Interim Stage 2 Cost Recovery Impact Statement:

Proposal to increase the transitional levy for Fire and Emergency New Zealand.

Agency Disclosure Statement

The Department of Internal Affairs (the Department) has prepared this Interim Cost Recovery Impact Statement (CRIS) to analyse options that enable Fire and Emergency New Zealand (Fire and Emergency) to meet increased costs as a result of settling a new Collective Employment Agreement with the New Zealand Professional Firefighters Union (NZPFU) in December 2022. The CRIS also supports a consultation document prepared by Fire and Emergency New Zealand.

The Department faced several constraints when developing options for assessment

Fire and Emergency are responsible for consulting with those affected by any changes to the levy and therefore, what options are consulted on. Fire and Emergency focused on reviewing the existing levy rates in the *Fire and Emergency New Zealand (Levy Rates and Information Requirements in Transitional Period) Regulations 2017*. They consider increasing the transitional levy is the only feasible option to meet the costs of settlement and continue operating in the short term (two years). Cabinet agreed to a repayable Crown loan of $75.4 million to ensure Fire and Emergency can maintain sufficient cash reserves over the next two years, until levy rates can be increased. In line with this Cabinet decision, and Fire and Emergency's preferred option, our analysis focused on an increase to the transitional levy.

For Fire and Emergency to maintain a sustainable financial position without reducing services, any increase in revenue must come into effect by 1 July 2024. This has limited the time available for analysis to the period between the Settlement in December 2022 and completion of a Cabinet paper by March 2023 to authorise consultation, which will occur in April 2023. Consultation will provide further information about impacts and implementation of the proposed change, including whether the proposal to increase the transitional levy will influence the purchasing behaviour of insurance policyholders. The outcomes of consultation will be used to update analysis for a final CRIS to support Ministers' decision-making.

We are reliant on financial estimates provided by Fire and Emergency. In some cases, financial estimates are based on preliminary mediator recommendations rather than the final Collective Employment Agreement. We do not anticipate the estimates varying substantially, therefore the analysis in this CRIS provides a reasonable overview of impacts.

Options not considered in this document and related assumptions

This document does not discuss existing costs and how they are cost-recovered. Broader engagement in Fire and Emergency's long-term funding requirements will be considered when setting Part 3 levy rates (proposed to come into effect 1 July 2026). The Part 3 model will replace the existing funding model for Fire and Emergency. Any financial modelling extending into the 2026/27 financial year assumes that the Part 3 levy will provide the same level of total revenue as the transitional levy. Final decisions on the Part 3 levy and the distribution of the levy amongst policyholders will be made through a separate process.

The Crown's contribution to Fire and Emergency remains as $10 million per annum. Cabinet has invited the Minister of Internal Affairs to report back on the appropriate level of Crown contribution to inform consideration of a potential future Budget bid [CAB-22-MIN-0520]. However, this is out of scope for this CRIS and the processes required would not allow enough time for it to occur in time for 1 July 2024.

We briefly considered alternative options such as an increase to the Crown loan. While an increase to the loan would enable Fire and Emergency to meet the costs of settlement in the short term, a levy increase would still be required to repay the loan. This would likely result in a substantial increase to the levy in 2026, when the Part 3 levy comes into force. It is more feasible to borrow less and recover costs over a longer period. An increase to the loan has not been explored in this CRIS.

Modelling of the levy assumes a two per cent increase in insurance inflation per annum (increase in insured values due to inflation, or because the amount of property insured has increased in line with growth). In the current inflationary environment, insurance inflation may be much higher. This will be tested further through public consultation.

Quality Assurance

A quality assurance panel (the panel) from the Department of Internal Affairs reviewed this interim CRIS in accordance with the quality assurance criteria set out in the CabGuide. The panel considers that the information and analysis summarised in the CRIS **partially meets** the quality assurance criteria.

The CRIS is clear, concise and tells a compelling case for why there needs to be an increase to the transitional levy. Consultation will help to fill in the gaps in terms of:

- understanding the impacts of an increase
- testing some of the underlying assumptions.

The CRIS convincingly explains why non-regulatory options are not feasible. But it does not adequately explore whether there could have been other alternative options for how to increase the transitional levy that could also align with the principles provided. The analysis would have been more convincing if it had identified other potential alternatives and explained why these would have not aligned with the principles (though consultation may be able to inform this).

17 Mar 2023

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Executive summary

1. Fire and Emergency deliver critical public services for communities. As well as fire related services, Fire and Emergency also have a role in hazardous substances, transport accidents, urban search and rescue, medical emergencies, natural hazard events, and other rescues.

2. Fire and Emergency are facing additional cost pressures following ratification of a new Collective Employment Agreement with the NZPFU in December 2022. The additional costs from the NZPFU settlement cannot be fully met through a reduction in Fire and Emergency's operational and capital spending without substantially impacting operations. Without change, Fire and Emergency's cash reserves will fall below the minimum level required to operate by the 2024/25 financial year.

3. Fire and Emergency receives 97 per cent of its revenue through a transitional levy on insurance contracts. Fire and Emergency have advised any reduction in expenditure will impact their ability to deliver critical services. To meet the costs of settlement and maintain sufficient cash reserves to operate, Fire and Emergency's revenue needs to increase. Therefore, the only practical way to increase revenue without impacting on Fire and Emergency's service delivery is to increase the levy rates.

4. Fire and Emergency's modelling suggests a 12.8 per cent increase to the levy is required to recover additional costs and maintain minimum levels of cash reserves without any impact to other spending and operations. This would increase levy costs by 12.8 per cent for levy payers. However, the impacts would be different for insurance policyholders who insure residential property, motor vehicles and non-residential property due to the way the levy system is currently designed. Wider impacts will be gathered through public consultation.

5. Any changes will require an amendment to regulations. The insurance sector, which gathers the levy through premiums, will require time to implement any changes before 1 July 2024. The amount of time for implementation is not currently known and will be tested through further consultation.

Status quo

Fire and Emergency deliver critical public services that support community wellbeing

6. Fire and Emergency was established in 2017 under the Fire and Emergency New Zealand Act 2017 (the FENZ Act). The establishment of Fire and Emergency brought together rural and urban fire services into a single unified national organisation.

7. Fire and Emergency deliver critical public services that support community wellbeing. It provides services across the '4R's' of emergency management – reduction, readiness, response and recovery. The services Fire and Emergency provide help communities to minimise the impact of emergency and disaster events and recover more quickly after the event occurs.

