Independent Pricing and Regulatory Tribunal
New South Wales

Review of prices for land valuation services provided by the Valuer General to councils

From 1 July 2019

Issues Paper

October 2018

ISBN 978-1-76049-261-8

The Independent Pricing and Regulatory Tribunal (IPART)

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Tribunal Members

The Tribunal members for this review are:

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Mr Ed Willett

Ms Deborah Cope

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Invitation for submissions

IPART invites written comment on this document and encourages all interested parties to provide submissions addressing the matters discussed.

The submission from the Valuer General is due by 30 November 2018. Submissions from all other stakeholders are due by 11 January 2019.

We would prefer to receive them electronically via our online submission form <www.ipart.nsw.gov.au/Home/Consumer_Information/Lodge_a_submission>.

You can also send comments by mail to:

Review of prices for land valuation services provided by the Valuer General
Independent Pricing and Regulatory Tribunal
PO Box K35
Haymarket Post Shop NSW 1240

Late submissions may not be accepted at the discretion of the Tribunal. Our normal practice is to make submissions publicly available on our website <www.ipart.nsw.gov.au> as soon as possible after the closing date for submissions. If you wish to view copies of submissions but do not have access to the website, you can make alternative arrangements by telephoning one of the staff members listed above.

We may choose not to publish a submission - for example, if it contains confidential or commercially sensitive information. If your submission contains information that you do not wish to be publicly disclosed, please indicate this clearly at the time of making the submission. However, it could be disclosed under the *Government Information (Public Access) Act 2009* (NSW) or the *Independent Pricing and Regulatory Tribunal Act 1992* (NSW), or where otherwise required by law.

If you would like further information on making a submission, IPART's submission policy is available on our website.

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1 Introduction

The Valuer General of NSW provides land valuation services to councils.[1] These land valuations are used by local councils as the basis for calculating and issuing rates notices to ratepayers. The income generated from rates comprises the main revenue source for councils, to fund infrastructure and services in their local government areas.

The Valuer General can charge a fee to local councils for providing them with land valuation services.[2] The Independent Pricing and Regulatory Tribunal of NSW ('IPART' or 'we') has determined the maximum charge that the Valuer General can levy councils for the provision of land valuation services.[3]

IPART last set the maximum prices the Valuer General can charge councils in May 2014. This determination is applicable for the period 1 July 2014 to 30 June 2019 (the 2014 determination period).

The Premier has requested IPART to determine the maximum prices the Valuer General can charge councils for the next six years, from 1 July 2019 to 30 June 2025 (the 2019 determination period).

This paper outlines our proposed approach to undertaking this review. It explains what this review will involve, outlines the issues we will consider, how we will conduct the review, and seeks comments from stakeholders.

1.1 What has IPART been asked to do?

The Premier has asked IPART, under section 12 of the *Independent Pricing and Regulatory Tribunal Act 1992* (the IPART Act), to set the maximum charges for the monopoly services provided by the Valuer General to councils, for the 2019 determination period. The Terms of Reference (ToR) ask us to:

- identify the Valuer General's full efficient economic costs of providing the monopoly services over the determination period or periods
- develop an efficient, effective and transparent pricing framework for the monopoly services
- consider the Valuer General's efficient costs of providing the monopoly services over the relevant determination period or periods

1 Section 48 of the *Valuation of Land Act* 1916 (the Act) requires the Valuer General to provide valuations to councils at least once every three years.

2 Section 55 of the Act.

3 The land valuation services provided to councils are 'government monopoly services'. The Valuer General also provides valuation services for taxation purposes and other specialist and private valuation services. These other valuation services are not monopoly services. Chapter 2 provides more detail on the role of the Valuer General.

- consider the efficient allocation of the costs of the monopoly services between the users of those services in accordance with relevant economic and pricing principles
- consider the scope for the Valuer General to achieve efficiency savings in providing the monopoly services, and
- specify the duration of the relevant determination period or periods.

In undertaking our role, we can also take into account any other matters we consider relevant. Our full ToR is listed at Appendix A.

Further, in reaching our decisions, we must also have regard to the range of matters listed under section 15 of the IPART Act. This includes having regard to the needs and interests of the regulated business, its customers, other stakeholders and the broader community (see Appendix B for the list of section 15 matters).

The referral period under the ToR is six years (1 July 2019 to 30 June 2025), which can incorporate annual or other periodic pricing determinations if necessary.

1.2 What does this Issues Paper cover?

This Issues Paper explains the process we will follow, the approach we will use and the key issues we will consider in conducting the review. It sets out our preliminary views on issues related to the review and seeks stakeholder feedback.

In accordance with our ToR, our proposed approach involves:

- establishing (not setting) the services that the Valuer General provides to its customers (ie, the obligations for service and expected level of service provided)
- establishing the efficient costs of providing those services (ie, determining the revenue requirements) including consideration of the scope for efficiency savings
- allocating the costs of the operation (revenue requirements) to the various user groups (in particular, local councils), and
- setting maximum prices for the valuation services provided to councils – by either determining a price path for the charges or a methodology for determining those charges in future years.

Figure 1.1 presents our approach to the review. The remainder of this paper is structured around this approach.

Figure 1.1 IPART's proposed approach to the review

Obligations for service provision

- What are the services that the Valuer General is required to deliver to customers and to what standard?
- What are consumers' expectations about the level of service to be provided?

Revenue requirements

Establish the efficient costs of providing the Valuer General's services to its customers. This will require:

- estimating the annual efficient operating expenditure
- assessing the appropriate asset base and asset lives to derive the appropriate
  - depreciation rate on assets invested (Return of Capital)
  - rate of return on assets invested (Return on Capital)
- assessing the prudence and efficiency of any projected capital expenditure over the period of the determination

Allocation of costs

How should the efficient costs of delivering the services be allocated between different users?

There are:

- Local councils
- Revenue NSW
- State Government on behalf of other departments and agencies
- Other users.

Price structure

- How should the Valuer General's prices be structured to recover the efficient costs of providing valuation services to local councils?

1.3 How will we conduct the review

For this review, we will conduct a public consultation process and our own research and analysis. This Issues Paper is the first step in helping us to identify and understand the key issues for the review and gather stakeholders' views.

In September 2018, we asked the Valuer General to submit a pricing proposal to this review. We asked the Valuer General to include information about past performance and proposed future prices (and the basis for these prices) as well as other issues the Valuer General considers important to this review. We have also included a list of questions in Appendix D for the Valuer General to address in his submission.[4] The Valuer General's pricing submission is due by **30 November 2018** and will be published on our website.

We raise questions throughout the paper (reproduced in Section 1.5) and invite interested stakeholders to respond to these questions, the Valuer General's submission, and to raise any other issue they consider important to this review.

Stakeholders will have multiple opportunities to express their views during this review, including by:

- making a submission in response to this Issues Paper and the Valuer General's submission
- attending the public hearing, and
- making a submission in response to our Draft Report.

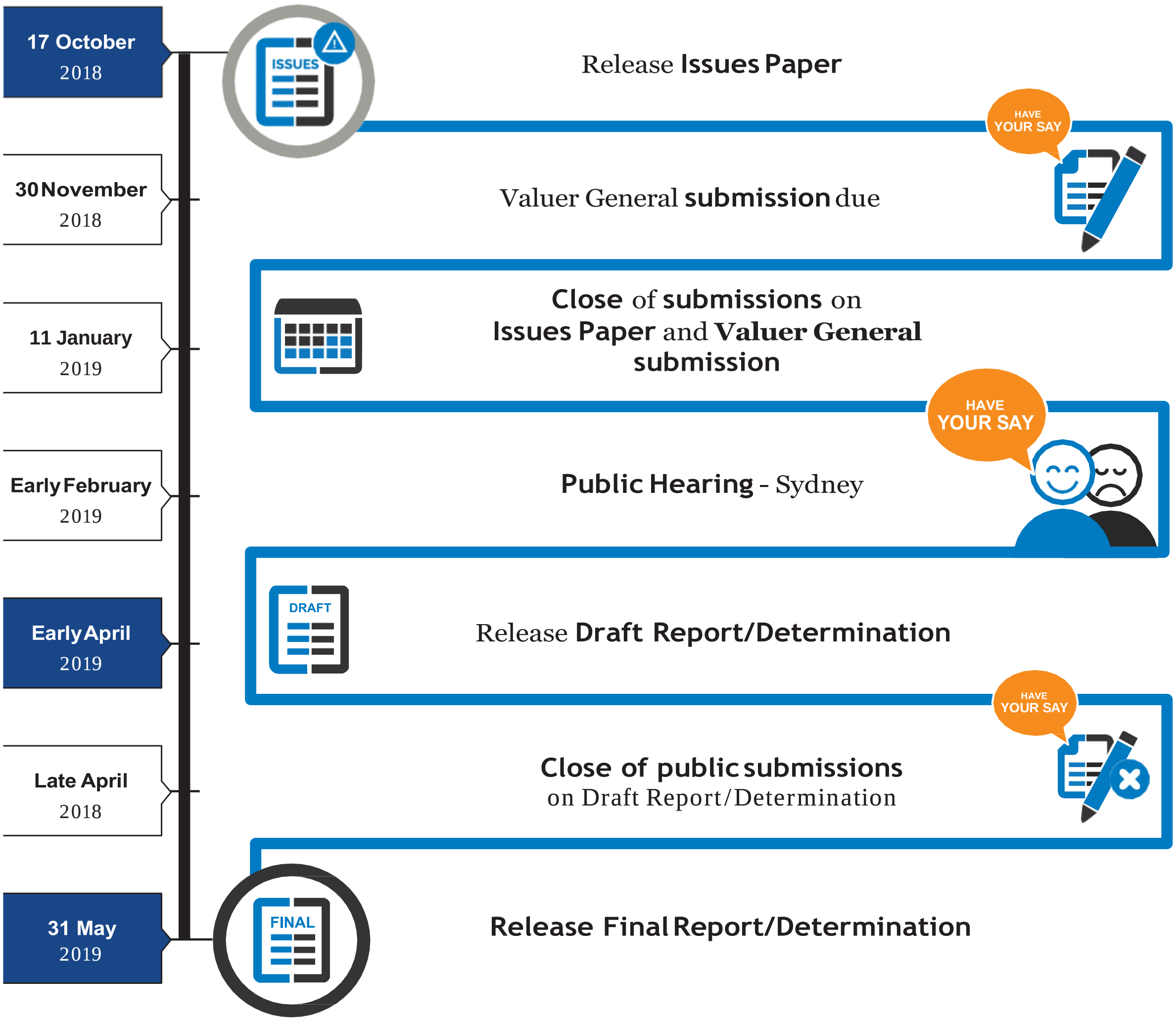
We invite all interested parties to lodge submissions in response to this Issues Paper. Details about how to make a submission are included at page iii above. Stakeholder submissions are due by **11 January 2019**.

