

# Regulatory impact statement

## Fire Services Review – costs of change and new funding arrangements

### Agency disclosure statement

This Regulatory Impact Statement (RIS) has been prepared by the Department of Internal Affairs. It provides an analysis of options relating to the costs of the reform of the New Zealand fire services and the proposed new funding arrangements. The structural reform was agreed by Cabinet in November 2015 [Cab 15 Min 0207 refers]. This RIS supports Cabinet’s consideration of the new funding arrangements and the likely costs of those arrangements.

There is no single, national, accounting data for the rural fire services, so a lot of information about the cost of the rural fire sector is unknown and the financial data is not collected or reported in a way that can be readily shared. The limited data on which to baseline costs and benefits reduces confidence with which modelling for the new levy and funding can be done. To better understand the financial picture, the Minister will undertake a review of performance and operations of the New Zealand Fire Service Commission (the Commission) to baseline its costs. The Minister will also expect the new Board to obtain financial information from the rural fire sector to develop a national financial overview of rural fire services. Further, the reforms of the fire services are expected to introduce improved systems to report on, analyse and monitor performance.

Any change to the levy will have an effect on all insureds including public sector, private sector and not for profit entities. Due to commercial sensitivity and privacy we are unable to access private sector data and therefore cannot model the precise nature and extent of this impact. For this reason, we propose a first transitional year of levy collection to provide better information to inform the first 3-year funding arrangements. Any necessary adjustments required from the transitional year will be made.

Detailed work will be required on the levy, charging on self-insurance, anti-avoidance mechanisms, information collected and provided by the insurance sector and other matters. Further analysis on the detailed levy design options and settings will be considered in the next month by Cabinet and a further Regulatory Impact Statement will support that process.

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## Executive summary

This Regulatory Impact Statement (RIS) presents analysis relating to the costs of sector reform of fire services in New Zealand and how this reform and the new organisation would be funded.<sup>1</sup>

Transformational change of the sort proposed comes at a cost. The total cost of change for four years is \$303 million. The expected value or risks avoided as a result of this investment are estimated to be \$386 million.<sup>2</sup> The proposed new costs are:

- new support costs \$191 million (2017/18-2020/21) – primarily for new volunteer supports and addressing urgent rural fire gaps; and
- transition costs of up to \$112 million (2016/17-2019/20) – for managing the transition from bringing the fire functions of multiple separate rural fire authorities together, and bringing the 400 plus legally independent volunteer brigades into a direct volunteer relationship with the new organisation.

If the transition costs are set too low, there is serious risk to realising the benefits sought from the reforms. Further, in a context where there are 13,000 volunteers comprising over 80% of the workforce, there is serious risk to service delivery if the workforce becomes dissatisfied and “votes with their feet”.

The new organisation must collect sufficient revenue from those who benefit from the potential use of fire services so that it can cover its costs. Current funding arrangements for the fire services revenue: do not adequately align costs to where the potential type of service use lies; are out of date and open to interpretation; and do not adequately align to the fire services’ strategic planning and monitoring. The funding arrangement that best resolves the problems, and delivers against the objectives and critical success factors is a new funding arrangement that includes a modified insurance levy, retaining the levy on contracts of comprehensive motor vehicle insurance and a new government public good contribution for costs that are not related to property or motor vehicle insurance.

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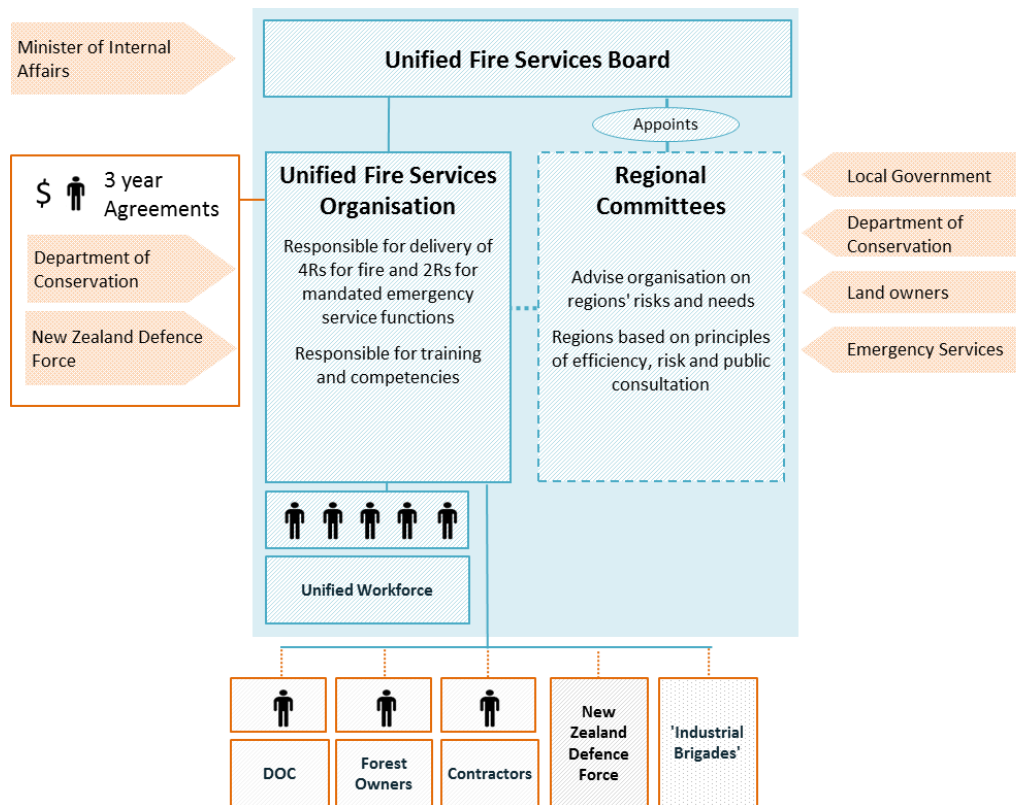
<sup>1</sup> Structural elements of the reform have already been decided by Cabinet [Cab15-Min-0207 refers].

<sup>2</sup> The expected value or risks avoided is an estimate because of limited strategic information.

## Background

1. Cabinet has made several decisions relating to structural reform of the Fire Services [Cab15-MIN-0207 refers], this RIS presents analysis relating to the
  - expected costs of the reform (\$303 million) over four years; and
  - how the services provided by the new organisation will be funded.

**Figure 1: Summary of new organisation that unifies the fire services**



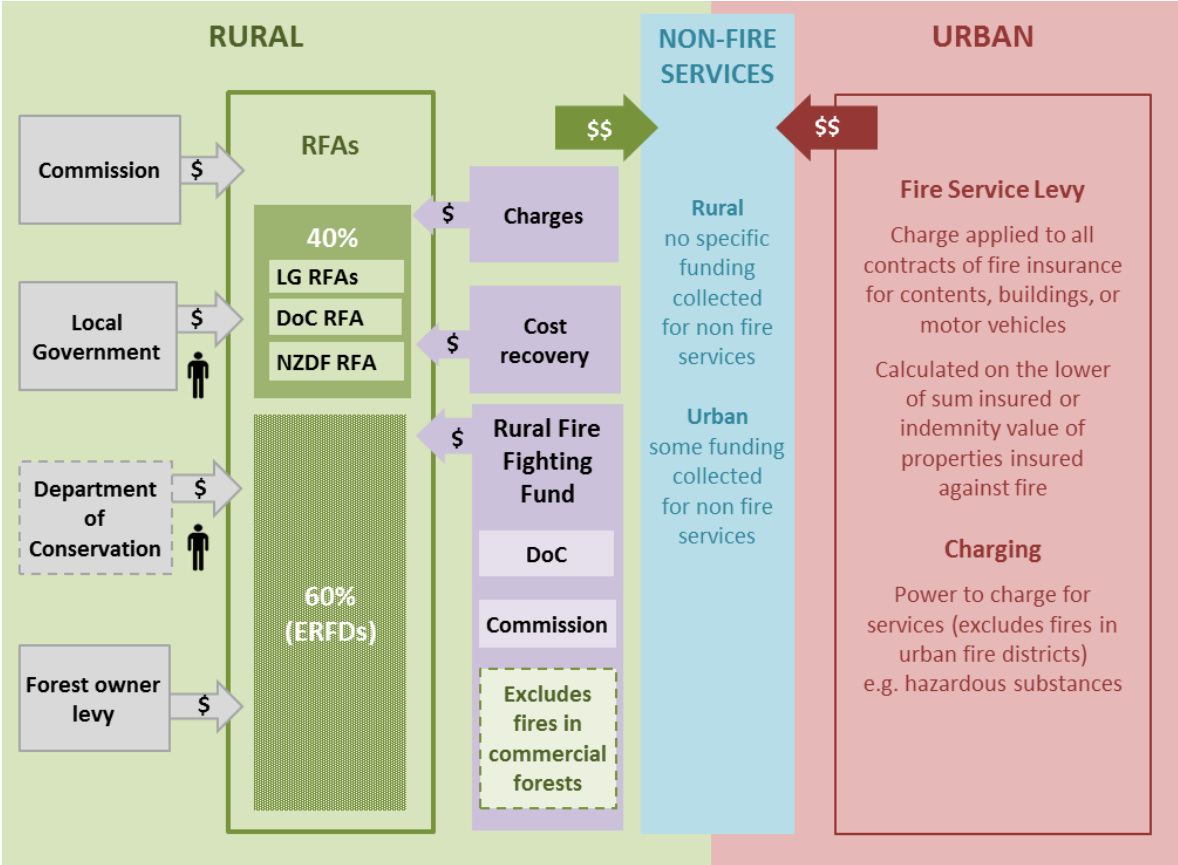
2. Early in the fire services review process, before the Fire Services Review: Discussion Document was published, the Government discarded two funding options: a levy on property values, and general taxation [CAB Min (15) 15/19 refers].

**Status quo**

**Overview**

3. Figure 2 provides an overview of the current model for funding the fire services. The structural separation of urban and rural fire is reflected in the different funding models that each has. These are depicted in the Diagram and discussed in more detail below.

**Figure 2: Current funding arrangements for the fire services**



**Fire Service Levy is applied to all contracts of fire insurance**

4. The New Zealand Fire Service Commission (the Commission) collects a fire service levy for the New Zealand Fire Service (NZFS) and the National Rural Fire Authority (NRFA). The levy is applied to all contracts of fire insurance covering New Zealand property and motor vehicle insurance. The levy is collected by insurance companies or brokers when customers obtain fire insurance for contents, buildings, or motor vehicles. Currently, the levy is calculated on the indemnity value of property insured or the sum insured, whichever is lesser. The indemnity value is fixed in the owner’s declaration or a valuation certificate. Some fire insurance contracts are exempt, usually because the owners of those exempted insurance contracts pay for a fire service in a different way, for example:

- hazardous substances are exempt because they are charged;
- forestry is exempt because they are either charged by the NZFS, or they contribute to rural fire funding.

### ***Rural fire funding is complex and varies through the country***

5. The funding arrangements for rural fire are complex and vary through the country. Funding is received from a number of sources, such as:
  - property owners through local authority rates, which have a variety of approaches across the country;
  - commercial forest owners through levies;
  - DoC (through their workforce and Rural Fire Fighting Fund contributions); and
  - the Commission through grants (e.g. for fire appliances and equipment and Rural Fire Fighting Fund contributions); and
  - cost recovery from the person responsible for the fire, or the forest owner (as appropriate).
6. Note, the New Zealand Defence Force (NZDF) does not seek cost recovery from NZFS or Rural Fire Authorities (RFAs) for support provided.

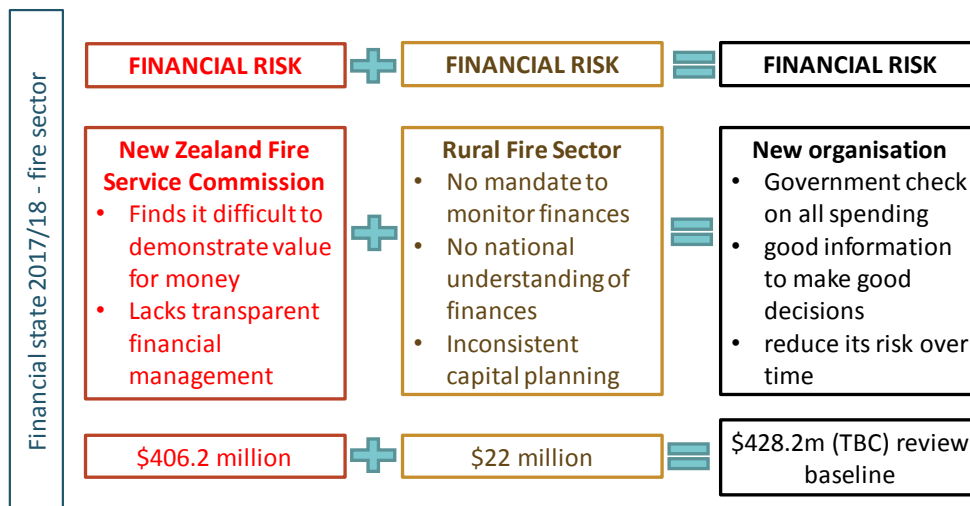
### ***Fire services property and assets are significant***

7. NZFS holds more than \$500 million in property, vehicles, plant and equipment, including over 800 appliances. In terms of property, NZFS own the following:
  - 79 career fire stations; and
  - 360 volunteer stations.
8. There is wide variation in ownership and management arrangements for rural fire property and assets. For example, some Enlarged Rural Fire Districts (ERFDs) now own all the fire equipment their stakeholders previously owned while others have not transferred ownership of any equipment to the ERFD, and others fall somewhere in between. Due to the diverse and regional ownership arrangements of rural fire there is no national asset register for RFAs or ERFDs and no common reporting arrangements for the regional assets to be readily shared. Current rural fire property and assets are estimated to be approximately \$90 million.

