users of a good or service know the true cost of what they demand, they demand only what they value.

The economic signal sent by your charges can be a useful instrument towards achieving the wider policy objectives of your council. For example, suppose you have some facility where demand is running over capacity, but for whatever reason your local authority does not want to expand capacity. Part of your strategy for managing demand, might then involve an increase in your charges for example to encourage use at off-peak times. Or to take an opposite circumstance, many local communities have adopted a community outcome relating to health and community wellbeing. It may make sense then for your council to decide to set charges for its recreational facilities below the true economic cost to encourage use. You might use parking charges for council owned facilities as a device to support transport and environmental objectives.

A well designed, council-wide system of charges will ultimately have the effect of enabling your councillors to:

- target the funds raised through local taxation (i.e. rates) at priority objectives
- design any subsidies for council services at key priority objectives and groups (such as concessions for the elderly or low income)
- build up a better understanding of community and user needs and priorities - the old adage that ‘s/he who pays the piper calls the tune’ is true here, paying directly for a service empowers the user to challenge costs and levels of service (such as quality, reliability and the like)
- support the long-term council community plan, annual plan, and annual report accountability loop as a demonstration of the value your local authority provides to your community. A person is more likely to associate a service directly with your local authority if they are paying directly for it.

The key message to take from this is that the decision to charge is not something to be entered into lightly or kind of a consequential decision taken in the light of a decision about rates and debt. A blanket ‘*last year plus or minus x percent*’ decision or responding to sudden budget crises (such as the identification of a capital or maintenance spike) may (and in the latter case will) fail to unlock the true potential of charges. A decision to charge is part of the ‘why pays what’ discussion the funding policy process of the *Local Government Act* promotes.

⁹ *Oxford English Dictionary.*

Some elected members and officers can be averse to charging. As Figure 1.1 shows, the charging decision can be a generator of what is sometimes referred to euphemistically as ‘robust’ debate. But in fact many of the common objections to charging are either specious or can be overcome with some thought to the:

- objectives for charging including both financial and service objectives
- rationale for charging
- needs and views of the user and the ‘market’ for the service
- manner in which issues are presented to the community (especially how the objectives for, and benefits of, charging are communicated)
- design of the charging scheme itself (including any subsidies or concessions).

Figure 1.1. The Charging Debate is Often ‘Robust’

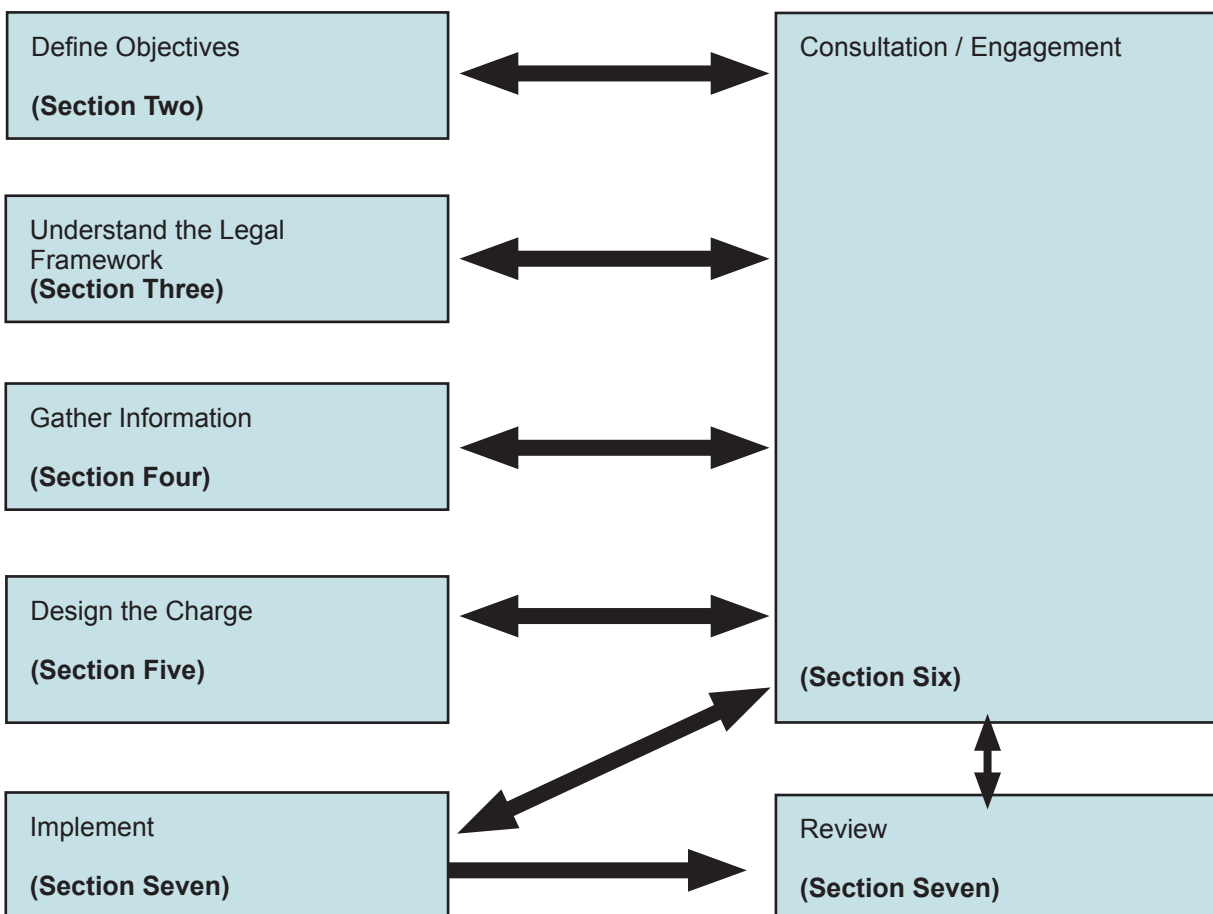
COUNCILLOR SMITH SAYS	COUNCILLOR JONES SAYS ...
Why should people have to pay twice for a service?	The property owner is the only person who pays rates directly – why should they have to subsidise the use of others?
Charging for a service is the first step towards its privatisation (especially water metering).	Local authorities have charged for services for many years without privatising those services. (Charging accounts for almost a fifth of the sector’s operating revenues).
Charging prevents low income people from accessing council services.	Charging structures can be designed to favour those in genuine need. Not charging means that de facto the property owner pays.
Charging for (service) is a tax on (desirable outcome) e.g. charging for lending paperbacks is a tax on education and/or knowledge.	Charging is one way to fund the maintenance and expansion of services.
Charging systems can be complex and confuse the general public.	Charging lets people see what they are getting for their money – people tend to value services more if they pay for them directly. The better the design of a charging regime the more transparent the basis of charging will be.
Charging, especially for regulatory services, is just about revenue generation.	A well-designed charge can support other policy objectives that the council has – for example by managing demand for a facility.
Charges can have higher risk of default.	Having a stream of revenue from fees and charges can mitigate risks e.g. two sources of revenue may be better than one.
Local authorities are a monopoly provider of services and can charge whatever they like.	Local authorities approach to charging for some services is regulated (in some cases heavily so), in others there is competition available, and in any case the democratic process acts as the best medium-term check on “rampant overcharging”.

1.4 The Roadmap for the Guide

Figure 1.2 sets out the basic roadmap that the remainder of the guide will follow:

- Section Two is a short section that discusses various types of policy objectives that are common to many councils and how charging can assist in the achievement of these. This section also discusses the links between charging and the wider local authority
- Section Three discusses the legal and constitutional framework in which local authority charging takes place. It will cover both the general and the specific charging powers and deal with issues such as what constitutes an actual and reasonable cost, and the circumstances in which charges can be challenged. This section also links in nicely with Section Six on consultation
- Section Four discusses what information might be needed to make a robust decision to charge, and introduces discussion about key costs drivers
- Section Five is where the ‘rubber hits the road’ and we discuss the actual design of charging systems including the advantages and disadvantages of different types of charging structures
- Section Six discusses the role of consultation in the process – including the general principles and rules about consultation that apply to any consultation process, and some specifics about consultation when designing charging systems
- Section Seven discusses implementation issues. This section also touches on a few principles for reviewing charges.

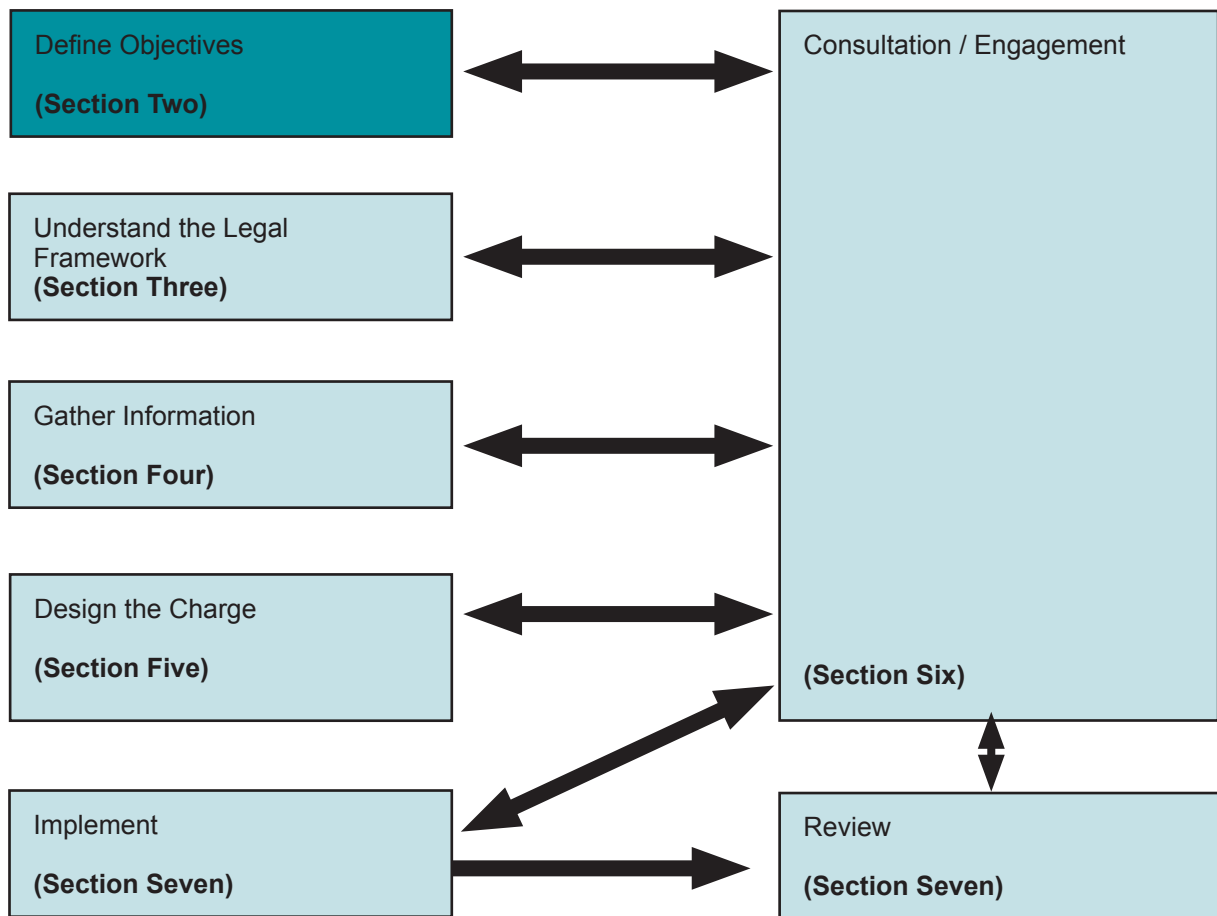
Figure 1.2: The Roadmap for the Guide



Things to Remember: Introduction

1. A charge is more than a device for raising revenue or recovering costs. A charge is also an economic signal which can be used as a means of achieving other policy objectives.
2. A charge can also help improve the relationship between the user and your local authority, help demonstrate value to the user, and help target rates revenues and/or concessions to the achievement of priority objectives and groups.
3. Charging therefore is not a decision that should be incidental to the setting of rates or other revenue sources. The objectives for, and design of charging systems is worthy of as much attention as any other funding decision would receive.

2.0 DEFINE YOUR OBJECTIVES

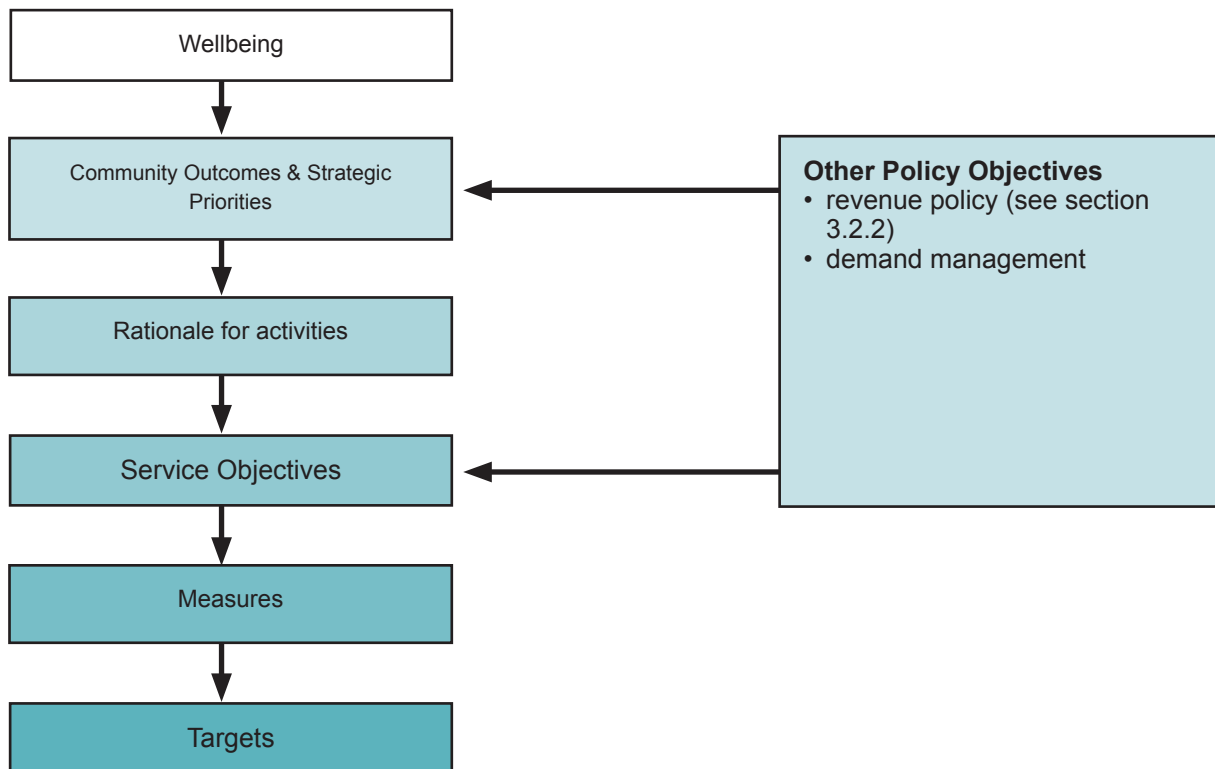


The first section demonstrated the power of charging in achieving the wider social, environmental, economic and cultural objectives of your local authority.

