



COMMISSION ON TAXATION
AN COIMISIÚN UM CHÁNACHAS

PART 11

FUTURE FINANCING OF LOCAL GOVERNMENT



Part 11:

Future Financing of Local Government – *consider options for the future financing of local government*

Section 1 is an introduction.

Section 2 gives the context for our review.

Section 3 outlines our review of potential taxation measures other than charges on property.

Section 4 deals with local commercial property taxation measures.

Section 5 examines the issue of an annual property tax as a source of local government funding.

Section 6 deals with the issue of development contributions.

Section 7 deals with the issue of water charges.

Section 8 deals with the issue of waste charges.

Section 9 deals with other means of financing local government.

Section 10 examines the balance of local government financing and the equalisation of funding.

Appendix 1 contains supplementary information.

Our recommendations in this Part are as follows:

Local commercial property taxation measures

11.1	The revaluation initiative should be expedited to ensure that a transparent nationwide valuation system, including a cost-effective route of appeal, is in place as soon as possible. Regular revaluations should be carried out thereafter, in order to ensure that the valuation base remains up-to-date. This should be done as provided for in legislation, at intervals of not more than 10 years.
11.2	The vacancy relief provisions should be amended to provide for the granting of vacancy relief by local authorities, in accordance with the following principles: <ul style="list-style-type: none"> • Vacancy relief should only be granted where the following conditions are satisfied: <ul style="list-style-type: none"> – An owner/leaseholder is <i>bona fide</i> unable to obtain a suitable tenant, or – A property is vacant due to repairs or alterations being carried out on it, and – That the relief, where granted, is time-limited so as not to encourage the owner of premises to allow it to become dilapidated, and – The rate of the relief to be granted by a local authority to be within the range 50-100% for the time-limited period • Vacancy relief should be applied <i>pro-rata</i> according to the period of vacancy in any year.
11.3	The provision which states that a property must be vacant at the time of the striking of the rate by a local authority should be removed.
11.4	Permanent offshore structures should be made subject to commercial rates.
11.5	Bed and breakfast accommodation and guesthouses should be brought within the commercial rates base where there are four or more bedrooms in a dwelling house provided on an ongoing basis for overnight guest accommodation. Self-catering apartments and holiday homes provided by tourism operators should also be brought within the rates base.
11.6	Third-level and professional institutions should be par-rated to reflect the fact that they generate significant funds from their own resources and conduct commercial activity on their campuses.
11.7	Community halls should be par-rated where significant commercial activity takes place in such facilities.
11.8	Agricultural farm buildings which are owned by a body corporate should be subject to commercial rates.
11.9	All buildings or land occupied by the State should be brought fully within the commercial rates base.

Annual property tax as a source of Local Government Funding

11.10	After an appropriate period all of the revenues from an annual property tax should be used for local government financing.
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11.11	The proposed annual property tax system should be established and operated as a national property tax system for a short initial period: <ul style="list-style-type: none"> • Its revenues should then be hypothecated for local government financing as soon as is feasible – once the tax has become established, and • By no later than the next local elections (June 2014) rate-setting powers should be devolved to local government subject to the considerations set out at section 5.3 of Part 11.
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11.12	A new method of equalisation of funding, using a needs and resources model, should be developed in conjunction with the devolution of rate-setting powers to local government to reflect the changed funding base for local government.
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Water charges

11.13	Measures should be put in place immediately to ensure that the costs of water services provided are fully recovered from the non-domestic sector.
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11.14	Domestic water charges should be introduced as a sustainable approach to realising an acceptable conservation culture.
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11.15	There should be some level of incentivisation to ensure that consumers are encouraged to install meters.
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11.16	Charges should be phased in over a period of time.
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11.17	The charging should commence with a flat rate charge and change to volumetric billing for consumers once meters are put in place.
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11.18	A waiver scheme should be provided for low-income householders.
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11.19	Water meters should be installed in all new housing units.
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11.20	A public information campaign should clearly outline the rationale for water charges and the way in which they will be implemented.
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11.21	Water pricing should be introduced for all water consumers by local authorities based on a consistent methodology and applying the principle of full cost recovery.
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Waste charges

11.22	The polluter pays principle should continue to underpin waste charges to ensure that all consumers pay for their own waste.
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11.23	The landfill levy should be increased to encourage behaviour to divert waste away from landfill and meet our obligations under EU law and a similar mechanism should be considered for other forms of final disposal.
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11.24	Waivers should be available from all service providers in all local authority areas to all clients who lack an ability to pay.
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11.25	We do not support the establishment of a national waiver scheme. The pricing of waste and water services should be designed to fund the cost of providing services to consumers who qualify for a waiver.
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11.26	Tax relief on service charges should be abolished.
Other means of financing local government	
11.27	<p>Following an efficiency review:</p> <ul style="list-style-type: none"> • The Department of the Environment, Heritage and Local Government should develop a charging system in conjunction with local authorities to ensure a higher proportion of planning costs are recouped from planning applicants. • Consideration should be given to devolving responsibility for setting planning fees from the Minister to local authorities subject to central guidelines being developed.
11.28	There should be no deviation from the policy that housing rents are based on a person's ability to pay. Maximum rent levels should be removed to ensure that some tenants and households do not benefit disproportionately.
11.29	A review of the current differential rents scheme should be carried out to improve the sustainability and effectiveness of the scheme, as previously recommended by NESC.
11.30	The significant disparity across local authorities between rents collected on an income per housing unit basis should be addressed without delay with a view to elimination.
11.31	The Needs and Resource Model should be periodically reviewed and evaluated to ensure that the difference in the costs bases of local authorities are reflected in relevant decisions by central government on equalisation funding. The reviews should be undertaken in partnership with local authorities.
11.32	The initiatives being undertaken to improve efficiencies in local authority expenditure programmes should continue to receive a priority focus at local authority level and from central government. That priority will be assisted by the new standardised costing system which provides for greater benchmarking of local authority performance.

Section 1:

Introduction

1.1 The Local Government financing remit

We were invited to examine options for the future financing of local government. Our considerations were influenced by other aspects of our terms of reference, in particular:

- To keep the overall tax burden low, and to implement further changes to enhance the rewards of work, while increasing the fairness of the tax system
- To consider how best the tax system can support economic activity
- To promote increased employment and prosperity, while providing the resources necessary to meet the cost of public services, and other Government outlays, in the medium and long-term
- To examine the balance achieved between taxes collected on income, capital and spending

Our examination of the local government financing system in Ireland was also conducted in the context set out in the Green Paper – Stronger Local Democracy – Options for Change and the commitment in the Programme for Government to reform local government with the aim of making it more transparent and responsive to customers.

1.2 Guiding principles

Our work is informed by a number of guiding principles which are set out in Section 3 of Part 2 of our Report. An important exception to the principle of tax neutrality is that of user/polluter pays. This was relevant to our review of local government financing, particularly our examination of charges for water and waste.

In addition to these principles, we also had regard to the need for equalisation of funding between different local authority areas, and the desirability of improving local accountability - so that democratically elected representatives have appropriate responsibility for the decisions taken at local level, and are clearly accountable for those decisions.

1.3 Overview of the financing of local government

Green paper on local government

The green paper on local government states: “The need for proper funding of local government is recognised. Autonomy in fund raising increases local discretion and accountability. However, there is little consensus on how best to achieve such autonomy. This is an issue which will receive in-depth analysis in the context of the recently established Commission on Taxation, which is to consider the issue of local government financing.”

The fact that there is little consensus on how autonomy for the local government sector is to be achieved is apparent from the relative absence of policy responses to the considerable number of reviews of the subject that have been carried out over recent decades. We have noted many other studies at national and European level touching on aspects of Irish local government financing. It is a policy issue that cannot be said to be understudied.

1.4 Sources of income

There are two broad sources of income for local authorities. The first is known as 'own resources', which are generated directly by local authorities. These account for over a quarter of current income. Own resource income is generated through commercial rates and from services provided by local authorities including waste charges, non-domestic water charges, housing rents, and planning fees. The second source of income is central government subvention via the Local Government Fund (LGF) general purposes grant and other Government grants and subsidies. The LGF is financed by Exchequer contributions, and the proceeds of motor taxation. In 2008, the aggregate share of local authority income sourced from central government resources was almost 45%. However, some local authorities in areas with strong economic bases, such as those in the greater Dublin region and elsewhere, are less reliant on central government funding. Others are far more dependent on central government resources.

In recent years, the financial position of many local authorities benefited significantly from construction activity in Ireland. Local authorities received over €1.7 billion in local development contributions in the period 2003 to 2006. Although this source of funding has dropped dramatically since then, reflecting the sharp downturn in construction activity, the additional industrial and commercial construction has greatly increased the base for commercial rates, particularly in some areas.

Ireland is one of the few countries which does not impose a tax on domestic property to fund local government. A form of domestic property tax – domestic rates – was in place in Ireland until 1978, and was collected and used by local authorities to fund services. Rates on agricultural property were abolished from 1983.

Subsequent efforts to provide for a property tax were ultimately reversed. A national property tax, known as Residential Property Tax, was introduced in 1983. It provided for a property tax in circumstances where the property exceeded a threshold value, and the household income exceeded a threshold amount. Because of these thresholds, it only targeted a very small proportion of residential properties. The number of assessments raised in any year was never more than just over 20,000¹. In 1996, the last full year of its operation, the yield was just under €17 million. It was a national tax and was not used for local government funding. It was abolished in 1997.

A farm tax, which was based on a concept of adjusted acreage, was introduced in 1986. It represented an amalgam of income tax and property tax elements. It was abolished the following year. The proceeds of the tax were intended to form part of the current income of local authorities. On its abolition, the Government indicated that: "farmers should be taxed on the same basis as other sectors of the community, that is, on actual income".

An international comparison of the balance between central and local sources of local government funding is difficult because of the many different models of local government with many jurisdictions having roles in areas such as the provision of education, health and social services and policing, which are not in the main provided by local government in Ireland. The absence of any local tax on domestic property in Ireland also makes comparisons less meaningful.

¹ With the exception of 1994 when a flat rate of RPT was payable

Section 2:

Context of the current review

2.1 Introduction

Local government financing has been the subject of periodic review over the past quarter of a century. The previous Commission on Taxation and NESG both reported on local government financing in 1985, and recommended that a local property tax should be introduced to improve local accountability and widen the national tax base. KPMG economic consultants reported in 1996 and concluded that a local property tax was the most feasible option for raising additional funding to finance local government. More recently, Indecon economic consultants reported in 2006 and published a number of recommendations including extending water charges to non-principal private residences; more economic charging for services generally; broadening the commercial rates base to include State properties, and expenditure rationalisation and efficiency measures. Their recommendations did not include the introduction of a local domestic property tax.

Since the abolition of domestic rates in 1978 – or more correctly, the transfer of the liability for paying domestic rates from the occupier to central government through the “domestic rates grant” – there have been a number of changes to local government financing. However, some of these changes have not endured, which highlights both the limited policy response to the recommendations of the various reviews, and the very significant political difficulties in implementing structural change to the local government financing base.

To allow local government to raise more finances from its own resources, a statutory provision was introduced in 1983² enabling local authorities to levy direct charges for services such as water and waste. Water charges for domestic users were subsequently abolished in 1997.

A central Local Government Fund (LGF), financed by the proceeds of motor tax and an Exchequer contribution, was introduced in 1999. The fund provides local authorities with discretionary resources to fund their day-to-day activities, non-national roads and for certain local government initiatives.

A Needs and Resources Model was developed in 2000 to provide for a more transparent allocation of general purposes grants to local authorities from the LGF. In addition, the Planning and Development Act 2000 opened up new sources of funding, by requiring developers to part-fund the provision of public infrastructure through development contribution schemes. That Act also enabled local authorities to acquire sites, land or houses at below market value for social and affordable housing.

