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Office of the Minister for Land Information

Cabinet Domestic Policy Committee

CROWN PASTORAL LEASES – POLICY FOR TIME PAYMENT OF BACK-RENT

Proposal

1. This paper requests Cabinet's agreement to a time payment policy for back-rent associated with Crown pastoral leases. This will enable the Commissioner of Crown Lands (CCL), in cases of significant financial hardship, to offer lessees the option of paying back-rent over a period of up to five years. The proposal in this paper is to be read with the proposal in the companion paper: *Crown Pastoral Leases — Earning Capacity Rents*.

Executive Summary

2. Over the last five years there have been larger than expected rental increases for high country pastoral leases; in part caused by the previous Government's change in the land valuation policy for intrinsic amenity values. These increases have resulted in almost half of all high country pastoral leases being referred to the Land Valuation Tribunal (LVT) for determination. This has caused a significant delay in finalisation of pastoral lease rent reviews.
3. When a new rental value is determined it is effective from the beginning of the rent review period; this results in lessees owing back-rent over multiple years. Back-rent may cause hardship and the preferred option is to enable the CCL to offer lessees, in significant financial hardship due to back-rent, the option of paying back-rent over up to five years.
4. A non-departmental capital expenditure appropriation will be required. Cabinet has previously agreed to a capital contingency of \$3 million for Crown pastoral lease time payment back-rents for 2010/11 [Cab Min (10) 13/4(31)].

Background

5. Pastoral leases are perpetually renewable 33 year leases of South Island pastoral land which were introduced by the Land Act 1948.¹ The leases include obligations associated with sustainable management of the land. The rent setting provisions for pastoral leases are set out in Part 1 of the Crown Pastoral Land Act 1998, which refers back to Part 8 of the Land Act 1948.
6. Pastoral lease rents are set once every 11 years at a rate of 2.25% of the value of the land exclusive of any improvements (VLEI). Lessees are required to pay the rent half-yearly in advance, and the rent is reduced to 2% of the VLEI if paid within one month of being invoiced.

¹ Although the pastoral leases were formally introduced in 1948, the land in question has been used for pastoral purposes since the 1850s.

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7. Before the start of the 11 year rent cycle the CCL issues a notice to affected pastoral lessees detailing the revised VLEI and the resulting new rent. A lessee has three months to either accept the new rent or advise that they wish the LVT to determine the VLEI used to calculate the rent. Until the rental values have been finally determined rent continues to be charged at the previously determined level (i.e. the rate previously set 11 years ago).

Finalisation of Pastoral Lease Rents

8. The VLEI of many pastoral leases has increased significantly in the last 20 years with a corresponding rent increase at the review date. In the last five years 113 lessees requested that their VLEI be reviewed by the LVT. This increase in the volume of reviews is related, in part, to the previous Government's change in policy to intrinsic amenity values associated with the land. The Crown and lessee representatives took Minaret Station VLEI review as a test case to the LVT to clarify the interpretation of the rent setting provisions of the Acts. The LVT decision in the case was delivered on 31 July 2009 and the Crown has lodged a partial appeal to the High Court.
9. In July 2009, Cabinet agreed that the Government's desired outcome for Crown pastoral land is that Crown pastoral land is put to the best use for New Zealand and that lessees of Crown pastoral land are charged rent on the basis of the earning capacity of the property [CAB Min (09) 26/7C]. Cabinet is currently considering advice on the implementation of this policy.
10. Regardless of the method used for setting future pastoral lease rent the lessees who have applied for a review will face back-rent when the review is complete.

Back-rent

11. Once rental values are determined they are effective from the 11 year review date regardless of the actual date of determination. The combination of likely increases in rental values and application of these values from the 11 year review date will result in affected lessees owing the Crown various amounts for rent between the rent review date and the date at which rental values are finally determined (i.e. "back-rent").
12. It is impossible to precisely quantify back-rent as the appeal of the LVT decision has not been heard, the impact of any appeal of the test case on all LVT reviews cannot be quantified, and the Government's new policy for setting pastoral lease rents according to earning capacity is in the process of being finalised. However, it is likely that back-rent will be a significant sum for many pastoral leases; for a limited number of leases there will be up to eight years of back-rent owing. Land Information New Zealand (LINZ) estimates that back-rent could reach a maximum of \$3 million, with an average of \$27,000 per lease. A small number of lessees are likely to owe back-rent in excess of \$100,000.
13. There may be cases of significant financial hardship because of back-rent. LINZ has not engaged with lessees on this issue and has no reliable basis for assessing what percentage of lessees might face significant financial hardship.

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14. There is also a risk that the back-rent burden on lessees might affect the sustainable management of the land that is required by the lease, and the level of land stewardship may fall.