The first step in this process is for your local authority to consider its objectives and how charging could be used to support these. Charges are an economic signal, without clear objectives for charging any signals may be contradictory or even work against the achievement of objectives.

Readers familiar with the SOLGM publication *Performance Management Frameworks: Your Side of the Deal*¹⁰ will know that local authorities have a hierarchy of objectives that shows how each of the council's activities contribute to the achievement of wider policy objectives. A stylised form of this is reproduced in Figure 3.1 overleaf:

¹⁰ This guide can be accessed by clicking [here](#).

Figure 3.1: The Hierarchy of Objectives

Source: Adapted from Office of the Auditor-General, 2006, *Local Government: Results of the 2004/5 Audits*.

The *LG Knowhow Guide to Decision Making* defines a community outcome as a 'desired result or state of affairs' and 'the things that the community thinks are important for its wellbeing'¹¹. Put another way these are the high level objectives that your community wants to achieve, many (though maybe not all) will be priorities for local authority – but sorting out exactly how your local authority will contribute to community outcomes is one of the single biggest policy decisions your local authority will make.

By their nature, community outcomes (and other strategic priorities) are objectives that cut across the council. Generally, more than one activity will contribute to the achievement of one community outcome. For example, it is reasonably common for communities to have an outcome that revolves around community health and safety. A local authority might then undertake several activities that promote this activity including installing security cameras in the town centre, regulation of dogs, food inspections, increasing the standard of drinking water, encouraging participation in sport and leisure employing a lifeguard for a particular beach, or putting traffic calming measures on a particular road.

Department of Internal Affairs (2006)¹² has identified nine key areas where local communities identified outcomes in 2006:

- economy
- environment, natural and built (including urban form)
- community
- arts, culture and recreation

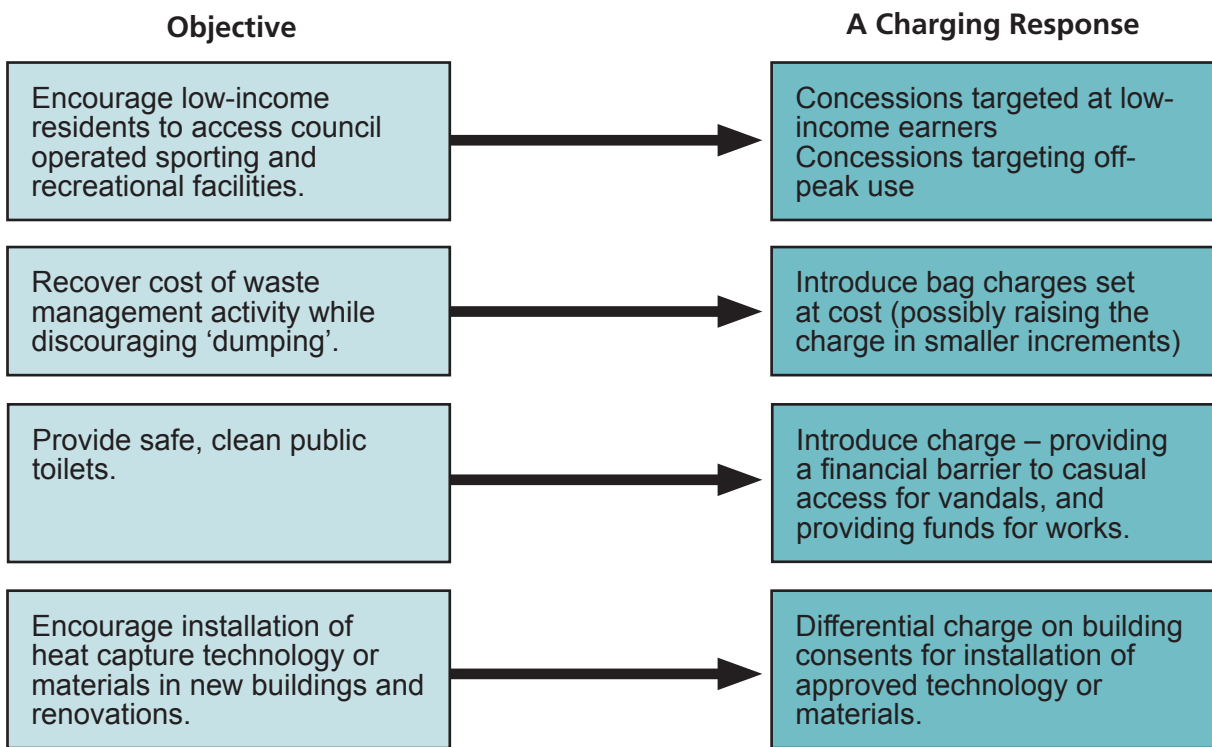
¹¹ Local Government New Zealand et al (2003), *Decision-Making Knowhow*, page 37.

¹² Department of Internal Affairs (2006), *Analysis of Community Outcomes from Draft Long-term Council Community Plans 2006 – 2016*, page 3

- governance – participation in decision-making, accessible leadership
- health
- education
- safety and
- services – or more specifically access, and appropriateness to need.

Usually a community outcome will be promoted through the achievement of what might be termed intermediate objectives. Often these may be linked to a single activity or identifiable group of activities, and will often be associated with a level of service and performance measure. It is through these that charging policy can have a role. Figure 3.2 provides some of the role of charging policy in achieving objectives that help enhance one common community outcome.

Figure 3.2: The Role of Charging Policy – Contributing to a Healthy Community Objective



In other words, the economic signal of charging is a tool that can be used to a number of ends.

Those familiar with *Your Side of the Deal* will have noticed an additional component to the ‘traditional’ performance management framework in Figure 3.1. The box entitled “other policy objectives” refers to those policies that your local authority might have that don’t necessarily appear to promote a community wellbeing in and of themselves. These include:

- the revenue and financing policy – it is not uncommon for councils to have specified percentages for recovery of funding from certain sources, for example “*user charges will account for 30 - 35 percent of funding for activity A*”.
- asset management objectives – for example demand management.

These sorts of objectives may appear to sit outside the performance management of Figure 3.1 framework, but many do not. For example, a decision to manage demand for an asset is usually motivated either by:

- concerns that an asset is at or near capacity use, demand management is then used to delay or avoid an extension to capacity (or de facto a decision to manage service levels)
- concerns over the negative effects of use of a service, demand management is then used as a tool to control the level of negative effect (again, sustainability objectives are often used as levels of service).

In a similar vein, while some funding policy objectives may appear to be purely the result of pragmatic or political compromise, there is almost always some policy rationale or service objective sitting underneath them (though sometimes it may not be expressed as such). For example, concerns that the fee for borrowing paperbacks are 'too high' may be the result of concern that the service may not be accessible for some (with accessibility being a level of service).

This means your decisions about charging should be linked with your objectives for delivering the service and the day to day management of the service which will be specified in the activity management plan for the service. If your charges are developed in isolation from the other service management decisions, then they serve only as a source of revenue and their potential to help deliver on your local authority's other priorities will remain undeveloped. This is an example of the kind of integrated thinking that the *Local Government Act 2002* was designed to promote.

The best people to understand the linkages between charging and the achievement of other objectives are the activity managers. As the people charged with the day to day management of the activity, they should have the best knowledge of:

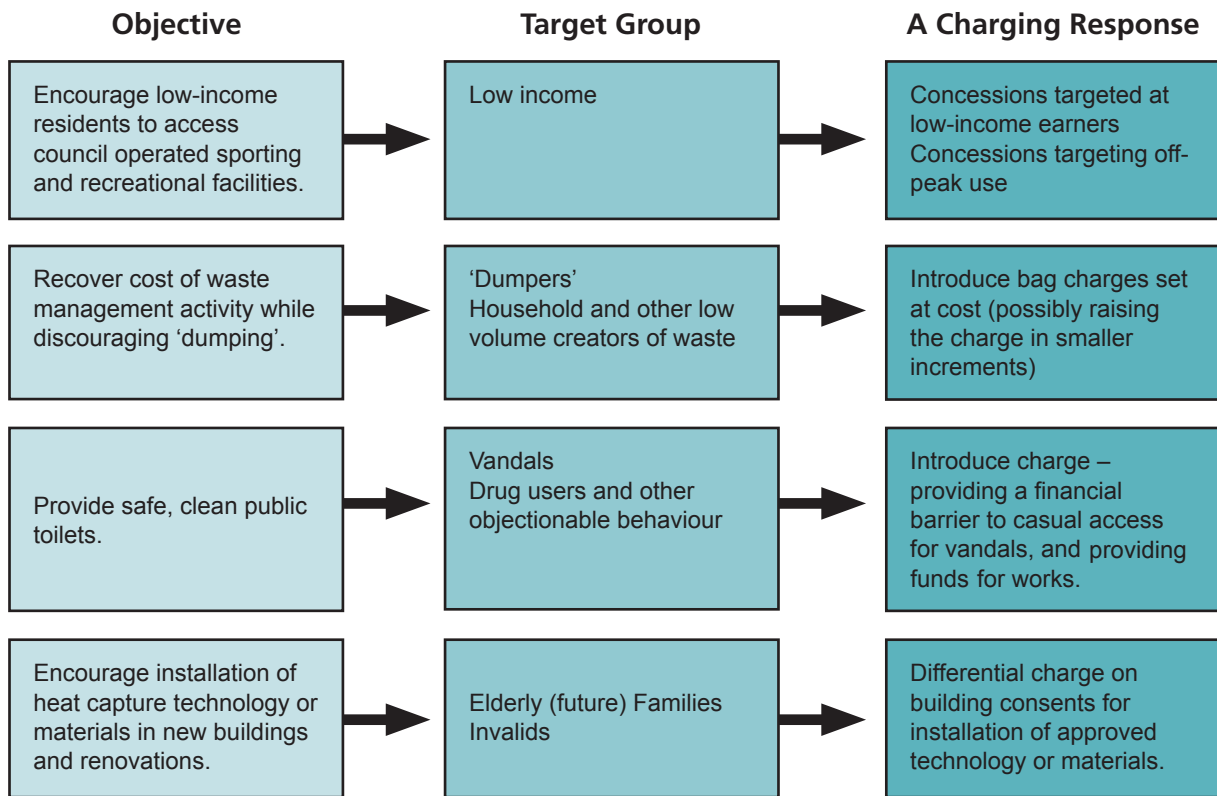
- the end user of the service (who uses the service, when do they use it, why do they use it etc?)
- the council's objectives for delivering the service (these will, or should, form the basis of their performance targets)
- the service in general (the activity management plan for the service).

For that reason, each activity manager should play a central role in the charging decision. But their input for their individual activities should be evaluated centrally by:

- *policy/planning staff* (or whoever it is that advises the council on community outcomes and other strategic priorities) – this is to ensure that the charging policy across the range of activities align and collectively promote the achievement of strategic objectives. This helps avoid situations where, for example, there is an unanticipated expansion in demand for one service because the council is trying to manage demand for another.
- *finance* – to ensure that charging decisions are consistent with the council's overall financial strategy and for other budgetary reasons, although the centrally imposed 'last year plus x percent' is also a policy to avoid
- *and (ultimately) the council itself.*

One useful tip for linking service objectives and charges is to begin talking about target groups, a group of current or potential future service users, or people affected by a service in some way. Thinking of target groups can help link the activity managers and the other parts of council that have an interest in the group. Identifying target groups encourages managers to look closely at the users of their services and identify how they might react to charges. In this way the charge can be linked to other objectives. Figure 3.3 replicates the 'healthy community' objectives in Figure 3.2 but with one very important difference – the target groups have been added.

