



Independent Pricing and Regulatory Tribunal

Review of prices for valuation services provided by the Office of the Valuer General for local councils

Other Industries — Issues Paper
February 2008



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Mr James Cox, Chief Executive Officer and Full Time Member

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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.

Submissions are due by 28 March 2008.

We would prefer to receive them by email <ipart@ipart.nsw.gov.au>.

You can also send comments by fax to (02) 9290 2061, or by mail to:

Review of Valuer General's Charges
Independent Pricing and Regulatory Tribunal
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Our normal practice is to make submissions publicly available on our website <www.ipart.nsw.gov.au>. 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 on the previous page.

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. IPART will then make every effort to protect that information, but it could be subject to appeal under freedom of information legislation.

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 Independent Pricing and Regulatory Tribunal (IPART) is responsible for setting charges for government monopoly services. The services of ‘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*’ are declared government monopoly services under section 4 of the *Independent Pricing and Regulatory Tribunal Act 1992*.

IPART last made a determination of the maximum prices to apply to valuation services in 1996. These prices were to apply from 1 July 1996. The Premier wrote to IPART on 7 December 2007 to request a new determination. The terms of reference for this review are included at Appendix 1.

The Valuer General made a submission in response to the terms of reference on 30 January 2008. This submission can be accessed at www.ipart.nsw.gov.au

The purpose of this issues paper is to identify the key issues IPART believes will be important in making its determination. However, IPART welcomes stakeholders raising other issues they believe are important in their submission to IPART. This paper is intended to be read in conjunction with the Valuer General’s submission¹ and therefore it is not considered necessary to repeat the facts and discussion contained therein.

1.1 Background

The statutory functions of the Valuer General set out in the *Valuation of Land Act 1916* are to:

- ▼ Establish and maintain the Register of Land Values. The register has to contain land ownership; title; location, description and area; occupation and value of the land.
- ▼ Make valuations of land.
- ▼ Deal with objections and appeals against valuations under this Act.

¹ Valuer General’s submission to Price review of rating valuation services by the Valuer General to local government, Department of Lands, January 2008 (the Valuer General’s submission).

The Office of the Valuer General is a small team of six people within the Department of Lands. The Valuer General is supported by Valuation Services Land and Property Information (VSLPI) in fulfilling the statutory functions of the Office. VSLPI is a discrete unit within Land and Property Information (LPI) within the Department of Lands.

VSLPI provides assistance to the Valuer General including land valuations and maintaining a database of those land valuations. This is one of the three main functions of LPI; the others being the maintenance of the State's spatial data information and a register of land title.

Specifically, VSLPI undertakes the following valuation services on behalf of the Valuer General:

- ▼ General valuations.
- ▼ Supplementary valuations.
- ▼ Objections.
- ▼ Land data management services.
- ▼ Compensation and special valuation services – fee for service.

A major proportion of the functions, and therefore the costs, of VSLPI are attributed to delivering the statutory functions of the Valuer General. Costs related to other services are excluded from the allocation calculations. A proportion of the costs of LPI are also attributed to the Valuer General's functions.

The main users and purposes of land valuation services are:

- ▼ **Local councils.** Local councils use land valuations to derive property rates.
- ▼ **Office of State Revenue (OSR).** OSR uses land valuations to determine annual land tax obligations.
- ▼ **NSW Fire Brigade.** NSW Fire Brigade sets levies on the insurance industry and local councils based on land values.
- ▼ **State government agencies.** Various agencies including NSW Maritime and Crown Lands use valuations for the calculation of leases. Other agencies use land valuations to determine compensation for the compulsory acquisition of land.
- ▼ **Commonwealth Grants Commission.** The Commonwealth Grants Commission uses land valuations to assist in the allocation of Commonwealth grants between States and Territories.

In addition, valuation information is used by private property information brokers and members of the public who purchase land value data.

