LOCAL GOVERNMENT NSW

Submission to IPART's Review of Prices for Land Valuation Services provided by the Valuer-General to Councils

February 2014

DRAFT

LOCAL GOVERNMENT NSW
GPO BOX 7003 SYDNEY NSW 2001
L8, 28 MARGARET ST SYDNEY NSW 2000
T 02 9242 4000 F 02 9242 4111
LGNSW.ORG.AU LGNSW@LGNSW.ORG.AU
ABN 49 853 913 882

LOCAL
GOVERNMENT
NSW

Opening

Local Government NSW (LGNSW) is the peak body for councils in NSW. LGNSW represents all the 152 NSW general-purpose councils, the special-purpose county councils and the NSW Aboriginal Land Council.

LGNSW is a credible, professional organisation representing NSW councils and facilitating the development of an effective community-based system of Local Government in NSW. LGNSW represents the views of councils to NSW and Australian Governments; provides industrial relations and specialist services to councils; and promotes NSW councils to the community.

LGNSW welcomes the opportunity to make a submission to the Independent Pricing and Regulatory Tribunal of NSW (IPART)'s Review of Prices for Land Valuation Services provided by the Valuer-General to Councils.

Response to IPART's issues paper

LGNSW provides the following comments on IPART's issues paper:

Service levels

IPART seeks comments on the following:

6. *Is the quality of services provided by the Valuer-General meeting customers' expectations?*

Close engagement with the valuation system has placed LGNSW in a good position to comment on the performance of the system over the past decade or more. LGNSW is a long term member of the Land Valuation Advisory Group (LVAG) and attends its regular meetings. The LVAG comprises representatives of property industry groups, the Office of State Revenue and LGNSW. The group monitors the quality of land values and provides a channel for communication between the Valuer General and property industry stakeholders. LGNSW is also represented on the tender panel for contracts for the provision of land valuation services.

LGNSW have witnessed a prolonged period of continuous improvement overall. This commenced with implementation of recommendations of the *Report of Inquiry into Operation of Valuation of Land Act* 1999 (the Walton Report) and the recommendations of subsequent reviews including the Ombudsman's report entitled *Improving the quality of land valuations issued by the Valuer General* 2005 and the Joint Standing Committee on the Office of the Valuer General's *Report on the Inquiry into the provisions of the Valuation of Land Act 1916* 2010, and continues with the NSW Parliament's Joint Standing Committee *Inquiry into the NSW Land Valuation System* 2013.

On the whole, administration of the present land valuation system appears to be working reasonably well for the purposes of Local Government rating. There has been a marked reduction in the number of objections received and in the number of successful objections over recent years. The number of objections steadily declined from 6,769 in 2007 to 3,513 in 2011. Objections represent a minute proportion of the 2.4 million valuations undertaken. Feedback received by LGNSW from councils on the quality of valuation services is generally positive with most indicating progressive improvement. LGNSW has also witnessed major improvements in contract management, objection processes and communication with key stakeholders and the broader community.

However, given the rating system in NSW, in particular rate pegging, the improvements are of relatively more practical value to the Office of State Revenue and the NSW Government than they are to Local Government.

Under the rate pegging system, the primary impact of updated land valuations is to have some redistributive impact on the rate burden within a Local Government area. Revaluations of established properties do not lead to an increase in councils' total rate revenue, increases in councils' general revenue are determined by service needs and limited by the limit determined by IPART. Therefore there is less sensitivity to the absolute accuracy of the valuations. This is one of the reasons why Local Government valuations are only required on a 3-4 year basis.

In contrast, updated valuations for land tax purposes are likely to result in an increase in the number of properties subject to land tax and also provide for an increase in the amount of land tax paid by those properties already over the threshold. There is a direct relationship with NSW Government revenue. Understandably, land tax valuations are required on an annual basis.

Finally, LGNSW sees room for further systemic improvement in the valuation system. LGNSW is aware of problems arising from poor contract performance in the Central West of the NSW. The Perilya case, discussed later in this paper, raises concerns about mine valuation methodology. However, the main deficiency from a LGNSW perspective is the continued use of land value rather than a market value for the majority of property valuations.

