MECHANISMS & ISSUES

Gwyn Morgan

Gwyn has been working in the policy field for over 20 years with Fonterra, Auckland Regional Council, DairyNZ and Federated Farmers. His experience through all of these roles has been working in the sustainable farming area. This has included policy development and implementation as well as extension tools that enable farmers to adapt to policy change in a way that is economically viable. TDR's are one of these tools available and they can be useful but that is dependent on many variables.

The first thing to make clear today regarding the notified Rotorua District Council Proposed District Plan and in particular Rule 13.10.1 and its associated parts in terms of TDRs is:

- 13.10.1.1 - 2 - 500kg reduction
- 13.10.1.1 – 3 Management Plan with subdivision application
- 13.10.1.1 – 4 Nutrient Loss Assessment Report

There is an assumption that they will apply. We know that they are proposed, we know that they could change and the key is to keep an open mind about how they might look in the end. I was encouraged by Councillor Oppatt's comments around the activity status of TDRs, looking at how it might apply in the future.

I am going to talk about the issues associated with TDRs in the Western Bay Plan change in relation to farming and tax issues. I will also show an overseas case study. In New Zealand the TDRs have been used quite widely by many District Councils but not in relation to nutrient reductions. I have found an example on Long Island in the USA which is to do with nutrient reductions around sewage.

Are TDRs the right mechanism to reduce N? Federated Farmers consider it a useful voluntary tool as anything that reduces nutrients is good. We looked at where else TDRs had been used and why I had to go offshore to find an example.

Is it the best tool? TDRs are usually used for native bush protection as opposed to transferring an issue. Protecting a bush lot to get a subdivision right is quite different to exporting a nutrient issue from one zone to another.

TDRs cannot be reversed, once they are in place they are there for perpetuity and go to the next land owner. Whatever limit agreed stays in place.

Do TDRs and the rules at the moment fit with N reduction initiatives? I am talking about Rule 11, in the spirit of the Oturoa agreement and no longer being in court. I just signed the consent order for the RPS last week over the provisions around the 435 tonnes in 20 years. At the same time we must ensure that whatever rules the District Council put in place, they must dove tail with the Regional Land and Water

Plan. When this is reviewed, and we know Rule 11 is going to be reviewed, it cannot contradict or oppose the position of the final District Plan.

The StAG group consider that in terms of N reductions the end result must be that farming remains economical. We have a 20 year RPS envelope to address this issue. Looking at what trialling and research alternatives AgResearch and Dairy NZ have achieved in the last 20 years, we do not have to fix everything today. We need to keep the long term time frame in perspective and allow enough flexibility for new technologies to be adopted in the future.

From an economic perspective what happens if TDRs do not sell? What happens if there is no market? $20,000 has been the bandied around number in valuation as a one off reward per TDR for a limit on production in perpetuity. A particular land owner in this generation gets a one off benefit, but is the market price going to justify that TDR what the land owner gives up going forward? Over the 20 years $20,000 is not even 10% of the loss of production from N.

Also touched on today, is the long term land value capital loss. What has not been talked about are the tax implications of TDRs. Keith Turner, from nsaTax, a law firm in Auckland, suggested that any gain on sale could be taxable as general business profits (Income Tax Act 2007):-

- as a profit making undertaking or scheme
- as personal property acquired for disposal
- or as income under ordinary concepts
- land taxing provisions could apply to the underlying subdivision itself