### ***Financial position***

9. Figure 3 summarises that the new organisation will have some financial risks carried over from the current state finances of the Commission and the rural fire sector. The new Board will need to review its base to manage the financial risk within the Commission and the rural fire sector. These risks might cause the new organisation's costs to increase.

**Figure 3 The new organisation will need to review its base to manage its financial risk**



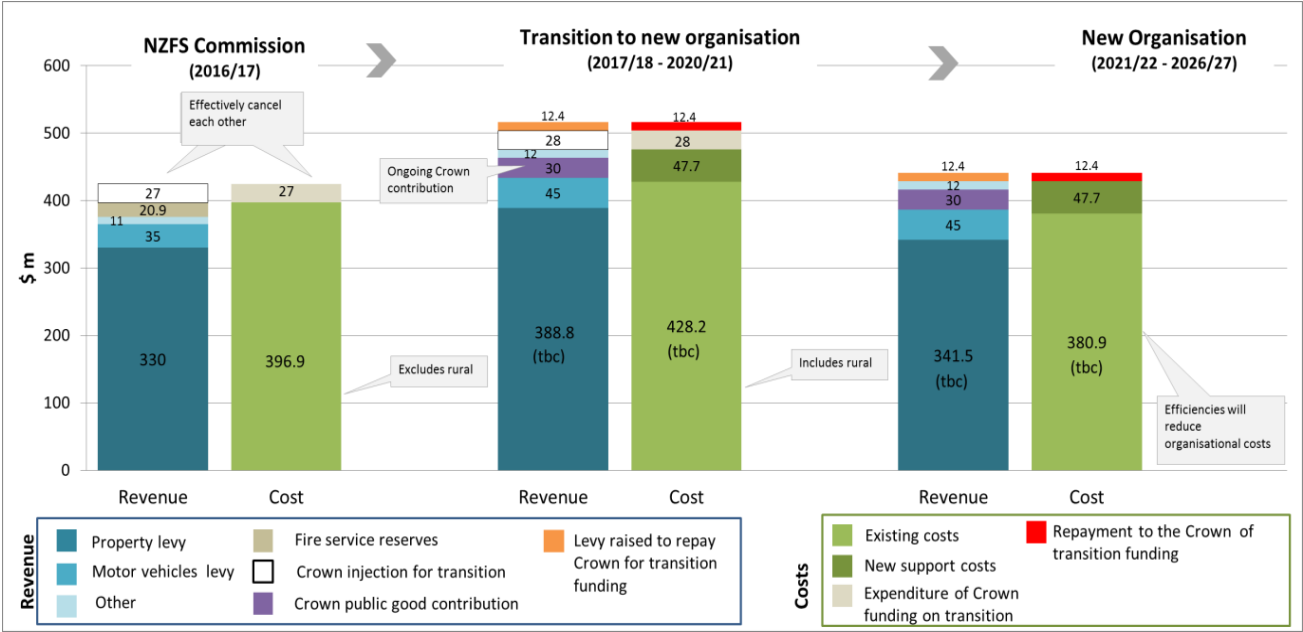
10. The Department of Internal Affairs (the Department) cannot find evidence that the Commission spends more than it needs but it is difficult to determine whether its spending is good value. The Department is working with the Commission on its current state. The Commission has not had a levy increase for quite some time, which is putting the Commission under pressure.
11. For rural fire no agency has the mandate to monitor rural fire spending and there are multiple governance structures. As a result, the rural fire sector has no national understanding of its finances and lacks some capital planning.<sup>3</sup>

<sup>3</sup> Hunn, N., and Ward, R., (May 2015). *Picture of Investment in Enlarged Rural Fire Districts*. Martin Jenkins: Wellington

### The change will cost \$303 million over four years

- 12. The complex sector change that is being proposed comes at a cost but is likely to improve value or result in avoiding costs that might have to be paid of approximately \$386 million. The preferred cost option is:
  - **new support costs** \$191 million over four years starting in 2017/18; and
  - **transition costs** of up to \$111.94 million over four years starting in 2016/18.
- 13. Figure 4 below summarises the expected costs for the new organisation, including the transition costs and new support costs. The Figure also shows where the revenue for the new organisation would come from (or who would pay the cost). The new funding arrangements are explained in the following section of the RIS.

**Figure 4: Average annual expected costs for new organisation and who would pay the cost**



- 14. We have a reasonable level of confidence in the estimated costs of change. After four years the new organisation is expected to be able to continue to provide the new support costs from efficiencies.<sup>4</sup>
- 15. The costs were prepared by the Commission and reviewed by the Department. The Commission engaged KPMG to develop the cost model and benchmark against industry standards. PriceWaterhouseCoopers (PWC) provided further financial modelling and review. The Treasury reviewed the cost methodology and considers them reasonable given the scale of change to be met, and viewed the process for determining the costs as robust.
- 16. A programme business case has also been prepared to the standards of The Treasury’s Better Business Case (BBC). A formal BBC was not required, but the model was followed to meet the Department’s monitoring standards. Despite the process there are some caveats on the costs:

<sup>4</sup>Efficiencies should be gained from improved use of capital, matching services with community risks and needs, and the use of a flexible service model that is not a rigid “one-size fits all approach”. If these efficiencies are not able to be fully realised by 2021, there will not workforce cuts to fund the shortfall.



- costs are estimates prepared to a standard for an investment decision and will be refined at each major stage gate during implementation; and
- level of certainty varies depending on information available – where benchmarking was available it was used, otherwise estimates were applied.

*What will the money be spent on*

17. New support costs will comprise:
  - new volunteer support of \$23.3 million;
  - regional committees of \$1.3 million;
  - rural fire services of \$17.3 million; and
  - \$5.8 finance, ICT and Corporate.
18. The transition costs are up to \$112 million and are what is required to firstly merge the people, assets, and equipment of separate Rural Fire Authorities and over 400 legally independent New Zealand Fire Service Volunteer Brigades (brigades) into one unified organisation, and to secondly ensure a modern, fit for purpose fire services organisation that is effective and efficient
19. These costs and the likely benefits expected from them are summarised in Table 1.

Table 1: Costs and benefits of the new support costs and the transition programme

	NEW ACTIVITIES	RURAL	NZFS	TRANSITION
	TOTAL OPERATING COST FOR NEW ORGANISATION \$480.9M + \$5.8M NEW CAPITAL			
<b>COSTS</b>	<b>NEW</b> Volunteer support \$23.3m Regional Committees \$1.3m	Finance, ICT, other corporate \$5.8m new for larger organisation		Costs over five years \$112m
<b>UNFUNDED</b>		Estimated rural funding gap \$11.5m Urgent rural capital \$5.8m		
<b>TRANSFER</b>		Estimated funded rural fire \$22m*	NZFS costs \$406.2m	
<b>SIGNIFICANT ITEMS</b>	<ul style="list-style-type: none"> <li>• \$8m on additional support resources for volunteers</li> <li>• \$5.4m on financial incentives for employers and volunteers such as levy reimbursements</li> <li>• \$1.2m on updating the employer recognition programme</li> <li>• \$4.9m on having the same wellbeing initiatives across workforces</li> <li>• \$3.4m on volunteer gratuities (noting extension to rural)</li> </ul>	<ul style="list-style-type: none"> <li>• \$4.1m new national rural fire reduction</li> <li>• \$5.8m urgent capital upgrade where life or property at risk</li> <li>• \$7.4m addressing gaps in training needs, maintenance, and wages</li> </ul>	<ul style="list-style-type: none"> <li>• No efficiencies costed e.g. might not need two separate fire stations in one rural community</li> <li>• Potential savings mean might not need new corporate costs</li> </ul>	<ul style="list-style-type: none"> <li>• \$43.2m ICT and emergency comms</li> <li>• \$19.2m service model redesign</li> <li>• \$17.9m - culture, stakeholder engagement</li> <li>• \$13.9m - programme management office and governance</li> <li>• \$7.2m - workforce and human resources changes</li> <li>• \$5.3m - set up Committees and support</li> <li>• \$4.9m new governance, planning, performance, levies</li> <li>• \$0.6m - audit of rural fleet/equipment</li> </ul>
<b>BENEFITS</b>	<ul style="list-style-type: none"> <li>• Increased volunteers in rural communities</li> <li>• Social capital in communities grows</li> <li>• Community resilience is enhanced</li> <li>• Volunteers have better support and less administration</li> <li>• Training is matched to each volunteer's level of commitment within operational constraints</li> </ul>	<ul style="list-style-type: none"> <li>• Every medium-high fire risk region would be ready to respond to rural fires (33% currently not ready)</li> <li>• Safe and effective response to rural fires</li> <li>• Reduced number of unwanted lit and escaped fires</li> <li>• Protected regional and national economies from significant fire</li> </ul>	<ul style="list-style-type: none"> <li>• New organisation with new unified governance, leadership and monitoring</li> <li>• New leadership and new governance - including from rural fire</li> <li>• New operating processes</li> </ul>	<ul style="list-style-type: none"> <li>• Transition is a merger designed alongside stakeholders</li> <li>• Efficiencies over time through better design</li> <li>• New strategic performance framework</li> <li>• Transparent financial management</li> <li>• Strong oversight and monitoring</li> </ul>
<b>RISKS</b>	<ul style="list-style-type: none"> <li>• Volunteer workforce continues to shrink - 30 rural brigades below complement</li> <li>• Volunteers leave the new organisation</li> <li>• increased costs with less service - if 30 brigades fail it could cost \$47m to replace with paid staff</li> <li>• volunteer management not done and paid staff model continues to be rolled out to volunteers (80% of workforce)</li> </ul>	<ul style="list-style-type: none"> <li>• Threat to life and property - 33% of medium-high fire risk regions need improvement in readiness</li> <li>• Lit or escaped fires are increasing</li> <li>• Firefighters or community are harmed or killed - eight out of nine operational reviews show deficiencies in safety and management practices and recent fatalities</li> <li>• Principal Rural Fire Officers say inadequate</li> </ul>	Some NZFS processes are not suitable for the new organisation e.g: <ul style="list-style-type: none"> <li>• the operational skills system risks spreading brigades and volunteers thinly</li> <li>• inadequate data to understand new organisation's performance</li> <li>• area managers not supported to spend time with their brigades</li> <li>• capability model is one-size fits all</li> </ul>	<ul style="list-style-type: none"> <li>• Scarce fire services capability and leadership</li> <li>• Change is very complex</li> <li>• New organisation is not successful or could cost more because volunteers leave or stakeholders do not engage</li> <li>• Essential emergency services might be compromised</li> <li>• Industrial dispute may arise</li> </ul>

\* The estimated rural fire income of \$22 million comes from the Martin Jenkins report *Picture of Investment in Enlarged Rural Fire Districts*

### **Alternative cost options considered**

20. Alternative cost options considered were:
- lower support cost options of \$166 million and \$126 million over four years with reduced benefits shown in Table 2 below; and
  - lower transition cost option of up to \$90 million over four years shown in Table 3.
21. The services that are cut to lower the costs are provided in Table 2 below. Reduced volunteer support costs might mean that we are unable to address volunteer shortages (particularly in some small communities areas), and thereby increase reliance on paid staff to serve rural communities. Currently 30 brigades are at-risk of failing because they fall below 70% of the complement required. To replace 30 brigades with an equivalent service delivered by paid staff would cost \$47 million.
22. Reduced corporate costs mean that the new organisation would continue to deliver a top-down management approach, thereby distancing itself from the community and its workforce. This is in a context where over 80% of the workforce comprises volunteers, and the risks relating to dissatisfaction are extremely high.