Revenue requirements and LPI Costs

IPART seeks comments on the following:

9. *What is the efficient operating expenditure incurred by the Valuer-General in the provision of general valuation services over the referral period?*

13. *How should costs be allocated from LPI to the Valuer-General?*

LGNSW is not in a position to assess the efficiency of the direct cost components and allocated cost components. However, LGNSW notes that the current arrangements of price regulation of the Valuer-General's land valuation services could provide incentives to over-allocate cost to the Valuer-General where other parts of the Department of Finances and Services and its agency, Land and Property Information (LPI), do not have the same ability to recover their costs. LGNSW urges IPART to fully test cost allocations and provide transparent methodology so that stakeholders can understand the results.

LGNSW also questions whether the Valuer-General should make contributions to the efficient fixed costs of LPI or whether it would be more appropriate to allocate cost on a marginal cost basis.

In its 2009 Determination, IPART accepted that valuation services are an integral and indivisible part of LPI and therefore considered that the Valuer-General should make a contribution to the efficient fixed costs of LPI (i.e. those incurred across all of LPI's functions). The fixed costs were allocated on an average cost basis using full time equivalent employees (FTE) and occupancy rates. However, on the basis that LPI would certainly exist without the provision of valuation services, it would seem appropriate for costs to be allocated to the Valuer-General on a marginal cost basis. This would be supported by a requirement for LPI to raise a larger proportion of revenues from private sector and public users.

Finally, it needs to be clarified whether the method of allocation to the Valuer-General of general administrative overheads of LPI and the Department of Finance and Services takes account of the proportion of LPI's Valuation Services unit's activity unrelated to rating and taxing work. According to the Valuer-General's submission (section 6.3.1), administrative overheads are allocated based on the proportion of FTE in the Office of the Valuer-General and LPI's Valuation Services unit compared to total FTE in the department. In section 3.4.4 the

Valuer-General's submission indicates that approximately 8% of staff time within LPI's Valuation Services unit is unrelated to rating and taxing work.

Rate of return – return on assets
IPART seeks comments on the following:
17. What is an appropriate rate of return for the Valuer-General's assets?

LGNSW does not consider it appropriate for provision of a commercial rate of return on capital to be included in the pricing of land valuation services for taxation purposes. LGNSW questions the concept of applying a business model to a service essential to the functioning of the land tax systems, including council rates, operating in NSW.

The reasons for this include:

- The valuation system is an integral part of the state taxation system, it is not inherently a commercial service;
- The use of the valuation services provided by the Valuer General and LPI to Local Government is not optional and is not contestable so the principles of competitive neutrality should not apply; and
- LGNSW's view is that the NSW Government should not "profit" from the provision of this basic essential service.

If a return on assets is to be applied it is arguable whether a risk premium above the long term Commonwealth rate should apply to Local Government valuations at all and, if so, it should be rated as an extremely low risk (no more than 3%). LGNSW does not believe that a comparison with water or electricity utilities is appropriate. There is negligible risk of any type associated with the provision of valuation services to Local Government that are derived from Local Government. It is a captured client subject to a statutory requirement to use the valuation services offered. Revenue and revenue growth are highly predictable and there is no practical risk of default on payments by the councils.

Cost allocation to councils and other users
IPART seeks comments on the following:
20. Is there a case for changing the methodology for allocating costs to councils? If so, on what basis should costs be allocated?

LGNSW questions the 60/40 allocation of costs between the Office of State Revenue and councils.

In IPART's 2009 Determination, the costs of the providing general valuation services were split 40:60 between councils and Office of State Revenue. All other users were either not charged, or paid the additional (marginal) cost of extending the service to them. The 40% of costs allocated to councils was based on the proportion of total valuations received per annum by councils (about 25%) and, among other things:

- Adjustments for economies of scale in valuations for Office of State Revenue, because councils only use valuations on a 3-yearly cycle, but benefit from the fact that valuations are conducted annually for OSR;
- Costs of printing, graphic services and postage services fully allocated to local councils; and
- 50% of the costs of processing objections allocated to councils.

