



FINAL REPORT

The costs and benefits of changing local council rate setting

*Prepared for
Independent Pricing and Regulatory Tribunal of NSW
December 2016*

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Executive summary

IPART is proposing to move from the unimproved value (UV) of land approach to rate setting to the capital improved value (CIV) approach. This is expected to allow for additional growth in rate revenue 'outside the peg', which will more closely align rate revenue with the increasing demand for council services, as a result of population and business growth.

- Revenue growth 'outside the peg' is currently around 0.2 per cent per year.
- By contrast, IPART estimates that under a CIV approach revenue growth 'outside the peg' could be around 0.9 per cent per year.

The benefits of IPART's proposal

The benefits of giving councils access to additional rate revenue could include the following.

- Fewer special variation applications — the special variation process is administratively cumbersome. Higher growth in rate revenue 'outside the peg' will reduce the need for special variations. This could reduce the administrative burden on councils in preparing applications, as well as IPART in assessing them.
- In addition, access to additional rate revenue could either:
 - Reduce the need for revenue from other sources — with rate revenue constrained, council services demanded by the community could be funded through alternative means, such as NSW Government subsidies (or bail-outs) or through developer charges. However, various studies have shown that council rates are a relatively efficient revenue source, compared to other sources available to councils or the NSW Government. IPART's proposal could therefore improve the efficiency of the tax mix.
 - Improve the level of service provided to the community — alternatively, the current constraint on council revenue could lead to an under-provision of public goods provided by councils. Under this scenario, IPART's proposal could improve the level of services provided to the community. Existing residents should be better off because they have access to better services, effectively paid for by rates collected from new residents.
- Better incentives for growth — under current arrangements, councils have an incentive to restrict development as they do not have the capacity to provide the services for growing residential and business populations. If rate revenue more closely aligns with demand for services arising from population growth, councils and the local community have a greater incentive to allow development in their local government area.

The costs of IPART's proposal

Moving to a CIV approach to rate setting will also involve costs as follows.

- Implementation costs — there will be costs associated with moving to a CIV system. Most prominently, the Valuer-General will need to establish (or purchase) a database with CIV valuations.
- Additional supplementary valuations — under a CIV approach, there are likely to be additional supplementary valuations required.
- Additional objections and appeals — changing the basis for rates is likely to result in more objections and appeals.

Net benefits estimates

Using the efficiency of revenue collection approach, we estimate that IPART's proposal could deliver a net benefit to the community of between \$713 million and \$2.1 billion in net present value terms over 15 years (post-implementation) using a discount rate of 7 per cent. The central case scenario would deliver a net benefit of around \$1.1 billion (table 6.1).

The costs of implementing the new system (including the cost of obtaining CIV data, additional supplementary valuations and additional objections) could be in a range between \$32 million and \$85 million in present value terms over 15 years (post implementation) using a discount rate of 7 per cent. However, the efficiency benefits are likely to significantly outweigh these costs.

1 Estimated net benefits — revenue collection approach

	Low	Central	High
	\$ million	\$ million	\$ million
Costs			
Implementation costs	- 10.83	- 8.85	- 6.87
Additional supplementary valuations	- 48.04	- 32.19	- 16.34
Additional objections	- 26.23	- 16.25	- 8.38
Total costs	- 85.10	- 57.29	- 31.58
Benefits			
Direct benefits			
Savings from fewer special variations	16.23	20.29	24.34
Efficient revenue collection	333.27	518.41	1 259.01
Indirect benefits			
Incentives for growth ^a	449.01	657.34	865.68
Total benefits	798.51	1 196.05	2 149.03
Net benefit/cost	713.41	1 138.75	2 117.44

^a Based on a 5 per cent reduction in the estimated cost of incentives to restrict growth in NSW.

Note: Estimates are present in net present value terms over 15 years (post implementation), using a discount rate of 7 per cent.

Source: CIE estimates.

Using the improved services approach to estimating the direct benefits of moving to CIV, the central case net benefit estimate is broadly similar to the efficiency of revenue collection approach presented above. We estimate that moving to a CIV approach for rate setting could deliver a net benefit of around \$1.1 billion in net present value terms over 15 years, using a discount rate of 7 per cent (table 6.2).

However, both the low and high estimates are lower using this approach, compared to the efficiency of revenue collection approach. In our lower bound estimate, IPART's proposal would deliver a net benefit of around \$443 million, while in our upper bound IPART's proposal would deliver a net benefit of around \$1.7 billion.

2 Estimated net benefits — improved services approach

	Low	Central	High
	\$ million	\$ million	\$ million
Costs			
Implementation costs	- 10.83	- 8.85	- 6.87
Additional supplementary valuations	- 48.04	- 32.19	- 16.34
Additional objections	- 26.23	- 16.25	- 8.38
Total costs	- 85.10	- 57.29	- 31.58
Benefits			
Direct benefits			
Savings from fewer special variations	16.23	20.29	24.34
Improved services	63.04	446.65	821.92
Indirect benefits			
Incentives for growth ^a	449.01	657.34	865.68
Total benefits	528.28	1 124.28	1 711.94
Net benefit/cost	443.18	1 066.99	1 680.36

^a Based on a 5 per cent reduction in the estimated cost of incentives to restrict growth in NSW.

Note: Estimates are present in net present value terms over 15 years (post implementation), using a discount rate of 7 per cent.

Source: CIE estimates.

Conclusions

Although there is some uncertainty around our estimates and they should be considered indicative only, we consider the broad conclusion that the efficiency benefits of IPART's proposal to move to a CIV approach to rate setting will outweigh the costs to be robust.

Our indicative estimates suggest the costs associated with moving to a CIV approach to rate setting could be in the tens of millions of dollars over time. However, even using highly conservative assumptions, the efficiency gains are estimated to be higher by a factor of between around 6 and more than 50, with benefits exceeding costs by a factor of around 20 in the central case. As an indicative estimate, these benefits could be

several hundreds of millions of dollars, up to more than \$2 billion. So even allowing for the possibility of significant errors in our estimates, it seems highly unlikely that the costs would outweigh the benefits.

1 *Proposed changes to rate setting*

IPART is proposing changes to the mechanisms by which local rates are set. This chapter sets out the current arrangements for the proposed changes put forward by IPART.

Current arrangements for rate setting in NSW

The current arrangements for rate setting in NSW involve the following components.

- An overall constraint on rate revenue collected by each local council
 - The overall rate peg allows for revenue to grow by an amount set by IPART, to reflect the change in councils' costs less a productivity adjustment
 - Rates can increase above this peg through councils applying for a Special Variation, such as to provide additional services, to replace ageing assets, or improve financial sustainability. A Special Variation has to be approved by IPART.
 - Rates can also increase through a supplementary valuation process, where a new value is assigned to a property and the impacts of this are allowed as growth outside the peg.
- A structure of rates that reflects:
 - a baseline amount, plus
 - a percentage applied to unimproved land value. A minimum amount may also be applied to this ad valorem component of the rates.

IPART proposals evaluated in this report

IPART's recommendations shift the overall growth of rate revenue and the structure of rates levied across properties.

- In terms of overall growth, IPART proposes that rate revenue increase in line with the growth in Capital Improved Value (CIV) arising from new investment in residences or businesses.
- In terms of the allocation of rate revenue, IPART proposes that the rate revenue would be based off CIV rather than unimproved land value (UV).

These recommendations are expected to increase growth in rate revenue relative to what would happen under existing arrangements, and allocate a greater part of the burden of rates on new residents and businesses and higher density housing (which has a higher ratio of CIV to UV). A smaller amount of revenue would be collected from houses in total, although more may be collected from some houses that have a high ratio of CIV to UV.

2 *Approach to estimating benefits and costs of proposed changes*

The steps in undertaking a cost benefit analysis (CBA) are set out in box 2.1.

2.1 Key Steps in a CBA

- **Articulating the decision** that the CBA is seeking to evaluate.
- **Establishing the reference case (or base case)** against which to assess the impacts of changes. For this project, the base case is the continuation of current rate setting arrangements.
- **Quantifying the changes (from options)** relative to the base case. This will focus on the incremental changes/impacts resulting from the options.
- **Placing values on the changes** and aggregating these values in a consistent manner to assess the outcomes.
- **Generating the Net Present Value (NPV) of the future net benefits stream**, using an appropriate discount rate, and deciding on the Decision Rule on which to assess the different options. The best decision rule is to choose the option that has the highest net benefits.
- **Undertaking sensitivity analysis** on a key range of variables, given the uncertainties related to specific benefits and costs.
- **Deciding on which option is better for society.** In practice, additional information, aside from the CBA results, may also be utilised when deciding on the preferred option.

This chapter sets out more specifically the approaches to measuring the impacts and valuing the benefits of the proposed changes.

In this report, the costs of IPART's proposal are presented as a negative value, while benefits of IPART's proposal are presented as a positive value.