2.2 Financial challenges

As the Green Paper on Local Government points out, there are significant financial challenges which will face the local government sector in the coming years. These include:

- Providing services to a growing population which is more diverse and mobile than ever before
- Implementation of the National Development Plan
- Improved environmental performance, particularly in areas such as waste management, water supply and ground water protection

- The significant additional costs of operating new water and waste-water treatment plants, as well as the cost of greater environmental compliance costs for all existing plants

2.3 A broader approach to financing local government

We examined the various existing and potential sources of local government finance. This approach is consistent with the identification in the Green Paper of some issues which should be taken into account by us in our consideration of local government financing. These include:

- whether some form of local taxation measures that are found in other jurisdictions should be introduced
- whether a local property tax should be considered as a base for local government finance
- whether further efforts should be made to secure more resources for local authorities
- how local taxation measures are balanced against the objectives of equity and balanced regional development
- how the 'polluter pays' principle should inform payment for services and the sustainable use of resources
- the role of central funding of local authorities, particularly the need to assist authorities with weaker economic bases

2.4 The financing mix of resources

Our approach had regard to the need to reach an appropriate financing mix of a local authority's own resources: that is, what balance should be struck between income generated from service charges, and from taxation measures, from both property and non-property sources. Our approach to service charges is based on the 'user/polluter pays' principle, which provides for the recovery of full economic costs of service delivery in the provision of water and waste-water services, and refuse services. We believe this approach provides the most direct link between the consumption of a service, and the payment for that service. It will also assist in bringing about the necessary societal behavioural change that is required to protect and enhance, in particular, water services in Ireland. It will make local authorities more accountable for these major arms of service delivery, which is an objective of the Green Paper.

It could also provide in the region of €500 million more per annum for local government finance from the authorities' own resources, by plugging a significant funding gap that arises from water and waste-water service provision over the next number of years. The combination of both these charges (for the domestic and non-domestic sectors) will mean a considerable increase in the amount of service charges (particularly for the domestic sector) over the amounts currently collected.

We consider that once the proposed annual property tax (APT) recommended in Part 6 of our Report becomes established as a national tax, all of its revenues should be directed to local government financing and provision made for each local authority to set its own rate. In other words, the tax would become a local property tax to be administered nationally by the Revenue Commissioners.

Section 3:

Local taxation measures other than charges on property

3.1 What is a local tax?

We believe that if local taxation measures are to be considered as a source of financing for local government, they should be consistent with the minimum requirement for what is a genuine local tax which is initiated by a local authority, at a rate which it determines, and is collected in its area of operation. Furthermore, we also consider that if local taxation measures are to make a worthwhile contribution to the financing of local government, then each measure should have the following characteristics:

- Its effects on after-tax income should be fair
- Its tax base should be widely distributed throughout all local authority areas, so that all areas might hope to receive sufficient revenue from it to make a contribution to the financing of local expenditure
- The cost of administration should be low in relation to the tax yield
- It should be capable of being levied at different rates by different local authorities

3.2 Local income tax

We recognise that a local income tax has some arguments in its favour. In particular, it would be a potentially buoyant source of revenue and would be linked directly to a person's ability to pay. However, in our view, the arguments against the introduction of a local income tax outweigh its potential benefits. This conclusion is influenced by the following:

- Locally determined income tax rates are not consistent with national employment policies
- A local income tax system would lead to considerable additional compliance costs on employers and on individual taxpayers
- There are difficulties in taxing non-PAYE income, such as investment income and dividends, which would give rise to anomalies. These could prove difficult to address in implementing an equitable local income tax system
- As an alternative to central government financing, a local income tax would not give an even distribution of income to each local authority given the varying density of population throughout Ireland. Central government would still have to transfer significant resources to provide equalisation of funding to some local authorities
- A genuinely local income tax that would possibly be levied at different rates by various local authorities could lead to some taxpayers choosing to live or work in areas where a lower tax rate applies
- It would increase the burden of tax on labour income

Conclusion

We do not recommend the introduction of a local income tax.

3.3 A poll tax/community charge

A flat-rate poll tax, also known as a community charge, was used relatively recently in the U.K. as a source of funding for local government following the abolition of a domestic rates system of local taxation³. A poll tax has no direct relationship to a person's income – rather, it is a fixed charge per individual resident (though those on lower incomes may be exempt from the tax).

We do not recommend the concept of a poll tax as an option for the future financing of local government as it has many features which are not consistent with our guiding principles. The tax is inequitable, as it is levied equally on all residents of a local authority area, resulting in well-off people paying the same amount as those on lesser incomes. It bears little relationship to ability to pay. It is a tax that is charged on all residents in a local authority area, as distinct from imposing a tax on each household. A significant section of the community may be able to avoid the tax, particularly in areas where some residents are transient.

In addition, we consider that a poll tax would not form part of a pragmatic approach to the future financing of local government for two reasons: firstly, because the proposed tax is inequitable; and secondly, we believe that it would be highly unlikely to be accepted by the public as a source of finance.

Conclusion

We do not recommend the introduction of a poll tax/community charge.

3.4 Local sales tax

Our consideration of this option for local government financing took into account the harmonisation of VAT laws across the EU. The common system of VAT, implemented through EU VAT Directives, does not allow the maintenance or introduction of taxes which have the characteristics of a turnover tax⁴. For this reason local sales taxes are not a feature of local government financing systems in the EU. In contrast, they provide significant sources of funding for state and local governments in the US and Canada.

EU legislative requirements therefore preclude us from considering an *ad valorem* sales tax, which is a tax based on the value of the product sold. In any event, the impact of such a tax on the cost base could adversely affect Ireland's competitiveness.

Conclusion

We do not recommend the introduction of a local sales tax.

3.5 A local bed tax or levy

This proposal has been put to us in a number of submissions as a financing option for local government. Such a levy or tax is a feature of local authority financing in some EU countries but it is not an *ad valorem* tax because of EU VAT rules.

The Department of Arts, Sport and Tourism outlined in its submission to us that:

³ Such taxes, i.e. a head or poll tax, were a common source of revenue for many governments until the 19th century but not since and were usually linked to a person's right to vote.

⁴ See Article 401 of the recast VAT Directive (2006/112/EC).

“We are not aware of any reason why hotels (as against any other individual enterprise sector) should be subject to a specific local tax given the very significant contribution of charges and rates already paid by the sector. Such a tax could have clear negative implications for the competitiveness of Irish tourism internationally if implemented in an isolated way without regard to competitiveness or other aspects of the tax system.”

We consider that a bed tax or levy has the potential to provide a local source of revenue which would enhance accountability within local authorities. However, its revenue-raising potential is extremely limited. Unless a relatively high levy is struck, it would not provide a material source of funding for most local authorities.

Using Discover Ireland data, which indicates that there are over 88,500 rooms available in the Irish market with an occupancy rate of 60%, a levy of €1 per bed-night would indicate an overall yield of approximately €19 to €20 million per annum from accommodation services.

We are also cognisant of the fact that it would be an additional tax or levy to the applicable VAT rate of 13.5%, which would make the sector less competitive in a tourism market which needs to remain competitive.

However, in areas where a significant number of hotel rooms are available for the tourism market, there is potential for a bed levy which could be used to enhance tourism facilities in these areas. Local authorities, in co-operation with tourism partners, could explore how a voluntary funding scheme might enhance tourism facilities in these areas.

Conclusion

The introduction of a local bed tax or levy as a source of local government financing is not recommended. However, the potential for some local authority areas with tourism activity to use a bed levy to enhance tourism facilities, within a voluntary funding scheme, could be further explored.

Section 4: Local commercial property taxation measures

4.1 The commercial rates base

The commercial rates system is a local property tax over which local authorities have a considerable measure of control. Rates are levied annually, and, each local authority has exclusive rating jurisdiction within its own area. Rates are levied on the occupiers of commercial property, based on the annual letting value of the property. The valuation of such property for rating purposes is carried out by a central government agency, the Valuation Office, with a right of appeal to a Valuation Tribunal. Each year the level of the charge in a local authority area is determined by the elected council as part of the budgetary process. The annual rates charge for a commercial premises is calculated by applying the annual rate on valuation (ARV) to the valuation of the property concerned.

We believe the current system of raising local authority finance from commercial rates works reasonably well, despite an outdated basis for valuing commercial properties. It raises a considerable amount of revenue for local authorities, and represents an additional taxation

contribution from the business sector (much of which is subject to the corporation tax rate of 12.5%). We consider that it should remain in place.

A revaluation initiative is now underway which will, in time, modernise an antiquated valuation system, and provide a more transparent system for charging commercial rates. The revaluation initiative was legislated for during 2001. However, some eight years later, due in part to industrial relations issues, only a very small number of local authority areas have been fully revalued. The process needs to be expedited and should have regard to safeguards to ensure equitable treatment of rate payers and a cost effective route of appeal.

Recommendation 11.1

The revaluation initiative should be expedited to ensure that a transparent nationwide valuation system, including a cost-effective route of appeal, is in place as soon as possible. Regular revaluations should be carried out thereafter, in order to ensure that the valuation base remains up-to-date. This should be done as provided for in legislation, at intervals of not more than 10 years.

4.2 Rating vacant properties/vacancy relief

The current position is that commercial properties are rated whether they are occupied or vacant. However, sections 14 and 23 of the Local Government Act 1946 provide for a refund in certain circumstances. The legislation distinguishes between vacant premises in urban and rural areas. In practice, Dublin City Council and the other county borough councils may refund up to 50% of the total charge. Other councils may refund up to 100% of the rates charged.

The refund, known as 'vacancy relief', may only be given in the following circumstances:

- an owner/leaseholder is *bona fide* unable to obtain a suitable tenant, or
- a property is vacant due to repairs or alterations being carried out on it

To obtain the relief the property must be vacant at the time of the striking of the rate by council. This provision creates obvious anomalies where premises are vacated at other periods during the year, and cannot avail of the relief.

Our consideration of the vacancy relief provisions in place was informed by the requirement to have an equitable incidence of taxation - in so far as possible to treat all the relevant taxpayers in a similar way. We took the view that the incidence of commercial rates should be as broad as is feasible, in order to spread the burden of local taxation in a fairer way. Furthermore, we believe that changing the vacancy relief provisions could improve the efficiency of the property market by offering an incentive to bring under-utilised property back into productive use.

However, we are cognisant of the fact that a proposal to standardise vacancy relief could be criticised as causing undue hardship to owners in areas where demand for property is low, particularly in areas where there is population decline.

Commercial property markets tend to operate more efficiently where there is a critical population mass, which leads to steady commercial and business activity, and a consequent need for commercial property.

The Department of the Environment, Heritage and Local Government carried out a survey of local authorities to determine the level of vacancy relief being granted. The survey results indicated that

if vacancy relief was standardised in all areas at 50%, local authorities would save an estimated €20 million in rate refunds.

Recommendation 11.2

The vacancy relief provisions should be amended to provide for the granting of vacancy relief by local authorities, in accordance with the following principles:

- Vacancy relief should only be granted where the following conditions are satisfied:
 - An owner/leaseholder is *bona fide* unable to obtain a suitable tenant, or
 - A property is vacant due to repairs or alterations being carried out on it, and
 - That the relief, where granted, is time-limited so as not to encourage the owner of a premises to allow it to become dilapidated, and
 - The rate of the relief to be granted by a local authority to be within the range 50-100% for the time-limited period
- Vacancy relief should be applied *pro-rata* according to the period of vacancy in any year.

Recommendation 11.3

The provision which states that a property must be vacant at the time of the striking of the rate by a local authority should be removed.

4.3 Rating permanent offshore structures

We considered the question of whether permanent structures which are located offshore, such as wind-farms or other offshore electricity generating stations, should be rated. At present, owners or occupiers of such structures are not liable to pay commercial rates. In contrast, commercial rates are payable in respect of on-shore permanent structures.