1.2 Proposed approach

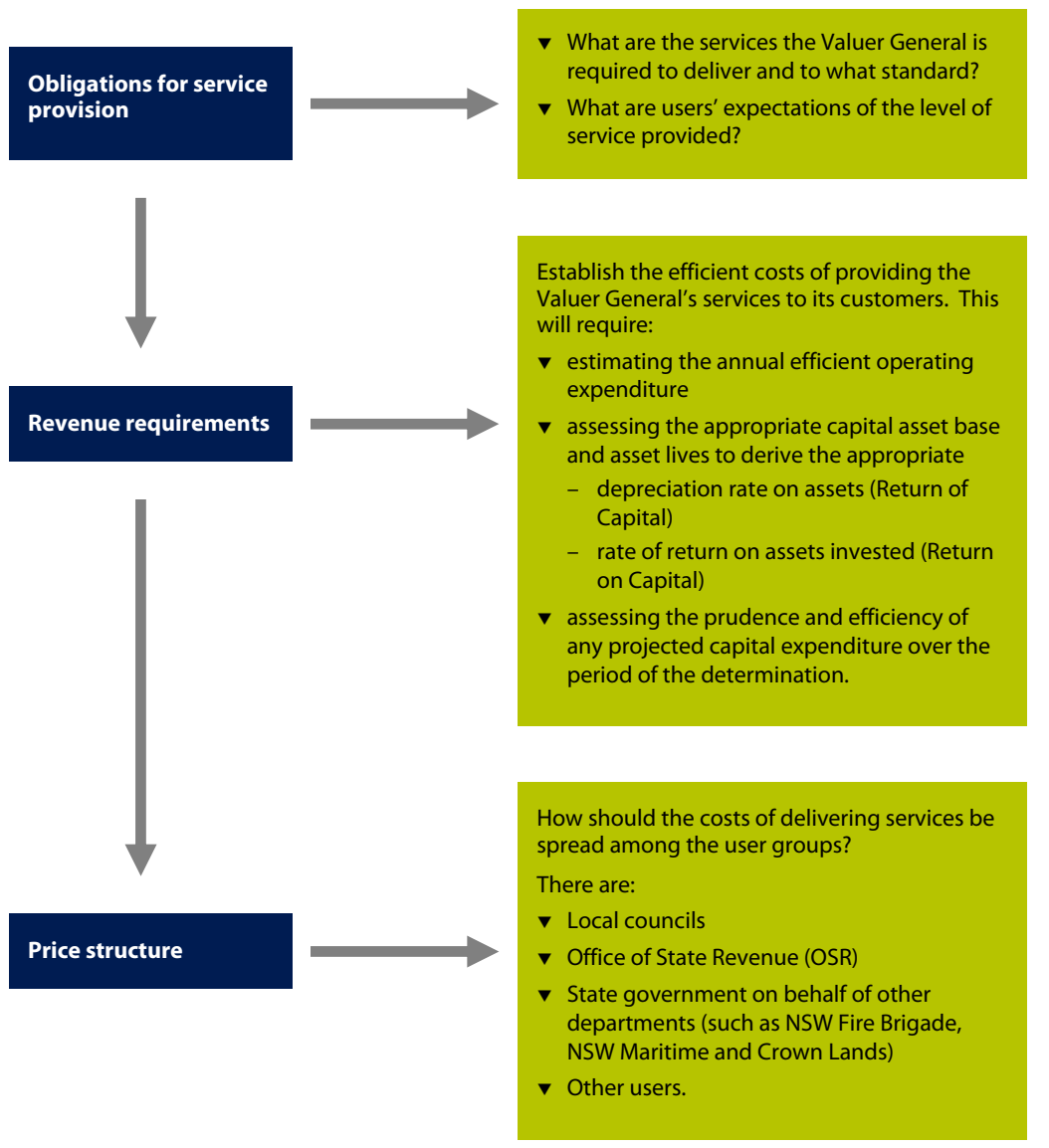
The approach IPART intends to adopt for this review is depicted in Figure 1.1. This approach will involve establishing a service level; establishing the efficient costs of providing the Valuer General's services to its customers. Once IPART has established the efficient costs of the providing all the services of the Valuer General the next task is allocating the costs of the operation to the various user groups.