We also invite all stakeholders to express their views at a public hearing on **12 February 2019**.

We will consider the comments of all stakeholders before making draft and final decisions. Figure 1.2 sets out an indicative timetable for the review. We may provide an updated timetable on our website as the review progresses.

4 The list of questions at Appendix D are specifically for the Valuer General's submission.

Figure 1.2 Indicative timeline for this review



Note: These dates are indicative and may change.

1.4 What is the structure of this Issues paper?

The rest of this Issues Paper provides more information on the review, our proposed pricing framework and the key issues we will need to consider:

- Chapter 2 outlines the context for the review including the Valuer General's role in providing valuation services and his legislative and regulatory responsibilities.
- Chapter 3 discusses the decisions we will need to make before we can set prices, including the form of regulation to apply, and how much revenue the Valuer General needs to provide his services efficiently.
- Chapter 4 outlines our overarching principles for setting prices, including price structures and potential price paths over the determination period.

1.5 Issues we seek comment on

Throughout this paper, we have set out the questions on which we particularly seek stakeholder feedback. For convenience, these questions are also listed below. Stakeholders are welcome to comment on any of these views and questions, and raise other issues they consider relevant to this review.

Decisions we will make before setting prices

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Allocating efficient costs to councils

12 Is there a case for changing the methodology for allocating costs to councils? If so, on what basis should costs be allocated? 27

Setting prices

IPART seeks comment on the Valuer General's pricing submission due in November

A pricing submission from the Valuer General is due on **30 November 2018.** We also seek stakeholder comment on the Valuer General's submission, which we will post on our website once we have received it. The questions we seek feedback on are listed here.

2 Context for the review

Our review will determine the prices the Valuer General can charge local councils for providing land valuation services for rating purposes. We will not set prices for the other land valuation services the Valuer General provides, as these are not government monopoly services.

This review also does not address issues with the land valuation system itself, such as the methodology used for valuations. However in the sections below we provide some background on the methodology used to determine land values as this influences the Valuer General's costs of undertaking land valuations.

The remainder of this chapter outlines the role of the Valuer General, the valuation services the Valuer General provides and the users of these valuation services. We also outline key developments since we made our 2014 determination and their potential implications for this review.

2.1 The Valuer General oversees the land valuation system

The Valuer General is an independent statutory officer appointed by the Governor of New South Wales to oversee the State's land valuation system.[5] The Valuer General sets the standards for the provision of a valuation system to meet the needs of various users, which include landowners, members of the public, ratepayers, land tax clients and state and local government.

The general role of the Valuer General is to:[6]

- exercise functions with respect to the valuation of land in the State
- ensure the integrity of valuations, and
- keep a Register of Land Values, which must contain information on ownership, occupation, title, location, description, area, and value of the land.[7]

2.1.1 Governance and accountability

The Valuer General reports administratively to the Minister for the Department of Finance, Service and Innovation (DFSI).[8] The Office of the Valuer General (OVG) is a small team of about seven people, but the Valuer General can delegate functions under the *Valuation of Land*

5 The statutory functions of the Valuer General are set out in the Act. See also http://www.valuergeneral.nsw.gov.au/about_us, accessed 4 October 2018.
6 Section 8 of the Act.
7 Section 14CC of the Act.
8 NSW Government, *Valuer General Governance and accountability*, accessed 4 October 2018 from http://www.valuergeneral.nsw.gov.au/about_us/governance_and_accountability

Act, 1916 (the Act)[9] and enter into valuation service contracts for the provision of valuation services.[10]

The Valuer General has delegated operational responsibilities to Property NSW (a business unit of DFSI), to manage the valuation system under a Service Level Agreement (SLA). Prior to 2016, the Valuation Services unit of Land and Property Information (VSLPI), a division of the then Office of Finance and Services (OFS), undertook this function.

Property NSW's valuation services include the provision of information to stakeholders, managing valuation contracts and the objection review process, maintaining the Register of Land Values, determining compensation and the development of operational procedures.[11]

When we set prices in the 2014 determination we reviewed the VSLPI's efficient costs. As Property NSW now undertakes VSLPI's functions and contributes most of the costs to the Valuer General's services, we will review the efficient costs of Property NSW's valuation services for our 2019 determination.

Other bodies that have a role in the Valuer General's operational framework include:

- The Parliamentary Committee on the Office of the Valuer General (the Committee), which monitors and reviews the exercise of the Valuer General's functions related to land valuations. The Committee does not have the ability to review individual valuations or objections to individual valuations. The Valuer General is responsible for processing these issues.
- The Land Valuation Advisory Group (LVAG) which monitors the quality of land valuations and provides a channel for communication between the Valuer General and stakeholders. The LVAG includes senior representatives from various organisations.[12]

The governance and administrative arrangements for the Valuer General are presented in Figure 2.1.

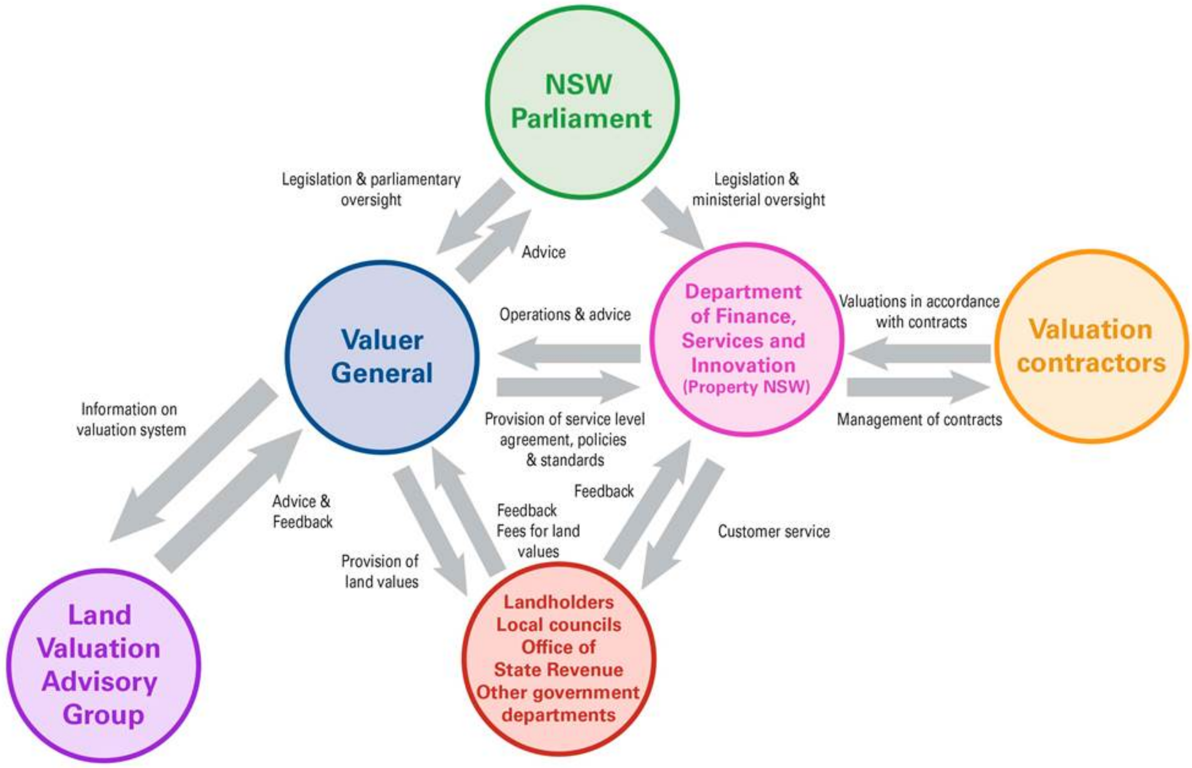
9 Under section 8 of the Act, the Valuer General may delegate any functions conferred or imposed on him to any other person.

10 Section 13A of the Act.

11 http://www.valuergeneral.nsw.gov.au/about_us/valuation_system_management, accessed 4 October 2018.

12 These organisations include, among others, the Australian Property Institute, Local Government NSW and the Real Estate Institute of NSW.
See http://www.valuergeneral.nsw.gov.au/about_us/governance_and_accountability,
Accessed 4 October 2018.

Figure 2.1 Operational framework for the Valuer General



Source: NSW Government, Valuer General *governance and accountability*, accessed on 4 October 2018 from http://www.valuergeneral.nsw.gov.au/about_us/governance_and_accountability

2.1.2 What valuation services does the Valuer General provide?

The Valuer General provides valuation services to councils for rating purposes, which are government monopoly services and within the scope of our review. The Valuer General also undertakes other land valuation functions which are outside the scope of this review. The full range of valuation services provided by the Valuer General includes:

- land values for rating and taxing purposes
- the determination of compensation following the compulsory acquisition of land
- an objections and appeals process against valuations, and
- specialist/private valuations and property advice to government.