Figure 3.3 - Linking Objectives, Target Groups and Charging Policy



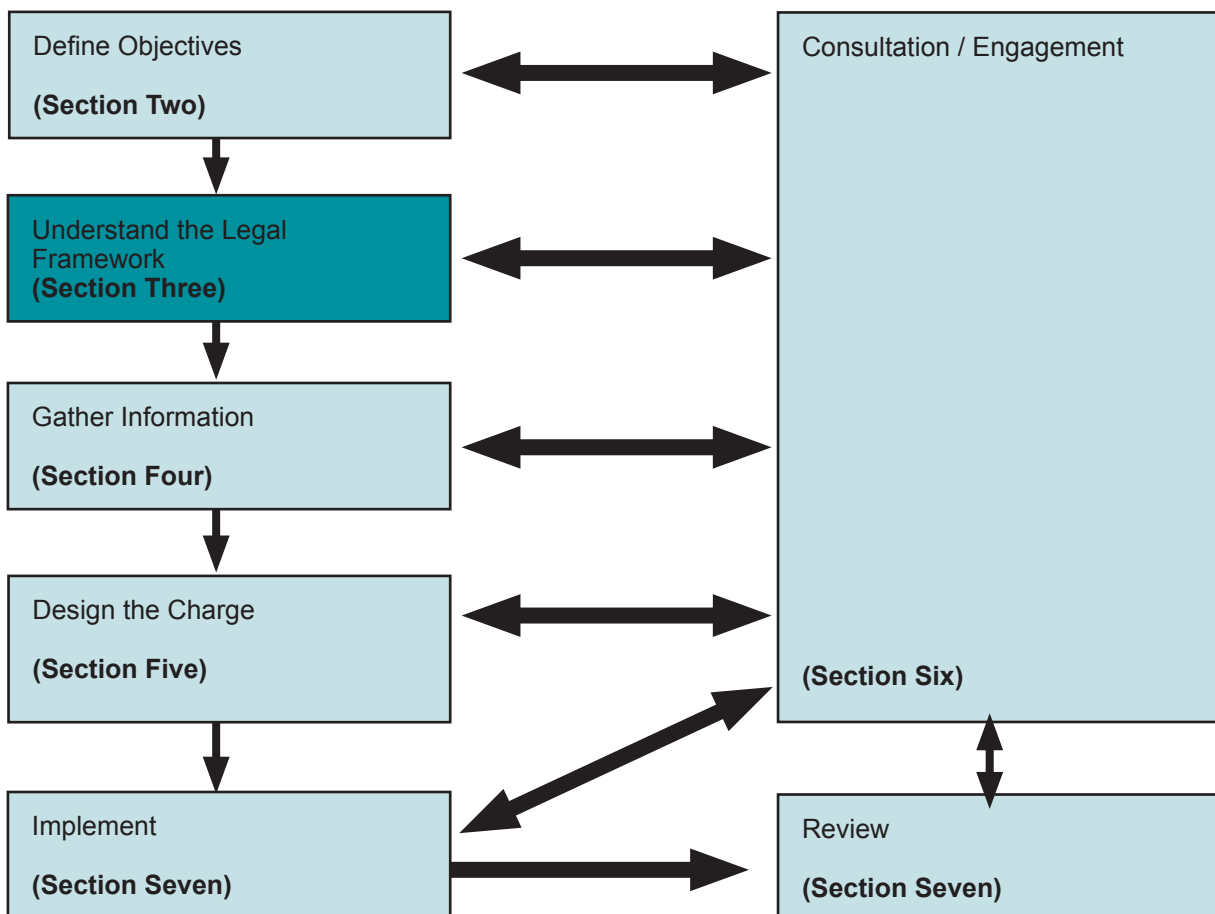
Monitoring and evaluation of the impact of your charges is important. The first step in this process should be to set clear targets – thus providing a measurable benchmark of the success of charging. If the objective was to raise revenue, then how much revenue was raised. If the objective is to change user behaviour, then how much did use change, or to what extent did the pattern of use change?

Many of the measures are likely to come from the suite of information that activity managers already collect for day-to-day management purposes (some of which may be disclosed in your long-term council community plan and annual plan). For other services (such as car parks) it may be possible to gather information from the technology your local authority uses for capturing entry and exit and determining the charge.

Things to Remember: Setting Objectives

1. Sensible charging policy requires clear objectives – without clear objectives there is a risk that charging for different activities may send contradictory signals or even actively work against the achievement of other objectives.
2. Those objectives may be drawn from the strategic priorities of council (including community outcomes), from service objectives or from financial and asset management policies.
3. Charging policy, is in the first instance, something to be developed by activity managers. However, the individual policies do need some form of centralised review to ensure they align and meet corporate priorities.
4. Setting clear targets for charging helps determine how successful the introduction of charging has been.

3.0 UNDERSTAND THE LEGAL FRAMEWORK



This section places charging in its legal context including:

- the links between charging and the making of funding policy under the *Local Government Act 2002*
- the legal scope of the present set of charging powers
- the constitutional and legal limits to charging
- other tips for avoiding successful legal challenge to your charging decisions.

3.1 The Legal Framework for Funding

Charges are one of a range of ten funding sources legally open to local authorities under *section 103* of the *Local Government Act*. As with other sources of funding, the design of your charging system is something which will come as the result of your application of the funding principles and framework of *section 101* of the *Local Government Act* and the documentation of this in a revenue and financing policy.

The discussion in this section is a précis of the discussion in the SOLGM/LGNZ publication *Developing Local Authority Revenues Systems*. Readers interested in the full discussion should click [here](#).

The funding policy process in *section 101(3)* is critical – all funding decisions (including the setting

of charges) must be taken in reliance on this, and its documentary expression in the revenue and financing policy.

3.1.1 Section 101(3) Analysis

Section 101(3) analysis is a two step process. The first step involves consideration of the following for each activity:

- community outcomes - the community outcomes to which the activity primarily contributes (in other words your rationale for service delivery)
- the user/beneficiary pays principle – the distribution of benefits between the community as a whole, any identifiable part of the community, and individuals
- the intergenerational equity principle – the period in or over which those benefits are expected to accrue
- the exacerbator pays principle – the extent to which the actions or inaction of particular individuals or a group contribute to the need to undertake the activity, and
- the costs and benefits, including consequences for transparency and accountability, of funding the activity distinctly from other activities.

These five matters are a ‘menu’ of considerations, no single criterion has greater weight *in law* than the others. Your local authority must be able to demonstrate it has considered each of the five criteria, but can attach more weight to some than others as a matter of policy.

Of these matters, probably only the intergenerational equity principle is of limited relevance to charging (other than to note that charging is one means of ensuring today’s community pays for today’s consumption of services).

Community outcomes and the rationale for service delivery are an important consideration in the design of charges. The rationale for service delivery will be linked to policy objectives that your local authority has, which will generally look like one or more of the objectives in section one.

The user/beneficiary pays principle is directly relevant as charging for services generally makes more sense for those elements of the service that are of primary benefit for individuals and groups, as opposed to the more local authority wide benefits. In a similar vein, where a local authority can demonstrate that a particular individual or group is creating a need for expenditure then they too may be candidates for a user charge.

Last but not least, consideration of the costs and benefits of funding the activity separately will involve consideration of a number of issues relevant to charging. These include:

- *the financial scale of the activity* – the smaller the activity is the less likely it is that charging will be economic
- *what administrative costs would be involved in funding the activity separately* – charging systems may require mechanisms for billing, collection and enforcement. These come with a cost – if these costs reach too great a level charging is unlikely to be economic
- *the distribution of benefits among the community may aid in your decision* – for example, something that is of benefit to a subset of the community may be a stronger candidate for charging than something that benefits the community as a whole, and
- *promotion of value* – separating some activities, especially those to be funded from rates, may assist your local authority in its promotion of value for money.
- *other benefits* – for example to the environment.

The second step is a consideration of the impact the results from the entire step one analysis have for the current and future wellbeing of the community. The following are some examples of things

that your local authority might consider in its *section 101(3)(b)* analysis. This is presented as a starting point to stimulate thinking and is not intended in any way to be an exhaustive list (nor is it a checklist of the things that *must* be considered):

- what is the likely impact of the mix of funding sources on the elderly and others on fixed incomes or low incomes (in other words is there a genuine affordability issue)?
- will the policy act as a barrier to the accessibility of some services (such as cultural and recreational facilities)?
- what implications does the policy have for community groups?
- what implications does the policy have for business in your local authority – are particular activities unduly penalized ?
- is the policy likely to have any effect on people's participation in community activities?
- what is the size of changes in funding arrangements – is some sort of transitional process necessary?
- what effect is the mix of funding sources likely to have on any particular sectors of your community?
- what are the current economic conditions and projected conditions over the life of the policy?
- what incentives will the policy have for development in the district?
- how is the burden of funding distributed across differing sectors of the community?
- what incentives does the policy provide to conserve scarce resources?
- does the policy provide incentives for people to avoid environmentally 'unfriendly' activities?
- what incentives does the policy provide for the preservation of natural heritage?
- what impact might the policy have on people's participation in sporting and cultural activities?
- does the policy provide any incentives for the preservation of historical and other cultural heritage?
- are there particular community or cultural groups that will be advantaged or disadvantaged by the policy?

3.1.2 Documenting Section 101(3) Analysis – The Revenue and Financing Policy

Your local authority must document its consideration of the above in a document called a revenue and financing policy. This is a requirement of *section 103 of the Local Government Act 2002*. Essentially this is a document setting out what revenue sources your local authority will use, and an explanation of why.

3.2 What Charging Powers Currently Exist?

3.2.1 Local Government Act - The Power of General Competence

Section 12 of the Local Government Act 2002 provides local authorities with

“full capacity to carry on or undertake any activity or business, do any act, or enter into any transaction”

and provides that for this purpose, local authorities have

“full rights, powers, and privileges”.

This power is limited by other provisions within the *Local Government Act*, and the provisions of other legislation. However, where there are specific provisions governing charging in the *Local Government Act* or in other legislation they prevail e.g. the charging provisions of the *Dog Control Act* would apply to a transaction involving an exercise of a power under that Act.

3.2.2 Local Government Act - Fee Setting by Bylaw

Section 150 of the *Local Government Act 2002* enables local authorities to prescribe fees or charges for a “certificate, authority, approval, permit, or consent from, or inspection by” the local authority for a matter covered in a bylaw made under the Act, or under another Act. A fee set under this section must not allow for recovery of more than the reasonable costs for the matter for which the fee is charged.

In the case of bylaws made under other legislation or regulation, any provisions relating to fees still apply. For example a local authority cannot use the authority of section 150 to set a fee for inspecting an amusement device, as the *Amusement Devices Regulations 1978*¹³ already set a scale of fees.

At the time of writing we understand that the most common uses of this power are for the:

- issuance of a permit for a class four gaming venue (under section 98 of the *Gambling Act 2003*)
- applications for exemptions from the requirements of the *Food Act* (under section 8B) of the legislation

3.2.3 Other Statutes

There are a number of other statutes which empower local authorities to set fees. These fall into two categories:

- those which prescribe a fee and
- those which provide for a local authority to set its own fees.

There are only a relative handful of powers that fall into the former category. These include:

- *Sale of Liquor* regulations made under the authority of the *Sale of Liquor Act 1989* where a prescribed fee must be paid on application for manager’s licences and liquor licences
- *Amusement Devices Regulations 1978* – made under the authority of the *Machinery Act 1950*¹⁴
- regulation 7(1)(a) of the *Heavy Motor Vehicle Regulations* allows road controlling authorities to charge a fee for issuance of a permit for heavy vehicles that exceed the mass limits of the rule.

Powers that allow for at least some discretion in the setting of fees include the following:

Building Act 2004

Section 219 allows local authorities to impose fees or charges in relation to building consents or for performance of any function or service under this Act. Unusually for regulatory legislation the power is not qualified with the words “actual” or “reasonable” or similar.

Dog Control Act 1996

Section 37 enables local authorities to set their own fees for dog registration and control functions under the Act. These “shall be the reasonable fees prescribed by resolution of that authority”. Section 68 makes similar provision for poundage fees. Both provisions further specify circumstances where a local authority is empowered to charge differential fees (for example for repeated impounding

¹³ Made under the authority of the *Machinery Act 1950*.

¹⁴ This particular regulation results in the often cited (and egregious) case of a local authority inspector having to travel four hours to inspect an amusement device, from which the local authority concerned recovered the princely sum of \$12.

of the same dog, or reductions for owners who can demonstrate competency in responsible dog ownership). Fees are set by resolution of the local authority, the only requirement is that fees must be notified in a newspaper in circulation in the district no less than a month before the start of a registration year¹⁵.

Hazardous Substances and New Organisms Act 1996

Section 23 of this Act provides for local authorities to set fees by bylaw or resolution in accordance with *section 150 of the Local Government Act 2002*. These can cover the exercise of performance of any power, function or duty under that legislation.

Health Act 1956

Section 65 of the *Health Act 1956* permits local authorities to make bylaws for 'the licensing or registration of persons or property' and 'for inspections and other services' and that these bylaws may provide for the '*payment of reasonable fees in respect thereof*'.

Other health related fee-setting powers, include the *Health (Burial Regulations) 1946*¹⁶, *Health (Registration of Premises) Regulations 1966*¹⁷, *Health (Hairdressers) Regulations 1980*, the *Food Hygiene Regulations (1974)*, and the *Camping Ground Regulations*.

Impounding Act 1956

This Act provides for the recovery of reasonable poundage fees. These are set by resolution. This Act also provides for the recovery of actual costs of sustaining impounded animals and of driving them from the place they were discovered to the pound.

Local Government Act 1974

Section 684 (1) (41) deals with the regulation of hawkers, peddlars and itinerant shops and the issuing of permits to trade. The provisions are accompanied by a power to "*fix charges in respect of those permits*". This is a bylaw-making power.

Reserves Act 1977

Local authorities may lease (or give licences to occupy) all or part of any reserve under their control. Local authorities may charge a fee "*for the preparation of the (lease or) licence*".

Resource Management Act 1991

This Act gives local authorities the power to fix charges for administering specified functions and duties under the Act including applications for preparing or amending a Policy Statement or Plan, processing and monitoring resource consents, providing information and supply of documents.

RMA charges must be set under *section 150 of the Local Government Act 2002* and with regard to the following criteria:

- the purpose of charging is to recover reasonable costs incurred by the local authority in respect of the activity
- Individuals should pay only those charges that can be justified on private benefit and/or exacerbator pays principles.

¹⁵ Poundage fees need only be notified 14 days before the resolution takes effect.

¹⁶ These regulations require payment of 'such fee as the local authority, by resolution prescribes from time to time'.

¹⁷ These regulations require payment of the appropriate fee for applications for certificates of registration. These regulations also apply to the *Hairdressers Regulations*, *Food Hygiene*, and *Camping Ground* regulations.

Waste Minimisation Act 2008

The charging powers in this legislation are unusually drawn from a local government standpoint. Section empowers local authorities to set bylaws covering a number of waste management related matters and to charge for services provided. However, *section 46* of that Act explicitly notes that *section 150* of the *Local Government Act* does not apply to the setting of charges, and that

“A territorial authority is not (emphasis supplied) limited to applying strict cost recovery or user pays principles for any particular service, facility or activity provided by the local authority in accordance with its waste management and minimisation plan.”

The Act goes on to mention pricing as an incentive for waste generators to reduce their level of waste.

Local Legislation

Occasionally local legislation will contain a specific authority to set fees and charges for some service or activity regulated by that enactment.

3.3 Charging Powers – The Constitutional and Legal Limits

Charging by public sector agencies, including local government, stems from one very fundamental constitutional principle – that only Parliament has the power to tax¹⁸.

Legislative authority is required. Usually this is done by placing specific authority for the charge in the legislation or in subordinate legislation (i.e. regulations).