IPART will set prices that are paid for valuations by local councils. The terms of reference require IPART to allocate efficient costs between different user groups for the purpose of setting charges for valuation service provided to local councils².

Finally IPART will determine either a price path for Valuer General charges or a methodology for determining those charges in future years.

² See Appendix 1.

Figure 1.1 Approach to the review



The indicative timetable for the review is shown in Table 1.1.

Table 1.1 Indicative review timetable

Task	Timeframe
Receive submission from Valuer General	31 January 2008
Release Issues Paper	29 February 2008
Closing date for public submissions on Issues Paper	28 March 2008
Release draft report	9 May 2008
Public Hearing	4 June 2008
Closing date for public submissions to the draft report	13 June 2008
Release final report	31 July 2008

Note: Please note that these dates are indicative and may be subject to change.

2 Establishing the revenue required

2.1 Service Level

To calculate the efficient costs and therefore the revenue required the first step is to define what level of service is to be provided.

The quality of the information provided by the Valuer General has been the subject of a number of Inquiries. The most recent being the *Ombudsman Report 2005*³ and those of the *Joint Committee on the Office of the Valuer General (2003-2007)*. IPART does not intend to prescribe the service level required as this has been addressed exhaustively by the Ombudsman and the Parliament. However, IPART does seek the views of stakeholders as to the level of improvement in quality of the services received from the Valuer General since 2005.

IPART seeks comments on the following:

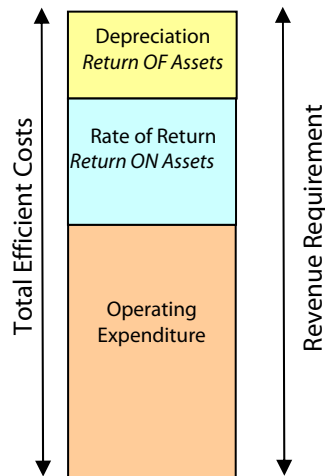
- 1 Stakeholders views as to the level of improvement in quality of the services received from Valuer General since 2005.

2.2 Revenue requirement

IPART calculates revenue requirement using the building block approach (as shown in Figure 2.1). This involves establishing the efficient costs of the Valuer General that comprise:

- ▼ Operating expenditure.
- ▼ Return of Capital (depreciation).
- ▼ Return on Capital (rate of return on capital).

³ 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.

Figure 2.1 Building block approach

2.2.1 Operating costs

Estimating the efficient operating expenditure of providing valuation services involves identifying the costs associated with each of the following:

- ▼ Direct costs of Valuer General's office, predominantly labour costs.
- ▼ Direct costs of VSLPI, including.
 - Direct labour costs and on-costs.
 - Rent.
 - Postage (property value notifications to ratepayers).
 - Mass valuation contracts.
 - Other valuation contracts (objections and appeals).
- ▼ Allocated costs from Department of Lands, Land and Property Information (LPI), including:
 - Graphic services.
 - Administration costs.
 - Other allocated costs.

IPART seeks the views of stakeholders on the efficiency of expenditure incurred in the provision of valuation services to local government and whether further investigation into the tendered costs of mass valuation and other valuation contracts is warranted given that these contracts are competitively tendered. The contracts currently account for over 55 per cent of the total direct costs⁴.

⁴ When allocated costs are included this proportion is approximately 43 per cent.

IPART seeks comments on the following:

- 2 The efficiency of expenditure incurred in the provision of valuation services to local government.
- 3 Whether detailed investigation is warranted given that mass valuation and other valuation contracts are competitively tendered.

