



Valuer General

Review of the Local Government Rating System

Submission to IPART

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1. Introduction

Thank you for the opportunity to provide input into the Review of the Local Government Rating System in NSW.

This submission is the NSW Valuer General's response to questions raised by IPART in the Review of the Local Government Rating System Issues Paper that are within the scope of the Valuer General's responsibility.

The Valuer General would welcome further analysis and invites IPART to discuss the review of the local government rating system further.

2. An overview of the valuation system in NSW

An efficient and effective system

NSW has a long established rating and taxing valuation system and is regarded as a leader in the field within Australia. A review into the Queensland *Valuation of Land Act 1944*¹ conducted in 2010 considered that "the NSW system...represents something of a benchmark for Queensland and indeed for other states,"² demonstrating the position of NSW as a leading authority in rating and taxing valuations.

The NSW valuation system has been reviewed on a number of occasions over the past two decades and found to be generally sound, "extremely cost effective"³ and efficient.⁴ The overall average cost per valuation in NSW for 2014/15 is \$17.53, as compared to the international average of \$28 per valuation.⁵

Recommendations have been made and implemented to further improve the system, particularly in the areas of valuation quality and reliability, and the processes to handle concerns and complaints raised by landholders.

Method for valuing land in NSW

The *Valuation of Land Act 1916* (NSW) does not prescribe the valuation methodology to be used in determining the value of land. Instead the focus is on valuation outcomes producing land values that represent market value to provide the basis for rating and taxing. This encourages greater flexibility in the method of valuation, allowing for changes in technologies and adoption of best practice valuation techniques. It also allows the valuer to apply the most suitable method of valuation for the property or land use. Irrespective of the methodology used, the overriding requirement is that each land value must be capable of being individually tested and supported against the available market evidence.

¹ Queensland's *Valuation of Land Act 1944* was replaced with the *Land Valuation Act 2010*, following litigation and a series of legislative amendments involving the 1944 Act.

² Department of Environment and Resource Management, *Queensland Statutory Valuation Reform Review*, prepared by Price Waterhouse Coopers (2010) 16.

³ Joint Standing Committee on the Office of the Valuer General, *Report on the Inquiry into the Land Valuation System and the Eight General Meeting with the Valuer General* (May 2013) ix.

⁴ NSW Ombudsman, *Improving the Quality of Land Valuations Issued by the Valuer General: A special report to Parliament under ss31 and 26 of the Ombudsman Act 1974* (October 2005).

⁵ International Property Tax Institute, *Australasian Council of Valuers-General 2015 Benchmarking Study* (23 October 2015).

In NSW, mass valuation processes are used in conjunction with strong quality assurance measures and individual assessments. This has proven to provide an efficient and effective rating base in NSW, and many other jurisdictions around the world.

Although the *Valuation of Land Act 1916* provides for three bases of valuation, NSW currently utilises only land value.⁶ NSW has developed a strong and robust methodology underpinning land values, which has been developed over a long period and has been accepted by the NSW Ombudsman as a sound basis of valuation.⁷ The value base was also considered by the NSW Inquiry into the Land Valuation System, which found that land value was “the appropriate basis of valuation for rating and taxing purposes”.⁸ The infrastructure to support an efficient and effective mass valuation system for unimproved land values exists in NSW. A structure and data that supports capital improved value has not been developed.

3. Land valuation methodology used as the basis for determining rates in NSW, as compared to other jurisdictions

There are three primary bases for the levying of property based rates and taxes, which are used in some form across Australia. These are the improved (capital) value of land, being the amount a property would likely be sold on the market; the annual value, based on the property’s rental value; and the land (for site or unimproved) value, being the value of the property if assumed to be vacant.

In all cases, the values are required to be market values. Courts have consistently found the best evidence of value to be open market transactions such as sales and rentals. A summary of the different methods appears in Table 1, below.

While valuation bases for council rating vary in Australia, all jurisdictions use some form of land value basis to determine land tax liabilities. Table 2, below compares the valuation bases for council rating and land tax across Australia.

The fundamental difference between capital improved value and land value is that a capital improved rating system is essentially a tax on effort. Conceptually, land value involves removing any improvements (other than land improvements), identifying the highest and best use of the land, and determining the value of the land reflecting potential use. While capital improved value is the value of land in its actual state, that is, it assesses the value of the land with any improvements presently on the site.