We plan to assess the Valuer General's total required revenue for providing all land valuation services including for rating, taxing and other purposes. We will then determine the share of these costs attributable to providing valuation services to council, to set prices for these services. The components of the revenue required to provide valuation services are outlined in further detail in Chapter 3.

The different valuation services provided by the Valuer General, including those to councils for ratings purposes, are outlined below.

Valuation of land for council rates and land tax

The main purpose for assessing and recording values of land is to enable the levying of taxes (eg, land taxes), rates (eg, council rates), and duties by the State and local governments.

The Valuer General must issue land values to councils for rating purposes at least every three years.[13] These land values are fixed for rating purposes until new land values are issued to the council. The Valuer General must also issue a Notice of Valuation to the landowner or any person liable to pay a rate or tax in respect of the land.[14]

Land values are also provided each year to Revenue NSW[15] for the calculation of land tax under the *Land Tax Management Act 1956* (NSW).[16] We do not regulate the prices of these services and, as noted, remove the costs of providing these services from the revenue requirement before setting prices for councils (see Chapter 3).

Those who receive a Notice of Valuation have a right of objection to the valuation by the Valuer General. They have a further right to appeal to the Land and Environment Court if they are dissatisfied with the results of the objections process.[17] The costs associated with the objection process (and any revaluation required) are included in prices, as this process forms part the of the land valuation service provided to councils.

Compensation for compulsory acquisitions

State and local government agencies may compulsorily acquire land for a range of purposes.

If a settlement cannot be negotiated between the acquiring authority and landowner, the Valuer General is to determine, in accordance with the *Land Acquisition (Just Terms Compensation) Act 1991 (NSW)*, the amount of compensation to be offered.[18] Relevant matters determining compensation include the market value of the land. As noted above, Property NSW manages this process under delegated authority from the Valuer General.

These valuations are charged on a fee-for-service basis. They are not declared a government monopoly service and therefore we do not regulate prices for them.

Private valuations and valuation services to other government agencies

The Valuer General may make a valuation of land at the request of any person.[19] Private brokers and the general public are charged on a fee-for-service basis.

Other government agencies that use the Valuer General's services include:

13 Section 48 of the Act.
14 Section 29 of the Act.
15 Previously Office of State Revenue (OSR).
16 Section 48 of the Act.
17 Part 4 of the Act.
18 Section 68 of the Act.
19 Section 9A of the Act.

- **Fire and Rescue NSW**: to set levies on the insurance industry and local councils. Land values are provided for all rateable land within any area constituted as a fire district under section 5 of the *Fire Brigades Act 1989* (NSW).[20]
- **NSW Government agencies**: various agencies, including Roads & Maritime Services and NSW Crown Lands, use valuations for the calculation of leases (rental of Government property). These agencies do not pay for access to the information.
- **Commonwealth Grants Commission:** uses land valuations to assist in the allocation of Commonwealth grants between States and Territories.

Private valuations and valuation services provided to other government agencies are charged on a fee-for-service basis. They are not declared a government monopoly service and therefore we do not regulate prices for them.

2.2 The Valuer General uses a mass valuation approach

Most land in New South Wales is valued using mass valuation, where properties are valued in groups called components.[21] The properties in each component are similar or expected to reflect changes in value in a similar way.

Representative properties in each component are individually valued as at 1 July each year to determine how much the land value has changed from the previous year.[22] The change is applied to all properties in the component to determine new land values. Sample valuations are checked to confirm the accuracy of the new values.[23]

Land valuations take into consideration factors such as the most valuable use of the land, zoning, heritage or other constraints, size, shape and features and nearby development and infrastructure.[24] Capital improvements to the land are excluded from land valuations.

Property sales are the most important factor considered when determining land values. Valuers analyse sales of both vacant land and improved properties, making adjustments for the added value of improvements.[25] Finding a comparable sales base can be difficult for certain, more specialised property types.[26]

When comparing property sales to the land being valued, valuers consider factors such as:[27]

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20 The Valuer General must provide these valuations under section 67 of the Act. The NSW Government had planned to change the funding system for fire and emergency services, from an ‘insurance-based’ to a ‘property based’ system from 1 July 2017. However, it deferred the introduction of the new system pending further policy review. In the interim, insurance companies will continue to collect the Emergency Services Levy (ESL) via insurance premiums as has been done in previous years.

21 NSW Government, *Valuer General, Valuation Method*, accessed on 4 October 2018 from http://www.valuergeneral.nsw.gov.au/land_values/valuation_method

22 Section 14B of the Act.

23 NSW Government, *Valuer General, Valuation Method*, accessed on 4 October 2018 from http://www.valuergeneral.nsw.gov.au/land_values/valuation_method, accessed on 5 October 2018.

24 http://www.valuergeneral.nsw.gov.au/land_values/valuation_method, accessed on 5 October 2018.

25 NSW Government, *Valuer General, Valuation Method*, accessed on 4 October 2018 from http://www.valuergeneral.nsw.gov.au/land_values/valuation_method

26 Hefferan, M.J. & Boyd, T, 2010, ‘*Property taxation and mass appraisal valuations in Australia – adapting to a new environment*’, *Property Management*, vol. 28, no. 3, p 9.

27 NSW Government, *Valuer General, Valuation Method*, accessed on 4 October 2018 from http://www.valuergeneral.nsw.gov.au/land_values/valuation_method

- the most valuable use of the land
- zoning, heritage restrictions or other use constraints
- land size, shape and features such as slope and soil type, and
- nearby development and infrastructure.

Our review does not address the integrity of land valuations or how they are used (ie, as the basis for *ad valorem* rates for councils). We note that the land valuation process (ie, the basis on which land is valued, the frequency of valuations, and sampling methods used to determine land values) will influence the cost of undertaking mass valuations (eg, contractor costs) and ultimately prices charged to users of the Valuer General's land valuation services.

2.3 Impacts from key developments since making the 2014 determination

This section summarises our understanding of the key developments since making our 2014 determination of the Valuer General's prices to councils in 2014.

2.3.1 Valuation services is now part of Property NSW

As noted in Section 2.1.1, the Valuation Services unit was transferred from Land and Property Information (LPI) to Property NSW in 2016. Property NSW is a business unit in DFSI. However, other than the direct transfer of functions, we are not aware of any material change in the type or level of valuation services provided by Property NSW compared to those previously provided by LPI.

2.3.2 Timing of land valuations for councils

Amendments to the Act in 2017 required the Valuer General to provide new valuations to all local councils at least every three years (in lieu of the previous four years) and removed the discretion to extend the period between valuations for rating, if the market was inactive.[28] In 2017, the Valuer General also implemented a common valuation cycle to provide all council valuations on the same day, every three years, to meet the then requirements of the *Fire and Emergency Services Levy Act 2017.*[29]

The Valuer General's 2016-17 Annual Report noted that all costs associated with printing, mailing, customer enquiries and objections were brought forward from future years, with the introduction of the common valuation cycle for councils.[30] However, given that the Valuer General undertakes annual valuations for Revenue NSW, we anticipate that the majority of costs (eg, contract costs) would still be evenly spread across the determination years.

The ToR for this review sets a six year referral period, compared to the previous five year referral period. This will allow for two full valuation cycles to be competed under the 2019 determination. While we understand that the Valuer General's costs and services are

28 NSW Government, *NSW Valuer General Annual Report 2016-17*, p 21.

29 As noted above, the implementation of the Fire and Emergency Service Levy (FESL) was postponed in May 2017. Nevertheless, the Valuer General has maintained the common valuation cycle implemented in 2017.

30 NSW Government, NSW Valuer General Annual Report 2016-17, pp 18 and 56.

relatively stable, six years may be a long period without some fundamental reassessment of costs, cost structures or levels of service. We also do not know the full impact of incurring the associated mailing and printing costs mentioned above, in the first and fourth years of a six year referral period.

Under the ToR we have scope to issue more than one determination over the referral period. We seek stakeholder feedback on whether IPART should undertake one or more determinations over the 6-year referral period.

IPART seeks comments on the following

1 Should IPART set one 6-year determination, or two 3-year determinations over the 6-year referral period?

3 Decisions we will make before setting prices

The rest of this Issues Paper sets out the key decisions we will make as part of this review to set the Valuer General's maximum prices to councils for valuation services.

This chapter discusses the issues we will need to consider before setting prices, including the level and type of services delivered, what form of regulation to apply, how much revenue the Valuer General needs to provide services efficiently and how much of that revenue requirement should be attributed to the valuation services provided to councils.

3.1 Level of service

To calculate efficient costs, the first step is to define the level of service to be provided. A change in the level of service delivered by the Valuer General, or how those services are delivered, may change the associated efficient costs.

As noted in Chapter 2, the functions of the Valuer General are statutorily defined and much of the nature of the land valuation services provided to councils is also prescribed under the Act (eg, general valuation is to be valued as at 1 July in the valuing year, information contained in the Register of Land Values, requirements to notify valuations to landowners).[31]

We also note that the quality of the valuation services provided by the Valuer General is regularly monitored, such as through the Committee's 2016 review of the Valuer General's annual reports and the 2013 inquiry into the land valuation system.[32] Other inquiries include those of the Ombudsman[33] and the earlier inquiries conducted by the Committee (2010).[34]

Previously land values for rating were provided to landholders and councils every three to four years on a rolling cycle, with approximately 700,000 to 800,000 notices issued each year.[35] As noted in Chapter 2, the Valuer General now provides all council valuations at the same time every three years. This may introduce a more lumpy cost structure, as non-contract costs are brought forward from future years to the common year in which valuations are provided to councils.[36]

IPART does not intend to prescribe the service level required. However, we do seek the views of stakeholders on the quality of the services received from the Valuer General since we last determined prices in 2014. We are also interested in knowing if and how the nature of services

31 Sections 14B, 14CC, and 32 of the Act.

32 NSW Government, NSW Valuer General Annual Report 2016-17, p 15; Parliament of NSW, *Report on the Inquiry into the Land Valuation System*, Report 2/55, May 2013.