The rating jurisdiction of a local authority extends to the high-water mark only. We acknowledge that there are significant issues that may need to be addressed, but consider that this area should receive some expert review so as to minimise anomalous treatment between permanent on- and off-shore structures.

The Department of the Environment, Heritage and Local Government pointed out in its submission that setting local authority boundaries beyond the high-water mark has significant practical difficulties as well as significant legal issues. Notwithstanding potential legal issues, we consider that these structures should be brought within the rates base subject to recognising existing territorial water limits. Expert consideration should be given to bringing them within the rates base of the local authority area of the nearest shoreline and the use of the high-water mark as the boundary for rating purposes should be reviewed.

Recommendation 11.4

Permanent offshore structures should be made subject to commercial rates.

4.4 Other commercial, for-profit premises which should be subject to commercial rates

Bed-and-breakfast premises, guesthouses, and self-catering accommodation provided by

tourism operators are exempt from commercial rates. We understand that Government, in the past, considered that there might be merit on equity grounds to rating B&B and self-catering accommodation, but did not proceed with such a measure in the absence of a compulsory national licensing or registration system for such premises.

We consider that any premises operating on a commercial for-profit basis should be included in the commercial rates base. It seems particularly anomalous that self-catering apartments and holiday homes that are owned or operated by hotels are not subject to a rates charge and we recommend that they be included in the rates base. However, we recognise that owners of some domestic houses may operate guest accommodation services on a seasonal basis or in support of educational purposes during school holidays, and only provide a very small number of rooms for accommodation, often for very short periods of time.

To address this issue, we suggest that a reasonable and consistent basis is provided for identifying B&Bs and guesthouses which should be rated. In essence, a B&B or guesthouse that provides four or more rooms for overnight guest accommodation should be brought within the commercial rates base⁵ by part-rating them.

Recommendation 11.5

Bed and breakfast accommodation and guesthouses should be brought within the commercial rates base where there are four or more bedrooms in a dwelling house provided on an ongoing basis for overnight guest accommodation. Self-catering apartments and holiday homes provided by tourism operators should also be brought within the rates base.

4.5 Properties currently exempt from commercial rates

Schedule 4 of the Valuation Act 2001 lists property types that are also excluded from the commercial rates base.

Property types excluded from the commercial rates base include:

- Agricultural and horticultural land and buildings
- Properties used exclusively for care or hospital or medical purposes which are publicly run and not-for-profit
- Land and buildings used for educational purposes which are publicly run and not-for-profit,
- Publicly funded museums and theatres
- Buildings occupied by charitable organizations, and
- Community halls

We consider that properties used or occupied by bodies which are not established for the purposes of making a profit, but where the body has its expenses defrayed wholly or mainly by the State, should continue to be included on the Schedule as should:

- Land and buildings used exclusively for religious worship
- Any body whose principal activity is the conservation of natural and built endowments in the State, and which is run on a not-for-profit basis

⁵ The Local Government (Planning and Development) Regulations 1994, specify that planning permission is required for the use of more than four bedrooms in a dwelling house as overnight guest accommodation. This provides a definition that could be used in the application of rates to properties where four or more rooms are used for overnight guest accommodation.

- Property used by a society established for the advancement of science, literature or the fine arts and which is used exclusively for that purpose and not for profit, and
- The organisations listed at part 12 of the Schedule⁶, all of which are publicly funded, are normally open to the public, and are not established and maintained for the purposes of making a profit, should remain not rateable

4.6 Broadening the rates base

Subject to the above we consider that the commercial rates base should be as broad as possible and we propose the following changes.

Educational institutions are exempt based on the fact that they have their expenses defrayed wholly or mainly by the Exchequer. Many third-level institutions and professional institutions are excluded from the rates base, despite the fact that many of them generate significant funds from their own resources, and conduct significant amounts of commercial activity on their campuses. We consider that these institutions should be partly rated⁷.

The level of part-rating should have regard to the level of commercial activity taking place on a campus. In order to support new businesses based in incubation units, whose purpose is to develop innovative and entrepreneurial business ideas which are based on research and development conducted on campus, such businesses should be exempted from part-rating for the first three or so years of activity.

A provisional estimate of funding from this source (from the Valuation Office and based on pre-2002 valuation lists) is about €10 million.

Community halls are not rateable. These are premises usually operated by bodies which are not established for the purposes of making a profit. However, we consider that such buildings should be part-rated if a significant amount of commercial activity operates from them. This proposal would put such business activity on the same footing as businesses carrying on similar activity which pay rates. The level of part-rating should have regard to the level of commercial activity taking place.

Provisions for the non-rating of agricultural land and farm building should remain, with one exception: farm buildings which are owned by a body corporate should pay commercial rates, as companies are subject to a lower rate than applies to farmers. Our rationale for this approach is that many farms owned by corporate businesses in the agri-food industry are subject to commercial rates on all other buildings occupied by them and that, for these, farm buildings should also be rated.

Recommendation 11.6

Third-level and professional institutions should be part-rated to reflect the fact that they generate significant funds from their own resources and conduct commercial activity on their campuses.

Recommendation 11.7

Community halls should be part-rated where significant commercial activity takes place in such facilities.

⁶ The National Museum of Ireland, the National Library of Ireland, the National Gallery of Ireland, the Irish Museum of Modern Art Company, the Arts Council, the Heritage Council, the National Concert Hall Company, the Chester Beatty Library, and the National Theatre Society Limited.

⁷ As was the case before the enactment of the Valuation Act 2001

Recommendation 11.8

Agricultural farm buildings which are owned by a body corporate should be subject to commercial rates.

4.7 State properties

Excluded from the commercial rates base are buildings or land occupied by government offices; the Defence Forces, the Gardaí, prisons, and constituency offices of TDs, MEPs, and Senators. HSE administrative accommodation is also deemed to be 'State occupied', and is therefore not rateable. The main rationale for including these properties in the rates base is that their exclusion reduces the size of the base in local authority areas with a high concentration of State properties. Their exclusion impacts on all local authority areas where government offices are located especially following various decentralisation initiatives.

Inclusion of such properties in the rates base would also ensure that commercial properties that are taken over by the State, such as toll bridges, remain within the base.

The State makes a contribution 'in lieu of rates' to the Local Government Fund in respect of State properties. It is not clear to us how the amount 'in lieu of rates' is calculated each year in the absence of each State property being valued for the purposes of striking a rate for the building.

This conflicts with our guiding principle of simplicity – that tax rules are easily understood, and that liability is clear.

A more transparent funding mechanism would be to have all State properties rated – as provided for in the Valuation Act 2001. This recommendation would replace the funding mechanism – the contribution 'in lieu of rates' that is in place – and would offer greater transparency and certainty in regard to this funding stream from the Exchequer to local authorities. While we recognise that the Local Government Fund would be correspondingly reduced, the proposed change is nonetheless desirable on the grounds of greater certainty and control for the local authority funding base.

The Minister for the Environment, Heritage and Local Government has made provision for the Commissioner for Valuation to include State properties in the revaluation initiative that is now underway. This will allow commercial rates to be collected in respect of them.

In the absence of precise valuations for each State-occupied building and the commercial rates charge that applies in each local authority area, it is not feasible to give a precise estimate of funds that would be generated by these rates charges for State properties. One provisional estimate⁸ is that revenues of almost €50 million could accrue to local authorities from rates on State properties.

Recommendation 11.9

All buildings or land occupied by the State should be brought fully within the commercial rates base.

Section 5:

Annual property tax as a source of local government funding

5.1 Introduction

We consider that once the proposed annual property tax (APT) becomes established as a national tax (see Part 6 of our Report), all of its revenues should be directed to local government financing and provision made for each local authority to set its own rate. In other words the tax would become a local property tax to be administered nationally by the Revenue Commissioners. We consider that the funding stream from an APT should replace the funding stream from motor tax revenues currently directed to the local government fund.

The introduction of an APT provides a unique opportunity to enhance the financing framework of local government and to improve its autonomy and accountability at a time when its scope and functions are being considered in the forthcoming White Paper on Local Government Reform.

An annual tax on residential property is a very common financing source for local and regional governments worldwide. It would be unusual that revenues from such an annual property tax on residences be used solely for central government finances.

Using revenues from a property tax, and from increased user charges (water, waste and planning services in particular) would provide greater clarity in how local services are funded and would help provide greater transparency over local services costs and how decisions on spending and resources have been made. This would help improve local accountability and provide for a more autonomous local government system. A distinction may need to be set out when implementing local government financing changes between user charges (such as for water and waste services) and an APT which would fund the wide range of other local authority expenditures.

5.2 How would using annual property tax revenues for local government financing impact on central government finances?

Replacing the motor tax revenue stream into the local government fund with a property tax revenue stream of the same dimension should not impact on central Government finances. In 2008 the motor tax stream of income amounted to €1.05 billion. Property tax revenues of the same dimension could replace this revenue stream. Any higher yield from APT could replace or part-replace the Government grants and subsidies funding (€1.272 billion in 2008) representing financing to local authorities from Government departments⁹. We note, however, that setting of the rate of APT is not a matter for the Commission.

Analysis

Advantages

- i) As set out at 5.2 above using the yield from APT could be revenue neutral for the Exchequer.
- ii) The provision of the APT yield for local government financing has the potential to provide greater clarity to the roles of central and local government and to provide an appropriate balance between local and national priorities.

⁹ Including about €550 million from the Department of Transport in respect of funding of non-national and regional road and about €180 million from the Department of Education and Science in respect of higher education grants.

- iii) Over €1 billion of local government financing comes from the proceeds of motor taxation (which is paid into the LGF). A more appropriate tax base for local government financing is one that is based on immobile assets such as property. It is consistent with the business property tax – commercial rates – which already provides 27% for financing current expenditure. We consider that the taxation of motor vehicles, and the national environmental policy underpinning that tax base (reducing carbon emissions), is more appropriate to a national taxation system the revenues from which should be directed to central government.
- iv) The necessity to improve the basis on which local authority financial planning is carried out is clear. The allocations to each local authority are only made known near year-end – at the time when each local authority finalises its budget. The Exchequer contribution to the LGF has to match the actual allocations to individual local authorities. This provides for a difficult budgetary process. The Green Paper argues that greater certainty on central government funding would be beneficial. The allocation of property tax receipts to the LGF would provide for a stable and long-term revenue stream for local government financing which would be desirable.
- v) Local government reliance on central government – 45% of its revenues come from central government – limits its capacity to improve local services. Its control over its own resource income is also constrained by central government to the degree that some of its own resource rates and charges – such as housing rents and planning fees – are controlled centrally. We consider that changes to local government structures to make it – as envisaged in the Programme for Government and the Green Paper on Local Government – ‘more transparent and more responsive to customers’ should coincide with changes to local government financing and make local government more accountable. These local government financing changes should be driven by effectiveness and efficiency and, as the Green Paper outlines, should be innovative, well-targeted, flexible and responsive to the citizen. Our proposals on water charges should allow local government to address and meet these objectives in the delivery of water services. A similar outcome should also be sought and can be achieved if property tax revenues are directed to local government financing.
- vi) The local government electoral cycle provides a very good landscape within which a local annual property tax on residential property could be constructed. The next local government elections will take place no later than June 2014. At that time, in our view, the proposed annual property tax (APT) should be well established and tested and it is appropriate that it should form part of the local government financing base before, or no later than, that time. It would represent a significant development of the degree of local autonomy currently held by local government and would form a constructive agenda for debate, at local level, in the context of the 2014 local elections. It would also ensure renewed and increased levels of accountability for all candidates at that time.