**Table 2: Savings generated by reduced additional ongoing costs**

<b>Medium cost option \$166m for four years</b>	<b>Reduced (\$M)</b>	<b>Low cost option \$126m for four years</b>	<b>Reduced (\$M)</b>
All financial incentives for volunteers included in preferred option are removed	0.8	All financial incentives for volunteers are removed	0.8
All financial incentives included in preferred option for employers are removed	5.0	All financial incentives for employers are removed	5.0
		Fewer additional volunteer support roles (from 48 to 16 nationwide)	2.6
		The amount of HR support available is reduced	1.6
		The amount of money available for rural risk reduction is reduced	1.7
		The amount of money available to provide non-financial benefits for volunteers is reduced	5.1
		There is no provision for uniforms other than those that provide protection	0.8
		Reduction in corporate staff	0.8
<b>SAVINGS Per annum</b>	<b>5.8</b>	<b>SAVINGS per annum</b>	<b>18.4</b>
<b>SAVINGS OVER FOUR YEARS</b>	<b>23.2</b>	<b>SAVINGS OVER FOUR YEARS</b>	<b>73.6</b>

23. It is possible to deliver the transition for less cost (up to \$90 million) but a cost reduction is more likely to result in the perception that the changes are a takeover rather than a merger because there needs to be greater reliance on existing NZFS

processes and systems. This risk is likely to lead to disengagement or rejections by the rural fire sector in the change process. Reduced cost also makes it more difficult to manage the complexity and risks not having the necessary capability in place to support the transition. The Board would also be less likely to be able to deliver the expected benefits, be on-time and within cost, and have essential emergency services operating safely from day one. Reduced transition costs means the transition would:

- become more top-down rather than delivered alongside stakeholders, volunteers, and firefighters;
- rely more and more on existing NZFS processes and systems that forces the new organisation to behave in a ‘takeover’ manner and increases risks to service delivery (because NZFS processes and systems are not fit-for-purpose for rural activity), and reduces the ability to build in new efficiencies;
- find it more difficult to attract suitably skilled candidates in the current market, which is currently very competitive because of the number of other change programmes underway;
- have less quality assurance in place; and
- have less fit for purpose information and communications technology in place. As an emergency services organisation, reliance on fit-for-purpose, reliable technology is a critical dependency. Low cost transition would impair the new organisation’s ability to implement an HR system to accommodate approximately 13000 people.

24. Table 3 below shows where savings would be made to lower the transition costs.

**Table 3: Reductions in cost from cutting activities from the transition programme**

<b>Below optimal \$90m transition over four years</b>	<b>Reduced (\$M)</b>
Size and rates reduced for the Programme Management Office	1.5
Reduction in Independent Quality Assessment	0.4
Reduced training for staff learning new processes and ways of working	2.1
Reduced communications	3.8
Reduced allocation for negotiation and consultation over new boundaries and structures	2.4
Reduced size and rates for service model redesign team	1.9
<b>TOTAL SAVINGS</b>	<b>12.1</b>

25. A further very low cost option set at \$70 million (both operating and transition) was assessed and discarded because:

- it meant the review would fail to meet the review’s investment objectives or the critical success factors;
- the level of risk becomes so high the programme starts to become unachievable;
- it was unlikely to deliver the expected benefits;
- there would be very limited external support for the programme and expects that all key roles and competencies to manage the change can be found within NZFS; and

- removes incentives for rural to participate in the establishment of new fire services.

26. Assessment of the different cost options is set out in Table 4 below.

Table 4: Assessment of cost options

	OPTION	WHAT IS REMOVED	RISKS
NEW ORGANISATION COSTS	Preferred option <b>\$47.7 million</b>	<ul style="list-style-type: none"> <li>can fully deliver the decisions made in the previous Cabinet paper on governance and support</li> </ul>	<ul style="list-style-type: none"> <li>risks remain but are managed effectively</li> </ul>
	Sub-optimal option <b>\$41.5 million</b>	<ul style="list-style-type: none"> <li>employer and self-employed financial and non-financial recognition</li> <li>volunteer levy reimbursements (so volunteers do not pay twice)</li> <li>some corporate services</li> </ul>	<ul style="list-style-type: none"> <li>can not attract and retain volunteers</li> <li>employers are less willing to let their staff volunteer</li> <li>new organisation does not build community resilience because it is cheaper to consult less and be top-down</li> </ul>
	Low cost high risk option <b>\$31.5 million</b>	<ul style="list-style-type: none"> <li>employer and self-employed financial and non-financial recognition</li> <li>volunteer levy reimbursements (so volunteers do not pay twice)</li> <li>Some corporate services</li> <li>reduction in volunteer support roles</li> <li>slower introduction of new uniform for all</li> <li>less risk reduction programmes</li> </ul>	<ul style="list-style-type: none"> <li>can not attract new volunteers</li> <li>existing volunteers leave</li> <li>increased workforce costs for less service, or some stations may have to close</li> <li>employers less willing to let their staff volunteer</li> <li>reduced social capital and rural economies worse off</li> <li>new organisation does not succeed</li> <li>cultural change may be compromised e.g. uniforms, leading to rural volunteers treated as 'poor cousins'</li> </ul>
TRANSITION COSTS	Preferred transition costs <b>\$112 million</b>	<ul style="list-style-type: none"> <li>transition is delivered smoothly with best opportunity to realise effectiveness and efficiency benefits</li> </ul>	<ul style="list-style-type: none"> <li>change remains a major undertaking but risks are managed effectively</li> </ul>
	Sub-optimal transition costs <b>\$90 million</b>	<ul style="list-style-type: none"> <li>12.5% reduction in programme team with less use of major change partner and less experience</li> <li>25% less training for workforce on new processes</li> <li>reduced design and baseline metrics for performance reporting and levies</li> <li>reduced communications</li> </ul>	<ul style="list-style-type: none"> <li>higher risk that volunteers and some stakeholders may feel poorly consulted and not support the new organisation</li> <li>more risk that programme will not run to time or develop new frontline processes that do not realise future efficiencies</li> </ul>
	Low cost high risk transition costs <b>\$70 million</b>	<ul style="list-style-type: none"> <li>25% reduction in programme team with small engagement with major change partner and significantly reduced rates for staff</li> <li>reduced funding for frontline operating processes</li> <li>50% less training for workforce on new processes</li> <li>smaller design and baseline metrics for performance reporting and levies</li> <li>reduced communications (same as medium transition costs)</li> </ul>	<ul style="list-style-type: none"> <li>higher risk that volunteers and some stakeholders may feel poorly consulted and not support the new organisation</li> <li>volunteers might leave</li> <li>high risk that programme will not run to time or develop new frontline processes that do not realise future efficiencies</li> <li>high risk of reduced engagement leading to a less effective, more top-down solution.</li> <li>extends NZFS processes leading to feeling like a takeover</li> <li>stakeholders relationships become fractured</li> <li>risk of takeover behaviours</li> </ul>

## **New funding arrangements: how the costs of the fire service will be paid**

### ***Problem definition***

27. This review consulted on the following three funding problems with the current funding arrangements:
- fire service levy revenue does not reflect the total risk of fire;
  - fire service levy does not reflect the range of activities (mandated emergency services functions are increasing); and
  - fire service levy can be confusing to calculate and difficult to forecast.
28. Further work refined the funding problems to include the combined funding picture of rural fire services and the fire service levy. This analysis led to the conclusion that the current funding sources do not adequately align costs to the:
- potential use of the fire services; and
  - fire services' strategic planning and monitoring.
29. The levy is also out of date and open to interpretation.

### ***The costs are not aligned to the potential to use the fire services***

30. The current fire service levy does not align costs to potential service use because:
- there is only one revenue source (the levy), which means that government does not pay some of its fair share of costs for the public good that is not related to property and motor vehicles (e.g. medical call outs);<sup>5</sup>
  - the residential levy payers are primarily cross subsidising the public good costs that are not related to property or motor vehicles;
  - there is an inability to set different fixed rates between the residential sector and non-residential sectors to reflect their different costs, which enables some cross-subsidisation between the sectors to occur (approximately \$60 million);
  - within each funding class, costs are not well-matched to potential use for example:
    - in the non-residential sector some large organisations seek to reduce their insurance costs, which in turn reduces their fire services contribution;
    - in the non-residential sector some large public and private entities do not pay their fair share of costs that relate to property causing costs to fall on small-medium businesses; and
    - approximately 20% of motor vehicle owners do not have comprehensive motor vehicle insurance, which means a significant number of motor vehicle users do not pay for the potential fire services they receive.

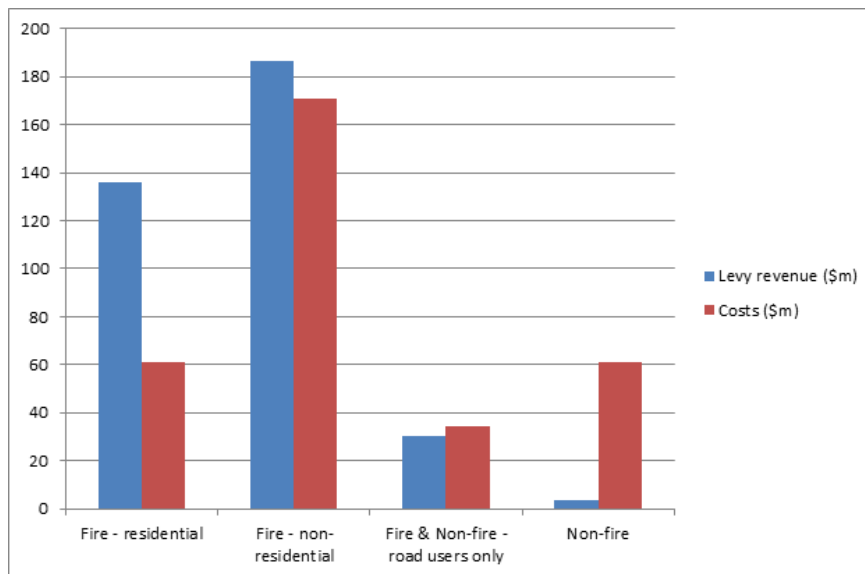
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<sup>5</sup> These activities are currently estimated to cost \$30 million and include the following activities:

- medical emergencies - \$11.2 million;
- special services (assisting the public) - \$8.2 million;
- special services (assisting police) - \$4.5 million;
- rescue and other emergencies - \$3.4 million;
- domestic and commercial water services - \$2.3 million; and
- wider emergency management - \$1 million.

31. Having separate fire-related funding sources was logical when the fire services primarily responded to fire incidents. However, fire services’ activities have expanded, as shown in Figure 5 below. The growing trend in non-fire call outs means the fire services are responding to more incidents, even as the number of structure fires is declining. The scale and scope of this change implies a need to reconsider funding arrangements. Funding our fire services from a levy limited to fire insurance or having separate rural fire funding creates gaps between those who pay for and those who potentially use the fire services.

**Figure 5: Comparison of fire service levy revenues and NZFS costs**



32. The gap caused by continuing to fund the fire service from fire insurance rather than fully reflecting the fire services broader mandate means that some levy payers are not paying as much as they should because:
- everyone benefits from the fire services wider response to earthquakes, floods and storms, and hazardous substances emergencies but only those with fire insurance pay for it;
  - some insure for material damage and fire but are only levied on fire, these are usually large public and private entities;
  - large public and private entities with high population density and large buildings in small compressed areas often require a more complex response from the fire services when they respond to fire and disasters and their levy contribution through their insurance arrangements should reflect this complex response but currently does not;
  - large public and private entities tend to avoid contributions through levy minimisation mechanisms as shown by the recent Supreme Court decision that ruled against excess of indemnity contracts and collective policies.<sup>6</sup>

<sup>6</sup> In *New Zealand Fire Service Commission v Insurance Brokers Association of New Zealand Incorporated and Vero Insurance New Zealand Limited* (SC 57/2014) [2015] NZSC 59

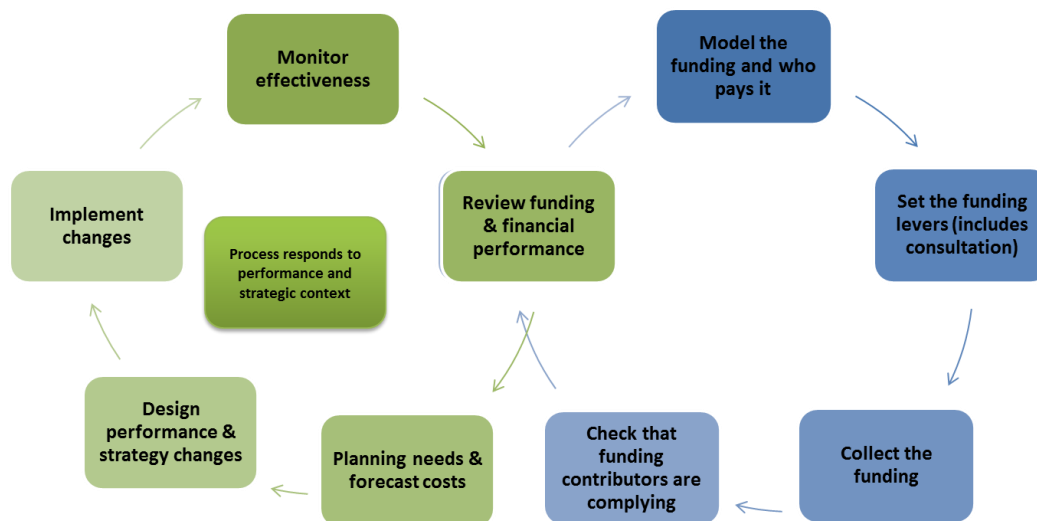


33. It is difficult to estimate the size of this gap because the Department does not have information on how common it is to have split contracts for fire and material damage, though the Insurance Council of New Zealand has confirmed that they are utilised by large public and private entities.
34. Rural fire funding also does not align to the potential use of the service because:
- all property owners benefit from rural fires being fought and put out – not just those who own crops or forests (who pay land owner levies to RFAs). All property owners currently pay through their rates for some rural fire services and through insurance levies for urban fire services;
  - there is likely underinvestment estimated to be \$17.4 million per annum where revenue does not adequately meet service needs;<sup>7</sup>
  - like NZFS in Figure 5 above, rural fire services are also responding to increasing numbers of motor vehicle incidents and other non-fire incidents; and
  - cost-recovery from the person who set the fire does not enable costs to align with all the beneficiaries of the fire being put out, especially if the setting of the fire was not negligent.