33 NSW Ombudsman, *Improving the Quality of Land Valuations issued by the Valuer-General: A special report to Parliament under s31 and s26 of the Ombudsman Act 1974*, October 2005.

34 See for example, *Report on the Sixth General Meeting with the Valuer General*, accessed on 5 October 2018, https://www.parliament.nsw.gov.au/ladocs/inquiries/1676/Final%20Report%20on%206th%20General%20Meeting.pdf

35 NSW Government, NSW Valuer General Annual Report 2016-17, p 18.

36 NSW Government, NSW Valuer General Annual Report 2016-17, pp 18 and 56.

provided by the Valuer General has changed since our last review, as well as the relationship between the nature and quality of services and the efficient costs of providing those services.

IPART seeks comments on the following:

2 Have the land valuation services provided by the Valuer General changed since the 2014 Determination?

3 Is the quality of land valuation services provided by the Valuer General meeting customers' expectations?

3.2 Should we change the form of regulation?

The 'form of regulation' we adopt is the set of methods we use to regulate prices for monopoly services. These methods involve how costs are assessed, how prices are controlled, and how our regulatory approach provides appropriate incentives for the Valuer General to become more efficient.

In our 2014 determination, we controlled prices directly by setting maximum prices for each year of the determination. This 'price cap' form of regulation uses the building-block approach to define the Valuer General's efficient costs (discussed below).

Our preliminary view is to maintain the price cap approach we used to set prices in 2014. However, the Valuer General or other stakeholders may propose changing the form of regulation we apply. Potential alternative approaches include:

- **Weighted average price cap(s) (WAPC)** – where we set an overall weighted average price that the Valuer General can charge for his services. The Valuer General then has some flexibility to vary the types and levels of individual charges to councils over the regulatory period, subject to defined constraints.[37],[38]
- **A revenue cap** – where we set the total revenue that the Valuer General can receive for his regulated monopoly services. This would also allow the Valuer General some flexibility around the individual charges to councils over the regulatory period.
- **Using a cost index to adjust prices** – where prices for subsequent years are determined by indexing the cost base, once a cost base is established. This would require an annual adjustment to prices as discussed below.

3.2.1 Using a cost index to adjust annual prices

Our 2014 determination raised the possibility of using an index as an approach to setting prices once an efficient cost base is established (eg, via the building block method discussed

37 For instance, we could set the weighted price for a single valuation based on a basket of the total number of residential and non-residential valuations. The Valuer General could then have the flexibility to develop an *individual* price for each of a residential and non-residential valuation – as long as the *weighted price* based on that basket was no higher than we set.

38 One possible WAPC approach may involve us setting price caps in the first year of the regulatory period, and allowing the Valuer General to progressively vary his individual charges in the following years, with constraints around how that price flexibility is applied.

in 3.3.1 below).[39] For example, this index could build on the cost base of 2018-19 (the last year of the 2014 determination), with prices determined from 1 July 2019 by indexing this cost base. Alternatively, it could build on costs and prices established in the first year of the 2019 determination period, with prices for subsequent years of the 2019 determination period calculated using the cost index.

Given operating expenditure accounts for more than 90% of total efficient costs and updated data on the drivers of these costs are readily available,[40] a case could be made for setting prices using an indexation approach. In submissions to our last determination, councils were concerned that any increase in prices for the Valuer General's services would not exceed the level of the rate peg, but noted that the index could be the rate peg that we set to cap councils' maximum annual general income increases.

For the 2014 determination, we set price caps based on a building block approach to ensure that prices are cost-reflective and that an efficient cost base is established to which an index could be potentially applied in future determinations.

We will assess any stakeholder proposals by considering whether the potential benefits are likely to outweigh the associated risks and costs. Specifically, we will consider the following:

- **Potential benefits**: whether the proposed change promotes outcomes that are more consistent with competitive market outcomes (including allocative, productive and dynamic efficiency);[41] the efficient allocation of risk between the Valuer General and councils; and responsiveness to customer preferences.
- **Potential limitations and risks:** whether the proposed change may lead to unintended consequences.
- **Potential costs**: whether the proposed change could lead to a more complex and administratively burdensome regulatory environment.

IPART seeks comments on the following:

4 Is the price cap methodology currently used, the most appropriate form of regulation for setting prices for land valuation services provided by the Valuer General to councils?

5 What alternative form of regulation should be adopted, if any?

6 Should an indexation approach be used to set the maximum annual prices for the Valuer General's land valuation services to councils, once an efficient cost base is established?

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39 IPART, *Review of prices for land valuation services provided by the Valuer-General to councils – From 1 July 2014 to 30 June 2019*, Final Report, May 2014, p 62.

40 For example, public sector wage increases as reported on a quarterly basis by the Australian Bureau of Statistics.

41 Allocative efficiency occurs when goods and services are distributed according to consumer preference; price always equals marginal cost. Productive efficiency occurs when the optimal combination of inputs results in the maximum amount of output at minimal cost; marginal costs equal average costs. Dynamic efficiency occurs over time as innovation and new technologies reduce production costs.

3.3 How much revenue does the Valuer General need to deliver services efficiently?

A critical step in determining prices is to calculate the notional revenue requirement (NRR), which represents our view of the total efficient costs of providing the Valuer General's services in each year of the determination period (Figure 3.1). We propose to:

1. use the 'building block' methodology to calculate the total NRR (Section 3.3.1)
2. determine what portion of the Valuer General's NRR should be allocated to providing valuation services to councils
3. generate the target revenue, or the revenue to be raised through prices to councils, having reference to the portion of the NRR allocated to providing valuation services to councils, and
4. set prices to recover the target revenue.

Any difference between our assessment of the councils' annual share of the Valuer General's NRR (step 2 above) and the target revenue to be recovered from prices to councils in each year of the determination period (steps 3 and 4 above) is likely just to ensure prices are sufficiently smoothed over the determination period and there is no unnecessary volatility. Our usual approach is to ensure that target revenue equates to the level of efficient costs (or share of NRR) to be recovered over the determination period, in present value terms (even though there may be some relatively minor differences in any one year).

3.3.1 The building block approach

As for our previous determinations, we intend to use the 'building-block' approach to calculate the Valuer General's NRR. This method involves determining, for each year of the determination period, an allowance for:

- **Operating expenditure**, which represents our estimate of the efficient level of forecast operating, maintenance and administration costs of delivering services. In our 2014 determination, operating expenditure made up around 94% of the total NRR allocated to councils.[42]
- A **return on assets** the Valuer General uses to provide valuation services. This is our assessment of the opportunity cost of the capital the Valuer General invests,[43] and ensures that the Valuer General can continue to make efficient capital investments in the future. To calculate this amount, we decide on the prudent and efficient levels of past and forecast capital expenditure, the value of the Valuer General's regulatory asset base (RAB),[44] and the appropriate weighted average cost of capital (WACC) to apply to the RAB.

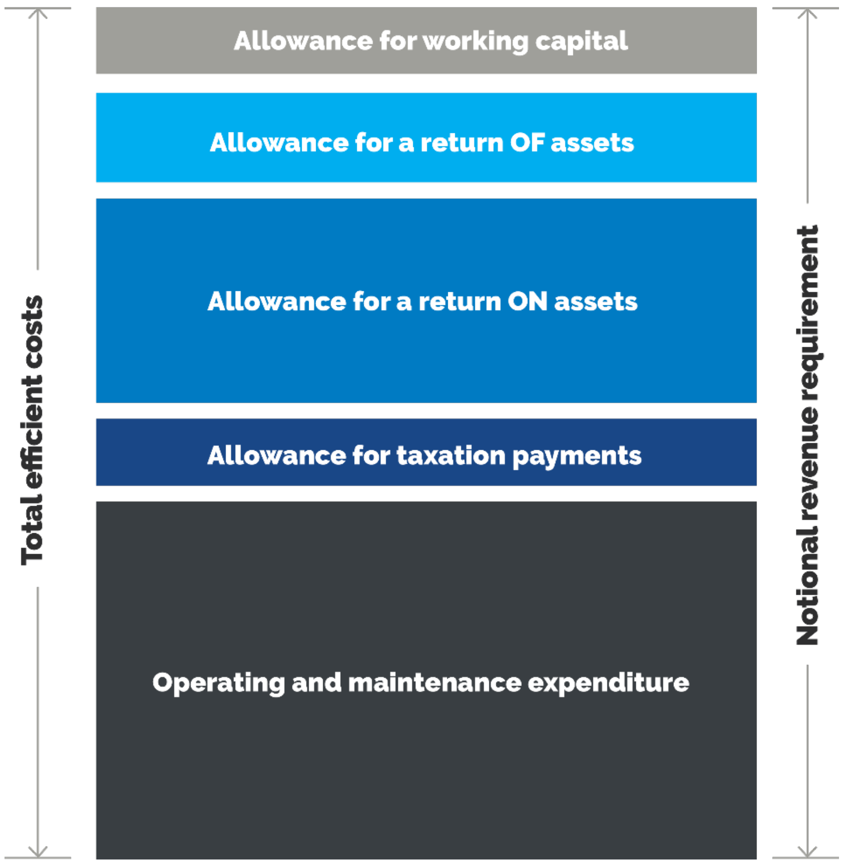
42 IPART, *Review of prices for land valuation services provided by the Valuer-General to councils – From 1 July 2014 to 30 June 2019*, Final Report, May 2014, p 55 and IPART analysis.