Disadvantages

- i) Central government ensures that local authorities with weaker economic bases have access to a pool of funding which helps equalise their funding position vis-à-vis local authorities with stronger economic bases. The equitable and transparent determination of the allocation of what is now the general purpose grant to local authorities is managed through a needs and resources model

developed by the Department of the Environment and Local Government in 2000.

Equalisation measures will still be required to protect the position of local authorities with higher levels of socio-economic need and low property tax raising abilities – whether from commercial rates or an annual property tax. The hypothecation of national property tax revenues to local authorities from the local government fund would permit the development of the current needs and resources model to ensure appropriate equalisation of funding. When fiscal powers are devolved to local authorities to permit them to set their own property tax rates, a new equalisation funding method will have to be developed to reflect the changed funding base. We recommend that this be addressed at or before that time.

- ii) The devolution of fiscal powers to local authorities permitting them to set their own APT rates may put pressure on central government to provide further funding to some local authorities whose APT rates are set at levels which would not permit them to meet their expenditure demands. This could potentially diminish local accountability.

5.3 The need to develop and establish the annual property tax system

We consider that there are a number of reasons why the proposed annual property tax should be established and bedded down before being devolved to local government.

- a) The focus during the first number of years of a new property tax should remain on the development of a robust and comprehensive tax base with a commensurate revenue yield. This will involve a concerted effort by the Revenue Commissioners, in particular, before the commencement of and during the operation of the first number of years of collecting the proposed tax including a nationally organised information campaign.
- b) The introduction of the proposed APT and the zero-rating of stamp duty on owner-occupied residential housing transactions (see Part 6) is central to our proposals for a newly restructured property tax system. Using some or all of the APT yield for local government financing during this period may, in our view, complicate the development of such a structural change.
- c) There is a requirement, in the short term, to bring a far greater degree of stability to the central government tax base. Certainty is one of the key characteristics of any tax system. It is important for the State – so that budgetary planning can be developed from a far less volatile tax base than has been the position over the past number of years – and for taxpayers. For the taxpayer, the development of a new tax system will mean that decisions to purchase a house – one of the most significant financial decisions that will be made by any taxpayer – will involve some different inputs into decision making.

In order to provide the greatest degree of certainty that is feasible for both taxpayers and the State it is appropriate that the new property tax system should, in the commencement and introductory period, have only one national set of rules including rate setting.

- d) One national organisation collecting and administering the tax will ensure that the cost of collection is kept to a minimum. One national set of rules which is administered by one agency nationally will also provide some clarity on how much revenue can be raised for the Exchequer. This will be an important issue in the first number of years of the operation of the proposed tax. It would also mean that a substantial set of established rules can form part of

any devolved system of rate-setting powers that may, in time, be given to local government.

- e) Before consideration is given to hypothecating revenues from APT, or devolving rate-setting powers, to local government financing, it is appropriate that all the substantial design features of the APT are put in place and bedded down for a period so that any devolution of functions to local authorities can be carried through from a solid and tested tax base. This period should cover the establishment of, and implementation of, all aspects of the property tax administration system – including appeal structures, wide-ranging payment options and the other ‘engine-parts’ necessary to a properly functioning tax administration system.
- f) It is appropriate that waiver and/or deferral schemes be fully developed and tested nationally before devolving fiscal powers to local government. Indeed we consider that waiver and/or deferral schemes should continue to be part of a centrally controlled function and be administered uniformly throughout all local authority areas after any proposed devolution of the rate-setting aspect of property tax system to local authorities.
- g) The implementation of our proposed water charging system will be a considerable challenge for local authorities over the next number of years and will also result in a considerable change to the funding base for local government financing. The imposition of water charges (estimated at about €500 per average household in 2014) and a local property tax would present a difficult, though not insurmountable, challenge for local authorities (elected representatives and management) over the next number of years, if both were to be rolled out concurrently.

5.4 Conclusions

Devolution of fiscal powers or hypothecation?

As the Green Paper points out, the ideal shape of local government would include a local government system which is less dependent on central government and that the primary way to achieve this objective is to give local authorities greater autonomy and accountability. Options for the future financing of local government being proposed by us – including increased own resources financing (by which we mean financing from local taxation measures – currently commercial rates, and user and service charges) – will help provide a basis for achieving this objective. Achieving these aims will take time and hard work and must be matched by clear democratic responsibility and accountability by local authority leaders who should have full responsibility for decision-making at local level.

After an appropriate period we consider that all of the revenues from a national property tax should be used for local government financing. However, we acknowledge that allocating fiscal powers between two layers of government (central and local) involves complex issues. The move from hypothecating central tax revenues to devolving taxing powers to local authorities is significant.

Hypothecating property tax revenues to local government financing rather than devolving fiscal powers to local government is the more appropriate approach in the short-term.

We consider that central government should influence the parameters of the overall tax burden on taxpayers. This would mean that central government would reserve powers to regulate how far local authorities can go in setting a local property tax rate. We recognise that such an approach may circumscribe the degree of autonomy and accountability that local government may have

but consider that it is a necessary approach given the number of local authorities that could set different local property tax rates. We consider a 'one step at a time approach' to be an advisable one. If powers are devolved to local authorities permitting them to set their own property tax rates these powers should be limited to rate-setting within clearly set parameters and which preclude a disproportionate variation in the local property tax base which would oblige central government to provide other sources of financing or which would put an undue burden on other "own resource income" of local authorities.

The impact of proposed changes to local government financing (that is, local annual property tax, water charges for domestic users, increased revenues from water charges from the non-domestic sector, other increased user charges and a broader commercial rates base) on the 2008 funding base will mean a significant restructuring of that funding base when all the financing options proposed are implemented – which should be no later than the end of 2014 in our view – see Table 11.8.

Recommendation 11.10

After an appropriate period all of the revenues from an annual property tax should be used for local government financing.

Recommendation 11.11

The proposed annual property tax system should be established and operated as a national property tax system for a short initial period:

- Its revenues should then be hypothecated for local government financing as soon as is feasible – once the tax has become established, and
- By no later than the next local elections (June 2014) rate-setting powers should be devolved to local government subject to the considerations set out at section 5.3 of Part 11.

Recommendation 11.12

A new method of equalisation of funding, using a needs and resources model, should be developed in conjunction with the devolution of rate-setting powers to local government to reflect the changed funding base for local government.

Section 6: Development contribution system

The development contribution system, which is a longstanding part of the planning system, was significantly revised in the Planning and Development Act 2000, in order to improve its transparency and increase the range of infrastructure that can be funded under this mechanism. Under the 2000 Act, the elected members of each planning authority must adopt a General Development Contribution scheme for their own functional area.

The development contribution system has been a successful method of enhancing local government funding, particularly since the start of this decade – see Table 11.1, which sets out the revenues raised by local authorities since the start of this decade. They total almost €3 billion, with a healthy growth pattern apparent in the period 2001 – 2007, reflecting the buoyant construction sector. Deterioration is apparent since then. These levies are therefore a very cyclical income stream. However, the income stream is

proportional to infrastructural requirements in a local authority area.

Table 11.1: Development contributions collected 2000 - 2008

Year	Development contributions collected €m
2000	110.4
2001	122.0
2002	151.0
2003	215.5
2004	337.3
2005	519.4
2006	671.1
2007	867.0
2008	382.7 est.

The development contribution system is a source of local government funding which is consistent with most, if not all, of the characteristics of a genuine local tax or levy. It is initiated by the local authority where the development takes place; the contribution is struck at a rate determined by the council (this is a reserved function of the elected representatives); it makes a worthwhile contribution to local authority financing (as is apparent from the figures in the table); it is reasonably widely distributed throughout all local authority areas – though areas with strong economic bases have fared proportionately better, due to factors like population shift and increased population density.

Given the sharp correction in the residential housing market, and the significant slowdown in the commercial property market, revenues from the scheme have declined significantly. However, this is happening at a rate more or less proportionate to the economic activity taking place in those areas.

The revenues arising from the development contribution system are specifically targeted at the provision of local public infrastructure (roads, water supply, drainage, parks and open spaces and community facilities).

Our proposed enhanced capital gains charge on development land will fall on the owner of land who is receiving an enhanced gain arising from rezoning decisions. Our proposed recurrent tax on rezoned land should incentivise the use of land that is rezoned for development. Both proposals should provide for more sustainable planning decisions in the future.

Conclusion

We consider that the development contribution system has worked reasonably well since the enhancement of the relevant provisions in 2000. The system should remain in place. However, we note that appeals against development levies are currently processed in conjunction with other aspects of the planning application. This can lead to inordinate delays and should be examined with a view to separating the process for appeals against the development contribution from other aspects of the planning application.

An enhanced capital gains charge on development land and a recurrent tax on rezoned land are recommended by us as part of our review of the taxation of property in Part 6 of our Report.

Section 7: Water charges

7.1 Local and EU context

Water charges are imposed on the business and commercial sector by local authorities. However, local authorities do not impose water charges on domestic homes. We are almost unique among EU Member States in this regard.

The EU Water Framework Directive (WFD)¹⁰ provides for the recovery of costs for water services. Article 9.1 states that:

“Member States shall take account of the principle of recovery of the costs of water services including environmental and resource costs, having regard to the economic analysis conducted ... and in accordance in particular with the polluter pays principle”.

Article 9.1 also provides for:

“an adequate contribution of the different water uses, disaggregated into at least industry, households and agriculture, to the recovery of the costs of water services ..”

Article 9.4, known as the ‘Irish Clause’, provides that Ireland will not be in breach of the Directive by not securing ‘an adequate contribution of different water uses’. This, effectively, allows Ireland not to impose water charges on domestic users. The clause was sought and obtained by Ireland following extensive debate at national level.

However, unmetered water charges were in place in almost every local authority area prior to 1997. These had been enabled by 1983 legislation designed to broaden the financing base of local authorities, following the removal of domestic rates in 1978 and agricultural rates in 1983.

7.2 The water challenge

In its submission to us, the Department of the Environment, Heritage and Local Government (DoEHLG) pointed out that the cost of providing safe and secure water services sufficient to meet future needs is increasing significantly in line with efforts to comply with EU standards on water safety.

The current system of funding domestic water services provision, by way of an unidentified element in the Local Government Fund (LGF) allocation, is becoming unsustainable.

The gap between the expenditure and income on local water services in 2007 was €394 million, based on local authority budgets. Local authorities contend that this gap is essentially the cost of domestic water services provision and that the funding available within the LGF is insufficient to cover it.

However, the €394 million shortfall may partly be accounted for by the fact that individual local authorities might not be applying full cost recovery to their non-domestic customers in setting their water charges. It also may be attributed to some non-payment of bills for water services supplied and a degree of water loss within the system.

A submission to us from the DOEHLG on water and waste water expenditure and income in all 34 water services authorities provides greater clarity on water and waste water costs. The Department

10 Directive 2000/60/EC

indicated that the methodologies used to measure the annual water supply and set waste water charges vary from authority to authority. There are also considerable differences in the cost base of each authority. Due to the lack of consistency and transparency in the systems and methodologies, and the variations in the cost base, the charges may be subject to dispute. The disparity in the 2007 and 2008 charges can be seen from the following figures for the combined charge per cubic metre for each year.

Table 11.2: Water charges 2007 and 2008

	2007	2008
Highest charge	€2.52	€2.71
Lowest charge	€0.99	€0.99
Average charge	€1.71	€2.07

The average charge for water per cubic metre in EU countries in 2007 was €3.25, but was considerably higher in countries that have full cost recovery e.g. Germany €5.09 and Denmark €5.63¹¹.

7.2.1 Cost of providing water services

The cost of providing water and waste water services is growing significantly and is placing an increasing strain on the LGF. The total current expenditure on water services has risen from over €442 million in 2004 to over €680 million in 2007, an increase of 54%. It is projected that the annual increase in the current costs of water services will be in the order of 14% to 15% over the next number of years. The total projected capital cost for water services over the lifetime of the current National Development Plan (2007 – 2013) is estimated at €4.7 billion. The income for 2007 from water services for the non-domestic sector was €169 million, whereas expenditure on this sector was €227 million: a recovery rate of 74%.