8. Under the FENZ Act, Fire and Emergency's principal objectives are to:[1]

- reduce the incidence of unwanted fire and the associated risk to life and property; and
- protect and preserve life, prevent or limit injury, and prevent or limit damage to property, land, or the environment.

9. Fire and Emergency do more than just fight fires. There are a broad range of functions under the FENZ Act that Fire and Emergency must carry out, including to:[2]

- promote fire safety, including providing guidance on the safe use of fire as a land management tool;
- provide fire prevention, response and suppression services;
- stabilise or render safe incidents that involve hazardous substances;
- provide for the safety of persons and property endangered by incidents involving hazardous substances;
- rescue persons who are trapped as a result of transport accidents or other incidents;
- provide urban search and rescue services; and
- efficiently administer the FENZ Act.

10. In addition, Fire and Emergency must assist in the following matters, should it have the capability and capacity to do so, including:[3]

- responding to medical emergencies;
- responding to maritime incidents;
- performing rescues, including high angle line rescues, rescues from collapsed buildings, rescues from confined spaces, rescues from unrespirable and explosive atmospheres, swift water rescues and animal rescues;
- providing assistance at transport accidents;
- responding to severe weather-related events, natural hazard events, and disasters;
- responding to incidents in which a substance other than a hazardous substance presents a risk to people, property, or the environment;
- promoting safe handling, labelling, signage, storage, and transportation of hazardous substances; and

[1] Section 10 of the FENZ Act.

[2] Section 11 of the FENZ Act.

[3] Section 12 of the FENZ Act.

- responding to any other situation if Fire and Emergency has the capability to assist.

Fire and Emergency respond quickly to incidents

11. Fire and Emergency generally perform well on incident response times in relation to their functions under the FENZ Act. The 2022/23 annual report shows that they meet, or are very close to meeting, their targets for response times as listed in **Table 1**.

Table 1: Fire and Emergency's performance measures[4]

Performance measure	Target	Actual	Met
Percentage of structure fires arrived at by career crews within 8 minutes.	80%	79%	✗
Percentage of structure fires arrived at by volunteer crews within 11 minutes.	85%	81%	✗
Percentage of vegetation fires arrived at within 30 minutes (anywhere in New Zealand).	90%	94%	✓
Percentage of Communications Centre events dispatched for all incidents in rural environments within 2 minutes of receiving the 111 call.	85%	90%	✓
Percentage of Communications Centre events dispatched for all incidents in urban environment, within 90 seconds of receiving the 111 call.	85%	89%	✓
Percentage of hazardous substances incidents arrived at by crews with specialist resources within 60 minutes.	85%	94%	✓
Percentage of motor vehicle accidents arrived at by crews with specialist resources within 30 minutes.	90%	97%	✓
Percentage of career crews who respond to medical emergencies within eight minutes.	85%	82%	✗
Percentage of volunteer crews who respond to medical emergencies within 11 minutes.	80%	75%	✗

Overview of Fire and Emergency's finances

Fire and Emergency's revenue mostly comes from a levy on insurance contracts

12. A transitional levy has funded Fire and Emergency since 2017 and will continue to do so until a new levy system under the FENZ Act begins on 1 July 2026.[5]

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[4] 2021/22 annual report

The transitional levy is outlined in Schedule 1 of the FENZ Act. All contracts of insurance that provide cover for physical loss or damage from fire pay a levy to Fire and Emergency. The levy is set at a fixed rate per amount of insurance for most property. For motor vehicles, the levy is a set amount per motor vehicle per annum.

13. The transitional levy rates are set out in the *Fire and Emergency (Levy Rates and Information Requirements in Transitional Period) Regulations 2017*. These regulations came into force in May 2017 before Fire and Emergency was established. The regulations have not been reviewed or amended since then as the focus has been on establishing the new levy system in the FENZ Act. This new levy is referred to as the 'Part 3 levy', because it is set out in Part 3 of the FENZ Act.

14. The transitional levy treats some property differently to others, as the transitional levy framework enables regulations to set differing levy rates for different types of property, as well as effectively cap the amount of levy paid for some property. This means the framework has created three different insurance 'policyholder' groups, whose treatment differs:

    - **Residential policyholders:** This includes residential home insurance and contents insurance.
    - **Motor vehicle policyholders:** This includes all motor vehicles under 3.5 tonnes.
    - **Non-residential policyholders:** This includes all other property not included above. Motor vehicles over 3.5 tonnes and non-residential property (including government and commercial buildings, farming property, factories, etc.) are all included in this policyholder group.

15. The key features of the transitional levy framework as it applied now are outlined in **Table 2** below:

[5] Section 2(5) of the FENZ Act. Note this section will be amended by the Fire and Emergency New Zealand (Levy) Amendment Bill so that the new levy system commences on 1 July 2026 as opposed to 1 July 2024, as the Act currently states. The Bill is currently proceeding through its remaining legislative stages in Parliament.

Table 2: Current transitional levy framework[6]

Insurance policyholder group	Levy rate	Maximum levy or cap
Residential	10.6c per $100 insured.	Capped at $100,000 of home insurance and $20,000 of contents insurance. Means maximum levy of $106 for home insurance and $21.20 for contents.
Motor-vehicle (under 3.5t)	Flat amount of $8.45 per vehicle.	N/A
Non-residential	10.6c per $100 insured.	No maximum levy or cap applied.

16. The insurance sector plays a significant role in the levy system. Because the levy is calculated based on insurance contracts, insurance companies and brokers calculate and collect the levy on behalf of insurance policyholders. This is then paid to Fire and Emergency, who undertake analysis and audit to ensure that the correct amount of levy has been paid.