43 The opportunity cost of using capital for one purpose is the expected revenue foregone from investing that capital in its best alternative use.

44 The regulatory asset base is our estimate of the economic value of assets needed to deliver the regulated services.

- A **return of those assets** (regulatory depreciation). This allowance recognises that, through the provision of services to customers, capital infrastructure wears out over time, and revenue must recover the cost of maintaining the RAB. We propose to continue to use the straight-line depreciation method, which means the total value of an asset is recovered evenly over its assumed life.
- An **allowance for meeting tax obligations** which reflects the forecast tax liability for a comparable commercial business.
- An **allowance for working capital**, which represents the holding cost of net current assets.

Figure 3.1 Building block approach for calculating the notional revenue requirement



Note: Proportions are illustrative only.

The sum of these allowances is the NRR. In determining the Valuer General's NRR, we will assess the prudent and efficient capital and operating costs of delivering the Valuer General's services. This will include an assessment of the efficiency gains the Valuer General can reasonably achieve over the 2019 determination period.

For our 2014 determination, we calculated the total NRR for each year of the determination period as shown in Table 3.1 (adjusted for inflation to convert to $2018-19).

Table 3.1 IPART's 2014 decision on the Valuer General's total NRR ($2018-19, $'000)

	2014-15 ($'000)	2015-16 ($'000)	2016-17 ($'000)	2017-18 ($'000)	2018-19 ($'000)	Allowance as % of total
Operating expenditure	47,278	47,278	47,278	47,278	47,278	94.2%
Regulatory depreciation	2,767	2,571	2,249	1,950	1,590	4.4%
Return on assets	559	515	473	451	449	1.0%
Allowance for working capital	134	138	142	145	148	0.3%
Allowance for taxation	80	76	67	57	48	0.1%
Notional revenue requirement	**50,818**	**50,579**	**50,209**	**49,881**	**49,513**	100%

Note: These figures represent the Valuer General's total NRR for delivering all valuation services in the 2014 determination period. The costs of providing valuation services to councils only account for a portion of the NRR presented here. Section 3.4 discusses how we determined the portion of the NRR applicable to councils.

Source: IPART, *Review of prices for land valuation services provided by the Valuer-General to councils – From 1 July 2014 to 30 June 2019,* Final Report, May 2014, p 28 and IPART analysis.

3.3.2 Operating expenditure

As seen in Table 3.1, operating expenditure made up around 94% of the Valuer General's total NRR. Therefore, our decision on the efficient level of operating expenditure is a critical step in determining the Valuer General's total efficient costs, the NRR.

Operating costs are the ongoing expenses of providing and maintaining valuation services. The following costs are generally associated with providing valuation services:

- Direct costs of the Valuer General's office, predominantly labour costs.
- Direct costs of Property NSW for providing general valuation services, including but not limited to:
  - direct labour costs and on-costs
  - mass valuation contracts
  - other valuation contracts (for objections and appeals), and
  - rent and postage (eg, property value notifications to ratepayers).
- Allocated corporate costs from Property NSW to Valuation Services Property NSW, including but not limited to:
  - corporate overheads, and
  - spatial, titling and graphic services.

Direct costs of Valuer General and Property NSW

Our 2014 determination found that labour and mass valuation contract costs formed the majority of total operating expenditure (at 30% and 42% respectively), with other valuation contracts related to objections accounting for another 7% of total operating expenditure.[45]

Although mass valuation contracts are competitively tendered, we are interested in whether the tendering process leads to efficient costs. For example, we are interested in stakeholder views as to whether the tendering process could be improved in order to enhance competition and the efficiency of costs for the Valuer General. We are also interested in whether the volume of valuations has changed over the period, and how this relates to efficient contract costs and other operating costs.

More generally, we are seeking stakeholders' views on the efficiency of expenditure incurred in the provision of valuation services and the cost drivers that the Valuer General could face over the next six years. This could relate to changes in service levels resulting from the Committee's inquiry into the land valuation system or to meet customers' expectations.

In 2014, as we found that efficiency savings were already embedded in the Valuer General's proposal, we did not apply a productivity factor to the Valuer General's operating costs.[46] For example, we found that mass valuation contracts were competitively tendered, 45% of the Valuer General's operating costs were outsourced in a competitive manner and labour costs were efficient, as they were at or below comparable benchmarks. We understand this situation continues for the Valuer General. We also did not apply a productivity factor in setting the 2019-20 rate peg, which caps the annual general income that councils can generate. This was because improvements in both labour and capital productivity are incorporated in the Local Government Cost Index, which we use to calculate the rate peg percentage.

IPART seeks comments on the following:

7 Could the Valuer General use more efficient methods for undertaking mass valuation services?

8 What are the potential cost drivers that the Valuer General could face in the future that would impact operating costs over the 2019 determination period?

IPART seeks comments on the Valuer General's pricing submission (due in November)

1 Is the Valuer General's proposed operating expenditure efficient?

Allocating Corporate Costs from Property NSW to the Valuer General

The 2014 determination accepted that valuation services were an integral and indivisible part of LPI. Therefore, we made an allowance for the Valuer General to contribute to the efficient fixed costs of LPI (ie, corporate overhead and ICT operational costs incurred across all of LPI and OFS functions).[47] The fixed costs were allocated on an average cost basis, using the

45 IPART, *Review of prices for land valuation services provided by the Valuer-General to councils – From 1 July 2014 to 30 June 2019*, Final Report, May 2014, pp 30-31.

46 IPART, *Review of prices for land valuation services provided by the Valuer-General to councils – From 1 July 2014 to 30 June 2019*, Final Report, May 2014, p 38.

47 Most of the assets used in the valuation process were located within LPI. Therefore, the return on and of assets was also predominately an allocation from LPI.

number of FTEs engaged in valuation services at LPI and all FTEs at the Office of the Valuer General. In 2014, corporate overheads and ITC operational costs for 125 FTEs out of a total of 818 operational FTEs were allocated to the Valuer General, comprising 15.3% of LPI's total fixed costs.[48]

Our preliminary view is to use the same approach to allocating costs from Property NSW to the Valuer General as we did in the 2014 determination – ie, to allow a contribution to the efficient fixed costs of Property NSW on the basis of operational FTEs. However, if the Valuer General or other stakeholders believe there is a case for changing the allocation of costs from Property NSW, then they should put this case forward in their submission, along with supporting evidence.

IPART seeks comments on the following:

9 Is it appropriate to use the same methodology for allocating costs from Property NSW to the Valuer General as we applied in the 2014 price determination?

3.3.3 Capital expenditure

To determine if there are additions to the Regulatory Asset Base (RAB) for pricing purposes, we need to know the Valuer General's forecast capital expenditure over the upcoming determination, as well as the proposed asset lives for each class of capital expenditure. We note that the Valuer General relies heavily on information technology, which typically has relatively short asset lives.

We will review the prudence of capital expenditure since 2013-14 and the efficiency of proposed capital expenditure to determine whether it should be included in the RAB for pricing purposes, as we will only include prudent and efficient capital expenditure in the RAB. We will also determine the appropriate asset lives for the Valuer General's assets to calculate depreciation (see below).

Our 2014 determination included an average of approximately $1.9 million (inflated for $2018 - 19) of capital expenditure per annum over five years.[49] Approximately 56% of this proposed expenditure was for plant and equipment and approximately 40% for intangibles, such as software and databases. [50]

We seek comments and feedback on the prudence and efficiency of the Valuer General's actual and proposed capital expenditure, as well as the proposed asset lives.

IPART seeks comments on the Valuer General's pricing submission (due in November)

2 Is the Valuer General's actual capital expenditure since 2013-14 prudent?

3 Is the Valuer General's proposed capital expenditure from 2019 onwards prudent and efficient?

48 IPART, *Review of prices for land valuation services provided by the Valuer-General to councils – From 1 July 2014 to 30 June 2019*, Final Report, May 2014, p 36.

49 IPART, *Review of prices for land valuation services provided by the Valuer-General to councils – From 1 July 2014 to 30 June 2019*, Final Report, May 2014, p 40.

50 IPART, *Review of prices for land valuation services provided by the Valuer-General to councils – From 1 July 2014 to 30 June 2019*, Final Report, May 2014, p 40 and IPART calculations.

3.3.4 Rate of return on assets

The allowance for a return on assets included in the revenue requirement represents our assessment of the opportunity cost of the capital[51] that the Valuer General has invested to provide the regulated services, and ensures that the Valuer General can continue to make efficient capital investments in the future.

To calculate this allowance, we multiply the value of the RAB[52] in each year of the determination period by an appropriate rate of return. Our standard practice is to determine the rate of return using an estimate of the WACC.[53] As for our 2014 determination,[54] we will use a real post-tax WACC to calculate the allowance for a return on assets, and provide for an explicit tax allowance as a separate cost building block.

We propose to use our updated method for calculating the WACC, which we reviewed in 2018.[55] Box 3.1 summarises the key changes we made to our WACC method in the 2018 review.

Box 3.1 Our approach to estimating the WACC

We use a 'trailing average' approach to calculate both historic and current cost of debt

Our 2013 method set a cost of debt as the midpoint between our estimates of the historic and current cost unless there is significant economic uncertainty, and did not update this cost during the regulatory period. In response to stakeholder feedback that this approach creates a refinancing risk for regulated businesses, we decided to estimate both the historic and current cost of debt using a trailing average approach, which will update the cost of debt annually over the regulatory period.