Measuring the benefits of the proposed changes

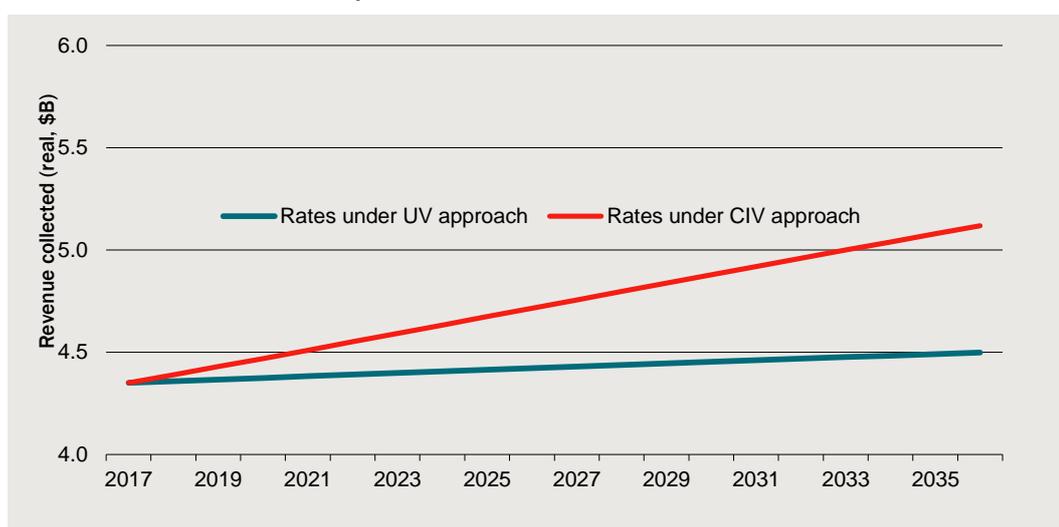
The changes to rate setting proposed by IPART have two direct implications.

- 1 The overall rate revenue available to a council will grow more rapidly in line with the growth of the business and residential community

2 The allocation of rate revenue will differ.

IPART's expected overall rate revenue changes from the proposal are set out in chart 2.2.

2.2 Baseline and IPART expected real rate revenue

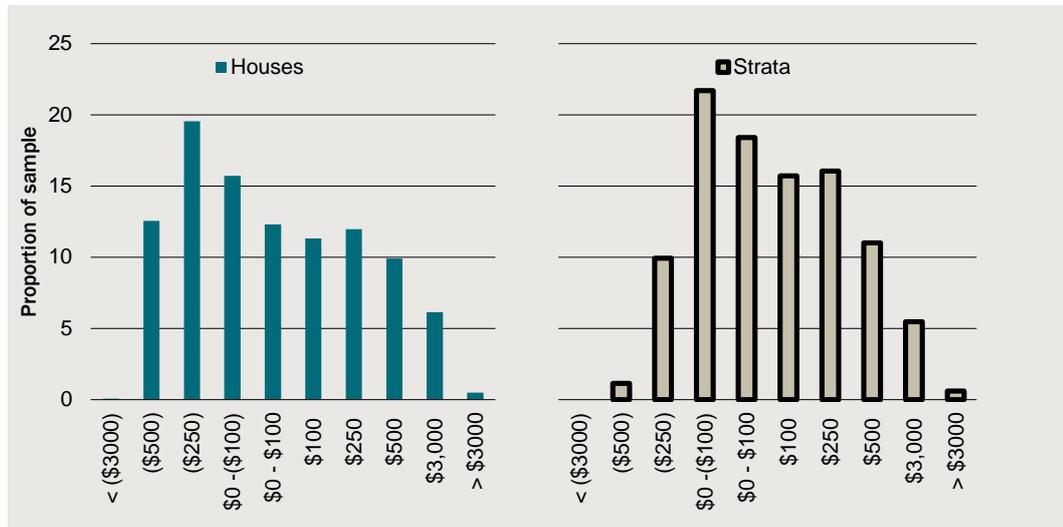


Data source: IPART.

The impacts in terms of allocation of revenue depends on each council's current use of base and minimum charges for rate setting. Using sales data for residential properties across NSW for 2013/14, we have estimated the pattern of impacts maintaining constant revenue for each council (chart 2.3).¹ The impacts compare the estimated annual rates for different types of dwellings based on the current approach and the IPART based approach using CIV only.

¹ The data includes 113,634 single dwelling residences and 53,393 strata properties. We assume that this sample is representative of rates that would be incurred by all residences in NSW.

2.3 Impacts across different residential property types



Note: Properties included in the sample are those located on land zoned R1 to R5, A, M, B4 and C.

Data source: The CIE.

The results highlight that, on average:

- Units will tend to face higher rates than currently, particularly where the council currently has low base and minimum rates. The average annual rate in 2013/14 for units across NSW is estimated at \$619 based on the current approach, compared to \$687 based on the proposed CIV only approach. It is estimated that 67 per cent of units will experience higher rates under the CIV approach. However, a large proportion of units will face lower rates - 22 per cent of properties will face rate reductions of up to \$100 per annum, with a further 10 that will face reductions of between \$250 to \$500 per annum.
- Houses will tend to have lower rates than currently. The average annual rate in 2013/14 for houses across NSW is estimated at \$1 140 based on the current approach, compared to \$1 106 based on the CIV only approach. 48 per cent of houses are expected to receive rate reductions if the CIV only approach applied with the other properties experiencing rate increases.

Indirectly, the impacts of the proposed changes will depend on how councils and the NSW Government respond. There are two methodological approaches that allow for different responses and can be used to value the benefits of IPART's proposal.

- 1 Allow for the community to receive a different (and more efficient) level of provision of public goods because under the proposed changes they can access a higher level of rate revenue over time
- 2 Allow for the service provision to be the same, but to be funded through other revenue raising instruments other than rates. This could include NSW Government subsidisation or developer contributions.

These two methods are set out below.

The efficient level of provision of public goods

Rate revenue is primarily for funding public goods — these are goods that are non-excludable (people cannot be excluded and hence charged directly) and non-rivalrous (one person's consumption is not impacted by the use of the good by others).

The efficient level of provision of public goods is where the cost of supplying public goods is equal to the demand for public goods. In chart 2.4, suppose a council is initially at Q_0 , supplying an efficient amount of public goods — the point where demand for public goods equals supply of public goods. The addition of new development increases demand for public goods. Unlike a private good, where an increase in demand leads to a quantity increase for a given price, for a public good an increase in demand means a higher value for any given level of provision of public goods. Then:

- The new efficient level of provision of public goods is Q_1 .
- If a council is constrained by the rate revenue available to it — for example in the case that the increase in demand reflects activity that leads to no increase in unimproved land values — then it continues to provide Q_0 of public goods.
- The loss of welfare is the shaded triangle in chart 2.4.

The shaded triangle can be measured as:

$$\Delta W = \frac{1}{2} \cdot \Delta V \cdot (Q_1 - Q_0)$$

Where ΔW is the change in welfare and ΔV is the change in value at Q_0 .

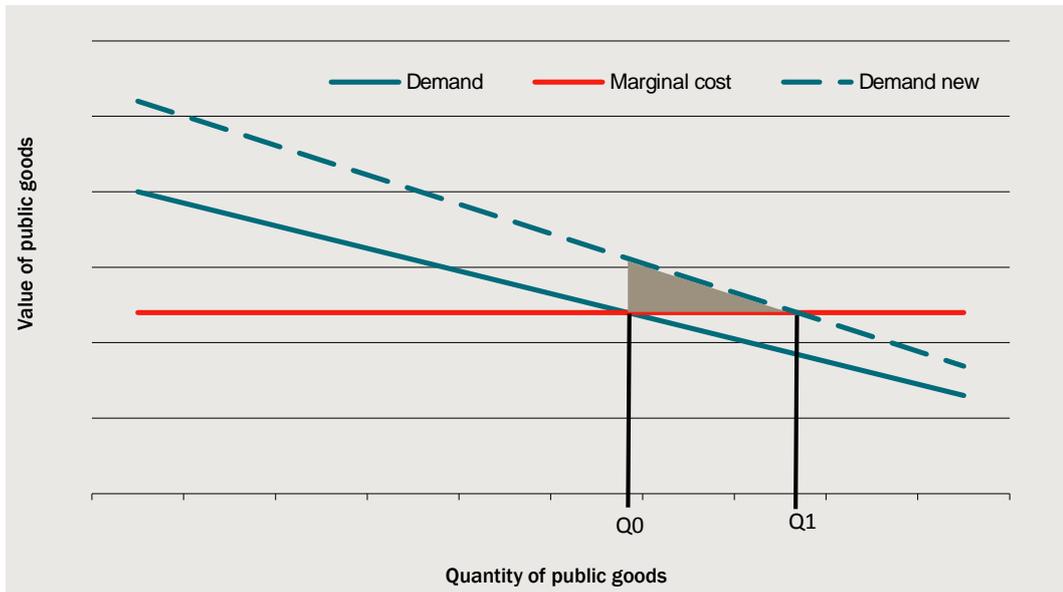
If we know the elasticity of demand for public goods, then this becomes:

$$\Delta W = \frac{1}{2} \cdot \left(\frac{\Delta V}{V}\right)^2 \cdot e \cdot R$$

That is, the change in welfare is equal to the proportional change in value squared multiplied by the elasticity of demand (e) multiplied by the initial revenue from rates (R).

To give an example, suppose the change in value was 10 per cent, initial rate revenue was \$6 billion per year and the elasticity of demand was -1, then the welfare cost would be \$30 million per year.