17. Fire and Emergency receives 97 per cent of its revenue from the transitional levy. The remaining revenue is made up of items such as interest revenue, charges for some services (for example, private fire alarm monitoring), recoveries for international deployments, and a Crown contribution for services provided by Fire and Emergency that are in the 'public good'. A breakdown of Fire and Emergency's forecast revenue for the 2022/23 financial year is shown in **Table 3**:[7]

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[6] Fire and Emergency New Zealand (Levy Rates and Information Requirements in Transitional Period) Regulations 2017

[7] Statement of Performance Expectations, 2022/23

Table 3: Fire and Emergency's forecast revenue for 2022/23 before the NZPFU settlement[8]

Revenue	Forecast 2022/23 ($ m)
Levy	641.93
Interest revenue	1.92
Other income	7.39
Crown contribution	10.00
Total revenue	**661.24**

18. The transitional levy is inflexible to short-term changes that impact Fire and Emergency's revenue needs. The levy is charged at fixed rates per amount of insurance, set in regulations that take time to change. This means that the levy can and does grow over time as the value and number of insurance policies grows over time. Conversely, the levy can also decline. However, this is mostly connected to economic conditions and not to Fire and Emergency's expenditure needs. Fire and Emergency's costs also increase each year due to inflationary pressures and standard salary increases that increase operational costs.

Fire and Emergency incurs substantial costs to deliver services to New Zealand

19. Fire and Emergency incurs both operational and capital costs to deliver its mandated functions under the FENZ Act. A substantial amount of Fire and Emergency's costs are in relation to fire related functions. Operational costs can be broken down into output classes (the broad functions that Fire and Emergency delivers). Forecast operational costs for the 2022/23 year are in **Table 4** below:

[8] Ibid

Table 4: Fire and Emergency's forecast costs for output classes in 2022/23[9]

Output class	Forecast expenditure ($ m)
Fire prevention including promotion of fire safety, compliance, and enforcement.	82.83
Fire response and suppression.	409.46
Render safe hazardous substances and provide for safety at incidents.	10.91
Rescue as a result of transport accidents and urban search and rescue.	82.27
Responding to other emergencies, including medical, maritime, other rescues and natural hazard events.	72.12
Total	**657.59**

20. Fire and Emergency also has a substantial capital expenditure programme to maintain and upgrade its substantial asset base of approximately $1.5 billion.[10] This asset base spans both rural and urban assets, which had widely varying asset management practices before Fire and Emergency was established in 2017. This means that some assets require greater investment than anticipated in 2017 and, particularly for rural assets, financial reserves to make this investment was not passed on to Fire and Emergency (from previous fire service organisations).

21. Fire and Emergency's capital expenditure programme is funded through a combination of accumulated depreciation[11] expense (yearly depreciation expense is included in the costs in **Table 4** above) and existing cash reserves.

22. The capital expenditure programme covers fleet (for example, fire trucks and other vehicles), property (for example, fire stations and corporate offices), Information Communication Technology (ICT), and equipment (for example, breathing apparatus and incident ground control radios). Budgeted capital spending for 2022/23 is shown in **Table 5** and results in a total yearly spend of $88.1 million.

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[9] Statement of Performance Expectations, 2022/23

[10] Ibid

[11] Depreciation is the estimated reduction in the value of a fixed asset within a financial year.

Table 5: Fire and Emergency's budgeted capital spend for 2022/23[12]

Capital item	Budget 2022/23 ($ m)
Fleet	23.30
Property	38.00
ICT	12.00
Equipment	14.80
Total	**88.10**

23. Fire and Emergency's capital expenditure is fundamental to its ability to deliver services (for example, arriving at an event on time as outlined in **Table 1**). Ensuring that fire stations, fire appliances and other supporting assets are well maintained and performing well helps to ensure that Fire and Emergency can maintain and improve response times and other important performance measures.

Fire and Emergency need to sustain a minimum level of cash reserves to operate

24. Fire and Emergency's cash reserves enable it to maintain liquidity (pay for expenses incurred, such as payroll) and fund capital expenditure. Fire and Emergency's cash reserves are impacted by any surplus (revenue higher than costs) or deficits (costs higher than revenue). Cash reserves are also reduced by additional capital expenditure required above the depreciation value on existing assets that is being charged to operating expenses, as well as finance costs (repaying borrowings, with interest if applicable) and other minor balance sheet movements.

25. There are two factors that contribute to Fire and Emergency's minimum required level of cash reserves – standard business requirements and delayed income due to transitioning to the new Part 3 levy in 2026/27.

26. In terms of general business requirements, Fire and Emergency aims to hold a minimum of $50 million cash reserves to provide funding for:

- working capital (to fund day-to-day operations) of $25 million;
- liquidity buffer (to allow for delayed levy receipts and/or unexpected payments) of $10 million; and
- one significant adverse event[13] (for example, earthquake or major vegetation fire) of $15 million.[14]

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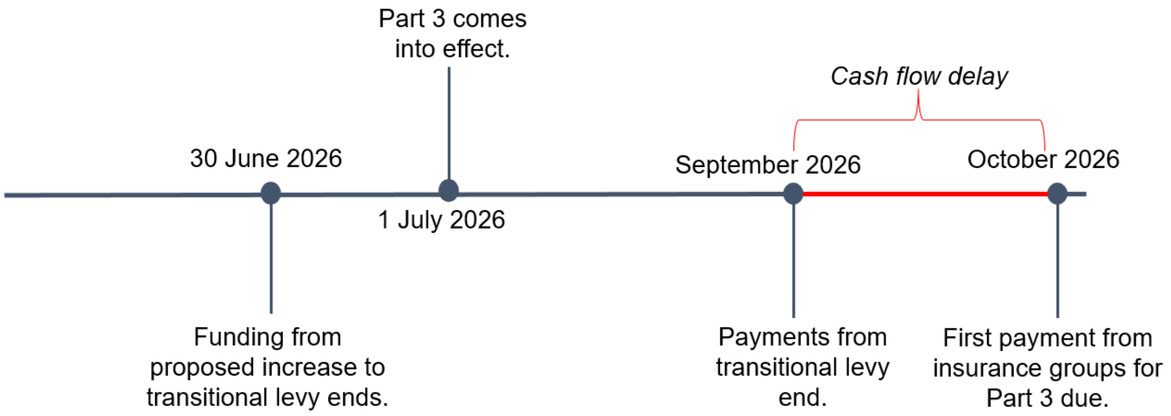
[12] Information provided by Fire and Emergency

27. In addition, Fire and Emergency will experience a one-month income delay in 2026/27. This will happen when the new Part 3 levy comes into effect, because this levy enables levy payments to be paid one month later than what is currently allowed under the transitional levy.[15] This means that, while the same revenue will be received overall, it creates a cash flow issue for the month where levy revenue is not received, and an increased cash reserve is needed to cover costs during this month. The timeline below depicts the cash flow issue.