*Costs are not adequately aligned to the fire services’ strategic planning and monitoring (or its performance framework)*

35. The Fire Service Act does not adequately align the levy review cycle to the performance framework. As Figure 6 below shows, the funding cycle should be connected to the performance review cycle to drive a cost effective approach.

**Figure 6: Funding review cycle is connected to the performance cycle**



<sup>7</sup> estimated by the National Rural Fire Authority based on a working knowledge of current state rural fire property and assets, and number of workforce, which was then compared to known current revenue estimates. This underinvestment and the revenue estimates have a low level of confidence and need to be verified by the new Board prior to setting the first funding arrangement.

36. The current fire service Levy is not as well connected to the performance cycle as it could be. The FS Act is reviewed by the Minister and the Act focuses the Minister’s review on whether the levy is sufficient and stable. The prescriptive nature of the FS Act has resulted in out-of-date levy setting that does not demonstrate value, or link with the Commission’s performance and strategy design. The out-of-date approach means that the Commission finds it difficult to demonstrate good value.

*Costs are out of date and open to interpretation*

37. The fire service insurance levy calculation is out-of-date because it hasn’t been substantially reviewed since it was first put in place. There have been some amendments since then, but the last time was in 1993 when the residential cap was aligned with the Earth Quake Commission (EQC) cover. At that time house prices were much lower than they are now. In addition, the EQC and the fire services regimes are not well aligned.
38. Support for reviewing the levy provisions has also come from the Supreme Court where in their decision they stated that reform of the fire service levy is necessary because the provisions are out of date and unclear.<sup>8</sup>
39. The full implications of the Supreme Court decision have not yet been felt but it is expected that it will result in some entities paying a higher levy than they have been and others are likely to explore the possibilities for new insurance arrangements.<sup>9</sup> The Commission has stated that it will not apply the Supreme Court’s decision retrospectively. All new policies that are entered into would have to be careful to ensure that levies are being paid in accordance with the Court’s decision.
40. The current fire service levy calculation is open to interpretation – as indicated by the Supreme Court’s judgement.<sup>10</sup> The rural fire funding is also open to interpretation, with some RFAs and ERFDs having to negotiate to obtain funding from their funders. These arrangements vary substantially across the country.
41. Rural fire funding sources are out-of-date because:
- cost-recovery, as a funding source, fails some of the tax principles (sufficiency, predictability, and non-distortionary), which are generally regarded as the modern approach to compulsory funding systems;

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<sup>8</sup> In *New Zealand Fire Service Commission v Insurance Brokers Association of New Zealand Incorporated and Vero Insurance New Zealand Limited* (SC 57/2014) [2015] NZSC 59

<sup>9</sup> The Supreme Court found that the correct interpretation of s48(6)(c) of the Fire Service Act 1975 requires that the levy is payable on the true indemnity value of the property. The sample policy provided insurance on terms more favourable than the indemnity value of the property. Section 48(7) does not exempt the excess of indemnity policy, except to the extent that it provides cover in excess of the true indemnity value. This better reflects the intention to set the levy to reflect the property owner’s level of insurance cover, and an interpretive approach favouring greater universality of the levy, which is in the nature of a tax for a public service.

The Supreme Court also found that the levy should be computed on the basis that each of eight port companies covered by the New Zealand port collective composite policy, cover for “all insureds collectively” in relation to fire damage, had an insurance contract on which the levy was payable. This finding was based on a number of features of the policy.

<sup>10</sup> SC 57/2014 [2015] NZSC59.

- the levy charged to forest owners was established when forest owners were the primary cause of rural fires. Tactical and strategic planning of ERFDs shows that the largest risk of rural fire is the urban-rural interface (which includes members of the urban population being in rural areas or small urban-like community clusters in rural areas); and
- the fire service levy is probably paying for more responses in rural areas than it did 25 years ago because the “red trucks” go to more rural calls and stay longer than they used to, causing funding inequities (whether perceived or real), which is not likely to improve.

***There are consequences of not addressing the levy problems***

42. If the funding sources for all fire services are not changed, the current funding base:
- may erode over time necessitating an increase in the levy rate to compensate;
  - would cause the full costs of the fire services to fall on a smaller, more limited funding base rather than being shared by all potential users;
  - the increased costs of implementing a new fire services organisation will also fall on the smaller more limited funding base;
  - would be subject to interpretation and legal challenge;<sup>11</sup> and
  - would continue to be difficult to review in terms of performance and accountability.

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<sup>11</sup> See for example, *New Zealand Fire Service Commission v Insurance Brokers Association of New Zealand Incorporated and Vero Insurance New Zealand Limited* (SC 57/2014) [2015] NZSC 59

## Objectives

43. The objectives for a new funding arrangement are:
- optimal balance of the tax principles – set out in rank order:
    - sufficiency (base x rate);
    - simplicity;
    - predictability;
    - adaptability; and
    - non-distortionary (insurance market);
  - funding charged to potential type of service use;
  - cohesive funding system that supports effective strategic decisions; and
  - clear legislation that is difficult to avoid.
44. The critical success factors are:
- minimises likelihood of avoidance;
  - compliance burden on funders and insurance industry is minimised;
  - compliance burden on new fire services organisation is minimised; and
  - does not significantly impact on other government funding regimes or expenditure priorities.

## ***Assessment of options***

45. The assessment of options prioritised simplicity and predictability over options that provided incentives for levy payers to reduce risk because:
- a simple approach reduces opportunities for avoidance and legal challenge;
  - using risk reduction incentives in levy setting (e.g. setting the levy based on the insurance premium) risks greater instability of revenue; and
  - risk reduction incentives would have a minimal effect on behaviour because:
    - insurance premiums already incentivise risk reducing behaviour and the levy is small compared to premiums;
    - there are other statutory obligations already requiring risk reducing behaviours (e.g. Building Act 2004, Resource Management Act 1991, Health and Safety in Employment Act 1992).

## ***The funding arrangement that best meets the objectives is preferred***

46. The funding arrangement that best meets the investment objectives and critical success factors is:
- a levy from insurance on property material damage (\$401 million in 2017/18);
  - a levy from insurance on motor vehicles (\$45 million in 2017/18);
  - a government public good contribution: a new enabling provision for the Crown to make a contribution for public good costs that are not related to property or motor vehicles (\$30 million in 2017/18 or a lesser amount) to begin at a time that is affordable for the Crown; and

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- other payments either through charging for certain services or other contributions (\$12 million).
47. The significant analysis for this funding arrangement is described in Table 5 below and is explained more in the following section.

**Table 5 Assessment of the funding options: status quo, enhanced status quo, and the mixed funding model based on sums insured**

	Status quo	Enhanced Status quo (sums insured with levy on self-insurance)	Mixed Funding Model (sums insured with levy on self-insurance)
<b>Description</b>	<p><i>Fire service levy:</i></p> <ul style="list-style-type: none"> <li>on contracts of insurance against fire</li> <li>calculated on lower of sums insured or indemnity value</li> <li>same levy rate on residential and non-residential</li> <li>cap on residential at \$100,000 (linked to EQC Act)</li> <li>no cap on non-residential</li> <li>fixed rate for residential and non-residential.</li> <li>exemptions in Schedule 3 to Fire Service Act</li> <li>provisions for penalty and surcharge for late and non-payment</li> <li>rate of levy reviewed at any time (and must be reviewed annually)</li> </ul> <p><i>Motor vehicles</i></p> <ul style="list-style-type: none"> <li>levy on insurance on motor vehicles</li> </ul> <p><i>Rural Funding</i></p> <ul style="list-style-type: none"> <li>various funding streams (levy, rates, cost recovery etc) for RFAs under the Forest and Rural Fires Act</li> </ul>	<p><i>New fire services levy</i></p> <ul style="list-style-type: none"> <li>on contracts of insurance against material damage</li> <li>calculated on sums insured</li> <li>applies different fixed rates to residential and non-residential</li> <li>increases cap on residential to \$300,000 (removing link to EQC Act, and providing flexibility for the cap to adjust under regulations)</li> <li>retains no cap on non-residential</li> <li>retains fixed rate for residential and non-residential</li> <li>removes exemptions from legislation, but allow power to make regulations for exemptions</li> <li>new information and audit requirements</li> <li>anti-avoidance provisions and/or penalty and surcharge provisions</li> <li>levy can be reviewed at least every three years (allowing flexibility to respond to immediate issues as they arise)</li> </ul> <p><i>Motor vehicles</i></p> <ul style="list-style-type: none"> <li>road users charged more broadly (under the NLTF or extended insurance levy)</li> </ul> <p><i>Rural funding</i></p> <ul style="list-style-type: none"> <li>separate rural funding streams removed</li> </ul>	<p><i>New fire services levy</i></p> <ul style="list-style-type: none"> <li>same as Enhanced Status Quo</li> </ul> <p><i>Motor vehicles</i></p> <ul style="list-style-type: none"> <li>same as Enhanced Status Quo</li> </ul> <p><i>Rural funding</i></p> <ul style="list-style-type: none"> <li>same as Enhanced Status Quo</li> </ul> <p><i>Crown appropriation added into the model</i></p> <ul style="list-style-type: none"> <li>public good component, and/or</li> <li>levy support for public and state service property owners affected by levy increase</li> </ul>
<b>Investment objectives</b>	<b>Status quo</b>	<b>Enhanced Status quo (sum insured with levy on self-insurance)</b>	<b>Mixed Funding Model (sum insured with levy on self-insurance)</b>
<p>Optimal balance of the tax principles – set out in rank order:</p> <ul style="list-style-type: none"> <li>sufficiency (base x rate)</li> <li>simplicity</li> <li>predictability</li> <li>adaptability</li> </ul>	<p><b>Not met</b> - overall</p> <ul style="list-style-type: none"> <li>partially met – non-residential levy base is eroding, although recent Supreme Court case could mitigate this. There is little growth in the residential levy base because it is linked to a cap in the EQC legislation</li> <li>partially met – one principal funding source is easier to administer for the current fire service organisation, but this is offset by complexity of funding sources in rural fire</li> <li>not met – reliance on ‘sums insured’ or ‘indemnity value’ combined with lack of information and no clear definition means can be difficult to forecast and know what income will be</li> <li>partially met – able to adjust the levy upwards and downwards and rate of levy reviewed at any time (and must be reviewed annually), but smaller base means not able to</li> </ul>	<p><b>Substantially met</b> - overall</p> <ul style="list-style-type: none"> <li>substantially met – broader funding base improves sufficiency and potentially reduces a little bit of minimisation</li> <li>substantially met – new funding class for road users means that new organisation needs to collect information and improve accounting practices across funding classes, offset by increased simplicity with removal of rural fire funding sources and removal of exemptions</li> <li>substantially met – small changes to the status quo and improved information collection means that it is easier to forecast income</li> <li>substantially met – adjustable levy rate and funding charges, different fixed rates for residential and non-residential, more funding sources gives increased flexibility</li> </ul>	<p><b>Fully met</b> - overall</p> <ul style="list-style-type: none"> <li>fully met – broader funding base with the additional government funding improves sufficiency because more sustainable and minimises any levy changes</li> <li>partially met – additional funding source from government for public good non-fire means that new organisation needs to collect information and increase accounting process for allocation across three funding classes, offset by increased simplicity of removal with rural fire funding sources and removal of exemptions</li> <li>fully met – broader funding base is more stable and easier to forecast</li> <li>fully met – the most funding sources gives the most adaptability</li> </ul>