2.4 The efficient level of provision of public goods

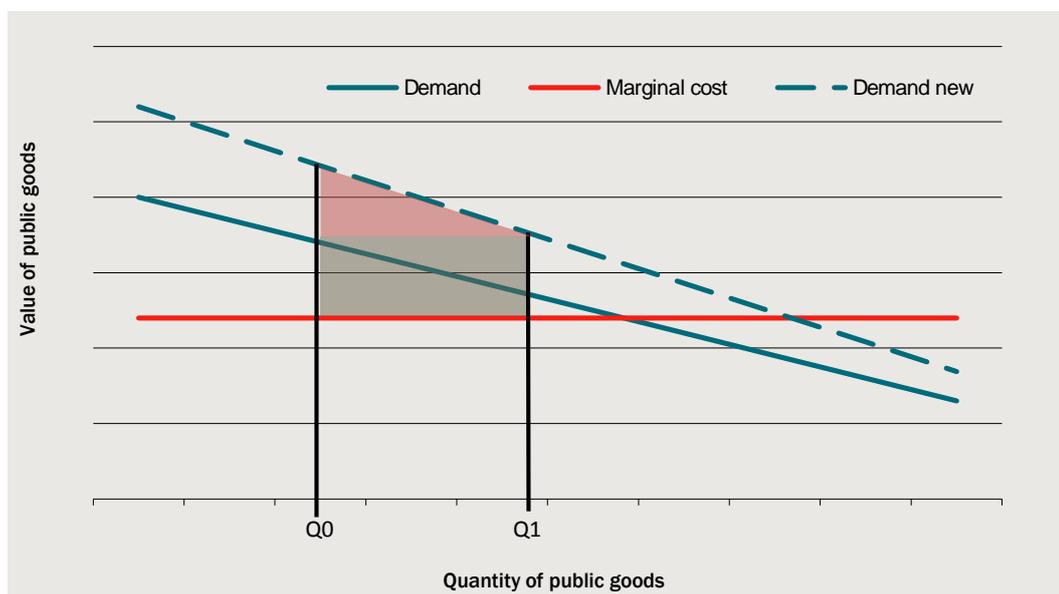


Data source: The CIE.

The above assumes that a council is at an efficient level of provision of public goods. It is more reasonable to assume that NSW councils are below the efficient level because of the historical impacts of using a UV base to collect rate revenue and rate pegging, in which case the costs of further demand increases are larger (chart 2.5).² As noted in chapter 4, NSW local councils per capita revenue from rates has grown much less rapidly than other states, and has started from a lower base.

² In this case the welfare impact is approximately $\Delta W = \frac{1}{2} \left(\frac{\Delta V}{V} \right)^2 \cdot e \cdot R + \frac{(v-c)}{c} \cdot e \cdot \frac{\Delta V}{V} \cdot R$, where c is the unit cost.

2.5 Impacts of additional revenue if councils are below the efficient level of public goods



Data source: The CIE.

In some cases the provision of council goods is rivalrous — for example when roads get crowded or parks get crowded. In these cases, in the absence of additional council expenditure then the value of council services to existing residents would fall. The underlying pattern of benefits from the expansion of the provision of services is similar, with IPART’s recommendations leading to benefits to existing residents and costs to new ratepayers relative to a continuation of current practice.

The rivalrous nature of some council costs, and that new development may lead to higher ongoing expenditure requirements in some cases (e.g. additional verges, footpaths and roads to maintain) is an important reason for the anti-development views of communities, and many local councils. Residents of Sydney are the least agreeable to population growth of Australian capital cities. They are the most likely to note transport congestion and public transport crowding as reasons for not wanting population growth.³

Alternative mechanisms to fund public goods

An alternative approach is to assume that councils find other mechanisms to fund the efficient level of provision of public services. In this case the services remain the same with and without IPART’s proposed changes, but the distortions of the funding mechanisms differ.

The mechanisms that would fund the additional local council rate revenue in the absence of IPART’s proposed changes could include:

- NSW Government subsidies or bail-outs

³ Productivity Commission 2011, *Performance benchmarking of Australian business regulation: Planning, zoning and development assessment*, Research Report, p. 28.

- increases in developer contributions
- increases in charges for other services where local councils have discretion
- increases in the number of applications for a special variation.

The immediate economic impact of the above is that different taxation instruments have different levels of economic distortion. Rate revenue would normally be considered as one of the most efficient taxation instruments, and moving to collect more revenue from this source would therefore improve the efficiency of the overall tax mix.

A number of studies have been conducted measuring the efficiency of taxation instruments. The main measure reported is the marginal excess burden of taxation per dollar of revenue raised. Results from selected published studies are shown in table 2.6. Chart 2.7 shows the efficiency for only actual taxes, rather than hypothetical taxes, and includes results using the CIE Regions computable general equilibrium model.

- NSW Government taxes are relatively inefficient, with payroll tax at ~30 cents of cost per dollar of revenue raised and stamp duties 60-70 cents. The most efficient state tax is the GST, which is not directly able to be set by an individual state government.
- Municipal rates are considered to be the most efficient taxation instrument, largely because they are levied on land, which is a fixed resource.

2.6 Relative efficiency of selected taxes (descending order), by study

KPMG Econtech ^a		KPMG Econtech		Commonwealth Treasury	
2010	MEB ^b	2011	MEB ^b	2015	MEB ^b
Municipal rates	0.02	Land tax	0.09	Broad based land tax	-0.1
GST	0.08	GST	0.12	Personal income tax (labour & capital)	0.16
Land taxes	0.08	Personal income tax	0.24	Broad based GST	0.17
Labour income tax	0.24	Motor vehicle stamp duty	0.33	Current GST	0.19
Conveyancing stamp duties	0.34	Payroll tax	0.35	Labour income tax	0.21
Motor vehicle stamp duties	0.38	Company tax	0.37	Company tax	0.50
Corporate income tax	0.40	Commercial transfer duty	0.74	Stamp duty on conveyances	0.72
Payroll tax	0.41	Residential transfer duty	0.85		

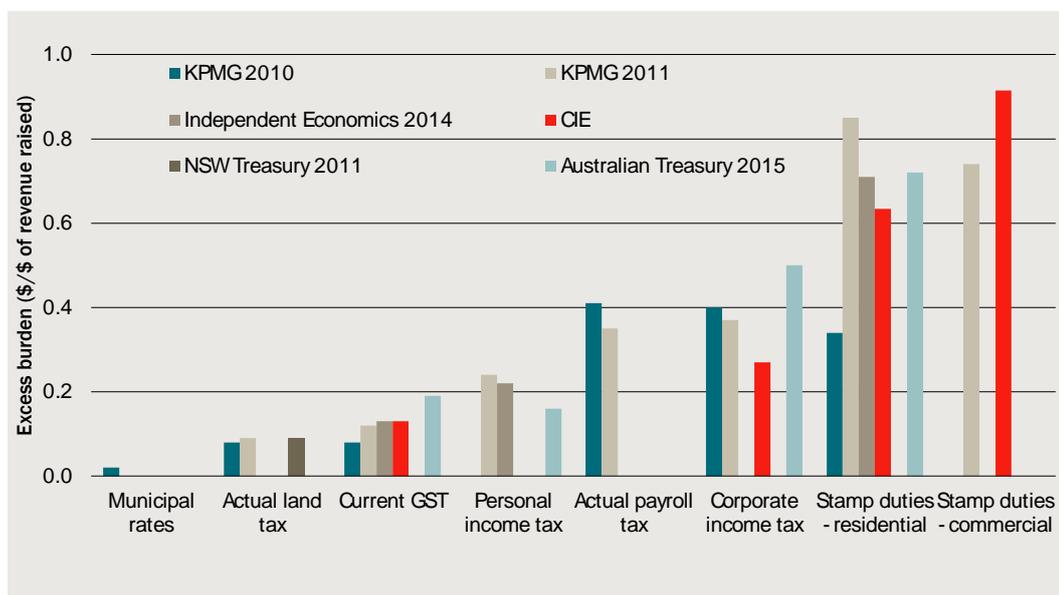
^a Modelling and results were prepared for and incorporated into the Henry Tax Review

^b Marginal excess burden is the cost of the tax due to changing it by a small amount (usually such that total government revenue increases by \$1).

Note: In all studies, all taxes are imposed at the Federal level. That is, no taxes create a distortion that sees economic resources move across state borders within Australia.

Sources: KPMG Econtech 2010, CGE analysis of the current Australian tax system, prepared for Department of Treasury, 26 March; KPMG Econtech 2011, Economic analysis of the impacts of using GST to reform taxes; Australian Treasury 2015, Understanding the economy-wide efficiency and incidence of major Australian taxes.

2.7 Excess burden of selected taxes



Note: NSW Treasury 2011 and Independent Economics 2014 are as reported in Australian Treasury 2015. The chart does not include modelling of hypothetical taxes, such as a broad-based payroll tax or broad-based land tax. These are shown in the body of the report.

Data source: The CIE; KPMG Econtech 2010, CGE analysis of the current Australian tax system, prepared for Department of Treasury, 26 March; KPMG Econtech 2011, Economic analysis of the impacts of using GST to reform taxes; Australian Treasury 2015, Understanding the economy-wide efficiency and incidence of major Australian taxes.

In distributional terms, IPART's proposed approach shifts costs from current residents onto future residents. The current inefficiencies in the way that councils collect rates from new residents (particularly where population and business growth has occurred due to densification) mean that ultimately existing residents bear much of the burden of funding new services through either:

- higher state taxes; or
- special variations which increase rates collected from existing residents and businesses.