28. Fire and Emergency have forecast an additional $69 million of cash is needed to cover the transition to the Part 3 levy. This figure has been calculated by looking at both the forecast levy revenue for the 2026/27 financial year and historic proportions of levy revenue received in the month where no levy will be received.

29. This means that Fire and Emergency require cash reserves of $120 million by the end of the 2025/26 financial year. Following that, cash reserves of $50 million are sufficient for business needs.

Fire and Emergency currently have a high level of cash reserves and yearly revenue and expenses broadly align

30. Fire and Emergency's existing cash reserves are high. At the start of the 2022/23 financial year reserves were $198 million. These high cash reserves are likely the result of greater than expected levy revenue growth, the need to repay existing Crown loans when Fire and Emergency was established, and the fact that the transitional levy rates have not been reviewed or adjusted since 2017.[16]

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[13] Fire and Emergency define a significant adverse event as an event that requires additional funding above and beyond normal budgeted costs to respond. The recent cyclone in February 2023 did not qualify as travel costs were the main expenditure and these are part of normal funding requirements.

[14] 2022/23 Annual Report

[15] Under section 88 of the FENZ Act, the part 3 levy must be paid to FENZ no later than the 15th day of the third month after the end of the month in which the contract of insurance was entered into.

[16] Fire and Emergency budget for 2 per cent levy growth each year. Data since 2017/18 suggests the levy growth has been around 3 per cent.

31. Prior to the settlement with NZPFU, Fire and Emergency's forecast revenue and expenses were broadly aligned, as shown in **Table 6**.[17]

Table 6: Fire and Emergency's forecast revenue, expenses, and surplus/deficit prior to the NZPFU settlement

	2022/23 ($ m)	2023/24 ($ m)	2024/25 ($ m)	2025/26 ($ m)	2026/27 ($ m)
Revenue	661.24	673.84	686.81	700.04	713.54
Expenses	657.59	663.69	681.94	690.27	703.15
Net surplus/(deficit)	**3.65**	**10.15**	**4.87**	**9.77**	**10.39**

32. The alignment of revenue and expenses means that any substantial changes to costs will either need to be offset by increasing revenue, reducing costs elsewhere within the organisation, or reducing cash reserves (or a combination of all three).

A recently agreed Collective Employment Agreement between Fire and Emergency and the New Zealand Professional Firefighters Union (NZPFU) has created significant additional costs for Fire and Emergency

33. Fire and Emergency and the NZPFU agreed on the terms of a new Collective Employment Agreement for professional firefighters in December 2022. The Collective Employment Agreement will raise professional firefighters' salaries in line with other similar jobs (for example, Department of Conservation firefighters) and provide medical benefits, such as early cancer screening, psychological support, and life insurance.

34. This agreement between Fire and Emergency and the NZPFU members will cost $145 million over three years. However, the true costs of the settlement for Fire and Emergency will be higher. Fire and Emergency are committed to retaining pay parity within the organisation. Fire and Emergency also need to apply some of the changes to non-NZPFU members as well. Furthermore, these additional costs will need to be embedded beyond the term of the existing Collective Employment Agreement, as these pay levels and employment benefits will continue to apply in the future.

35. Additional costs start to be incurred in the current financial year (2022/23) and will cover both 2021/22 costs and those in 2022/23. The ongoing costs of the settlement are shown in **Table 7** below and broken down into salary increases for NZPFU members and non-NZPFU members, as well as increased job benefits (only for NZPFU members). The costs increase each year because the salary increases from the previous years must continue to be met in the next

[17] Statement of Performance Expectations, 2022/23 and data provided by Fire and Emergency for 2025/26 and 2026/27 financial years.

year, plus planned adjustments (either as agreed in the Collective Employment Agreement, or as planned for regular salary increases from market increases).

36. Fire and Emergency had already budgeted for additional costs resulting from settlement. Furthermore, there are costs to service a repayable Crown loan (discussed further in paragraph 1440). The existing budget and loan affect the total additional costs for Fire and Emergency and are also shown in **Table 7**.

Table 7: Annual costs incurred from NZPFU settlement[18]

	2021/22 ($ m)	2022/23 ($ m)	2023/24 ($ m)	2024/25 ($ m)	2025/26 ($ m)	2026/27 ($ m)
Salary increases NZPFU	28.90	43.00 *Previous year plus $14.1*	58.10 *Previous years plus $15.1*	67.40 *Previous years plus $9.3*	77.10 *Previous years plus $9.7*	87.20 *Previous years plus $10.1*
Benefits NZPFU	0.60	6.40	8.30	11.50	8.90	9.30
Salary increases non-NZPFU	0.00	5.90	12.10 *Previous year plus $6.2*	16.40 *Previous years plus $4.3*	21.00 *Previous years plus $4.4*	25.50 *Previous years plus $4.5*
Total cost of settlement	**-**	**84.80**	**78.50**	**95.30**	**107.00**	**122.00**
Provided for in Fire and Emergency budget	-	(30.18)	(30.47)	(40.89)	(53.06)	(62.00)
Cost of servicing Crown loan	-	0.79	2.22	3.81	4.20	3.70
Total impact on Fire and Emergency expenses	**-**	**55.41**	**50.25**	**58.22**	**58.14**	**63.70**

37. With these additional costs, Fire and Emergency's costs exceed their revenue. Forecast total costs compared to forecast revenue, after factoring in the

18 Information provided by Fire and Emergency. Costs for 2021/22 are paid in 2022/23 financial year.

additional costs of settlement are shown in **Table 8** below (note that 2021/22 costs above are paid in the 2022/23 financial year, along with 2022/23 costs). Orange highlighted boxes in **Table 8** show where figures have changed from what was provided in **Table 6**.

Table 8: Fire and Emergency's forecast revenue, expenses and surplus/deficit with additional NZPFU costs[19]

	2022/23 ($m)	2023/24 ($m)	2024/25 ($m)	2025/26 ($m)	2026/27 ($m)
Revenue	661.24	673.84	686.81	700.04	713.54
Expenses	713.00	713.94	740.16	748.41	766.85
Net surplus/(deficit)	**(51.76)**	**(40.11)**	**(53.35)**	**(48.37)**	**(53.31)**

38. Additional cost pressures resulting from the NZPFU settlement mean that expenses now exceed Fire and Emergency's revenue, resulting in ongoing deficits.