7.2.2 Unaccounted for water (UFW)

The level of reported unaccounted for water in the 34 local authorities varied in both 2007 and 2008, from 18% to 65%. The average level of UFW was 45% in 2007 and 44% in 2008. This contrasts to UFW rates which varied from 16% to 82% in a 2000 National Water Study. By unaccounted for water we mean the amount of treated water entering the distribution system that cannot be accounted for by legitimate use. It can be comprised of water mains and reservoir losses, distribution network losses and user supply pipe leakage, as well as water taken illegally and water used for such operational purposes as system flushing and fire-fighting.

Local authorities have set themselves medium-term and long-term targets for unaccounted for water (see Appendix 1 for more on this). In order to achieve these targets the majority are now implementing water conservation programmes funded by the Department of the Environment, Heritage and Local Government. However, given the slow progress with the conservation programmes, there has been little improvement in recent years in the level of UFW. We note with concern that of the €298 million made available since 2003 for water conservation programmes, only €115 million (39%) had been drawn down by local authorities by May 2009. We understand from DoEHLG that activity under this expenditure programme is expanding and it expects this trend to continue over the next number of years as local authorities gear up their water conservation operations.

11 Survey by N.U.S. Consulting for Forfás

We consider that the reduction of unaccounted for water must continue to be aggressively pursued. Water gains that accrue from reducing unaccounted for water to acceptable limits will help provide for a more cost-efficient delivery of water services to consumers in the future.

7.2.3 The capital cost of water infrastructure

We consider that capital investment in water infrastructure in Ireland should have as its primary focus a demonstrable improvement in environmental performance. The principal outcome of this should be a sustainable and cost-effective water supply. Future capital investment must seek to meet or exceed international best practice, and to deliver optimum value for money. This would allow local authorities to:

- Meet the consumption needs of a growing population
- Achieve water quality standards
- Minimise water leakage, and
- Achieve the highest standards of environmental protections and compliance

In order to ensure a long-lasting and sustainable water supply, capital investment programmes at both local and national levels must place a higher priority on expanding infrastructural water conservation activity. This should be done particularly by rehabilitation and reinforcement of existing water networks, and by sharing water networks to achieve efficiencies and economies of scale. To meet this objective, local authorities should maximise efficiencies that can accrue from sharing infrastructure where feasible.

7.3 Contribution of commercial sector under the current water charges regime

The Government's water pricing policy requires local authorities to recover the cost of water services from users, except from households using the service for domestic purposes. The policy provides for full cost recovery without profit, with charges based on actual metered consumption. This policy should mean that no subsidisation should occur between the non-domestic and domestic sectors. The fact is that full cost recovery from the non-domestic sector is not being achieved. The cost of providing water services to the non-domestic sector will have to be met in full by 2010 to comply with the EU Water Framework Directive. At present the cost recovery ratio from the non-domestic sector is 73% resulting in a shortfall of about €58 million in 2008. We consider that this shortfall should be addressed immediately.

Despite the intended policy to recover the full cost of water services from commercial users, it is clear that the full capital cost of providing water services to commercial users is not applied to their water charges. According to the DoEHLG, only the marginal cost of the capital services is applied to commercial water charges¹². The application of the proportionate capital costs to the commercial sector would result in water charges that would more closely approximate the EU average.

The DoEHLG also pointed out that the lack of any deterrent to excessive use of water by the domestic sector supports the contention that a greater-than-normal proportion of water services costs in Ireland are attributable to that sector. The indications are that excessive volumes of water are being used by a population that largely perceives water to be a free and limitless resource.

12 We understand that what the DoEHLG means by marginal cost in this instance is: "the cost over and above the cost that would apply to a domestic service".

In the non-domestic sector in contrast, as the metering programme has progressed and customers have been forced to switch from flat charges to volumetric bills, local authorities report that large levels of leakage within non-domestic premises have come to light and been addressed.

Excessive usage leads to shortage of supply, resulting in higher demand for additional water services infrastructure, and increased local authority expenditure on the provision of water services (totalling an estimated €680 million in 2007). There are also positive lessons to be learned from metering that already exists in group water schemes which provide water services to 170,000 or more domestic users.

Recommendation 11.13

Measures should be put in place immediately to ensure that the costs of water services provided are fully recovered from the non-domestic sector.

7.4 Contribution of domestic sector

Some submissions to us have suggested a more universal application of water charges to ensure a proportionate contribution from all sectors, domestic and non-domestic, to the costs of providing water services.

The Green Paper on Local Government points out that Government policy to date has been to prohibit the charging for water to domestic homes on the basis that this is 'a core public service'. However, we note that this is in contrast to a charging regime that was in place in many areas between 1983 and 1997. In 1996, almost all local authorities imposed annual flat rate charges for water services to domestic properties. Charges were usually fixed across an authority, and ranged from €65 to €184 per household at that stage. Approximately €63 million was collected in domestic water charges in 1996.

Absence of a conservation mindset

The difficulty with the current policy approach is that it does not give the appropriate signal to homeowners that water is a resource which is costly to treat for drinking, and even more costly to treat as waste water, before it can be released back into the environment. These costs have risen in recent years, as Ireland puts in place the expensive infrastructure required to meet the discharge quality standards which are now required. Ireland is almost unique in Europe in not charging the domestic user for these costs.

The absence of a 'conservation' mindset in relation to water actually costs the taxpayer significantly more, as additional capacity has to be built, maintained and operated, to provide the additional drinking water and waste water treatment.

We believe that the unsustainable nature of this approach in the long term must be addressed and that charging domestic users for water services on the basis of use should form part of a revised approach. The fact is that a domestic water user in Ireland may install a swimming pool and access a free water supply to maintain that pool all year round at no cost. In our view, this is hardly a core public service¹³.

13 Section 56 of the Water Services Act 2007 (which commenced with effect from 15 December 2007) gives local authorities powers to issue notices ordering corrective action to be taken to prevent wastage or excessive consumption of water. In the absence of metering, establishing whether water is being used excessively is difficult.

The user/polluter pays principle

Public acceptance of charges for local authority services can be difficult to secure, as was evident from the introduction of waste charges. The Green Paper points out that there is a conflict between the principle that the taxation system should pay for certain essential public services delivered by local authorities in Ireland, and the principle of the 'polluter pays' which underpins the charging regimes for water services in most EU Member States. The 'polluter pays' principle recognises that much human activity has an environmental cost – which, if paid for in a visible way, encourages corrective behaviour. We consider that the polluter pays principle, which underpins the EU Water Framework Directive, should also underpin the policy approach to providing water for domestic users in Ireland.

Recommendation 11.14

Domestic water charges should be introduced as a sustainable approach to realising an acceptable conservation culture.

Water charging and metering

The major focus of our consideration was the following: what financing base for water services is the most appropriate and sustainable approach in the medium-term and long-term? We took the view that, at the very least, a sustainable medium- or long-term vision should involve the measurement of water consumption across all sectors, including the domestic sector. A metering system measures consumption and encourages better behaviour in the use of a valuable resource through the provision of a means for householders to see what they are consuming. Importantly, it would provide for a transparent charging mechanism.

In order to provide a transition to a transparent basis for water charges, water meters should be provided for all domestic and non-domestic users. We understand from discussions with the DoEHLG that a meter installation programme will cost in the region of €400/€450 million (in 2008 terms) over a period of five years or more. This should be seen in the context of the multi-billion euro investment programme for water services currently underway. It should also be noted that the full cost should not be borne up-front by the State, and can be passed on to the consumer. Incentivising consumers to purchase water meters is an essential step which must accompany the introduction of water charges.

Users should be incentivised to install meters by a reduction in or exemption from water charges in the year in which a user installs a water meter and for a period thereafter, as necessary. Local authorities should also be incentivised or encouraged to prioritise investment to reduce water leakage during the window where National Development Plan funding for water infrastructure is available. Failure by a local authority to achieve acceptable leakage rates will leave them in the unsatisfactory position of having to explain water charges based on full economic recovery whilst leakage rates are at an unacceptable standard.

Where metering is in place, jurisdictions that take water conservation seriously impose a sliding scale where the charge increases – typically very sharply – from a very low rate for the first units of consumption per month to a high rate. We note that with modern metering technology, there is no problem with implementing such a sliding scale.

A free quota?

We considered the possibility of providing a free quota of water to every household. Agreeing on an appropriate quota is fraught with difficulty. Setting a relatively generous quota would do little or nothing to encourage water conservation; setting a low quota, or giving a number of units per member of the household, would present huge administrative difficulties. We concluded that it is preferable to have no quota in place and that those on low incomes could be dealt with through a waiver system.

Waiver

Our approach to the provision of a waiver system for water and waste charges is set out at section 8.5 below. In the context of the provision of water to domestic users, we suggest that a number of free units of water should be provided, for each billing period where the household income is below a certain threshold similar to other free household benefit schemes operated by the Department of Social and Family Affairs. We do not intend to be prescriptive on what that income threshold should be, and recommend that the waiver system should have regard to the ability-to-pay criteria similar to the application of free units of electricity for those whose income is below a certain threshold.

In the period before metering is provided, during which our proposed flat charge is in place, the waiver should be based on setting aside an appropriate portion of the flat charge.

We consider that the cost of providing free units to consumers who qualify for a waiver should be met by local authorities and not centrally.

7.5 Phasing-in of water charges for the domestic sector

It will take some time for a metering system to be put in place on which water charges can be based. However, the re-introduction of water charges should in our view commence without undue delay. Pending the rolling out of meters to all domestic users, we consider that water charges should be phased in, to commence the recovery of the economic cost of water services to domestic users.

With regard to the phasing in period, we make the following observations:

- Water charges for domestic users should be phased in over a period of time. By the end of the period full economic costs of delivering water services should be recovered from users and be consistent with the objectives of the EU Water Framework Directive. The exception for full economic recovery should be for 'free scheme' recipients who should be exempt or partially exempt from water charges initially and receive a defined amount of free units once meters are installed
- The phasing-in period should coincide with the timeframe for the NDP capital investment programme, and exclude the recovery of capital costs for domestic users for that period
- During that period every effort should be made by local authorities to provide metering for all domestic housing units (and the non-domestic users that are not metered). The charging system should provide an incentive for users to install meters at as early a stage as is practicable. This could be provided through exempting, or part-exempting, users from a water charge for the year in which they install a meter, or offsetting the cost of the meter installation against the water charge
- Initially, water charges should be set at a low flat basic rate and be increased on a graduated basis over the phasing in period so that the basic flat charge equates, on an overall basis, to

full economic cost recovery at the end of the phasing in period. Users who convert to meters should be charged by reference to metered use (if this is lower than the basic charge). They should receive a discount on their volumetric bills if higher (measured against the basic flat charge) for a period, say one or two years, after the installation of the meter;

- It should be compulsory that water meters are installed in all new housing units.

7.6 Public information

For the re-introduction of water charges for domestic users to gain public acceptance it will be necessary for local authorities, and for central government, to make it clear to all water consumers through public information campaigns, the need for a water conservation mindset and what is being charged for and why it is necessary to charge. This campaign will need to set out how it is proposed to introduce a graduated system for water charges over a set period of time.

Recommendation 11.15

There should be some level of incentivisation to ensure that consumers are encouraged to install meters.

Recommendation 11.16

Charges should be phased in over a period of time.

Recommendation 11.17

The charging should commence with a flat rate charge and change to volumetric billing for consumers once meters are put in place.

Recommendation 11.18

A waiver scheme should be provided for low-income householders.