As the discussion in section 3.2. makes clear – the scope and requirements of charging provisions across the range of local government legislation can differ widely (sometimes even within the same statute). Avoid making assumptions about charging powers, and always seek legal advice if in any doubt.

As a general rule:

- if the transaction involves the exercise of regulatory or other statutorily required function then the framework is either the relevant statute/regulation conferring the power or (if none is available and the charges is for a certificate, authority, approval, permit, consent or inspection) *section 150 of the Local Government Act 2002*
- if the transaction involves sale of a good or a service that a local authority is not required to provide by statute then the legal authority and framework for charging is *section 12 of the Local Government Act 2002*.

The second core principle is that as only Parliament can provide a power to tax, any charges levied in reliance on statute must bear a proper relation to the cost of providing the service or performing the function. This is particularly true of those charges set for the mandatory functions of local government.

A charge does not need to be called a tax, to be regarded as one for legal purposes. A charge that is

¹⁸ This is enshrined in *section 22* of the *Constitution Act 1986*.

potentially a tax can be challenged in the Courts, or at Parliament’s Regulations Review Committee. Where the courts view a particular charge as an unauthorised tax, they will declare them *ultra vires* and set them aside¹⁹. The Regulations Review Committee will report a charge of this nature to Parliament which may then (by vote of the House) either allow or disallow the charge²⁰.

Generally speaking, the characteristics of a tax are that it is mandatory, levied for a public purpose, and enforceable by law²¹.

A fee that bears a proper relation to the cost of providing a service or performing a function will not generally be seen as a tax. In a similar vein, a charge for a service where the customer has a choice in whether to consume the good and/or choose the supplier is unlikely to be seen as a tax (for example, a swimming pool entry fee).

So what do phrases such as “bear a proper relation to” and “reasonable costs” actually mean? The main thing to keep in mind is to know the legal authority for charging well as what is reasonable may vary from statute to statute. Some important principles in this regard are:

1. *statute generally permits recovery of the direct costs of performing functions by way of a charge* - in the first instance it is the relationship of a cost to a particular service or function that determines whether it is a direct or indirect cost, as opposed to the type of cost or part of the organisation that incurred the cost. Only those costs directly related to the service or function can be classified as a direct cost. This principle and the third are less relevant to those charges set under the authority of *section 12 of the Local Government Act 2002 as matters of legal compliance*, but are still useful to keep in mind as *when developing robust and equitable charges*
2. *cross-subsidisation is generally not permitted* – statutory provisions generally tie the recovery of costs for performing regulatory functions to the provision of specified services or functions. Using revenue recovered from a charge for one function (say issuing dog licences) to fund another (say resource consents) is generally not permitted. Care should also be taken when setting charges for different functions empowered by the same legislation, as the degree of specification in a statute may not empower cross subsidisation even between these activities. This principle may not apply to charges for discretionary activities (such as the swimming pool fee) but may also be relevant from a policy standpoint. If your local authority is using revenue from one function to fund another it is effectively expecting users of that service to fund the consumption of others. A clear rationale is needed (this should be located somewhere in your revenue and financing policy).
3. *care should be taken if incorporating indirect costs, where recovery of these costs is permitted* – some costs may contribute to the provision of a service or function while not

¹⁹ In *Carter Holt Harvey vs North Shore City Council (2006)* the High Court found that four local authorities could not require licensed waste collectors to pay a waste levy that was unrelated to cost recovery for a service received. In *Re a Bylaw of Auckland City Council 1924* Stringer J held that a charge for a taxi license fee made under the Bylaws Act 1910 that went above the reasonable cost of ‘the legitimate purpose of regulation’ was taxation for the use of public streets and required express authority.

²⁰ But note that the Regulations Review Committee can consider charges on the following other grounds:

- (a) the charge is not in accordance with the general intent of the statute, for example where a fee is set so high it defeats the purpose of the statute by say encouraging non-compliance
- (b) the charge trespasses unduly on personal rights and liberties – including imposition in unfair circumstances, a charge set that reflects inefficiency on the part of the organisation setting it,
- (c) a charge set other than in accordance with any consultation and notice provisions of the relevant legislation
- (d) a charge that makes an unusual or unexpected use of a power
- (e) a charge that represents such a shift in policy that it is more appropriate for Parliamentary enactment.

²¹ These were contained in an *Australian High Court decision, Air Caledonie and Others vs Commonwealth of Australia*.

being incurred exclusively for that purpose. Commonly referred to as overheads these include items such as rent, electricity and (even) the Chief Executive's salary. Legislation varies in the degree to which it allows recovery of these costs, but one that is almost never incorporated into legislation is the cost of policy development (so for example the cost of developing a gaming policy cannot be recovered through the issuing of permits for class four gaming facilities)²².

Note that the above discussion was deliberately pitched at the level of general principles rather than an enactment by enactment discussion. Readers can doubtless identify exceptions to the above. Again, the lesson is be familiar with the specific legislation governing the activity your local authority wants to set charges for.

3.4 How to Avoid A Legal/Constitutional Challenge

As we have seen charging can arouse 'robust' debate – some of the biggest opponents of charging can be among the most articulate and 'connected' (in the political/media savvy sense) in the community. But following the advice in these guidelines should minimise your risks.

Some situations to avoid include those where:

- your proposed charges are out of line with comparable fees elsewhere – without apparent justification (this is not a recommendation for benchmarking)
- decisions of council and/or working papers contain (or betray) a hint that the charge may contain some elements of cross-subsidisation (for example, where some charges have been substantially increased and others left unchanged, with no explanation of why)
- working papers do not explain how the charge was arrived at
- the charge seems excessive in relation to the service provided (also a favourite of the media).

At a minimum then a report to council should:

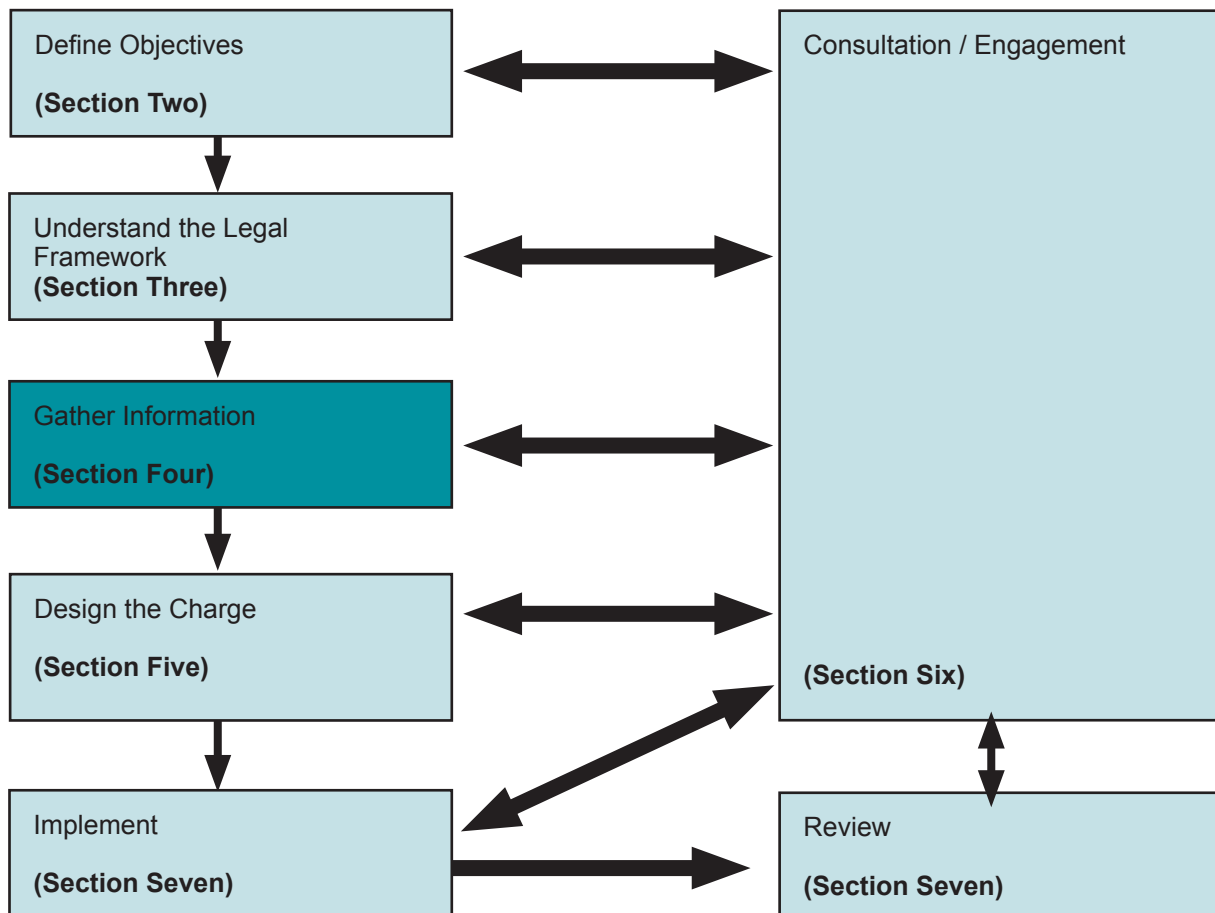
- be clear in its description of objectives of, and methodologies for charging (no local authority wants to be "done by its own documents")
- set out specifically the legal basis for the charge
- a clear description of what service is provided and why (legal requirement, community outcomes etc)
- objectives for the charge
- how the charge was calculated (with specific reference to the costs both direct and indirect have been included – and if any excluded)
- an explanation of the charging methodology – specific enough that the reader should be able to determine for themselves exactly what was put in (or left out) and why.

²² The reason that is usually given is that there is a strong element of community good that arises from the development of these policies, and that a community contribution is the 'price the community pays' for being able to determine where and on what terms certain types of activity take place.

Things to Remember: Understanding the Legal Framework

1. As with other funding decisions, a decision to charge should emerge out of your local authority's consideration of the funding principles of *section 101(3) of the Local Government Act*, and be documented in a revenue and financing policy.
2. Fees for services that a local authority is under legal obligation to provide cannot be set without legal authority.
3. The exact scope of the legal authority for charging varies from enactment to enactment – make sure you understand the specific framework for your proposed fee or charge before you begin.
4. Fees should bear proper relation to the cost of providing a service. A fee that does not meet this test may be a tax in disguise especially if the fee is mandatory, levied for a public purpose and enforceable by law.
5. Statute generally permits recovery of the direct costs of performing functions by way of a charge.
6. Cross-subsidisation between services is generally not permitted.
7. Care should be taken if incorporating indirect costs, where recovery of these costs is permitted.

4.0 GATHER INFORMATION

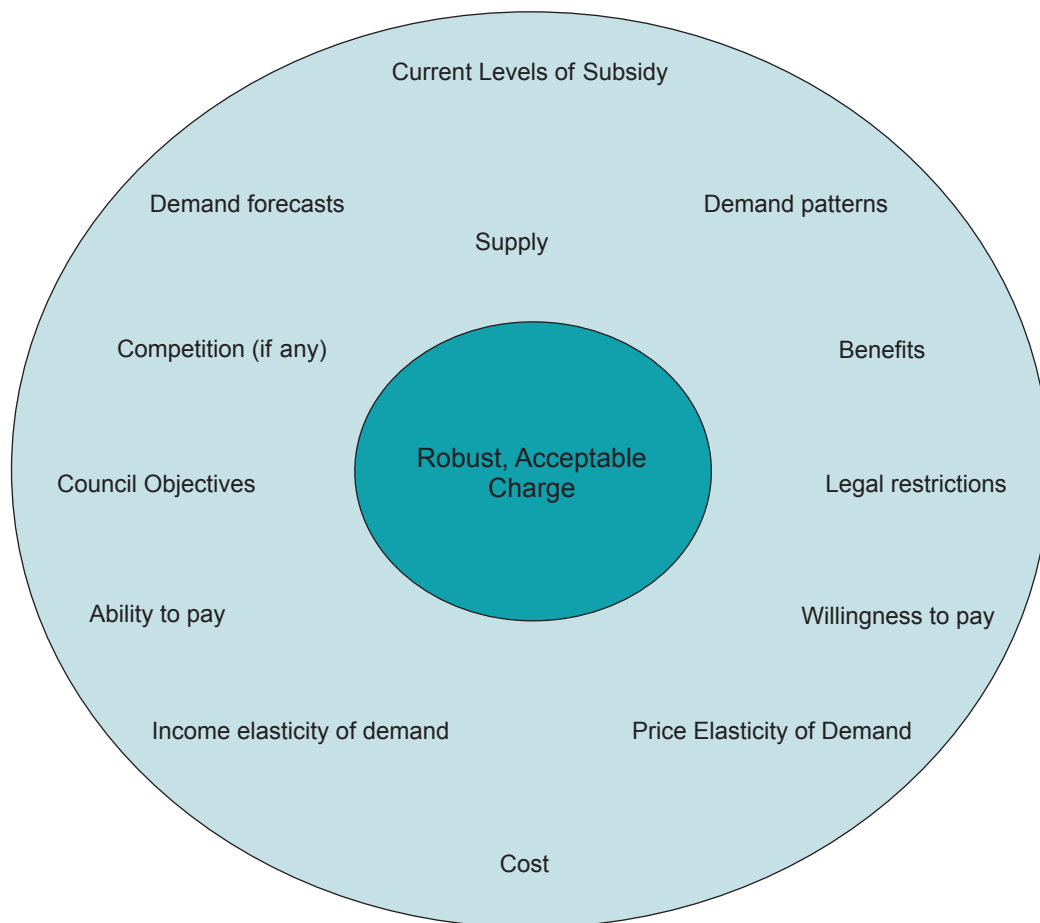


Do any of the following seem familiar:

- charges set on an across the board basis
- charges set on the basis of last year's charge plus (or minus) some predetermined factor (often the rate of inflation though not always)
- charges set with little reference to the likely impact on levels of use (or often without information on current levels of use)
- debate at council level focussed on 'ability to pay', without any facts to support or refute contentions
- the process of getting users views is left for LTCCP/annual plan consultation (where it either overshadows the other issues in the plan or the community alleges it has been 'blindsided' by the issue)

If any of this sounds familiar to you, then it may be that the information you've gathered, and on which the decision is based, is lacking some key element. This section helps you obtain all of the information that is relevant to a robust charging decision.