Improved values are generally considered to tax the capital input and economic endeavour of the landholder and it can be argued that this creates a level of disincentive for landholders to improve or maintain property to the highest and best use, given a higher valuation would result in a larger rating and taxing liability. As the Henry Tax Review identified, the “efficiency of council rates is likely to be reduced in councils that use improved values to assess the tax, as this discourages capital improvements.”⁹

⁶ s14A, *Valuation of Land Act 1916 (NSW)*.

⁷ NSW Ombudsman, above n 4, ii.

⁸ Joint Standing Committee on the Office of the Valuer General, above n 3, 129.

⁹ Commonwealth Attorney General’s Department, *Australia’s Future Tax System: Report to the Treasurer* (December 2009) 258

Table 1: Land Valuation Methods used in Australia.

Method	Description	Advantages	Disadvantages
Capital Improved Value (CIV)	Includes the values of the land and buildings.	<ul style="list-style-type: none"> The valuation reflects the property in the form it would be traded on the open market, so it is easily understood by ratepayers. There is little if any adjustment required to compare valuations to sales evidence. 	<ul style="list-style-type: none"> Significant investment required to establish and maintain consistent and reliable data on property improvements to support the valuation process. The inclusion of the added value of improvements in the rateable value may create a disincentive for landholders to improve or maintain property to the highest and best use. Increases the need for supplementary valuations as updates to valuations are required whenever improvements are changed.
Annual Value	Based on rental returns for a property.	<ul style="list-style-type: none"> Regarded as providing similar rating and taxing outcomes as CIV. 	<ul style="list-style-type: none"> Not well understood by ratepayers. Increases the need for supplementary valuations as updates to valuations are required whenever improvements are changed.
Land Value	Value of the land excluding structures or improvements, but including land improvements such as drainage, filling and clearing.	<ul style="list-style-type: none"> Considered to provide an equitable base for the setting of land based rates and taxes and is seen as having the least impact on markets and capital. Captures the increase in value from the range of activities around the land. Land value said to be the most economically efficient and the best equipped to address cost benefit principle considerations.¹⁰ Least resource-intensive and hence least costly to administer. 	<ul style="list-style-type: none"> Assessing land values will generally involve the analysis of sales of both vacant and improved properties. Sales of improved properties require adjustment to remove the added value of the improvements of the land. The lack of evidence of vacant land sales in developed areas means that land values may not be readily understood by landholders.

Table 2: Valuation Bases for Council Rates and Land Tax – Australia.¹¹

	NSW	VIC	QLD	WA	SA	TAS	NT	ACT
Council rates	LV	SV, NAV, CIV	Rural: UV, Non-rural: SV	Rural: UV, Non-rural: GRV	CV, SV, AV	LV, CV, AAV	UCV, AV, ICV	UV
Land Tax	LV	SV	SV	UV	SV	LV	N/A	UV

Notes:

Bases Excluding Improvements

LV = Land Value
 UCV = Unimproved Capital Value
 UV = Unimproved Value
 SV = Site Value

Bases Including Improvements

CV = Capital Value
 CIV = Capital Improved Value
 ICV = Improved Capital Value

Bases Including Improvements (Rental Value)

AV = Annual Value
 AAV = Assessed Annual Value
 GRV = Gross Rental Value
 NAV = Net Annual Value

¹⁰ Report by Access Economics Pty Ltd for the Local Government Division, Department of Premier and Cabinet (Tasmania), *Valuation and Local Government Rating in Tasmania: a robust framework for the future* (October 2012) v.

¹¹ Commonwealth Attorney General's Department, above n 9, 258.

So a landholder's effort in improving their property is what becomes taxable; whereas, the argument for land value based rating, is that what is taxed is what has been referred to as the unearned increment in value. That is, the increase in value over time that comes about through factors other than the effort of the landholder. This reflects the added value of changes that society might make such as improvements to infrastructure. Where new infrastructure is built, the increase in value generated in surrounding lands will be reflected in their land value, and so that benefit would form part of the taxable component of the value.

In addition, the NSW Parliamentary Inquiry into the Land Valuation System acknowledged that “any transition to annual value or capital improved value would create distortions in the investment market and involve material switching costs”.¹²

The Tasmanian experience

Tasmania conducted a review into local government rates, to address concerns about the volatility of rates and taxes following changes in property value. The review was completed in April 2013,¹³ and considered the different valuation bases for rating.