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	Status quo	Enhanced Status quo (sums insured with levy on self-insurance)	Mixed Funding Model (sums insured with levy on self-insurance)
• non-distortionary	<p>distribute costs across classes; rural fire is not very adaptable and fully dependent on affordability</p> <ul style="list-style-type: none"> <li>partially met – has least impact on insurance industry but enables continued distortion on the levy</li> </ul>	<ul style="list-style-type: none"> <li>substantially met – insurance market has least distortion</li> </ul>	<ul style="list-style-type: none"> <li>fully met – insurance market has least distortion and government contribution for public good non-fire reduces this distortion further</li> </ul>
Funding charged to potential use of service type	<b>Not met</b> – small funding base and insurance minimisation means funding not charged to potential service use; in rural fire reliance on DOC and forest owner contributions means funding is not charged to potential service use	<b>Partially met</b> – assessment on material damage policies means funding better matches potential service use. Without the Crown contribution the wider levy paying population subsidises the costs of the public good service	<b>Substantially met</b> – the most funding sources means funding is better matched to potential service use
Cohesive funding system that supports effective strategic decisions	<b>Not met</b> – across the fire services there the connection of the funding with the strategic direction is not transparent with options not considered leading to reduced ability to make effective strategic directions	<b>Fully met</b> – new funding model is strongly and transparently linked to the strategic direction and there is improved information and options to make strategic decisions	<b>Fully met</b> – new funding model is strongly and transparently linked to the strategic direction and there is improved information and options to make strategic decisions
Clear legislation that is difficult to avoid	<b>Not met</b> – substantial legal challenges and Supreme Court signals levy should be reviewed, other legal cases in train; in rural fire the legislation is ambiguous leading to multiple differences across the country in how funding is calculated and charged	<b>Substantially met</b> – new legal definitions and terms improve clarity and avoidance. Perfect compliance not feasible	<b>Substantially met</b> – new legal definitions and terms improve clarity and avoidance. Perfect compliance not feasible
<b>Overall assessment</b>	<b>Not met</b>	<b>Substantially met</b>	<b>Substantially – fully met</b>
Minimises likelihood of avoidance	<b>Not met</b> – no low level anti-avoidance mechanisms and difficult to approach organisations directly; does not address first loss policies	<b>Partially met</b> – modernised anti-avoidance mechanisms, improved information collection and enhanced ability to collect on self-insurance arrangements reduce avoidance	<b>Partially met</b> – modernised anti-avoidance mechanisms, improved information collection and enhanced ability to collect on self-insurance arrangements reduce avoidance
Compliance burden on funders and insurance industry is minimised	<b>Partially met</b> – no change in this system but insurance companies have to create information in some circumstances and also respond to or bring legal challenges	<b>Partially met</b> – initial compliance burden with levy changes and greater information compliance for insurance industry but stabilises over time and is easy to administer over the long term	<b>Partially met</b> – initial compliance burden with levy changes and greater information compliance for insurance industry but stabilises over time and is easy to administer over the long term
Compliance burden on new organisation is minimised	<b>Partially met</b> – difficult to obtain information needed so compliance burden is high, with legal challenges creating further inefficiencies; rural fire authorities spend a lot of time negotiating funding	<b>Substantially met</b> – initial compliance burden setting up new system and improving information that is recorded and establishing new allocation systems but over time new system is easy to administer and manage	<b>Partially met</b> - initial compliance burden setting up new system and improving information that is recorded and establishing new allocation systems. There will be additional compliance with three different funding sources but over time as the new system beds in it will be simple to administer and manage.
<b>Overall assessment</b>	<b>Not met</b>	<b>Partially met</b>	<b>Partially met</b>

## Options considered for new funding arrangements

48. Early in the review process, before the Discussion Document was published, two funding options were discarded: a levy on property values, and general taxation [CAB Min (15) 15/19 refers]. These are explained below.

### *Discarded options*

#### *Levy on property values*

49. One alternative to an insurance-based fire levy could be local government collecting a levy on the improved value of property. Local government could collect this levy at the same time as it collects rates.
50. When compared to an insurance-based levy, this option has the following advantages:
- providing a stable funding base;
  - avoiding distortions to the insurance market; and
  - avoiding administrative problems associated with an insurance levy (e.g. the timing of some insurance payments comes after the fire service levy is due, which exposes insurance companies to interest costs and penalties for late payment from the Commission).
51. Many Australian states have moved from insurance-based levies to a mix of property-based levies and state funding over the past 20 years. However, there is significant under-insurance and non-insurance in Australia. In New Zealand, rates of insurance are higher and 'free-riding' is less of a problem.
52. Further, there are many administrative and practical issues associated with a property levy that resulted in it being rejected as an option. The funding base for property is narrower than under the status quo. Contents and motor vehicles are not covered by rates. In commercial property, the contents can be more valuable than the buildings. If using local government valuations, it would make sense to align the types of properties where the levy is collected with those that are subject to rates. If so, there are insured properties that are subject to the current fire service levy, which would be exempt from local government rates. Some examples are Crown property, churches and marae. This means a property funding model could shrink the funding base.
53. There would also be significant transitional costs. A new system for collection and administration would need to be set up. This would be complicated because local authorities construct and maintain their rating databases independently.
54. Local authorities are likely to oppose what the public may perceive as an increase in rates, when local authorities would have no influence on how the funding is spent. If local authorities did influence how the funding was spent, it would undermine the advantages of a national organisation delivered with influential regional committees.
55. Local government has already been encouraged by central government to restrict its focus to its core activities. Collecting the fire service levy on behalf of the new organisation does not align with the core activities for local government.
56. Therefore, the review concluded that a property-based levy should not be considered as an option. This is consistent with the Swain Report, which did not recommend any further work on this option, given its shortcomings.



*General taxation*

57. Another alternative to an insurance-based funding model would be to fund from general taxation. The level of funding for each year would be agreed in advance by Ministers and appropriated by Parliament through the annual Budget process. This is how most government departments and many Crown entities are funded.
58. When compared to an insurance-based levy, this option has the following advantages:
- it would ensure that all taxpayers are required to contribute;
  - it would remove the lack of clarity in legislation that has given rise to levy minimisation;
  - it would be highly cost effective, as the Government would be able to use its existing tax revenue collection systems;
  - it would be relatively stable and predictable; and
  - funding decisions would be subject to Treasury scrutiny, potentially increasing the Commission's accountability and efficiency.
59. This option would require a large annual appropriation funded out of Crown revenues. Ministers have decided that the Government will not pursue further investigation into this option as part of this review process.

*Insurance levy based on premiums*

60. The discussion document on fire services reform considered two options for collecting the levy: the value of sum insured or the insurance premium. The primary purported benefit of attaching the levy to insurance premiums was that the levy paid would better reflect the risk of fire.
61. However, following consultation it was determined that there are several problems with attaching a levy to premiums:
- premium values are highly volatile, and there has recently been a 10 per cent decline in the value of gross written premiums in the Australian market;
  - as a result, the fire services' revenue would be vulnerable in 'softer' market conditions;
  - premiums are affected by other factors besides risk like global financial markets, the cost of reinsurance and domestic competition; and
  - premiums are also vulnerable to levy minimisation as they are affected by the excess level agreed by the insurer and insured.
62. Given this, and the strong insurance sector support for the simplest possible option, the Department does not support attaching the levy on the value of the insurance premium.

***Shortlisted options****Including the Crown in the funding arrangements to pay for public good*

63. Fire services are increasingly responding to incidents that are not related to property or motor vehicles. This reflects the benefits of having a capability on standby. These public good type activities include disaster relief and responding to medical calls.

64. The government public good contribution covers medical emergencies, services to the public and police, rescue and other emergencies, domestic and commercial water services and wider emergency management that are currently paid by residential levy payers. The government public good contribution is attached to the readiness and response costs for incidents that:
- cannot be easily apportioned to property or motor vehicles;
  - cannot be easily apportioned to a third-party stakeholder (ie has more than private benefit); and/or
  - where attaching the cost to a third-party stakeholder risks creating a perverse incentive particularly if that stakeholder is a member of the public and not an emergency services provider.
65. The Crown could choose to scale this option through the Budget Bid process because of affordability in the ways described in Table 6 below. The costs of the public good services provided by the fire services must be met. If the Crown reduces its contribution then residential levy payers would need to bridge the gap. A lower Government public good contribution would be made transparent to the public in any future consultation by the new organisation on the fire services funding. This could be mitigated by messages that the Crown would look to make a larger contribution if and when budget resources allowed.

**Table 6 Reduced Government public good contribution with levy payers to pay the difference<sup>12</sup>**

<b>Option 1 \$30 million public good contribution (\$2.05 average increase for residential property owner)</b>	<b>Option 2 \$20 million emergency services (\$7.75 average increase for residential property owner)</b>	<b>Option 3 \$14.6 million public health and safety (\$11.60 average increase for residential property owner)</b>
<ul style="list-style-type: none"> <li>• medical emergencies - \$11 million;</li> <li>• special services (assisting the public) - \$8 million;</li> <li>• special services (assisting police) - \$4.4 million;</li> <li>• rescue and other emergencies - \$3.3 million;</li> <li>• domestic and commercial water services - \$2.3 million; and</li> <li>• wider emergency management - \$1 million.</li> </ul>	<ul style="list-style-type: none"> <li>• medical emergencies - \$11.2 million</li> <li>• special services (assisting police) - \$4.5 million</li> <li>• rescue and other emergencies - \$3.4 million</li> <li>• wider emergency management capability - \$1 million</li> </ul>	<ul style="list-style-type: none"> <li>• medical emergencies - \$11.2 million</li> <li>• rescue, hazardous and other emergencies - \$3.4 million</li> </ul>

<sup>12</sup> These costs are based on the MartinJenkins report (which estimates total non-fire costs – excluding motor vehicles - to be approximately \$62 million in 2012/13) and incident reporting data provided by the fire service, which includes activities associated with medical emergencies, services with Police and the public, water and smoke issues, aircraft standby, natural disaster response and animal rescue. Some this non-fire cost can be apportioned to a new levy on material damage (as opposed to the current levy on fire insurance)

*Charges for road incidents*

66. Three options were considered to fund the costs relating to motor vehicle incidents, detailed in Table 7. A levy on vehicle licensing was discarded because it involved significant and ongoing administrative costs. Using the National Land Transport Fund (NLTF) was also considered. This funding option failed because the decision to use this fund would significantly affect the government's existing funding commitments under the NLTF. Using the NLTF would also mean that business would pay a disproportionate amount of the motor vehicle costs, which conflicts with the Business Growth Agenda by disproportionately resting on business to fund the fire services motor vehicle related costs. There are also concerns that providing funding to the fire services would set a precedent for other emergency services to make claims on the NLTF.
67. The final option (and preferred approach) is to continue to levy comprehensive insurance for motor vehicles.
68. We explored, but discarded extending the levy on motor vehicle insurance to third party motor vehicle insurance. There is a moderate free-rider problem as a Ministry of Transport survey (2009) of 4000 New Zealanders found that 20 per cent do not take out comprehensive motor vehicle insurance. The costs would be better aligned to potential service use if the motor vehicle levy is collected from all motor vehicle insurance, including third party insurance. This would create a broader funding base (as much as 92 per cent of motor vehicle users would be levied – though IAG insurance estimates that actual coverage would be less than 90 per cent) ensuring that the majority of those who benefit from the fire service contribute to the levy. It would mean an \$8 increase to third party motor vehicle insurance.
69. The insurance sector has advised that this option would be more complex to administer, and easier to avoid, than the status quo. The increased administrative costs could result in some increase in insurance costs for consumers and businesses. Because the profit margins for third party insurance are already small, there is a risk that increased costs may result in insurers ceasing to provide separate third party motor vehicle cover. Given that most people who purchase third party insurance do so because they are unable to afford full insurance, this risks reducing overall insurance coverage across the sector.
70. Because third party insurance is a form of liability insurance there is also uncertainty regarding when the levy would apply. Without carefully defining what types of policy the levy applies to it is possible that other types of liability insurance contracts (such as travel insurance) could be unintentionally hit by the levy.
71. At the same time, if a careful restricted definition of the 3<sup>rd</sup> party motor vehicle insurance is developed for the new levy regime, the levy could be subject to avoidance. For example, it is also possible that new insurance products may emerge such as "all risks" personal insurance which would cover life, health, property, travel and other liability risks (including liability insurance for motoring activities).
72. The increased costs of insurance policies (a likely increase of 3-5% above current premiums) may also result in increased non-insurance, reducing cover for a portion of the market more likely to be involved in accidents. However, the Insurance Council was unable to provide evidence on the elasticity of demand in the liability insurance sector.

73. Therefore, the current funding arrangements for motor vehicles should be retained because extending the levy to cover third party insurance risks increasing insurance costs and administrative complexity. Retaining the status quo for motor vehicles would result in only a slight increase in the motor vehicles levy (approximately \$3 annual increase compared to a \$2 increase if the third party levy option was progressed).

### ***Modernising the levy provisions***

74. Many of the levy provisions in the FS Act have not been reviewed for a significant period of time. As outlined above, there are problems with the levy provisions that need to be addressed.