2.2.2 Asset Base

The Valuer General has stated that the depreciated historic cost of the asset base of LPI is \$107.3m (2006/07) of which \$9.110m⁵ (8.5 per cent) has been allocated to VSLPI. The asset base has been allocated by the Valuer General on the basis of building occupancy rates and full time equivalent staff (FTE) and is detailed in Appendix C of the submission⁶.

IPART seeks comments on the following:

- 4 Whether the depreciated historic cost is an appropriate methodology for determining the regulatory asset base for valuation services.
- 5 Whether the Valuer General's allocation (8.5%) based on occupancy rates and FTE is appropriate for apportioning the regulatory asset base to valuation services.

2.2.3 Depreciation – return of assets

In determining the return of assets IPART will need to determine the economic lives of the assets. The Valuer General has estimated 83 years for land & buildings, 5 years for plant and equipment and 4 years for intangibles⁷. The average remaining lives for these categories are estimated at 41.7, 2.5 and 2 years respectively⁸.

Changing the assumed asset lives affects the returns *on* and *of* capital. Decreasing the asset life increases the annual return of capital (depreciation) but reduces the annual return on capital.

With the relatively large proportion of the asset base attributed to Intangibles there is a large depreciation allowance each year but this reduces the asset base and thus reduces the return on capital.

IPART seeks comments on the following:

- 6 The asset lives proposed by the Valuer General.

⁵ The asset base for 2006-07 for VSLPI is \$11.3 million when working capital is included-Valuer General's submission to Price review of rating valuation services by the Valuer General to local government, Department of Lands, January 2008, pp 36 and 77.

⁶ Valuer General's submission to Price review of rating valuation services by the Valuer General to local government, Department of Lands, January 2008 (the Valuer General's submission).

⁷ Intangibles includes in-house developed software and databases.

⁸ As reported in the annual accounts and cited in p 37 of the Valuer General's submission.

2.2.4 Rate of return – return on assets

In determining the appropriate rate of return to use for the capital employed in the delivery of valuation services the Valuer General has calculated 11 per cent pre tax nominal (approximately 8 per cent real) for its weighted average cost of capital (WACC). This value has been based on the Commonwealth Government's Competitive Neutrality Guidelines⁹. The rate is derived by adding a risk premium to the long term Commonwealth bond rate. The interest rate on 10 year Commonwealth bonds is generally used as the proxy for the risk free rate¹⁰

The Valuer General has assessed the market risk for the valuation services as being a medium risk operation and has proposed a risk premium of 3 to 5 per cent above the risk free rate (Commonwealth bond).

In determining a commercial rate of return the volatility of the cash flow is an important component of any assessment. The lower the volatility of the cash flow, the lower the risk premium that is added to the risk free rate. It could be argued that the Valuer General is certain to receive the revenue from 800,000 land valuations per annum from local government. Similarly, if a per-valuation charge is to apply to the OSR then this also provides certainty of annual revenue. The balance, being the services provided to the Valuer General's "secondary" customers¹¹, is less certain and may fluctuate with the business cycle.

IPART seeks comments on the following:

- 7 Stakeholders views on the appropriate rate of return to use for the Valuer General's services.

⁹ Australian Government Competitive Neutrality Complaints Office (2004), *Australian Valuation Office: Investigation No 11*, p 8.

¹⁰ Whilst there is little or no default risk in 10 year bonds there is however, an interest rate risk on long term fixed interest bonds, which sees a premium above the real risk free rate.

¹¹ Price review of rating valuation services by the Valuer General to local government – submission to IPART, Department of Lands, January 2008, p 81.

2.2.5 Prudence of future capital expenditure

The Valuer General has proposed capital expenditure (capex) of approximately \$2.3m per annum over the next 5 years. Approximately 60 per cent of this capex is intangibles such as in-house developed software and databases.¹² The Valuer General's services are, by their nature, information based and therefore heavily reliant on information technology.

IPART seeks comments on the following:

- 8 The prudence and efficiency of the capital expenditure proposed by the Valuer General.