Under IPART's proposed approach, new services would largely be funded through higher rates on new residents and businesses. This is effectively a transfer from current residents to new residents of around \$1.85 billion in present value terms (using a discount rate of 7 per cent) over 15 years.

Indirect benefits of the proposed changes

Indirectly, the proposed changes would have additional benefits, which are likely much larger than the direct gains. Most importantly, the proposed changes would lead to new development contributing to greater rate revenue. This would shift the incentives for councils and the local community to allow development.

Currently councils actively seek to restrict development reflecting:

- additional development brings greater cost for councils without a corresponding increase in rate revenue, without special variations;

- additional development brings impacts on existing residents, because service provision does not keep up with demand for services, leaving existing residents facing more crowded roads, public transport and parks. Some of these impacts are NSW Government impacts.

Under the proposed change, existing residents should be better off because they have access to additional services, effectively paid for by rates collected from new residents.

The CIE has previously documented the considerable evidence of problems with the current NSW planning system, covering a range of different elements as follows:⁴

- The planning system is not delivering good outcomes for NSW
 - Housing completions in NSW have not kept pace with population growth, or levels achieved in other states and particularly Victoria. Recent increases in housing approvals and completions reflect that prices are sufficiently high to encourage additional supply, and the impact of some improvements the NSW Government has made to the planning system.
 - Housing is least affordable in Sydney of all Australian capital cities and commercial rents are the second most expensive.⁵ This increases the cost of living for people in NSW and the cost of doing business.
- Businesses and residents do not trust the current NSW planning system
 - Residents of Sydney have the lowest agreement that the state is effective at planning of any city surveyed (at 14 per cent) and the second lowest that local government is effective at planning (15 per cent).⁶
 - NSW businesses have a more negative view of planning competence and the ease of doing business than those in Victoria and Queensland.⁷
- The planning system is overly complex and costly
 - NSW is noted for the complexity of its planning system, both legislative complexity and complexity for users, which increases time and financial costs for users.⁸
 - Even minor developments have historically gone through merit assessment processes unlike in other states, leading to higher costs for new development.⁹

⁴ The CIE 2014, *Better regulation statement for the NSW Planning Reforms*, prepared for NSW Planning.

⁵ ABS Residential Property Price indices; Domain Group, *Domain House Price Report*, June 2016; NSW Treasury 2012, *Submission to NSW Planning system review*.

⁶ Productivity Commission 2011, *Performance benchmarking of Australian business regulation: Planning, zoning and development assessment*, Research Report, p. XXXVIII.

⁷ Productivity Commission 2011, *Performance benchmarking of Australian business regulation: Planning, zoning and development assessment*, Research Report, p. 385.

⁸ Property Council 2013, *Planning gone mad: a story about the NSW planning system and how it drives applicants crazy*; Productivity Commission 2011, *Performance benchmarking of Australian business regulation: Planning, zoning and development assessment*, Research Report, p. 379.

⁹ NSW planning development assessment statistics; NSW Planning 2013, *A new planning system for NSW*, White Paper, p. 123.

The expansion of exempt and complying development codes is starting to address this issue.

- The planning system has not allowed NSW to respond to economic and demographic change.¹⁰
 - The planning system has limited the response to changing preferences for higher density development, leading to lower supply of new housing and inefficient use of land.
 - The planning system has responded slowly to changes in the industrial structure of the NSW economy, leading to an inefficient use of land.

In 2014, the CIE quantified the overall costs of the problems with the NSW planning system at in the order of \$1-\$2 billion per year.¹¹

The planning system is complex, and the NSW Government is undertaking many changes to seek to address the problems of the existing system. These include the creation of the Greater Sydney Commission to oversee strategic planning and the expansion of exempt and complying development. Even with these reforms, local councils will retain incentives to push development elsewhere, because there will be additional costs associated with new development, while their revenue sources are constrained.

Local councils retain substantial control over the development that occurs in their area through their local environment plans (LEPs) and development approval processes. This leaves them in a position where additional development has a net cost to council and they are able to influence the amount of development that occurs.

These issues are discussed further in chapter 5.

¹⁰ The CIE and ARUP 2012, *Costs and benefits of alternative growth scenarios for Sydney focusing on existing urban areas*, prepared for NSW Planning, p. 55

¹¹ The CIE 2014, *Better regulation statement for the NSW planning reforms*, prepared for NSW Planning. The Better Regulation Statement estimated the impacts of the introduction of the *Planning Bill 2013* and the *Planning Administration Bill 2013* in conjunction with the regulatory changes that would occur alongside the primary legislation.

3 Estimated costs of proposed changes

This chapter considers the costs of implementing IPART's proposed approach.

Additional data requirements

In order to implement IPART's proposed approach, additional information will be required, which is not currently collected by the NSW Government. The CIV estimates would be based on the most recent sales data for a property, where it is available. Currently, the NSW Government collects information on the estimated unimproved land value of each property as well as the price which a property was sold, where available.

However, many properties sell relatively infrequently which could limit the availability of recent data on the CIV of a property. In these instances, additional information would need to be collected on which to estimate the CIV for each property.

There are a range of different approaches that could be adopted to estimate the CIV for each property, where recent sale price data is not available. This ranges from manual processes including valuations based on site visits of properties to more statistical analysis that seeks to determine the contribution of different property characteristics to the overall sale price. Where statistical analysis is used additional information such as the property characteristics (e.g the number of bedrooms, bathrooms and car parking space) as well as other features (e.g. proximity to public transport and green space) would also be required.

Approaches to collecting additional data

There are different approaches that could be adopted to collect the additional data required to support the analysis. As noted earlier, one approach is to collect the data via site inspections which could be a time consuming and costly exercise if applied to all properties where recent sales data is not available.

An alternative to this is to collect the data from a range of existing sources. Through stakeholder consultation we are aware that there are a number of datasets available in the industry including (but not limited to) spatial information, market and transaction data, attribute information, and valuation risk data (e.g. distance to infrastructure including bus, train, green space). One stakeholder confirmed that they currently consolidate 40 different datasets (a mixture of databases that they are licenced to access, and those that they own) to provide property valuations for their clients. These products are currently used by the banking industry for lending and insurance purposes.

While we do not make recommendations or draw conclusions about the appropriateness of these systems to be used to generate CIV for rating and taxation purposes, our consultation suggests that there are IT platforms available that may be able to be designed for the Government's purpose, without the need to build a database and collect the data from the 'ground up'.

During our short consultation with industry, (building on IPART's consultation on their report: *Review of the Local Government Rating System*), we understand that consolidating the datasets available across industry, councils and state bodies (for example, the Land Titles Office, Sydney Water) could provide a basis to generate CIV estimates for properties (residential, commercial and rural) across NSW. A detailed investigation into the required data is beyond the scope of this paper as these requirements will need to be defined in consultation between those who use (and pay for) the data, and those who collect and analyse the data.

As a comparison, in Victoria, property valuations are provided predominately through a common IT platform where the government owns the data, and councils pay annual fees to access the IT system based on the number of valuations they require. Councils release valuation tenders and these valuations are provided using the common IT platform.

Costs of alternative approaches

Designing a mass evaluation system in NSW that consolidates the latest data from a range of sources, and that has sufficient flexibility to achieve greater levels of automation could reduce the current costs spent in NSW on mass evaluations. The direct and indirect costs incurred by the Valuer General's office to conduct mass valuations in 2014/15 was \$22.1 m and \$1.8 million respectively. In our CBA, we have not assumed that these costs would reduce with the introduction of this system (therefore we provide a conservative estimate of the benefits), however it is likely that there would be some cost reductions. Further analysis would need to be done on the extent to which efficiencies would be achieved.

We consider that there will be five broad stages of costs to shift to a system based on CIV rather than unimproved land value:

- 1 Planning
- 2 Analysis and design costs
- 3 Build and implementation costs
- 4 Integration testing and deployment
- 5 Ongoing costs:
 - a) System maintenance
 - b) Supplementary valuations (due to DAs, subdivision and amalgamation)
 - c) Special variations.

Table 3.1 provides the estimated costs for the first four cost stages. Ongoing costs are discussed in the following section.

3.1 Costs to move to a CIV system

Stage	Cost occurrence	Cost	Description
1	Once off	\$2 – 4 million ^a	Cost to NSW councils and state government to negotiate process and data requirements and release
2 – 4	Once off	\$5 – 7 million (database) \$0.1 – 0.2 million (methodology) ^a	Cost to acquire database Cost to Government for methodology

^a Indicates CIE estimate

Source: CIE and stakeholder consultation.

Stage 1

This phase would involve discussion between all stakeholders including the Valuer-General, IPART, local councils, and industry to understand what databases are currently available and what information would be required in order to calculate CIV.

Discussions would need to be made around ownership of the data (state/council), and what the licensing/access arrangements would be between users (councils and valuers) and the owner.

In this phase, it would be imperative to engage councils to understand what data they currently hold and how this information could be used in this process and identify security controls that need to surround this type of sensitive information. Councils would also need to adapt their internal systems to use the CIV base for their rates purposes.

Note that we have not consulted with councils in the preparation of this report.