### ***Move from fire insurance to material damage with affordability measures***

75. Paragraph 31 above describes the problem that is caused by collecting the levy on fire insurance rather than material damage, in that it creates a gap between those who pay for fire services and those who potentially use or benefit from the fire services.
76. It is proposed that the levy be extended from contracts of fire insurance to contracts of material damage, because it:
- represents the simplest option for the insurance industry to administer;
  - makes it more difficult for levy payers to reduce their contributions by adopting split insurance policies;
  - reflects that fire services are responding to a growing number of non-fire related incidents (e.g. work to protect housing and businesses from flooding); and
  - will expand the levy base.
77. The change from fire insurance contracts to material damage insurance contracts is expected to broaden the funding base because larger entities will be required to make a contribution that more accurately reflects their potential use of the new organisation's wider services. Collecting the levy on fire insurance contracts rather than material damage means that smaller businesses tend to cross-subsidise larger businesses because smaller businesses do not split their insurance contracts into fire and material damage contracts.
78. Just as the Department cannot estimate the overall size of gap between those who don't pay as much as they should for their fire services, we cannot estimate the impact of collecting levies on material damage on individual levy contributions. Given that some large public and private entities could face significant levy increases, two affordability measures were explored. These were either using levy smoothing or a levy cap for entities that have a significant levy increase.
79. While affordability measures would make the levy more affordable, they would also have the following potential consequences:
- small-medium business would make up the shortfall created by the affordability measures;
  - the administration of the levy would be more complex for the insurance sector, which the sector is likely to pass onto entities through their insurance premiums;

- the administration of the levy and public consultation would be more complex for the new organisation; and
  - adding any complexity into the levy setting increases the ability of entities to avoid paying the levy, which only further erodes the levy.
80. It is proposed that the affordability measures be considered alongside regulations that set the levy rate so that there can be public consultation on the affordability measures and the expected consequences of them. Following consultation, government can decide the merits of the affordability measures when Cabinet is asked to approve levy rates and affordability mechanisms.

### *Modernising the levy calculation*

81. Two variations of a levy based calculation were explored: ‘sums insured’ or ‘total assets insured’.<sup>13</sup> Table 7 presents a comparison of these two options.
82. ‘Total assets’ fails when measured against the critical success factor ‘the compliance burden on funders and the insurance industry is minimised’. This is because this option would require many insureds to get a valuation on their properties, plant and equipment. For the most part insureds do not tend to get valuations on their contents, plant and equipment. Making a valuation compulsory would not be a viable option due to the costs of doing so (up to \$15,000).
83. Further, there are risks involved with pursuing a levy based on ‘total assets’, including very large cost increases for some entities that already undergo significant expense to minimise their fire risk (e.g. hospitals). Advice from the District Health Board (DHB) insurance collective and Kiwirail indicates that in some cases the levy may be larger than the insurance premium. The Department considered various options for capping or moderating costs for affected entities but determined these were not practicable. For these reasons this option was discarded.
84. Analysis indicates that calculating on the basis of ‘sums insured’ is the preferred option because it:
- more closely aligns the costs to potential type of service use;
  - more closely aligns with the tax design principles.

### *Other modernising in the provisions to address the problems*

85. Under the status quo, the definition of residential property for the purposes of charging the fire service levy is based on section 2(1) and section 18 of the Earthquake Commission Act. This results in the same cap on residential levy payments for the Earthquake Commission (EQC) levy (\$100,000) applying to the fire service levy. It is proposed that this link between the two Acts be removed, so that the new unified fire service organisation can set the cap on residential fire service levy separately from the EQC by way of regulation making powers in the new Act.

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<sup>13</sup> The analysis was done on “sums insured” rather than “amount insured” to keep the analysis comparisons simple. The FS Act Levy is calculated on the lower of sum insured or indemnity value of properties insured against fire. “Amount insured” enables the new organisation to use the definitions that are insured for to calculate the levy. Most of the time this would probably be “sums insured”.

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86. This would enable the levy cap to better reflect the context of the fire service levy, and to reflect the fact that when the cap was first established it represented the 75<sup>th</sup> percentile of housing insurance. Based on this, and analysis of existing housing values, it is proposed to raise the current cap to \$300,000 for residential properties.
87. It is further proposed that the levy rate should vary across residential and non-residential policy holders. Under the current universal levy rate, residential policy holders pay more than twice the costs associated with fires at residential properties. Allowing the levy rate to differ between residential and non-residential policy holders will better align costs to potential fire services use.
88. In the design phase, it will be important to validate the following assumptions that the:
  - integration of the funding streams enables a stable and predictable flow of revenue to the new fire services organisation; and
  - costing against funding classes will be the appropriate method of reporting that the new fire services organisation will use.

**Table 7 Assessment of motor vehicle insurance, motor vehicle registrations, and National Land Transport Fund against the investment objectives and critical success factors**

	Status quo	Fire service levy on comprehensive and third party motor vehicle insurance	Vehicle licensing registration (Rego) levy	National Land Transport Fund (NLTF) contribution
Description	<ul style="list-style-type: none"> <li>Levy on comprehensive motor vehicle insurance for:                             <ul style="list-style-type: none"> <li>\$6.08 for contracts covering vehicles under 3.5 tonne; and</li> <li>7.6c per \$100 of insured value for vehicles over 3.5 tonne.</li> </ul> </li> </ul>	Levy on comprehensive, third party and other motor vehicle insurance for: <ul style="list-style-type: none"> <li>approx \$8.50 for contracts covering vehicles under 3.5 tonne; and</li> <li>approx 8.9c per \$100 of insured value for vehicles over 3.5 tonne.</li> </ul> The increase in the levy rates is to reflect the increased costs of funding rural road user incidents.	<ul style="list-style-type: none"> <li>Road users charged through a levy (approx \$12) on renewal of motor vehicle licensing (“rego”).</li> </ul>	<ul style="list-style-type: none"> <li>Road users charged through fuel excise taxes and road user charges.</li> <li>Road user incidents funded through a contribution from the NLTF.</li> </ul>
Investment objectives	Status quo	Levy on comprehensive and third party motor vehicle insurance	Vehicle licensing registration (Rego) levy	National Land Transport Fund (NLTF) contribution
Optimal balance of the tax principles – set out in rank order:	<b>Substantially-partially met</b> - overall balance	<b>Substantially-partially met</b> – overall balance	<b>Substantially met</b> – overall balance	<b>Substantially met</b> – overall balance
<ul style="list-style-type: none"> <li>sufficiency (base x rate)</li> </ul>	<ul style="list-style-type: none"> <li>partially met – currently under collects from the non-insured (21% of road users). However, current revenues nearly cover road user costs (\$30.3m revenue compared to \$34.1m costs).<sup>14</sup> New fire services organisation will increase cost requirements (to approx \$45 m).</li> </ul>	<ul style="list-style-type: none"> <li>Substantially-partially met – a 2009 Ministry of Transport survey found that 92% of the motor vehicle owners have at least 3<sup>rd</sup> party insurance. IAG insurance have estimated that more than 10% of the motor vehicles market are completely uninsured.</li> </ul>	<ul style="list-style-type: none"> <li>substantially met – broader funding base reduces per-user cost and improves sufficiency. Generally very low rates of avoidance.</li> </ul>	<ul style="list-style-type: none"> <li>fully met – broadest funding base with fire service motor-vehicle activities representing only approx. 1% of the NLTF.</li> </ul>
<ul style="list-style-type: none"> <li>simplicity</li> </ul>	<ul style="list-style-type: none"> <li>substantially met – one principal funding source (levy revenues on comprehensive insurance).</li> </ul>	<ul style="list-style-type: none"> <li>partially met –less simple than the status quo. Uncertainty regarding how the levy will attach to broader liability insurance policies that cover motor vehicles (e.g. student travel insurance).</li> </ul>	<ul style="list-style-type: none"> <li>fully met – simple to collect bulk payment from NZTA.</li> </ul>	<ul style="list-style-type: none"> <li>fully met – simple to collect bulk payment from NLTF.</li> </ul>
<ul style="list-style-type: none"> <li>transparency</li> </ul>	<ul style="list-style-type: none"> <li>substantially met – insurance levy presented as a separate line item on insurance invoices.</li> </ul>	<ul style="list-style-type: none"> <li>substantially met - insurance levy presented as a separate line item on insurance invoices.</li> </ul>	<ul style="list-style-type: none"> <li>substantially met – fire levy presented as a separate line item on rego invoice.</li> </ul>	<ul style="list-style-type: none"> <li>partially met – fire service activities noted in government policy statement, but costs not immediately clear to road users</li> </ul>

<sup>14</sup> MartinJenkins, 17 March 2014, *New Zealand Fire Service – Report on Expenditure and Service Delivery*, p.34.

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	<b>Status quo</b>	<b>Fire service levy on comprehensive and third party motor vehicle insurance</b>	<b>Vehicle licensing registration (Rego) levy</b>	<b>National Land Transport Fund (NLTF) contribution</b>
<ul style="list-style-type: none"> <li>predictability</li> </ul>	<ul style="list-style-type: none"> <li>substantially-partially met – funding has been stable in recent years, though in the long term could be disrupted by new technologies (e.g. ICNZ have suggested driverless cars could disrupt the insurance market for motor vehicles). Volvo has stated that they will accept full liability for accidents that happen will cars are in full autonomous mode – however Volvo has not yet announced a clear timeline for a large scale commercial roll out of driverless vehicles. Driverless vehicles will likely begin to enter the market by 2020.</li> </ul>	<ul style="list-style-type: none"> <li>Substantially- partially met – funding has been stable in recent years, though in the long term could be disrupted by new technologies (e.g. ICNZ have suggested driverless cars could disrupt the insurance market for motor vehicles). Volvo has stated that they will accept full liability for accidents that happen will cars are in full autonomous mode – however Volvo has not yet announced a clear timeline for a large scale commercial roll out of driverless vehicles. Driverless vehicles will likely begin to enter the market by 2020</li> <li>Risk that because the profit margins in 3<sup>rd</sup> party insurance are low that insurers will simply cease to offer these types of insurance products.</li> </ul>	<ul style="list-style-type: none"> <li>substantially met – vehicle licensing numbers are stable and avoidance is low, so forecasting is relatively straightforward.</li> <li>In the longer term the future of motor vehicle licensing is uncertain as its role (attaching a vehicle to an owner for regulatory purposes) may be achieved through other transactions. However, ‘Rego’ is likely to remain a revenue collection tool for the next 10-20 years.</li> </ul>	<ul style="list-style-type: none"> <li>partially met – broader funding base is more stable and easier to forecast. As the number of electric vehicles increases the funding base may decline. However, the Ministry of Transport has advised they would respond to this by adjusting other road user charges to account for this.</li> </ul>
<ul style="list-style-type: none"> <li>adaptability</li> </ul>	<ul style="list-style-type: none"> <li>substantially met – able to adjust the levy upwards and downwards at regular reviews for comprehensive car insurance and third party insurance, supported by the 3-yearly funding review cycle. However, the insurance industry would need to adjust to respond to any changes.</li> </ul>	<ul style="list-style-type: none"> <li>substantially met – able to adjust the levy upwards and downwards at regular reviews for comprehensive car insurance and third party insurance, supported by the 3-yearly funding review cycle. However, the insurance industry would need to adjust to respond to any changes.</li> </ul>	<ul style="list-style-type: none"> <li>substantially met – an increase in licensing fees would come under public scrutiny, though the Ministry of Transport does not consider that this would affect levy setting (ACC has recently made substantive and widely publicised changes to its rego levy). The levy revision process would be supported by the 3-yearly funding review cycle.</li> </ul>	<ul style="list-style-type: none"> <li>substantially met – increased funding could be applied for every three years as part of the review of the National Land Transport Programme. However, this would involve greater scrutiny of the fire services costs by MOT and Cabinet, and the fire services would have no control over the outcome. Any cost increases (e.g. on fuel excise tax) would be marginal, likely making change more acceptable to the public.</li> </ul>