Figure 4.1 shows the information that managers often find useful when making decisions about charging. Of the items in the diagram, we have covered council policy objectives (section two) and the legal restrictions (section three). This section discusses the rest.

Figure 4.1: The Charging Decision – Relevant Information**Note**

This section provides a checklist of information which can be helpful in making charging decisions. Not all the information will be relevant to a particular decision, other information may be relevant in some cases. No local authority is under any obligation to obtain every item described in this section.

4.1 Cost

Firstly, and most obviously, a robust charging decision needs to take account of the cost of providing the service.

It is important to ensure that all costs are identified, even if your local authority does not intend to recover them via a charge as the level of subsidy from general revenues:

- should be the result of a conscious policy decision not the accidental by-product of one
- is both a useful piece of information when consulting and a useful piece of information when the inevitable question 'what do I get for my rates' is asked

4.1.1 What Does Cost Mean?

What do we mean by cost? When you ask most people to define cost, they tend to go straight to the definition of cost as promulgated by the accounting/financial profession. This definition of cost includes all operating and capital expenditure and all of the other items typically found in an income and expenditure statement (or the activity statement and budget for the activity in question). This definition of *accounting* or *financial* cost may include non-cash items such as depreciation²³ (where relevant).

This is distinct from *economic cost* which would also include an allowance for the opportunity cost of capital used in providing the service. Most standard economics textbooks would recommend that where possible this cost should be incorporated into charging. Few local authorities in New Zealand use cost of capital as a resource allocation tool, and the issue has created controversy in the past. Suffice to say, if your local authority is one of those that uses cost of capital in this way then it would make sense to include this in your charges (where possible). Readers interested in exploring this further are referred to Wilkinson (2005), *Local Government Asset Decisions and the Cost of Capital*.

4.1.2 Types of Cost

Understanding costs and cost drivers is a critical piece of information for the setting of charges. Some types of charging structure are better for recovering costs than others. Before examining cost drivers in detail we need to briefly identify the two different types of cost – fixed and variable. A *fixed* cost is those which are incurred even if no actual output is produced, that is they remain at the same level even as output increases. On the other hand variable costs increase and decrease as output increases or decreases.

Costs can also typically be categorised into the following types:

- access (or customer) costs
- capacity (or demand) costs
- commodity (or volume) costs
- common (or overhead) costs.

Access costs are related to the connection of users to a system and maintaining the connection. These are often associated with infrastructural networks such as the cost of laying a pipe or installing a meter to a user's home and the ongoing costs of maintaining these. But there are other examples of access cost in those services that are targeted specifically to individuals such as the cost of registering someone for library services, or social housing. There are both one-off and ongoing costs of this nature – for example the one-off cost of installing a meter and then the ongoing cost of reading a meter.

Capacity costs are those involved in providing for peaks in the use of a particular service. These represent the cost of structuring delivery of the service in order to meet what is estimated to be the maximum demand in use of the service. Often these are associated with the infrastructure heavy

²³ As a general rule, it is not appropriate to recover the cost of capital expenditure directly through charging. These items are “lumpy” which can create volatility in the charge. Attempting to recover capital costs via a charge may offend against intergenerational equity principles – that is to say that current users would be expected to subsidise the consumption decisions of future users. Capital costs can quite reasonably be recouped through incorporating either of interest on borrowings for capital, or through depreciation (but not both). If the latter then this is a very important practical reason for obtaining robust asset values.

services (such as the need to provide water pressure at sufficient levels for fire-fighting needs and for “dry” seasons), but can also apply to other services as well (for example there are particular times of the year that people are more likely to seek consents for particular activities such as lighting outdoor fires, building work etc). Generally peak use is easily forecast from historic data.

A *commodity cost* is a textbook example of a variable cost, and will increase as more of the service is produced. Returning to the water example – some examples of commodity costs might be pumping costs and the cost of the chemicals used in treating water for consumption. Many of these types of cost involve consumption of consumables.

Common costs – a catchall term for costs not associated with access to a system, usage or meeting peak demands.

The above are all examples of *direct* costs which few could argue should be recovered (if the legislation permits). But there are a whole other category of *indirect* costs which contribute to the production of a service but are not incurred directly for that purpose. These items are commonly referred to as overheads and include items such as rent, electricity, salaries of staff in back office roles (such as the Chief Executive). Some charging powers allow for the recouping of these costs and where allowed it is good practice to recoup these costs in this way.

If your local authority wants to recoup these costs via charging then it will need to develop robust means for allocating these costs across different activities. Ideally these would be related to the extent to which the indirect cost gives rise to, or was created by the good or service. Where a causal relationship cannot be inferred then the allocation needs to be conducted systematically across all activities. Some examples of possible bases might include number of staff, volume of service, office space used.

Determining methodologies for allocating these indirect costs is a decision that must be made on an organisation wide basis. Some element of ‘size’ and ‘scale’ should be applied to allocation of costs – a very small activity might be allocated little or no indirect cost if for example the impact of that cost would dwarf the direct cost. All decisions on cost allocation must be rigorously documented both for transparency’s sake and for future reference.

Be realistic in your assessments of cost – no-one will thank you if at the end of the year your activity has under-recovered. Costing should be based on the best available information and reasonable assumptions – costings that are not prepared on this basis run the risk of successful challenge.

There may be different costs involved in providing service to different types of user. Where these differences are not significant then a blanket ‘one size fits all’ approach to costing is appropriate, where there are significant differences it may be necessary to segment.

4.2 Demand Forecasts and Demand Patterns

The next important pieces of information relate to forecasts of future demand, and any information that your local authority has on patterns of demand. In some circumstances it could be appropriate for a local authority to base forecasts on the expected production of a service, rather than demand (for example, where a local authority is consciously deciding to set aside an inventory of some particular good).

In addition to the total level of demand it may be necessary to collate information about patterns of demand where:

- there are differences in the nature of the service provided to different users
- there are differences in the cost of providing the service to different users
- one or more groups of users are currently, or may be, provided with a concession.

Some of the information that may be useful includes:

- *users* - what groups actually use the service, when and how
- *non-users* - are there any target groups not using the service and what is known about the reasons for their non-use (are there particular barriers)
- *peaks and troughs in demand* – is the service used more at some points than others (for example at particular points in the day, or periods of the year). If so, why is use more common at those points than at others.

The main information source for information will be your asset management plans and performance management systems. For a particularly significant activity (where for example, revenues are high) some data might be obtained through surveys and other field-type exercises.

Another important caveat is that the introduction of, or significant change to, charges can have impacts on services that are substitutes. For example, a significant increase in entry fees for the council run swimming pool, might increase usage of other recreational facilities. You may need to give consideration to this.²⁴

4.3 Price Elasticity of Demand – Estimating Likely Customer Response

Have you ever noticed that an increase in charges does not necessarily mean that use of the service declines by the same amount (or on occasion use does not decline at all). Economists refer to the relationship between change in price and change in demand as *price elasticity of demand*. This is a valuable desktop tool that can be used as one method of estimating the impact that changes in the charge for a service could have on demand. The formulae for estimating price elasticity of demand is very simple

Price elasticity = Percentage change in quantity demanded/percentage change in price.

If the result is less than one then demand for the service is said to be inelastic (e.g. as price changes, demand will change by a lesser percentage). If the result is greater than one, then demand for the service is said to be elastic (in other words as price changes, demand changes by a greater percentage). If the result is exactly one then demand is said to be unitary (or unit) elastic (that is to say that demand will change in exact proportion to price).

Economic theory holds that:

- price elasticity of demand tends to be greater where there are substitutes for a particular good or service (in other words the demand for services that the consumer has little or no choice but to consume will tend towards the inelastic²⁵)

²⁴ One tool for assessing the likely impact of charging in one service on demand for another is cross elasticity of demand. Measured as the percentage change in demand for a service (A) divided by the percentage change in price of another good B. If the result is positive then the two goods are said to be substitutes and you can expect that a change in the charge for B could have an impact on demand for A.

²⁵ This may be one economic policy reason for legislative prescription that exists on many forms of charging for regulatory functions, inelastic demand means there is potential for charges to be increased.

- price elasticity of demand tends to be greater in the long-run than in the short-run
- as incomes increase, an individual's price elasticity of demand tends also to increase.

The concept of price elasticity of demand can have important policy implications. To take some examples:

- if demand for a particular service is inelastic then an increase in charges is likely to generate an increase in revenue (though of a lesser degree than the increase in the charge). On the other hand if demand for a service is elastic then the likely consequence of an increase in the charge will be a reduction in revenue as demand falls by a greater degree than the charge^{26, 27}
- using charges as a tool for demand management will be most effective where demand for the service is elastic, although where demand for services is inelastic there will still be some reduction in demand.

4.4 Ability to Pay and Income Elasticity of Demand

How often have you heard an elected member or community member express concerns that a change in charges may 'make a particular service unaffordable' or that a particular charge might deny access to the lower-income. These are perfectly valid concerns to have, but often judgements like these are based on emotion rather than solid facts.

A robust assessment of ability to pay will involve some form of comparison of the actual charges and/or public spending on the particular service vis-à-vis income in your district. If desired you could also compare the charge with the levels of support paid to various low-income groups (superannuitants, the unemployed etc). These data can readily be obtained from:

- Statistics New Zealand (average and median annual incomes, these can be obtained down to census area unit level)
- Work and Income New Zealand (levels of the different types of income support).

If there are particular target groups outside the low-income it may also be worth considering their ability to pay (if access is the reason for identifying them as a target group).

This kind of data lends itself well to a comparison of the charge and levels of income. Note however that this type of analysis works for services that householders demand, it will not be as useful for services that are demanded more by businesses (such as various types of health inspection fees, and consents).

Related to ability to pay is the concept of income elasticity of demand, a measure of how responsive demand is to changes in incomes. This is calculated as the percentage change in demand divided by the percentage change in income. If the result is negative then the service is said to be an inferior²⁸ good (i.e. as incomes increase less of the good is demanded), if the result is positive the service is said to be a superior or luxury good²⁹.

²⁶ And in the rare cases where demand is unit elastic, a change in charges will ceterus paribus, have no impact on revenue as the demand response exactly matches the change in the charge.

²⁷ One particular pricing strategy (known as Ramsey pricing) involves targeting the services where demand is most inelastic.

²⁸ Note that the terms inferior, superior or luxury are purely economic jargon and does not indicate any value judgement about the goods themselves (it may be wise to avoid using the terms inferior and superior in reports that are likely to be made public).

²⁹ The classic example given in many economic textbooks of income elasticity of demand in action is in demand for meat, where eye fillet steak is usually viewed as a superior good and luncheon sausage as an inferior good in that as income increase people will demand more of the former and less of the latter. Many of the leisure and recreational services provided by a local authority may have lower income elasticities, for example as income increases people may make fewer 50 cent paperback hires from the library and go to the movies instead.

Note that funding from property taxation may have the impact of obscuring the relationship between income and demand for a good. The higher the level of rate funding vis-à-vis the cost of providing the service the less likely it is that any estimate of the income elasticity of demand will have real meaning.

4.5 Supply

The supply of a service can be a relevant factor to a charging decision, especially where supply is very limited and there may be a need for rationing. This is commonly used with car-parking in central business districts, where tariffs are designed in such a way to encourage short-term stays and ensure parking spaces are regularly turned over. Usually a pricing approach to these sorts of issues will also be linked with other strategies such as regulation enforcement (e.g. ticketing, bylaws etc).

4.6 Current Subsidy/Concession

There are two levels of subsidy at work in many charging decisions:

- the first is at the macro-level and involves the subsidy of the cost of services from general revenues (general rates and other non-activity specific revenue)
- the second is at more micro-level and involves situations where a local authority determines that one group of users should receive the service at a reduced rate.

Both need to be the result of a conscious policy decision on the part of council so that both the amount of subsidy and the rationale can be exposed for community consultation and debate.

From time to time you may come across a particular subsidy where there does not appear to be a rationale stated. These “historical accidents” should be identified clearly in all reports without attempting to retrofit a rationale.

4.7 Willingness to Pay

Willingness to pay is a different concept from that of ability to pay, yet the two are often confused. The key distinction is best thought of as “don’t want to pay” as opposed to the genuine “can’t pay” or as one regional council put it “our (charges) are unpopular as opposed to unaffordable”. It is surprising how often the public refer to affordability when they are actually making a statement about their willingness to pay, and how often elected members refer to affordability when they are really referring to their perceptions of willingness to pay.

Willingness to pay is the amount that a potential user would be willing to pay or sacrifice in order to receive a service.

Obtaining information about willingness to pay is not something that should be regarded as essential to every charging decision. For example, there is little point in recovering information about willingness to pay where charging powers are tightly limited to recovering reasonable costs or similar. But willingness to pay might be an issue where there is some major expansion or upgrading to the service and there are doubts as to whether users see the cost-level of service tradeoff.

This is information that can be drawn from formal surveys or from consultation with the community (including possibly drawing information from the results of previous exercises).

4.8 Competition

Circumstances where local authorities are in *direct* competition with the private sector are rare.

What may be more common are circumstances where the private sector offers a service that is a substitute for a service offered by the local authority (for example the movie theatre or video store as an alternative to paperback hire from the library).

