

Office of the New South Wales Valuer General

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Independent Pricing and Regulatory Tribunal
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13 June 2008

Dear Dr Keating

Response to the Draft Report on the review of prices for valuation services provided by the Valuer General to local councils

Thank you for providing the opportunity to respond to the Draft Report on the review of prices for valuation services provided by the Valuer General to local councils. The report provides IPART's draft determination on the prices it proposes to allow the Valuer General to charge to local councils for the period 1 July 2009 to 30 June 2014.

I welcome the Draft Report as an important step in the process of putting the provision of valuation services to local councils onto a sustainable footing, after a period of fourteen years of falling real prices. I believe that IPART has struck a reasonable balance between two competing needs: to achieve full cost recovery and to provide councils with time to adjust to prices set on this basis.

This letter focuses on some remaining issues about which there appear to be differing views, particularly in light of the public forum held on 4 June 2008. It discusses:

- The glide path to full cost recovery;
- The proposed prices and the efficiency of the underlying costs;
- The approach to cost allocation between OSR and councils;
- The prices proposed for the City of Sydney; and
- Misunderstandings about the valuation process.

1. The glide path to full cost recovery

It was apparent from the public forum that at least some councils appear to be unaware of the magnitude of the savings offered by the proposed glide path. The proposed glide path will deliver approximately \$10m less in revenues over 5 years compared to the estimated efficient costs.¹ This proposed glide path recognises the need to ensure councils have time to adjust to paying fully cost reflective prices and I fully support this approach.

¹ This is outlined on page 3 of the Valuer General's submission.



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2. The proposed prices and the efficiency of the underlying costs

The Draft Report states that *“prices required to recover the ARR (Annual Revenue Requirement) were comparable to adjusting the prices in the 1995 Determination by changes in the Consumer Price Index (CPI).”*

While IPART has proposed that the additional service provision resulting from the NSW Ombudsman’s 2005 Report can be accommodated by increasing prices by CPI, this will not allow for all the incremental costs of implementing the Ombudsman’s recommendations. As a result, the prices proposed by IPART produce a shortfall of approximately \$1m per annum in the real revenue requirement by 2013/14.

Our submission to IPART outlined that current costs can be considered to be efficient on the basis that approximately 90% of costs are either market tested or are broadly in line, if not below, comparable benchmarks. Valuation Services, Land and Property Information (VSLPI) is also considered a ‘low cost’ service provider on the basis of a benchmarking study undertaken by the International Property Tax Institute (IPTI).² VSLPI will have to achieve significantly greater efficiency gains than it proposed to have costs consistent with IPART’s draft determination for 2013/2014.

It should be recognised that it will be harder to replicate the efficiency improvements that have been achieved in recent years because outsourcing and IT investment largely provide one-off efficiency improvements. In this respect it is worth reiterating that by 2013/14, VSLPI will have achieved significant increases in the quantity and quality of valuations, while at the same time continuing to experience falling revenue in real terms. More specifically:

- Staff numbers will have reduced from 322 in 1995 to 150 in 2014, a reduction of 47%;
- The number of valuations will have increased from 2.14 million in 1995 to 2.54 million in 2014, an increase of 19%; and
- VSLPI will have implemented all 33 of the Ombudsman’s recommendations for which it is responsible, but is unlikely to have had the costs of doing so fully funded.

VSLPI believes, therefore, that IPART’s draft determination provides a challenging target for it to reach, given the need to improve service levels at the same time.

3. The approach to cost allocation between OSR and councils

At the public forum, some councils suggested that the cost allocation between the OSR and councils proposed in our submission and endorsed by IPART in its Draft Report are unreasonable. Some argued that instead of a 60-40% split between the OSR and councils, a 70-30% split would be more appropriate. It is difficult to respond to these arguments in any detail because we are unaware of any work undertaken to support them.

At least one council appeared to assert that councils valued the service less because they needed to use it less than the OSR, and the accuracy of valuations were less important to them because it does not influence the level of revenue the councils generate.

In regard to the less frequent use of valuation information, two points should be noted. The 40% allocation to councils is based on ‘bottom up’ analysis of component costs rather than a generic ‘top down’ approach. This approach involved VSLPI considering both the costs directly attributable to servicing councils as well as the shared costs allocated to councils. Some of these shared costs (such as the valuation contract) are allocated on a 30% basis to councils as a result of the frequency of valuation

² IPTI, Benchmarking 2007 Summary Report, 2007

information. Other costs, such as objections, were allocated on a 50% basis to councils based on analysis of the objections received in 2007.

The stand alone cost of providing the service to councils was also estimated. That analysis can be found on page 85 of our original submission. That analysis found that a 40-60% split was reasonable, on the basis of the costs that would be avoided if valuations were only undertaken every three to four years for councils. In other words, on a stand-alone basis only 40% of the costs would be avoided.