Stages 2 – 4

These stages would involve developing the methodology and designing, building and testing the database. This stage would most likely involve internal costs from the Valuer General (with regards to methodology), and costs associated with engaging a contractor. In our analysis, we have used estimates of \$5 – 7 million as provided by industry representatives for this stage. Industry estimates that these stages could take between 18 and 24 months.

To benefit most from this system, information would need to be updated in a timely and in a consistent manner (we understand that the current lag in valuations in the Victorian system is approximately 2 years). For example, information regarding a development application could enter the system in a number of ways. Councils could update the valuation in the system based on a supplementary valuation, or could send this information on to DPE or contractor to update the system, after issuing a construction certificate, where an index could be used to estimate the change in value based on the construction value estimation. The risks of moving to a higher level of automation would need to be balanced with anticipated cost increases in the number of objections that may arise.

We have estimated internal government costs regarding design of the methodology to between \$0.1 – 0.2 million.

Stage 5

The Valuer-General currently incurs ongoing costs to maintain their database for land values. We have assumed that they will continue to do this under the proposed system using the CIV approach. If the ongoing maintenance of the system was outsourced, costs would be in the order of \$3 million to \$4.5 million per annum.

Other costs

In addition to the costs associated with implementing the CIV system, there are likely to be other additional costs.

Additional supplementary valuations

Under the current arrangements, supplementary valuations occur:

- when land is rezoned; or
- there is a change in the number of rateable properties on a block of land.

However, under the CIV approach, supplementary valuation could occur due to:

- newly created parcels of land in subdivisions
- the transfer of part of land which is included in an existing valuation
- the amalgamation of parcels of land into a single valuation
- changes to zoning
- an error being detected in the valuation process; or
- significant capital improvements are made to a property.

This suggests there could be significantly more supplementary valuations under the CIV approach. This will impose an additional cost on the Valuer-General. Based on the Valuer-General's 2014/15 Annual Report, the average cost of a supplementary valuation is around \$67 (table 3.2).

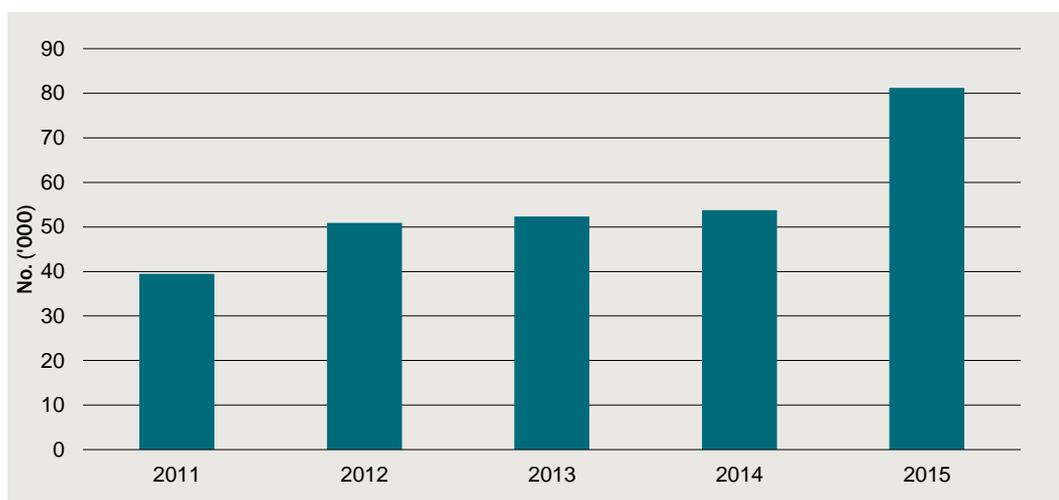
3.2 Cost of valuations

	Mass valuations	Land management and supplementary valuations
Costs (\$'000)		
Direct costs	22 130	3 687
Indirect costs	1 778	1 760
Total	23 908	5 447
Average cost		
Number of valuations (No.)	1 850 887	81 225
Average cost (\$)	12.92	67.06

Source: Valuer-General, Annual Report, 2014/15.

The number of supplementary valuations increased significantly to more than 80 000 in 2014/15, although this was due to changes to Local Environment Plans (LEPs) during the year (chart 3.3). During the previous three years, the number had been relatively steady in the low 50 000s. We use the average over the previous five years (around 55 500) as the baseline number of supplementary valuations.

3.3 Supplementary valuations



Data source: Valuer-General, Annual Report, 2014/15.

In 2014/15 there were around 84 000 development applications (DAs) and complying development certificates (CDCs) in total. Each of these could potentially require a supplementary valuation under the CIV approach.

However, it is not clear how many of these would be additional to the existing number of supplementary valuations.

- As a lower bound estimate, we assume that all of the DAs and CDCs would be additional (i.e. there would be an additional 84 000 supplementary valuations).

- As an upper bound estimate, we assume that the 84 000 DAs and CDCs would include the existing 55 500 supplementary valuations. The additional supplementary valuations would therefore be around 28 600.
- Our central case estimate is the average of the upper and lower bound estimates (i.e. around 56 000 additional supplementary valuations).

Based on these assumptions, the additional cost to the Valuer-General would be between \$1.9 million and \$5.6 million per year (table 3.4). Over 15 years (post implementation), the cost would be between around \$16.3 million and \$48 million in present value terms (using a discount rate of 7 per cent).

3.4 Estimated costs of additional supplementary valuations

	Low	Central	High
Additional supplementary valuations (No.)	84 159	56 391	28 622
Annual cost (\$ million)	- 5.64	- 3.78	- 1.92
Net present value (\$ million) ^a	- 48.04	- 32.19	- 16.34

^a Estimated over 15 years (post-implementation) using a discount rate of 7 per cent.

Source: Valuer-General Annual Report 2014/15, CIE estimates.

Additional objections

The Valuer-General's submission also notes there could be additional objections associated with a change in the approach to setting rates. The submission notes that under a CIV approach there can be objections that the value is set too low, as well as too high. In particular, the Valuer-General notes that in New Zealand in around half of the objections lodged, landholders are concerned that the valuation is below the market value.¹² This suggests there could be a permanent increase in objections, as well as a temporary increase due to the change in the way rates are set.

Based on the Valuer-General's 2014/15 Annual Report, reviewing objections costs around \$950. In addition, the total cost of objections that go to the Land and Environment Court are around \$1.6 million, including costs incurred by the Crown Solicitor (table 3.5).

¹² Valuer-General, *Review of the Local Government Rating System*, Submission to IPART's Draft Report, 14 October 2016, p. 23.

3.5 Cost of objections and appeals

	Objections review	Objections to court
Costs (\$'000)		
Direct costs	3 636	39
Indirect costs	485	20
Crown Solicitor costs	0	1 568
Total	4 121	1 627
Average cost		
Number of valuations (No.)	4 346	n.a.
Average cost (\$)	948.23	n.a.

Source: Valuer-General Annual Report 2014/15.

The increase in objections as a result of a move to a CIV approach is not known. As an indicative estimate, we assume there is a permanent 5 per cent increase in objections. We also assume court costs increase by 5 per cent permanently.

In addition, we assume there is a temporary increase in objections and court costs as follows.

- In the lower bound case, we assume objections and court costs increase by 75 per cent for six years.
- In the central case, we assume objections and court costs increase by 50 per cent for five years.
- In the upper bound case, we assume objections and court costs increase by 25 per cent for four years.

Based on the above assumptions, the additional cost of objections and appeals to the NSW Government is estimated at between \$8.4 million and \$26.2 million over 15 years, using a discount rate of 7 per cent (table 3.6).

3.6 Estimated increase in objection and appeal costs

	Low	Central	High
	\$ million	\$ million	\$ million
Temporary increases (four years)			
Objections	- 4.22	- 2.90	- 1.58
Court costs	- 1.36	- 0.94	- 0.51
Permanent annual increases			
Objections	- 0.25	- 0.25	- 0.25
Court costs	- 0.08	- 0.08	- 0.08
Net present value^a	- 26.23	- 16.25	- 8.38

^a Over 15 years (post-implementation) using a discount rate of 7 per cent.

Source: CIE estimates.

4 Quantifying the direct benefits

Reduction in special variation applications

One benefit from giving councils access to more rate revenue is an expected reduction in applications for special variations. The special variation process is administratively cumbersome. IPART estimates the costs for each application are as follows.

- The council incurs a cost of around \$166 000 on average in preparing the application.
- IPART incurs a cost of around \$32 500 in assessing the application.

Currently, there are around 24 special variation applications annually. IPART expects that this could fall by around 50 per cent if the basis for rate setting changes from UV to CIV (we used a fall of 40 per cent and 60 per cent as a lower and upper bound estimate respectively). This would deliver annual savings of between \$1.9 million and \$2.86 million per year. Most of these savings would be captured by councils (table 4.1).

Over the 15 year period (subsequent to the 2 year implementation period), the total administrative savings would be between \$16.2 million and \$24.3 million in present value terms, using a discount rate of 7 per cent.

4.1 Estimated administrative saving from fewer special variation applications

	Low	Central	High
	\$ million	\$ million	\$ million
Annual savings			
Councils	1.59	1.99	2.39
IPART	0.31	0.39	0.47
Total	1.91	2.38	2.86
Net present value ^a			
Councils	13.58	16.97	20.36
IPART	2.65	3.32	3.98
Total	16.23	20.29	24.34

^a Calculated over 15 years (post implementation), using a discount rate of 7 per cent.