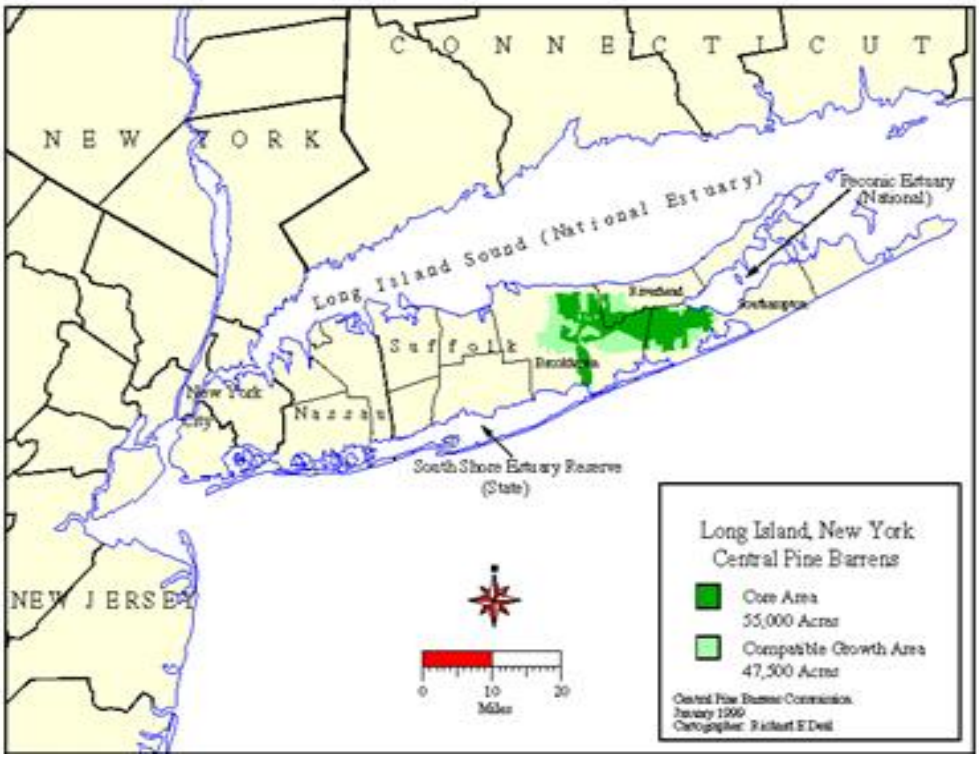
Therefore TDRs could be a tax liability for the donor and developer. They would need tax advice for the best way to set them up. For a farm such as Simon presented today, taking one of those options for 8, 9 or 10 TDRs, it would potentially be quite a big tax liability.

Mechanisms

The talk today around free market or a TDR bank, annual allocations or a limit, and which is the best solution, is really hard to know until the market indicates what it is doing. How do we know what it will do and the best way to regulate it? Do we issue 20 a year or 10, or 5, or per zone, or region wide, or the whole catchment? It is important to build in flexibility and a simple system with tangible benefits to both sides.

The case study I will talk about shortly developed TDRs in a particular way and some good things happened and some not so good things. King County, Washington State, USA, was an example of a way to deal with simplifying the system and easing the burden on the donor. They had a public benefit running system where they got a rebate for doing work on top of other initiatives.

Case Study - Long Island Pine Barrens, Long Island, New York, USA



Slide 1

When you think of nutrient reductions you probably do not think of New York, but for 30 to 40 years they had a problem with sewage. In 1993 the New York State Legislature introduced an Act to protect the 55,000 acres of pines known as the Pine Barrens (in the dark green in **Slide 1**) through the development and implementation of a comprehensive land use plan. There was too much treated sewage going into the waterways of Moriches Bay and Great South Bay. Their council decided that there must be a way to remove the sewage (N and P). All of Long Island's drinking water comes from ground water wells in the Pine Barrens (the dark green area); none of the island's water comes from reservoirs. They re-zoned the light green area and said, 'We can have some development there if we introduce a TDR scheme associated with removing N from the sewage away from the coast to the inland. How are we going to do that?'

They included the towns of Brookhaven, Riverhead and Southampton into a scheme hosting the sending and receiving areas and the Greater Suffolk County receiving areas as well. In Riverhead a Pine Barrens Credit was equivalent to 300 gallons (1,135 litres) of raw sewage flow per day per acre. The sewage was exported out into one of the developments in the Greater Suffolk area. Essentially they were moving the risk and reducing the leaching into another area.