Meeting these additional costs without any changes to revenue or costs will move Fire and Emergency's cash reserves below the minimum required level and into overdraft

39. Fire and Emergency cannot meet these additional costs through their existing cash reserves. Fire and Emergency's modelling shows that, without change to its revenue or costs, its cash reserves would fall below $50 million (the minimum amount needed for general business needs as outlined from paragraph 24) within three years. Furthermore, Fire and Emergency would be in overdraft by $200 million once the new Part 3 levy system comes into effect (exacerbated by the month where no revenue is received).[20] This would mean that Fire and Emergency would be in an unsustainable financial position and could not deliver mandated services.

40. The modelling accounts for a repayable capital loan provided by the Crown to Fire and Emergency [CAB-22-MIN-0520]. This loan was provided by the Crown to support a sustainable cash position for Fire and Emergency until further revenue could be found. This loan is worth $75.4 million and can be drawn down in instalments from 1 December 2022 to 30 June 2025. It will be repaid in full, with interest no later than 2032/33.

41. Fire and Emergency's modelling is shown in **Table 9**. Orange highlighted boxes show where Fire and Emergency's cash reserves fall below minimum required levels.

[19] Information provided by Fire and Emergency

[20] This assumes that the Part 3 levy in 2026/27 would continue to generate the same amount of levy revenue for Fire and Emergency as the transitional levy.

Table 9: Fire and Emergency's modelling of cash reserves[21]

($m)	2022/23	2023/24	2024/25	2025/26	2026/27
Opening cash balance	198.5	142.0	107.9	42.0	(48.6)
Cost of operating Fire and Emergency	(713.0)	(713.9)	(740.2)	(748.4)	(766.9)
Net capital expenditure (capital expenditure less depreciation)	(8.1)	(7.1)	(6.0)	(16.7)	(18.6)
Repay borrowings	(15.5)	(15.8)	(16.0)	(24.1)	(9.1)
Other balance sheet movements	(6.5)	3.9	(15.5)	(1.5)	(2.8)
Part 3 levy (losing one month of cash)	N/A	N/A	N/A	N/A	(69.0)
Funding					
Crown contribution (subject to annual budget processes)	10.0	10.0	10.0	10.0	10.0
Repayable capital loan	25.4	25.0	25.0	-	-
Other income and cost recoveries	9.3	9.1	9.0	8.9	8.8
Funding from levy	641.9	654.7	667.8	681.2	694.8[22]
Closing cash balance	**142.0**	**107.9**	**42.0**	**(48.6)**	**(201.4)**

Maintaining a minimum level of cash reserves is not possible through solely reducing costs

Reducing operational costs would likely significantly reduce Fire and Emergency's ability to deliver services

42. Fire and Emergency data shows that reducing operational spending only to offset the additional costs would require 277 full time equivalents (FTEs) to be made redundant.[23] This would be made up of 141 frontline roles (approximately 24 per cent of total) and 136 back-office staff (approximately 24 per cent of total back-office staff).

[21] Information provided by Fire and Emergency

[22] Assumes that the Part 3 levy will provide the same total revenue to Fire and Emergency as the transitional levy (factoring in natural growth in the levy base).

[23] Calculated using the average wage of staff groups and factoring in one-off redundancy costs that would be incurred.

43. Staff reductions would need to be supplemented with a reduction in other operating costs of $18.7 million per year. This would mostly come from a reduction in professional fees, contractors and other funding required to implement initiatives as the loss of staff would slow these initiatives down.

44. This reduction would result in $247.8 million of savings over five years until 2026/27 and would mean that Fire and Emergency have a closing cash balance of nearly $50 million in 2026/27 (the minimum required in that year). The savings are shown in **Table 10**.

Table 10: Forecast savings from operational expenditure reductions[24]

($m)	2022/23	2023/24	2024/25	2025/26	2026/27	Total (four years)
Staff savings	34.1	34.1	34.1	34.1	34.1	170.5
One off redundancy	(16.2)					(16.2)
Additional operating costs	18.7	18.7	18.7	18.7	18.7	93.5
Total savings	**36.6**	**52.8**	**52.8**	**52.8**	**52.8**	**247.8**

45. The impact of losing 24 per cent of other frontline and back-office roles would be significant to how effectively Fire and Emergency can deliver services. Time constraints have limited the analysis that can be completed to understand the extent to which these redundancies would affect services. However, it is a reasonable assumption that a 24 per cent loss in frontline support and back-office support staff would have a significant impact.

46. Furthermore, trying to reduce costs would lead to delays in implementation of several important projects within Fire and Emergency because of a lack of staff and reduction in professional and contracting fees. This includes delays in health standards (investigating options to do health standard checks for staff to remain healthy and well while they undertake duties), carcinogen control (improving policies and procedures to reduce exposure to carcinogens and manage the consequences of exposure) and working safely in water (improving water training capability).

47. Therefore, meeting the costs of settlement solely through a reduction in operational costs carries significant risks and is not a viable option.

[24] Information provided by Fire and Emergency

Reducing capital spending would likely lead to delays in necessary maintenance and upgrades and result in higher costs in the future

48. Fire and Emergency modelling indicates that meeting the costs of settlement through a reduction in capital spending only would require a 56 per cent reduction in capital spend. This would result in $48.8 million of savings each year from the approximately $88 million average planned capital spend. Further information is provided in **Table 11** and **Table 12** below.

Table 11: Forecast savings from capital spend reductions[25]

($m)	2022/23	2023/24	2024/25	2025/26	2026/27	Total
Planned capital expenditure	88.1	87.3	88.1	88.1	88.1	439.7
Reduced capital expenditure	(48.8)	(48.8)	(48.8)	(48.8)	(48.8)	(244)
Revised capital expenditure	39.3	38.5	39.3	39.3	39.3	195.7

49. These reductions would be spread across fleet, property, equipment, and ICT spend and equate to the following savings:

Table 12: Breakdown of yearly capital spend reductions[26]

Capital spend	Savings ($m)	Impacts
Fleet	13.4	Equivalent to cost of 23 vehicles in total.
Property	21.4	Equates to four station rebuilds.
Equipment	7.2	Would delay equipment replacement programmes (for example, incident ground control radios, breathing apparatus).
ICT	6.8	Delay ICT programmes, including replacement of ICT equipment in stations, regional offices, and national headquarters.

50. Overall savings of $244 million would be achieved over five years and would leave Fire and Emergency with just under the $50 million required cash reserves at the end of the 2026/27 financial year.