Source: IPART, CIE.

Other responses to revenue shortfalls

As discussed previously, the current rating arrangements mean that councils are unable to raise sufficient funding through rates to keep up with rising demand for services as a result of population and business growth.

We use two different approaches for estimating the benefits from improving the ability of councils to raise sufficient rate revenue to keep up with the growing demand for services.

Less efficient revenue raising mechanisms

One possible consequence of retaining the current approach to rate revenue growth outside the cap is that councils provide the level of service demanded by the community, but seek funding from other sources, such as:

- NSW Government subsidies or bail-outs
- increases in developer contributions
- other charges.

To estimate the benefits of shifting the tax mix towards rates and away from other sources, we make the following assumptions.

- The marginal excess burden (MEB) of council rates is around 2 per cent (see table 2.6 above). That is, for each additional dollar raised through rates, there is an additional efficiency cost to the economy of around 2 cents.
- Each additional dollar raised in rates is a dollar that would no longer need to be raised from another (less efficient source).
 - As a lower bound estimate, we assume that the MEB of the alternative revenue source is around 20 per cent. This is close to Commonwealth Treasury's estimate of the MEB of the GST, which is the NSW Government's most efficient tax. However, the NSW Government does not have the power to change GST rates on its own.
 - As a central case scenario, we assume the MEB of the alternative revenue source is around 30 per cent. This is close to KPMG Econtech's estimate of the MEB of payroll tax and motor vehicle stamp duties.
 - As an upper bound estimate, we assume the MEB of the alternative revenue source is around 70 per cent. This is close to Commonwealth Treasury's estimate of the MEB of stamp duties on conveyances, among the NSW Government's least efficient revenue sources.

We note that the alternative revenue source could also be developer contributions. Developer contributions can be an efficient approach to funding services to new developments, when set at a level that reflects the efficient cost of providing services to a specific development. Similar to IPART's proposal, funding new services through developer contributions would shift the burden away from existing residents and businesses onto new ones. However, the main benefits of IPART's proposal relates to generating additional rate revenue from developments that increase density. In general, there is less scope to raise revenue from developer contributions for infill developments (compared to greenfield) because less infrastructure can be specifically attributed to an infill development. Furthermore, it is unlikely that developer contributions are currently being set at an efficient level for infill developments under the current framework that applies in NSW. In many circumstances, upfront developer contributions will be less efficient than council rates in recovering the long run costs of development.

IPART's revenue projections suggest that rate revenue would grow by:

- around 0.2 per cent in real terms under the current arrangements; and
- around 0.9 per cent under the CIV approach.

This suggests that rate revenue will be around \$1.9 billion higher in present value terms under the CIV approach over 15 years (using a discount rate of 7 per cent). This implies the efficiency gains from adopting the CIV approach could be between \$333 million and \$1.3 billion expressed in the same terms (table 4.2).

4.2 Estimated efficiency improvements

Year-ended June	Additional rate revenue	Efficiency gains - low	Efficiency gains - central	Efficiency gains - high
	\$ million	\$ million	\$ million	\$ million
2017 ^a	0.00	0.00	0.00	0.00
2018 ^a	0.00	0.00	0.00	0.00
2019	31.51	5.67	8.82	21.43
2020	63.33	11.40	17.73	43.06
2021	95.42	17.17	26.72	64.88
2022	127.69	22.98	35.75	86.83
2023	160.09	28.82	44.83	108.86
2024	192.60	34.67	53.93	130.97
2025	225.18	40.53	63.05	153.12
2026	257.78	46.40	72.18	175.29
2027	290.39	52.27	81.31	197.47
2028	322.94	58.13	90.42	219.60
2029	355.40	63.97	99.51	241.67
2030	387.76	69.80	108.57	263.67
2031	419.98	75.60	117.60	285.59
2032	452.15	81.39	126.60	307.46
2033	484.24	87.16	135.59	329.29
Net present value	1 851.48	333.27	518.41	1 259.01

^a Implementation period.

Note: Net present value calculated using a discount rate of 7 per cent.

Source: IPART, CIE.

Efficient level of service provision

The alternative approach is to assume that the constraint on a council's revenue manifests as an under-provision of public goods. Reducing the constraint on revenue by moving to the CIV approach would therefore allow councils to provide public goods at a more efficient level.

Our estimates are based on the following assumptions:

- In all scenarios, the elasticity of demand for council-provided public goods is -1.

- The lower bound scenario effectively assumes that NSW councils are currently providing an efficient level of public goods, but this will decline over time as rate revenue fails to keep pace with increasing demand from population and business growth.
- The central case scenario assumes that NSW councils are already under-providing public goods by around \$920 million. This estimate is based on a comparison of rate revenue growth for NSW councils over the 2005/06 to 2014/15 period, compared to councils in other states. Over this period, the average growth rate in NSW was around 4.5 per cent, compared to around 7 per cent in other states. The constraint on rate revenue growth left NSW councils with a \$920 million revenue shortfall (the implicit assumption here is that at the beginning of this period, NSW councils were providing an efficient level of service).¹³
- The upper bound scenario assumes that NSW councils are currently under-providing public goods by around \$1.8 billion per year. If NSW councils collected the same average rate revenue per capita as the average of other states, rate revenue would be around \$1.8 billion higher.¹⁴

Based on these assumptions, the benefits could be in a range between around \$63 million and \$822 million in present value terms over 15 years (post implementation), using a discount rate of 7 per cent (table 4.3).

¹³ See chapter 5 for further details.

¹⁴ See chapter 5 for further details.

4.3 Estimated benefits from improved service efficiency

Year-ended June	Low estimate	Central case	High estimate
	\$ million	\$ million	\$ million
2018 ^a	0.00	0.00	0.00
2019 ^a	0.00	0.00	0.00
2020	0.11	6.74	13.22
2021	0.46	13.75	26.76
2022	1.04	21.03	40.59
2023	1.85	28.56	54.69
2024	2.91	36.33	69.03
2025	4.20	44.34	83.61
2026	5.73	52.58	98.41
2027	7.50	61.03	113.40
2028	9.50	69.70	128.59
2029	11.73	78.56	143.94
2030	14.18	87.60	159.43
2031	16.85	96.82	175.05
2032	19.74	106.21	190.80
2033	22.84	115.78	206.70
2034	26.15	125.53	222.74
Net present value	- 63.04	- 446.65	- 821.92

^a Implementation period.

Note: Net present value calculated using a discount rate of 7 per cent.

Source: IPART, CIE.

The central case estimate is broadly consistent with the estimate using the alternative revenue efficiency approach. However, both the lower and upper bound estimates are significantly lower.

5 *Quantifying the indirect benefits*

The main indirect benefit of the proposed changes is that it leads to better incentives for councils and the local community to allow new development, particularly in infill areas of Sydney. The estimated costs of restrictions on development in NSW are in the order of \$1-\$2 billion per year.¹⁵ Attributing some component of this to IPART's proposed changes is difficult. However, even if IPART's proposed changes addressed five per cent of the problem, this benefit alone is many multiples of the cost of the proposed changes to the rating system.

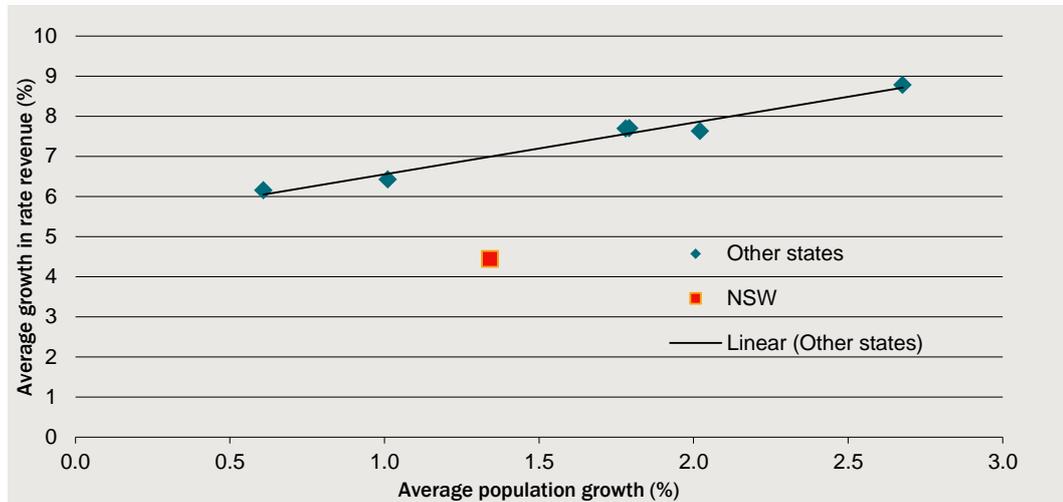
This chapter sets out some of the outcomes arising from the incentives for councils in NSW.

Restrictions on council revenue

A number of inter-related factors contribute to the current incentive structure for councils and local communities. This includes the developer contribution framework, the UV base for levying rates and determining growth in rates, and the local council rate cap. These are unique features of local government funding arrangements in NSW. The UV base and rate cap restricts the capacity of local government in NSW to raise revenue from new developments to recover the long run costs of providing councils services to these new developments. The impact of the UV base and rate cap on local government revenues in NSW can be seen in chart 5.1. Over the period between 2005/06 and 2014/15, the rate revenue received by local government in NSW has grown at a significantly slower pace compared to other states and territories, where a UV base, growth in rates based on UV, and the rate peg does not apply.

