

**Response to
IPART’s Draft Report
Into
Local Government Rating**

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1. Summary

LM RAG agrees with many aspects of the IPART Draft Report as it generally addresses a number of aspects of the current Unimproved Land Value system that LM RAG has long had issues with and in particular the unfair nature of the Land Valuation process and system that it delivers.

Whilst LM RAG is fully supportive of a change to a Capital Valuation approach we do however hold significantly different views in two very specific aspects,

- **Firstly**, we disagree with the Report's recommendation for Local Government to have the option of adopting the Capital Value process and
- **Secondly**, that the Report fails to provide any insight as to how to establish the required Data Base being the Capital Value for each and every property throughout the State in a timely and cost effective manner.

This enquiry provides an almost once in a lifetime opportunity to correct the inequity issue that the current land value system engenders in Local Government Rates. This opportunity must not be squandered by adoption of half measures.

It remains our firm view that adoption of a Capital Value process should be mandatory for Local Government to use in its calculation of individual property rate notices, unless the Local Government area can justify the retention of the UV system provides for a fairer outcome for all ratepayers. To retain the UV system the Local Government area should have to apply to and gain approval from the Local Government Minister to do so.

Retention of the UV system should not be an easy, copout option for its retention by any Local Government.

Most speakers from the Panel at the September Public meeting conceded that a Capital Valuation approach would provide a fair and equitable rating process whilst providing for an enduring and growth path of their revenue base. It was felt that those Councils who expressed a desire to retain the UV system have not fully thought through the ramifications and benefits of a Capital Valuation process.

Whilst we agree wholeheartedly with the majority sentiment for a change to a Capital Valuation system, the Report unfortunately fails to deliver or provide insight into how to deliver a low cost, self-regulating, market based mechanism for the implementation of such a Capital Value system and specifically, how to establish the prerequisite Data Base.

The LM RAG submissions and proposals are not too dissimilar to the general thrust of IPART's primary recommendations for the adoption of a Capital Improved Value (CIV) model; however the LM RAG proposal of CAV included a simple time-based mechanism to enable a simple, timely compilation of a broad Data Base required for the implementation of a Capital Valuation model for rating purposes.

It is our view that in determining a property's Capital Value (CIV or CAV) it must start with the intrinsic value of the property.

That value is best captured in the last Sale price of the property as that Sale price not only reflects the land value but also the nature of the construction of any capital development as well as the finish and fitments and real estate market conditions at the time of purchase.

However in most cases, that Sale price would have taken place sometime, possibly a number of years prior, so a time dependent factor must be applied.

Similarly the property in question may have undergone further capital improvements in the intervening period and if so, these must also be accounted for. See modified comments below.

So until the State-wide Capital Valuation system (Data Base) captures all properties equally, based on land use to make the system more fair and equitable, whatever rating structure that Local Governments adopt will remain fundamentally flawed.

2 Property Capital Valuation Process

As noted in our opening Summary, the Draft Report critically fails to outline any approach as to how the individual CIV property value is to be determined so as to establishment the required State-wide property Data Base.

That being so leaves us to conclude from other statements in the report that IPART proposes that each and every property be routinely individually valued by either the Valuer General or by an Independent Valuer at a cost to each Local Government area around the State, not just once but on a regular ongoing basis.

We find this concept as unwieldy and impractical. At best, it would prove to be a very costly and extremely time consuming exercise, quite apart from being an unnecessary step in the process in the adoption of a capital valuation model for rating purposes. It has the potential of once again reintroducing unacceptable algorithms into the valuation process.

Based on the 2011 Census data and a report for the Department of Planning and Environment there was estimated that there would be around 2,983,800 households in NSW at the present time (2016) serving a population of around 7,606,000 people. From the 2011 Census data for NSW, 67.9% (or ~2,026,000) of households were separate dwellings and 30.7% (or ~916,000) were of medium and high density.

Based on these numbers, trying to conduct nearly 3 million individual property valuations is therefore, clearly impractical.

It is estimated that relatively few properties (between 10 and 15%) would likely change hands in any calendar year thereby giving only those properties (less than 500,000) a true accurate market Capital value.

To arrive at a reasonable Capital Valuation for each property LM RAG suggests that five factors need to be taken into account.

- 1 Last sale price. As each property is unique, the last property sale price is the only measure that reflects that uniqueness and must therefore be the starting point for any Capital Valuation process and State-wide Data Base. That Sale price also reflects the owner's ability to pay at that point in time.**
- 2. A factor that accounts for the time between that last sale date and present time.**

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3. **Any property capital development that has been applied to the property during that time period,**
4. **A factor that accounts for the time between that further capital development date and present time and,**
5. **A factor that reflects recent local Market changes during that time period.**

Upon reflecting on our earlier submissions, LM RAG had taken only four of the above factors into account in the recommended CAV process.

We had not fully appreciated or taken due consideration of potential changes in the real estate market, point 5 (either generally or more specifically, locally) into account, which in some instances, could prove to be quite significant to the CAV to be more representative of actual or potential present day market Capital value, hence the reason for the following proposed modified approach to CAV.

On reflection, LM RAG is now of the view that by a relatively simple process a Modified CAV could be applied to better reflect today's market value of each property and to significantly reduce both the cost and time to develop a State-wide property Data Base.