The final allocation led to a credit certificate in exchange for a permanent conservation easement. This meant that to subdivide in the light green zone you

had to give up a portion of land between 2 and 4 hectares and had a right to put in a septic tank which was purchased with the TDR. The process was complex, but they thought it was a way to solve several problems. The new credits go onto the market to be sold to 'redeemers' or 'credit wholesalers'.

They did have site redemptions capped to avoid 'piling on', basically to avoid throwing too much on to the market, or the opposite effect, getting 8, 10 or 12 close knit subdivision lots within a certain area, so there was not a huge infrastructure burden.

From a governance perspective, the Pines Barrens Commission was set up to approve and implement the Central Pine Barrens commercial plan. They hear and decide on the allocation appeals and establish the policies. They also established a Pine Barrens Credit Clearing House Board run by the Suffolk County to keep the credits in one place and control the sale and purchase of those credits and link them directly back to the consents. They apply the county plan, overseeing the initial credit allocations, manage the funds and establish operational policies.

The Credit Certificate administration was:

- Issued simultaneously with the placement of a conservation easement on the sending/donor property
- Issued only by the Clearinghouse
- Redeemable, Saleable or Transferable
- Serial numbered
- Assigned to a specific owner (not bearer documents)
- Registered with the Clearinghouse
- Tracked by the Clearinghouse

The consent process for the receiver, not the donor, was a separate process.

What happened?

Over 15 years 906 conservation easements and credit certificates were issued. Of those only 38% (344) were redeemed and used for subdivision. 62% were declined lawful building consents and not sold. One reason was because they had a separate process for establishing a credit and then getting a conservation easement. Apart from the consent process, all credits were issued with the conservation easements, but there was no guarantee with the activity status of the consent applications that they would be granted. Neil touched on this earlier - controlled versus restricted discretionary or discretionary activity status. Developers had bought the certificates thinking they could do developments closer to the trees and export the sewage, achieving a good environmental outcome and more high density housing.

In reality what happened was that they did not get consents. It put a huge burden on the Council Authority to manage the infrastructure for the subdivisions going ahead and over the 15 years they fell behind. Even though they granted consents they did not have the infrastructure in place for the consent holders to build their properties.

One of the limitations was that the receiving area was across 4 different parts of the State. That is not the same as Rotorua, SP1 and SP2 which are within a limited zone. If they had changed the system to have one receiving environment and the whole area as donors it would have made a big difference to their infrastructure expenditure and possible to keep a check on the development and contributions.

One developer was upset that they had bought a lot of these credits and TDRs and they were ready to do a subdivision near Riverhead but their consents were not granted even though they had complied with everything that was required. There was a back log of infrastructure work to be done and they could not give them what was needed to build houses.

On 25 June 2013 the developers, Pluralis LLC, a company which owned nearly 50% of the outstanding Pine Barrens Credits, took a law suit against Suffolk County in the Supreme Court against a value loss of $20million in damages sought. They had been sitting on these credits for 15 years; they could not enact them or get a consent, nor sell them. At one stage they were worth US$110,000, but because they could not do anything with them for lack of infrastructure they dropped to US$7,500. So this case study is a good example of things not to do.

Take Home Message

Donor properties in the whole catchment would work, but make sure the receiving environment is limited to a zone with good infrastructure. The activity status of the consents within the receiving environment should be as closely controlled. There needs to be certainty. Spending $100,000 on a credit and getting a TDR that cannot be used for the proposed purpose, even though it complied with the District Plan when applied for, is appalling. The Council would be better to not grant the consent. We do not want to end up in that position.

There is a lot of work to be done. What we can learn from the Long Island example is that if it is not tied up tightly right from the start there will be some big headaches 15 years down the track.