

Regulatory Impact Statement

Earning Capacity Rents for Crown Pastoral Leases

Agency Disclosure Statement

This Regulatory Impact Statement has been prepared by Land Information New Zealand (LINZ). It provides an analysis of options to implement the Cabinet agreed policy for earning capacity rents for Crown pastoral leases (CPLs).

Earning capacity rent for Crown pastoral leases: report to Ministers

Officials from LINZ and the Ministry of Agriculture and Forestry (MAF) prepared a report *Earning Capacity Rent for Crown Pastoral Leases* ("the ECR report"). The ECR report addresses many of the substantive issues required by a RIS and this RIS refers to the ECR report in areas rather than repeat the same information. The ECR report is available on the LINZ website¹.

Key assumptions

The ECR report and the Status Quo in this RIS assume that the decision in the *Commissioner of Crown Lands v Minaret Station Ltd* is correct in terms of the finding that:

- (a) rent should relate to the lease used for pastoral farming; and
- (b) intrinsic (land) amenity values are not to be taken into account when determining rent for CPLs.

The analysis in the ECR report was assisted by the creation of a model that showed possible rents under both the current system and the new system. The modelling in the ECR report is subject to the following caveats:

- The modelling used a representative current stock number that is not exactly the same as what will be used under the new system. Officials expect a high degree of correlation between the two numbers.
- The modelling extrapolated a detailed analysis of original stock numbers for 13 representative leases across the entire CPL estate. The new system will require detailed analysis of the original stock carrying capacity across all the CPL estate, and officials expect some differences between the early figures and the subsequent figures.

¹ <http://www.linz.govt.nz/crown-property/pastoral-land-tenure-review/index.aspx>

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- The value of the factor to recognise the development potential of a CPL was assumed to be 0.1. Subsequent policy decisions by Ministers (advised by officials) have set the value of the factor at 0.15.

Further work required

Further policy decisions are required on two final details of the earning capacity rent policy.

The ECR report recognised the need to determine an economically based rental rate per stock unit, and expressed an early analysis of what this could be based on. A detailed analysis of how to determine a rental rate per stock unit is currently being undertaken.

The ECR report also recognised the need for a modern alternative dispute resolution (ADR) process. Officials have not been able to complete the analysis of the best ADR process, and officials will need to assess the impacts of moving to an ADR process.

The Cabinet paper this RIS is attached to notes these final details and recommends that Cabinet delegate final policy approval on both of the final points to the South Island High Country Ministers for the rental rate formula and South Island High Country Ministers and the Minister of Justice for the alternative dispute resolution process.

The earning capacity rent policy decisions will not:

- impair private property rights, market competition, or the incentives on businesses to innovate and invest, or
- override fundamental common law principles.

Under the proposal, business costs (including rents and other associated compliance costs) are likely to reduce for the average CPL.

Whilst overall rents under the preferred option will be at similar levels to what can be expected under the current system, some lessees will pay higher rents and other lessees will pay lower rents. Overall equity between lessees (in terms of rent paid) will be maintained.

This RIS was prepared by David Kelliher, Senior Policy Analyst, Land Information New Zealand.

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Status quo and problem definition

Rent for Crown Pastoral leases is based on the unimproved value of the land and is set every 11 years. The legislative framework for this is set out in sections 131-137 of the Land Act 1948 and sections 6-8 of the Crown Pastoral Land Act 1948.

On 27 July 2009, Cabinet agreed that “lessees of Crown pastoral land will be charged rent on the basis of the earning capacity of the property”.

The problem with the status quo is that calculation of pastoral lease rent is complex, costly, time consuming, uncertain, and highly subjective. Unimproved land value does not effectively connect to earning capacity.

Detailed information on the problems and costs associated with the status quo is set out in Chapter 5 of the ECR report *Earning capacity rents for Crown pastoral leases*.

Objectives

The objective of the policy proposal is to efficiently and effectively implement Cabinet’s agreed policy to charge CPL lessees rents based on the earning capacity of their property that are objective and certain .

The criteria for assessment and the results of the assessment are set out in the ECR report at page 2.

Regulatory impact analysis

There are 3 options for achieving the objectives:

- option 1 – current system (detailed in Chapter 5 of the ECR report);
- option 2 – improved version of current system (detailed in Chapter 5 of the ECR report); and
- option 3 – preferred - production based system (detailed in Chapters 1 and 6 of the ECR report).

All three options have broadly neutral impacts on rent revenue collected. The key features and impacts of each option are set out in ECR report. Additional information on the preferred option is set out below:

Rent Setting System

Under the preferred option rent will be set by looking at two distinct factors: the production of the CPL and the current farming economy:

The production of the CPL will be measured in two parts (using standardised stock units):

Part 1 – the unimproved carrying capacity of the lease; and:

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Part 2 - the current carrying capacity (developed state) of the lease in the hands of an average efficient farmer

A fixed portion (0.15) of the difference between Part 1 and Part 2 will be assigned to the development platform that the Crown has provided to the pastoral lease (See ECR report glossary).

The stock units for Part 1 and 15% of the stock units for Part 2 will be added to get the total stock units for rent setting purposes.