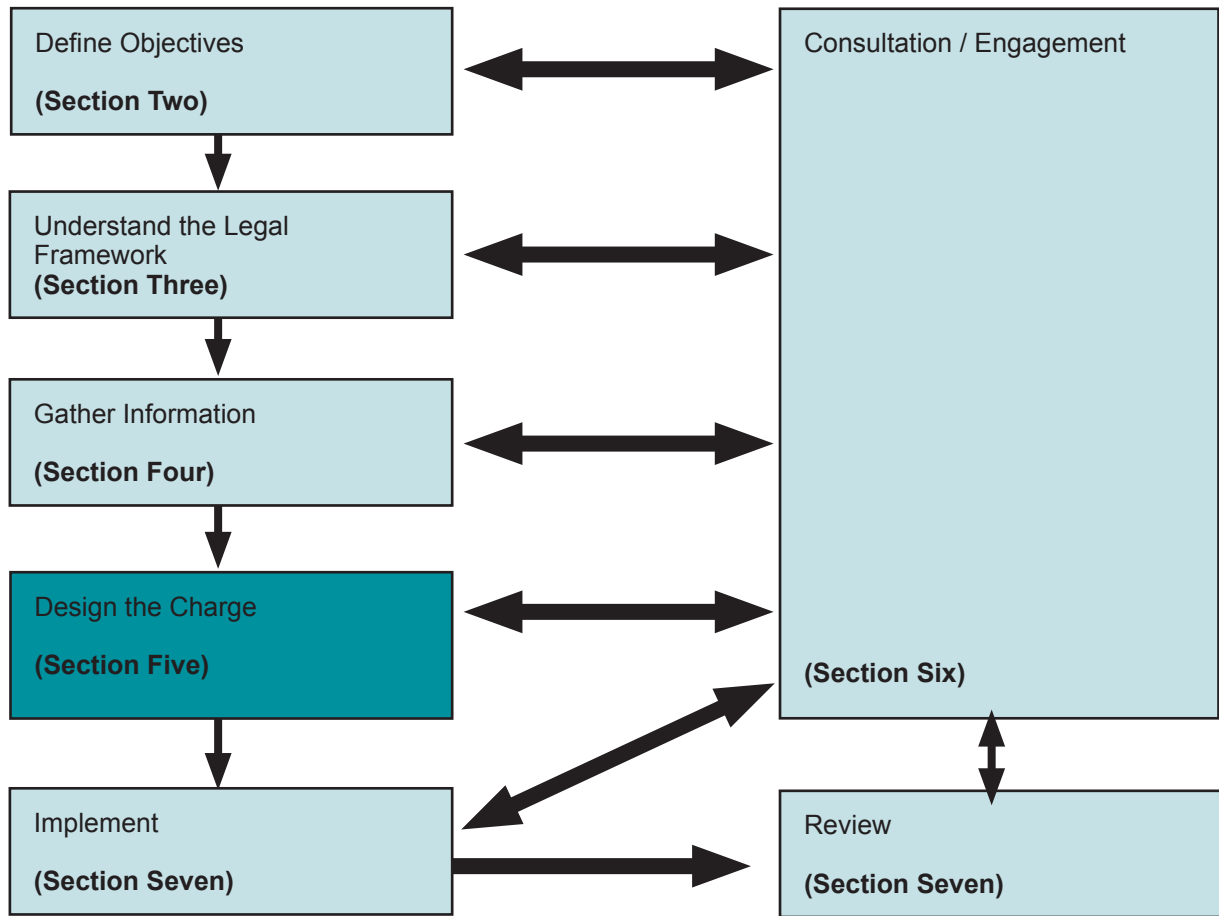
While local authorities should actively seek to deliver services at the lowest possible price consistent with legal requirements, the existence of the private sector needs to be retained in the 'back of the mind'. The best way to do this is to price to recover full costs where possible, with subsidy being a clearly explained exception rather than the norm.

Consideration of the effects on, and possible response from, the competition may not be information necessary for every decision (for example, those services where there is no competition).

Things to Remember: Gathering Information

1. Local authorities may find the following information useful when making pricing decisions:
 - cost
 - council objectives
 - legal restrictions
 - demand forecasts (or occasionally production forecasts)
 - demand patterns
 - price elasticity of demand /consumer reaction
 - ability to pay and the income elasticity of demand
 - supply
 - willingness to pay
 - current levels of subsidy (both of individuals/groups and from general revenues).
2. All costs should be identified, even if your local authority is unlikely to agree to (or is prevented from) full cost recovery when charging. The community should have the opportunity to comment on proposed subsidy (if any).
3. In many cases, recovery of indirect costs is contemplated by legislation. Where authorised these should be costed. The methodology for allocating these costs across activities should be robust and consistently applied.
4. It is important to categorise costs into fixed and variable and determine drivers of cost – these may be relevant for the design of charging and concession structures.
5. Price elasticity of demand is a useful tool for estimating the degree of response that demand for a service may have with respect to changes in the level of charge for the service.
6. If ability to pay is likely to be an issue then robust statistics on household incomes can be obtained from Statistics New Zealand and Work and Income. Income elasticity of demand can also be a useful tool.
7. Where competition exists some analysis should be undertaken of the impact of charges on competition.

5.0 DESIGN THE CHARGE



Having looked at the legal framework for charging and thought about the information requirements for a charging decision and what your local authority is hoping to achieve by charging, you will now be in a position to think meaningfully about the actual design of a charge. This section begins with a discussion of some key principles for charging before moving to a warts and all discussion of various strategies for designing a charge. Finally, this section turns to a brief discussion of equity issues and collection systems.

5.1 Setting the Charge – Some General Principles

The following are some general principles that should be observed when actually designing a charging structure:

1. In the ideal world, charges would be set before the good or service is produced. In cases where production and charge setting coincide (or charges are set post production) there may be some undermining of incentives to cut cost.
2. The initial proposals for design of the charge should ideally be undertaken by the relevant activity manager, and reviewed by policy and/or finance staff for consistency with organisational objectives, correctness of the calculation and the like.

3. Charges should be set on the basis of full cost recovery unless legislative or policy considerations dictate otherwise. Full costs include both direct and indirect costs (where recovery of these is permitted) including depreciation, interest, and cost of capital (where a local authority uses this tool). Where full costs are not recovered then the rationale must be made clear and explicit (e.g *section x of the ABC Act 19xx* does not permit recovery of ..., or the council wishes to etc). Subsidy from general revenues should be declared.
4. Charging structures should be simple to understand and implement as is consistent with the nature of the service and the objectives for the charge. For example, your local authority would probably avoid designing a complicated charging structure for a service where demand was homogenous (see principle 6 below) and the amount at stake was a small portion of the total cost of providing local services.
5. If your local authority has decided to segment users (and current non-users) into target groups and different service is provided to the different groups, then the groups should be assessed different charges (if differential charging would not undermine any policy objectives and is economically and practically feasible),
6. In a similar vein, if substantially the same service is provided to different categories of user, simplicity in the fee structure suggests that the charge should be the same unless there is a policy reason to charge differentially. In particular, users who demand priority service should be charged a premium price (where this is possible).
7. Where legally possible and sound on policy and economic grounds, consideration should be given to differentials for peak and off-peak demand to better spread demand for services (and manage the need for capacity extensions).

5.2 Some Charging Strategies

In cases where demand for a service is homogenous and/or the service is a minor part of the overall local authority and/or the sole objective is cost recovery the appropriate pricing strategy might very well be to charge at average cost³⁰. But there are many other strategies which can be applied to the design of charging structures. Four of the more common strategies are:

- marginal cost pricing
- two or multi-tier charging
- block charging
- rate of return charging.

5.2.1 Marginal Cost Pricing

Marginal cost is the cost of producing the next unit of the service. Classical economic theory tells us that setting your charge equal to marginal cost provides the best signal from the standpoint of economic efficiency.

Marginal cost pricing is likely to be more effective as an instrument where there are no significant elements of fixed cost associated with the service i.e. costs are mostly variable. In other cases marginal cost pricing generate either a significant revenue shortfall or require some form of fixed charge on top (see two-tier pricing in section 6.2.2).

³⁰ Total cost number produced.

Marginal cost pricing in its purest form is unlikely to generate prices which are stable –especially in cases where costs vary according to seasonal or daily peaks or where capability to deliver the service requires clumps of resource. In practice, many marginal cost pricing schemes involve some degree of smoothing and a small number of rates.

5.2.2 Two or Multi Tier Pricing

A two tier price has two components – a flat charge and a charge that is based in some way on usage. With multi-tier pricing the usage based charge is split into differing components – these are often designed to reflect marginal costs by applying different rates at peak times and the like.

This pricing strategy should be very familiar to most readers – it is common with utility supply (energy, telecommunications and the like³¹) and is also a common basis for local authority metering of water consumption. It may also subconsciously feature in many decisions around the user charge/rate split at the present time (with the rate component being used as a surrogate for the fixed charge).

Two or multi tier pricing usually arises out of concerns that pricing purely on marginal costs may mean some fixed costs are not-recoverable. For this reason two-tier pricing lends itself well to those activities that draw on ‘networks’ of infrastructure (as would be obvious from the above examples).

Two-tier pricing can be justified on equity grounds (e.g. everybody who accesses the network contributes the same amount, and then you pay for what you use on top). But attention does need to be paid to the level of the fixed components of any charge and the affordability implications of these. Opponents of user charging also claim that, at the margin any user based charge acts as an incentive for people to economise on their use of the service – possibly to their detriment (although there is often little or no evidence to support this).

5.2.3 Block Charging

Block charging is a volume based charge where the amount of the charge varies as consumption changes. For example, for the first 100 units consumed, the charge is \$1 per unit, for the next 100 it is \$2 and so on.

The two main block charging strategies are *increasing block* charges where the first tranche of consumption is charged at a lower amount, and each successive tranche is charged at a higher rate. This may be an appropriate strategy to use:

- where access for low income earners is a concern (the low charge for initial tranches of consumption allows them to access at least some of the service)
- a local authority wants to encourage use of the service to achieve some policy objective
- demand management is a key objective (over and above a certain level of use the charge increases and encourages only those who truly value the service to keep using).

Decreasing block charges start with a high charge for the initial tranche of consumption and then reduce with each successive tranche. This may be an appropriate strategy to use where:

- there are strong economies of scale in the delivery of the service (and hence where the marginal costs of producing high levels of output are very low)

³¹ Many privately owned utilities also take this a step further and charge a connection charge to recover the one-off costs of connecting new users to the network.

- there is some negative effect associated with consumption of the service and the local authority wishes to minimise use of the service.

5.2.4 Rate of Return Pricing

Rate of return pricing is a strategy where costs are estimated and a predetermined rate of return (profit) is factored in. The charging structure is then designed in such a way as to achieve this rate of return. This is sometime referred to as “cost-plus” pricing in that the price is arrived at through identifying the costs and then adding some pre-set additional level of charge.

Most local government charging powers are based on the recovery of actual or reasonable costs – the concept of rate of return is not usually contemplated, making this strategy a non-starter. It may be an option in some cases where charges are set under the authority of *section 12, Local Government Act 2002*.

The main drawback of this type of charging strategy is that it provides weaker incentives on managers to control their costs than other strategies. In a situation where demand is likely to change rapidly, rate of return strategies would mean either frequent changes to prices or some degree of tolerance in the expectations of return (i.e. ‘overs’ and ‘unders’ would be permitted).

An explicit ‘rate of return’ strategy is likely to be controversial (e.g. arguments are often raised that local government does not exist to make a profit, the profit is being used to cross-subsidise other services etc).

Rate of return pricing could be seen as inequitable as those with the lowest price elasticities of demand (e.g. people who ‘need’ the service or have no alternative sources of supply, contribute most to the return while others do not).

While this strategy is available in some circumstances, it should be used with extreme caution.

5.3 Equity Concerns

Equity in local government funding can be an important objective especially as it relates to some or all of the following:

- low income users
- smaller entities (especially where users of the service are primarily benefits)
- users located in remote areas and
- heavy users of the service.

There are a number of concepts of equity in existence, making equity a subjective concept (is it equitable that some users cannot access the service because the price is ‘too high’, alternatively is it equitable for some users to pay a higher price than others). Some other useful notions of equity are:

- *horizontal equity* is the idea that like should be treated alike, those in similar circumstances should be treated in a similar way

- *vertical equity* is the idea that those who have a higher income should be treated differently. This is often linked to the concepts of progressive, regressive or proportional tax systems³²
- *intergenerational equity* – relates to the treatment of individuals over time, all other things being equal, today's residents and ratepayers should not subsidise the consumption and production decisions of future ratepayers and vice-versa.

Equity is a policy decision for elected members. While reductions in charges for target groups could and should be considered, the revenue and policy impacts means that equity policy should not be made 'on the fly'. In preparing for discussions with elected members a wise local authority will attempt to frame the debate on these issues ahead of time.

Where equity is being framed in terms of affordability and its impact on access to the service, your council should form a judgement on what role it sees itself having with income distribution. If your council considers something is an income issue then it may be more appropriate that the matter be left for central government resolution through the tax and benefit system (or other central government programmes such as the SuperGold card for superannuitants).

If your local authority considers that concessions are a necessary adjunct to charging then:

- ensure the criteria for concessions are clear and unambiguous – they should receive the same level of attention to detail as a rates remission or postponement policy. And the criteria must be rigorously and consistently used. Unclear or ambiguous criteria will be tested by the public. The inconsistent application of criteria adds to the perception that charging is purely arbitrary
- try to design concessions with wider applicability than a single activity, if charging for two or more activities that have the same target groups there is a case for a single concession with the same criteria. Multiple concessions are confusing for those trying to claim a concession, can reinforce perceptions that the charging system is illogical or arbitrary. It is also administratively wasteful
- where possible base the criteria for concessions on information that people have readily on hand (for example, possession of a SuperGold or Community Services Card)
- ensure that an individual's access to concessions is reviewed periodically. For this reason receipt of a concession should involve some form of action on the part of the user, usually some type of application process is the best means for this.

5.4 Collection

An efficient and effective system for collecting the charge is critical. If evasion or avoidance is high it will undermine the credibility of the system, and mean that local authorities fail to collect revenue. Collection is therefore a critical element in the design of any charge.

Cost and inconvenience in collection should be minimised, and costs of collection should be an important factor in any analysis of the economics of the charge. If the revenue from a charge is likely to be too small to justify collection, then it is probably not sensible to introduce a charge.

³² In a progressive tax system, the share of an individual's income taken up by tax increases as their income increases (as is the case with our system of income tax). In a regressive tax system, the share of an individual's income taken up by tax increases as their income decreases (as is the case with GST – lower income people spend a higher proportion of their income and thus pay more in percentage terms than an individual with sufficient income to save – something supporters of a local GST should bear in mind). In a proportional tax system shares do not change as income changes.

As a first principle the charge and delivery of the service should be either simultaneous or the charge should be prepaid.

Fortunately for many local authorities services collection need not be particularly complex – with many regulatory services the service can be withheld unless the charge is paid, and denial of access is the first and easiest means to ensure the charge is paid.

In cases where payment and delivery cannot coincide, then invoices should be sent out in a timely manner with clear deadlines for payment

Thought will need to be given to enforcement in the event of non-collection. Where possible cessation or withholding of service should be the first resort (some of the regulatory powers explicitly permit withholding in this way³³). Enforcement as a civil debt is generally available to local authorities, and while generally effective also has a cost, and should therefore be the last resort.