[25] Information provided by Fire and Emergency

[26] Ibid

51. The impact on service delivery of this reduction in capital spend could also be significant. Fire and Emergency owns a large amount of ageing assets with 27 per cent of fire appliances beyond their target asset life (of 20 to 25 years) and 27 per cent of fire stations more than 50 years old. The age of buildings does not necessarily determine their fitness for purpose, but the functionality of 36 per cent of Fire and Emergency's stations has been assessed as poor or very poor.[27]

52. Delaying these upgrades would mean some of these assets cannot perform to Fire and Emergency's required standards, maintenance costs would continue to increase over time and increased capital spending is required in the future to catch-up with deferred asset renewal.

53. Furthermore, the recent bargaining with the NZPFU highlighted professional firefighters' concerns that the current working state of the fleet is poor and urgent attention is needed to upgrade these assets. Delaying this investment in particular is not a realistic option for Fire and Emergency in light of the new Collective Employment Agreement.

54. Time constraints have limited the analysis which could be completed to understand the full impact of reducing this capital spend. However, it is reasonable to assume that this level of reduced capital spending would result in significant risks to service delivery and is not a feasible option to meet the costs of settlement.

An increase in Fire and Emergency's revenue is needed to ensure it can retain a sustainable level of cash reserves

55. Fire and Emergency require an increase in revenue by the start of the 2024/25 financial year. Because the costs of settlement cannot be met by a reduction in spending alone, Fire and Emergency's revenue must increase to ensure services can continue to be delivered at the right level of quality and sustainable cash reserves are maintained. If this does not happen, Fire and Emergency will drop below its minimum required cash reserves by the end of the 2024/25 period and this position will continue to worsen over time (refer **Table 9**).[28]

56. Further borrowing is not a feasible option for Fire and Emergency. While this would result in a short-term cash increase, the borrowing would need to be repaid over time. It does not create additional revenue for Fire and Emergency over the long-term to pay for ongoing costs and maintain necessary cash reserves.

57. This CRIS assumes an increase to the Crown's contribution of $10 million to Fire and Emergency is not being considered, due to the uncertainty of whether such funding would be available by 1 July 2024. Cabinet has invited the Minister of Internal Affairs to report back on the appropriate level of the Crown

[27] Fire and Emergency's Briefing to the Incoming Minister, January 2023.

[28] The situation would be partially mitigated by increased levy rates under the Part 3 Levy, coming into effect on 1 July 2026. However, a significant acute levy increase would be needed to recover the necessary cash reserves and would lead to an over-recovery for the remainder of the levy period (three years).

contribution to inform consideration of a potential future Budget bid [CAB-22-MIN-0520]. These processes will not be completed in time to be incorporated into an increase by the 2024/25 financial year, but will inform future levy setting processes.

58. This means that an adjustment to the transitional levy is necessary to provide sufficient revenue for Fire and Emergency to cover the ongoing costs of settlement with the NZPFU. The levy covers a significant majority (97 per cent) of Fire and Emergency's total revenue and is the only remaining revenue that can be adjusted.

59. Cabinet has not yet decided to increase the transitional levy. In November 2022, when approving the terms of the loan to enable Fire and Emergency to retain a sustainable cash position, Cabinet noted that Fire and Emergency's levies will need to increase on 1 July 2024 to enable the costs of settlement to be met and for the repayment of the Crown loan to start in the 2025/26 financial year [CAB-22-MIN-0520]. Cabinet decisions to increase the transitional levy and by how much are expected in July 2023 following public consultation.

Cost Recovery Principles and Objectives

60. The principles to guide this cost recovery proposal are:

- **Justifiability:** levy reasonably relates to services it is charged for;
- **Authority:** the levy is charged within its statutory authority;
- **Sufficiency:** transitional levy must provide sufficient funding for Fire and Emergency to deliver statutory functions at appropriate quality level while maintaining minimum cash reserves;
- **Simplicity:** any changes to the levy must be consistent with the existing transitional levy framework to avoid creating unnecessary complexity. The framework will be reviewed to implement the new Part 3 levy;
- **Transparency:** levy payers have enough information to assess levy framework and provide meaningful feedback; and
- **Timeliness:** adjustment of the transitional levy system must be able to be implemented by 1 July 2024.

61. Selection of these principles assumed that the levy will be increased and therefore apply to options that meet this assumption (ie the feasible options).

62. The principles have been derived from Treasury and Office of the Auditor General guidance, as well as features of the Fire and Emergency levy. They have guided the development of options for Fire and Emergency's consultation. The principles also serve as the objectives of the cost-recovery proposal.

63. Inclusion of an equity principle was considered. That is, whether the levy is set at a level that reflects the policyholders use of, or benefit from the potential use of Fire and Emergency's service. However, due to timing constraints and the need for a timely, simple option to address the shortfall, the decision was made to exclude equity from this analysis. This decision was made with the

assumption that equity will be considered as part of the Part 3 levy work (set to come into force on 1 July 2026).

Policy rationale, level of proposed fee (cost recovery model) and impacts

Several options have been ruled out, as they are not considered feasible

64. As noted earlier in this CRIS, it is not feasible for Fire and Emergency to meet the additional costs solely through a reduction in operational costs (refer paragraph 42 onwards), or solely through a reduction in capital expenditure (refer paragraph 48 onwards).

Differential increases for policyholder groups were not considered as feasible options

65. Options that resulted in differing increases across policyholder groups were considered but ruled out by Fire and Emergency as not feasible. This would mean that certain policyholder groups would see a larger increase than others. These options require costs to be allocated according to property type, according to historic information in Fire and Emergency's incident response data (for example, motor vehicles, residential property or non-residential property). This information was not available when the existing transitional levy rates were set.

66. This would conflict with the principle of Simplicity. Because the existing rates are not allocated in this way, it would be overly complex and challenging to model what an appropriate increase should be to align the new costs appropriately. This complexity is unnecessary because the entire allocation of the levy model will be reconsidered when the Part 3 levy is developed and will be based off response data.

67. This approach may also conflict with the Timeliness principle. More complicated changes likely require longer to implement, which may mean the changes cannot be implemented by 1 July 2024. Any implementation challenges are being tested through consultation.