In regard to the accuracy of valuation information, I believe that councils are concerned about the quality of valuations. This is because it could affect the distribution of costs between councils and their ratepayers, disputes about rates and ultimately the integrity of the rating system. Indeed a significant number of councils meet or correspond with me regarding these very issues.

Some councils indicated that in terms of quality it is the parity between values rather than the absolute amount of the values that is important. If anything, this is the more complex and costly element of the quality control aspect of valuations. Using mass valuation systems it is relatively easy to adjust all values in an area to a level approximating the market value. However, it is far more complex to ensure that the relationships between individual values are correct. The consistency of these relationships is measured through the statistical measure of the Coefficient of Dispersion. The proportion of local government areas where residential values meet the parameters for this measure has increased by 130% from 42.1% of local government areas at 1 July 2003 to 96.6% of local government areas at 1 July 2007.

Nevertheless, I am bound to meet the statutory requirements for the Valuer General in relation to the quality of the service and these have been established by a number of independent reviews and endorsed by the government. Consequently VSLPI is not authorised to provide a lower quality of valuation services to save costs.

4. Prices proposed for the City of Sydney

I support IPART's view that there are additional contract costs incurred for the valuation of properties in the City of Sydney area. IPART's draft decision to charge the City of Sydney the same price as non-residential valuations means, that the proposed prices within the City of Sydney will be significantly more cost reflective than they are currently.

There was some discussion at the public forum regarding the degree to which the City of Sydney is a special case in regard to the cost of undertaking valuations. We believe that the City of Sydney has significantly different valuation costs when compared to other councils because it has:

- Significant variability between properties substantially reducing the capacity to apply mass valuation techniques;
- The greatest concentration of complex property types requiring further analysis of market sales and rental evidence;
- The greatest concentration of highly improved properties requiring more time consuming analysis of the added value of improvements;
- The greatest concentration of the most valuable properties in NSW making the valuations more contentious; and
- Complex planning and development constraints requiring detailed analysis and consideration.

This complexity is demonstrated through the rating and taxing valuation contract costs determined through the competitive open market tender process. As described in our initial pricing proposal these contract costs indicate a differential of 2.63 times the average contract cost across the state. Some councils argued that this differential may

be simply due to the fact that the City of Sydney is the only local government area in its contract area and so this area does not benefit from economies of scale. However, if the City of Sydney were incorporated in a larger contract area with less complex properties the costs of valuing the city would be the same but the average cost per valuation would be lowered simply due to cross subsidisation. There is also a range of other evidence demonstrating the increased costs of servicing the City of Sydney:

- Prices for reviewing objections to land values are quoted through a competitive open tender process. In 2007 the average price per objection in the City of Sydney was 1.7 times the average price across the remainder of the state. While the data is not yet complete, a similar (though somewhat higher) trend is evident for objection processing in 2008. While this differential is less than the ratio demonstrated by the comparison of the main rating and taxing valuation contracts this is to be expected as all objections are individually reviewed and so these prices are less sensitive to variations in volume.
- VSLPI applies a higher level of internal resources to the management of valuations in the City of Sydney. 2 full time valuers are allocated to this task which equates to 1 valuer per 13,800 valuations compared to a state average of 1 valuer per 62,800 valuations.

If it was considered appropriate to charge the City of Sydney under a similar pricing arrangement to other councils (i.e. a standard residential and non-residential split) then this would increase prices for other councils to ensure cost reflectivity. Our preliminary analysis suggests this would increase the standard residential price by approximately \$0.04 and the standard non-residential price by approximately \$0.07 over the current prices proposed by IPART.

IPART's views on whether it would envisage further reforms in the price structure over time may also be useful to address the cross subsidies inherent in the current charging structure, as this may assist all stakeholders understand whether further developments in pricing structures might be considered in future reviews.

5. Misunderstandings in relation to the valuation process

There was also some discussion at the public forum about the nature of the valuation process itself and its reliability. In particular, there was some confusion around the specific valuation of 20% of properties on an annual basis, and what this implied about the mass valuations. The specific valuation of 20% of properties refers to the on-going review of base land value data as recommended by the Ombudsman and consistent with international best practice. It needs to be noted that the specific valuation of a proportion of properties is an integral part of the mass valuations process in all jurisdictions that adopt this approach.

A number of claims were also made about the accuracy of land values. Pages 53 to 57 of our original submission to IPART outline the recent improvements in service quality which have been made, according to standard measures of the quality of valuations recognised by major mass valuation jurisdictions throughout the world.

Thank you once again for the opportunity to comment on this issues which arose from the public forum. Should you have any queries in regard to these comments please do not hesitate to contact me. I would welcome the opportunity to discuss any matters that IPART is considering in making its Final Determination

Yours sincerely



Philip Western
Valuer General