¹² Ibid p 36.

3 Users of the Valuer General's Services

The Valuer General's services are used by a number of different agencies and organisations. In order for IPART to apportion the costs fairly it is necessary to identify each user and the extent to which they use the standard services provided.

The Valuer General classifies the users of its services as either primary or secondary and allocates costs on a per-valuation basis to the primary users. A small amount of revenue is received from secondary and minor users. This is deducted from the revenue requirements from the primary users.

3.1 Local government users

Individual councils receive valuations every three to four years for rating purposes¹³. For sub-divisions and new properties supplementary valuations are provided monthly. Local government rate-payers have the right to object to the valuations provided by the Valuer General and therefore utilise the objections and appeals process.

3.2 Office of State Revenue

The OSR receives all valuations, for every council area, every year for land tax purposes¹⁴. As with local government users supplementary valuations are provided monthly for any sub-divisions or new properties. The objections and appeals process is used by land tax payers who object to valuations.

3.3 Other NSW government agencies

Crown Lands, NSW Maritime and Western Lands Commission use valuation data with no additional analysis to assess the value of Crown Land leases. These agencies do not pay for access to the information.

¹³ There are in the order of 2.4million valuations updated each year of which approximately 800,000 are posted directly to individual rate-payers.

¹⁴ OSR receives the 2.4million updated valuations electronically every year. From this, OSR derive approximately 124,000 land-tax assessments.

NSW Local Government Grants Commission use aggregated land value data to assess revenue allowances for Local Government. For this service the Commission pays a fee of approximately \$15,000 per annum. NSW Fire Brigade uses the valuation data and analysis to recover statutory contributions from the insurance industry and local government. It pays approximately \$25,000 for this information. These charges are to recover the cost of extracting, compiling and analysing the valuation data.

The Roads and Traffic Authority and Department of Housing use property and property sales information to calculate charges for leases and/or compensation for compulsory acquisitions¹⁵. For this information Roads and Traffic Authority and the Department of Housing pay \$3,500 and \$7,500 respectively.

Rural Lands Protection Board and law enforcement agencies have access to the database. They are not charged for this.

3.4 Other government agencies

Australian Bureau of Statistics uses valuation data with no additional analysis for compiling national statistics. The data is generally used for statistical reporting therefore does not introduce any objections or appeals. The Commonwealth Grants Commission uses land valuation data with land tax thresholds added to allocate tax revenue and Commonwealth grants. Neither of these agencies pays for this service.

3.5 Other users

Private brokers and the general public also have access to land valuation and other LPI information for a number of purposes, which is charged on a fee-for-service basis.

IPART seeks comments on the following:

- 9 Stakeholders' comments on the allocation of costs to different users.

¹⁵ This information provided to the RTA and Department of Housing has not had any additional analysis or input from the Valuer General. That is to say that the incremental cost of the Valuer General supplying this information is relatively small.

4 Allocation of costs

There are a number of ways that the costs for the Valuer General's services can be recouped from users. These options are outlined below together with the implications of each.

4.1 Average cost

Under this approach all users make a contribution towards the fixed costs of providing the service. These costs can be allocated in a number of ways. The price proposal allocates the fixed costs of LPI to the Valuer General using either a ratio derived from FTE or building occupancy ratios.

4.2 Marginal cost

Marginal cost is also often referred to as incremental or avoidable cost. It is argued that the fixed costs should be covered by the principal users of the service and other users should be charged the marginal or avoidable cost of extending the service to them.

In allocating the total cost incurred by the Valuer General to the users of valuation services, the fixed costs have been shared solely between the OSR and local governments on the basis of the number of valuations used per annum¹⁶. The "secondary users" identified in Section 3 are either not charged at all or are charged the marginal or incremental cost of providing valuation services to that group.

4.3 Allocating costs from the Valuer General

If IPART was to follow the Valuer General's proposal for allocating costs to users then OSR and local councils, as the primary users, would share all the fixed costs and other users would only be charged the marginal or incremental cost of extending a service to them.