Recommendation 11.19

Water meters should be installed in all new housing units.

Recommendation 11.20

A public information campaign should clearly outline the rationale for water charges and the way in which they will be implemented.

7.7 Pricing

The cost of providing water services is subject to a range of local variable factors, such as the number of sources of water supply and the number of treatment plants and pumping stations required. Local authorities are currently required, when pricing water services for non-domestic customers, to recover the costs of providing the service to those customers. We believe that water pricing should be introduced for all water consumers by local authorities based on a consistent methodology and applying the principle of full cost recovery.

Recommendation 11.21

Water pricing should be introduced for all water consumers by local authorities based on a consistent methodology and applying the principle of full cost recovery.

Section 8:

Waste charges

8.1 Overview of waste collection services

Local authorities raise revenues in respect of waste management services by putting in place charges on consumers (domestic and commercial) for the collection and disposal of waste, where the local authority itself is the waste collector. Where waste collection is undertaken by a licensed waste management operator, the revenue and expenditure accrue to the private operator, with no involvement by the local authority.

Local authorities also raise revenues from gate charges at their own landfill sites. The revenue from the landfill levy does not accrue to local authority funds; it is directed to a central Environment Fund which is utilised for a range of purposes to improve the quality of our environment.

Encouraging change

Waste management activity by local authorities is financed by the charges imposed on occupiers of domestic and commercial premises, and the gate charges at landfills. We believe that cost recovery should not be the sine qua non of imposing waste charges. Encouraging behavioural change to ensure that all consumers manage waste in a more efficient manner, and that waste reduction is achieved in line with the principle of 'reduce, re-use and recycle' should – along with landfill minimisation targets – be a primary focus of waste charge rates.

The 1998 Policy Statement on Waste Management¹⁴ recognised that:

"Ireland's waste management infrastructure has been consistently under-resourced, and that significant capital investment will be necessary to achieve the radical improvements which are required".

The policy statement also pointed out that waste collection and disposal services provided by local authorities do not reflect the full economic costs of these services:

"Many households face relatively low waste charges, or no charges at all, while waste charges levied on commercial interests are often well below the true economic cost of managing their waste. Local authorities must move rapidly towards full cost recoupment for the waste services they provide."

Since 1998 the position has changed significantly. Indecon economic consultants estimated that cost recovery for waste collection services in Ireland is in the region of 80%, which is due to the introduction of waste charges. This is 'laudable' per the OECD, which points out that cost recovery is significantly lower in other OECD countries.

Waste charges are now in place in all local authority areas, with pay-by-use and pay-by-weight being the dominant forms of charging. We support continued efforts to secure further cost recovery to ensure that all consumers pay for their own waste.

Recommendation 11.22

The polluter pays principle should continue to underpin waste charges to ensure that all consumers pay for their own waste.

8.2 Levies and final disposal

While cost recovery for waste collection in Ireland is 'laudable', our efforts at recycling and diverting waste away from final disposal require serious attention and concerted action. In order to meet our obligations under the 1999 EU Landfill Directive, the target for bio-degradable waste (paper, food waste and garden waste) that must be diverted from landfill by 2013 is 1.7 million tonnes. The Comptroller and Auditor General in his 2005 Annual Report has raised the concern that, based on our performance to date, there is a significant risk that we will fail to meet the targets set by the Landfill Directive. If this is the case, financial penalties will apply. The latest National Waste Report from the Environmental Protection Agency (EPA) has further highlighted these concerns and has indicated that a degree of urgency is required if penalties are to be avoided.

In regard to the cost of final disposal, we note that there are cost recovery (capital and operating) and environmental costs associated also with incineration (and probably some of the other final disposal technologies being considered).

8.3 Conclusion

The landfill levy is one mechanism which can be utilised to encourage behaviour to divert waste away from landfill and meet our obligations under EU law. It should be increased so as to further encourage this behaviour. In the interests of economic efficiency final disposal charges should not favour any particular type of disposal and should be based on the sum of capital, operating and environmental costs imposed.

Recommendation 11.23

The landfill levy should be increased to encourage behaviour to divert waste away from landfill and meet our obligations under EU law and a similar mechanism should be considered for other forms of final disposal.

8.4 Privatisation of waste management services

The contracting out of waste collection services to the private sector has implications for local government financing, particularly in the provision of waivers for consumers on limited incomes. In general, waivers are not provided in local authority areas where the waste collection services are provided by the private sector. There are very few exceptions.

We are concerned about an approach that limits waivers to areas where waste is collected only by local authorities, as it breaches one of our guiding principles of equity. We note the formal investigation of complaints on this issue by the Ombudsman which found that:

"where somebody lives or who collects their rubbish should not determine whether they can get a waiver or how much of the charge is set aside".

The Ombudsman recommended that the appropriate legislation should be amended to provide for an

obligation on operators to provide waivers. We consider that waste collection charges, whether supplied by a private operator, or directly by a local authority, should factor in the cost of waiver provision.

The principle of an equitable incidence of taxation and a person's ability to pay are clearly challenged by the absence of waivers for people in certain areas. We take the view that nobody who should be entitled to a waiver on inability-to-pay criteria ought to be excluded on the basis of a lacuna in legislation. The relevant legislation should be amended immediately.

As part of its review of the Irish Public Service during 2007/2008¹⁵, the OECD carried out a case study, which reviewed the regulation and provision of municipal waste management services in Ireland. It identified that the shift from public service provision to an increased involvement of private enterprises in the waste management market raises concerns about the selective servicing of the most lucrative markets, and the delivery of environmental and social public goods¹⁶.

In the last decade or so, local authorities have increasingly ceded waste collection to the private sector, especially outside of the Dublin region. The OECD point out that the entry of the private sector into the waste collection area has been enabled, firstly, by the ability to charge user fees; and secondly, by a rise in quality standards driven by the EU, which has increased costs. This increase created an opportunity for the private sector to move where local authorities were either unwilling, or unable, to collect waste, particularly in non-urban areas.

We consider that where a public service obligation exists, then there should be no unequal treatment of citizens. The relevant legislation should be amended to ensure that all waste collection operators are obliged to provide waivers where appropriate.

The OECD case study on local waste management in the local government sector also pointed out that local authorities are incentivised to achieve returns on the landfills they own, by utilising existing landfill capacity as much as possible, regardless of national efficiency concerns or environmental targets such as waste minimisation or waste recycling.

Recommendation 11.24

Waivers should be available from all service providers in all local authority areas to all clients who lack an ability to pay.

8.5 A waiver system for water and waste charges

Some of the submissions from local authorities have asked us to consider the introduction of a national waiver scheme to fund the cost of waivers, where consumers are exempted from paying service charges if their income is below a certain threshold.

We consider that a waiver system should be put in place for service users. It should be based on ability-to-pay criteria, similar to – for example – the application of free units of electricity for those whose income is below a basic income threshold.

We looked at the question of whether or not a national waiver scheme should be introduced to

¹⁵ See OECD Public Management Reviews, Ireland: Towards an Integrated Public Service

¹⁶ It is estimated by the Irish Waste Management Association that annual revenues are now in the region of €1.5 billion. In recent years there has been significant consolidation in the private waste market with companies now offering services throughout the various stages of the waste chain (collection, disposal, recycling etc.). Rising fees coupled with the small geographically spread-out nature of the consumer base has encouraged the horizontal integration as larger operators acquire the businesses of smaller private operators. This process of consolidation is likely to continue. The potential for monopolies to develop within the waste sector may ultimately lead to higher charges and loss of choice for the consumer.

cover the cost to local authorities of providing waivers.

We believe that the management of revenue streams, including overseeing and funding waivers – whether they are from local services charges such as for waste and water services, or from taxation measures such as a local property tax – should remain fully within the ambit of each local authority. To dilute that responsibility by devolving it to a third party – such as the Department of Social and Family Affairs, as has been suggested – would weaken a local authority's control over the management of, and responsibility for, the revenue stream from each of these services.

For that reason the pricing framework for waste and water services should include a proportion which will fund the cost of providing services to consumers who qualify for a waiver. A central set of guidelines should be developed. We consider that a local authority should not find its cost recovery pricing framework disadvantaged because a large number of low income households are in its area. Within the guidelines which should be developed we propose that some element of equalisation funding should be available to compensate for a waiver provision in local authority areas with a high incidence of low income households.

Recommendation 11.25

We do not support the establishment of a national waiver scheme. The pricing of waste and water services should be designed to fund the cost of providing services to consumers who qualify for a waiver.

8.6 Tax relief on service charges

Tax relief is available for local service charges that are paid in full and on time, either by the person liable for them, or by another person who resides in the premises to which the service relates. It is provided whether the service fee is paid to a local authority or independent contractors.

The relief is given at the standard rate of tax for any service charges paid, including bin tags, in the previous year¹⁷. The cost of the relief will be considerable if water charges are introduced in line with our recommendations. The overall revenue from water and waste charges by the end of the transition phase for introducing water charges is likely to be more than €750 million. The tax expenditure, based on relief at the standard rate, would be €150 million per annum.

The relief was originally introduced in the Finance Act 1995 and gave effect to one of the undertakings in the then Government's policy agreement, "A Government of Renewal". We noted the speaking note provided for the then Minister for Finance for the Committee stage of the debate:

"As acknowledged in ["A Government of Renewal"] there is a strong feeling of inequity about service charges by many people. The allowance being provided for ... is envisaged as a short term measure until the question of the overall funding of local government can be resolved. It is also being granted in recognition of the fact that local charges are regarded by some persons as constituting double taxation."

¹⁷ The total tax relief that can be claimed for both fixed charge payments (including lift charges and pay-by-weight) and bin tags is subject to an overall limit of €400. 20% of this amount is allowed as a tax credit.

Recommendation 11.26

Tax relief on service charges should be abolished.

We consider that this short-term measure should now be brought to an end. The polluter pays principle should underpin the charging process for local authority services and should not be diluted by the provision of tax relief. If this was the case, there would also be a rationale for tax relief on other utility bills.

Section 9: Other means of financing local government

9.1 Planning fees

Planning fees charged by local authorities are set centrally by the Department of the Environment, Heritage and Local Government (DoEHLG). Local authorities have no discretion in the matter¹⁸.

The Indecon review of local government financing highlighted the chasm that exists between the cost of running the planning system and the revenue received in planning fees. The Department of the Environment, Heritage and Local Government estimates that when the full costs of the planning functions provided by local authorities are included, the average cost of processing an application for planning permission exceeds the average fee income by more than €1,500¹⁹.

In 2006 the estimated funding gap was just under €40 million, approximately 50% of the overall cost of the planning service²⁰. There is no relationship between planning costs and other related costs in the construction industry. The shortfall in funding is met from the general resources of local authorities.

A number of submissions raised this funding shortfall as an issue for us. The Green Paper also suggests that there is potential to recover more costs in this area.

The DoEHLG published a consultation paper, *Resourcing the Planning System*, which concludes that:

“Application fees charged in Ireland fall well short of those charged by our nearest neighbouring jurisdictions and significant shortfalls exist between fees charged and costs to planning authorities.”

By far the majority of planning fees come from the residential development area, specifically the construction of houses or domestic extensions. The consultation paper points out that during 2006, over 70,000 planning applications were made under this category. The current fee payable for an application for permission to build a new house is €65 (compared to €470 in the UK), while the fee for material alterations to a house is €34. As the consultation paper states:

“Such low charges mean that in a period of significant house price inflation and rising construction costs, the fee for delivery of the service which constitutes a critical stage in the construction of a house is barely equal to the cost of a few litres of paint.”

18 Section 246 of the Planning and Development Act 2000 sets out the powers of the Minister (of the DoEHLG) to set fees.

19 *Resourcing the Planning System – Consultation Paper*, May 2008, DoEHLG.