If your council is likely to be “squeamish” about recourse to enforcement mechanisms then a charging proposal may not be the best option. Enforcement mechanisms should be in place, and advised to the community before a charge takes effect. Where the service is provided on a contractual basis, the enforcement mechanisms must be written into the contract.

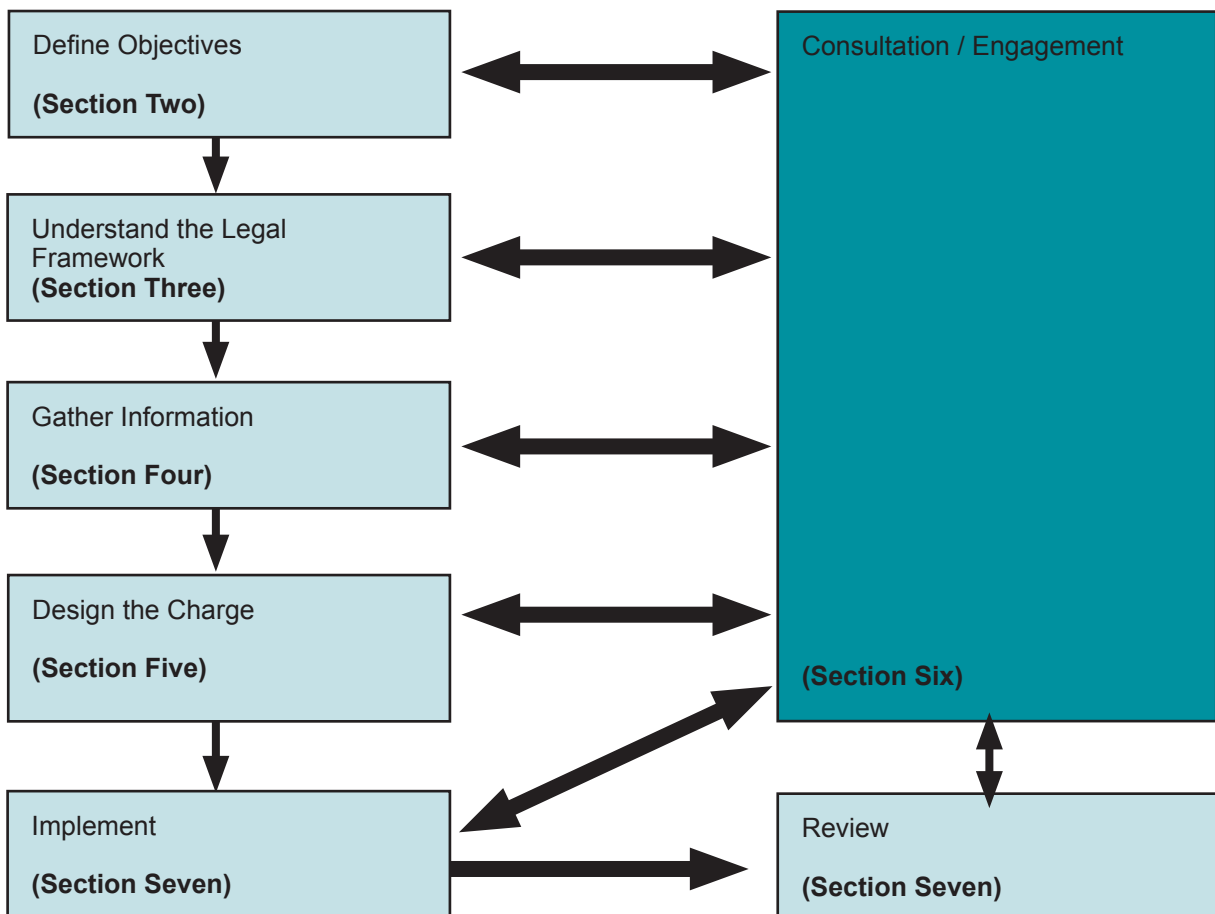
Non-payment should be followed up immediately. Recourse to enforcement mechanisms needs to be transparent, applied consistently, and (ideally) the decision should be delegated to officer level (preferably senior level).

³³ One prominent example where withholding of the service is not available is for charging for water supply.

Things to Remember: Designing Charges

1. Charges should be set before the good or service is produced.
2. The initial proposals for design of the charge should ideally be undertaken by the relevant activity manager, and reviewed by policy and/or finance staff for consistency with organisational objectives, correctness of the calculation and the like.
3. Charges should be set on the basis of full cost recovery unless legislative or policy considerations dictate otherwise. Full costs include both direct and indirect costs (where recovery of these is permitted) including depreciation, interest, and cost of capital (where a local authority uses this tool). Where full costs are not recovered then the rationale must be made clear and explicit.
4. Charging structures should be simple to understand and implement as is consistent with the nature of the service and the objectives for the charge.
5. If your local authority has decided to segment users (and current non-users) into target groups and different service is provided to the different groups, then the groups should be assessed different charges (if differential charging would not undermine any policy objectives and is economically and practically feasible),
6. In a similar vein, if substantially the same service is provided to different categories of user, simplicity in the fee structure suggests that the charge should be the same unless there is a policy reason to charge differentially. In particular, users who demand priority service should be charged a premium price (where this is possible).
7. Where legally possible and sound on the policy and economic, consideration should be given to differentials for peak and off-peak demand to better spread demand for services (and manage the need for capacity extensions).
8. Equity considerations are a policy decision for elected members, but need the same level of attention as any other policy objective. Where concessions are granted it should be on the basis of clear objectives and clear and regularly reviewed eligibility criteria.
9. Ideally collection would take place at the same time as service delivery. Where this is not possible invoicing should be done on a timely basis.
10. Non-payment should be followed up immediately. Enforcement mechanisms should be in place before charging starts. Recourse to these should be transparent, consistent and delegated to officer level.

6.0 CONSULTATION/ENGAGEMENT



A decision to charge is a decision for the purposes of *Part Six* of the *Local Government Act 2002*. Local authorities are under an obligation to consider community views and preferences when making decisions. This section explains the obligations to seek community views and processes for engaging with the community where a formal process is considered necessary.

6.1 The Decision-Making Process

In addition to any specific requirements to consult that come with charging powers, *section 78* of the *Local Government Act* places local authorities under a general requirement to give consideration to the views and preferences of people most likely to be affected by, or have an interest in, the decision to charge.

Consideration of community views must be given at the point where:

- problems are defined and objectives for the decision are identified
- the identification of reasonably practicable options
- the assessment of options and development of proposals
- adoption of proposals (i.e the move to make a final decision).

These four “stages” of the decision-making process need not be undertaken in a rigid linear process, in *Whakatane District Council vs Bay of Plenty Regional Council* (2009) Duffy J found that the four stages might overlap. A demonstrable failure to consider community views and preferences, including a failure to consult in circumstances where consultation should have occurred, can be

enough to invalidate a decision (for example in *Council of Social Services vs Christchurch City Council* failure to seek fresh information on community views and preferences at the second and third stages was sufficient to invalidate a decision to raise rentals).

Section 78 is an obligation to consider community views, in and of itself *section 78* is not an obligation to consult (and this is expressly stated in the provision). For example, a local authority need not consult if it considers it has sufficient information regarding the views and preferences of the community³⁴. *Section 79* also allows tailoring of a decision-making process to the extent of the local authority's resources, and the nature of the decision and circumstances in which it is taken.

When a local authority is required to, or decides to consult, then it is obliged to have regard to the following principles of consultation:

- a local authority must provide anyone who, will or may be affected by the decision, or has an interest in the decision with reasonable access to relevant information in a manner and format that is appropriate to their preferences and needs
- anyone who will or may be affected by the decision, or has an interest in the decision should be encouraged by the local authority to present their views
- anyone who is invited or encouraged to present views to the local authority should be given clear information about the purpose of the consultation, and the scope of decisions to be made after views have been considered
- anyone who wishes to have views considered by the local authority should be given a reasonable opportunity to present those views to the local authority in a manner and format that is appropriate to their needs
- a local authority should receive views with an open mind, and should give those views due consideration when making a decision.
- anyone who presents views should be given information by the local authority on the decisions and reasons for them.

Consultation also forms part of your local authority demonstrating accountability to:

- users of the service (so that they can assure themselves they are not being 'overcharged' and that they are receiving the service as promised)
- your wider community (primarily the accountability here is for the prudent and efficient use of public money) and
- Parliament (the accountability here is also about the use of public money, but is also about assuring Parliament that powers, especially powers to charge are being used appropriately)

Actual "face time" with users can generate a lot of useful qualitative and anecdotal information about users are experiencing or receiving the service, often this is not available from the standard residents and other surveys. This information tells you something about how the service is valued (or not) and can generate ideas for improving or modifying the service, which when bundled with the charge itself can create a better demonstration of value. Consultation is also one obvious early warning of customer attitude, particularly where user resistance to the charge is anticipated. Good consultation can also strengthen the community's "buy-in" to particular decisions, especially where changes are made as a result.

³⁴ Be wary when making a judgement on whether any information your council holds on views and preferences is sufficient to meet the requirements of the Act. A 2008 judgement *Council of Social Services vs Christchurch City Council* traversed the issue of whether results of previous consultation can be used to satisfy section 78. In finding that in this instance they could not Chisholm J appears to have considered the following as relevant: material changes in circumstances (in this case significant forecast cost increases), the elapsed time between the decision point and previous consultation; the degree of change from existing policy; and changes in the membership of council.

The best run consultation processes are those that are approached with a positive mindset rather than the 'we do this because we have to'.

6.2 What is Consultation?

The dictionary defines consultation as:

"an exchange of views, to listen to others views, to take account of"

and that is a pretty good description of what consultation in the local government sense is.

The leading case law authority on consultation in New Zealand is *Wellington International Airport v Air New Zealand* (1992). Although not involving a local authority, the principles in this case have been applied by the courts to local decision-making (most notably in *South Taranaki Energy Users Association v South Taranaki District Council*). The key principles in the *Wellington Airport* case are:

- *consultation is an exchange of information, and meaningful exchange of views*³⁵. Don't forget that consultation on a charging decision is a two way process. A well-managed consultation will take the opportunity to provide the community with information about the proposed charge, how the charge was determined, and the rationale for the charge, as well as seeking community views
- *sufficient information should be provided to the parties being consulted so that they can make intelligent and informed decisions*. Effective consultation on a charging issue may require your local authority to provide enough information to understand both the cost structure³⁶ and design of the charging policy. The more you can provide your community (within limits) the easier it will be for them to understand and accept proposals, and for you to counter misunderstandings or deliberate 'misinformation'
- *sufficient time must be allowed and genuine effort must be made to listen to and consider views*
- *the local authority is obliged to consider any feedback received in the consultation with an open mind and, if need be, demonstrate a willingness to change*. This does mean that the your local authority cannot have a working plan for charging in mind, but it does mean that it must be prepared to start afresh if feedback warrants it.

Consultation is not:

- merely presenting information or telling
- negotiation towards an agreement or consensus outcome
- *a referendum or binding vote*. The decision in *South Taranaki Energy Users Association vs South Taranaki District Council* (1997) noted that mere numbers for or against a particular proposition are not, in themselves, determinative³⁷. The test is that feedback is considered with an open mind. More recently, in *Willowford Family Trust v Christchurch City Council*³⁸, a majority view of respondents to a form of public consultation in relation to a new bylaw expressing a preference for a particular form of bylaw, was not enough to save the bylaw from being held to be invalid.

³⁵ Or as the learned judge in *Greensill vs Waikato Regional Council* (1995) noted "Consultation is a two way process. It is not intended to mean having deliberation with any party and abandoning the project if those deliberations do not appear fruitful".

³⁶ If for no other reason than one of the standard comments that comes back in these sorts of consultation is the ubiquitous "the service costs too much".

³⁷ In this particular case the council had decided to sell shares in an energy company, when consulting some 95 percent of submissions received (mostly coupon style submissions) had been against the sale.

³⁸ [2006] NZLR 791

6.3 What Could You Expect From Consultation on Charging

Consultation is a two way exchange of views and information. In order to get quality information back from the community, you will need to ensure that the proposals or issues you place before them are well designed, and easily understandable.

Some examples of the kinds of information that could be exchanged during consultation are shown in Figure 6.1 (overleaf).

STEP IN THE PROCESS	USERS CAN PROVIDE	YOUR COUNCIL MIGHT MAKE INFORMATION AVAILABLE ABOUT
Define Objectives	<ul style="list-style-type: none"> • are objectives important to the community, and do these objectives mean the community views charging as the right option • merits of other charging options 	<ul style="list-style-type: none"> • proposed objectives (policy and service) and why these are important • how charging helps achieve these objectives (including any evidence from other local authorities or from overseas) • other non-charging options and their merits
Understand the Legal Framework	<ul style="list-style-type: none"> • views on <i>section 101(3)</i> analysis (what might be called ‘a reality check’) 	<ul style="list-style-type: none"> • what can and cannot be legally recovered • which options are out of scope for legal reasons • <i>section 101(3)</i> analysis (NB – this could also be regarded as something that could be regarded as part of the ‘gather information’)
Gather Information	<ul style="list-style-type: none"> • experiences of/with the service • willingness to pay • current use and estimates of changes in use (if any) • demographic, economic and other data for determining membership of target groups • ideas for controlling/containing costs (as distinct from the ‘it costs too much’) • views on possible cost/level of service tradeoff 	<ul style="list-style-type: none"> • costs (including direct, indirect) and cost structures (fixed vs variable costs) • demand patterns (seasonal, daily or other peaks; what groups use the service etc) • other assumptions used to set the charge (for example projected future levels of service)
Design the Charge	<ul style="list-style-type: none"> • views on the level of charge and its design (this is the point where most public interest will be generated) 	<ul style="list-style-type: none"> • charging structure chosen and the rationale • level of charge and how this was determined • other alternatives (including those rejected and the rationale for their rejection) • concession arrangements (if any) • collection arrangements (especially where payment and service delivery do not coincide) • enforcement procedures
Implementation		<ul style="list-style-type: none"> • when charging will commence • transitional arrangements (if any)
Review	<ul style="list-style-type: none"> • user assessment of whether charge met the objectives and whether it was ‘worth it’ • experiences of/with the service • views on whether charging should continue 	<ul style="list-style-type: none"> • council assessment of whether the charge has met its objectives, and if not, why not • revisions to any of the above information (for example changes in cost or other assumptions) • proposed changes (if any)

Note: the presentation of this table in steps does not mean that your local authority is obliged to, or even should, conduct a separate consultation exercise at each step of the process set out in the roadmap.