We update the cost of debt annually within a regulatory period and decide how annual changes are passed through on a case-by-case basis, as part of our price review process.

We considered whether we should update prices to reflect the updated cost of debt annually, or use a regulatory true-up in the notional revenue requirement for the next period, which we would pass through to prices at the beginning of the next period. We decided to determine the most appropriate option on a case-by-case basis, as part of our price review process. Where we decide to use a true-up, we will use the WACC as the discount rate for calculating the true-up.

We use the expected rate of inflation over the regulatory period

We decided to use the expected rate of inflation over the regulatory period. We calculate the expected rate of inflation by first calculating the geometric average of the forecast change in the level of prices over the regulatory period, and then converting this average into an annual inflation rate separately.

Source: IPART, *Review of our WACC method – Final Report*, February 2018.

51 The 'opportunity cost' of using capital for one purpose is the expected revenue forgone from investing that capital in its best alternative use.

52 The regulatory asset base is our estimate of the economic value of assets needed to deliver the regulated services. At each price review we adjust the RAB to reflect regulatory depreciation, prudent and efficient expenditure, asset disposals and cash capital contributions.

53 The WACC for a business is the expected cost of its debt and equity, weighted to take account of the relative share of debt and equity in its capital structure.

54 In the 2014 Determination, we calculated the return on assets using a post-tax WACC of 5.1%.

55 IPART, *Review of our WACC method, Final Report – Research*, February 2018.

3.3.5 Regulatory depreciation – return of assets

In the 2014 determination we used a straight line depreciation method to calculate the allowance for regulatory depreciation. Under this method, the assets in the RAB are depreciated by an equal value in each year of their economic life, so that their written down value follows a straight line over time, from the initial value of the asset to zero at the end of the asset's life.[56] This means that, through the regulatory allowance, the total value of an asset is recovered evenly over its assumed life.

3.3.6 Other building block components

Other building block components include allowances for working capital and tax.

Working capital allowance

Working capital represents the level of net current assets at the end of each financial year. We typically include an allowance for working capital in our building block approach when setting the NRR. This allowance recognises that sometimes a regulated entity needs to hold on to excess cash in order to fund its day-to-day activities.[57] The working capital allowance compensates the regulated entity for the economic holding cost of this cash.

For our 2014 determination we removed working capital from the RAB, meaning that working capital was not depreciated. We separately calculated a return on working capital as a component of the NRR. Working capital had a value of $2.4 million for 2014-15.[58]

In July 2018, we commenced a review of how we calculate the working capital allowance. Our Information Paper[59] sets out the key issues we are reviewing and stakeholders' views on our proposed changes. We are scheduled to release a Policy Paper setting out our decisions in November 2018. We will have regard to the decisions in our Policy Paper in calculating the Valuer General's working capital allowance.

Tax allowance

The inclusion of a tax allowance is consistent with the post-tax building block framework and meets IPART's principle that a regulated entity's revenue should be as close as possible to that of a well-managed privately owned business, operating in a competitive market. This includes any taxes payable on the entity's taxable income.[60]

In our 2014 determination, we calculated tax allowances in each year of the determination period by applying a 30% statutory corporate tax rate adjusted for gamma[61] to the Valuer General's (nominal) taxable income. To calculate the taxable income, we deducted the Valuer

56 IPART, *Review of prices for land valuation services provided by the Valuer-General to councils – From 1 July 2014 to 30 June 2019*, Final Report, May 2014, p 44.

57 This can arise when there is a significant timing difference between when expenditure occurs, and when revenue is received.

58 IPART, *Review of prices for land valuation services provided by the Valuer-General to councils – From 1 July 2014 to 30 June 2019*, Final Report, May 2014, p 45.

59 IPART, *Review of working capital allowance – Information Paper*, July 2018.

60 IPART, *The incorporation of company tax in pricing determinations – Final Decision*, December 2011, p 5.

61 Under a post-tax framework, the value of imputation (franking) credits (gamma) enters the regulatory decision only through the estimate of the tax liability.

General's operating cost allowances, tax depreciation, and interest expenses from the notional revenue requirement (excluding tax allowance). In addition to calculating taxable income we:

- calculated tax depreciation forecasts based on the three asset classes, whereas the Valuer General used a weighted average asset life,[62] and
- based interest expense on the parameters used to calculate the WACC (ie, gearing ratios, nominal risk free rate and debt margin).

In March 2017, the Commonwealth enacted legislation that introduced different rates of corporate income tax for businesses of different sizes. Appendix C sets out more detail regarding our consideration of the appropriate corporate tax rate and how we might use it in our determination of the Valuer General's maximum prices.

IPART seeks comments on the following

10 Should we take the variable corporate tax rates into consideration in our review of the Valuer General's tax allowance?

11 Should we use the same business unit level for determining the tax rate as we do for determining the WACC, or are there reasons to move away from applying this approach?

3.4 How much of the efficient costs should be allocated to councils?

Once we have determined the Valuer General's total NRR, we will decide the share of the NRR that should be allocated to councils – to be recovered from the Valuer General's prices to councils for valuation services.

The costs for the Valuer General's services can be recouped from users based on an average cost or marginal cost approach. Under an average cost approach, all users make a contribution towards the fixed costs of providing a service. Under a marginal cost approach, fixed costs are borne by the principal users of a service and other users pay the marginal or avoidable cost of extending the service to them.

Our 2014 determination used the marginal cost approach. This means that the fixed cost of providing valuation services was split between the two main users of the services, ie, the councils and the OSR (now Revenue NSW, the Valuer General's other customer) on a 34:66 ratio. Other minor users of these services (eg, private brokers, the general public and other government agencies) were charged on a fee-for-service basis, with fees to these users covering marginal costs of services provided.[63]

Table 3.2 sets out the allocation of cost items to councils in the 2014 determination. We allocated 34% of the Valuer General's total costs to councils based on how much and how frequently councils used the Valuer General's services. We applied a bottom-up approach to allocating costs based on the following:[64]

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62 Valuer General NSW, *Review of prices for land valuation services provided by the Valuer General to councils – Submission to IPART by the Valuer General* (Valuer General submission), 7 February 2014, p 54.

63 IPART, *Review of prices for land valuation services provided by the Valuer-General to councils – From 1 July 2014 to 30 June 2019*, Final Report, May 2014, p 47.

64 IPART, *Review of prices for land valuation services provided by the Valuer-General to councils – From 1 July 2014 to 30 June 2019*, Final Report, May 2014, p 52.

- the usage share of mass valuations – eg, we attributed 25% of the mass valuation contract costs to councils on the basis that the Valuer General conducted about 2.4 million valuations each year which were issued to OSR; 800,000 of which also went to councils
- direct costs attributable to councils – eg, we attributed 100% of postage and graphic service costs to councils as these services were provided for ratings purposes only, while we split other valuation contract costs (such as objection valuations) equally (50:50) between councils and OSR
- frequency of valuations – eg, we calculated that of the remaining costs, about one-third could be attributed to councils and two-thirds to OSR as councils were only provided valuations every three to four years on average; hence cost items such as rent, labour, and corporate overheads were only used about one-third or 33% of the time by councils.[65]

We concluded that in total, 34% of the NRR should be allocated to councils, compared to the Valuer General's proposal of 40% in 2014.[66]

Table 3.2 Allocation of cost to councils by cost item (% of total cost for each cost item)

Cost items	IPART allocation
Labour costs	33%
Mass valuation contract costs	25%
Other valuation contracts costs	50%
Postage	100%
Rent	33%
Other direct costs	33%
LPI corporate costs	33%
OFS corporate costs	33%
ICT operation costs	33%
Graphic	100%
Spatial	33%
Title and Images	33%
Percentage of total costs allocated to councils	34%

Source: IPART, Review of prices for land valuation services provided by the Valuer-General to councils, From 1 July 2014 to 30 June 2019, Final Report, p 51

Table 3.3 below sets out our 2014 decision on councils' share of the Valuer General's total NRR over the 2014 Determination period.

65 IPART, *Review of prices for land valuation services provided by the Valuer-General to councils – From 1 July 2014 to 30 June 2019*, Final Report, May 2014, pp 50-53.

66 Valuer General submission, 7 February 2014, p 40.

Table 3.3 Councils' share of IPART's 2014 decision on the Valuer General's total NRR ($2018-19, $'000)

	2014-15	2015-16	2016-17	2017-18	2018-19
Total NRR	50,818	50,579	50,209	49,881	49,513
Councils' share of NRR	17,278	17,197	17,071	16,959	16,834
Councils' share (%)	34%	34%	34%	34%	34%

Source: IPART, *Review of prices for land valuation services provided by the Valuer-General to councils – From 1 July 2014 to 30 June 2019,* Final Report, May 2014, pp 28, 55 and IPART analysis.

As Chapter 2 discussed, we anticipate that the majority of the Valuer General's costs for valuation services would be evenly spread across the determination years, however, we do not know the full impact of bringing forward mailing and printing costs to the first and fourth years of the six-year referral period. We will need to consider whether the cost pattern justifies allocating a higher ratio of costs to councils in the first and fourth years of the determination period compared to other years of the determination period.

IPART seeks comments on the following

12 Is there a case for changing the methodology for allocating costs to councils? If so, on what basis should costs be allocated?

IPART seeks comments on the Valuer General's pricing submission

4 Is the Valuer General's proposed cost allocation to councils reasonable?

4 Pricing framework

In Chapter 3, we discussed how we would establish the Valuer General's revenue requirement (ie, the NRR, reflected by the efficient building block costs), and then councils' share of this revenue requirement – to determine the level of revenue (or costs) to be recovered from prices to councils over the determination period.