20 Per the Indecon Review of Local Government Financing.

The average cost of processing an application for a one-off house is estimated to be €489. We consider that this gap needs to be reduced through increased user charges.

We note that for very large developments a maximum fee of €38,000 is set for application fees with, in practice, developments of up to 10,550 square metres charged on a floor area basis, with fees for anything greater than this area capped at €38,000. We consider that large developments should not receive the benefit of such a cap.

The consultation paper proposed that some classes of planning fees be increased to a level that more adequately reflects the cost of providing the service. A minimum fee is also proposed for some classes of planning application.

The consultation paper proposed that fees should be increased, but not to a level which would allow for full economic cost recovery at this time – on the grounds that the widening gap between the cost of providing the planning service and the revenue received in application fees needs to be addressed. It recognised that to address the gap fully would require very significant increases (up to 750% in some cases), which could have major consequences for customers of the planning system.

An analysis of the planning income and expenditure for a selection of local authorities²¹ indicates that expenditure is greater than revenue for most of the councils reviewed, and that there is significant variation in the ratio of costs to income per planning application across the sector. This supports the proposal in the Consultation Paper that the widening gap between the cost of providing the planning service and the revenue received in application fees needs to be addressed.

We consider that an efficiency review of the cost of planning services is the appropriate way forward before consideration can be given to devolving the setting of planning fees from the Minister to local authorities.

However, we take the view that any future charging regime should have regard to wider issues including access to the appeals process on planning decisions, and the interaction of planning costs for developers and other charges that result from planning decisions, such as development levies.

- We have reservations about moving to full economic cost recovery for a number of reasons: Firstly, some of the fixed costs borne by local authority planning units provide general planning advice and services for which planning applicants should not be asked to bear the cost
- Secondly, there may be a significant impact on the costs to the construction and development sector which require further detailed examination
- Thirdly, further consideration needs to be given to what is an appropriate charging matrix for planning appeals, and whether it is equitable that planning applicants should be asked to fund some or all of the costs of appeals, particularly where some third party appeals may be technical, or have a public or common good interest, or are simply vexatious

Notwithstanding these reservations we consider that the funding gap outlined above needs to be considerably reduced and that this process should begin immediately. Setting an implementation period for the recovery of a higher proportion of planning costs would allow users of the planning service time to prepare for higher charges, and ensure the least possible impact on development patterns across Ireland and on competitiveness.

21 As set out in the Indecon Review of Local Government Financing.

Recommendation 11.27

Following an efficiency review:

- The Department of the Environment, Heritage and Local Government should develop a charging system in conjunction with local authorities to ensure a higher proportion of planning costs are recouped from planning applicants.
- Consideration should be given to devolving responsibility for setting planning fees from the Minister to local authorities subject to central guidelines being developed.

9.2 Housing rents

Rental income provides the main source of funding for the management and maintenance of the local authority housing stock. However, this revenue does not provide an income stream for local authorities to re-invest more money in the provision of more social housing, or for refurbishing or regenerating existing social housing stocks as the revenues from housing rents do not meet the cost of housing provision by local authorities.

Rental income from local authority housing is not linked to the market value of the property; it is linked to a tenant's ability to pay through a differential rent system. Since 1986 the power to determine rent levels was devolved to local authorities. However, the determination of the rent levels is still controlled to some extent by central government, through guidelines issued by DoEHLG. These require that rent levels should continue to reflect a tenant's ability to pay. However, there is considerable variation of the income per housing unit across local authorities.

The Housing (Miscellaneous Provisions) Act 2009 provides for more up-to-date guidance for local authorities in determining rent levels. It aims, according to the DoEHLG, to "eliminate some irrationality that has developed".

Our analysis was informed by the National Economic and Social Council (NESCC) review of housing policy in Ireland, which identified a number of issues regarding public rental policy for further analysis and debate²²:

- The current differential rental scheme for Irish social housing results in a continuing shortfall between rents collected, and the costs of maintenance and management.
- Adjusting rents to tenants' ability to pay has a major social value when, as is the case with local authority housing, tenants are concentrated at the lowest end of the income spectrum.
- The operation of the current differential rental scheme has a number of unintended drawbacks:
 - It constitutes a continuing drain on local authority resources rather than a financial asset. The stock is unable to generate a surplus for further investment (e.g. refurbishment and regeneration is dependent on securing separate funding) and a continuing dependence is created on central funding and decision-making.
 - The existence of maximum rent levels reduces the overall efficiency of the scheme, as higher income tenants benefit disproportionately.
 - Other possible inequities arise from the capping of rent contributions by subsidiary earners in a household, which makes it possible for multi-earner households to pay a much lower proportion of their income in rent than single earner households.

22 Housing in Ireland: Performance and Policy, NESCC Report No 112, November 2004.

- The failure to reflect the quality of, or demand for, particular dwellings in the calculation of rents leads to horizontal inequities; tenants with identical incomes and family circumstances can find themselves paying the same rent for dwellings whose locations or quality give a wholly different value.
- Inefficient pricing can arise as the age of houses largely determines maximum rent variations, while age is often poorly correlated with the overall quality of dwellings and the supply of, and demand for, different dwellings and locations.
- Finally, people in similar circumstances can also be treated very differently because of the county or borough in which they are renting. There is considerable variety in all aspects of rent calculation across local authorities, in the treatment of dependants and subsidiary earners, maximum rent limits and income banding.

NESC concluded that it is important, in the interests of both equity and efficiency, that rental policies across the range of long-term accommodation for social tenants are consistent. They should impose a fair rent, while reflecting the ability to pay. For all these reasons, NESC recommended that a review of the current differential rents policy be carried out to improve the sustainability and effectiveness of the current scheme. We note that the suggested review has not been undertaken to date.

The report by the NESC also indicated that local authority housing rents in Ireland receive a larger subsidy than public housing in other European countries. We recognise that ability to pay and the differential rent scheme is an important tool in improving social inclusion.

We also recognise that there may be sound reasons in some local authority areas why the income per housing unit is lower than an average:

- Where there is a high vacancy rate due to difficult social conditions
- Where a local authority has significant numbers of disadvantaged, and low income, households which give rise to much lower rent charges

However, given the significant capital investment being made in social housing, we believe that concerted action is needed to ensure that the disparities in income per unit across local authorities are reduced. These issues should be examined as part of the on-going review of housing policy.

We consider that there must be no deviation from the policy of basing housing rents on a tenant's ability to pay. The situations where higher income tenants and households which have subsidiary earners benefit from the existence of maximum rent levels needs to be reviewed to ensure that they do not benefit disproportionately.

The gap between rents collected and the cost of maintenance of houses and management of estates is an issue which, from a local government financing perspective, merits detailed examination - particularly in view of the unintended drawbacks identified in the NESC review.

Recommendation 11.28

There should be no deviation from the policy that housing rents are based on a person's ability to pay. Maximum rent levels should be removed to ensure that some tenants and households do not benefit disproportionately.

Recommendation 11.29

A review of the current differential rents scheme should be carried out to improve the sustainability and effectiveness of the scheme, as previously recommended by NESC.

Recommendation 11.30

The significant disparity across local authorities between rents collected on an income per housing unit basis should be addressed without delay with a view to elimination.

Section 10: The balance of local government financing and the equalisation of funding

10.1 Introduction

The Green Paper on Local Government has as a central theme the idea that local government can deliver more if equipped to do so. The paper identifies autonomy in fundraising as one way in which local authority discretion and accountability can be increased. However, the Green Paper also points out that there is little consensus on how such autonomy should be achieved. This goes to the heart of whether, and how, the balance of funding should be changed to reflect the ideals of the Green Paper that local government can deliver more if equipped to do so.

This Section of our Report sets out the existing position and how, in broad terms, our recommendations will change the balance of funding.

10.2 The present balance of current funding

The balance between nationally provided and locally collected sources of income for local government current financing was broadly as follows in 2008:

Table 11.3: Local government sources of financing

	2007	2008
Commercial rates	€1.344	27%
Receipts for own goods and services	€1.403	28%
Local government fund	€0.999	20%
Government grants and subsidies ²³	€1.272	25%
Total	€5.018	100%

In general, local authorities' source around 55% of their overall current income from their own generated resources such as: commercial rates, housing rents and receipts for goods and services, such as waste charges and also water charges from the commercial sector. The share of local authority budgeted income provided directly by the State amounted to just over €2 billion – or 45% of total current income.

However, overall figures mask considerable variation between local authorities as to their sources of income. The following table indicates that city and town councils are far less reliant than most

23 Of which approximately €180 million relates to higher education grants funded by the Department of Education and Science and paid out by local authorities to grant recipients. This funding cannot be used by local authorities for any other purposes.

county councils on revenue generated from the central government. This reflects the fact that large city councils, such as Dublin and Cork have very strong economic bases from which healthy commercial rates revenue streams can be generated.

Table 11.4: Breakdown by local authority type

2007	County Councils %	City Councils %	Borough Councils %	Town Councils %	Total %
Commercial rates	22.0	35.8	37.0	40.1	26.8
Receipts for own goods and services	26.1	30.8	35.3	30.6	27.7
Local government fund	22.4	13.5	17.7	21.1	20.0
Government grants and subsidies	29.5	19.9	10.0	8.3	25.5
	100	100	100	100	100

10.3 Commercial rates

Commercial rates – which are a form of taxation on property – are a local source of income, over which local authorities have a considerable measure of control. Rates are levied annually by county, city, borough and certain town councils. Each of these authorities has exclusive rating jurisdiction within its own area.

If accepted, our recommendations on the broadening of the rates base will mean, on an overall basis, that local government funding from this source will increase in the order of €80 – €90 million.

This is broken down as follows:

Table 11.5: Additional own resources from broadening the commercial rates base

	Estimated Revenues
Rating State properties	€50 million +
Rating vacant properties	€20 million
Rating offshore structures	€ minimal
Rating B&B, guesthouses and self-catering	€3 million*
Farm buildings owned by corporates	€ minimal
Part-rate third level and professional educational institutions	€10 million
Part-rating of community halls	€ minimal

* Tentatively estimated at €3 million plus

Note: If our recommendations are accepted future revenues from some of the base broadening measures above will be minimal. Factors other than revenue raising underpinned those recommendations. For example, rating offshore structures such as wind-farms puts them in the same rating position as onshore wind farms. Part-rating community halls puts them in same rating position as local businesses carrying on similar commercial activity.

10.4 Receipts for own goods and services

Local authorities charge for the services they provide, for example: commercial water charges; housing rents, waste charges, parking charges and planning application fees. In most cases the

charge or fee is set locally. However, certain charges or fees, such as planning fees, are fixed at national level²⁴.

Our focus on increasing own resources from user charges, particularly water charges, will mean a very significant increase in income under this heading. This will impact on the overall balance of local government financing. We estimate the potential increased resources in this area to be in the order of €500 million at the end of our suggested transition period for the provision of full water charges – see Table 11.6. Subject to the outcome of the proposed review of the housing rents scheme, the charges involved should be decided on at local level, bearing in mind the principle that they should be based on the recovery of full economic costs and having regard to the development of a framework for water pricing.

Table 11.6: Additional own resource income from increasing user and service charges

	€million
Full water charges on all domestic users	€450 million
Full cost recovery for water services to non-domestic sector	€58 million
Full economic cost recovery of waste charges*	
Planning fees	up to €40 million
Housing rents	subject to further review

* We are not giving an estimate for additional income from this source as any estimate may change if, as has been the case, local authorities continue to cede waste collection to the private sector.

10.5 Local government fund

The Local Government Fund (LGF) for general purpose grants was established in 1993 and is funded from the following sources:

- An Exchequer contribution
- The full proceeds of motor tax, and
- Bank interest

The general purpose grants are the Government's contribution towards the cost to local authorities of providing their day-to-day services.