This figure will then be multiplied by an economically derived rent per stock unit figure (\$ per stock unit).

The resulting figure will be rent.

Cost and revenue impacts

The modelled effects of the proposed new system show that, overall, there is both horizontal equity (i.e. similar leases paying similar rents) and vertical equity (i.e. similar rent levels to rents that would be charged under the current system in future).

The modelling is not accurate enough to predict the exact effects on any given lease. This may mean that there are some lessees who pay markedly different rent levels under the proposed new system than under the current system.

We consider that any possible negative effects on horizontal and vertical equity are likely to be small and will be offset by the certainty and lower compliance costs of the proposed new system.

Lessees will benefit from greater certainty of rent levels that are explicitly related to economic conditions. They will be better able to plan their business models as their rent review approaches. Lessees will also share in the benefits of a cheaper and faster system and a better dispute resolution process.

We estimate that over one 11 year rental cycle the Crown will save about \$1.2M because of cheaper rental assessment requirements alone. Added to this will be the costs saved from avoiding litigation by more use of alternative dispute resolution systems. The latter is impossible to quantify — but as an example the Minaret Station case would have had a combined cost to the Crown and lessees of over \$1M. The Crown's general relationship with lessees would correspondingly improve.

Rent review period

To further reduce any financial risks to the Crown, officials have considered whether to increase the frequency of rent reviews. The current system has a rent review period of 11 years. We have considered the possibility of increasing the frequency of rent reviews as the proposed system is highly suitable to a shorter rent review period.

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Increasing the frequency of rent reviews would be a substantive change to the nature of a pastoral lease. Changing the nature of the lease in this way would almost certainly result in calls for compensation from lessees. We therefore consider that the risks of changing the frequency of rent reviews would outweigh any benefits.

Over time, land values fluctuate significantly more than wider economic conditions. The proposed system will set rents based directly on economic conditions for pastoral farming rather than involving land value calculations. There is therefore significantly less financial risk to the Crown from differences between economic conditions at the start of the review period and economic conditions at the end of the review period (compared to differences in land values).

Consultation

Officials from LINZ and MAF consulted the High Country Accord. The Accord is a pastoral lessee representation group representing a majority of pastoral lessees. The Accord, through a dedicated sub-committee, has consulted widely amongst its constituency however the Accord has **no** ability to bind individual leaseholders.

Details of the consultation process are set out in the ECR report on page 17.

The High Country Accord agrees in principle with the proposals contained in the Cabinet paper. Particularly the High Country Accord agrees with the use of a fixed factor to recognise the platform for development that the lease provides.

The High Country Accord, however, disagrees with using a value of 0.15 to recognise the platform for development. The Accord argues for a factor of 0.1. Ministers were presented with information supporting both values and decided on the use of 0.15.

The consultation was limited to lessees as rent arrangements are an agreement between two parties – the Crown and lessees. Rent arrangements are separate to issues of land management. Land Management issues are dealt with separately in the Land Act and the Crown Pastoral Land Act.

The Ministry of Agriculture and Forestry, Department of Conservation and the Treasury were consulted on this RIS. The Ministry of Justice, the State Services Commission and the Department of Prime Minister and Cabinet were informed of this paper.

Conclusions and recommendations

The conclusion of the ECR report and this RIS is that a new system for setting CPL rents in option 3 be implemented. The rationale for this conclusion is set out in the ECR report.

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Implementation

The proposed new rent setting system will be given effect by amendments to the Crown Pastoral Land Act 1998. Secondary and tertiary legislation (rules and guidelines) will also be required from the Valuer-General. There is currently no subordinate legislation for setting CPL rents.

The new rent system will apply to all pastoral leases where the rent review date is after the date the legislation comes into force. The legislation will also provide for a voluntary opt-in clause to allow lessees who are currently disputing their rent under the current system to voluntarily select to have their rent set under this system.

Land Information New Zealand has set up a dedicated project team to reduce compliance costs to lessees of the new system, including providing adequate information and notice to lessees. This dedicated project team will also mitigate any risks of implementing the new system. The early work on implementing the new system will feed into the legislative design. This will ensure that risks are captured and mitigated before the legislation is set.

There is no need for a specific enforcement strategy beyond the inclusion of the new rent setting system into the business-as-usual work programme for LINZ. CPL rents are required to be set every 11 years and this will continue under the new system.

Monitoring, evaluation and review

LINZ will monitor the effectiveness of the new system by looking at the following measures:

- the business-as-usual costs of the new system (expected to decrease);
- the number of CPLs disputing rental assessments (expected to decrease);
- the costs associated with settling disputed rental assessments (expected to decrease).

LINZ will collect this data in the course of standard business reporting.

There are no plans to proactively review the primary legislation. LINZ expects that any issues with the effectiveness of the system will be picked up in the monitoring outlined above. LINZ also expects that lessees and representative groups will advise of any issues that they feel need to be addressed. A reactive review may be required based on the results of the monitoring and feedback.

The subordinate legislation will be reviewed as part of the ongoing LINZ regulatory scan under the Government's Regulatory Review Programme.