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	<b>Status quo</b>	<b>Fire service levy on comprehensive and third party motor vehicle insurance</b>	<b>Vehicle licensing registration (Rego) levy</b>	<b>National Land Transport Fund (NLTF) contribution</b>
<ul style="list-style-type: none"> <li>non-distortionary</li> </ul>	<ul style="list-style-type: none"> <li>substantially met – only marginal distortion - the number of non-insured vehicles is not out of step with other jurisdictions such as the UK and the US.</li> </ul>	<ul style="list-style-type: none"> <li>partially met – unknown, price increases will be small (\$8, an increase of 3-5% on the cost of 3<sup>rd</sup> party insurance policies) but those who have third party insurance do so because they cannot afford comprehensive insurance. Risks reducing coverage for a portion of the market that is more likely to be involved in accidents (while uninsured drivers make up 7.6% of the population, a 2015 survey found that of those who had made a car insurance claim in the last 3 years, 11% had been involved in court action with an uninsured driver).</li> </ul>	<ul style="list-style-type: none"> <li>partially-substantially met – there is: likely little or no distortion in the insurance market (generally speaking, insurers do not check upfront whether or not a vehicle is licensed); and potentially a distortion in motor vehicle licensing as more individuals may be incentivised to avoid licensing their vehicles.</li> </ul>	<ul style="list-style-type: none"> <li>fully met – there is: no distortion in the insurance market; and no significant distortion to road user decisions as any potential increases in fuel excise duties would be minute.</li> </ul>
Funding charged to potential use of service type	<b>Partially met</b> – smaller funding base means funding only partially reflects service use. No allowance for risk.	<b>Substantially met</b> – larger funding base means funding generally better reflects service use. No allowance for risk.	<b>Fully met</b> – levy on rego means the funding base covers almost all road users. No allowance for risk.	<b>Fully met</b> – widest possible funding base. However, reduces burden on energy efficient vehicles (including high risk vehicles like motorbikes) and electric vehicles. The later can be addressed by the Ministry of Transport introducing road user charges for electric vehicles.
Cohesive funding system that supports effective strategic decisions	n/a	n/a	n/a	n/a
Clear legislation that is difficult to avoid	<b>Partially met</b> – the levy on vehicles weighing less than 3.5 tonnes is straightforward and clear. The levy on vehicles weighing more is subject to the same interpretative issues as the fire service levy more generally.	<b>Partially met</b> - the levy on vehicles weighing less than 3.5 tonnes is straightforward and clear. The levy on vehicles weighing more is subject to the same interpretative issues as the fire service levy more generally.	<b>Fully met</b> – removes necessity for insurance based legal definitions and ties funding to an existing Government revenue collection mechanism.	<b>Fully met</b> - removes necessity for insurance based legal definitions and ties funding to an existing Government revenue collection mechanism.
<b>OVERALL</b>	<b>Partially-Substantially met</b>	<b>Partially–substantially met</b>	<b>Substantially–fully met</b>	<b>Substantially–fully met</b>
<b>Critical Success Factors</b>	<b>Status quo</b>	<b>Fire service levy on comprehensive and third party motor vehicle insurance</b>	<b>Vehicle licensing registration (Rego) levy</b>	<b>National Land Transport Fund (NLTF) contribution</b>
Minimises likelihood of avoidance	<b>Substantially met</b> – possible for the insurance industry to adjust products to minimise levy, though there is little minimisation activity (i.e. first loss insurance products) operating in the motor vehicles sector currently.	<b>Partially met</b> – possible for the insurance industry to adjust products to minimise levy, and to attempt to avoid the levy by bundling 3 <sup>rd</sup> party motor vehicle as part of larger insurance policies.	<b>Substantially met</b> – addresses any current insurance minimisation issues. Some road users may still choose not to licence their vehicles.	<b>Fully-substantially met</b> – hardest to avoid currently, as almost everyone owns vehicles that rely on fuel. This may change

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	Status quo	Fire service levy on comprehensive and third party motor vehicle insurance	Vehicle licensing registration (Rego) levy	National Land Transport Fund (NLTF) contribution
Compliance burden on funders, other government entities and insurance industry is minimised	<b>Partially met</b> – no change in this system.	<b>Partially met</b> – initial compliance burden with the new levy changes for the insurance industry. Administrative costs may have a significant impact because of the small profit margins that exist for 3 <sup>rd</sup> party insurance.	<b>Not met</b> – compliance burden removed from the insurance sector. The transition and ongoing costs of adjusting the NZ Transport Agency’s (NZTA) revenue collection model could be significant, resulting in increased cost burden on the new organisation and levy payers. However ICNZ have suggested they may be prepared to cover at least a portion of the transition costs of this option (up to \$1 million)	<b>Substantially-partially met</b> – compliance burden removed from the insurance sector. Road users face no additional burden as they pay road user charges and fuel excise duties already. Heavy road users (e.g. potentially freighting companies) may carry a larger proportion of the costs. NZTA faces little additional cost as they are able to leverage the existing NLTF funding collection and allocation model.
Compliance burden on new organisation is minimised	n/a	n/a	n/a	n/a
Impact on other government funding regimes	<b>Fully met</b> – no impact	<b>Fully met</b> – no impact	<b>Partially met</b> – the rego, as a land transport revenue toll, but has not been able to perform as needed because the impact of other costs attached to it (e.g. ACC). While the cost of the ACC levy on ‘rego’ has fallen recently, the Ministry of Transport has advised that if rego is to be retained as a transport revenue tool, then it is better not to encumber it with other charges.  A levy on ‘Rego’ could set a precedent for other emergency services to seek funding, potentially resulting in a large impact on licensing costs (which would be paid for by motor vehicle owners and businesses).	<b>Not met</b> - Providing a contribution from the NLTF will divert funding from existing road safety, infrastructure and road policing services. The only option to avoid this would be to increase road user charges and fuel excise duties.  On its own, the costs of fire service motor vehicle activities is small (only approx. 1% of the NLTF). However, the NLTF currently does not offer funding for any emergency response activities. A contribution for the fire service could set a precedent for other emergency services to seek funding, potentially resulting in a large impact on the National Land Transport Programme’s costs (which would be paid for by motor vehicle owners and businesses).
<b>Overall</b>	<b>Substantially met</b>	<b>Partially-substantially met</b>	<b>Not met</b>	<b>Not met</b>

**Table 8 Assessment of ‘sums insured’ and ‘total assets insured’ against the investment objectives and critical success factors**

	Sums Insured with new legal definition and indemnity value removed	Total Assets Insured with replacement value
Definition	Just ‘sums insured’ rather than with ‘indemnity value’ Indemnity value is difficult to calculate at the time the levy calculated (i.e. at the time that the insurance policy is purchased) because it refers to the amount paid for the assets at the time of a claim. It is simpler to separate this insurance product choice from the levy calculation.	‘Total assets insurance’ means the replacement value of all assets covered for damage under an insurance policy. Replacement value best aligns costs to potential type of service use. Book value means that the age of the entities and their assets would distort markets and not align costs to potential type of service use because new entities or entities with new assets would pay more.
<b>Investment objectives</b>	<b>Investment objectives</b>	<b>Investment objectives</b>
Optimal balance of the tax principles – set out in rank order: <ul style="list-style-type: none"> <li>sufficiency (base x rate)</li> <li>simplicity</li> <li>predictability</li> <li>adaptability</li> <li>non-distortionary (insurance market)</li> </ul>	<b>Partially met</b> - overall <ul style="list-style-type: none"> <li>partially met – smaller base charged higher levy rate, which is less sustainable over time</li> <li>substantially met – needs to be defined in the legislation to minimise ambiguity about how it is interpreted and applied</li> <li>partially met – the amount of sums insured might change depending on insurance costs (so as premiums go up, some property owners might reduce the amount of cover); initially there might be some uncertainty while new definition beds in but likely to be easier to implement</li> <li>not applicable</li> <li>partially met – some entities use ‘sums insured’ to minimise their insurance costs and/or their fire services levy</li> </ul>	<b>Partially met</b> - overall <ul style="list-style-type: none"> <li>substantially met – larger base charged lower levy rate</li> <li>partially met – while the legal definition of ‘total assets insured’ based on replacement value will have some compliance costs it is simple for the insurance industry but more difficult for levy payers who will be required to obtain a valuation of their assets insured.</li> <li>substantially met – the amount of total assets insured might change depending on insurance costs (so as premiums go up, some property owners might reduce the amount of cover); total assets is more predictable because more properties would be assessable for levies so the base is larger; initially there might be some uncertainty while the new concepts ‘bed in’</li> <li>not applicable</li> <li>not met – we prevent some minimising cover distortions but we may cause: <ul style="list-style-type: none"> <li>more self-insurance with some larger entities;</li> <li>increased number of compulsory valuations (cost to levy payers of \$700-15,000 each);</li> <li>if shift to book value it distorts start up and capital markets</li> </ul> </li> </ul>
Funding charged to potential type of service use	<b>Partially met</b> – new legal definition helps spread more of the levy within the class, but minimising cover choices means that some pay less than they should	<b>Partially met</b> – there is a larger base because using ‘total assets insured’ so better spread of the levy within the class but some property owners may reduce their insurance costs and/or levy liability by either choosing self-insurance or reducing their ‘total assets insured’. Small to medium business may have more of a ‘free-ride’ because the larger asset base means they might pay a lot less.
Cohesive funding system that supports effective strategic decisions	<b>Partially met</b> – a few more property owners are charged a levy, which raises awareness of fire and emergency risks and reduction activities (eg sprinklers and good land management practices)	<b>Substantially met</b> – a lot more are charged a levy, and the levy is higher for property owners with large assets, which raises awareness of fire and emergency risk and reduction activities
Clear legislation that is difficult to avoid	<b>Partially met</b> – new definition of ‘sums insured’ adds clarity and transparency, but continues to enable first loss structures (ie using the single largest loss against a portfolio rather than the total assets in the portfolio covered by the insurance)	<b>Substantially met</b> – once implemented ‘total assets’ with ‘replacement value’ definition is clear and makes it harder to avoid through using a first loss structure
<b>Critical Success Factors</b>	<b>Critical Success Factors</b>	<b>Critical Success Factors</b>
Encourages compliance with the levy	Not applicable	Not applicable
Compliance burden on funders and insurance industry is minimised	<b>Partially met</b> – over time the insurance industry will need to assist the new organisation more to ensure insured property owners are complying with the fire services levy	<b>Not met</b> – there is an initial compliance burden on the insurance industry while it adjusts to the new definitions and charging the fire services levy on ‘total assets’ with replacement value. But over time it is easier to comply with because total assets are more stable. Levy payers have high compliance costs.
Compliance burden on new organisation is minimised	<b>Partially met</b> – ‘sums insured’ has a smaller base so will require increased forecasting and modelling efforts	<b>Substantially met</b> – total assets is a larger base so tends to be more predictable and easier to work with over time
<b>Overall assessment</b>	<b>Partially met</b>	<b>Not met</b>

## Impact analysis of the preferred funding arrangements

89. The funding arrangements are affected by:
- the size of the base (which is not certain);
  - the new support costs; and
  - the costs of the transition programme.
90. While we have reasonable certainty of the change costs, we have less certainty over the size of the base. Therefore, the full implications will not be known until the new Board has:
- undertaken a baseline review of the Commission and obtained a national financial budget for rural fire services;
  - has done more detailed work on setting the levy rate.
91. Therefore, the new funding arrangements will be set through a separate Cabinet processes (supported by RISs) early in 2017 (subject to the new legislation passing). The RIS for the new funding arrangements will discuss the effects of the changes on different classes of levy payers in more detail.
92. The new funding arrangements will impact individuals and entities in different ways. Overall, every levy payer will pay slightly more to cover the transition costs and the new organisation's ongoing costs. The increase that each levy payer will pay is reduced by introducing new funding sources and by broadening the levy base. Further, within each levy class some levy payers will pay less and some will pay more depending on their individual circumstances, an indication is presented in Table 9 and Figure 7 below.

**Table 9: Levy payer increases: the wider funding base from the new funding arrangements, minimises the overall effect of new support costs and transition programme costs**

Size of government public good contribution	\$30m	\$21m	\$14.6m	\$0
Residential property owner	\$2.05	\$7.75	11.60	\$21.00
Small-medium business with insurance for \$230,000 of property	\$32.00	\$32.00	\$32.00	\$32.00
Large business with insurance for \$10 million	\$1400.00	\$1400.00	\$1400.00	\$1400.00
Type of motor vehicle (MV) insurance arrangement	With 3 <sup>rd</sup> party MV insurance		Without 3 <sup>rd</sup> party MV insurance	
Comprehensive MV insurance	\$2.00 (average)		\$3.00 (average)	
Third party MV insurance	\$8.00 (flat rate)		\$0.00	

Figure 7: Impact of fire services funding arrangements on specific stakeholders

	Residential levy payers	Non-residential levy payers	Local Government	Forest owners	Motor vehicle levy payers
<b>PAY MORE</b>	Are insured for more than \$158,000 Average increase <b>\$2.05</b> with govt public good contribution or <b>\$21</b> increase without it	Have low "fire" insurance contracts, high "material damage" insurance contracts (mostly larger entities) \$32 Increase for small-medium business with \$230,000 property insurance \$1400.00 increase for large business with insurance for \$10 million Self-insure	A few local government - those that do not make rural fire contributions - may pay more due to increases in levy.		Comprehensive motor vehicle insurance increase of \$2 or \$3 if no third party insurance  Third party insurance new cost of \$8
Current fire services contribution					
<b>PAY LESS</b>	Are insured for less than \$158,000 Pay for rural fire through rates	Minimise insurance through first loss contracts	Almost all local government entities will pay less due to the removal of rural fire contributions.	No longer pay forest owner levies or pay to put out fire in their forests	

93. Local government currently fund rural fire through their ownership/stakeholder role. Through the new funding model this funding of rural fire services would cease but they would still pay for fire services through the fire services levy on "material damage" for sums insured, and the enhanced ability to charge a levy on self-insurance. This could have significant cost implications for local government if the current fire service levy exemptions are removed.<sup>15</sup>
94. It is estimated that local government could pay \$21 million in fire service levy if the exemptions are removed, which is roughly the amount they currently pay for rural fire services compared to \$9 million if the exemptions remain.<sup>16</sup> The development of the exemptions criteria will use a principled approach and involve discussions with local government about the implications.
95. Large forest owners would be better off because they will no longer be charged a rural fire levy. Those who carry insurance or who operate their own brigades will continue to make contributions to rural fire services.