For 2009, it is envisaged that the LGF will comprise a €520 million contribution from the Exchequer; €1.085 billion from motor taxation receipts, with a small balance of €4 million accruing from interest on LGF funding invested with the National Treasury Management Agency. In addition, Budget 2009 provided for a new revenue stream to accrue to the LGF from an annual €200 charge on non-principal private residences. It will be levied and collected by local authorities, and used to contribute to Exchequer funding to local authorities for operational costs. The Budget 2009 estimate of revenue from this source was €40 million in a full year.

24 We mention in Part 3 of our Report that, in a Judgement delivered on 16 July 2009, the European Court of Justice ruled that Ireland was in contravention of Council Directive 2006/112/EC (Case C-554/07) in not having a general requirement that public authorities be subject to VAT where they were engaged otherwise than in their capacity as a public authority. We note that this ruling has implications for a wide range of services provided by local authorities, such as waste collection, car parking and recreation and amenity services.

For 2008 the Local Government Fund income was distributed as follows:

Table 11.7: Distribution of local government fund income 2008

	€million
General purpose grants	€999 million
Non-national roads payments	€565 million
Other miscellaneous payments	€80 million

Our focus on increasing own resources from user charges and on broadening the rates base will mean that there should be less reliance on the Local Government Fund as a source of financing for local government.

10.6 An annual property tax as a source of local government financing

Our recommendation that all of the revenues from an annual property tax (APT) - once it becomes established as a nationally administered tax by the Revenue Commissioners – should be used for the future financing of local government, will bring about a structural change in the financing of the local government sector. In conjunction with our other recommendations on local government financing it will provide the potential for local government to be financed primarily from own resource income – see Table 11.8.

We conclude that the taxation of motor vehicles, and the national environmental policy underpinning that tax base (reducing carbon emissions), is more appropriate to a national taxation system, the revenues from which should be directed to central government and that the proposed APT should become a source of local government financing.

By way of illustration, the impact of our proposed changes to the 2008 local government financing (annual property tax should it yield approximately €1 billion per annum, water charges for domestic users and increased revenues from water charges from the non-domestic sector, other increased user charges and a broader commercial rates base) funding base will mean a significant restructuring of the funding base when all the financing options we recommend are implemented – which should be by no later than the end of 2014 in our view.

Table 11.8 – The financing mix of local government financing in 2008 and after our recommendations are implemented in 2014 using 2008 as a base year.

		€billion 2008	%	€billion 2014	%
1	Commercial Rates	€1.344	27%	1.427	28%
2	Receipts for Own Goods and Services	€1.403	28%	1.951	39%
3	Local Government Fund – General purpose grants – <i>from APT</i>	€0.999	20%	1.0	20%
4	Government Grants and Subsidies (including €550m from D/Transport for local and regional roads, c€170 million for higher education grants <i>and an amount for an equalisation fund which could be transferred from the LGF line above</i>)	€1.272	25%	0.64	13%
	TOTAL	€5.018	100	€5.018	100

Note 1: The first three categories could then be classified as own resource income as all are derived from user charges or local property taxation in its two forms: commercial rates and annual property tax. Local property taxation has the potential to contribute almost half of local government financing, with user charges contributing almost 40%. There may be no need for a LGF classification going forward.

Note 2: The question arises as to how central government stamp duty revenues would be replaced if all of APT revenues are used for local government financing? We propose that APT revenues (should they have a projected yield of €1 billion or more) could replace motor taxation revenues as a source of local government financing. This would still leave a 'gap' of about €500 million. This gap arises from the loss of the previous stamp duty yield (other than the 'windfall gains' that arose from stamp duty in the 2003 – 2007 period in particular). In effect the possible yield from water charges – about €500 million - reduces the reliance, by that amount, on the central Exchequer for direct government grants and subsidies and effectively fills the 'gap'.

Our recommendations mean:

- **Water charges** – at present there is an unidentified water services allocation on the general purpose grants allocation which would not be required once full water charges are in place at the end of the five-year transition period recommended by us.
- **Rating State-occupied properties** – the contribution in lieu of rates, estimated at €35 million, would no longer be required from this source of funding. (However, if State properties are to be subject to full rates charges, as recommended by us, some additional funding from Exchequer resources may be required to enable the public body occupying the State property to meet the rates charge.)
- **Planning fees** – the funding gap of €40 million that arises from the relatively low planning fees that are in place, is met from the general resources of local authorities. These resources are funded in part from the general purposes grant provided for by the LGF. This can also be reduced.

10.7 Government grants and subsidies

Government grants and subsidies to local authorities are paid by a number of Government departments, including the DoEHLG. The most significant are:

- **Grants for road works:** these are categorised into national and non-national roads. For national roads, funding is provided by the Department of Transport to the National Roads Authority, which then determines the allocations to local authorities for improvement and maintenance work on roads.
- **Grants for water supply and sewage schemes:** These grants cover the approved costs of major water supply and waste water schemes undertaken under the Water and Sewage Investment Programmes. Some of this funding is provided by the Department of Community, Rural and Gaeltacht Affairs.
- **Grants for housing:** the major grants are for local authority housing construction, remedial works, voluntary housing and traveller accommodation.
- **Higher education grants** – for which funding of approximately €180 million is provided by the Department of Education and Science.
- **Civil defence** – for which funding is provided by the Department of Defence.

Our recommendations will have little or no impact on this source of central government local authority funding.

10.8 The equalisation of funding and the needs and resources model

The Department of the Environment, Heritage and Local Government developed a Needs and Resources Model in 2000 to ensure that the allocation of general purpose grants to local authorities from the LGF is done on an equitable and transparent basis. A number of submissions to us from local authorities have suggested changes to this funding model.

It is appropriate that central government should have a role in ensuring that local authorities with weaker economic bases have access to a pool of funding which helps to equalise their funding position vis-à-vis local authorities with stronger economic bases. Similar equalisation procedures are also found in other jurisdictions.

The aim of the model is to bring about equalisation between local authorities over time, so that each will have sufficient resources from a combination of central grants and local income, to provide an acceptable level of services to their customers. The Lyons Review of local government finance in the UK²⁵ put it well: “it is important to ensure that communities with high levels of socio-economic need and low tax raising abilities are not left behind”.

Amendments and refinements are made to the model each year following consultations with local authorities to ensure that the unit costs and unit incomes in the model reasonably reflect local authority cost bases.

We understand from DoEHLG that the model was independently evaluated to verify its approach and to guide its further development. The findings of this evaluation confirmed that the principles of the model are sound and reasonable.

A further review of the model is underway to reflect the differences in the cost bases of individual local authorities, using the improved financial reporting systems that are now in place. Ongoing periodic review and evaluation of the model is appropriate. Local authorities themselves should be part of that review and evaluation process. A more comprehensive review of the model will be

25 Lyons Inquiry into Local Government – Final report, March 2007, HMSO.

required if our recommendation that the revenues from an annual property tax be used as a source of local government financing is accepted and implemented.

Recommendation 11.31

The Needs and Resource Model should be periodically reviewed and evaluated to ensure that the difference in the costs bases of local authorities are reflected in relevant decisions by central government on equalisation funding. The reviews should be undertaken in partnership with local authorities.

10.9 Efficiencies and shared services

The recent OECD review of the Irish public service²⁶ pointed out that:

“Local Government seems to provide a good example of using shared services in the Irish public service. This is mainly because the Local Government Computer Services Board, a separate and independent organisation, provides a centre of competence with aggregated buying power and represents a critical mass for standardisation. The rest of the Irish public service, however, has been slow to catch on.”

The OECD went on to point out that the Local Government Computer Services Board is very progressive in information, communications and technology (ICT) and the development and provision of shared services and works closely with a range of central government bodies.

The social partnership agreement, Towards 2016, also commented on the “marked progress” throughout the local government sector in implementing change and modernisation programmes in areas that include enhanced customer service and the adaptation of technology and flexible working arrangements. The agreement pointed out that: “there is a growing ease of personal and technological access to ongoing developments in areas such as environment, planning and registration processes”.

The Indecon review of local government financing made a number of recommendations which focused on efficiency improvements in local authority expenditure programmes, which were combined with reforms in the methods of funding of local authorities - particularly through more effective charging and additional local funding sources.

We consider that the introduction of water charges to the domestic sector (and non-domestic users not currently charged) provides a huge incentive for local authorities to more quickly address water leakage rates, which are at an unacceptable level. Efficiency gains have been achieved where metering has been provided both through the identification of leaks and damaged pipes, and more economic water usage. We also believe that the provision of charges based on recovering further economic costs in the planning area has the potential to secure further efficiencies in that service. It may also be an area where shared services between local authority areas could be more actively explored.

As Indecon also pointed out, the revenue collection activities of local authorities should be examined in order to ascertain whether the sharing of resources between local authorities could achieve more efficiency gains.

26 OECD Public Management Reviews, Ireland – Towards an Integrated Public Service, 2008

We support the approach taken in the Report of the Taskforce on the Public Service²⁷ that the use of shared approaches, whether in-sourced, outsourced or co-sourced, should be prioritised for areas such as:

- Data centre facilities.
- Services for civil and public service bodies.
- Shared payroll systems.
- The administration of performance management systems.
- Training, upskilling and certification of personnel in the civil and public service.

The Taskforce identified the use of shared services in HR, Finance, Procurement and ICT as a way to achieve potential benefits to achieve such outcomes as:

- Economies of scale
- Tangible service improvements
- The enhancement of reporting and accountability
- The standardisation of processes and reporting across the Public Service.

We consider that the approach set out by the Taskforce should be wholeheartedly endorsed by the local authority sector and guided, where appropriate, by the sector working with the Department of the Environment, Heritage and Local Government.

We are conscious that local authorities are continually exploring ways to achieve further efficiency gains and cost-saving measures and that they are committed to realising the potential for shared services, as outlined in Towards 2016, in areas identified by the Taskforce and in areas such as, waste management, water treatment plants, procurement and data capture.

Recommendation 11.32

The initiatives being undertaken to improve efficiencies in local authority expenditure programmes should continue to receive a priority focus at local authority level and from central government. That priority will be assisted by the new standardised costing system which provides for greater benchmarking of local authority performance.

27 Report of the Taskforce on the Public Sector: "Transforming Public Services - Citizen Centred – Performance Focused", November 2008, Department of the Taoiseach.

Appendix 1

Unaccounted for Water (UFW)				
Local Authority	2007 UFW %	2008 UFW %	Medium Term Target %	Long Term Target%
Carlow	49	49	37	25
Cavan	54	42	30	22
Clare	48	48	36	27
Cork City	55	55	49	30
Cork County	50	50	27	27
Donegal	50	50	45	40
Dublin City	37	37	30	22
Dun Laoghaire/Rathdown County	20	24	20	20
Fingal	23	23	20	15
Galway City	54	52	40	20
Galway County	64	64	45	30
Kerry	54	53	48	43
Kildare	26	26	24	22
Kilkenny	60	60	35	25
Laois	53	53	38	25
Leitrim	37	37	–	–
Limerick City	42	42	40	20
Limerick County	38	22	–	–
Longford	44	42	40	20
Louth	47	47	30	30
Mayo	45	45	30	25
Meath	48	44	40	30
Monaghan	46	43	30	25
North Tipperary	50	50	40	30
Offaly	53	51	45	30
Roscommon	64	60	50	35
Sligo	55	50	45	35

Unaccounted for Water (UFW)				
Local Authority	2007 UFW %	2008 UFW %	Medium Term Target %	Long Term Target%
South Dublin	17	18	18	16
South Tipperary	65	65	50	35
Waterford City	46	41	37	34
Waterford County	41	41	35	25
Westmeath	41	39	33	23
Wexford	39	39	35	25
Wicklow	26	26	26	22
Average	45	44		

Source: Local Authorities