¹⁵ The CIE 2014, *Better regulation statement for the NSW planning reforms*, prepared for NSW Planning. The Better Regulation Statement estimated the impacts of the introduction of the *Planning Bill 2013* and the *Planning Administration Bill 2013* in conjunction with the regulatory changes that would occur alongside the primary legislation.

5.1 Relationship between population growth and rate revenue — 2005/06 to 2014/15



Data source: The CIE based on ABS data.

While these features have been successful in constraining total rate increases for councils, the impact on council revenue is significant.

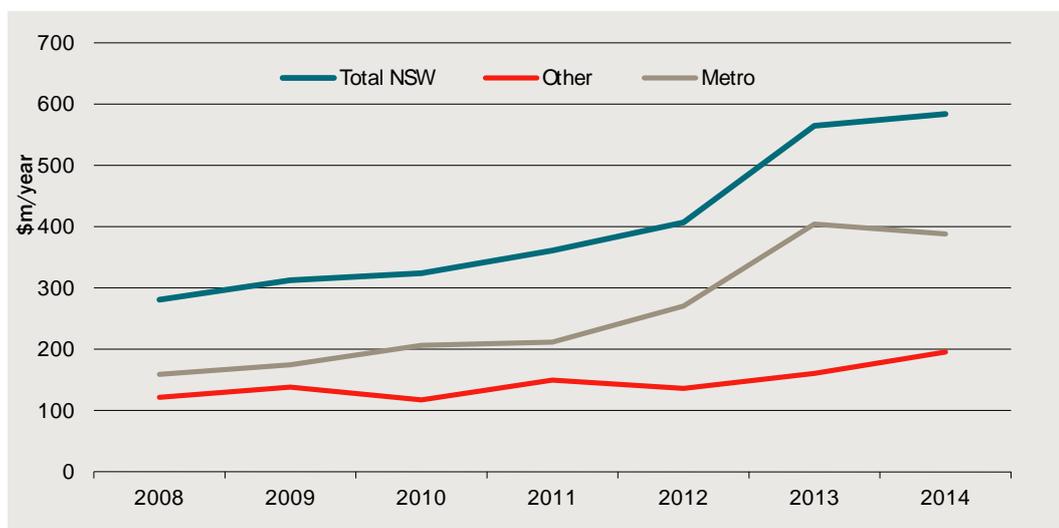
- The constraint on growth since 2005/06 means council revenue was \$922 million lower in 2014/15 than if it had grown at the same rate as other states.
- NSW per capita rate revenue also started at a lower level, leading to an additional \$900 million revenue shortfall.
- Hence, if rate revenue per person was the same in NSW as the average of other states, council revenue would have been \$1.8 billion higher in 2014/15.

Councils have sought to shift costs onto developers

The restrictions on council revenue and the current developer contributions framework have encouraged councils to shift as many costs as possible onto developers (chart 5.2). This has included costs directly related to the development, which is consistent with developer contributions being viewed as a user charge. However, it has also included shifting costs onto developers that are population-related or unrelated to either a specific development or population growth, such as amenity improvements or environmental projects.

Consequently, developer contributions in many LGAs exceed the marginal cost of development, meaning that some socially beneficial developments would be unfeasible. This would restrict development and over time, contribute to higher house prices.

5.2 Developer contributions collected by local councils

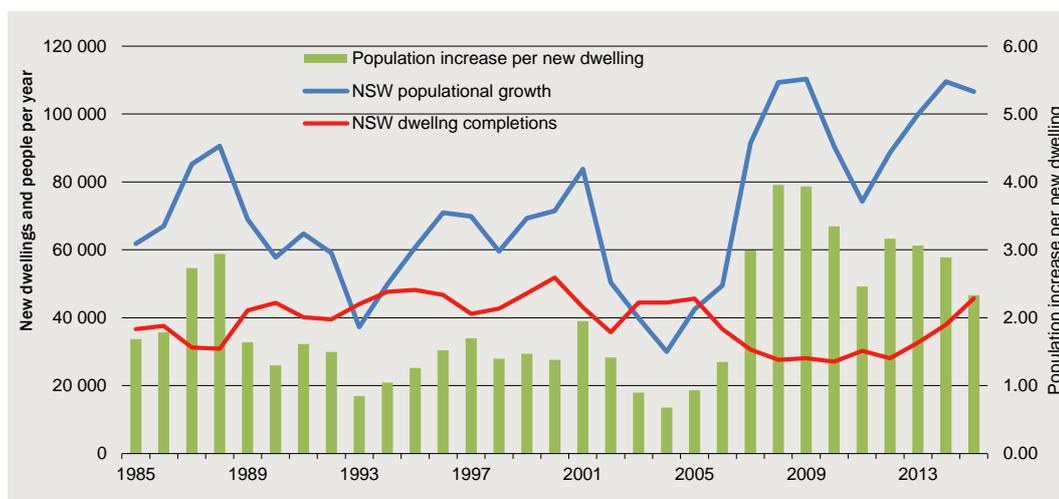


Data source: NSW Planning and Environment, based on council Not 17 reporting.

Councils have an incentive to restrict development

Alternatively, councils and local communities have an incentive to avoid population-related costs through restricting development. While at the statewide (or citywide) level, population growth and development are not closely related (chart 5.3), there is a closer relationship at the local level. Population tends to increase more in those LGAs with high levels of building approvals (chart 5.4). This suggests that councils that encourage development will incur a larger share of the population-related costs. However, this also implies that individual councils can avoid some of these costs by restricting development in their LGA.

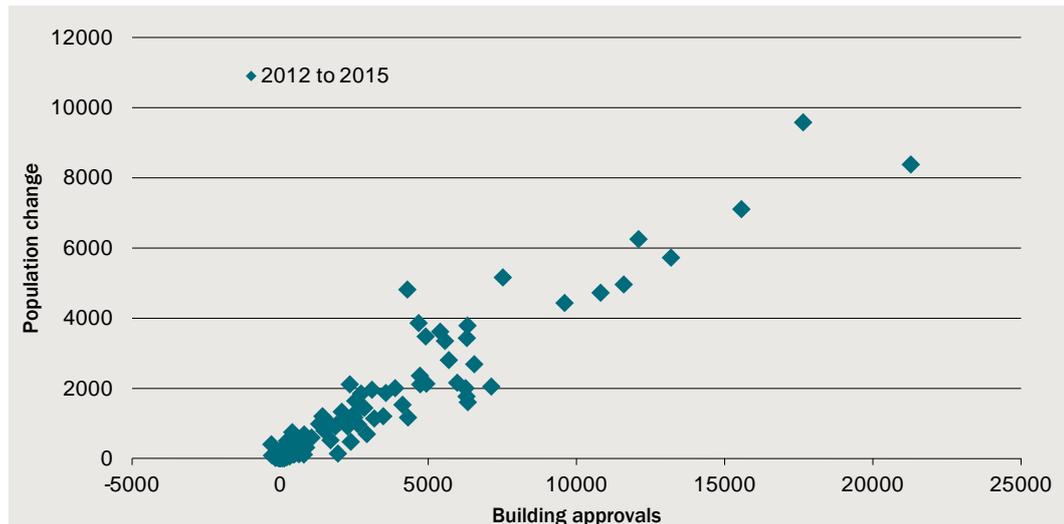
5.3 Population and dwelling growth NSW



Data source: The CIE based on ABS Building Activity and ABS Population data.

The Productivity Commission 2011 noted that fiscal constraints on local governments, such as rate capping in New South Wales, have led to a greater reliance on other funding alternatives (including development contributions) to fund infrastructure.¹⁶

5.4 Relationship between population change and building approvals by LGA



Data source: The CIE based on ABS Building Approvals and ABS Regional Population Estimates data.

Community opposition to development

The disconnect between population growth and council revenue also contributes to community opposition to development. Residents of Sydney have the lowest agreement level of any city surveyed by the Productivity Commission (14 per cent) to the statement that their State government is effective at planning and the second lowest agreement to the statement that local government is effective at planning (15 per cent).¹⁷

Further reflecting a distrust of planning, residents of Sydney are also the least agreeable to population growth. They are the most likely to note transport congestion and public transport crowding as reasons for not wanting population growth.¹⁸

How incentives manifest themselves

The incentives against new development manifest themselves through two main channels:

¹⁶ Productivity Commission 2011, Performance benchmarking of Australian business regulation: Planning, zoning and development assessment, Research Report, p. 207.

¹⁷ Productivity Commission 2011, Performance benchmarking of Australian business regulation: Planning, zoning and development assessment, Research Report, p. XXXVIII.

¹⁸ Productivity Commission 2011, Performance benchmarking of Australian business regulation: Planning, zoning and development assessment, Research Report, p. 28.

- In strategic planning an area, such as through the zoning and development controls applied through the Local Environment Plan and Development Control Plan, a council and their local community is incentivised to make decisions that allow for less development, or make it more costly for development to occur.
 - In practice, zoning does not act as a pure constraint on development, as zoning can be changed, but at a cost. Developers undertake spot rezonings to try to move sites to allow for more development
 - Development controls such as height restrictions or floor space ration restrictions also act to restrict development, but can be overcome if a developer is willing to incur the costs of seeking to do so, including through the courts
- In the development assessment process, councils can also seek to make changes to development sites, or can make this process more costly because they are negatively incentivised towards growth.