Conversely, if IPART was to allocate costs on an average cost basis then all users would make a contribution to the fixed costs of providing the service.

¹⁶ Department of Lands submission, Price review of rating valuation services by the Valuer General to local government, January 2008, pp 82-83.

4.4 Allocating costs from LPI to Valuer General

In the Valuer General's submission the revenue requirement includes a proportion of the fixed costs of LPI, which have been allocated on an average cost basis using FTE and occupancy rates. This is based upon the assumption that the three functions of LPI are indivisible and equally important.

However, if it was considered that LPI would still exist without the provision of valuation services then it may be appropriate to only allocate the marginal (incremental) costs that Valuation Services (Valuer General) imposes on LPI. This would reduce the costs the Valuer General needs to recover from users.

IPART seeks comments on the following:

- 10 Whether the Valuer General's costs should be allocated on a marginal or average cost basis between users.
- 11 Whether LPI's costs should be allocated on a marginal or average cost basis to the Valuer General.

4.5 Differential prices for councils

The Valuer General has proposed significantly different prices for the City of Sydney council to all other local councils¹⁷. The Valuer General justifies this differential based on the difference in direct costs incurred in undertaking these valuations. This is due to the uniqueness of properties within the City of Sydney area, which increases the number of benchmark properties required and therefore leads to greater cost of valuing these properties.

IPART seeks comments on the following:

- 12 Whether differential pricing should be applied to the City of Sydney Council.

¹⁷ Department of Lands submission, Price review of rating valuation services by the Valuer General to local government, January 2008, pp 60-64.

5 Price path

IPART's terms of reference for this review require IPART to "develop a methodology to adjust for any future changes in the Valuer General's cost base"¹⁸. Within the regulatory environment there a number of ways that IPART can fulfil this requirement.

IPART could develop a methodology that allows annual changes in prices based on changes in the number of valuations or some similar criteria. Alternatively, IPART could set a $CPI \pm X$ ¹⁹ price path based on its projections of efficient costs. This approach would allow the Valuer General to manage the risks and opportunities involved in providing valuation services. This provides the incentive that any further efficiency savings that can be made are retained by the organisation.

The Valuer General has proposed a $CPI \pm X$ price path within the submission²⁰. The Valuer General believes that there is scope for 1 per cent efficiency gains per annum over the period of the determination. These gains have been included in the submission as an increase in the volume of valuations undertaken with no corresponding increase in costs and include:

- ▼ Increased automated data loads of new subdivision information.
- ▼ Reductions in printing and postage costs through increased electronic services of notices.
- ▼ Increased electronic exchange of data with objection valuations contractors.
- ▼ On-going consolidation of offices.

IPART seeks comments on the following:

13 The price adjustment mechanism to be employed.

14 The level of efficiency savings to be achieved over the price path.

¹⁸ Appendix 1 Price review of rating valuation services by the Valuer General to local government - Terms of reference, December 2007.

¹⁹ $CPI \pm X$ means that prices change each year based on movement in the Consumer Price Index plus or minus a constant to reflect expected changes in either costs or efficiency. The X factor is determined at the time of the determination.

²⁰ Department of Lands submission, Price review of rating valuation services by the Valuer General to local government, January 2008, p 64.



Appendices

A Terms of Reference



Premier of New South Wales
Australia



7 DEC 2007

TCO/03057

Dr Michael Keating
Chairman
Independent Pricing and Regulatory Tribunal
PO BOX Q290
QVB POST OFFICE NSW 1230

Dear Dr Keating

I am writing regarding the price of rating valuation services provided by the Valuer General to local government.