Partial cost recovery is also not considered feasible

68. Fire and Emergency do not consider partial cost recovery of the additional costs of settlement to be feasible. This would require operational or capital expenditure to be reduced elsewhere within the organisation.

69. Partial cost recovery would conflict with the principle of sufficiency as Fire and Emergency would not be able to maintain the minimum level of cash reserves and deliver statutory functions at appropriate quality level. This would place additional pressure on the organisation and likely result in a reduction of services or unacceptable health and safety risks to firefighters across New Zealand. For example, failure to upgrade operation critical equipment such as

breathing apparatuses would put frontline Fire and Emergency staff at risk and impact their ability to fulfil their roles and responsibilities on the frontline.

An additional Crown loan is not feasible

70. Fire and Emergency do not consider an increase to the Crown loan a feasible option. While it may provide a short-term solution to meet the costs of settlement, the loan would still need to be repaid and borrowing a larger amount would increase the accrued interest. This would likely result in a significant increase to levy rates in 2026 when Part 3 comes into effect.

71. Increasing the loan would place an unfair fiscal burden on policy holders who would face a significant increase to their existing levy rate in 2026 and ultimately pay more to enable Fire and Emergency to recover the additional interest costs. Increasing the levy in 2024 is more affordable than a significant increase two years later in 2026.

Hybrid option

72. Under a hybrid option, Fire and Emergency would balance a minor reduction in expenditure and a partial increase to the Crown loan. A hybrid option was not considered feasible, therefore, the ratio of the hybrid option was not developed any further.

73. Minor reductions to operational or capital expenditure would not satisfy the substantial cost pressures Fire and Emergency face as a result of the settlement. In addition, the limitations imposed by an additional Crown loan would still apply. Under this option, Fire and Emergency would not be able to maintain the minimum level of cash reserves and deliver statutory functions at appropriate quality level. Policy holders would likely face a substantial levy increase in 2026 to recover the additional interest costs and address reduced cash reserves and underinvestment in capital expenditure.

Impact Analysis

Fire and Emergency are considering one option to recover the additional costs of settlement

74. The option being consulted on proposes a 12.8 per cent increase to all levy rates or annual amounts under the transitional levy, this would mean the following levy framework would apply as set out in **Table 13**.

Table 13: Difference in the transitional levy framework under a 12.8 per cent increase

Policyholder group	Levy element	Current rate	New rate	Difference (per annum)
Residential home	*Rate*	10.6c per $100 insured	11.95c per $100 insured	12.8 % increase
	Cap	$100,000	$100,000	No change
	Maximum	$106	$119.53	$13.53 increase
Residential contents	*Rate*	10.6c per $100 insured	11.95c per $100 insured	12.8 % increase
	Cap	$20,000	$20,000	No change
	Maximum	$21.20	$23.91	$2.71 increase
Non-residential	*Rate*	10.6c per $100 insured	11.95c per $100 insured	12.8 % increase
	Cap	No cap	No cap	No change
	Examples	$1 million insurance: $1,060 levy (per annum) $5 million insurance: $5,300 levy	$1 million insurance: $1,195 levy (per annum) $5 million insurance: $5,975 levy	$1 million insurance: $135 increase (per annum) $5 million insurance: $675 increase
Motor vehicle *(under 3.5 tonnes)*	*Flat amount*	$8.45	$9.53	12.8 % increase $1.07 increase

75. Insurance policyholders would face a 12.8 per cent increase in their levy costs. This will ultimately increase their insurance costs, as the levy is calculated and paid at the same time that an insurance policy is taken out.

76. A 12.8 per cent increase in the levy would create different impacts for different policyholder groups. For example, residential home levies would increase by $13.50 per year, residential contents by $2.70 and motor vehicles by just over $1.00. Non-residential policyholders increase would depend on the amount of insurance they have (because there is no cap for the levy). Because the cap for residential home and contents are set at a relatively low amount, most levy payers will pay the maximum levy and the impact is relatively easy to understand. The same is true of motor vehicles because of the flat amount paid per year.

77. Understanding the impacts for non-residential policyholders is more challenging. Because there is no cap, the amount of levy depends on how much insurance a non-residential policyholder has. The specific impacts within the non-residential policyholder group are also difficult to model (i.e how the costs

are distributed), because the commercial sensitivity of insurance information means we have little information about the insurance within this group. However, we do know that a non-residential policyholder with $1 million in insurance can expect a $135 change in levy per year, one with $5 million can expect a $675 change.

78. We do not have any information as to whether these changes will have any wider impacts for stakeholders (for example, reduced insurance cover), or different impacts on different groups. Further information will be gathered through consultation.

79. The above changes would mean that each policyholder group contributes more to the levy annually than previously. These changes as forecast for the 2024/25 year are shown in **Table 14**.

Table 14: Change in policyholder group contributions to total levy revenue[29]

Policyholder group	2024/25 (existing levy rate) ($m)	2024/25 (12.8 per cent increase) ($m)	Difference ($m)
Residential home and contents	217.9	245.6	27.7
Non-residential	402.8	454.1	51.3
Motor vehicle *(under 3.5 tonnes)*	47.1	53.1	6.0
Total	**667.8**	**752.8**	**85.0**

80. This approach replicates the existing framework of the transitional levy, where different rates of levy continue to apply to different policyholder groups. The proportions of levy paid by each policyholder group also remains the same. This means that the principles of Justifiability and Authority are met. It also means the principle of Consistency is met as additional complexity is not introduced to the transitional levy framework for two years before the new Part 3 levy takes effect.

81. The principle of Transparency is met through this impact assessment and consultation process being followed. Fire and Emergency will publicly consult on the proposal and the interim CRIS will supplement this.

82. The principle of Timeliness will be considered for implementation. However, this approach requires minimal changes to the transitional levy framework which increases the chances of changes being able to be implemented by 1 July 2024.

[29] Information provided by Fire and Emergency

A 12.8 per cent increase would mean Fire and Emergency has a sufficient cash reserve in 2026/27

83. Under this approach, Fire and Emergency would have enough additional revenue to operate a necessary surplus from 2024/25 to ensure minimum cash reserves are in place by 2026/27.[30] This would fully recover the additional costs of settlement, meaning that Fire and Emergency do not need to reduce operational or capital expenditure elsewhere. This meets the Sufficiency principle – as Fire and Emergency will have enough revenue to deliver statutory functions at their existing levels.