Under the ToR we are required to develop a pricing framework that is efficient, effective and transparent for the land valuation services provided to councils. That is, we are to:

- consider the Valuer General's efficient costs of providing these services over the relevant determination period, then
- consider the efficient allocation of the costs of the services between the users of those services in accordance with relevant economic and pricing principles.

In this chapter we seek stakeholder views on a pricing framework that best achieves the required objectives of our ToR. This includes an appropriate price path and pricing structure that recovers efficient costs, and considers the potential impact on councils during the upcoming determination period.

4.1 Price path to recover efficient costs

Our 2014 determination uses a 'price cap' form of regulation and smooths prices over the course of the determination to produce a stable price path. However, as discussed in Chapter 3, stakeholders may propose changing the form of regulation we apply. Alternative approaches may include a 'Weighted average price cap', a 'Revenue Cap' or some other hybrid form of regulation. We also discussed whether a cost index approach could be considered for setting annual prices, once an efficient cost base was established. We will assess any proposals based on whether the potential benefits are likely to outweigh the associated risks and costs.

Our preliminary view is to maintain the price cap approach we used to set prices in 2014.

The price path implemented in 2014 held prices constant in real terms over the five year determination period to 2018-19 (see Table 4.1). Prices were smoothed to produce a stable price path. This was achieved by applying a very small downward step in prices (0.5%) in the first year of the determination - ie, between the last year of the previous determination period (2013-14) and the first year of the 2014 determination period (2014-15)[67] - and maintaining prices for the remaining years in the determination period.

67 IPART, *Review of prices for land valuation services provided by the Valuer-General to councils – From 1 July 2014 to 30 June 2019*, Final Report, May 2014, p 56.

4.2 Price structures

Ideally, prices should be cost-reflective. This means that the price for a service should recover the prudent and efficient costs of delivering that service. Prices that are cost-reflective promote the efficient allocation and use of resources – by ensuring that service providers recover their efficient costs, and by sending accurate signals to customers about the cost of services.

In addition to cost-reflectivity, other considerations are:

- customer preferences and potential impacts of customers – eg, a significant change in price levels or price structures may need to be phased-in over a period of time to minimise impacts on customers, and
- the importance of ensuring that prices are transparent and easy for customers to understand, and not too costly for the regulated business to administer.

Under the price cap approach of the 2014 determination, we set different maximum charges for residential and non-residential properties. However, we did not set different prices for different councils. That is, we set a single price for a residential valuation, which applied to all councils; and a single price for a non-residential valuation, which applied to all councils.

4.2.1 Residential and non-residential prices

The current residential and non-residential prices for the Valuer General's valuation services reflect the costs incurred in providing the services and take into account the cost differentials (ie, higher costs involved) in valuing non-residential properties.

In our 2014 Determination, we used a multiplier of 2.2 to set the non-residential price. This means that the price a council pays for a non-residential valuation is 2.2 times higher than a residential valuation. We found that the costs of non-residential valuations are, on average, higher than residential valuations, primarily due to the relative complexity of the valuations and the uniqueness of these properties.[68]

As seen in Table 4.1, to enable price stability over the determination period, we set a lower price in 2014-15 (reflecting a price decrease of 0.5% in that year), which was maintained in real terms over the remainder of the determination period to 2018-19.[69]

68 IPART, *Review of prices for land valuation services provided by the Valuer-General to councils – From 1 July 2014 to 30 June 2019*, Final Report, May 2014, pp 58 and 60.

69 IPART, *Review of prices for land valuation services provided by the Valuer-General to councils – From 1 July 2014 to 30 June 2019*, Final Report, May 2014, p 2.

Table 4.1 2014 Determination on the Valuer General's prices to councils ($/valuation)

	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
$2013 -14 prices in real terms						
Residential	5.37	5.34	5.34	5.34	5.34	5.34
Non-Residential	11.81	11.75	11.75	11.75	11.75	11.75
Prices in nominal terms						
Residential	5.37	5.50	5.57	5.64	5.76	5.87
Non-Residential	11.81	12.09	12.25	12.40	12.67	12.91

Source: IPART, *Review of prices for land valuation services provided by the Valuer-General to councils*, From 1 July 2014 to 30 June 2019, Final Report, p 2 and Determination, p 4; and IPART analysis.

We are seeking views from stakeholders as to whether pricing on this basis is still appropriate or practical.

We note that price structures should strike a balance between being cost-reflective and relatively transparent and simple to administer. For example, a single 'postage stamp price' for all land valuations (ie, merging the residential and non-residential charge) could improve the simplicity and transparency of the current pricing framework. However, it may not reflect the different costs (on average) of providing valuations for residential and non-residential customers, and therefore unduly shift costs between councils (ie, councils with more non-residential properties could potentially pay less under this price structure and those councils with predominately residential properties could pay more).

IPART seeks comments on the following:

13 Should the current price structure of residential and non-residential prices be retained, or is there a more appropriate pricing structure for land valuation services?

IPART seeks comments on the Valuer General's pricing submission

5 Are the Valuer General's proposed prices for residential and non-residential valuations reasonable?

4.2.2 Should we set different prices for councils?

In our previous determinations, we set uniform prices across NSW. That is, there was a single price for a residential valuation and a single price for a non-residential valuation. Regardless of the size, type or location of a council, all councils paid the same price. In our previous determinations, there was overwhelming stakeholder support to maintain uniform prices.

Our preliminary position is to maintain uniform prices in the 2019 Determination. As set out in our 2014 Final Report: [70]

> …we decided not to pursue differential pricing for councils between residential and non-residential areas. To do so, would have involved estimating the differences in costs of servicing the councils,

70 IPART, *Review of prices for land valuation services provided by the Valuer-General to councils – From 1 July 2014 to 30 June 2019*, Final Report, May 2014, p 61.

and weighing up the benefits of differential pricing against likely increases in administrative costs that would incur. We are mindful that the current structure is relatively simple and administratively efficient.

Nevertheless, we recognise there may be a case for charging differential prices to councils, based on cost-reflectivity. Where the costs of undertaking valuations in a council or region are significantly different from the average cost, there may be efficiency benefits in setting prices which better reflect these differences. For instance:

- some councils may have valuation costs that are significantly lower than the NSW average, due to the scale and uniformity of land use in this region, and
- some councils may have valuation costs that are significantly higher than the NSW average, due to the complexity of property transactions.

We are interested in stakeholder views on differential pricing. In particular, we are interested in whether the efficient costs of undertaking valuations are clearly and significantly different for certain councils (or regions), and the reason for those differences. We are also interested in what the additional administrative costs of differential pricing would be for both councils and the Valuer General, as well as the potential impact on councils' budgets.

IPART seeks comments on the following:

14 Should we maintain the current common charge across all councils or move to differential pricing for councils?

15 How should the price path account for impacts on customers (ie, councils)?

Appendices

A Terms of Reference

NSW GOVERNMENT

Gladys Berejiklian MP
Premier of New South Wales

Ref: A2725812

Dr Peter Boxall
Chair
Independent Pricing and Regulatory Tribunal NSW
PO Box K35
HAYMARKET NSW 1240

Dear Dr ~~Boxall~~, Peter,

Thank you for your correspondence of 3 October 2018, regarding the request for a new pricing determination for land valuation services provided to local councils by the Valuer General.

Noting the outcomes of stakeholder consultation, I approve the final Terms of Reference attached to this letter without changes. Please commence this review.

I look forward to receiving the final report and determination by 31 May 2019.

Yours faithfully,

Gladys Berejiklian MP
Premier

CC: The Hon Victor Dominello, Minister for Finance, Services and Property

PRICE REVIEW OF RATING VALUATION SERVICES PROVIDED BY THE VALUER-GENERAL TO LOCAL GOVERNMENT – FINAL TERMS OF REFERENCE

I Gladys Berejiklian, Premier of New South Wales, under section 12 of the *Independent Pricing and Regulatory Tribunal Act 1992* (IPART Act), refer the matter set out in these 'terms of reference' to the Independent Pricing and Regulatory Tribunal (IPART) for investigation and report.

Background
By the *Government Pricing Tribunal (Valuer-General's Services) Order* dated 11 August 1993 made under section 4 of the IPART Act, the following services provided by the Valuer-General were declared as government monopoly services:

> "Furnishing valuation lists and supplementary lists under Part 5 of the *Valuation of Land Act 1916* by the Valuer-General to a council of an area under the *Local Government Act 1993*" (**Monopoly Services**).

On 30 December 2013, the Premier requested that, pursuant to section 12 of the IPART Act, IPART make a determination of the pricing for the provision of the Monopoly Services to apply for a period of 5 years

In May 2014, IPART released its determination of maximum prices for the Monopoly Services provided by the Valuer General.[1] These maximum prices apply until 30 June 2019.

Reference to the Tribunal
IPART is requested by the Premier, under sections 12(1) and (3) of the IPART Act, to investigate and report on the determination of the maximum prices for the Monopoly Services provided by the Valuer-General to apply in total for a period of 6 years (**Referral Period**). Under section 12(3) of the IPART Act, this referral may extend to an annual or other periodic determination of the pricing of the Monopoly Services during the Referral Period.

Matters for consideration
In its investigation, IPART should:

- identify the Valuer-General's full efficient economic costs of providing the Monopoly Services over the determination period or periods;
- develop an efficient, effective and transparent pricing framework for the Monopoly Services;
- consider the Valuer-General's efficient costs of providing the Monopoly Services over the relevant determination period or periods;
- consider the efficient allocation of the costs of the Monopoly Services between the users of those services in accordance with relevant economic and pricing principles;
- consider the scope for the Valuer-General to achieve efficiency savings in providing the Monopoly Services; and
- specify the duration of the relevant determination period or periods.