The estimated costs of restrictions on development in NSW of \$1-\$2 billion per year, comprise the combined changes of these and other effects.¹⁹ They include a higher cost of the development assessment process, higher risk for a developer of changes that influence their returns and the costs of restricting land from moving to its highest value use (table 5.5).

5.5 Estimates of potential gains from improved planning in NSW

Item	Low	High
	\$m/year	\$m/year
Costs associated with excessive delay and cost	174	312
Excessive risk	216	432
Inefficient land allocation	665	1 289
Total	1 055	2 034

Source: The CIE 2014, *Better regulation statement for the NSW planning reforms*, prepared for NSW Planning.

Benefits of improved incentives for councils

Attributing a part of the removal of these costs to improved incentives for councils and communities is difficult. It is not possible to be precise in this. However, even minor reductions (say 5 per cent) of this problem would have benefits well beyond the costs of the proposed changes (table 5.6).

- Based on a 5 per cent reduction, the benefits of IPART's proposal could deliver a benefit to the community of between \$450 million and \$865 million in present value terms over 15 years (post implementation), using a discount rate of 7 per cent.

¹⁹ The CIE 2014, *Better regulation statement for the NSW planning reforms*, prepared for NSW Planning. The Better Regulation Statement estimated the impacts of the introduction of the *Planning Bill 2013* and the *Planning Administration Bill 2013* in conjunction with the regulatory changes that would occur alongside the primary legislation.

- If IPART's proposal achieved a 10 per cent reduction, the benefits to the community could be between around \$900 million and \$1.7 billion in present value terms over 15 years (post implementation), using a discount rate of 7 per cent.

5.6 Indicative benefits of better incentives for councils

	Low	Central	High
	\$ million	\$ million	\$ million
Annual benefits			
5 per cent reduction	52.75	77.23	101.70
10 per cent reduction	105.50	154.45	203.40
Net present value^a			
5 per cent reduction	449.01	657.34	865.68
10 per cent reduction	898.02	1 314.69	1 731.35

^a Over 15 years (post implementation) using a discount rate of 7 per cent.

Note: Based on IPART proposal contributing 5 per cent to solving problem.

Source: CIE estimates.

Reduced constraints on population growth

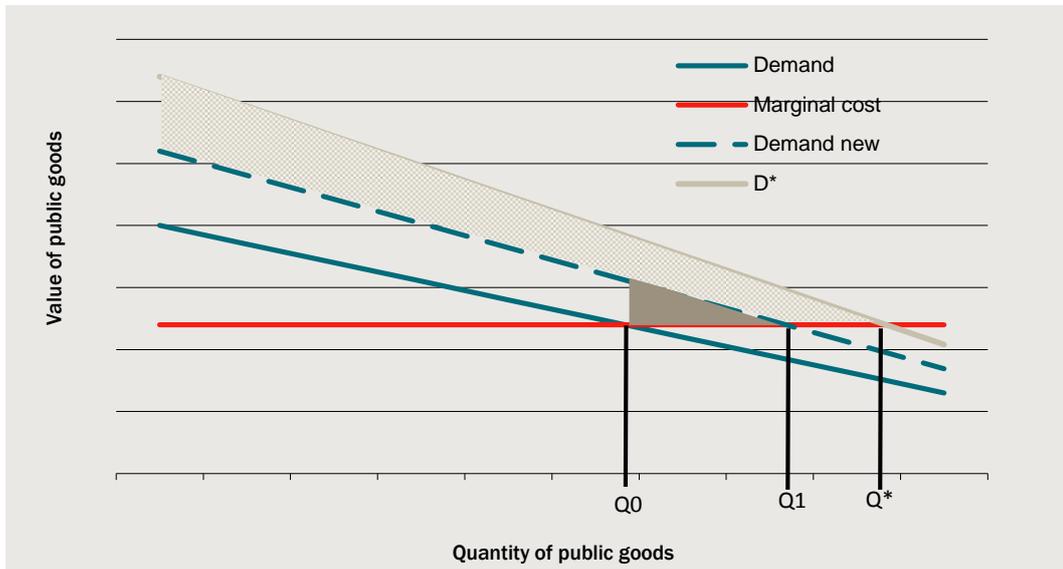
As noted by IPART, an alternative way to view the impact of its proposal is that it reduces the constraint on population growth (although chart 5.3 above suggests the relationship between development and population growth is weak). Additional development due to better incentives for councils and local communities could reduce the number of working aged people who are discouraged from residing in NSW (due to high house prices and traffic congestion etc.).

This would be a benefit to those people who would live in NSW, rather than a less preferred location (see the light-shaded area in chart 5.7). In addition, there may be some additional benefits to the broader community from higher population growth. Recent work by the Productivity Commission showed that younger people tend to have a net positive lifetime impact on the budget.²⁰ According to the NSW Government's recent Intergenerational Report, a growing population is one of the key strategies for addressing the emerging fiscal gap.²¹ Growth in the working age population is likely to alleviate the need for future tax increases to support the ageing population.

²⁰ Productivity Commission, *Migrant Intake into Australia*, Modelling immigrants fiscal impacts — Part 1, Technical Supplement D, April 2016, p. 18.

²¹ NSW Government, NSW Intergenerational Report 2016, Future State NSW 2056, p. 88.

5.7 Benefits to existing and new residents



Data source: IPART.

6 Summary of costs and benefits

Net benefits using the revenue collection approach

Using the efficiency of revenue collection approach, we estimate that IPART's proposal could deliver a net benefit to the community of between \$713 million and \$2.1 billion in net present value terms over 15 years (post-implementation) using a discount rate of 7 per cent. The central case scenario would deliver a net benefit of \$1.1 billion (table 6.1).

There are costs associated with implementing the new system, including the cost of obtaining CIV data, additional supplementary valuations and additional objections. As an indicative estimate, they could be in a range between \$32 million and \$85 million in present value terms over 15 years (post implementation) using a discount rate of 7 per cent. However, the efficiency benefits are likely to significantly outweigh these costs.

6.1 Estimated net benefits – revenue collection approach

	Low	Central	High
	\$ million	\$ million	\$ million
Costs			
Implementation costs	- 10.83	- 8.85	- 6.87
Additional supplementary valuations	- 48.04	- 32.19	- 16.34
Additional objections	- 26.23	- 16.25	- 8.38
Total costs	- 85.10	- 57.29	- 31.58
Benefits			
Direct benefits			
Savings from fewer special variations	16.23	20.29	24.34
Efficient revenue collection	333.27	518.41	1 259.01
Indirect benefits			
Incentives for growth ^a	449.01	657.34	865.68
Total benefits	798.51	1 196.05	2 149.03
Net benefit/cost	713.41	1 138.75	2 117.44

^a Based on a 5 per cent reduction in the estimated cost of incentives to restrict growth in NSW.

Note: Estimates are present in net present value terms over 15 years (post implementation), using a discount rate of 7 per cent.

Source: CIE estimates.

Net benefits using the improved services approach

Using the improved services approach to estimating the direct benefits of moving to CIV, the central case net benefit estimate is broadly similar to the efficiency of revenue collection approach presented above. We estimate that moving to a CIV approach for rate setting could deliver a net benefit of around \$1.1 billion in net present value terms over 15 years, using a discount rate of 7 per cent (table 6.2).

However, both the low and high estimates are lower using this approach, compared to the efficiency of revenue collection approach. In our lower bound estimate, IPART's proposal would deliver a net benefit of around \$506 million, while in our upper bound IPART's proposal would deliver a net benefit of around \$1.7 billion.

6.2 Estimated net benefits — improved services approach

	Low	Central	High
	\$ million	\$ million	\$ million
Costs			
Implementation costs	- 10.83	- 8.85	- 6.87
Additional supplementary valuations	- 48.04	- 32.19	- 16.34
Additional objections	- 26.23	- 16.25	- 8.38
Total costs	- 85.10	- 57.29	- 31.58
Benefits			
Direct benefits			
Savings from fewer special variations	16.23	20.29	24.34
Improved services	63.04	446.65	821.92
Indirect benefits			
Incentives for growth ^a	449.01	657.34	865.68
Total benefits	528.28	1 124.28	1 711.94
Net benefit/cost	443.18	1 066.99	1 680.36

^a Based on a 5 per cent reduction in the estimated cost of incentives to restrict growth in NSW.

Note: Estimates are present in net present value terms over 15 years (post implementation), using a discount rate of 7 per cent.

Source: CIE estimates.

Conclusions

Although there is some uncertainty around our estimates, we consider the broad conclusion that the efficiency benefits of IPART's proposal to move to a CIV approach to rate setting will outweigh the costs to be robust.

Our indicative estimates suggest the costs associated with moving to a CIV approach to rate setting could be in the tens of millions of dollars over time. However, even using highly conservative assumptions, the efficiency gains are estimated to be higher by a factor of between around 6 and more than 50. Our benefit estimates are in the order of hundreds of millions of dollars, up to more than \$2 billion. So even allowing for the

possibility of significant errors in our estimates, it is highly unlikely that the costs would outweigh the benefits.



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