84. Forecast revenue and expenses under this option are shown in **Table 15**. Orange highlighted boxes show where Fire and Emergency returns to a surplus, as compared with **Table 8**.

Table 15: Fire and Emergency's forecast revenue, expenses, and surplus/deficits under a 12.8 per cent levy increase[31]

	2022/23 ($m)	2023/24 ($m)	2024/25 ($m)	2025/26 ($m)	2026/27 ($m)
Total revenue	661.24	673.84	771.83	786.77	802.00
Total expenses	713.00	713.94	740.16	748.41	766.85
Net surplus/(deficit)	**(51.76)**	**(40.101)**	**31.68**	**38.36**	**35.15**

85. The return to a surplus would have a corresponding impact on Fire and Emergency's cash reserves. Fire and Emergency's modelling of the impact to cash reserves is shown below.

86. The modelling in **Table 16** below shows that the return to a surplus in 2024/25 enables Fire and Emergency to build and sustain the required minimum level of cash reserves (for general business needs, the transition to Part 3 levy, and to repay Crown loans). This would result in a $58.7 million cash reserve in 2026/27, after a loss of $69 million in cash after moving to the Part 3 levy. The orange highlighted boxes can be compared with **Table 9** to show the change in levy revenue and cash reserves.

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[30] This assumes a two per cent increase in the insurance base per annum. The increase in insurance values may be higher than this within the currently inflationary environment. This assumption is being tested through public consultation.

[31] Information provided by Fire and Emergency

Table 16: Fire and Emergency's modelled cash reserves under a 12.8 percent increase to the levy[32]

($m)	2022/23	2023/24	2024/25	2025/26	2026/27[33]
Opening cash balance	198.5	142.0	107.9	127.0	123.1
Cost of operating Fire and Emergency	(713.0)	(713.9)	(740.2)	(748.4)	(766.9)
Net capital expenditure (capital expenditure less depreciation)	(8.1)	(7.1)	(6.0)	(16.7)	(18.6)
Repay borrowings	(15.5)	(15.8)	(16.0)	(24.1)	(9.1)
Other balance sheet movements	(6.5)	3.9	(15.5)	(1.5)	(2.8)
Part 3 levy (losing one month of cash)	N/A	N/A	N/A	N/A	(69.0)
Funding					
Crown contribution (subject to annual budget processes)	10.0	10.0	10.0	10.0	10.0
Repayable capital loan	25.4	25.0	25.0	-	-
Other income and cost recoveries	9.3	9.1	9.0	8.9	8.8
Funding from levy	641.9	654.7	752.8	767.9	783.2
Closing cash balance	**142.0**	**107.9**	**127.0**	**123.1**	**58.7**

87. These changes to Fire and Emergency's revenue and minimum cash reserves would occur without any financial impact elsewhere in the organisation. This reduces any risk that service levels will be impacted to meet these additional costs, as Fire and Emergency will not need to offset the costs from expenditure elsewhere within the organisation.

These changes are not expected to affect the demand for Fire and Emergency services

88. Changes to the levy are unlikely to affect demand for Fire and Emergency services. When Fire and Emergency services are requested, there is no charge to the requestor.

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32 Information provided by Fire and Emergency

33 Part 3 levy will operate for this year and this modelling assumes the same total amount of levy revenue will be received under this year of the Part 3 levy.

Changes in underlying assumptions

89. If there were a change to the level of the Crown contribution, this would impact the financial estimates provided above. An increase or decrease in the Crown contribution would require the levy to be adjusted accordingly to reflect the new level of income received outside of the levy.

90. An increase to the assumed two per cent level of inflation in insurance policies would impact the financial estimates that have been provided. This would reduce the percentage increase to the transitional levy required. This assumption is being tested through consultation and may be updated for the final CRIS.

Consultation

91. Public consultation is planned for April 2023. Fire and Emergency have prepared a consultation document that presents the options discussed in this interim CRIS. This document is intended to be published on Fire and Emergency's website and shared with the public for a period of 4 weeks.

92. Feedback from this consultation will be incorporated into a final CRIS when Cabinet makes policy decisions on any changes to the transitional levy rates.

93. We intend to meet with peak bodies from the insurance sector to discuss the proposed change to the transitional levy in March 2023.

Conclusions and recommendations

94. To enable Fire and Emergency to meet increased costs as a result of settling a new Collective Employment Agreement with the NZPFU, increasing the transitional levy by 12.8 per cent is recommended. However, the recommendation is subject to change following consultation noted above.

Implementation plan

95. Changes to the transitional levy will require an amendment to the *Fire and Emergency New Zealand (Levy Rates and Information Requirements in the Transitional Period) Regulations 2017.* This will occur through standard regulation amendment processes.

96. Any change to the transitional levy requires system changes for both Fire and Emergency and the insurance sector (the insurance sector calculates and collect the levy on behalf of insurance policyholders). It is critical that both organisations have enough time to carry out necessary updates to their systems to enable the new levy amounts to be collected.

97. Fire and Emergency will update and provide new guidance on the new levy rates to support stakeholders to understand the change. Given the changes to the system relate to the amount of levy paid only (as opposed to process and information requirements), it should be relatively simple for stakeholders to adapt to the new approach.

98. The length of time for implementation is being tested through consultation. There is a risk that there will be insufficient time to complete the required processes to amend regulations, as well as provide the insurance sector with their desired length of time for implementation for changes to take effect by 1 July 2024. The extent to which this is a risk will be considered when final policy decisions are sought.

Monitoring and evaluation

99. Existing monitoring and evaluation will be used to monitor and evaluate this change. Fire and Emergency provide regular performance updates to the Department which will provide information as to whether the intended effects of this change are occurring. These performance updates include:

- Quarterly financial reports
- Statement of Performance Expectations
- Annual report, including performance measures (for example, response times, speed to process fire permits, other organisational milestones)

A broader consideration of Fire and Emergency's costs will occur when the new Part 3 levy is designed

100. This change relates only to the increased ongoing costs as a result of settlement between Fire and Emergency and the NZPFU. These costs have already been agreed to and must be paid by the organisation.

101. The extent to which Fire and Emergency's existing costs before the NZPFU settlement are reasonable will be considered when the new Part 3 levy is being designed.

Review

102. No review is required as any change to the transitional levy will cease to take effect from 1 July 2026 when the new Part 3 levy takes effect. The design of the Part 3 levy is in effect a review of the transitional levy.