This modification to the CAV model would be to;

- determine the CAV for all properties by discrete local areas (say suburb or population centre) as previously proposed,
- then test a small number of recent (within the last 6 or 12 months) of actual property sales in each discrete local area,
- compare the CAV for each test property to the recent Sale price of that test property,
- determine the percentage difference between the CAV value and market sale price,
- average these percentage differences across the number of test properties,
- Then apply that average difference to each of the property CAV's in the discrete local area thereby arriving at a time and market adjusted, Modified CAV valuation for each property.

This process could be applied without the need to visit, observe and value each of the nearly 3 million properties and households in NSW, thereby saving a vast amount of time and money for Local Government and their ratepayers. It is our view that the vast majority of properties could be valued this way within a matter of months using simple computerised spreadsheets.

This Modified CAV concept would therefore form a more reliable market indicator of the valuation of each property (that to a large extent reflects the owner's ability to pay by the market price they were originally prepared to pay and by their continued retention of the property in question), as both the purchase price and market conditions have been duly taken into account and have been suitably adjusted over time.

If the Modified CAV model proposed above were to be adopted it will achieve the overall stated terms of reference and overarching objective to restrict excessive rate increases on individuals, irrespective as to whether those properties reside in merged Council areas or standalone Councils.

Furthermore, it will capture and correct the current imbalance that exists between contribution to Local Government revenue from multi-unit developments as well as medium and high density apartments compared to single, detached housing in the most equitable manner.

The approach of a Modified Capital Asset Valuation (MCAV) process fits within the National vision of smart cities with an increasing emphasis on high density living. It also provides a plausible mechanism to reflect changing market conditions for real estate whilst retaining the uniqueness of each property as it is based on an actual sale price.

It neither imposes any restriction on owners wanting to downsize properties as they move into older age or those wanting to improve their respective property in a capital sense than any other Capital Based (CIV) approach.

It will also be directly applicable to regional NSW as well as commercial activities and poses no deterrent to people moving from large properties to small units or retirement homes.

Moreover, its introduction in NSW would establish the State as a leader in Local Government and set a pattern for others to follow and replicate.

3 Comment with Respect to Reference to LM RAG Proposals

It is felt that the draft Report comments regarding the LM RAG Capital Asset Valuation (CAV) proposals (Reference to page 150 of the report) can easily be misconstrued and taken out of context. Those comments do not fully represent the high degree of equity that such proposal represents. We totally disagree that CAV would be inequitable or inefficient.

We believe that point 1 should be replaced with the following;

“Properties with the same purchase price at different purchase dates will inevitably pay different rates, however, properties that have the same, market and time adjusted Capital Value (CAV) will pay the same rate making it very equitable.”

As for point 2, the same argument can be levelled at any Capital Value system, including CIV which IPART is recommending.

The concept of making time and market adjustments to a property purchase price under CAV inevitable rules out the relevance of a “much lower rate bill” based on the property last sale price when compared to a newly purchased property. It is largely for this reason that we have amended our CAV approach to also account for local market price changes not captured by the relevant Compounding factors.

With respect to point 3 it must be recognised that the CAV valuation takes into account the time adjustment and market force changes that occur over time and hence the relativity of valuation from date of purchase remain largely in step with current market value of each property without the need to conduct millions of valuations on an annual basis.

The time adjusted Modified CAV will automatically reset for each property at the next sale date and so maintain the voracity of the valuation system for rating purposes.

4 Recommendations

Having spent many years looking at rating issues, hardships and inequity that the current Legislation imposes on Local Government Rating, LM RAG have long held the view that most of the problems emanate from a fundamentally flawed Land Valuation process and its failure to adequately capture and collect income from apartments and other medium and high density living arrangements.

Over the years LM RAG members have spent many hours with Council arguing how to best apply the Legislation ie, the Base Rate system to achieve a fairer outcome across the community so that some ratepayers are not hit with unreasonable rate bills that are many multiples of the average rate.

However, once having reached the maximum 50% Base Rate limit there is no more that Councils can do to moderate rate increases.

The greatest roadblock to early adoption of a Capital Valuation process appears to be the lack of a suitable State-wide Data Base and a process to develop it in a cost effective and timely manner.

Accordingly, LM RAG closes this response to the Draft Report with a call for IPART and the Panel adopt the following recommendations:-

- 1) **LM RAG urges IPART and the Panel to call together a select Working Party of interested Departments, Councils and Associations to convene a brief workshop(s) comprising several days to devise a suitable mechanism to establish and test a Capital Valuation process and that that process be contained in the final Report to Government.**
- 2) **That IPART recommends that;**
 - a) **Legislation be changed to adopt the fundamental principle of a market based, Capital Valuation process across the State to determine property values.**
 - b) **It is mandated for Local Governments to adopt the Capital Value process unless they can justify and obtain approval from the Minister for Local Government not to do so.**
 - c) **It is mandated for Local Government to adopt the Two Part, Base Rate Structure.**
 - d) **It is mandated for Local Government to adopt a Two-stage approach to Budgets (Capital and Operational).**
 - e) **The intended period of 4 years for freezing of rates be reduced to just two rate periods.**
 - f) **Only approved SRV's apply to the revenue for a newly merged Council for the reduced period of rate freeze.**
 - g) **Newly merged Councils apply to seek a new SRV beyond the period of rate freeze.**
 - h) **For the immediate implementation of a new Capital Valuation Process and Rating Structure be adopted uniformly across the State for merged Councils from year 2 and immediately (year 1) for standalone Councils.**