In addition, IPART may take into account any other matters it considers relevant.

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1 IPART, *Review of prices for land valuation services provided by the Valuer-General to councils – From 1 July 2014 to 30 June 2019*, Determination No.2, 2014.

Consultation

IPART must undertake such consultation as is required under the IPART Act and may undertake such further consultation as it considers appropriate, including with key stakeholders such as government agencies responsible for management of the land valuation and rating systems.

Reporting

IPART is to submit its final report and determination to the Premier by 31 May 2019 and is to submit any subsequent reports and determinations to the Premier on such other date or dates as agreed.

Determination commencement

It is intended that the determination or, in the event of a periodic determination of pricing, the first determination, will commence on 1 July 2019.

B Matters to be considered by IPART under section 15 of the IPART Act

In making pricing determinations, we are required by the IPART Act to have regard to the following matters (in addition to any other matters IPART considers relevant):

a) The cost of providing the services concerned

b) the protection of consumers from abuses of monopoly power in terms of prices, pricing policies and standard of services

c) the appropriate rate of return on public sector assets, including appropriate payment of dividends to the Government for the benefit of the people of New South Wales

d) the effect on general price inflation over the medium term

e) the need for greater efficiency in the supply of services so as to reduce costs for the benefit of consumers and taxpayers

f) the need to maintain ecologically sustainable development (within the meaning of section 6 of the Protection of the Environment Administration Act 1991) by appropriate pricing policies that take account of all the feasible options available to protect the environment

g) the impact on pricing policies of borrowing, capital and dividend requirements of the government agency concerned and, in particular, the impact of any need to renew or increase relevant assets

h) the impact on pricing policies of any arrangements that the government agency concerned has entered into for the exercise of its functions by some other person or body

i) the need to promote competition in the supply of the services concerned

j) considerations of demand management (including levels of demand) and least cost planning

k) the social impact of the determinations and recommendations

l) standards of quality, reliability and safety of the services concerned (whether those standards are specified by legislation, agreement or otherwise).

C The corporate tax rate

As a statutory position, the Valuer General does not pay tax or tax equivalents. However, the regulatory tax allowance is not intended to match the Valuer General's actual tax liability. Our building block approach aims to set prices that reflect the full efficient costs the Valuer General would incur if operating in a competitive market. This includes recovering a tax allowance, so that the Valuer General does not have any advantage over an equivalent private business.

Under the legislation, from 1 July 2018 a business with an aggregated turnover of less than $50m (base rate entities) will pay 27.5% tax, while companies with a higher turnover must pay 30% tax on all their taxable income.[71] From 2024-25, base rate entities will pay 27.0% tax, and this rate will reduce to 26.0% in the following year and 25.0% in 2026-27. Thresholds are not indexed for inflation.

The introduction of the company tax threshold raises two questions for IPART when estimating a regulated entity's tax allowance:

1. Should IPART take the variable tax rates into consideration when modelling the tax allowance for regulated entities, and if so
2. What business unit level NRR should be compared to the threshold, and how should IPART account for the variable corporate tax rate in its tax allowance modelling?

C.1 Preliminary views

IPART's preliminary view is:

1. IPART should take into consideration the variable corporate tax rates in calculating the Valuer General's tax allowance.
2. That, as a default, we would use the nominal NRR for the business unit level for which the WACC parameters are set as the comparator to the threshold.[72]
3. That, where the WACC parameters are set on a basis other than the whole business, we would consider on a case-by-case basis whether to use the whole of business nominal NRR as the comparator to the threshold.
4. To determine the appropriate tax rate:
   a) Our preliminary view is to use 30% as the default tax rate to estimate the Valuer General's tax allowance, then
   b) Take the average of the nominal annual NRR estimates over the regulatory period.
      i) If this average is greater than the threshold, we propose to apply the 30% tax rate in all years of the review period.

71 *Treasury Laws Amendment (Enterprise Tax Plan) Act 2017*.

72 Due to circularities that using turnover as a comparator to the $50m threshold would create in the building block framework, we propose to use a business's NRR as a proxy for turnover.

ii) Conversely, if the average is below the threshold, we propose to apply the 27.5% tax rate in all years of the review period.

While we acknowledge businesses with turnover near the threshold may attract a different tax rate one year to the next, it is our preliminary view that this cannot be estimated in advance, and that a simple approach to assessing which tax rate to use will increase certainty in the modelling of the Valuer General's NRR.

In relation to which business unit level to use when setting the tax rate, our preliminary position is to use the business unit level related to the NRR for Valuer General's total services, not just the monopoly services to councils. This is consistent with our view that the WACC should be set on the whole of the Valuer General's business.

We are interested in stakeholders' views on IPART's preliminary position in relation to the assessment and treatment of the variable corporate tax rate in the calculation of the Valuer General's tax allowance.

D Information required from the Valuer General

We seek comment from the Valuer General on the following issues:

Land valuation process

1. Has there been any material change to the land valuation process? How does this impact the cost of undertaking valuations (ie, contract costs)?
2. Should IPART set one 6-year determination or undertake multiple periodic determinations over the 6-year referral period?
3. In what circumstances should IPART consider making a new determination?
4. What is the forecast number of valuations in each year?
   - split between Revenue NSW and the councils
   - residential and non-residential.

Service levels

5. Have the land valuation services provided by the Valuer General changed since the 2014 Determination?
6. Is the quality of services provided by the Valuer-General meeting customers' expectations?

Revenue requirement

7. What is the revenue requirement forecast for each year of the referral period (ie, next six years)?
   - revenue from primary and secondary users
   - revenue by valuation service.

Operating expenditure

8. What is the Valuer-General's operating expenditure over the 2014 determination period, by item and year?
9. What is the efficient operating expenditure incurred by the Valuer-General in the provision of general valuation services over the referral period (ie, next six years)?
10. What are the main drivers or determinants of the Valuer-General's efficient costs of providing valuation services to councils?
11. Does the tendering process for general valuations lead to efficient costs?
12. What is the scope for the Valuer-General to achieve efficiency gains over the referral period (ie, next six years)?

13. How should costs be allocated from Property NSW to the Valuer-General?

Capital expenditure

14. What is the Valuer-General's capital expenditure over the 2014 determination period, by item and year?
15. What is the prudent and efficient level of capital expenditure of providing general valuation services over the referral period (ie, next six years)?

Depreciation

16. What is the appropriate asset life for each class of capital expenditure?

WACC

17. What is an appropriate rate of return for the Valuer General's assets?
18. What is the appropriate equity beta and gearing ratio on which to calculate the Valuer General's rate return?

Tax allowance

19. What is an appropriate tax allowance for the Valuer General?

Allocation to councils

20. Is there a case for changing the methodology for allocating costs to councils? If so, on what basis should costs be allocated?

Price structures

21. What are the Value General's proposed prices to councils over the referral period?
22. Should the current price structure of residential and non-residential prices be retained, or is there a more appropriate pricing structure for land valuation services (eg, a single price)?
23. What is the impact on customers (ie, councils) from the proposed change in price structures?
24. Is there new evidence that would warrant differential pricing for councils and a move away from a common charge across all councils?

Price path

25. Should an indexation approach be used to set the maximum prices for the Valuer General's land valuation services to councils?
26. What level of efficiency savings should be achieved over the price path?
27. How should the price path account for customer impacts?

E Glossary

2019 Determination	Refers to the upcoming price period – ie, prices from 1 July 2019 to 30 June 2025 (unless the 2019 Determination is replaced by a subsequent determination during the referral period).
2014 Determination	Refers to the current price period – ie, prices from 1 July 2014 to 30 June 2019.
ABS	Australian Bureau of Statistics
Ad valorem tax	A tax based on the value of real estate or personal property.
ATO	Australian Tax Office
Council	Councils of areas under the Local Government Act
Declared services	The services declared to be government monopoly services under the *Government Pricing Tribunal (Valuer-General's Services) Order 1993* (Gazette No. 89, 13 August 1993, page 4571): “Furnishing valuation lists and supplementary lists under Part 5 of the *Valuation of Land Act 1916* by the Valuer-General to a council of an area under the *Local Government Act 1993”.*
DFSI	Department of Finance, Service and Innovation.
OFS	Office of Finance and Services (now DFSI)
Glide path	A method of setting prices such that they transition towards cost-recovery over the determination period.
IPART	The Independent Pricing and Regulatory Tribunal of NSW
IPART Act	*Independent Pricing and Regulatory Tribunal Act 1992* (NSW)
JSCOVG	The Joint Standing Parliamentary Committee on the Office of the Valuer-General that monitors and

	reviews the exercise of the Valuer-General's functions with respect to land valuations.
LPI	Land and Property Information - previously part of the Department of Finance and Services, which managed the valuation system on behalf of the Valuer-General. Functions now transferred to Property NSW.
Local Government Act	*Local Government Act 1993* (NSW)
NPV	Net present value
Property NSW	Part of DFSI - manages the valuation system on behalf of the Valuer General under a Service Level Agreement (SLA).
RAB	Regulatory asset base
RBA	Reserve Bank of Australia
Referral period	The period over which the determination(s) is to apply - ie, from 1 July 2014 to 30 June 2019. The ToR require that new determination(s) of maximum pricing for the Valuer-General's land valuation services to councils apply in total for a period of five years.
SLA	Service Level Agreement, which is reviewed regularly, establishes performance standards and defines the separation of responsibilities and accountabilities between the Valuer General and Property NSW.
Valuation of Land Act	*Valuation of Land Act 1916* (NSW)
Valuer-General	An independent statutory officer appointed by the Governor of New South Wales to oversee the valuation system.
VSLPI	Valuation Services business unit of LPI, which provides the majority of valuation services to the Valuer-General.
WACC	Weighted average cost of capital