Options to Address Significant Financial Hardship from Back-Rent

15. LINZ officials identified four options for addressing significant financial hardship associated with back-rent:
 - a. Status quo;
 - b. Time payment of back-rent;
 - c. Collect rent at levels set at previous rent review; or
 - d. Collect rent at earning capacity based rent levels.

Option A - Status quo

16. Under the status quo lessees are required to pay back-rent in full once the review values have been set. The rationale for this option is it reflects the existing lease agreement and lessees have been aware that back-rent will need to be paid on completion of the review.
17. The rationale above does not take into account the unusual factors of this situation. The resolution of the valuation issues associated with intrinsic amenity values has taken significantly longer than anticipated and determining the *Minaret* appeal is only a starting point for the resolution of other cases.
18. It is likely that a demand to pay back-rent immediately would result in a level of defaulting payments. Pastoral lessees may see this option as a land grab, by either forcing lessees to come to hasty tenure review conclusions in order to pay back-rent or by forfeiture of the lease for non-payment.²
19. This option requires no policy implementation. But it is likely to require a future policy decision on the approach to take to defaulting lessees.
20. The Crown has committed to improving the relationship with lessees and Option A will not assist with that goal.

Option B - Time payment of back-rent

21. Option B is the preferred option and is recommended.
22. Option B will continue to set and collect rents as required by the Crown Pastoral Land Act 1998, or any new system as appropriate, while allowing lessees suffering significant financial hardship to pay any back-rent over a period of time. This option will decrease the immediate pressure on lessees from back-rent which was, in part, exacerbated by the previous Government's policy on intrinsic amenity values. This option will go some way to re-building the

² Tenure Review is a voluntary process entered into by the Crown and the lessee to negotiate the freehold of some of the land and the return of some of the land to full Crown ownership.

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relationship between the Crown and lessees and enable affected lessees to continue maintaining the land.

23. Time payment of back-rent does not require any legislative amendment, strikes a balance between the Crown's and lessees' interests, and provides a high degree of certainty. It is simpler to implement than the alternatives and is consistent with the Crown's strategic direction for Crown pastoral land. The CCL is in a good position to assess the financial circumstances for each lessee and offer on a case by case basis the proposed time payment option.
Implementation of Time Payment Policy
24. If Cabinet agrees to the time payment policy there are a number of decisions required to enable the CCL to implement the policy.
25. The CCL would require confirmation from the Minister of Finance that the time payment option is necessary or expedient in the public interest to do so as the time payment option is a loan under the Public Finance Act 1989. The Minister of Finance may lend money if it appears to the Minister to be necessary or expedient in the public interest to do so.
26. It is expedient in the public interest to lend money to lessees as the Crown contributed to the delay in rent reviews, the Crown has an interest in farmers maintaining good land stewardship and the loan provides an efficient collection mechanism for possible outstanding back-rent.
27. I recommend that Cabinet invite the Minister of Finance:
 - a. To approve the time payment of back-rents as expedient in the public interest for the purposes of s.65L of the Public Finance Act 1989; and
 - b. To delegate the authority to approve individual time payment agreements to the Secretary of the Treasury and allow further delegation to the CCL. The scope of the delegation is to approve time payment arrangements for pastoral lease back-rent consistent with the policy statement.

Scope of Time Payment Policy

28. I recommend Cabinet agree to the following policy statement to address significant financial hardship due to back-rent:
 - a. Rent, including back-rent associated with lease reviews, is expected to be paid consistent with the terms of the lease agreement;
 - b. Back-rent paid in full within 1 month of invoice will receive the same early payment discount that is applied to rent;
 - c. Time payment options can be considered by the CCL where a lump sum payment of back-rent due to lease reviews would cause significant financial hardship;
 - d. Time payment agreements must:
 - i. Be based on the back-rent excluding early payment discount;

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- ii. Be over the shortest practical time period but not exceeding a term of five years;
 - iii. Provide for immediate recovery of any back-rent owing if a lease is sold or transferred to another party; and
 - iv. Be a floating rate loan with interest at the official cash rate.
29. Following advice from the Treasury I propose that interest on the loan be charged at the official cash rate, being the standard rate for floating term borrowing. It is the most transparent and readily available rate and has been used in Treaty agreements. Charging interest at the official cash rate complies with World Trade Organisation guidelines on financial assistance. Treasury advised that an additional margin above the official cash rate is not required.
30. The responsibility for the form of the loan agreements, consistent with the Cabinet approved policy statement, resides with the CCL.

Option C - Collect rent at pre-rent review levels

31. Under this option the Crown would accept rent payments at the current levels while earning capacity rents are implemented. This would mean not collecting any back-rent. This option will likely require a legislative amendment as the Crown Pastoral Land Act specifies the rent process.
32. This option will reduce the amount of rent that lessees are required to pay to the Crown until earning capacity rents are introduced. This option will have a positive impact on the relationship between the Crown and lessees and removes the need for the Crown and lessees to undergo an expensive LVT process to determine the correct rent from the latest land review.