Under Part 5 of the *Valuation of Land Act 1916*, the Valuer General must provide local councils with land valuation and supplementary lists, which are used by councils for rating purposes. As you are aware, the services are a declared monopoly under section 4 of the *Independent Pricing and Regulatory Tribunal Act 1992* (the Act) as a result of the *Government Pricing Tribunal (Valuer-General's Services) Order 1993*, and the maximum price which may be charged by the Valuer General is subject to IPART's pricing determination.

I am advised that the price of these rating valuation services has not changed in over ten years.

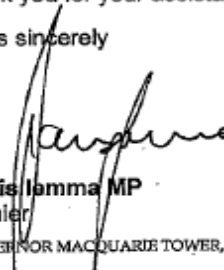
I therefore request, pursuant to sections 12(1) and (3) of the Act, that the Independent Pricing and Regulatory Tribunal make a new determination of the pricing for the rating valuation services provided by the Valuer General, to apply for five years.

The investigation relating to the pricing determination is to be conducted in accordance with the attached Terms of Reference.

If you require further information, please contact Mr Paul Elton, Policy Manager, Natural Resources and Economic Development Branch, Department of Premier and Cabinet, on (02) 9228 5493.

Thank you for your assistance in this matter.

Yours sincerely


Morris Iemma MP
Premier

LEVEL 59, GOVERNOR MACQUARIE TOWER, 1 FARRER PLACE, SYDNEY 2000, AUSTRALIA. TEL: (02) 9228 5239 FAX: (02) 9228 3905
G.P.O. BOX 5341, SYDNEY 2001

**PRICE REVIEW OF RATING VALUATION SERVICES PROVIDED BY THE
VALUER GENERAL TO LOCAL GOVERNMENTS**

TERMS OF REFERENCE



Background

The following services are declared government monopoly services pursuant to an Order dated 11 August 1993 made under section 4 of the *Independent Pricing and Regulatory Tribunal Act 1992*:

“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*”

The latest pricing review by IPART pursuant to the Order was undertaken in 1996. The pricing structure of rating valuation services has therefore not been reviewed for ten years.

Reference to the Tribunal

The Independent Pricing and Regulatory Tribunal is therefore requested by the Premier under sections 12(1) and (3) of the *Independent Pricing and Regulatory Tribunal Act 1992* to undertake a new determination of the pricing for the rating valuation services provided by the Valuer General to local government to apply for five years.

The Tribunal is specifically requested to develop a transparent framework for the price of valuation services.

In so doing IPART is requested to:

1. Identify the Valuer General's full efficient economic costs of service provision;
2. Develop an efficient, effective and transparent pricing framework for the Valuer General's valuation services;
3. Ensure full recovery of the Valuer General's efficient costs;
4. Ensure that prices equitably allocate the costs of valuation services between the users of those services in accordance with relevant economic and pricing principles; and
5. Develop a methodology to adjust for any future changes in the Valuer General's cost base.

B List of issues for comment

1 Stakeholders views as to the level of improvement in quality of the services received from Valuer General since 2005.	6
2 The efficiency of expenditure incurred in the provision of valuation services to local government.	8
3 Whether detailed investigation is warranted given that mass valuation and other valuation contracts are competitively tendered.	8
4 Whether the depreciated historic cost is an appropriate methodology for determining the regulatory asset base for valuation services.	8
5 Whether the Valuer General's allocation (8.5%) based on occupancy rates and FTE is appropriate for apportioning the regulatory asset base to valuation services.	8
6 The asset lives proposed by the Valuer General.	8
7 Stakeholders views on the appropriate rate of return to use for the Valuer General's services.	9
8 The prudence and efficiency of the capital expenditure proposed by the Valuer General.	10
9 Stakeholders' comments on the allocation of costs to different users.	12
10 Whether the Valuer General's costs should be allocated on a marginal or average cost basis between users.	14
11 Whether LPI's costs should be allocated on a marginal or average cost basis to the Valuer General.	14
12 Whether differential pricing should be applied to the City of Sydney Council.	14
13 The price adjustment mechanism to be employed.	15
14 The level of efficiency savings to be achieved over the price path.	15