The report found that both capital improved value and land value would be superior to the assessed annual value valuation base. The report highlighted that the two bases had different merits and did not recommend one method over the other. Land value was found to be the most economically efficient and the best equipped to address benefit principle considerations, while capital improved value was found to better address capacity-to-pay considerations and was best understood by ratepayers.¹⁴

The final report recommended that the Tasmanian Government discontinue valuations on assessed annual value and assist councils to transition to capital improved value by 1 July 2016. The Government has since decided that implementation of the major reform requiring all councils to move to capital improved value and changes to the valuation cycle should be deferred. The reason for the deferral is that some of the factors driving the need for reform have eased and that there is not presently a consensus in local government for reform at this time.¹⁵

4. Factors to consider in changing the method of valuation

The Valuer General does not have a preference for the use of land values or capital improved values for levying rates. Each can be applied effectively and equitably and indeed both are used in different jurisdictions around Australia and across the world. For example, in Victoria, rates are based on capital improved value; whereas, NSW and Queensland both levy rates based on land values. Depending on which is used, there will be different groups within the community that are comparatively better or worse off.

¹² Above n 3, 129.

¹³ Division of Local Government, Department of Premier and Cabinet (Tasmania), *Valuation and Local Government Rating Review Final Report* (April 2013).

¹⁴ *Ibid*, 9.

¹⁵ Tasmanian Government (19 May 2016)

<http://www.dpac.tas.gov.au/divisions/local_government/legislation/previous_legislation_reviews/review_of_valuation_and_local_government_rating>.

However, it is considered that any decision to change the basis of valuation in NSW needs to have regard to the benefits to be achieved versus the costs of implementation.

There are a number of issues to consider with the transition to an alternative valuation base within NSW. Consideration needs to be given to:

- development and modification of rating systems to support the transition to an alternate base
- administrative demands to model alternate rating resolutions, and
- resources required to ensure that communities understand rating policies adopted by councils to support the transition.

The main issue would be the cost and implementation of a change to capital improved value. The provision of capital improved value would require accurate and reliable data on property improvements. Victoria has extensive databases with substantial information about individual improvements for properties which have been built up over many years. As capital improved values have not been used in NSW for over 30 years, this information has not been maintained within the valuation system. Consequently a move to use capital improved values would require substantial investment to source, collate and maintain built attribute data for all properties in the state.

Periodic informal enquiries by the Valuer General have found that this information is not available in a comprehensive or complete record for all properties across NSW. While information may be available in some form through local councils or commercial organisations, the information is likely to be held in a range of forms which would require standardisation in order to be suitable for application as the base for mass valuations. Anecdotally, much of the information is held in hard copy or in scanned images and is unlikely to be suitable for incorporation into modern databases and computerised valuation models without substantial manual effort. Furthermore as data would need to be obtained from a variety of sources, the level of accuracy and consistency would likely be uncertain. This is expected to lead to costs in data validation and/or increased objections to valuations.

While detailed costing of the development of these databases and systems has not been undertaken, it is expected that this cost would be many tens of millions of dollars. Preliminary investigations conducted by the Office of the Valuer General suggest that a system wide implementation of capital improved values would need to be spread over a number of years and that costs would exceed \$100 million.

5. Use of the Valuer General's property valuation services

The Valuer General oversees the state's land valuation system. Valuation services for rating and taxing purposes are outsourced to independent and professional valuation contractors under procurement guidelines set by the NSW Government.

In NSW, the use of contract valuers is market tested and offers a number of advantages to the valuation system by providing independence, access to expertise with local market knowledge, a spread of resources, and cost savings to government on infrastructure and staff.

Contract valuers are selected through open market tenders to provide land valuation services which underpin core activities and commitments on behalf of the NSW Valuer General. The rating and taxing contracts are worth approximately \$20 million per annum. These procurement activities are carried out with principle objective of:

- achieving best value for money within a framework of probity and fair dealing
- ensuring a high quality of service from the provider as determined by agreed metrics
- engaging and opening up opportunities for small and medium enterprises, and
- supporting alignment with the strategic directions of LPI and the Valuer General.

Valuation services are currently provided by 19 valuation firms who service 41 contract areas across NSW. The structure of the contracts is reviewed at each procurement round to achieve optimum outcomes. Contract areas are not set by local government boundaries and may be adjusted in order to achieve better value for money and/or improved service outcomes having regard to the capacity of the private sector to provide the services.