Option D - Collect rent at earning capacity based rent levels

33. Under this option the Crown would accept rent payments at earning capacity basis (under an interim policy) until a legislated regime for earning capacity rents could be implemented. This option would require a substantive legislative change. The interim policy would be consistent with the Government's future strategic direction for Crown pastoral land. But this option would require a substantive legislative change and the policy work for implementing earning capacity based rent would need to be completed, agreed, and implemented in legislation.

Conclusion

34. Option B (time payment of back-rent) is a practical solution that achieves the right balance of recognising the underlying causes of the back-rent issue and allows the parties to focus on resolving the future rent setting issues without excessive distraction from historic events. The provision of a discount for early payment of back-rent and restricting the time payment option to cases of significant financial hardship creates the correct incentives to achieve an optimal solution to the historic back-rent issue.

Rental Adjustment

35. LINZ has a rental adjustment scheme to allow lessees to off-set rents in exchange for undertaking environmental services and superior stewardship activities above the minimum required by a pastoral lease. The rental adjustment scheme could be used in conjunction with the time payment policy. To date no lessees have utilised the rental adjustment scheme but this may change as a common understanding develops of the value of these activities.
36. I recommend that Cabinet note the rental adjustment scheme is an option for lessees and that lessees should be encouraged to utilise it.

Consultation

37. The Treasury, Ministry of Agriculture and Forestry, the Department of Conservation, and the State Services Commission have been consulted on this paper. The Department of Prime Minister and Cabinet has been informed.

Financial implications

38. Establishment of the loan facility by the Crown will have no net impact on debt provided that the official cash rate interest rate is charged and principal is repaid at the end of the back-rent agreement. The diminution in value of the back-rent, caused by the delayed collection of the back-rent due, will be offset by the interest charged on the outstanding balances.
39. A non-departmental capital expenditure appropriation will be required. Cabinet has previously agreed to a capital contingency of \$3 million for Crown pastoral lease time payment back-rents for 2010/11 [Cab Min (10) 13/4(31)].

Human rights

40. The proposals in this paper are consistent with the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993.

Legislative implications and regulatory impact analysis

41. There are no legislative implications and a Regulatory Impact Statement is not required.

Publicity

42. LINZ will manage any publicity surrounding this policy.

Recommendations

43. The Minister for Land Information recommends that the Committee:
 1. **note** that rent setting for Crown pastoral lease reviews has been significantly delayed which will cause lessees to owe back-rent;

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2. **note** that lessees will be encouraged to utilise the LINZ rental adjustment scheme in order to partially address the amount of back-rent;
3. **agree** the following policy statements to address significant financial hardship due to back-rent:
 - a. Rent, including back-rent associated with lease reviews, is excepted to be paid consistent with the terms of the lease agreement;
 - b. Back-rent paid in full within 1 month of invoice will receive the same early payment discount that is applied to rent;
 - c. Time payment options can be considered by the CCL where a lump sum payment of back-rent due to lease reviews would cause significant financial hardship;
 - d. Time payment agreements must:
 - i. Be based on the back-rent excluding early payment discount;
 - ii. Be over the shortest practical time period but not exceeding a term of five years;
 - iii. Provide for immediate recovery of any back-rent owing if a lease is sold or transferred to another party; and
 - iv. Be a floating rate loan with interest at the official cash rate.
4. **invite** the Minister of Finance to:
 - a. Approve the time payment of pastoral lease back-rents as expedient in the public interest for the purposes of s.65L of the Public Finance Act 1989; and
 - b. Delegate to the Secretary to the Treasury authority to approve individual time payment agreements for back-rent and allow the Secretary to delegate the authority to the Commissioner of Crown Lands as required;
5. **agree** to establish a new Non-Departmental capital expenditure appropriation in Vote: Lands entitled *Loans for Crown pastoral lease holders*;
6. **agree** that the scope of the appropriation for *Loans for Crown pastoral lease holders* is "This appropriation is limited to loans made to Crown pastoral lessees who suffer significant financial hardship due to back-rent under the Crown Pastoral Land Act 1998";
7. **note** Cabinet has previously agreed to a capital contingency of \$3 million for Crown pastoral lease time payment back-rents for 2010/11 [Cab Min (10) 13/4(31)];

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8. **approve** the following changes to appropriations to enable loans to lessees with no impact on debt:

Vote: Lands Minister for Land Information	\$m - increase/(decrease)				
	2010/11	2011/12	2012/13	2013/14	2014/15 and out years
Non Departmental Capital Expenditure: -Loans for Crown pastoral lease holders	3.000	-	-	-	-

9. **agree** that the proposed changes to appropriations for 2010/11 be included in the 2010/11 Supplementary Estimates and that, in the interim, these expenses be met from Imprest Supply.



Hon Maurice Williamson

Minister for Land Information

17 / 7 / 2010