<sup>15</sup> For example water reticulation pipes and roads are currently exempt from the fire service levy under Schedule 3 of the Fire Service Act.

<sup>16</sup> These estimates are based on an analysis of information from the Local Government New Zealand survey regarding local government insurance arrangements from 54 of the 78 local authorities. The data is therefore incomplete and further work needs to be done to understand the full implications. The figure has been calculated using a revised levy rate of 8.7 c per \$100 of insured value. This modelled levy rate has been increased in order to meet the ongoing and transition costs of the new organisation, but does not assume a wider levy base in the private sector. As a result, it should be treated as a high-end estimate.

96. Some public and state service property owners would pay more fire service levy than before, so a tagged contingency of up to \$10 million each year from 2017/18 is recommended as a pre-commitment against the Budget 2016 operating allowance. This tagged contingency will prevent social services being jeopardised, yet still allow a top-up of affected agency baselines to be considered on a case-by-case basis as part of Budget 2016.

***The effect of the new funding arrangements will not be fully known in the first year***

97. The proposed start date for the new funding model is 1 July 2017, to align with government processes and to stagger the governance and support and funding changes. The Commission has limited time to collect information from insurers and forecast the new levy, as well as consult and model different affordability mechanisms.
98. The first financial year 2017/18 needs to be a transitional year, subject to the usual regulation making process and other government processes. It is proposed that the first new three year funding cycle with the increased funding base would apply from 2018/19. Any shortfall or over-collection should be addressed

***Financial implications for the Crown***

99. The total implications for the Crown of the change are:
- **government public good contribution** (which is estimated to \$30 million for 2017/18 or a lesser amount and that will be confirmed by the baseline review);
  - **government agency contingency:** \$10 million put aside for government agencies that cannot afford the new levy and can demonstrate the effect on frontline services; and
  - **repayable Crown injection:** \$112 million Crown injection to be paid back over 10 years.
100. The Crown is considering these costs through the Budget Bid process. It is possible that the Crown might decide to scale the Crown contributions, or not agree to fund some or all of these costs.

**Improving the alignment of setting the revenue with the performance framework**

101. The setting of the revenue in the funding arrangements can be better aligned with the performance framework in the following ways.
- the amount of revenue required should be reviewed (at least every three years);
  - to determine the amount of revenue that the organisation requires, the new organisation would be expected to undertake a baseline review of cost-effectiveness and efficiency including consideration of its planning assumptions and strategic direction;
  - ahead of setting the funding (at least every three years), there must be public consultation on the amount of revenue required and how much levy payers (and Crown) would need to contribute; and
  - setting the funding (at least every three years) will give all levy payers and collectors, (and the Crown) some certainty to plan for the amount of levy that must be paid.

102. To be able to ensure that costs are appropriately charged to the levy payer or government public good contribution the new organisation would need to implement a suitable arrangement for levy payers and the Crown to understand costs and how they are paid by levy payers and the government public good contribution. This type of financial management would be new to the fire services.
103. The responsible Minister should continue to set the levy following a thorough review. I recommend that:
- the new Board ensure its business planning and accountability processes are closely linked to its levy and funding reviews; and
  - the Board be able to spread levy costs over more than one funding cycle, if spreading the costs would make increased costs easier to bear.

## Consultation

### *Government*

104. The Commission, the Treasury, State Services Commission, New Zealand Police, the Departments of Conservation, and Corrections, National Ambulance Sector Office, NZDF, Accident Compensation Corporation, Canterbury Earthquake Recovery Authority, Housing New Zealand Corporation, WorkSafe New Zealand, Maritime New Zealand, Ministries of Primary Industries, Culture and Heritage, Defence, Health, Business, Innovation and Employment, Transport, Environment, Education, and Civil Defence and Emergency Management and the Department of Internal Affairs' Local Government and Community and Voluntary Sector portfolios were all formally consulted on aspects of the review. The Department of Prime Minister and Cabinet has also been involved.
105. A Ministerial group has also been providing direction to officials throughout the review process. This group is comprised of the Ministers of: Finance, Internal Affairs, Local Government, Primary Industries, Civil Defence, Police, Conservation, Community and Voluntary Sector; and Associate Ministers of: Local Government, Primary Industries and Health.

### *Stakeholders*

106. The review has taken a high-engagement approach with stakeholders. Officials began consulting with various non-government stakeholders including rural interest groups, unions, business and insurance sector groups, emergency sector agencies and workforce representatives at the end of 2014.<sup>17</sup>
107. This early and on-going engagement with a wide range of stakeholder groups enabled officials to confirm the nature and the size of the problems facing fire services and to identify potential solutions. These were detailed in the Discussion Document.<sup>18</sup>

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<sup>17</sup> [EGI Min (14) 18/8] refers.

<sup>18</sup> [CAB Min (15) 15/19] refers.

108. The Discussion Document presented options to resolve issues with governance and support of fire services, and funding sources. Consultation closed on 10 July 2015 and 235 written submissions were received. In addition, officials gathered feedback at 35 meetings with stakeholders around New Zealand. The Minister of Internal Affairs attended many of these stakeholder meetings and the Associate Minister of Local Government also attended some.
109. In addition to that formal feedback there have been continuing conversations with key stakeholder groups such as the Insurance Council of New Zealand, Insurance Brokers New Zealand, Business New Zealand, Local Government New Zealand, and forestry interests.
110. The submissions and other stakeholder engagement demonstrated reasonably strong support for changing the funding model, with 57 per cent of submitters indicating a preference for change. Many submissions expressed interest in either rates or general taxation as funding sources, even though the discussion document had rejected these options – 21 of the submitters who selected Funding Option 2 would have preferred the Commission to be funded through other means (12 would have preferred general tax, seven would have selected rates and two submitters would have selected a combination of the two).
111. Many submitters were interested in the comparative fairness of the options and how the funding options addressed the issue of free riding.<sup>19</sup> Two particular areas of concern were non-insurance and under-insurance (including of government-owned property) and non-insurance of motor vehicles.
112. There was some support for a government contribution for incidents where the fire services supported the Police and ambulances. Other submitters were interested in a government contribution to reflect the under-insurance of government property. Submitters also provided various options for funding medical callouts, primarily from the Ministry of Health or ACC.
113. Funding for motor vehicle incidents was also discussed. A levy on annual vehicle licensing was seen by some submitters as capturing more motor vehicles than an insurance-based levy, while being relatively simple to collect. The other main option was road tax revenue, which was again seen as capturing more motor vehicles than an insurance-based levy.

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<sup>19</sup> 'Free riding' refers to people who do not insure, or who underinsure, so do not pay a fire service levy, or pay a reduced levy, when they may benefit from fire services.

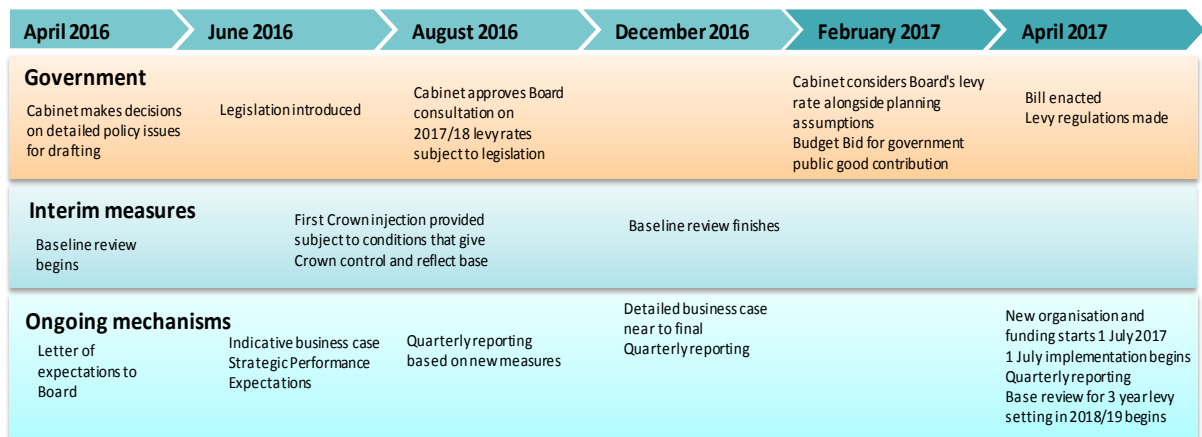


## Monitoring and review

### *Government will supervise the new organisation to ensure value for money*

114. Government can have some oversight of the transition and can also ensure the new organisation's costs have value for money by using the mechanisms described in Figure 8.

**Figure 8 Mechanisms to enable government supervision of the Crown Agent**



### *Letter of Expectations process will help review the changes*

115. The Letter of Expectations to the Board will:

- be used more frequently (where appropriate) to address issues as they arise that are specific to the changes;
- be published;
- have specific directions related to review of the costs and the changes for example directing baseline reviews, requiring prudent financial management, developing new strategic performance measures and reporting on those, and improving management of financial and performance reporting.

### *Government will also monitor the changes*

116. The Department of Internal Affairs is changing from a traditional monitoring approach to a strategic approach, which means:

- increasing the capacity and capability of the monitoring to be strategic and work with the organisation to improve its systems and strategic planning; and
- increased oversight of the levy review, so that the organisation's baseline review, strategic planning assumptions, and value for money decisions are transparent.

117. There is also a Budget Bid for the transition costs to be funded by a repayable Crown injection with conditions attached to the drawdown. These conditions will government greater ability to closely monitor the transition programme.

118. By using the above mechanisms the government will be able to ensure that the organisation is appropriately funded for its size and responsibilities and that the benefits of the changes are being achieved.

*The Board will also monitor the change process*

119. The transition programme is likely to use an Independent Quality Assurance (IQA), or something similar, the life of the Transition programme to review key deliverables and at each stage gate, including the revised business case. Future IQA reviews are most likely to be presented to the Transition Governance Group, the Board, and the Department as monitoring agency for the Commission (and in its capacity as Government Chief Information Officer).
120. To date the Fire Services Review team has been advised that a Gateway Review is not required; however the opportunity to undertake Gateway Reviews may be considered by the Transition Governance Group as an option for providing independent advice. Budget has been allocated to enable gateway 0 – 5 reviews and associated IQA to be undertaken through the life of the Transition programme.
121. The Performance Improvement Framework Agency Model is a well-recognised independent review tool being used increasingly by the Crown entity sector to assess how well placed an organisation is to deal with the issues that confront it in the medium-term future.<sup>20, 21</sup> The Minister will expect the new organisation to use tools like these to monitor the organisation's performance. PIF Reviews assess six dimensions of performance and are conducted by external expert parties and inform views on current state (at a chosen time), and where an organisation needs to focus to make itself fit-for-purpose and fit-for-the-future. It may be appropriate for this method of assessment to be used to assess reform progress at a relevant time.

## **Implementation plan**

122. During 2016/17 the Board will be expected to baseline review the Commission and develop a national picture of rural fire funding. This review will inform the following implementation processes:
- an indicative business plan prepared for the funding arrangements by June 2016;
  - public consultation on the funding arrangements under the current legislation and under the new legislation (subject to the legislative processes) from August-October 2016;
  - a detailed business case for the funding arrangements that can inform a 2017/18 Budget Bid (if required);
  - the funding for the revenue will be set in regulation by March/April 2017 to take effect from 1 July 2017;
  - the funding will be set for a transitional year using the above information; and
  - the first three year funding period with prescribed consultation will follow the transition funding year.

## **Further consideration**

123. Further consideration of these matters by Cabinet and Parliament is planned as follows (subject to Parliamentary process):

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<sup>20</sup> <https://www.ssc.govt.nz/pif>

<sup>21</sup> For example, the New Zealand Transport Agency, New Zealand Trade and Enterprise, and Careers New Zealand.

**Table 9 Timeframe of further Cabinet and Parliament milestones**

<b>Expected Milestone</b>	<b>Estimated Timeframe</b>
Submit first tranche of drafting instructions to PCO unifying the fire services with regional committees	Mid-November 2015
Submit second tranche of drafting instructions to PCO detail on funding arrangements	Early April 2016
Submit third tranche of drafting instruction to PCO detail regarding penalties, levy, etc	Mid-April 2016
Bill drafted	November 2015-May 2016
Bill of rights vet/prepare for introduction	May 2016
Bill introduced	June 2016
Bill first reading	June 2016
Bill reported back from Select Committee	December 2016
Final House stages	December 2016
Enact Legislation	December 2016
New fire services organisation commences	April – June 2017