Firstly, LGNSW is of the view that costs should be allocated on an average cost basis between all users of valuation services including law enforcement agencies and the Australian Bureau of Statistics and for commercial users

For example, other government clients are using the data as the basis for raising revenue through taxation (rate or levy) or commercial leases. While smaller users than the Office of State Revenue or councils in aggregate, they are essentially using the data for the same purposes. It would be unfair to expect Local Government to subsidise these users, particularly when valuations are being utilised for commercial purposes by government business units. For example, NSW Maritime and other government agencies such as the Department of Finance and Services are moving towards commercial rentals for private leases.

Accordingly, LGNSW considers that the terms of reference for the review are deficient in that they only provide for a review of pricing of valuation services to councils. An objective review would include the pricing of services to all users of land valuation services.

Secondly, LGNSW questions the 100% allocation of graphic services costs to Local Government.

According to the Valuer-General's submission to this review, graphic services is a business unit that provides LPI's in-house capability in graphic design and desktop publishing, printing, conservation and binding, digital imaging and mail processing and dispatch services. Graphic services produce and mail Notices of Valuation, as well as objection correspondence and a range of valuation information.

While it is acknowledged that the costs of preparing and printing valuation notices are largely attributable to councils, the Valuer-General and LPI produce a number of other papers and online publications that do not strictly pertain to Local Government. These include newsletters, fact sheets and information brochures. These publications benefit all clients of the Valuer-General clients and the general public. It is inappropriate to allocate the cost of these publications exclusively to Local Government.

Thirdly, LGNSW questions the 50% allocation of costs associated with objections to land valuations. Land tax valuations for the Office of State Revenue are far more contentious and more sensitive to accuracy than council rate valuations mainly because of the existence of the land tax threshold. It has been land tax and disputed land tax valuations that have been the basis of many objections, complaints and negative media on the land valuation system.

Fourthly, as noted above, continuous improvement of the valuation system is of more practical value to the Office of State Revenue than it is to councils and it is appropriate that Office of State Revenue bear the largest proportion of these costs. This put into question the ongoing application of the historical 60/40 ratio.

Given all this and the fact that Office of State Revenue is the heaviest user of valuation services because of its requirement for annual valuations, LGNSW maintains that the cost allocation to Local Government should be less than 40%.

Financial situation

LGNSW urges IPART to take account of limitations placed on councils' revenue growth, particularly rate pegging, when considering increases in the pricing for Valuer-General Services.

The recent NSW Treasury Corporation's assessment of the financial sustainability of NSW councils indicates that existing revenue restrictions, including rate pegging, severely hamper council's ability to fund current and future levels of service and rates the financial sustainability of 39 (25.7%) of the 152 councils as weak or very weak.

NSW councils' financial capacity to maintain existing services and infrastructure is already stretched. In many instances councils are already being forced to cut services and defer critical infrastructure expenditure. The recent Local Government Infrastructure Audit undertaken by the Department of Premier and Cabinet, Division of Local Government in 2013 found an infrastructure backlog of $7.4 billion at 30 June 2012.

Conclusion

LGNSW appreciates the opportunity to respond to IPART's issues paper.

LGNSW considers that the terms of reference for the review are deficient in that they only provide for a review of pricing of land valuation services to councils (and the Office of State Revenue). An objective review would include the pricing of services to all users of land valuation services.

LGNSW maintains that it is inappropriate for valuation services to councils (or to the Office of State Revenue or other agencies) to be provided on a commercial basis. That is, full cost recovery in this instance should not include a rate of return on capital. Land valuations are an essential component of the taxation system and as such should not be considered a commercial service.

LGNSW urges IPART to test and provide a transparent methodology for allocating costs from the Department of Finance and Services and LPI to the Valuer-General. LGNSW also believes that the current distribution of cost between the Office of State Revenue and councils of 60:40 does not reflect the utilisation of the Valuer-General's land valuation services by, and the importance of these services to, these two stakeholders.

Finally, LGNSW urges IPART to take account of limitations placed on councils' revenue growth, particularly rate pegging, when considering increases in the pricing for Valuer-General Services.

LGNSW looks forward to further contributing to the review process.