Use of independent valuation services in other jurisdictions

In Victoria where the use of the Valuer General's property valuation services is not mandatory, a number of councils are moving to have the Valuer General conduct their valuations. Victoria has 79 councils that are each responsible for completing valuations. Since 2010, councils have been able to transfer this responsibility to the Valuer General.¹⁶ To date, 15 councils have opted for the Valuer General to complete their valuations.¹⁷

It is important to note that the Victorian Valuer General retains responsibility for the overall valuation system, including establishing and maintaining valuation records and ensuring the integrity of the system under the *Valuation of Land Act 1960 (Vic)*.¹⁸ The centrality of an independent Valuer General in the integrity of land valuation systems was highlighted in the recent Queensland example, where the Government re-legislated to establish an independent Valuer General responsible for assessing land values.¹⁹ Similarly, the New Zealand Valuer General oversees the operation of the valuation system in that jurisdiction.

In Tasmania the Valuer General has oversight and responsibility of the valuation system in that state. Valuation services are outsourced by the Valuer General to private valuation firms and paid for by the relevant council. Tasmanian councils do not have the option of using other private valuers. The Valuer General is responsible for the competitive tendering system which awards contracts for valuation services under the *Valuation of Land Act 2001 (Tas)* and for monitoring the quality of valuation services performed by contractors.

Consequences of a new approach

The valuation system in Tasmania, Victoria and New Zealand are overseen by a Valuer General, even where councils are able to independently engage private valuations. In NSW, a move to have councils using private valuation firms would need to consider that:

¹⁶ s10(1), *Valuation of Land Act 1960 (Vic)*.

¹⁷ Victoria Valuer General < <http://www.dtpli.vic.gov.au/property-and-land-titles/valuation/council-valuations/valuer-general-as-valuation-authority> >

¹⁸ All valuations must comply with the Best Practice Specifications Guidelines published by the Valuer General under the *Valuation of Land Act 1960 (Vic)*.

¹⁹ Joint Standing Committee on the Office of the Valuer General, above n 3, 56.

- the NSW Valuer General will need to establish agreements with councils to ensure that the Valuer General has access and receives final valuation recommendations which will form part of the Register of Land Values.
- quality and audit checks need to be considered and performed by councils to ensure the accuracy and consistency of valuation recommendations
- inconsistency in valuation contract requirements for different council areas and loss of a coordinated centralised quality assurance process raises the risk of inconsistency in valuation outcomes across council areas and potential loss of confidence in the valuation process
- there could be unnecessary duplication of contract management and/or quality assurance effort with councils directly contracting with valuation contractors while the Valuer General will continue to oversee the process to ensure quality outcomes
- there will likely be perceived conflicts of interest where councils contract and approve values and then levy rates based on those values. This has the potential to reduce independence and fairness.

6. What changes could be made to rating categories?

Councils may vary the way they calculate rates for different categories of property. Currently rating and taxing for a single strata unit is worked out using the unit entitlement listed in the strata plan. A single land value is determined for the land under the strata scheme. The unit's land value is a portion of the strata scheme land value, based on the unit entitlement. Unit entitlements reflect the comparative value of units within the strata scheme.

As the proportion of high density dwellings is increasing it has been questioned whether rates for strata properties should be based on capital improved values to more appropriately represent the comparative value of strata units and detached dwellings.

Accurately determining capital improved values for individual strata units would require knowledge of the individual quality of each unit including internal condition and access to light and views. Producing these values would require an initial internal inspection and development of a method to capture value movement, both positive and negative, due to the actions of individual landholders. There would be a considerable cost to implement capital improved value for strata units and an ongoing maintenance cost to maintain the database of improvements.

The equity issues associated with strata units, particularly in areas experiencing significant levels of strata development, may be addressed were a different system used to levy rates from that used for other property. The use of a separate rate category would allow councils to levy rates for single strata units more reflective of the individual use of council services.

The Joint Standing Committee on the Office of the Valuer General recognised that adopting greater flexibility in the application of rate levies on strata and non-strata holdings would achieve the required equity outcomes.²⁰

The Valuer General recommends the creation of a separate strata rating category for councils irrespective of the value basis used for determining rating and liability.

7. Other reforms to the system

The *Valuation of Land Act 1916* provides mechanisms for valuations to be corrected through a number of different processes. However, there appears to be some inconsistency in the operation of sections 14DD and 62(2) of the *Valuation of Land Act 1916* and section 511A of the *Local Government Act 1993*. Combined, these provisions serve to disadvantage councils in catching up income lost due to reductions in valuation where errors are corrected other than by an objection being lodged by the landholder.

The Valuer General recommends that the interaction of these sections should be considered to ensure the correct intent is achieved.

²⁰ Joint Standing Committee on the Office of the Valuer General, above n 3, 126-127.



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