6.4 Running an Effective Consultation on Charges

Here are some tips for running an effective consultation on charges:

- depending on your assessment of the significance of the proposal it may be worthwhile inviting target groups to help with the design of the process
- if the proposal requires consultation via the special consultative procedure, don't forget this is only the legal minimum, other techniques and forms of engagement can be used to supplement that procedure. The principles of consultation in section 78 of the Local Government Act will also be relevant when considering how to consult
- if the consultation is about the introduction of a charge then be prepared to debate the merits of charging alongside other funding solutions. This is likely to involve coming to the consultation with an explanation of the objectives and rationale for the charge and details of any present cross-subsidies (who is benefiting and to what extent).
- determine what information on community views and preferences for the services and/or previous consultations on charging your council already has, the extent to which this can still be relied on³⁹. As a rule of thumb, a proposal to introduce a charge should generally be made following consultation, a decision on changing a charge may have more scope for drawing on the results of previous work (depending on the significance of the change)
- be clear about the exact proposal you are consulting on and what is and is not "on the table". If the proposal involves a change to a charge be clear that consultation is not about the decision to charge, but how much or how charges will be structured
- users will generally be a group whose views need to be considered – don't assume a consultation with the community in general will obtain information from the users
- identify target groups and consider whether the "standard" special consultative procedure is an effective means of getting them involved. For example, low income people (other than the elderly) generally do not participate the more formal consultation processes. If the low income are a target group then the special consultative procedure will generally need supplementing
- explain the objectives and rationale for charging clearly and without jargon. Terms like "demand management" may mean very little to the general public, talk instead of better spreading of the use of the facility. If the only objective is to generate revenue, be especially careful to explain why users should be meeting the cost of this service
- always present information on the degree of subsidy the service is receiving via rates (and other general funding sources) and the degree of use. This is a good device for focussing the community onto the issue of who benefits and whether they should pay
- depending on the nature of the service you may find that people are more willing to contribute if you go out and engage at the point where the service is delivered (though this may not work as well for some of the regulatory functions where the council occasionally has to say "no" or "but")
- link the charge and levels of service – people are generally more willing to pay if they perceive something has a real value to them
- (activity managers only) – talk to your strategic/community planners, they have a wealth of expertise in obtaining community views and should be able to advise what works and what doesn't
- let your service centres, call centres etc know there is a consultation going on and how to handle requests for information

³⁹ This is a critical judgement call for any consultation, but all the more so for something as emotive as charging.

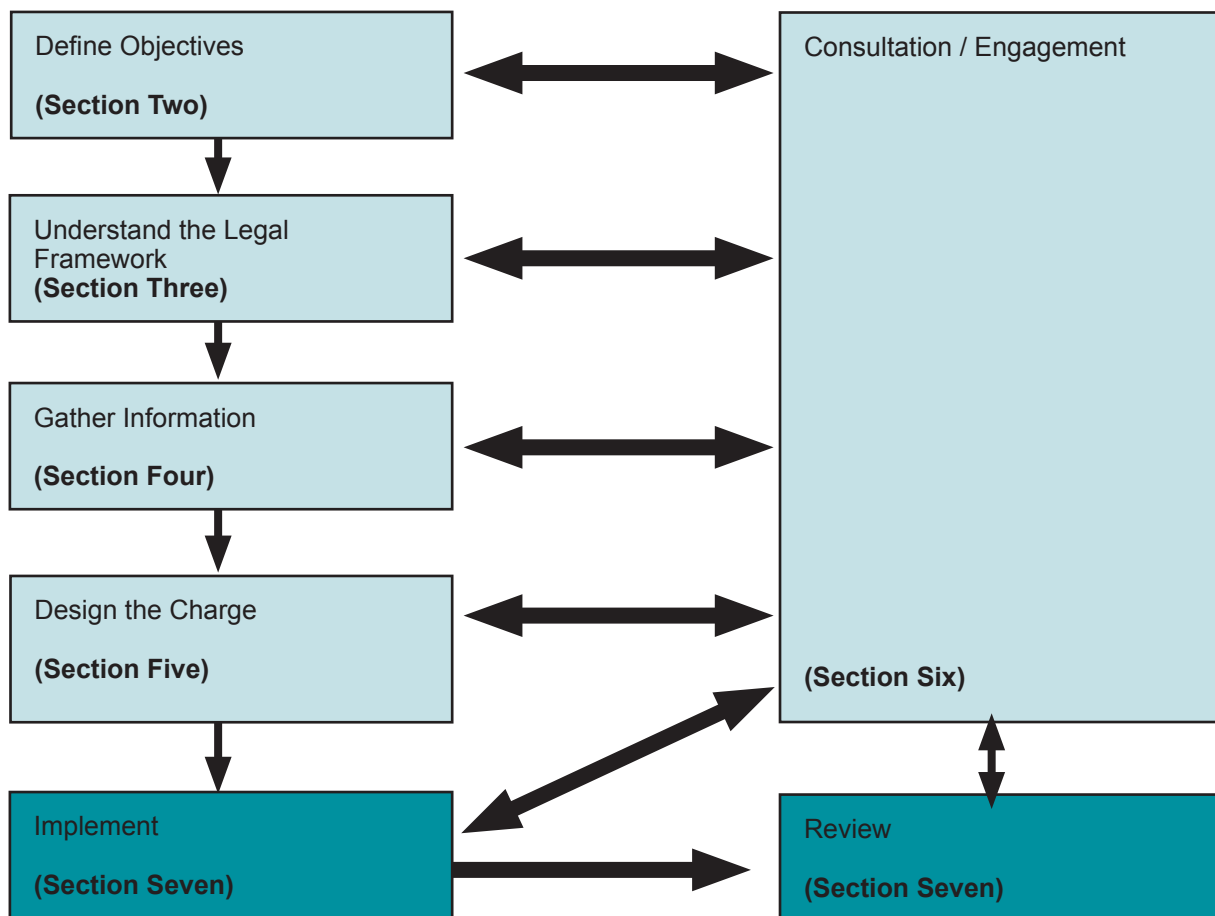
There is a wealth of information available on techniques for consultation and their merits and disadvantages. A good place to start for most would be the LG Knowhow Guide to Decision-Making.⁴⁰

Things to Remember: Consultation/Engagement

1. The decision-making provisions in Part Six of the Local Government Act 2002 contain obligations to consider community views and preferences when making decisions.
2. Some charging powers include a requirement to consult when introducing or amending a charge. Subject to the exact wording of each provision (see section two) these should be regarded as the legal minimum.
3. A well managed consultation process can help obtain “buy-in” to whatever the final decision is, generate information that is helpful in designing the charge, and generate useful information from the users about how they experience or use the service.
4. A consultation about charging is not a negotiation towards an agreed structure or amount. It is a two-way exchange of information.
5. During a consultation on charges, sufficient information should be placed in front of the community to enable it to understand what the rationale for charging is and how the charge will be determined. This may mean placing some information on the cost of the service and the cost drivers.
6. It is useful to determine who targeted groups are both for charging and any concessions, it may be necessary to use methods to supplement the standard consultation procedures in some cases.

⁴⁰ This can be accessed by clicking [here](#). Appendix G of this guide (pages 147-150) provides a particularly helpful (and short) discussion of the merits of 12 of the most commonly used techniques.

7.0 IMPLEMENTATION AND REVIEW



In this last section of the guide we discuss some common issues that arise with the implementation of charging systems and with the review of charging structures.

7.1 Implementation Issues

7.1.1 Communication

One of the first steps after the decision to charge is to communicate the decision to the community. The communication should set out:

- when the charge will take effect
- what the charging structure is and how this was determined
- why the charge has been introduced
- how the charge will be collected and what mechanisms will be in place to collect the charge.

Ideally the community would be advised well ahead of the introduction of the charge (and in some cases, such as the *Dog Control Act*, there are actually formal notification requirements).

Details of the charge must be explained to the front-line staff (such as customer service/call centre staff, and staff engaged in delivering the service). These are the staff who are most likely to receive

queries about the charge, and should be provided with accurate, clear information to be able to answer these queries fully. Staff involved in service delivery should also be clearly told how the delivery of the service and expectations on them will change under the proposal.

Last, but by no means least, the elected members themselves should be given clear information about the charge and related issues.

7.1.2 Security

If the charge involves payment on delivery and the service is being delivered at a place where charges have not previously been collected (such as pools, community centres and the like) then your local authority will need to consider how to receive and store money securely. Staff may also need training in handling money and on security related matters (e.g. what to do in the event of an attempted robbery).

7.1.3 Procedures

Sitting alongside communication, new or amended procedures will need to be documented and staff trained. Procedures might include:

- changed expectations regarding the way service should be delivered and/or changed standards of service
- determining eligibility for concessions (or otherwise)
- handling complaints or disputes in relation to the charge
- handling money
- collection and enforcement procedures – including delegations for decision-making around the initiation of these procedures
- monitoring and evaluation (including the rollout of targets into performance agreements where this is appropriate).

7.1.4 Resources

The assessment and collection of charges will almost always require some amount of additional resource, whether it be an additional customer service person, or new software, or even a cash register. It's important that these needs are scoped in advance and fully costed before the decision to charge is made. The costs of hiring additional staff, or some types of software and systems can be considerable and may defeat the objectives of charging if not available or not working properly.

7.2 Review

Ongoing monitoring and evaluation of charging is important as:

- ongoing monitoring of revenue levels will help determine whether any accidental over or under-recovery has occurred or is likely to occur (in which case some changes may be required)
- assessment of progress against targets will help determine whether the revenue and policy objectives for charging are being achieved. For example, if one of the objectives of charging was demand management, and no discernible impact on use is occurring it may be that the charge has been set at too low a level
- sometimes users react in unexpected or perverse ways when charged for a service (for example, has the design of concessions incentivised people to 'game' the concession system)

- costs are not constant, charges must be reviewed regularly as will methods for allocating indirect costs and other assumptions on which a charge is based.

The Auditor General recommends that local authorities conduct a full-scale review of charges at least once every three years. It may also be useful to consider whether there should be triggers for initiating reviews of a charging policy such as:

- persistent or large scale under or over-recovery of costs
- significant changes in forecast costs
- significant changes in forecast demand
- changes in your local authority's policy objectives
- sudden external changes that impact on the design of the charge – for example, if eligibility for a concession is dependent on the recipient being eligible for a government sponsored form of assistance that is discontinued.

In between full-scale reviews, your local authority should conduct 'mini' reviews focussing on changes in cost or in other data that is known to change frequently. Ideally your local authority would conduct a full review of all charges at the same time – items such as the allocation of indirect costs are likely to have implications for all charges.

In a full review of a charging structure – attention should focus on:

- *objectives* – did charging achieve its revenue and policy objectives. If not, why not?
- *legal framework* – have there been any changes in the legal framework that would rule recovery of particular cost items in or out of scope
- *costs* – what has happened to the cost of delivering the service in the intervening period
- *forecasting assumptions* – including demand
- *cost allocation* (where permitted) – is the basis of cost allocation still reasonable (note this is likely to have implications for all of your charging not just those for a particular activity or subset of activities)
- *users* – what feedback has there been from users about the charge and the service received? How have target groups been influenced by the charge (if at all)
- *concessions* – to what extent were concessions taken up? Were there any unanticipated issues with determining eligibility? Did the community understand the concession criteria – if not what was the issue?

Things to Remember: Implementation and Review

1. Don't overlook the implementation aspects of a decision to charge. A decision to introduce or change a charge will require communication to the community, staff and elected members. New procedures may be required and staff trained in their use – particularly where charging is accompanied by changes to the service. Attention may need to be paid to security aspects. New resources will be required.
2. Your plans for implementation should be in their final form before any irrevocable decision to charge is made.
3. Charging should be reviewed regularly. At the minimum charges should be fully reviewed at least once every three years, with more frequent mini reviews if costs and other assumptions are known to change frequently.
4. A full review of charges should be conducted for all activities. A full review should include the objectives; the legal framework; costs of delivering the service (including the allocation of indirect costs); forecasting assumptions; user perceptions; and concession policy.

8.0 FURTHER READING

Audit Commission (1999), *The Price Is Right*, although this is (understandably) an anglocentric publication it provides a useful non-technical discussion of pricing issues in a free and frank manner, there are many observations that apply equally to the New Zealand sector. Note that the discussion on the funding law in New Zealand is based on the legislation that preceded the *Local Government Act 2002* and should not be relied on as a statement of the current law.

Legislative Advisory Committee (2001), *Guidelines on the Process and Content of Legislation*, especially *Part 3.4* (a useful discussion of the legal and constitutional principles underpinning what is a charge and what is de facto taxation).

Local Government New Zealand et al (2003), *The LG Knowhow Guide to Decision-Making*, especially *section 5* and *Appendices F, G and H*. These all relate to consultation processes and techniques – while the information is intended to be relevant to consulting on any issue, the lessons in that information are readily applicable to consulting on charging. There are also references to other resources.

OAG (2008), *Charging Fees for Public Sector Goods and Services*, sets out the Office's expectations with regard to the setting of charges. In particular it is very strong on the need for legal authority, the identification of full costs, and consultation.

OECD (1998), *Best Practice Guidelines for User Charging for Government Services*, a principled discussion, but one that appears to be of more direct relevance to central government.

Regulatory Review Committee (1989), *Report of the Regulations Review Committee on the Inquiry into Constitutional Principles to Apply When Parliament Empowers the Crown to Set Fees by Regulation*, although 20 years old this is still the best explanation of dry constitutional law and its applicability to fee-setting that there is.

SOLGM et al (2008), *Developing Local Authority Revenue Systems – An Update*, especially *section 3.1- 3.3*, very strong discussion on funding policy and the case law supporting that (including the case law on consultation). Note however, the case law is very focussed on rating cases and some of the principles will not apply here (especially as they relate to the taxation aspects of rates)

Treasury (2005), *Guidelines for Setting Charges in the Public Sector*, this has been designed for government departments and so incorporates a lot of discussion around assessing service delivery options and the like, but also has some in-depth discussion of costs and cost drivers.



Building capability and excellence
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